

## 1999 NIAGARA INTERNATIONAL MOOT COURT COMPETITION

### NOTE BY THE AUTHOR

The problem presents a strictly hypothetical set of facts. The problem is not intended to raise issues that concern the purely constitutional or regulatory law of either party. All references to court cases are hypothetical except for the reference to the *Beef Hormones* case.

## FACTS

George MacInnes is a hog farmer in Saskatchewan. He is involved in hog farming in a large-scale way. He has made effective use of modern technology and full use of growth hormones, including in particular, the hormone "Incregrow". Incregrow is widely used by hog farmers in Canada and some other countries. However, hog farmers in the United States have not used Incregrow.

For a number of years MacInnes exported live hogs to markets in the United States. He decided to integrate his operations in Canada so he established abattoirs and processing facilities in Saskatchewan and other western provinces. The Canadian integrated operation was so successful that he decided to extend it to the United States. Accordingly, he made a considerable investment in establishing an abattoir and processing facility in South Dakota. The operation was well managed and very successful, with excellent response from the U.S. consuming public.

From time to time, MacInnes had administrative difficulties exporting hogs to the U.S. but these were usually cleared up through informal negotiations by the Department of Foreign Affairs and International Trade with the U.S. Government. However, his difficulties mounted when the Government of the State of South Dakota enacted legislation that banned the distribution in the state and the export from the state of pork that had been grown using Incregrow. While there appears to have been some anecdotal evidence that Incregrow might create health risks, no scientific studies had ever been commissioned that established that this was the case. Rules under Codex Alimentarius governed the use of Incregrow but these rules merely stipulated maximum safe dosages (with which MacInnes had always complied).

MacInnes tried to make do in his U.S. operations with hogs purchased from local suppliers, both in South Dakota and adjacent states. However, a regulation was promulgated under the legislation banning the distribution of pork grown with Incregrow that required that any abattoir and processing facility that had slaughtered and processed hogs grown with Incregrow be inspected and if, in the sole discretion of the inspector, the facility was deemed to be contaminated with Incregrow the facility would be shut down. An inspector was sent to inspect MacInnes' South Dakota facility and made the finding that the facility was contaminated. The facility was ordered closed. This order was indefinite as it is not possible to decontaminate facilities contaminated with Incregrow. The regulation provided for an administrative review

procedure which MacInnes invoked. The review board dismissed MacInnes' application without giving reasons. The inspector in question was the brother-in-law of one of the largest pork producers in the state, but there was no hard evidence that this relationship had influenced the inspector's decision.

MacInnes sued the Government of the State of South Dakota in the state court system, alleging that the finding that his plant had been contaminated was arbitrary and unfair. He further alleged that the effect of the ban on his business operations and the forced closure of the plant amounted to an expropriation. A trial was held before a jury and, much to the consternation of the State Government and the surprise of the local press, the jury found in favour of MacInnes. The court ordered that the finding of the inspector be reversed, the condemnation order be lifted and the State Government pay MacInnes \$10,000,000 in damages for lost business. The damage award corresponded more or less with MacInnes' business losses, including damages for the loss of two lucrative long-term contracts. Distributors had terminated the contracts because, as a result of the ban and forced plant closure, MacInnes was not able to supply the quantities of pork required under the contracts.

The Government of the State of South Dakota promptly appealed to the South Dakota Supreme Court and the Supreme Court, without giving any reasons, set aside the jury verdict and ordered that the condemnation order be reinstated. Counsel for South Dakota and counsel for MacInnes had argued the appeal before the Supreme Court over four days. MacInnes received legal advice to the effect that it is almost unheard of for a state supreme court to overturn a jury verdict unless there was evidence of jury tampering or unless the jury finding was totally perverse. Neither situation applied in this case.

Shortly after the South Dakota Supreme Court decision, the United States Supreme Court released a decision in a case where the State of California had banned the distribution and sale of an herbal remedy. In enacting the legislation, the State of California had relied on a preliminary scientific study, which although incomplete, suggested that the herbal remedy posed health risks to consumers. A farmer who grew the herbal remedy challenged the legislation as arbitrary and a taking of her herbal remedy business. The United States Supreme Court dismissed the claim and affirmed the state's right to impose regulatory restrictions, including bans, where the purpose

of the legislation is the protection of health and even where there is no definitive scientific evidence of health risks.

MacInnes was told by legal counsel that he could appeal to United States Supreme Court but that, even if the United States Supreme Court agreed to hear the appeal, the appeal would be very expensive and given the recent decision in the herbal remedy case his chances of success were less than 10%.

By that time, MacInnes was in a precarious financial position because of the closure of his U.S. operation. Unable to pay further legal fees, he gave up his court fight and sold off the equipment and the property in South Dakota at fire-sale prices. However, MacInnes was determined, that somehow, the U.S. Government or the Government of the State of South Dakota would be made to pay for what had happened to him.

In the meantime, there had been several developments between Canada and the United States that made it much more difficult for MacInnes to pursue a claim internationally. The *North American Free Trade Agreement* had provided for investor state dispute settlement procedures that could have been invoked by MacInnes. However, a year before MacInnes' difficulties began, the United States government had been sued by a Canadian investor for a large sum of money over an environmental regulation, and the arbitration tribunal established under Chapter 11 of NAFTA had decided in favour of the Canadian investor and had awarded damages of \$200,000,000. U.S. environmental groups applied enormous pressure on the newly elected administration in Washington to re-open NAFTA with the Canadian and Mexican Governments to do away with these procedures. The new administration, while not normally sympathetic with environmental groups, was highly protectionist and disliked a number of provisions of NAFTA, such as the Chapter 19 binational procedures in antidumping and countervailing duty matters. The U.S. administration refused to pay the award and demanded that far-reaching amendments be made to NAFTA, including dispensing with the entire investment chapter, which was now viewed as a threat to U.S. sovereignty. The Canadian and Mexican governments objected strongly and the U.S. government made good its threat to withdraw from NAFTA. The U.S. withdrew from NAFTA two days before the South Dakota Supreme Court made its decision.

The Canadian Government had requested consultations with the U.S. Government regarding the South Dakota legislation respecting the hormone Incregrow under the *WTO Dispute Settlement Understanding*. A number of U.S. states were seriously considering similar legislation. The consultations failed to result in a resolution of the dispute and the Canadian Government had requested a panel. The Canadian Government thought that it had a good case under the *WTO Agreement on the Application of Sanitary and Phytosanitary Measures* (the "SPS Agreement") because of the failure of the South Dakota Government to conduct a risk assessment and because of the lack of a scientific basis for the legislation. The European Union, having lost a WTO case involving growth hormones, strongly supported the U.S. position. The WTO panel released its decision about eight months after South Dakota Supreme Court decision. The WTO panel, using similar reasoning to that in the *Beef Hormones* case, decided that the ban on Incregrow was not based on a scientific risk assessment, did not comply with the requirements in the SPS Agreement and was an unjustifiable trade restriction.

MacInnes felt partially vindicated by the WTO panel decision but the damage had already been done. By this time he had sold his South Dakota operations and he vowed never to return to South Dakota. Even if he had the funds to continue his fight in the U.S. courts, the time period for appealing to the United States Supreme Court had passed and an appeal could not be made at this point.

While the WTO Panel decision meant that South Dakota's legislation would have to be repealed in order for the U.S. to be in compliance with international trade law, the issue of compensation remained outstanding. MacInnes had powerful friends throughout western Canada and prevailed upon the Canadian Government to take the matter of his treatment by the State of South Dakota and the South Dakota Supreme Court to the International Court of Justice. The United States Government vigorously denied that there was any entitlement to compensation and argued that the rule requiring exhaustion of local remedies required the claim be brought and adjudicated in U.S. courts.

In order to resolve the matter, the Canadian and United States governments agreed in the compromise to refer three specific questions to the International Court of Justice.

1. Does the rule requiring the exhaustion of local remedies preclude Canada from advancing a claim?
2. Is the South Dakota Supreme Court decision to overturn the jury verdict a denial of justice under international law?
3. Does the South Dakota legislation, the regulation and the condemnation order amount to expropriation (or regulatory taking) without compensation contrary to international law?

The compromis indicates that, by agreement, Canada would be the applicant and the United States the respondent and that both countries accepted the jurisdiction of the ICJ for the purposes of the submission. The parties agreed that if the ICJ determined that compensation were payable, the parties would decide between themselves the appropriate standards for determining compensation and the level of compensation.

One member of each team will argue the exhaustion of local remedies and the denial of justice issues. The other member of each team will argue the regulatory taking issue.