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Frank E. Loy

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ON A COLLISION COURSE?
TWO POTENTIAL ENVIRONMENTAL CONFLICTS BETWEEN
THE U.S. AND CANADA

Frank E. Loy[†]

Let me start by expressing the profound regret of all Americans for the disaster that occurred in Afghanistan yesterday, which took the lives of four brave, young Canadians and seriously injured six others.¹ Friendly fire is a cost of war, but what happened is unbelievably regrettable, and I am just as sorry as I can be that it happened. I know all my American colleagues share in that sentiment.

Let me also say, as an introduction, that it is an enormous pleasure to share a platform here with Alan Nymark, the Deputy Minister of Environment Canada. Alan and I knew each other, and worked with each other, for a number of years. He is respected enormously by all Americans and, in fact, by everyone on the international scene that has dealt with him (and that is *a lot* of people). Canada is lucky to have him in his position. I am glad to share a moment with him.

In view of Henry's imposed time limitations, I am going to stick largely to some policy issues on two questions that are going to be discussed in greater detail in the coming days. First, what are the possible implications and consequences of Canada being a party to Kyoto Protocol on Climate Change² the United States not being a party? And, second, I want to say a couple words about the large number of cases that have arisen under Chapter 11, the investment chapter of NAFTA,³ and what they mean for public policy in the area of police powers, health and environment.

[†] Former U.S. Undersecretary of State for Global Affairs (1998-2001). B.A., University of California, Los Angeles; LL.B., Harvard University. Additional biographical information available at page xiv.

¹ See, e.g., Mark Turner & Ken Warn, *Probe Planned After U.S. Kills Canadians in Afghanistan*, FIN. TIMES, April 19, 2002, at P11.

² See Kyoto Protocol to the United Nations Framework Convention on Climate Change, U.N. Doc. FCCC/CP/1997/7/Add.2, 37 I.L.M. 32 [hereinafter Kyoto Protocol].

³ North American Free Trade Agreement, Can.-U.S.-Mex., Dec. 17, 1992, Ch. 11, 32 I.L.M. 605, 639 [hereinafter NAFTA Chapter 11].

THE KYOTO PROTOCOL

Kyoto is an innovative and meaningful response to what I believe (and what I think Canada also believes) is today's most significant threat to our environment. Canada and the United States collaborated exceptionally well in shaping that agreement. They, together with Australia, Japan, and a couple other countries, operating under a name of the "Umbrella Group," sought to bring forward an agreement with two fundamental qualities: (1) an assurance that reductions in greenhouse gases really happened; and (2) an assurance that those with obligations to make the reductions happen – namely, corporations and governments, but principally the corporations – would be permitted to limit their emissions in the most cost-effective manner.⁴

This would require a degree of built-in flexibility that has not been present in all that many international agreements, and the provisions that produced this flexibility were counterintuitive to many Europeans, particularly to those who were more inclined to mandate specific "how-to" provisions.⁵ In Kyoto, this flexibility is achieved by the inclusion of all greenhouse gases, not just CO₂;⁶ by permitting emitters to achieve their reductions by investing in clean technology in developing countries;⁷ and by establishing an emissions trading mechanisms among various entities, thereby permitting those that could reduce greenhouse gases more cheaply to trade "credits" with those that could not.⁸ Furthermore, we included in the overall equation a credit system that would not only take into account actual emission reductions, but would also include credits for carbon that is taken out of the atmosphere – mostly by growing trees.⁹ Were it not for the insistence of the Umbrella Group, these provisions would not be in agreement.

Now, of course, it is bittersweet that we find ourselves in the position that, having achieved an agreement that I believe to be in many respects an excellent one, the United States has decided it will not become a party to Kyoto, at least not any time soon.

What are the potential Canadian-U.S. issues that may arise from the decision by the U.S. not to become a party to the Protocol, while, presumably, Canada will be a party?

⁴ See *Fact Sheet on the Kyoto Protocol: The U.S. View*, at http://www.epa.gov/globalwarming/publications/actions/cop5/kyoto_99.html (Oct. 1999).

⁵ See, e.g., Gordon Smith, *We Must Act Now To Cool Carbon Fever*, *GLOBE & MAIL*, Nov. 30, 2000, at A17.

⁶ See Kyoto Protocol, *supra* note 2, Annex A.

⁷ See *id.*, art. 12(3).

⁸ See *id.*, art. 16 *bis*.

⁹ These are what are commonly known as "sinks." See *id.*, art 3(3).

Canadian Policy and the Concerns of Industry

Some of your judgments may be different than mine, but I think that Canada *will* ratify the agreement. I say that, although I am aware of the opposition from western Canada,¹⁰ because of the careful and rather nuanced support of the Protocol in Prime Minister Chrétien's letter to the Canadian Manufacturers and Exporters (CME) organization.¹¹ Let me comment about three points the Prime Minister raised, because Canada is an important leader in this field, and it is important to know what its government is thinking.

First, he said that Canadians ought to understand how they are going to meet their Kyoto target before deciding on ratification.¹² That seems like a rather sensible requirement. I am quite sure when Minister David Anderson and Alan Nymark come up with their implementation plan, that requirement will be met. However, I suspect that whatever the government proposes will be greeted by various groups ready to show that it will cause economic disaster. CME has already published a document showing that Kyoto could cost the manufacturing sector as many as 450,000 jobs and up to \$40 billion dollars over eight years.¹³

Our experience in the U.S. has been that these predictions of disaster are almost always wildly exaggerated. We had to deal with similar predictions when we adopted the 1990 amendments to the Clean Air Act (involving sulfur dioxide emissions), when we were negotiating the Montreal Protocol regarding ozone-depleting substances, and we heard them in connection with the Kyoto negotiations. I would urge very careful scrutiny of the analyses behind their predictions as well as some factoring in of the benefits to Canada for becoming more energy-efficient.

Second, the Prime Minister mentioned the Protocol's positive impact in stimulating innovation and environmental technologies.¹⁴ He is absolutely right. It cannot be anything but beneficial for Canadian industry and exports to be more energy efficient, and to grow an entire industry devoted to energy efficiency and environmentally beneficial products and processes. This would be in star contrast with U.S. industries, which have very modest

¹⁰ See, e.g., Jill Mahoney, *Anti-Kyoto Alternative Wins Airing*, GLOBE & MAIL, Jun. 7, 2002, at A10.

¹¹ Letter from The Right Honourable Jean Chrétien, Prime Minister of Canada, to the Honourable Perrin Beatty, P.C., President & CEO of Canadian Manufacturers & Exporters (March 26, 2002) (on file with CME and available online at http://www.the-alliance.org/kyoto/documents/PM_letter.pdf) [hereinafter Chrétien Letter].

¹² See *id.* at 1.

¹³ See CANADIAN MANUFACTURERS AND EXPORTERS, PAIN WITHOUT GAIN: CANADA AND THE KYOTO PROTOCOL 9 (2002), available at http://www.the-alliance.org/kyoto/documents/kyoto_release.pdf.

¹⁴ See Chrétien Letter, *supra* note 11, at 2.

incentives to work towards energy efficiency, I would guess that Canada's steps to meet its targets will represent a competitive plus for Canada.

Yesterday, Governor Engler of Michigan decided to devote 50 million dollars to a program to try to help the automotive industry in Michigan develop new technologies, particularly new engines.¹⁵ Kyoto will provide incentives to industries in Kyoto countries to do just that. Governor Engler's proposal, as elementary and modest as it may sound, ought to be applauded.

The third point the Prime Minister made was that he recognized the damage climate change can bring, and that mitigating the disruptive changes in Canada's climate will bring major benefits, even if those benefits are hard to measure.¹⁶ There was no disingenuousness in his letter, no "we do not know enough about the possible harm to climate from human activities to take meaningful action" rhetoric that we sometimes hear from the current American administration. The Prime Minister should be complimented on his forthrightness because, the fact is, the consequences of climate change are going to be big. Sensible public policy needs to take into account the cost of not acting. Science is rarely 100 percent certain. However, there was not a single public policy issue that I faced during the years I was in government where the science was as clear as it is in the case of global climate change. The fact is that climate change will produce consequences, and they will be severe.

Canadian industry has made two legitimate points that need to be taken into account. First, there is the fear that, because the U.S. is not participating in Kyoto, Canada will become uncompetitive. I tried to address that a moment ago when I spoke about the long-term benefits of being energy efficient. The second objection raised is that Canada's participation will not be effective to halt climate change. After all, the reductions contemplated in the first period of Kyoto, from 2008 to 2012, are not large enough. Moreover, the U.S. and developing countries will not have binding emissions targets.

Concerning the first point: it is absolutely true that the 2008 to 2012 reductions are not large enough. But the point of Kyoto is not primarily the modest reductions that it will achieve in the first budget period, for they will be especially modest in light of the United States' withdrawal. What Kyoto does provide is an architecture for a long-term effort in an agreement that, as the Prime Minister recognized, "represent[s] a very real first step towards the kind of international cooperation that will be required to address the problem."¹⁷

¹⁵ See, e.g., David Paulson & Rick Haglund, *State Launches Center for New Power Sources*, GRAND RAPIDS PRESS, Apr. 18, 2002, at A1.

¹⁶ See Chrétien Letter, *supra* note 11, at 2.

¹⁷ See *id.*

It is right to point out that developing countries, which today account for almost 50 percent of greenhouse gas emissions, must participate more intensively in an international effort in the future. I believe they will. But it is clear to me that they will not do so until they see that the developed countries have taken serious steps to reduce their emissions. Kyoto represents such a step. In fact, it is the agreement that the developing countries have helped shape. There is no surer way to delay stronger efforts by developing countries than to let Kyoto flounder. Once the developed world takes significant action, by implementing the Protocol and by bringing it into effect and by implementing domestic actions that reduce their own emissions, then and only then will the developing countries come along in some form of meaningful participation.

Current U.S. Policy – The Bush Plan

The other non-participant is the United States, the source of about a quarter of all greenhouse gas (GHG) emissions. In the long run, no GHG emission reduction scheme will work unless the United States takes a meaningful role. I think one effective way to get the U.S. to participate in an international regime will be to bring Kyoto into effect, to demonstrate that it is an effective instrument, and to demonstrate the true costs of reducing carbon emissions.

I do not think the present U.S. administration will soon change its mind about Kyoto – maybe it never will. However, no administration lasts forever. I think that, faced with a near-universal Kyoto Protocol that is proven to be effective working instrument, the chances that the U.S. will participate in some form of an international regime are not at all bad.

As Canada contemplates domestic measures that it needs to take to reduce emissions, it ought not to be seduced in any way by the “alternate approach” unveiled by President Bush in February.¹⁸ His domestic U.S. program will work to reduce American “greenhouse gas intensity” by 18 percent over the next ten years (greenhouse gas intensity being the ratio of greenhouse gas emissions to economic output measured by GDP or some other index).¹⁹ We need to be candid and recognize that this program is a plan to do essentially nothing for at least ten years.

The program has three major flaws. The first is that the proposed reduction in greenhouse gas intensity reflects what has already been happening, *without any emissions reduction measures*, for the last ten

¹⁸ See *Executive Summary – The Clear Skies Initiative*, at <http://www.whitehouse.gov/news/releases/2002/02/clearskies.html> (Feb. 14, 2002).

¹⁹ *President Bush Announces Clear Skies & Global Climate Change Initiatives*, at <http://www.whitehouse.gov/infocus/environment/> (last visited Aug. 1, 2002).

years.²⁰ We have had a reduction in greenhouse gas intensity for ten years at about the same level simply by switching to a more service-oriented economy and taking some voluntary measures that have usually involved relatively low-hanging fruit. There is no reason to believe that, in the years ahead, American industry has to do anything different to achieve the President's policy goal.

The second flaw is that it relies entirely on voluntary actions. We have had ten years of very thoughtful, very good, and sometimes quite sizable voluntary actions by the United States, by industry, and by local governments, to reduce gas emissions. Even the federal government has joined the effort. We have learned a quite a bit from these experiments. One thing we learned, however, is that relying on voluntary action alone is wholly inadequate to solve the problem at the scale that it needs to be solved.

The third flaw is that the program lacks serious and concrete measures to provide the incentives that would change the trajectory of the U.S. emissions. There are no real measures to spark innovation, to harness the power of the market, or to unlock the technological potential of U.S. industry to address climate change. Canada should avoid following this particular model.

Trade Consequences of Kyoto

When Canada does take steps to implement whatever it needs to in order to meet its Kyoto targets, several possible trade questions arise. Let me just mention a couple.

A day may arise when, in order to achieve its targets, Canada adopts certain "policies and measures,"²¹ a term used in Article II of the Protocol. Such measures might include energy efficiency standards for vehicles or for appliances, or industrial manufacturing standards. The question is whether doing so will trigger any problems under Canada's WTO obligations. I would say that, clearly, Canada is free to adopt such measures under Article III of the GATT,²² so long as the standards are applied to the *product*, and are identical for both domestic and foreign products.²³

If, however, a standard were to be applied not just to the *product* but to the *process* by which that product is manufactured, then we get into a more difficult area. The environmental exceptions of Article XX(b) and (g)²⁴

²⁰ See, e.g., Kelly Sims Gallagher, *Bush's Hot Air Plan*, at <http://www.fpif.org/pdf/gac/0202greenhouse.pdf> (Feb. 2002).

²¹ Kyoto Protocol, *supra* note 2, art. 2(1)(a).

²² See General Agreement on Tariffs and Trade, Oct. 30, 1947, art. III(2), 61 Stat. A-11, A-14, T.I.A.S. No. 1700, 55 U.N.T.S. 194, 206.

²³ See *id.*, art. XX

²⁴ See *id.*, art. XX(1):

ought to allow the standard, provided that the non-discrimination requirement in the chapeau of Article XX is met. In the WTO Shrimp-Turtle Case,²⁵ the Appellate Body determined that a regulation that sought to protect an endangered species by fixing standards on how seafood imported into the United States was to be gathered was *per se* valid under Article XX.²⁶ The U.S., which had adopted the environmental regulation, lost the case, but only because of a finding that the regulation did not meet the nondiscriminatory test.²⁷ Even though, in principle, WTO decisions have no precedential value for subsequent WTO cases, the Shrimp-Turtle case's determination – that nations may legitimately consider the process and procedures of manufacturing a product when importing goods – should support Canada's right to adopt standards on manufacturing processes.

Yet another policy and measure that Canada might adopt involves product labeling. In countries, such as both of ours, that have a strong bias toward market-based solutions, labeling a product to demonstrate the degree of its energy efficiency provides perhaps the most attractive method to steer consumers toward choosing environmentally-friendly, energy-conserving products. However, the risk is that the label could be accused of being – and could in fact be – a disguised form of protection. A mandatory label that is very directly related to the product's inherent character (“this apparatus consumes X amount of fuel”) would probably not be a problem. What if, however, the label addressed the production characteristics of an item (“the production of this item resulted in the emission of X amount of greenhouse gases”)? The law is not clear. My guess is that Canada should be able to impose such a requirement on Canadian-produced goods. Whether, however, this requirement could also be imposed on U.S.-produced goods or components is unclear.

Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade, nothing in this Agreement shall be construed to prevent the adoption or enforcement by any contracting party of measures: . . .

(b) necessary to protect human, animal or plant life or health; [or]

* * *

(g) relating to the conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption . . .

²⁵ WTO Dispute Panel Report on United States – Import Prohibition of Certain Shrimp & Shrimp Products [hereinafter Shrimp-Turtle case], WTO Doc. No. WT/DS58/R/Corr.1 (May 15, 1998), 37 I.L.M. 832 (1998).

²⁶ See *id.* at 299, ¶¶ 7.60, 7.61; WTO Appellate Panel Report on United States – Import Prohibition of Certain Shrimp & Shrimp Products, WTO Doc. No. WT/DS58/AB/R, ¶ 186 (Oct. 12, 1998), 38 I.L.M. 121, 174-175 (1999).

²⁷ See *id.*; Shrimp-Turtle Panel, *supra* note 25, ¶ 7.49, 37 I.L.M. at 295.

A measure that quite likely could pose a contentious issue involves climate-change-related taxation. Canada might seek to achieve its emissions goals by some form of taxation either on energy or on carbon emissions. Clearly, a significant energy or carbon emissions tax could hurt Canadian manufacturers exporting to countries without such a tax. The generally-acceptable WTO response is via a "border tax adjustment,"²⁸ wherein Canada, in order to make a product competitive in another market, would "take off" its domestic tax once the product crossed the border. Would such adjustments be acceptable in this case? I do not know, but such a tax is more likely to be permissible when it seeks to compensate for taxes imposed on such things as fuel, rather than taxes on products that have become more expensive to produce because of the taxes on fuel.

The fact that Kyoto will be (correctly) viewed as an agreement of major environmental significance, that it has such broad participation by the nations of the world, and that it has its own fully-articulated compliance regime, should bear significantly on the manner that issues that arise will be dealt with by WTO Appellate bodies. I suspect that environmental measures taken by Canada to comply with its obligations under Kyoto, while not relieving it of its WTO obligations, will have a standing that they would not have if they were simply adopted under domestic programs.

NAFTA CHAPTER 11: INVESTOR ENRICHMENT AT THE EXPENSE OF ENVIRONMENTAL PROTECTION?

Chapter 11, designed to protect investors from one NAFTA country that invested in another NAFTA country, has been in effect for some eight years now. It has, unexpectedly, spawned a number of cases challenging environmental laws and regulations in all three NAFTA countries. These cases raise starkly the question whether NAFTA's efforts to protect investors has unacceptably compromised our nations' right to legislate in a way so as to protect the environment and the health of their citizens. The cases sent shock waves through the environmental community. Regulating the environment requires a delicate balancing of important public interests, and many believe that the balance has been tilted by these cases in such a way so that many environmental laws and regulations are threatened. In the United States, there was a time in the early 1900s (often called the "Lochner Era," after the Supreme Court decision of *Lochner v. New York*²⁹) during which a

²⁸ See J. ANDREW HOERNER, THE ROLE OF BORDER TAX ADJUSTMENTS IN ENVIRONMENTAL TAXATION: THEORY AND U.S. EXPERIENCE 6 (2000), available at <http://www.sustainableeconomy.org/bta.pdf>.

²⁹ In *Lochner v. New York*, 25 S.Ct. 539, 198 U.S. 45 (1905), the Supreme Court overturned a conviction of a baker whose employees were permitted, contrary to state labor

number of public measures, such as wage and hour laws and workplace safety laws, were ruled unconstitutional “takings” under the U.S. Constitution. The question is whether we are in that kind of era in Canada-U.S. relations, or whether the fear is overstated.

I want to distinguish this discussion from the more fundamentalist argument put forth by a few American environmental organizations who preach the gospel that much of our investment in foreign countries must be viewed with concern because there is a linear progression from increased investment to increased wealth to increased consumption to increased environmental degradation.³⁰ That argument seems to be both bad economics and a political dead end.

Rather, here, I am talking about whether these NAFTA-protected investments curtail the ability of nations to protect their citizenry. That protection requires governments to fix the context in which the investment takes place and to set the standards that serve to balance the dual public policy interests.

The NAFTA cases are both substantively and procedurally groundbreaking. Substantively, the investor’s charge is not that there is a violation of some constitutional provision about taking without compensation, but rather that there are treaty provisions designed to protect investments which give the investor a specific new basis to challenge environmental laws, a basis the investor would not otherwise have. These cases are procedurally new because the process provides for arbitration between a private foreign investor and the government of the jurisdiction wherein the investment took place. Historically, trade disputes – charges of discriminatory treatment or improper expropriation – have been tested in state-versus-state cases.

NAFTA Tribunal Decisions Implicating Chapter 11

The first of the NAFTA cases was *Ethyl Corporation v. Canada*.³¹ Even though it was never decided, the case set off shock waves. *Ethyl* challenged a Canadian law banning the import and inter-provincial trade of MMT,³² an additive to gasoline.³³ Ethyl Corporation, a U.S. company, was the only manufacturer of MMT in the world. It had established a Canadian subsidiary, Ethyl Canada, to receive MMT from the parent and mix and

law, to work more than 60 hours per week.

³⁰ See, e.g., Megan Uzzell, *Should Trade and the Environment Be Linked?* at <http://www.drake.edu/artsci/PolSci/ssjrn/uzzell.html> (last visited June 8, 2002).

³¹ *Ethyl Corporation v. Canada*, 38 I.L.M. 708 (NAFTA Arb. Trib. 1998).

³² That is, methylcyclopentadienyl manganese tricarbonyl. See *id.* at 709.

³³ See *id.* at 710.

distribute it across Canada. Canada had banned the import for a number of reasons, none of which were ever quite clearly stated. Two reasons seem to have been (1) a concern that the manganese in MMT had toxic properties not fully assessed by science, and (2) a worry that the MMT would cause newly-mandated pollution control equipment on automobile exhaust systems to malfunction. The law did not, however, directly ban the sale or use of MMT in Canada.³⁴

Ethyl claimed that Chapter 11 had been violated in three ways: First, the requirement of national treatment – that is, the requirement to treat foreign investors no less favorably than domestic ones, as per Article 1102 – had been violated because there was no ban on internal production and sale.³⁵ This claim was made even though there was no domestic Canadian producer of MMT. Second, it was claimed that the import restriction, which, in effect, required Ethyl to produce MMT in Canada, was equivalent to a “performance requirement” banned by Article 1106.³⁶ Third, and most serious, Ethyl claimed that the Canadian ban was tantamount to expropriation – a measure for which Ethyl should be fully compensated.³⁷

The Arbitral Tribunal never ruled on these three claims. After it rejected some Canadian jurisdictional arguments,³⁸ Canada settled the case, paying Ethyl \$13 million for costs and lost profits while the Act was in place, and withdrew the legislation.³⁹ Canada explained that it settled mainly because of an unfavorable domestic decision under Canada’s Agreement on Internal Trade (AIT),⁴⁰ which stemmed from a complaint brought by the governments of Alberta and some other provinces that claimed that the ban was a restriction on interprovincial trade that violated the AIT.⁴¹

³⁴ *Ethyl*, 38 I.L.M. at 711.

³⁵ *Id.*

³⁶ *Id.*

³⁷ *See id.*

³⁸ *See id.* at 722-730.

³⁹ *See Another Broken NAFTA Promise: Challenge by U.S. Corporation Leads Canada to Repeal Public Health Law*, at <http://www.bdidut.com/trade/more/Ethyl.htm> (last visited June 8, 2002).

⁴⁰ Agreement on Internal Trade, July 18, 1995 (Can.), available at http://strategis.ic.gc.ca/sc_mrkti/ipttrade/engdoc/console4.pdf.

⁴¹ The AIT Arbitration panel found that [i]t is clear . . . that it was the automobile manufacturers who were the driving force behind the elimination of MMT. They claimed that the on-board monitoring equipment in new vehicles would be impaired by the use of MMT-enhanced gasoline. The evidence as to the impact of MMT on the environment is, at best, inconclusive. Letter from U.S. Council of International Business to Gloria Blue, Office of the U.S. Trade Representative (Aug. 21, 2001) (on file with the U.S. CIB and available online at <http://www.uscib.org/index.asp?documentID=1829>).

One might think that a case never decided is a case destined for obscurity. This was not the fate of *Ethyl*. The litigation raised a storm within the environmental community. The community had been largely responsible for the strong opposition to, and the eventual death of, the Multilateral Agreement on Investments (MAI), then being negotiated at the OECD.⁴² It had feared challenges, such as Ethyl's NAFTA challenge. The MAI was described by one opponent as "NAFTA on steroids."⁴³

Ethyl was followed by several other cases. In *Metalclad v. Mexico*,⁴⁴ an American corporation sued Mexico for failure to provide a transparent and predictable framework for business planning, which resulted in Metalclad's failing to receive a necessary license.⁴⁵ In *S.D. Myers v. Canada*,⁴⁶ an American corporation sued Canada over its ban on the export of PCBs.⁴⁷ In *Methanex v. U.S.*,⁴⁸ a Canadian manufacturer of methanol, a constituent of the gasoline additive MBTE, claimed that California's ban on MBTE went far beyond what was necessary to protect the public.⁴⁹ In yet another case, *Pope and Talbot v. Canada*,⁵⁰ an American company with operations in Canada claimed that the loss of its traditional softwood lumber market due to a Canadian export quota was an expropriation.⁵¹

A Few Serious Concerns

Let me briefly comment on five concerns raised by these cases.

Determining What Constitutes an "Expropriation": A New Standard?

This is at the heart of the debate, and I would say there is legitimate cause for concern. These cases are the first under any investment treaty to rule that

⁴² See R.C. Longworth, *Activists on Internet Reshaping Rules for Global Economy*, CHI. TRIB., July 5, 1999, at 1, available at 1999 WL 2889904.

⁴³ The phrase may have been coined by Lori Wallach, President of Public Citizen's Global Trade Watch. See *MAI: NAFTA on Steroids*, at <http://www.igc.org/lpa/lpv25/lp02.htm>.

⁴⁴ *Metalclad Corp. v. Mexico*, 40 I.L.M. 36 (NAFTA Arb. Trib. 2000).

⁴⁵ See *id.*, ¶¶ 40-41, 40 I.L.M. at 43.

⁴⁶ *S.D. Myers Inc. v. Canada*, 40 I.L.M. 1408 (NAFTA Arb. Trib. 2000).

⁴⁷ See *id.*, ¶ 123, 40 I.L.M. at 1419.

⁴⁸ *Methanex Corp. v. U.S.* (NAFTA Arb. Trib. 2000), available at <http://www.naftaclaims.com>.

⁴⁹ See Complaint of Methanex Corporation in the Matter of a Claim Under Chapter 11, Section A of the NAFTA 11 ¶ 33(vi) (Dec. 3, 1999), available at <http://www.state.gov/documents/organization/8772.pdf>.

⁵⁰ *Pope & Talbot Inc. v. Canada* (NAFTA Arb. Trib. 2002), available at <http://www.naftaclaims.com>.

⁵¹ See Statement of Claim by Pope & Talbot Inc. Under the Arbitration Rules of the U.N. Commission on International Trade Law and the NAFTA ¶¶ 89-95 (Mar. 25, 1999), available at <http://www.dfait-maeci.gc.ca/tna-nac/pubdoc3.pdf>.

an environmental regulation may be tantamount to expropriation, even if the regulation is non-discriminatory in its application and was undertaken for a valid public purpose.

Several of the cases involve unclear or mixed motivation for the legislation being challenged. That was true in *Ethyl, S.D. Myers*, and in some others. But several of the tribunals seem not to care about the lawmakers' intent. In *Metalclad*, the Tribunal expressly noted that it need not "decide or consider the motivation or intent"⁵² of the environmental measure at issue. Rather, it said the test should be whether there was a significant impact "on the use or reasonably-to-be-expected economic benefit" of the property.⁵³ In *Pope and Talbot*, the Tribunal again said that the test for expropriation is one of the degree of interference with the investment. Although the Tribunal found that the interference was not substantial enough,⁵⁴ it did not apply a balancing test of any kind. Furthermore, nothing was said about the public policy grounds for the measure.

Clearly, the public welfare stakes are enormous. If this standard is upheld, governments are going to have to pay for damages to investors caused by their regulations even if the intent of the law is clearly environmental protection. I cannot believe this will not result in some "regulatory chill" – a timidity of regulation for fear of subjecting the state to big liabilities. One Canadian official has suggested that he had not observed such a "regulatory chill" effect to date; I actually find that hard to understand. After all, the first two environmental laws adopted at the federal level in Canada after NAFTA were both challenged under Chapter 11. One was repealed and a big damage award paid (as per *Ethyl*); the other was held to be a breach of Chapter 11, and a damage award is pending.⁵⁵

In July of last year, the trade ministers of the three NAFTA countries (the North American Free Trade Commission), taking into account the many complaints about the process from both governments and NGOs, issued an interpretation – the July Interpretation⁵⁶ – of certain provisions of Chapter 11. The expropriation issue was not addressed. This was a major mistake. It is highly desirable for the ministers to state clearly that non-discriminatory laws that address the environment, public health, or similar public interests should

⁵² *Metalclad*, 40 I.L.M. at 51.

⁵³ *Id.* at 50.

⁵⁴ See *Pope & Talbot v. Canada* Interim Merits Award ¶¶ 74-76 (NAFTA Arb. Trib. 2000), available at <http://www.appletonlaw.com/cases/P&T-INTERIM AWARD.PDF>.

⁵⁵ That is, in the *S.D. Myers* arbitration.

⁵⁶ NAFTA Free Trade Commission, Notes of Interpretation of Certain Chapter 11 Provisions, July 31, 2001, available at <http://www.dfait-maeci.gc.ca/tna-nac/NAFTA-Interpr-e.asp> [hereinafter July Interpretation].

enjoy the traditional police power status in cases raising the expropriation question.

Broadening the Scope of Investor Protection: The Definition of “Investments” and the Concept of “Minimum International Standards”

The expropriation problem is compounded by the tribunals’ interpretations of certain terms in Chapter 11. In *S.D. Myers*, the Tribunal included as an “investment” assets such as the market share a company had achieved even though it owned no physical plant in the country.⁵⁷ That makes it difficult for a government even to identify potential challengers to its environmental laws.

Chapter 11, like most bilateral investment agreements, requires a host country to treat foreign investors in a way that meets minimum international standards. Specifically, it requires “treatment in accordance with international law, including fair and equitable treatment and full protection and security.”⁵⁸ The *Metalclad* Tribunal read this requirement very broadly indeed, and found that Mexico violated it because, among other things, Metalclad was not notified of an important town meeting,⁵⁹ and Mexico failed to establish clear ways for investors to know the rules. A breach of Mexican law by any government agency at any level amounted to a breach of this requirement.

The July Interpretation, in its most important part, went a long way to fix this problem by stating that this obligation is no more onerous than that which is granted under customary international law, and that a breach of some other NAFTA provision or the provisions of some other international agreement does not necessarily constitute a breach of Article 1105.⁶⁰

The Baptist-Bootlegger Problem

If, contrary to the *Metalclad* and *Pope and Talbot* cases, the motivation for enacting the legislation is a key to its validity, what of the case where the motivation appears mixed? An instance is *Ethyl*, where Canada’s legislative motivation admittedly is quite unclear. There is evidence to support the proposition that Environment Canada was genuinely concerned about air quality, but there is also the claim of three Canadian provinces, echoed by

⁵⁷ See *S.D. Myers*, 40 I.L.M. at 1431-34.

⁵⁸ NAFTA Chapter 11, *supra* note 3, art. 1105, 32 I.L.M. at 639.

⁵⁹ See *Metalclad*, ¶ 54, 40 I.L.M. at 44.

⁶⁰ See July Interpretation, *supra* note 56, § B(3).

Ethyl], that the ban “is a blatant example of Ottawa favoring the Ontario-based car makers over the refineries.”⁶¹

Virtually every piece of environmental or conservation legislation or regulation affects a commercial sector, and will thus be politically supported (or opposed) by private interest groups. Often it will not be easy to tell what motivated the governments. This is the “Baptist/Bootlegger” problem, an obvious reference to the support given U.S. prohibition legislation by two factions with wildly differing aims: the moral aims of the Baptists and the commercial aims of the bootleggers. Just how much should this possible duality matter? I would think that public policy would be best served by a clear statement that is not, unfortunately, to be found anywhere in the Chapter 11 cases. The mere fact that environmental legislation aids some private interests and that the legislature took those interests into account should not, by itself, invalidate the legislative measure, provided that it has some basis in environmental protection. This is yet another instance where the July Interpretation could have been expanded.

Environmental Standards and the “Sound Science” Rule

In the WTO, the crucial test to determine whether an environmental trade sanction is permissible has been to ask whether the piece of legislation was based on sound science.⁶² The dispute between the U.S. and the E.U. involving beef hormones is a case in point.⁶³ The problem of factoring sound science into decision-making in trade issues almost scuttled the negotiations on the Biosafety Protocol,⁶⁴ the agreement concerning international trade in genetically modified agricultural products.

Some governments have challenged the concept that any standard for valid regulation must be based on a “sound science,” saying that it is much

⁶¹ Shawn McCarthy, *Provinces Attack MMT Ban: Alberta Leads Charge in First Case Under Internal Trade Pact*, GLOBE & MAIL, Apr. 16, 1998, at B1.

⁶² See, e.g., *Beef & Beef Hormones Case (U.S. v. E.U.)* ¶ IV(25) (WTO Panel, 1997), available at http://www.wto.org/english/tratop_e/dispu_e/horm1.wp5:

Measures must be based on *scientific* principles, as opposed to non-scientific ones, such as superstition. If a measure was aimed at reducing or eliminating a risk to health, then it must actually address that risk in a manner which [*sic*] could be scientifically justified. If, for example, the measure was aimed at eliminating a pathogenic organism from a food, there were several methods, e.g. heating, salting, pickling, etc. which could be scientifically proven to be effective. If, however, a Member required prayers to be said over the food, or a ritual dance to be performed around it, that would not be compatible with the SPS Agreement because such methods could not be scientifically proven to be effective [emphasis added].

⁶³ See *id.*

⁶⁴ Cartagena Protocol on Biosafety to the Convention on Biological Diversity, 39 I.L.M. 1027 (2000).

too tough a test, especially if it means that a rigorous cause-and-effect nexus between the empirical scientific evidence and the national regulatory measure chosen must be shown.⁶⁵ They point to examples where government has acted at a time when the evidence of harm was not conclusive. At a time when the evidence of lead's harmful health effects was still controverted, the U.S. banned the sale of leaded gasoline.

The alternative to the "sound science:" test that has been suggested is the "precautionary approach," which holds that if there is a small but serious risk, regulators may and should err on the side of caution, even in the absence of totally convincing evidence.

However, there is a legitimate concern that these Chapter 11 cases are guided neither by the "sound science" nor the "precautionary approach" standard. But it is probably premature to draw that conclusion. The cases to date present a somewhat confused picture, and their effect on environmental lawmaking and regulations remains unclear. In the *Ethyl* case, the Canadian government's case was complicated by the fact that Canada did not ban MMT as toxic under the Canadian Environmental Protection Act.⁶⁶ In any event, in *Ethyl*, the health claims behind the ban on MMT were not based on its direct toxic effect, but rather on the fact that it would cause auto exhaust systems to malfunction, which would lead to increased pollution.

Concerns about Tribunal Secrecy and Restricted Participation

When I was in government and we contemplated trade issues and disputes, we filtered our decision of whether to take a case to the WTO tribunal, a NAFTA tribunal, or some other place through a wide spectrum of public interest concerns: political relations with the other nations, domestic public reaction, the precedent for future cases, or if our taking a case to the tribunal would affect pending domestic legislation. I am not suggesting we always came out on the correct side; we probably brought some cases we should not have brought and did not bring some cases that we should have. Nevertheless, that decision was made in a public policy context.

In sharp contrast, under Chapter 11, the investor has no such quandaries to consider when he files his complaint. The investor has but one objective, and that is a commercial one – one that will enable him to make money.

⁶⁵ There is certainly a lack of agreement on what exactly "sound science" should mean; what may amount to necessary phytosanitary standards in one country may indeed discriminate against others. See, e.g., John S. Wilson, *Advancing the WTO Agenda on Trade and Standards: A Developing Country Voice in the Debate*, available at <http://www.aercafrica.org/documents/standardsgeneva.doc>.

⁶⁶ *Ethyl*, 38 I.L.M. at 711.

The problem of bringing to light public interest concerns is made more difficult to date by the tribunals' maintenance of strong rules on secrecy – surely to a much greater degree than is required. Filings and other documents are not made public. While the July Interpretation pledged that the parties to a Chapter 11 dispute will “make available to the public in a timely manner all documents submitted to” a Chapter 11 tribunal.⁶⁷ However, they also added an exception to this pledge for “information which the Party must withhold pursuant to the relevant arbitral rules, as applied.”⁶⁸ Given the history of decisions by the tribunals, there is no way to tell whether the pledge will have any practical effect.

Another procedural area that needs attention and change is whether third parties have the right to participate fully in the process. A positive beginning note was struck in *Methanex*, where the Tribunal indicated its intent to permit the filing of *amici curiae* briefs by two NGOs.⁶⁹ On the other hand, the organizations were not permitted to present oral arguments.⁷⁰

CONCLUSION

A “fix” of the problems in Chapter 11 is clearly needed. For a start, we should look to the trade ministers who govern the NAFTA Commission and are authorized to interpret NAFTA. According to NAFTA itself, those interpretations carry significant weight.⁷¹ The ministers took a meaningful though timid step with the July Interpretation last year. Yet, they did not touch the issue of expropriation at all. Both of our countries need to look at this issue very carefully and, in concert with Mexico, should press the Commission to insure, in some fashion, that NAFTA, in its efforts to protect investors, does not jeopardize the ability of governments to protect their citizens' health and to protect the environment. The balance between those two interests at the moment is in jeopardy, and it is up to our two governments to fix it. Thank you.

⁶⁷ July Interpretation, *supra* note 56, § A(2)(b).

⁶⁸ *Id.*, § A(2)(b)(iii).

⁶⁹ See *Methanex v. U.S.*, On Petitions of Third Parties to Intervene as “Amici Curiae” ¶ 52 (NAFTA Arb. Trib. 2000), available at <http://www.naftalaw.org/methanex/Methanex - Amicus Decision.pdf>.

⁷⁰ See *id.*

⁷¹ See, e.g., NAFTA ch. XX(2).