The Worst Is Still Ahead: The Privileging of Free Investment over Environmental Protection under NAFTA

by

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A thesis submitted in conformity with the requirements for the degree of Master of Laws (LLM)
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Abstract

When created, the North American Free Trade Agreement (NAFTA) was considered historic since it was the first multilateral trading regime to incorporate environmental considerations.¹ This dissertation argues that NAFTA's model of liberalized investment has instead given priority to economic growth over environmental protection. It is true that in some cases, foreign investment triggered through NAFTA brought clean technologies;² however, these gains are exceptions rather than the rule. I contend that economic stimulation under NAFTA is coupled with a weak environmental institutional framework, made up of side agreements and institutions that are inhibited by, inter alia; the uncertainty of interpretation of its environmental provisions; the expansive definitions of measures covered, and is exacerbated by the existence of Chapter 11 dispute settlement mechanism.

Acknowledgments

Foremost, I would like to express my sincere gratitude to my advisor Prof. Jutta Brunnee for her aspiring guidance, invaluably constructive criticism, patience, and immense knowledge during all the time of research and writing of this dissertation. I am sincerely grateful to her for sharing her truthful and illuminating views on different issues related to my dissertation which were very fruitful for shaping up my ideas and research. I could not have imagined having a better advisor and mentor for my master's study.

I would also like to thank my parents for the support they provided me through my entire life and my siblings for being supportive and caring.
# Table of Contents

Introduction.......................................................................................................................... 1

Chapter One – Overview of NAFTA Key Provisions.......................................................... 3
  1.1 Introduction......................................................................................................................... 3
  1.2 Pre-NAFTA Trade Liberalization Efforts......................................................................... 4
  1.3 Objectives of NAFTA..................................................................................................... 5
  1.4 NAFTA Key Provisions.................................................................................................. 7
    1.4.1 Elimination of tariff and non-tariff trade barriers (trade in goods).......................... 7
    1.4.2 Rules of Origin............................................................................................................ 8
    1.4.3 Trade in Services......................................................................................................... 9
    1.4.4 Government Procurement......................................................................................... 10
    1.4.5 Foreign Investment..................................................................................................... 11
    1.4.6 Intellectual Property Rights (IPR)........................................................................... 12
    1.4.7 Dispute Resolution.................................................................................................... 14

Chapter Two – Investor's Rights under NAFTA Chapter 11............................................. 16
  2.1 Introduction....................................................................................................................... 16
  2.2 Article 1101 - Scope of Coverage.................................................................................. 17
  2.3 Article 1139 - Investments and investors.................................................................... 18
  2.4 Articles 1102 and 1103 - National Treatment and Most Favored Nation (MFN)
    Treatment......................................................................................................................... 20
  2.5 Article 1105 - Minimum Standard of Treatment.............................................................. 22
  2.6 Article 1106 - Performance Requirements.................................................................. 23
  2.7 Article 1110 – Expropriation.......................................................................................... 28

Chapter Three - NAFTA's Approach to Environmental Protection.............................. 31
  3.1 Introduction....................................................................................................................... 31
  3.2 Background Brief of Inclusion of Environmental Provisions in NAFTA..................... 32
  3.3 NAFTA Environmental Provisions................................................................................ 34
    3.3.1 Sanitary and Phytosanitary Measures (Chapter 7)................................................. 34
    3.3.2 NAFTA Chapter 11 adjudication of SPS Measures.............................................. 36
    3.3.3 Standards-Related Measures.................................................................................. 38
    3.3.4 Impact on State and Provincial Laws..................................................................... 39
    3.3.5 Impact on Environmental Treaties......................................................................... 40
    3.3.6 Investment............................................................................................................... 41
  3.4 North American Agreement on Environmental Cooperation (NAAEC)...................... 41
Introduction

The objective of this paper is to review the provisions and processes of NAFTA specifically relevant to investor protection and environmental regulation to be able to identify the on-going clash between investors' rights and environmental regulation. The analysis will look into the impact of Chapter 11 dispute settlement mechanism on environmental protection, demonstrating the danger it represents to the sovereign capacity of the States to enact laws applicable within their territory and the damage it has inflicted to the protection of the environment by sometimes forcing the reverse of some environmental laws.

In the first chapter of my thesis, I will present an overview of NAFTA as a comprehensive trade agreement that improves virtually all aspects of doing business within North America. I will examine its key provisions to identify NAFTA overarching obligations related to tariff reduction and/or elimination for goods, market access commitments, rules governing trade in services and other provisions.

In the second chapter, I will discuss investors’ rights according to Chapter 11 of NAFTA which contains a variety of new – despite being long established rights in most of the Bilateral Investment Treaties (BITs) and International Investment Agreements (IIAs) - rights and protections for investors and investments in NAFTA countries which ensure agreed standards of protection to foreign investors. I will look at different interpretations of the established rights as explained in relevant academic literature and support them by case studies.

In the third chapter, I will look at NAFTA environmental provisions in detail. It will first examine the key chapters dealing with environmental concerns and their impact on state and provincial regulatory power in addition to some relevant environmental provisions. This chapter then deals with NAFTA Environmental Side Agreement the North American Agreement on Environmental Cooperation (NAAEC) and the new institution established under its umbrella, the Commission for Environmental Cooperation (CEC) setting out its specified purposes and programs. Overall, this chapter is intended to contribute to an understanding of the potential environmental effects of NAFTA's initiative to liberalize trade and investment.
The fourth chapter gives an outline of the main rules of procedure of investor-state dispute resolution mechanism under NAFTA Chapter 11. It then discusses some cases that demonstrate the reach of Chapter 11 mechanism into critical areas of public policy making in relation to environmental matters. A focus is put on the concerns that have been raised with respect to Chapter 11 process of dispute resolution including deficits of legitimacy and transparency. It considers the disadvantages of Investor-State Dispute Settlement (ISDS) mechanism under NAFTA and demonstrates how investors can abuse the investor-state system, which may raise further questions about ICSID’s viability going forward. This will be supported by relevant case law to manifest the clash between the full realization of foreign investors’ rights and the protection of environment.
Chapter One
Overview of NAFTA Key Provisions

1.1 Introduction

The North American Free Trade Agreement (NAFTA), signed in December 1992 and entered into force in January 1994, has clearly led to greater economic integration in North America. NAFTA was regarded as both controversial and significant when first proposed, due to it being the most comprehensive structure for trade and investment negotiated at the time engaging three nations with such radically different levels of development and for incorporating environmental protection. NAFTA included several ground-breaking provisions that served as a model for the subsequent generation of Free Trade Agreements (FTAs) in Western Hemisphere and other parts of the world influencing negotiations in areas of trade, foreign investment and related issues.

Whether NAFTA has been a remarkable success story for all three partners or not is not our concern in this dissertation. But it is worth noting that, as with all trade agreements, NAFTA triggered massive debate amongst scholars. Advocates argued that the agreement would help create thousands of new jobs, raise living standards, reduce income disparity in the region, and improve environmental conditions in a country like Mexico. On the other hand, opponents forewarned that the agreement would launch a race-to-the-bottom in wages by causing huge job losses in the region as companies move production to Mexico to benefit from lower costs, undermine democratic control of domestic policy-making and threaten health, environmental and food safety standards.

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6 Until NAFTA, trade agreements only dealt with cutting tariffs and lifting quotas to set the terms of trade in goods between different countries. While NAFTA contained rules to which each state was required to conform all of its domestic laws regardless of whether voters and their democratically-elected representatives had previously rejected the very same policies in state legislatures or city councils.
The rules contained in the NAFTA agreement can be taken as a baseline for the purposes of our analysis. NAFTA’s rules consist of those specified in the agreement itself and its tariff annexes. Of key interest are rules that change those of the Canada-United States Free Trade Agreement (CUFTA) or the General Agreement on Trade and Tariffs (GATT) and hence this chapter makes some comparisons to the rules found in these two agreements. We will first touch upon pre-NAFTA trade liberalization efforts and the agreement’s objective and then this will be followed by a discussion of those of NAFTA’s specific rules that are of greatest relevance.

1.2 Pre-NAFTA Trade Liberalization Efforts

Of course the process of North American economic integration was well under way long before NAFTA, particularly between US and Canada. A good example is the landmark Automotive Products Agreement (commonly known as the 1965 Auto Pact) signed in 1965 between the United States and Canada\(^7\) that greatly liberalized trade in cars, trucks, tires, and automotive parts between the two countries. The Auto Pact was recognized as the backbone\(^8\) for creating an integrated North American automotive sector.\(^9\) Also, the United States and Canada recently marked the 26th anniversary of the January 2, 1988 signing of the CUFTA which was one of the most economically significant bilateral FTAs signed by the two countries.\(^10\)

In the case of Mexico, the government had been implementing reform measures to liberalize its trade since the mid-1980s, which shifted Mexico from one of the world’s most protected economies into one of the most open. Mexico’s first steps in opening its closed economy focused on reforming its import substitution policies in the mid-1980s. Further reforms were made in 1986 when Mexico became a member of the GATT.\(^11\) As a condition of becoming a GATT


\(^9\)The Canada-United States Automotive Products Agreement removed tariffs on cars, trucks, buses, tires, and automotive parts between the two countries. NAFTA effectively superseded this agreement.


member, for example, Mexico agreed to lower its maximum tariff rates to 50%. By 1990, when NAFTA negotiations began, Mexico had already taken significant steps towards liberalizing its protectionist trade regime as it now has 12 FTAs involving 44 countries.

Hence, NAFTA was in reality an extension of the free trade relations that existed under CUFTA at the time and an opportunity to expand the growing export market to the south. An FTA with Mexico would help U.S. and Canadian businesses expand exports to a growing market of almost 120 million people. U.S. officials also recognized that imports from Mexico would likely include higher U.S. content than imports from Asian countries.

1.3 Objectives of NAFTA

Free trade agreements are, in general, credited with enhancing economic linkages between countries, increasing the availability of lower priced consumer goods and improving living standards and working conditions. NAFTA, as a multilateral FTA, had been expected to stimulate trade and investment in North America beyond the levels that existed in 1991. The agreement is designed to lead to a more efficient use of North American resources, land and labor by the gradual elimination of tariff and non-tariff barriers to trade and removing impediments to investment such as performance requirements and investment screenings. In

13 World Trade Organization (WTO), Regional Trade Agreement Database, available at http://www.wto.org; and Organization of American States, Foreign Trade Information System, available at http://www.sice.oas.org. These include agreements with most countries in the Western Hemisphere including the United States and Canada under the North American Free Trade Agreement (NAFTA), Chile, Colombia, Costa Rica, Nicaragua, Peru, Guatemala, El Salvador, and Honduras. In addition, Mexico has negotiated FTAs outside of the Western Hemisphere and entered into agreements with Israel, Japan, and the European Union.
16 Performance requirements are used to describe any requirement established by regulatory authority to try to influence the behavior of foreign investors and secure certain benefits for their economies. They may constitute, for example, licensing requirements in specific sectors, or may relate to capital structure and management of an investment such as local equity requirements. As a result, they can distort investment decisions by imposing conditions on investors that are not related to market considerations.
17 An illustration of the foreign investment screening process is to require foreign investment proposals in excess of certain monetary thresholds to be screened and approved as being in the ‘national interest’ prior to their execution.
addition, the agreement covers other subjects that will affect business in the region, such as intellectual property rights and environmental issues.

Article 102(1) is specific in the manner in which it lays out the appropriate context for interpretation of NAFTA’s text. It not only sets out the aims of substantially increasing investment opportunities and promoting conditions of fair competition in the free trade area, but it also provides that these objectives are “elaborated more specifically through its principles and rules, which include national treatment, most favored nation treatment, and transparency”.

It is an easy task to list the objectives of NAFTA as clearly outlined in Article 102 of the agreement, however, it would be more realistic to ask what benefits the consumers and businesses are actually reaping from the three countries free trade alliance. Consumers participate in international trade each day as they purchase goods and services that cross international borders. This free movement of goods and services are sometimes confronted with barriers – such as quotas limiting the quantity of products imported or labeling requirements – that can significantly increase the cost of products.

Under NAFTA free trade regime, consumers are expected to enjoy variety of choices in goods and services, lower prices, improved quality products and stronger health and safety standards. Creating more jobs by expanding access to imported goods and services is another benefit under NAFTA. This is evidenced by the 1996 increase of import-supported jobs when the US exports to Canada and Mexico created an estimated 2.3 million jobs which represented an increase of 311,000 jobs since 1993.\textsuperscript{18}

Moreover, businesses would have access to the large North American market, new investment opportunities, effective dispute settlement procedures and compatible standards of goods between the three countries. The provisions of NAFTA suggest that the economies of the three countries would be rather described as an integrated marketplace driven by supply and demand than by barriers to trade.

\textsuperscript{18}Clinton, B. (1997), Study on the Operation and Effects of the North American Free Trade Agreement, DIANE Publishing, Executive summary, i.
1.4 NAFTA Key Provisions

Many of the CUFTA provisions were incorporated into, or rather expanded in NAFTA. However, the CUFTA did not include, or specifically exempted, some issues that would appear in NAFTA for the first time.

In this section I will provide an overview of key NAFTA provisions including elimination of tariff and nontariff trade barriers, rules of origin, trade in services, government procurement, foreign investment, intellectual property rights protection, and dispute resolution. Labor and environmental provisions were included in separate NAFTA side agreements. Major focus will be placed on foreign investment and dispute resolution under Chapter 11 as they make an essential part of my dissertation.

1.4.1 Elimination of tariff and non-tariff trade barriers (trade in goods)

Given that CUFTA was already in place, most of NAFTA market opening measures resulted in the removal of U.S. and Canada tariffs and quotas applied to imports from Mexico, and correspondingly Mexican trade barriers applied to imports from the United States and Canada. NAFTA provisions gradually eliminated tariffs on US, Canadian and Mexican products and most non-tariff barriers on goods produced and traded within North America over a period of fifteen years after it entered into force.\(^{19}\) Some tariffs were removed immediately while others were phased out in various schedules of five to ten years.\(^{20}\)

NAFTA includes a provision that allows the option of accelerating tariff reductions if the countries involved agreed.\(^{21}\) The agreement also contains safeguard provisions through which the

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importing country could restrict imports if the domestic industry faced serious damage as a result of increased imports from another NAFTA country.²²

Standard-Related Measures (SRM)²³ constitute an example of technical trade barriers that were not extinguished but were revamped to protect and serve the needs of the domestic economic groups.²⁴ SRM may directly or indirectly affect trade in goods or services, hence the reason NAFTA stipulates that SRM must provide both national treatment and most-favored nation treatment.

Furthermore, NAFTA encourages agreements between governments and private sector organizations for mutual acceptance of test results and certification procedures and establishes conformity assessment procedures. This aims at determining whether the requirements set out in technical regulations or standards are being complied with.²⁵

1.4.2 Rules of Origin

The success of NAFTA in promoting trade creating comes despite its restrictive rules of origin.²⁶ The rules of origin established by NAFTA at the outset have been very tough as they require that products contain substantial North American content in order to enjoy NAFTA trade preferences.²⁷ The purpose of the rules of origin is to prevent "trade deflection"²⁸, by precluding third-country exporters from exploiting a NAFTA country for merely trans-shipping products with the lowest tariff rate or undergoing only minor operations to receive NAFTA preferential tariff treatment. Only North American goods traded among the three NAFTA partner countries are eligible for NAFTA benefits. According to Article 401 of NAFTA, two rules of origin

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²²The importing country may increase tariffs, or impose quotas in some cases, on imports during a transition period if domestic producers faced serious injury as governed by Article 802 of NAFTA.
²³Standards-related measures are included in Chapter nine of NAFTA. NAFTA affirms the right of the Member States to adopt, apply, and enforce standards-related measures to promote safety and protect people, animals and plants, and the environment.
²⁵North American Free Trade Agreement, 1993, 32 I.L.M. 289, Articles 906 - 908, respectively.
²⁶Supra note 8, at 24.
mechanisms are utilized: tariff-shift rules\textsuperscript{29} as provided by Annex 401 origin rules, and value-content rules\textsuperscript{30} for those goods which do not meet Annex 401 rules of origin.

That said, NAFTA rules of origin are seen as market-distorting as they have a protectionist side effect in certain sensitive sectors (notably textiles, apparel\textsuperscript{31} and autos\textsuperscript{32}). NAFTA rules of origin for textiles and apparel define a triple transformation test for when imported textile or apparel goods qualify for preferential treatments. For most products, the rule of origin is “yarn forward”, which means that goods must be produced from yarn made in a NAFTA country to benefit from preferential treatment.\textsuperscript{33} Moreover, this suggests that these rules may create significant administrative burdens to trade in goods within NAFTA – by keeping lengthy records on sources of components used in highly fabricated goods. For example, it was found that compliance costs entailed by rules of origin significantly offset, and in some cases outweigh, market access preferences granted under NAFTA - particularly in textiles and apparel.\textsuperscript{34}

Recognizing this problem, some progress has been made since NAFTA was ratified. NAFTA members have negotiated changes that allow simpler and less restrictive product-specific rules of origin. The first changes were negotiated for some products including alcoholic beverages and petroleum which went into effect in January 2003 in Canada and the United States and in July 2004 in Mexico.\textsuperscript{35}

\textsuperscript{29}Tariff-shift rules require that all non- NAFTA inputs must be in a different tariff classification than the final product. For instance, a manufacture in a Member State of porcelain tableware decorated in several colors, and the final product holds a certain tariff heading. Certain materials (plain porcelain tableware, pigments and decorative designs) from countries outside the free trade zone are used to produce it. If the plain tableware is classified in the same tariff heading as the final decorated tableware, the working carried out in the Member State of the free trade zone does not fulfill the product specific rules based on tariff change and the decorated tableware therefore cannot be considered as originating in the free trade zone.

\textsuperscript{30}Under NAFTA’s value-content rules, a set percentage of the value of the good must be North American. For instance, in order for computers to qualify for duty-free treatment under NAFTA, the motherboard (a key component which generally accounts for between twenty percent to forty percent of the value of a computer) must be made in North America.

\textsuperscript{31} NAFTA rules of origin for textiles and apparel define when imported textile or apparel goods qualify for preferential treatments. For most products, the rule of origin is “yarn forward”, which means that goods must be produced from yarn made in a NAFTA country to benefit from preferential treatment.

\textsuperscript{32}Supra note 8, at 24.


\textsuperscript{34} Supra note 8, at 24.

1.4.3 Trade in Services

NAFTA Chapter 12 addressing trade in services establishes a set of basic rules and obligations among partner countries. The agreement basically expands on initiatives in the CUFTA to create internationally-agreed regulations that ensure cross-border trade in services is conducted in a non-discriminatory manner.\textsuperscript{36} The principles cover a wide spectrum - the provision of services within a NAFTA country, from one NAFTA country to another, within a NAFTA country by an individual provider from another NAFTA country, or the consumption of services in one NAFTA country by consumers from another NAFTA partner.\textsuperscript{37} However, there were some country-specific exclusions and reservations. These included maritime shipping (United States), film and publishing (Canada), and oil and gas drilling (Mexico).\textsuperscript{38}

1.4.4 Government Procurement

Chapter Ten of NAFTA is devoted to achieving greater transparency in and competition for government procurement by eliminating the discriminatory practice of requiring the use of domestic purchasers/suppliers. The mechanisms for liberalizing and opening the government procurement market to non-discriminatory bidding include predetermined procedural disciplines as set out in Sections B and C of Chapter Ten and the principles of national treatment and most favored-nation treatment which will be discussed below under Chapter Two. NAFTA Chapter Ten covers federal government agencies, provincial or state government entities, and enterprises in each contracting State.\textsuperscript{39} It applies to contracts for goods and services greater than $56,190 and construction contracts greater than 7.3 million for federal departments and agencies.\textsuperscript{40} This entails that NAFTA broadens the scope of liberalized procurement practices in terms of the number of entities and types of contracts covered than either the GATT Procurement Agreement\textsuperscript{41} or the

\textsuperscript{37} Supra note 25, Article 1213 (2).
\textsuperscript{39} Supra note 25, Article 1001.
\textsuperscript{41} Government procurement is addressed in the WTO by the Government Procurement Agreement, a plurilateral agreement i.e. accession to the agreement is voluntary.
CUFTA. Nonetheless, NAFTA allows the parties to deny the benefits of the government procurement provisions for strategic and national security reasons as well as to protect health, safety, morals, the environment, or intellectual property.

The process of liberalizing North American government procurement markets under NAFTA still seems to be far from complete. This is implied by Article 1024 that states that Parties may commence further negotiations no later than 1998 with a view to further liberalize their respective government procurement markets. This was marked by the 2010 Canada-US Agreement on Government Procurement where both governments commit to exploring the potential to a longer term agreement that liberalizes government procurement further than either NAFTA or to the GATT.

1.4.5 Foreign investment

NAFTA's Chapter 11 provides a road map for the flow of investment capital within North America. NAFTA's coverage of investment issues includes all forms of ownership and interests in a business (minority and majority interests): tangible property, intangible property, and contractual rights.

Chapter 11 is divided into 3 sections. Section (A) setting out the investment obligations as agreed to by the NAFTA Parties. These obligations relate to the treatment of investors and investments of the other NAFTA Parties in their territories. They will be explained in detail in Chapter Two.

Section (B) laying out the procedures for the settlement of disputes between a Party and an Investor or an investment of another Party within its territory. This investor-protection mechanism provides recourse for alleged breaches of the provisions of Section (A) of Chapter 11 by a Party that have resulted in loss or damage to the investment of an investor. Investors may

43Supra note 25, Article 1018.
44Available at: http://www.canadainternational.gc.ca/sell2usgov-vendreaugouvusa/procurement-marches/agreement-accord.aspx?lang=eng
45Supra note 25, Article 1139.
also use the dispute settlement mechanism outlined in Section B of Chapter 11 to resolve certain disputes arising out of alleged breaches of the NAFTA Article 1503(2) (State Enterprises) and Article 1502(3) (Monopolies and State Enterprises). When investor rights were first introduced, the Chapter 11 provisions were, prima facie, uncontroversial, in fact, they were hailed as a better forum than national courts for resolving investment disputes.\textsuperscript{46} In practice, however, Chapter 11 rules (e.g. the ban on indirect expropriation under Article 1110 and the minimum standards under Article 1105) have fostered litigation by business firms against a broader range of government activity than originally envisaged. Dispute settlement mechanism will be explained in detail later in Chapter Four, and finally section (C) consisting of definitions of certain terms found in the NAFTA Chapter 11.

The principles included in the NAFTA are not unprecedented, and the dispute resolution mechanisms listed for investor-state disputes are drawn from literally hundreds of bilateral investment treaties.\textsuperscript{47} Despite of that, investment provisions were subject to some reservations maintained by NAFTA countries such as Mexico that reserved the right to prohibit foreign investment in the energy sector in order to maintain its constitutional ban in this regard. \textsuperscript{48}

\subsection*{1.4.6 Intellectual Property Rights (IPR)}

IPR are rights granted to inventors, artists, and other creators regarding the use of their innovations.\textsuperscript{49} The focal point of NAFTA’s Chapter 17 differs in some aspects from the general coverage of the whole agreement as presented earlier in this chapter in that its focus is placed on the protection of intellectual property rather than measures associated with liberalization of trade and improving market access. NAFTA built upon and went beyond the then-ongoing Uruguay Round negotiations that have created the Trade Related Aspects of Intellectual Property Rights


\textsuperscript{48}See Brookhart, supra note 3, at 17-1, 17-2.

(TRIPS) agreement in the World Trade Organization and on various existing international intellectual property treaties including the Berne Convention and Geneva Convention.\(^\text{50}\)

The rationale for incorporating IPR protection provisions in a trade agreement like NAFTA is to ensure its consistency with free trade principles; otherwise trade will be rather strangled if the laws of one country do not protect the intellectual property of its trading partners. NAFTA's approach in this regard involves three main points. First, Chapter 17 of NAFTA provides for minimum standards of intellectual property protection revolving around non-discriminatory national treatment in IPR protection provided by each party in its territory.\(^\text{51}\) Second, NAFTA requires that effective and expeditious enforcement procedures are in place and available to rights holders to ensure that IPR holders are protected from infringement by imported products.\(^\text{52}\) In all events, IPR enforcement measures should not themselves become barriers to legitimate trade. Finally, in addition to Chapter 17 provisions, the more general enforcement provisions are found in Chapters 11 and 20. IPR holders in the three NAFTA countries can have recourse to mechanisms of both mentioned chapters when domestic law doesn’t adequately protect their rights in case of IPR infringements. Chapter 11 allows a private investor to bring a claim directly against a NAFTA state party that has allegedly infringed its intellectual property rights and caused damages. Chapter 20 provides a procedure for one state party to bring a complaint against another, to be settled by means of a specified dispute resolution process.\(^\text{53}\)

The threat to public welfare from intellectual property rules rises when the protection of IP holders' rights comes at the expense of environmental protection.\(^\text{54}\) The U.S. competitive advantage in high technology is now fully protected under NAFTA, while a country like Mexico would be the country most affected by the inclusion of IPR in NAFTA due to the expected shortcomings in a developing country's IPR protection. Developing countries had traditionally

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\(^\text{54}\)An example is the negative effect of intellectual property protection on biodiversity. For more details, see McManis, C. R. (1998). Interface between International Intellectual Property and Environmental Protection: Biodiversity and Biotechnology, The. Wash. ULQ, 76, 255.
excluded food and medicine from their IPR laws to insure that these basic necessities are accessible, affordable and not controlled by monopolies. But now under trade rules, living things – plant, animal, and human – can be patented on a world-wide scale.

1.4.7 Dispute resolution

This part covers the different methods of dispute resolution mechanisms provided by NAFTA chapters for various purposes such as the interpretation and application of the agreement, antidumping and countervailing cases...etc, which are briefly discussed below. The Chapter 11 dispute settlement mechanism falls within these methods and will be discussed in detail in Chapter four of this dissertation.

The number of dispute settlement processes introduced in NAFTA is commensurate with the general notion laid down by the agreement concerning trade liberalization and breaking down any related barriers as the possibility of trade friction becomes greater. Starting with the general dispute settlement related to interpretation and application of NAFTA, NAFTA permits complainants to choose between NAFTA and WTO dispute settlement for any matter arising under both agreements, but not to pursue the same complaints in both forums. However, the rules and coverage of both NAFTA and the WTO Agreement differ in certain respects; therefore, NAFTA is sometimes regarded as the only available mechanism for resolving disputes involving obligations that only exist under NAFTA.

Moreover, NAFTA created a Trilateral Trade Commission to regularly review trade relations among the NAFTA governments and to discuss the general implementation of NAFTA and related problems. The Commission may also establish bi-national or tri-national panels, as appropriate, of private sector trade experts to resolve NAFTA disputes involving interpretations

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56Supra note 25, Article 2005.
58Supra note 25, Article 2001.
or application of the NAFTA. The panels will rule on whether or not an action taken by a NAFTA country is consistent with its NAFTA obligations. If the panel finds an action inconsistent, the panel will make a recommendation and calls for the NAFTA country to follow it "wherever possible". If a country decides not to comply with a panel's recommendation, it must offer acceptable compensation. If not, the aggrieved country can retaliate by withdrawing equivalent trade benefits concessions.

Special provisions were also contained in NAFTA to deal with disputes involving environmental and health issues as panels may call upon experts for advice. Scientific review boards may be convened to provide written reports on factual issues to assist panels. This provision is an improvement over the CUFTA, which requires the approval of both parties for scientific input.

There are also special bi-national panels to review antidumping and countervailing duty cases as set out in Chapter 19 of NAFTA. The panels' mandate is limited to whether decisions rendered by Mexico, the U.S. or Canada are consistent with their domestic law. Further, NAFTA encourages and facilitates the use of alternative dispute settlement, including arbitration, for international commercial disputes between private parties. Each country must have in place legal mechanisms to enforce arbitration contracts and awards. Finally comes along the innovative provision of NAFTA that allows any investor from US, Canada or Mexico to seek binding international arbitration in disputes with NAFTA governments involving monetary damages arising from violations of the NAFTA's investment provisions for example, over just compensation in the event of expropriation.

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59 Supra note 25, Articles 2008-2010.
60 Supra note 25, Articles 2018-2019.
61 Supra note 25, Article 2015.
63 Supra note 25, Article 2022.
Chapter Two
Investor's Rights under NAFTA Chapter 11

2.1 Introduction

Unlike other trade agreements, such as the WTO Agreement, NAFTA devoted one of its chapters to address investment issues according rights to foreign investors to acquire, own and operate broad categories of NAFTA-defined “investments” within the NAFTA nations. NAFTA's investment chapter (Chapter 11) contains a variety of new – despite being long established rights in most of the BITs and IIAs - rights and protections for investors and investments in NAFTA countries.

This Chapter analyzes the substantive legal provisions embedded in Chapter 11 that extend the unprecedented reach of the investor-state process. I will begin with explaining the expansive range of state actions that are covered under the notion of “measures” and the range of investors and investments that are covered. I will then move to the five separate obligations imposed on NAFTA governments which play an important role in defining the relationship between the investor-state process and environmental regulation. This chapter argues that the investor-state process in Chapter 11 contains an extensive combination of rights and remedies provided to foreign investors in the context of an international trade agreement.

The original purpose of the investor-state protections appears, on its face, to be defensive - to protect against capricious and unjustified government actions against foreign investors. Today, however, the exercise of these rights has drastically changed. They are now being used by

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64 The term “Investment” under Article 1139 of NAFTA is broadly defined, including anything from an enterprise to a debt security. A holder of a bond from a multinational enterprise is thus an investor, and enjoys the extensive legal rights discussed in this Section.
foreign investors in a strategic manner to shield themselves from the adoption of new laws or regulations that would have an adverse economic impact on them.66

The threat to environmental and public welfare regulation-making from these protections arises from the unprecedented wide coverage set out in Chapter 11. A broad range of government actions are included under the word “measure.”67 It clearly covers all forms of environmental regulation and the administration of those regulations, for instance, environmental assessment and permitting procedures.

Another substantive factor is also the resulting unique ability for investors to bring issues of public interest into the arbitration process. This covers the ability to challenge both new environmental laws and regulations even if they will possibly have an effect on a potential investment68, and the enforcement of those that exist69. This is heightened by the inclusion of an expansive definition of “investor”;70 indeed, a minority shareholder in a foreign investment can initiate arbitration even without the consent of the actual company involved.

2.2 Article 1101 - Scope of Coverage

Article 1101(1) of NAFTA defines the scope of coverage of the investors' protections. Despite being a defined term under NAFTA, the wording of this article uses the broad term measure as it states that "This chapter applies to measures adopted or maintained by a Party relating to....". Article 201 of NAFTA states that the term “measure" includes any law, regulation, procedure,

67 Supra note 25, Article 201.
68 For example, Glamis Gold Ltd v. United States of America, which is a NAFTA arbitration conducted in accordance with the UNCITRAL Arbitration Rules before the ICSID Additional Facility. Glamis is a publicly-held Canadian corporation engaged in the mining of precious metals, who alleged injuries relating to a proposed gold mine project in Imperial County, California. Glamis challenged Senate Bill 22, a regulation that was newly issued by California State Mining and Geology Board at the time and could have adversely affected Glamis Plan of Operations if implemented. Glamis claimed damages of not less than $50 million.
69 An example is Chemtura Corporation (formerly Crompton Corporation) v. Government of Canada, an Ad Hoc NAFTA Arbitration conducted under UNCITRAL Rules. This was a lawsuit against Canada by the manufacturer of an agricultural pesticide, lindane. Following an elaborate scientific review, the Canadian Pesticide Regulation Agency banned lindane in the early 2000s on health and environmental grounds. Chemtura lobbied against the enforcement of the ban in Canada, challenged Canada’s measures in the Federal Court of Canada, and then sued Canada under NAFTA Chapter 11.
70 Supra note 25, Article 1139.
requirement or practice.” The definition itself is not firm; the word "includes" implies that there are other forms of government actions that could also be considered a measure under NAFTA, such as policies or orders.

A relevant case here is the Loewen Group, Inc. and Raymond L. Loewen v. United States of America.\(^{71}\) This case involves an award issued by the Mississippi state courts in O'Keefe v. Loewen Group, Inc.\(^{72}\) resulting in a $500 million damage award against the Loewen Group, a Canadian investor. This arguably raises a question as to whether a jury ruling in a civil contract case constitutes a "government measure" against which foreign investors are granted NAFTA protections. A preliminary ruling issued by the ICSID tribunal in this case stated that there is nothing that prohibits Chapter 11 claims related to private law and civil procedures.\(^{73}\) This illustrates the potential breadth of the term “measure” as used in Chapter 11.

### 2.3 Article 1139 - Investments and investors

The scope of Chapter 11 is further defined by Article 1139 which defines the term "investment" to include virtually any enterprise, any form of equity participation in an enterprise; debt security; any loans to an enterprise; property, including intangible or intellectual property, acquired in the expectation of an economic benefit; interests arising from the commitment of capital or other resources in the territory of a party; and so on. It follows that minority shareholders in a company and often passive investors can all use the rights granted to investors under Chapter 11 without even having the consent of the concerned company itself.\(^{74}\) In other words, an investor is only required to show loss or damage to his interest in an investment – that could be a fairly minimal investment - in order to file an action under Chapter 11\(^{75}\) and which can be used to found full challenges to environmental measures.

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\(^{71}\) The Loewen Group Inc. and Raymond L. Loewen v. The United States of America, ICSID Case No. ARB(AF)/98/3, Notice of Claim, Submitted by Loewen Group on October 30, 1998.


\(^{74}\) The company consent is only required only if the investor was actually suing on behalf of the company, rather than out of alleged damage to its own investment in the company.

\(^{75}\) Supra note 25, Article 1121.
An illustrative example is Lone Pine Resources Inc. v The Government of Canada, which was filed in November 2013 under NAFTA Chapter 11. Lone Pine is organized under the laws of and is registered in the State of Delaware, while its principal place of business is based in Calgary, Canada where it has its facilities and maintains its operations. It held several permits and approvals from the government of Quebec to recover shale gas from beneath the St. Lawrence River. A moratorium was placed by Quebec on hydraulic fracturing operations beneath the St. Lawrence River by suspending Lone Pine's permits relating to oil and gas resources and subsequently implemented legislation purporting to revoke these permits without compensation. Lone Pine is seeking damages in $250 million in damages claiming that Canada violated its obligations under Chapter 11, including Article 1105 to accord U.S. investors with “treatment in accordance with international law, including fair and equitable treatment and full protection and security,” and also its obligation under Article 1110 not to expropriate investments of U.S. investors without a public purpose, without due process, and without the payment of compensation. It is thwarting to even think that Canada would have to pay Lone Pine in order not to continue its drilling operations for safeguarding the environment - ironically a scenario that any domestic investor would not be privileged enough to enjoy. At this pace, we are likely to see even more dangerous cases attacking environmental laws and regulations in private tribunals.

It appears that the major investment in relation to this claim is the company organized under the laws of Alberta where its conduct of operations is located, and the establishment mainly and largely affected by Quebec actions is the same Canadian, not the enterprise registered in Delaware. This suggests that the mere registration of the company in Delaware was used to qualify it as a foreign investment in order to have access to the extraordinary rights and remedies established in Chapter 11.

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2.4 Articles 1102 and 1103 - National Treatment and Most Favored Nation (MFN) Treatment

These two principles establish the backbone of the non-discrimination obligation imposed on NAFTA countries. The national treatment and MFN standards establish the obligation to accord to investors of other NAFTA countries no less favorable treatment than they give to their own investors or investors of another Party or non-parties. Put differently, all NAFTA parties shall be “most-favoured”.

Ethyl Corporation, a US Company, manufactured a fuel additive, MMT, to increase the octane level in unleaded gasoline. MMT contains manganese, a potential human neurotoxin. Ethyl's wholly owned Canadian subsidiary, Ethyl Canada, imported this gasoline additive into Canada and, after processing it, distributed it across the country. In 1997, because of health and environmental considerations, the Canadian parliament prohibited the import of MMT into Canada and also prohibited inter-provincial trade of the additive within Canada under a federal statute. Ethyl claimed damages in a tribunal established under the rules of the UNCITRAL.

Invoking the "national treatment" article, Article 1102, Ethyl alleged that by banning MMT's import in the absence of a domestic ban on the production and sale, Canada had breached its obligation to treat foreign sovereign in a "no less favorable manner" than domestic investors. It alleged that the import ban created less favourable treatment for investors that imported MMT than for investors that manufactured MMT, or a competitive product, domestically. However, there had never been any domestic Canadian production of MMT – it was only imported.

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79 Supra note, Articles 1102-1103.
80It passed the Manganese-based Fuel Additives Act 1997, c. 11.
82Ibid.
In its Notice of Arbitration, Ethyl argued that "even formally identical equal treatment could in practice still result in less favourable treatment for a foreign product, and that the term “no less favourable” calls for “effective equality” in treatment in respect of the application of laws and regulations.\(^85\)

In Loewen Group, Inc. and Raymond L. Loewen v. United States of America, the investor, as mentioned earlier, was the defendant in a civil suit filed against its US subsidiary in Mississippi. Loewen's central allegation was that the Mississippi civil proceedings were deliberately biased that they amount to a denial of justice of procedural and substantive aspects contrary to the minimum standard of treatment under NAFTA.\(^86\) It further alleges bias and lack of due process by effectively being denied the right to appeal which is considered a denial of its right to equal protection under the law, and hence of the national treatment obligation. The Notice of Claim invoked, among other grounds, the national treatment obligation based on the no less favourable treatment standard. This was tied to deliberate efforts to inflame the jury specifically because of the company’s foreign status.\(^87\)

Further, it is common in US civil cases for excessive jury awards to be reduced on appeal for "good cause". To initiate an appeal, Loewen would have had to post a bond into court of 125% of the award against it, a requirement beyond its financial capacity. The appeal court had the discretion to reduce this requirement, but refused to do so, instead required the bond to be posted within seven days of its decisions for the appeal to be heard.\(^88\)

Finally, it is useful to note that the national treatment and MFN principles apply to all stages of conducting business between NAFTA parties and a potential investor. They apply to “the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.”\(^89\) This would include, for instance, environmental assessment and

\(^{87}\)Supra note 71, Notice of Claim, October 30, 1998, pp. 50-51.
\(^{88}\)Supra note 85, at 456.
\(^{89}\)Supra note 25, Article 1102 (1), (2) and Article 1103 (1), (2).
issuing permits based on environmental studies or factors. This too could make a good argument for foreign investors to challenge like measures for being encumbering or constraining conditions in relation to the construction or operation of a facility as compared to a domestic facility and, therefore, provide a basis for compensation.

2.5 Article 1105 - Minimum Standard of Treatment

Article 1105 contains a requirement to accord foreign investors "minimum standard of treatment" as per the norms on treatment of aliens under international law. The text leaves this requirement undefined by including vague prose about fair and equitable treatment and full protection and security in accordance with customary international law.\(^{90}\) The purpose of setting such a minimum standard is to ensure that the national treatment test is not applied so as to produce a situation where nationals and foreign investors are treated equally badly.\(^{91}\) They should be met, whether domestic investors receive a similar minimum level of guarantees or not.

The threshold of this minimum standard provision lies in providing due process and good faith considerations that ensure fair and equitable treatment of an investor.\(^{92}\) This entails being free from malicious, unreasonable or discriminatory measures. Several cases provide some illustration of the nature and role of the minimum international treatment provision under Chapter 11.

In S.D. Myers v. Canada, a US hazardous waste disposal company operated a PCB waste treatment service in Ohio. It had a Canadian affiliate, S.D. Myers Canada. The affiliate exported PCB to its parent company in Ohio for treatment and recycling services. The US Environmental Protection Agency (USEPA) authorized such imports through an enforcement discretion, although it had determined them to be harmful both to humans and the environment and had banned them under its Toxic Substances Control Act for 15 years prior to that time. Canada then

banned exports of PCB wastes under its Environmental Protection Act. The S.D. Myers Notice of Intent to arbitrate states simply that the PCB export ban was promulgated in a discriminatory and unfair manner which constituted a denial of justice, thereby breaching the requirement of Article 1105. A majority of the tribunal also concluded that a breach of article 1102 establishes a breach of 1105, in part because the minimum standard was considered broader in scope than the national treatment provisions.

In the aforementioned Loewen Group case, the linkage between the alleged inappropriate treatment by the host country and the fact that they are foreign investors is highlighted. In its claim, Loewen alleges that the Mississippi judicial process violated NAFTA provisions in relation to foreign investor’s entitlement to a fair and impartial hearing before any court or tribunal, free of irrelevant and discriminatory remarks and considerations. It further argues that the introduction of anti-Canadian testimony and counsel comments during the trial violated Articles 1102 and 1105.

Loewen’s arguments also address the concepts of a substantial denial of justice through an egregiously wrong or excessive judgment (or decision), or through a procedural denial of justice. Therefore, it follows that the mentioned concepts are be properly recognized as part of the minimum standard requirement.

2.6 Article 1106 - Performance Requirements

Article 1106 provides a series of prohibitions on host countries against making the right of investment dependent on fulfilling certain requirements or conditions to be imposed on investors as a condition of entry and establishment. Requirements like the sourcing of domestic inputs or those linked to the export or import of a manufactured product might reduce the investment's

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93 Nanda & Pring, supra note 83, at 569.
95 Matiation, supra note 85, at 476.
96 Supra note 71, Notice of Claim, at para. 43-139.
97 Supra note 71, Notice of Claim, at paras. 50-59.
efficiency and competitiveness. Unlike most provisions of NAFTA, these performance requirement prohibitions apply to all investments, domestic and foreign. However, domestic investors are not allowed to have recourse to any of the remedies that foreign investors have under the investor-state process.

The main performance requirement prohibitions are set out in Article 1106(1). There are two separate environmental exceptions for these rules. The first exception is included in Article 1106(2), a technology requirement that might fall under paragraph (f) but that is imposed in order to meet generally applicable health, safety or environmental requirements is not considered in violation to the prohibition in that paragraph, as long as it is in line with Articles 1102 and 1103, i.e. is non-discriminatory.

The second one is in Article 1106(6). It allows, by way of exception, measures “(a) necessary to protect human, animal or plant life or health, or (b) necessary for the conservation of living or non-living exhaustible natural resources,” provided the measures are not applied in an arbitrary or unjustifiable manner, and do not constitute a disguised barrier to trade or investment. This exception brings into play the necessity test under trade law in order for a measure to be non-inconsistent. In the trade law context, in the Appellate Body Report concerning Brazil's imposition of an import ban on retreaded tyres, it set out the elements of the Article XX test as follows: in assessing the necessity of the impugned measure, "a panel must consider the relevant factors, particularly the importance of the interests or values at stake, the extent of the contribution to the achievement of the measure's objective, and its trade restrictiveness."

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99 Supra note 25, Articles 1101(1) (c) and 1106 (1).
100 Article 1106 (f)reads as follows: “No Party may impose or enforce any of the following requirements, or enforce any commitment or undertaking, in connection with the establishment, acquisition, expansion, management, conduct or operation of an investment of an investor of a Party or of a non-Party in its territory: [...] (f) to transfer technology, a production process or other proprietary knowledge to a person in its territory, except when the requirement is imposed or the commitment or undertaking is enforced by a court, administrative tribunal or competition authority to remedy an alleged violation of competition laws or to act in a manner not inconsistent with other provisions of this Agreement [...] ."
There are no clear-cut guidelines as to what constitutes a performance requirement. In the S.D. Myers case, it was argued that a trade measure constitutes a performance requirement, with the export ban on PCB wastes being identified as a performance requirement for waste disposal operators to use Canadian services and facilities only, thereby creating a preference for Canadian service providers.

Also, in the Ethyl case, the trade ban on the gasoline additive MMT was argued to be a performance requirement, in breach of the obligation not to require an investor to achieve a certain level of domestic content for inputs into its products or manufacturing processes. Ethyl claimed that (1) the ban forced it to use domestically produced substitutes in place of the additive it was importing, (2) it required Ethyl to build MMT facilities and operations in each Canadian province, and (3) it forced them to open and operate domestic production facilities to use only domestically produced MMT.

While Ethyl considered the effect of the ban on its business operations, the Canadian government relied on the text and form of the legislation. This is evidenced in its Statement of Defence as it stated that Article 1106 was “intended to cover conditions or obligations placed on the presence or operation of a business in the territory of a Party,” and the legislation placed no such requirements on any investor. These examples manifest a high probability that a trade measure, which could be driven by environmental considerations, be challenged as a performance requirement under Chapter 11, be it an import or export ban, a quota, or a tariff.

In another recent NAFTA arbitration convened under the Additional Facility Rules, Mobil Investments Inc and Murphy Oil Corporation v. Government of Canada (‘Mobil’), the tribunal has ruled in favour of two US-based oil companies in a dispute over research and development expenditure obligation imposed by the Canadian province of Newfoundland. It ruled that Canada

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103 Nanda & Pring, supra note 83, at 570.
104 Supra note 82, para. 43.
breached NAFTA Article 1106 (Performance Requirements)\textsuperscript{107} and could not benefit from a reservation specifically adopted for such measures under NAFTA Article 1108.\textsuperscript{108} The dispute arose following the Canada-Newfoundland and Labrador Offshore Petroleum Board’s (the Board) adoption of new guidelines in 2004 requiring investors in offshore petroleum projects to spend a fixed percentage of project revenues on an annual basis on R&D and E&T activities.\textsuperscript{109}

These guidelines were adopted under the Accord Act which is listed as a “Non-Conforming Measure” (NCM) in the NAFTA, and hence excluding it from the treaty’s restraints on performance requirements.\textsuperscript{110} The objective of the reservations to treaty provisions is intended to provide States with regulatory flexibility within its territory. The Accord Act was an attempt by Canada to ensure that investment in offshore oil reserves produced long term benefits for sustainable growth and development and to address the oil projects’ many environmental and technological challenges.\textsuperscript{111}

Despite the fact that the subject of the dispute is indirectly relevant to environmental protection, it is useful to look at the tribunal's interpretation of an example of performance requirements in light of Articles 1106 and 1108. There are two relevant provisions in this regard. The first is NAFTA Article 1108(1) which lists exceptions to which treaty's restraints on performance requirements should not be applied. These exceptions include any existing NCM \textsuperscript{112} and an amendment to any NCM provided that the amendment does not decrease the conformity of the measure in order to benefit from the reservation "non decreasing conformity test".

The second provision is Annex I, paragraph (2)(f)(ii) which extends the definition of a protected NCM to any subordinate measure adopted or maintained under the authority of and consistent with the measure "consistency test". The question is now did the tribunal consider the R&D

\textsuperscript{107}Decision on Liability and on Principles of Quantum, Mobil Investments Canada Inc. and Murphy Oil Corporation v. Government of Canada, 22 May 2012, para. 246.
\textsuperscript{108}Ibid, paras 405-413.
\textsuperscript{109}Glick, supra note 20, at pp. 27-28.
\textsuperscript{110}Johnson, L. Mobil v. Canada – Ratcheting Down the Scope of Treaty Reservations. Investment Policy Hub, UNCTAD, 10 September 2013.
\textsuperscript{111}Ibid.
\textsuperscript{112}This includes the Canada-Newfoundland Atlantic Accord Implementation Act, 1987, c. 32 as per Schedule of Canada to Annex I of NAFTA Agreement.
expenditure requirement an amendment to a NCM that must follow the “the non decreasing conformity test” or a New Subordinate Measure (NSM) that must follow the consistency test?

The tribunal acknowledged the above distinction in its Decision on Liability and Principles of Quantum (May 22, 2012) [Mobil Majority], paras 305-307). However, the tribunal considered the expenditure requirement an NSM and applied to it the “non-decreasing conformity” test instead of the “consistency test". In other words, the Majority reformulated the consistency test as "whether the new measures enlarge [or unduly expand] the non-conforming features of the reservation." (Mobil Majority, 336, 341, 411.)

The Majority seems to suggest that only the “character” of burdens imposed by NCMs and NSMs (as opposed to their weight) can vary, (Mobil Majority, para 339) despite that the three NAFTA Parties (Canada, Mexico and the United States) agreed that a NSM “could impose some additional and/or more onerous commitments than those that were imposed by the earlier measure." (Mobil Majority, paras 374, 400).

The question remains; why did the majority proceed in such fashion? One might suggest that the tribunal might have interpreted it this way out of fear that State Parties might circumvent the more demanding test for amendments by adopting subordinate measures instead – at the expense of ensuring the correct application of law. This calls into question the neutralism and impartiality of the forum in which investor-state disputes are resolved. In doing so, the tribunal failed to address the specific objectives of reservations to NAFTA as mentioned above as opposed to the overarching purposes of NAFTA as a whole on which it relied heavily in favour of investors.

Further, the majority of the tribunal give no specific guidance on how “consistency” should be established in future cases, leaving States with some uncertainty as to what performance requirements may be permitted under the scheduled reservations.113 Given how an unjustified breach of NAFTA was found, this award represents a potential expansion of liability under investment treaties in a manner unforeseen by States.

2.7 Article 1110 – Expropriation

Article 1110 of NAFTA guarantees foreign investors just compensation, in addition to some other restraints imposed on NAFTA state parties in favor of foreign investors as we will explain below, from the NAFTA governments for any direct government expropriation or indirect expropriation or any other action that is "tantamount to" an expropriation. There are two narrow exceptions in Article 1110 setting out certain types of regulatory or administrative actions that do not constitute compensable measures. Chapter 11 cases have raised the question of what circumstances provide sufficient grounds for governments to pay compensation to foreign investors as a result of environmental protection measures that have an effect equivalent to expropriation on their business.

The provision on the protection from expropriation is found in Article 1110(1), it provides for three types of expropriation – as listed above- and four conditions that all must be met in order not to be in breach of NAFTA rules on expropriation. This of course indicates an intensified risk of the scope of compensable measures being expanded under this article.

Hence, a measure can be for a valid public purpose, non-discriminatory, and enacted with full due process but it would still require compensation to be paid if it falls within one of the three types of expropriation. An easily recognized example of direct expropriation is implementing a public purpose project with legitimate benefits to the public such as building a train line across an existing residential area to be able to transport people more effectively. In order to do this, it is necessary to expropriate the land even though the owner may not be willing to sell it and we see no reason to exclude such a result for foreign investors. However, this involves

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114 The majority of investment treaties do not provide a definition of indirect expropriation, including NAFTA, which can be interpreted to create unlimited expectations by investors. In general, tribunals view the two expressions “indirect expropriations” and “measures tantamount to expropriations” as covering the same concept of being restrictive measures that fully or partially deprive the investor of its rights.
115 See Article 1110(7) and (8) for these exceptions.
116 Article 1110 (1) states that: "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, (c) in accordance with due process of law and Article 1105(1);and(d) on payment of compensation in accordance with paragraphs 2 through 6."
117 Mann & Moltke, supra note 90, at 38.
considering whether the state's laws are compatible with investment principles in relation to expropriation in order to prevent arbitrary expropriation without just compensation taking place.

But, the regulation of different forms of investment activity with a view to preserving the environment and preventing harm to human health is simply not the same. For instance, an environmental ban may cause project facilities to suspend its operations temporarily or to terminate some production line, or to prevent certain products from being used or sold, any of which clearly impacts on a company’s operation and management. Does this type of measure constitute a case where the investor will be fully indemnified? Or is it a measure for which the investors should accept the risks involved and bear its costs because it is driven by environmental rationale?

Investors’ allegations suggest that liability of the government is not affected by the fact that it has acted for legitimate environmental reasons and in accordance with its laws. As established earlier, just compensation is required as long as the measure is classified as either an indirect expropriation or tantamount to expropriation under Chapter 11 of NAFTA, even if the conditions from (a) to (c) of Article 1110 (1) are satisfied and no matter how critical the public purpose of the action taken. As NAFTA countries adhere to a general policy of trade and investment liberalization, this type of regulatory measures is more likely to be challenged using the alternative legal recourse provided for foreign investors under Chapter 11.

In its Notice of Arbitration, Ethyl argued that an “expropriation exists whenever there is a substantial and unreasonable interference with the enjoyment of a property right.”119 In its Statement of Claim, Ethyl relied on the MMT ban adverse effects on its business to assert the threshold of "measures tantamount to expropriation".120

In the Loewen case, it argued in its Notice of Claim that "under settled international law, an expropriation occurs where government action interferes with an alien’s use or enjoyment of property".121 In particular, it clearly demonstrates the connection between the effects on an

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119 Supra note 84, para. 32.
120 Supra note 82, para. 37
121 Supra note 71, Notice of Claim, October 30, 1998, para. 164.
investment and the notion of a measure tantamount to expropriation. It argued "The excessive verdict, denial of appeal, and coerced settlement were tantamount to an uncompensated expropriation in violation of Article 1110 of NAFTA…these measures had the effect of severely infringing and interfering with Loewen’s property rights…they were also the product of anti-Canadian discrimination, and thus not imposed on a non-discriminatory basis under Article 1110". 122

Finally, Article 2103(6) of NAFTA draws a very important model of bureaucratic review before certain types of measures can be challenged. NAFTA’s "gatekeeper" model is applied to chapter 11 challenges with respect to taxation issues. 123 It requires private parties to submit their claims to competent authorities designated within each party for a determination whether the challenged governmental action constitutes an expropriation in violation of investor protection under Chapter 11. 124

Each of the above mentioned investor privileges is fraught with significant uncertainty as to how they will be applied in an investment context, particularly in light of the uncertainty in the terminology of some terms such as "measure" as previously discussed. Nevertheless, I contend that cases where environmental or health and safety measures have been utilized as a cover for protectionism will be clearly distinguishable from those where action was motivated by a legitimate desire to protect the public and/or the environment.

122 Ibid, paras. 162, 167
123 Mann & Moltke, supra note 90, at 58.
124 Supra note 25, Article 2103(6) and Annex 2103 (6).
Chapter Three
NAFTA's Approach to Environmental Protection

3.1 Introduction

As we have seen, the discussion and examples in the first two chapters illustrate that NAFTA is one of the most far reaching and innovative trade agreements. NAFTA text deals with trade, investment, and other aspects of economic life. It brought about extensive changes to the rules governing North American trade and related activities. These rules often go beyond those of previous bilateral agreements such as the CUFTA and multilateral agreements such as the GATT/WTO.\textsuperscript{125}

Further, we have demonstrated that NAFTA's model grants foreign investors extensive privileges and provides for their private enforcement outside of the domestic courts system. To be able to fully realize how, in practice, foreign investors' rights laid down by NAFTA may come into conflict with the protection of the environment, it is important to consider how NAFTA approaches environmental protection issues and to assess the potential impact of trade and investment liberalization under NAFTA on the environment.

This chapter begins with an introduction that addresses the background to how environmental provisions were included in NAFTA. The analysis is then split into two parts. The first examines the key chapters dealing with environmental concerns - Sanitary and Phytosanitary (S&P) Measures and Standards-Related Measures (SRM) and their impact on state and provincial regulatory power in addition to some relevant environmental provisions. The second part discusses NAFTA Environmental Side Agreement\textsuperscript{126}, the North American Agreement on Environmental Cooperation (NAAEC) and the new institution established under its umbrella, the


\textsuperscript{126}NAFTA Environmental Side Agreements also include the US-Mexico Border Environmental Cooperation Agreement (BECA) signed between US and Mexico and established two bi-national institutions - The Border Environmental Cooperation Commission (BECC) and The North American Development Bank (NADBank). However, although relevant, we will not cover this bilateral cooperation in the context of this dissertation.
Commission for Environmental Cooperation (CEC). To be able to envisage the impact of CEC, it is of central interest to examine its specified purposes, programs and agenda. Overall, this chapter is intended to contribute to an increased understanding of the potential environmental effects of NAFTA's initiative to liberalize trade and investment. It is designed to provide a number of possible ways in which NAFTA's rules and its institutional forces may be transformed into environmental impacts. It does not comprehensively provide a conclusive assessment of NAFTA’s actual environmental effects.

3.2 Background Brief of Inclusion of Environmental Provisions in NAFTA

In negotiating NAFTA's comprehensive trade accord, none of the governments of Canada, Mexico, and the United States initially intended to include environmental provisions as part of the negotiations. However, the serious trans-border environmental problems, in particular air and water pollution and disposal of hazardous wastes, faced by United States, Canada, and Mexico nurtured environmental advocates' pressure, which began demanding the reinforcing of previous bilateral environmental agreements such as La Paz, and eventually the three governments were pressed to accept and include the environmental provisions in NAFTA.

The environment-related provisions included in NAFTA were unsatisfactory to environmental groups, they were only politically plausible for the Congress to approve the main NAFTA text in 1992 and were lauded for their inclusion in a trade agreement where the economies of a

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129 The La Paz Agreement (Agreement on Cooperation for the Protection and Improvement of the Environment in the Border Area) was signed by Mexico and the United States in 1983 in La Paz, Baja California Sur, Mexico. It established a framework for cooperation on environmental problems that has been carried forward by subsequent presidential administrations in Mexico and the U.S and is implemented through multi-year bi-national programs.
major industrial country (the United States) and a developing country (Mexico) were brought together, along with Canada, to create a major free trading zone.

This reluctant acceptance by the three governments, accompanied by their differences in terms of environmental priorities and laws were sufficient to give an early indication of how limited the scope of environmental provisions would be. Consequently, numerous environmental groups started to question whether NAFTA does enough to protect the environment and public health. However, the NAFTA was recognized as inadequate to fill the gaps by the Clinton administration and there was a strong consensus that NAFTA should seek to improve environmental quality. In an effort to remedy some of the said problems related to environment and labor, Clinton stated that he would not sign legislation implementing the trade agreement until new “supplemental agreements” had been negotiated with Mexico and Canada regarding those issues. Given the considerable divergence between the three countries in their environmental regulatory powers, priorities, and the status of environmental regulations, they mainly focused on the enforcement of environmental laws and the assurance that NAFTA would not undermine the value of environmental standards existing at the time as we will explain below.

In the end, environmental issues were addressed in two supplemental agreements to the NAFTA. These were the North American Agreement on Environmental Cooperation (NAAEC) and the US-Mexico Border Environment Cooperation Agreement (BECA) which will not be covered in this paper. NAAEC promotes trilateral cooperation on environmental matters and includes provisions to address a party's failure to enforce environmental laws and the dispute settlement process.

133 Steinberg, supra note 130, at 190-191.
134 Charnovitz, supra note 62, at 24.
3.3 NAFTA Environmental Provisions

The preamble of the NAFTA agreement expresses the resolve of the NAFTA governments to undertake their obligations "in a manner consistent with environmental protection and conservation, ... to strengthen the development and enforcement of environmental laws and regulations [and] to promote sustainable development." 137 This at least provides a shield against accusations directed to the parties' when complying with their environmental obligations which are often described as trade barriers.

3.3.1 Sanitary and Phytosanitary Measures (Chapter 7)

Article 724 defines Sanitary and Phytosanitary measures (SPS) as "standards that protect human or animal life or health in a state's territory from risks arising from the introduction, establishment or spread of a pest or disease, or from the presence of an additive, contaminant, toxin or disease-causing organism in a food, beverage or feedstuff, or from a disease-causing organism or pest carried by an animal or plant, or a product thereof, ....".

Considering the provisions contained within NAFTA Chapter seven and the SPS jurisprudence that has emerged therefrom, it appears that there are five fundamental principles that would apply in consideration of SPS measures. First, there is a clear recognition of the sovereign right of states to formulate, adopt, implement and maintain SPS measures to protect human, animal or plant life or health, including measures that could be more stringent than international standards subject to certain agreed rules according to Article 712 setting out the basic rights and obligations of the parties.

It reserves to each party the right to set its appropriate levels of protection for human, animal, or plant life or health that are considered appropriate in the circumstances by those states. 138 As appears from the text of the agreement, it places no restrictions on the utilization of this right, save for two regulatory conditions. The first is that each party is required to consider, where

137 Supra note 25, Preamble.
138 Supra note, Article 712 (2).
relevant, the relative cost-effectiveness of alternative approaches to limiting risks, when dealing with animal or plant pests or disease. The second condition is that each party shall, with the objective of achieving consistency in such levels, avoid arbitrary or unjustifiable distinctions in such levels in different circumstances but this applies only where such distinctions result in arbitrary or unjustifiable discrimination against a good of another Party or constitute a disguised restriction on trade. The operative language of these two conditions suggests that neither of them represents a threat to the environment or public health.

Second, although there is little discipline on the level of protection that a party sets, the S&P chapter does regulate measures used to achieve such protection. For example, the measure must be "necessary" for the protection of human, animal, or plant life or health and can be applied only to the extent "necessary" to achieve the party's chosen level of protection. My concern here is that since NAFTA incorporates many of GATT's obligations by reference, there is a possibility that the term "necessary" be parochially interpreted in the same manner as the counterpart GATT provision, Article XX (d). Third, NAFTA also requires that a measure be based on sufficient scientific basis and an appropriate scientific risk assessment and not maintained where there is no longer a scientific basis for it.

Fourth, SPS measures must result neither in an arbitrary or unjustifiable discrimination between a party's goods and like goods of another Party or between goods of another Party and like goods

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139 Supra note 25, Articles 715 (2).
140 Supra note 25, Articles 715 (3).
141 Article 712.1 reads as follows: "Each Party may, in accordance with this Section, adopt, maintain or apply any sanitary or phytosanitary measure necessary for the protection of human, animal or plant life or health in its territory, including a measure more stringent than an international standard, guideline or recommendation."
142 Article 712.5 reads as follows: "Each Party shall ensure that any sanitary or phytosanitary measure that it adopts, maintains or applies is applied only to the extent necessary to achieve its appropriate level of protection, taking into account technical and economic feasibility."
143 Article XX (D) of the GATT provides that: "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: (d) necessary to secure compliance with laws or regulations which are not inconsistent with the provisions of this Agreement, including those relating to customs enforcement, ....". For a GATT-inconsistent measure to be justified, it must be shown that: (1) that the measure must be designed to secure compliance with laws or regulations that are not themselves inconsistent with some provision of the GATT (2) that the GATT-inconsistent measure is necessary to secure such compliance. Several GATT and WTO panels have interpreted the term "necessity" within the context of relevant Article XX exceptions. However, the exact scope and meaning of the necessity test as interpreted by GATT and, later, by WTO tribunals remain unclear.
144 Supra note 25, Article 712.3.
of any other country, where identical or similar conditions prevail. It is useful to note that the introductory clause of Article XX of GATT Agreement precludes arbitrary or unjustifiable discrimination where the "same" conditions prevail, but NAFTA goes further, forbidding such discrimination where "identical or similar conditions prevail."\(^{145}\) Finally, SPS measures must be developed and imposed in a transparent manner.\(^{146}\)

Overall, these principles are designed to prevent the use of SPS measures as disguised restrictions on trade by constraining their use to legitimate cases, while safeguarding each country's right to take SPS measures to protect human, animal or plant life or health.

Furthermore, Article 714 provides that "without reducing the level of protection of human, animal or plant life or health, the Parties shall, to the greatest extent practicable and in accordance with this Section, pursue equivalence of their respective sanitary and phytosanitary measures." This means that parties may work on ensuring that domestic food safety standards, for instance, are met by imported goods provided that those standards are not in fact disguised trade barriers. Nevertheless, the text reassures that it is not an absolute requirement by adding the phrase "to the greatest extent practicable". The NAFTA also established a committee on S&P measures to oversee implementation of the SPS provisions and to promote technical cooperation between the three parties.\(^{147}\)

3.3.2 NAFTA Chapter 11 adjudication of SPS Measures

It is of considerable concern to touch on the way in which a NAFTA investment tribunal might deal with an investment dispute involving SPS measures in the fields of human, plant, and animal life or health. Chapter 11 rules do not even include a fundamental exception provision that deliberately ensures that no provisions may be construed to prevent the adoption or enforcement of measures necessary to protect human, animal or plant life or health; such as those found in NAFTA Article 2101(1) and General Agreement on Tariffs and Trade (GATT) Article XX(b). The articles most likely to be invoked in the context of SPS measures are 1102, 1103, 1104.

\(^{145}\) Supra note 25, Article 712.4.
\(^{146}\) Supra note 25, Article 718.
\(^{147}\) Supra note 25, Article 722.
1105 and 1110 concerning national treatment, (MFN) treatment, the minimum standard of
treatment and compensation for expropriation, respectively.

So, in any SPS dispute arising under NAFTA Chapter 11, it is important to rely upon the above-
mentioned SPS five principles to interpret and prove the content of the investors' privileges, set
out in Chapter 11, in any given case. This authority is derived from NAFTA Article 1131(1).
NAFTA Article 1131(1) requires tribunals to decide matters before them in accordance with
"NAFTA itself and the applicable rules of international law."

For instance, article 1105(1) states that investments must be provided with “treatment in
accordance with international law, including fair and equitable treatment and full protection and
security.” NAFTA tribunals are expected to consider the relevant SPS principles when necessary,
however, the mere breach of one of the rules applicable to SPS measures doesn’t necessarily
constitute a breach of Chapter 11 obligations, as illustrated below.

In S.D. Myers, Inc. v. Canada, the tribunal ruled that the breach of a rule of international law
by a host Party may not be decisive in determining that a foreign investor has been denied “fair
and equitable treatment”, but the fact that a host Party has breached a rule of international law
that is specifically designed to protect investors will tend to weigh heavily in favour of finding a
breach of Article 1105 i.e. it can certainly be regarded as a manifestation of a failure to secure
the necessary amount of “fair and equitable treatment” for an investment in any given case.

A useful report to cite here is one issued by the WTO Appellate Body concerning a ban imposed
by the EU on imports of meat and meat products from cattle treated with any of six specific
hormones "Beef Hormones Report”. This report reflects a manifestation of the connection
between Article 1105 and Article 712 (3) (c) (which is akin to article 5.1 of WTO SPS
Agreement). The WTO Report requires the existence of a reasonable relationship between the
operation of the SPS measure and a valid risk assessment procedure. A valid risk assessment

149WTO Appellate Body Report on European Community Measures Concerning Meat and Meat Products,
Available at: http://www.wto.org/english/tratop_e/dispu_e/hormab.pdf
would normally require a government to identify a problem and its possible hazards, and to evaluate the associated risks, and how the proposed measure might reduce the risks. In the Beef Hormones Report, the Appellate Body did not consider the risk assessment presented by the EC as valid ones because it did not focus specifically enough on residues in meat for the first five hormones and that for the sixth hormone, MGA, no risk assessment had been performed.  

3.3.3 Standards-Related Measures

As SRM Measures have been dealt with before in Chapter 1 of this dissertation, my discussion here will be confined to its environment-related provisions. Article 906.1 states that "recognizing the crucial role of standards-related measures in achieving legitimate objectives, the Parties shall, in accordance with this Chapter, work jointly to enhance the level of safety and of protection of human, animal and plant life and health, the environment and consumers."

Article 906.2 further states that "without prejudice to the rights of any Party under this Chapter, [...] the Parties shall, to the greatest extent practicable, make compatible their respective standards-related measures, so as to facilitate trade in a good or service between the Parties".

In a nutshell, NAFTA parties have made commitments by signing this agreement to make compatible and enhance environmental standards while explicitly securing their right to set their own levels of environmental and health protection. Also, NAFTA leaves out the "least trade restrictive" test included in Article 9.4 (4) of the GATT Agreement, which requires that standards "shall not be more trade restrictive than necessary to fulfill a legitimate objective". This grants the governments greater regulatory flexibility under NAFTA rules than under GATT rules.

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150Ibid, para. 201.
151Article 9.4 (4) reads as follows: "No Party may prepare, adopt, maintain or apply any standards-related measure with a view to or with the effect of creating unnecessary obstacles to trade between the Parties. To that end, standards-related measures shall not be more trade restrictive than necessary to achieve a legitimate objection, taking into account of the risks that non fulfillment would create."
3.3.4 Impact on State and Provincial Laws

As we have seen earlier, the sovereign right of nations to set their own levels of environmental protection is repeatedly and explicitly reaffirmed in NAFTA. It represents an interlocking set of obligations of the central governments of Canada, the United States and Mexico. One of these obligations is to take "all necessary measures" to give effect to the provisions of NAFTA, "including their observance … by state and provincial governments."\footnote{152}{Supra note 25, Article 105. The Standards’ chapter (Article 902) has a much weaker requirement.}

NAFTA explicitly allows the parties, including sub-states and provinces, to enact environmental or health standards that are tougher than national or international standards.\footnote{153}{As evidenced by Articles 712 and 715 for instance.} Accordingly, sub-states and provinces are obliged to take the necessary measures, which could take the form of enacting environmental measures, and eventually they will sit on their hands while their proposed measures are being reviewed by and challenged before dispute settlement panels. This is because sub-states and provinces are not parties to NAFTA and, hence, have no rights under it.

It is useful to consider a hypothetical example. Assume that Florida enacts a food safety measure that is more stringent than international or federal government standards. Enforcing this measure requires the prohibition of importing certain products from Mexico. In response, Mexico files a complaint. Florida cannot invoke NAFTA Article 712 to state that this standard constitutes its appropriate level of protection because this right is only available to parties. Nothing even permits Florida to defend itself before a dispute settlement panel. Even if the US, presumably, decides to defend Florida's measure, another potential hurdle might arise as a result of the above mentioned SPS first principle requiring parties to avoid arbitrary or unjustifiable distinctions" in levels of protection in different circumstances. The U.S. could then be asked to justify why Florida needs a higher standard than the other 49 states. Mexico might allege that Florida's measure is overprotective and hence arbitrary. This example proves that NAFTA, as it stands, is not even capable of providing the protection that would be anticipated by its environmental provisions. Article 712, for example, gives the parties the right to set their appropriate level of
environmental protection, however, when enforced a sub-state might encounter serious practical challenges as illustrated above.

3.3.5 Impact on Environmental Treaties

In my view, trade treaties should always yield to environmental treaties given that trade is a direct cause of environmental problems and that the fast-paced trade regime needs to be reined in by inviolable environmental regulations, however, NAFTA gives little attention to that. NAFTA addresses its relationship to international environmental agreements involving a NAFTA party. It identifies three trade-related environmental agreements that may take precedence over NAFTA where implementation conflicts arise, provided that the agreement is implemented in the least NAFTA-inconsistent manner. The listed agreements include the Montreal Protocol on Substances that Deplete the Ozone Layer; the Basel Convention on the Control of Trans-boundary Movements of Hazardous Wastes and their Disposal; and the Convention on International Trade in Endangered Species (CITES) which authorizes restrictions on certain types of environmentally-harmful trade. U.S.-Mexico and U.S.-Canada bilateral waste-trade agreements also are included, and the parties may add others. This explicit statement on treaty hierarchy seems like a promising principle.

\[154\] Independently from NAFTA side agreements, the three parties are also signatories to other international environmental pacts such as UNFCCC and its Kyoto Protocol (excluding Canada which has turned its back on Kyoto Protocol in 2011). This extends the reach of the environmental obligations imposed on these countries. However, although relevant, we will not cover these agreements in the context of this dissertation.

\[155\] Pursuant to Article 104.1 of NAFTA, the Parties are required to use the least restrictive means that is “reasonably available” and would be “equally effective” for achieving compliance with their obligations under the listed environmental agreements. Hence, a measure taken pursuant to a listed environmental agreement may still be deemed inconsistent with NAFTA.

\[156\] For instance, the Tuna-Dolphin GATT case where the United States stated that under the CITES, a party is obligated to prohibit the importation of products in order to protect endangered species found only outside the jurisdiction of that party.

3.3.6 Investment

Article 1114.2 of NAFTA states that "a Party should not waive or otherwise derogate" from domestic health, safety, or environmental measures to encourage an investor.\textsuperscript{158} Regrettably, in my opinion, this provision is not given due weight because of its non-mandatory language, a real prohibition would use "shall" rather than "should." This non-mandatory nature is heightened by stating in the same article that it is "inappropriate" to relax environmental measures to encourage investment, not that it is deemed a fundamental breach of NAFTA to do so. Also, it only discourages relaxation of environmental laws if done solely to encourage investment, and not that it is forbidden under any circumstances. Finally, a party who considers that another one is inappropriately relaxing safety or environmental measures is to request a consultation with a view to avoiding such encouragement and not even to be heard by a NAFTA dispute-settlement panel.

3.4 North American Agreement on Environmental Cooperation (NAAEC)

This part will examine key provisions of the NAAEC and will discuss briefly the role of the Commission for Environmental Cooperation (CEC) established by NAAEC, which is intended to support national institutions in minimizing the negative environmental impacts of trade.

The (NAAEC) entered into force on January 1, 1994, the same day as NAFTA.\textsuperscript{159} By creating a free trade zone and in light of the absence of any enforceable sanction for breach of Article 1114(2), NAFTA may entice the parties to relax their environmental laws in favor of liberalizing trade and investment.\textsuperscript{160} This led to the approach of the NAAEC being to protect and enhance the North American environment in the context of free trade, through increased cooperation on trans-boundary problems and better environmental practices and joint environmental programs.

\textsuperscript{158} Supra note 25, Article 1114.2.
\textsuperscript{160} Ibid, at 112.
\textsuperscript{161} As indicated by its objectives set out in Article (1).
The NAAEC identifies a diverse array of potential cooperation\textsuperscript{162} bound by the ability of the three countries to reach unanimity on priorities and lines of action in its annual program of work.

To achieve its objectives and help the Parties implement its provisions, the NAAEC created the CEC\textsuperscript{163}, an international body designed to investigate allegations of environmental violations by NAFTA countries, as per Article 8 and set out its structure, procedures and functions in Articles 9 to 12. The CEC does have a mandate to assist in developing a constructive relationship between trade and environment issues. \textsuperscript{164} Ideally, CEC would: (a) address regional environmental concerns by broadening environmental cooperation\textsuperscript{165}; (b) help prevent potential trade and environmental conflicts\textsuperscript{166}, acting as a dispute settlement mechanism to resolve government-to-government environmental disputes\textsuperscript{167}, and (c) promote the effective enforcement of environmental laws and regulations in all NAFTA countries.\textsuperscript{168}

The CEC consists of a Council, Secretariat and Joint Public Advisory Committee (JPAC).\textsuperscript{169} It is directed by a Council consisting of cabinet-level environmental official of each country.\textsuperscript{170} An independent secretariat is appointed by the Council and headed by an executive director who is charged with selecting the CEC's staff.\textsuperscript{171} The council and the secretariat will be advised by a 15-person Joint Public Advisory Committee (JPAC).\textsuperscript{172}

As part of its duty to serve as a forum for discussion of environmental matters that may arise between the Parties, the Council adopts a cooperative work program on a range of issues

\textsuperscript{162} Article 10(2), for example, sets forth a non exhaustive list of nineteen possible areas for the Parties to consider and develop recommendations, including: pollution prevention techniques and strategies; transboundary and border environmental issues; exotic species that may be harmful; environmental matters as they relate to economic development; and “other matters as it may decide.” NAAEC, supra note 135, art. 10 (2).
\textsuperscript{163}Steinberg, supra note 130, at 174.
\textsuperscript{167}Ibid, at 9.
\textsuperscript{168}Ibid.
\textsuperscript{169}Steinberg, supra note 130, at 174.
\textsuperscript{170}NAAEC, supra note 135, Article 9 (1).
\textsuperscript{171}NAAEC, supra note 135, Article 11 (1), (2).
\textsuperscript{172}NAAEC, supra note 135, Article 16.
concerning the North American environment. The CEC Secretariat provides technical, administrative and operational support to the Council as well as preparing an annual program, budget, and reports on matters within the scope of the approved annual work program. Reports on any other environmental matters, including any issue related to whether a country has failed to enforce its environmental laws and regulations, may not be reported independently as the preparation of which may be blocked by the Council. Except for a few important exceptions, Council decisions are taken by consensus. As for the JPAC, it consists of fifteen individuals appointed by the head of state in each country to advise the Parties on any matter within the scope of the NAAEC, and to comment on the Secretariat’s work plan.

Despite the divergence in the level of development across the three parties, the CEC is financed equally by the three of them. The CEC was originally promised a $15 million annual budget in 1994, but as of 1999, was operating on a $9 million dollar budget. The inadequate funding of the CEC has resulted in various shortages, and has contributed to its limited scope and autonomy. It must have also led to a less than efficient performance of its mandate functions especially in relation to enforcing environmental legislation and to performing as a dispute settlement mechanism.

3.4.1 The NAAEC Enforcement Provisions

In regard to enhancing levels of environmental protection, the preamble of the NAAEC reaffirms “the importance of the environmental goals and objectives of the NAFTA, including enhanced

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174 NAAEC, supra note 135, Article 11 (5), (6), (7).
175 NAAEC, supra note 135, Article 13 (1).
176 NAAEC, supra note 135, Article 9 (6).
177 NAAEC, supra note 135, Article 16.
180 Wold, supra note 172, at 227.
levels of environmental protection.”¹⁸² This principle is reiterated among the objectives of the agreement set out in Article 1, one of which is to “foster the protection and improvement of the environment in the territories of the Parties for the well-being of present and future generations.”¹⁸³ These provisions connote a policy against lowering environmental standards and its degradation.

Part Two of the NAAEC discusses "Obligations.”¹⁸⁴ The three governments committed themselves to "promote the use of economic instruments for the efficient achievement of environmental goals" and to "consider" prohibiting the export of pesticides or toxic substances to the other two parties when the use of the pesticide or substance is banned in one's own territory.¹⁸⁵ The NAAEC also requires Parties to “effectively enforce” its environmental laws through appropriate government action. Further, Parties are required to ensure that administrative and judicial proceedings are transparent and available and that appropriate sanctions and remedies are provided to compel enforcement with environmental law.¹⁸⁶

Perhaps the most lofty commitment in the NAAEC is the one carried forward in Article 3 which reinforces the principles laid down in NAFTA Article 1114 (2) and NAAEC Preamble as shown above, which states:

"Recognizing the right of each Party to establish its own levels of domestic environmental protection and environmental development policies and priorities, and to adopt or modify accordingly its environmental laws and regulations, each Party shall ensure that its laws and regulations provide for high levels of environmental protection and shall strive to continue to improve those laws and regulations.”¹⁸⁷

One may be surprised by the odd mix of mandatory wording (“shall”) in NAAEC that is usually followed by words that often weaken the obligation. Article 3 is an example, as it requires that each Party “shall ensure that its laws and regulations … and shall strive to continue to improve

¹⁸² NAAEC, supra note 135, Preamble.
¹⁸³ NAAEC, supra note 135, Article 1(a).
¹⁸⁴ NAAEC, supra note 135, Article 2.
¹⁸⁵ NAAEC, supra note 135, Art. 2.1 (f), 2.3
¹⁸⁶ NAAEC, supra note 135, Art.5 (1), (2).
¹⁸⁷ NAAEC, supra note 135, Article 3.
those laws and regulations.” Similarly, commitments are often framed in an overambitious language such as “strive for”, “promote”, or “seek to”.

Ironically, at the conclusion of the negotiations of the NAFTA side agreements on August 13th, 1993, U.S. Trade Representative Mickey Kantor boasted that NAFTA and its side agreements would guarantee that America's burdensome environmental and labor regulations could never be lessened: "No nation can lower labor or environmental standards, only raise them, and all states and provinces can enact even more stringent measures....". On August 17, Kantor again opined that, under NAFTA, "no country in the agreement can lower its environmental standards...ever”.

Nevertheless, nowhere do the Parties define or establish threshold limits for “high levels”, the commitment embodied in this article, in my opinion, is still vague and because a country may modify its laws as it sees fit, it is unclear whether this provision will operate as Kantor suggests. The other obligation to “strive to continue to improve” environmental laws and regulations is no different; it is only an implied obligation not to lessen them in force or effect, while it could be stronger if it was simply “to improve” them.

Yet, Article 3 in its present form might seem like the most straight forward expression in the NAAEC reinforcing NAFTA Article 1114(2). Other provisions of the NAAEC may be supportive of the weak language of Article 3 too. For instance, Article 10(3)(b) states that:

"the Council shall strengthen cooperation on the development and continuing improvement of environmental laws and regulations, including by[,] without reducing levels of environmental protection, establishing a process for developing recommendations on greater compatibility of environmental technical regulations,

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190 One might suggest that “high levels of environmental protections” can be evaluated in light of Principle 21 of the Stockholm Declaration which calls for states to enforce their own environmental laws and cooperate in ensuring that activities within their jurisdiction or control do not have trans-boundary effects by causing damage to the environment of other States. Despite being non-binding, it includes provisions that are understood to reflect customary international law.
standards and conformity assessment procedures in a manner consistent with the NAFTA.\textsuperscript{191}

Further, Article 10(6)(b) gives the CEC a potent role in the implementation of NAFTA Article 1114(2), requiring it to "provide assistance in consultations under Article 1114 of NAFTA where a Party considers that another Party is waiving or derogating from, or offering to waive or otherwise derogate from, an environmental measure as an encouragement to establish, acquire, expand or retain an investment of an investor, with a view to avoiding such encouragement."

These commitments and most of the other party obligations in the NAAEC have rightly been described as "akin to unilateral declarations of intention since they are not enforceable under the NAAEC."\textsuperscript{192}

### 3.4.2 Provisions on Environmental Impact Assessment

The NAAEC also put into effect provisions regarding environmental impact assessment, article 2(1)(e) obligates each party to "assess, as appropriate, environmental impacts."\textsuperscript{193} Further, Article 10(6)(d) requires the CEC Council to "consider on an ongoing basis the environmental effects of the NAFTA." Conducting environmental assessment is an important tool for considering the environmental implications of economic development and for which the CEC has developed models.\textsuperscript{194} For instance, concerning the scale effects of economic activities (i.e., more trade-stimulated economic activity means more impact), the work of the CEC has shown that the increased production, resource exploitation, transportation and energy needs that result from increased trade "pose serious challenges to environmental infrastructures and policy implementation".\textsuperscript{195} Indeed, the environmental impacts have been well documented to show that

\textsuperscript{191}NAAEC, supra note 135, Article 10(3)(b).
\textsuperscript{192}Johnson & Beaulieu, supra note, 158, at 146.
\textsuperscript{193}NAAEC, supra note 135, Article 2(1)(e).
\textsuperscript{194}The CEC has concluded that “no single or ‘best’ assessment method exists, and that a range of different approaches, models, indicators and means of building meaningful correlations between free trade and environmental change ought to be pursued simultaneously. Work thus far shows a sufficient empirical basis to suggest causality between trade liberalization and trade expansion, and changes in both environmental quality, and environmental policies.” Scott Vaughan & Greg Block, CEC Secretariat, Free Trade and the Environment: The Picture Becomes Clearer 31 (2002).
\textsuperscript{195}Wold. C. (2008), supra note 172, at 224.
the commitments to environmental protection in the post-NAFTA period have weakened and regrettably resulting in substantial depletion of specific natural resources. For example, NAFTA has led to increased water pollution from nitrogen loading in areas of intensive farming.196

3.4.3 Dispute Settlement Processes

Perhaps most notable are the NAAEC's dispute settlement processes that, as a last resort, may impose monetary assessments and sanctions in order to effectively enforce their environmental laws. The NAAEC established two measures: a citizen-driven accountability mechanism that can yield detailed investigative reports, called factual records, on allegations that a party has failed to effectively enforce its environmental law,197 and a party-to-party dispute process that can lead to monetary sanctions or loss of NAFTA benefits. 198

We will see below how these processes could be described as deliberately convoluted; however, this is justified by the Parties' reluctance to adopt effective measures. Historically, Mexico and Canada staunchly resisted the incorporation of dispute provisions in the side pacts and only accepted a compromise process that was long on consultation and short on adjudication.199

3.4.3.1 Citizen Driven Submissions

The CEC secretariat permits "submissions" by any NGO's and private persons residing in North America to challenge whether Parties are enforcing their environmental laws.200 Once a Submission on Enforcement Matters (SEM) is received the Secretariat reviews it to determine whether it meets certain criteria, and if so, whether it merits a response by the accused party. One of the factors that the Secretariat considers in deciding whether to solicit a response from a party is whether "private remedies available under the Party's law have been pursued." The secretariat may then seek a response from the accused country201 and thereafter may recommend that a

197NAAEC, supra note 135, Articles 14, 15.
198NAAEC, supra note 135, Articles 22-36.
199Hufbauer, supra note 8, at 55.
200NAAEC, supra note 135, Article 14 (1).
201NAAEC, supra note 135, Article 14(2).
A factual record be assembled subject to approval by the council. However, if the matter is the subject of a pending judicial or administrative proceeding, the secretariat may not pursue it. With a majority vote of the Council, the Secretariat conducts a detailed investigation into the allegations and produces a factual record, which requires a majority vote of the Council for publication.

Once a factual record is assembled, the role of the secretariat comes to an end. It is now up to one of the parties to the treaty to initiate an action if the matter is to be further pursued. In other words, the Factual Record is simply a summary of the facts found by the Secretariat as well as the legal arguments put forward by the Submitter and whether the Party is effectively enforcing its environmental laws. It provides information to allow members of the public to decide for themselves if the party has failed to effectively enforce its laws, but it may not provide a conclusion of its own, make recommendations or require a remedy, neither is it not an arbitration award or any type of adjudication. It serves only to spotlight the Party's environmental enforcement practices. The Factual Record derives its authority solely from the independent investigation and fact finding conducted by the CEC Secretariat.

It appears from the above that the development of a factual record is very intricate and restricted to cases of public initiation. The Council is only entitled to order the Secretariat to develop a factual record concerning specific enforcement practices if three conditions are met together: (a) a submitter identifies them in a submission, (b) if the Secretariat determines that development of a factual record concerning them is appropriate, (c) and makes a recommendation to that effect to

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202NAAEC, supra note 135, Article 15(1).
203NAAEC, supra note 135, Article 14 (3) (a).
204NAAEC, supra note 135, Article 15(2).
205NAAEC, supra note 135, Article 15(2)-(6).
206NAAEC, supra note 135, Article 15(7).
208Johnson & Beaulieu, supra note 158, at 158.
209Ibid.
the Council. This entails that the Council does not have the authority, to direct the Secretariat to deliver a factual record on a particular enforcement failure, unless a Submitter first raises this issue and the Secretariat delivers the same opinion in a recommendation to the Council.

Further, the Council has on several occasions either limited or redefined the scope of the factual records from general failures to isolated incidents that were not the main focus of the submissions.\(^{212}\) A good example is the Migratory Birds submission\(^{213}\) where the Submitters allege that the United States Government failed to effectively enforce Section 703 of the Migratory Bird Treaty Act (MBTA), 16 U.S.C. par. 703-712, which prohibits the killing of migratory birds without a permit.\(^{214}\) The Secretariat recommended that a factual record be drafted concerning the United States' alleged failure on a nationwide basis to enforce the Migratory Bird Treaty Act (MBTA).\(^{215}\) The Secretariat's recommendation provides no indication at all that the factual record should be limited to two isolated instances of alleged failures to effectively enforce the MBTA. However, the Council's resolution limited the factual record to two isolated instances of alleged failures.\(^{216}\) The submitters emphasized the alleged "systemic" failure to enforce and devoted a single paragraph to these two instances in their submission just to illustrate the wider failures. The United States did not even mention the two alleged examples in its response, and the Secretariat devoted little attention to them in its recommendation and focused on the general failure.\(^{217}\)

As a result of the Council's limitations on the scope of factual records and other limitations they have imposed on the process, the SEM process has not lived up to its potential.\(^{218}\) This infers that CEC in its present status does not have the autonomy, the authority nor the organizational


\(^{214}\) Available at: http://www.cec.org/Page.asp?PageID=2001&ContentID=2370&SiteNodeID=250


\(^{217}\) Ibid.

structure needed to initiate reports, gather information or enforce environmental actions, limiting its ability to comply with its mandate of promotion of environmental law enforcement.

As demonstrated earlier, the NAAEC does not require a government that is the subject of a factual record to take any action or respond in any other way following its publication. For this reason and for the limitations that may be imposed on the process, factual records are not a particularly promising means to hold the parties accountable for weak enforcement of environmental laws. In 2012, the Council adopted measures that "call for Parties to follow up on concluded submissions with information on any new developments and actions taken regarding matters raised in such submissions."220

3.4.3.2 The Governments Sanctions Process

Part V (Articles 22-36) of the NAAEC explicitly targets systemic or widespread failures to effectively enforce environmental laws in the NAFTA countries and establishes party-to-party dispute resolution.221 A Party initiates this process by requesting consultation to determine whether another Party is engaging in a “persistent pattern of failure to effectively enforce its environmental law,”222 defined as “a sustained or recurring course of action or inaction beginning after the date of entry into force of this agreement.”223

When these consultations fail to resolve the matter and the dispute concerns trade between the Parties, the Council may upon a two-thirds vote convene an arbitral panel to prepare a report with recommendations for better enforcement.224 Panelists are chosen from a roster for this temporary assignment; in other words, they are not permanent judges. They may be chosen for their "expertise or experience in environmental law or its enforcement," or for other expertise.225 There is no requirement that a panel adjudicating an environmental dispute have panelists with

219Markell & Knox, supra note 214, at 286.
221Johnson & Beaulieu, Supra note 158, at 149.
222NAAEC, supra note 135, Article 22.
223NAAEC, supra note 135, Article 45 (1).
224NAAEC, supra note 135, Article 24 (1).
environmental expertise.\textsuperscript{226} The panel is not permitted to seek information from outside experts unless the disputing parties agree.\textsuperscript{227}

If the panel finds a persistent failure to enforce environmental law by a Party, the disputing Parties may agree on a “mutually satisfactory action plan, which normally shall conform to the determinations and recommendations of the panel.”\textsuperscript{228} If the Parties cannot agree on a plan or there is disagreement over implementation of a plan, any disputing Party may request the panel to reconvene, which may impose a plan on the Parties.\textsuperscript{229} If the panel concludes that a Party is not fully implementing the plan, it may impose a monetary enforcement penalty not to exceed .007\% of total trade between the Parties in accordance with Annex 34 of NAAEC. If a Party fails to pay, the other Party in the dispute may suspend NAFTA benefits in an amount not to exceed the monetary assessment.\textsuperscript{230} Article 3 of Annex 34 states that after a party pays the penalty to CEC, the Council expends the money “to improve or enhance the environment or environmental law enforcement in the Party complained against.” So instead of paying compensation to the complaining Party who incurred damages as a result of the other Party's failure to enforce its environmental laws, the complained against Party ultimately receives the penalty money. This is an extraordinary deviation from prevailing approaches to punishment. It seems that these penalties are intended to be more like symbolic fines.

In addition, Article 45.1 of NAAEC states that a determination of ineffective enforcement shall not be made when there is a "reasonable exercise" of investigatory, prosecutorial, or regulatory discretion, or when there have been "bona fide decisions to allocate resources" to enforcement of higher priority environmental matters."\textsuperscript{231} This means that to succeed in an environmental dispute under Part V, a Party is expected to satisfy these circumscribed definitions in establishing its case and fending off defenses. It would also have to show that the alleged failure to effectively enforce environmental law pertains to goods traded in the North America or produced by export-competing industries as per Article 24.

\begin{footnotes}
\item[226] NAAEC, supra note 135, Article 25.2 (a).
\item[227] NAAEC, supra note 135, Article 30.
\item[228] NAAEC, supra note 135, Article 33.
\item[229] NAAEC, supra note 135, Article 34.
\item[230] NAAEC, supra note 135, Article 36 (1).
\item[231] NAAEC, supra note 135, Article 45(1).
\end{footnotes}
I conclude this part with two general remarks. The NAAEC adopts a narrow approach to environmental protection by specifically excluding laws whose "primary purpose" is to manage the commercial harvesting or exploitation of natural resources.\(^{232}\) Hence, it is uncertain whether major environmental issues such as energy extraction and surface mining or coastal fishing, are included or excluded.

Part V dispute settlement process has become a moot and impotent mechanism\(^{233}\) especially that no single dispute was initiated by NAAEC parties to date\(^{234}\). Many procedural issues such as how to determine an enforcement failure in light of the limited information provided by the parties that would only present "convictions"\(^{235}\), who bears the burden of proof, public submissions such as amicus briefs or public observation of the dispute settlement process. Twenty years have passed and the parties have not yet adopted model rules of procedure for Part V as required under Article 28\(^{236}\).

Simply put, the NAFTA governments wanted to have an agreement that would lead to increased investment with barely any constraints and they did conclude provisions to that effect. They also wanted to reinforce the free investment with an effective enforcement mechanism and they did so in NAFTA chapter 11 by waiving their sovereign immunity so as to allow foreign investors to seek monetary awards for breach of the NAFTA’s investor protections through binding arbitration.\(^{237}\) Only if they wanted to protect environment as well, they would have taken the necessary measures to attain that.

The opening up of national markets for foreign investments would certainly urge governments to attempt to impose new requirements on business operations in order to serve environmental ends. They would then face a challenge under NAFTA Chapter 11 for measures “tantamount to expropriation” of a foreign corporation’s potential profits. The result is a threatened erosion of

\(^{232}\)NAAEC, supra note 135, Article 45 (2) (b).
\(^{233}\)Charnovitz, supra note 224, at 8.
\(^{235}\)The NAAEC states that the panel "shall base its report on the submissions and arguments of the Parties ...."
\(^{237}\)NAFTA, supra note 25, Articles 1115-1138.
sovereignty, as foreign private corporations are able to override the will of democratically elected governments. The accusation of expropriation is merely an example of the instruments that investors can use to lodge claims against domestic law as facilitated under Chapter 11 mechanism. Overview of Chapter 11 dispute settlement mechanism is covered in the following chapter.
Chapter Four
Dispute Resolution Mechanism under NAFTA Chapter 11
Critical Nature of Investor-State Dispute Settlement (ISDS)

4.1 Introduction

We have discussed in Chapter Two of this dissertation the extensive combination of rights and remedies provided to foreign investors under Chapter 11 of NAFTA and analyzed the relevant articles in some detail. These investor protections have been invoked repeatedly to challenge new environmental laws, or applications of existing laws, that adversely affect foreign investors or investments. The link between these investor protections and their use to challenge environmental laws and regulations is the investor-state dispute settlement process which is the focus of this chapter.

It is a strikingly broad and aggressive process that gives investors the right to directly challenge host governments on any type of public welfare or public policy measure that might impact on the establishment, operation, management or control of a company. This chapter provides an overview of the scope and significance of the investor-state process. It starts with an outline of the ISDS main rules of procedure, and then will move to discuss some cases that demonstrate the reach of Chapter 11 mechanism into critical areas of public policy making in relation to environmental matters and finally will examine some of concerns that have been raised in relation to it supported by relevant cases.

4.2 Fundamental Rules of Procedure

Pursuant to Article 1120 of NAFTA, a disputing investor may submit a claim to arbitration under one of the three arbitration centers that are established to accommodate disputes between an

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investor and a state. They are referenced in Chapter 11 as one of the three facilities that an investor must choose from when initiating an arbitration claim.\(^{240}\) These centers are the International Centre for the Settlement of Investment Disputes (ICSID), to which both national parties must belong for an investor of one state to sue the host state; the ICSID Additional facility, which allows its use when only the Party of an investor or the host state is a party to its rules; and the United Nations Centre For International Trade Law (UNCITRAL), created within the United Nations system. Each has its own rules of procedure which are applied once the facility is chosen by the investor, unless they are modified in the text of NAFTA itself.

These systems are all roughly similar, and all drawn from a traditional commercial arbitration model\(^ {241}\) which proves that for the most part, the system in question was intended to handle cases involving specific contractual disputes between governments and corporate contractors and not to adjudicate broad questions of public policy and the appropriate use of governmental regulatory authority.\(^ {242}\)

The central aspect of this system is the automatic right of foreign investors to initiate direct actions, either on their own behalf or on behalf of an enterprise\(^ {243}\), against host governments alleging that a NAFTA government breached one of the substantive rules which constitute the obligations described above in Chapter Two. This unfettered right to initiate a proceeding has its authority in Articles 1116 and 1117 as it explains that investors are only required to show loss or damage resulting from the alleged breach.

There are also some procedural steps such as Article 1118\(^ {244}\) that imposes an obligation on both Parties to first attempt to settle the claim through negotiation or consultation and the minimum time periods before an arbitration can be initiated. Also, in submitting a claim under Article 1120, the investor must consent to the arbitration procedure, and must waive their right to initiate

\(^{240}\) NAFTA, supra note 25, Article 1120 (1).


\(^{243}\) NAFTA, supra note 25, Articles 1116 - 1117.

\(^{244}\) Investor- State arbitration provisions are covered under articles 1115 to 1138 of NAFTA.
or pursue any administrative or judicial process involving the same claim. These conditions should be met by investors but none of them seems like it could negate the right to initiate an action.245

Procedural issues like the constitution of tribunal and selection of members are governed by the procedures drawn from a combination of Articles 1123-1125, and the rules of procedure of the three different arbitral bodies adopted by Chapter 11 to support an arbitration. At a minimum, the investor initiating the challenge selects one of the arbitrators, doing so on the basis of known views or orientations that would tend to support its position.246 Unlike commercial arbitration where money is usually the central issue, it is not common to have such a bias process in areas where important public policy issues are at the heart of a dispute.247 From the investors' perspective, only their operations and profits are at stake while public interest is of no importance.

One might think that the presumption behind the development of this approach is that foreign investors wouldn’t receive just and unbiased treatment in domestic courts of a developing country when hearing a claim which involves a government action. As a result, an alternative legal process is put in place in response to investment promotion and investor security demands. However, this brings into question two points. The first is that whether the transparent judicial system in countries like Canada and the US are conceived of in the same way as developing countries' courts system and hence an alternative legal process is needed. It is unquestionable that relevant academic literature has always asserted that judiciaries in developing countries frequently fall far short of developed countries' standards.248 I assume that these standards call for their security and justice systems to be more effective, responsive and accountable. It seems that little attention was paid to that when addressing investors’ concerns explained above. The second is that while an alternative system should have been innovated for the above reasons of non-transparency and injustice, a system that is largely devoid of any procedural or public

245 NAFTA, supra note 25, Article 1121 (1).
247 Grinspun & Shamsie, supra note 60, at 301.
interest safeguards established in the judicial systems of developed, and many developing, countries to ensure a proper balance between private rights and public interest, was created.

By this, foreign investors are allowed to circumvent traditional methods of complaining about laws and regulations and the safeguards they provide to all litigants.\textsuperscript{249} This is attained by giving them direct access to private arbitral tribunals made up of for-profit arbitrators rather than full time judges, where investors have legal standing to seek regulatory relief or monetary compensation for government policies or actions that investors believe violate their rights under NAFTA. Compensation can be awarded in unlimited amounts of taxpayer dollars from the treasury of the offending state\textsuperscript{250} even though it has gone around the country's domestic court system and laws to obtain such an award.

### 4.3 Case Law

In this section, we will discuss two cases that show the unprecedented reach of Chapter 11 mechanism into critical areas of public policy making in relation to environmental matters. The Ethyl case illustrates well the practical impact of the unfettered ability to pursue a singular private interest at the international level.

The history of the company goes back to 1922 when Ethyl started to produce tetraethyl lead, the additive used to make leaded gasoline, to enhance auto engine performance.\textsuperscript{251} Shortly after production started, many of the workers at its New Jersey plant began hallucinating and experiencing acute convulsions and eventually five of the workers died.\textsuperscript{252} Many years later, the U.S. federal government took action to eliminate lead from gasoline and developed in the 1950s a new gasoline additive called methylcyclopentadienyl manganese tricarbonyl (MMT)\textsuperscript{253}, a

\begin{itemize}
  \item \textsuperscript{249}Frakes, V., L., In the Driver's Seat: NAFTA's Chapter 11 as a Judicial Vehicle for the Expansion of Investor Rights, 1 Bus. L. Brief (AM. U.) 49 (2005), 50.
  \item \textsuperscript{250}Hussain, A. (2010). The impacts of NAFTA on North America: Challenges outside the Box. New York: Palgrave Macmillan, 95.
  \item \textsuperscript{252}Ibid.
\end{itemize}
known human neurotoxin\textsuperscript{254}. As indicated in Chapter Two, a concentrated form of MMT is produced in the United States, and then imported into Canada by the Ethyl subsidiary there, Ethyl Canada, where it is diluted at a plant in Ontario and sold to Canadian gasoline refiners.\textsuperscript{255}

It is worth noting that in 1977, MMT was banned from use in unleaded gasoline by California, which has its own state-level Clean Air Law, and then by the U.S. Environmental Protection Agency (EPA) due to environmental and public health concerns until an adverse domestic court ruling in 1995.\textsuperscript{256} So in 1997, the Canadian Parliament imposed a ban in April 1997 on the import and inter-provincial transport of MMT for a number of reasons, most important of which is the concern about the potential health effects of exposing workers and drivers to airborne manganese particles via MMT.\textsuperscript{257} Canadian officials were concerned that MMT could undermine the Canadian government’s efforts to control air pollution, and could contribute to the build-up of greenhouse gases that contribute to global warning.\textsuperscript{258}

While the prospective ban was being debated in the Canadian Parliament, Ethyl Corporation notified the government of Canada that it would file a claim for compensation under NAFTA’s investment chapter if restrictions were placed on MMT.\textsuperscript{259} The Parliament disregarded these threats and passed the ban a year later in April 1997\textsuperscript{260} and on the same month Ethyl filed the claim for compensation at $250 million in damages\textsuperscript{261}. In addition to Ethyl's arguments based on Articles 1102 and 1106 of NAFTA covered under Chapter Two, Ethyl argued that the Canadian MMT ban amounted to a NAFTA-forbidden indirect expropriation of its assets as defined in NAFTA Article 1110.\textsuperscript{262}

\textsuperscript{258}Ibid.
\textsuperscript{259}Denver Journal of International Law and Policy, Volume 28, 1999-2000, 413.
\textsuperscript{260}Murphy, supra note 81.
\textsuperscript{261}Ethyl Corporation v Government of Canada, supra note 84, "Relief Sought and Damages Claimed".
\textsuperscript{262}Ethyl Corporation v Government of Canada, supra note 82, paras. 20-24.
I gather from the above that while Canada was being threatened by initiating an arbitration claim against it, the Canadian Parliament did not give in to this pressure and still passed the ban. Canada acted in this way, despite having inconclusive results of health effects studies; because it did not want to repeat the devastating health and environmental problems caused by leaded gasoline and chose to take a precautionary measure to protect the public health. Despite of that Ethyl was able to initiate and run its litigation, and the case ended with an out of court settlement whereby the legislation it opposed was withdrawn, and Canada paid damages of $13 million US Dollars for the period the legislation was in force. It also issued a statement for Ethyl’s use in advertising, declaring that “current scientific information” did not demonstrate MMT’s toxicity nor that MMT impairs functioning of automotive diagnostic systems.

In Chemtura Corporation (formerly Crompton Corporation) v. Government of Canada, Canada banned the import of lindane-based seed treatments for canola on environment and health grounds and the question was whether the government of Canada should pay compensation to a United States agricultural pesticide manufacturer for this ban. Crompton US, the manufacturer, argued that the ban forces its Canadian subsidiary to buy local substitutes, and thus is in effect a local purchasing requirement. This might lead us to think that the ban was in fact motivated by a desire to benefit the domestic producers of substitute products and by a politically charged conflict between Canada and US, as alleged by Chemtura. It is worth noting here that the production and agricultural use of lindane was banned under the Stockholm Convention on persistent organic pollutant in 2009 as it has been classified as a persistent organic pollutant and a neurotoxin and US was ironically one of the numerous countries that banned its use locally.

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263 Markell & Knox, supra note 214, at 182.
264 Murphy, supra note 81.
267 According to the US Environmental Protection Agency (EPA), animal studies have demonstrated that lindane can cause liver cancer when ingested by mice. The EPA considers lindane a possible human carcinogen, regulates lindane products under six separate statutes and has restricted most uses since 1983.
270 Second Notice of Arbitration, 10 February 2005, supra note 252, paras. 35 - 41.
So at the time when Canada moved to implement a similar ban within its territory and protect the public health, US alleged that Canada has substantially deprived Chemtura of its investment. The company claimed compensation for the losses attributed to the ban pursuant to articles 1102 (National Treatment), 1103 (MFN), 1105 (minimum standard of treatment), 1106 (Performance Requirements) and 1110 (expropriation). Chemtura claimed that it was being treated differently, in violation of NAFTA article 1102, than its Canadian competitors, because they produce low-cost, lindane substitutes in Canada and would not be as affected by the change in policy. As well, pursuant to article 1103, the company alleged that it received less favourable treatment than similar investors. Further, Chemtura contented that it did not receive, as Article 1105 states, “treatment in accordance with international law, including fair and equitable treatment and full protection and security.” Chemtura also claimed that the government of Canada is instituting a NAFTA-illegal “performance requirement” in violation of NAFTA Article 1106 that negatively impacts Chemtura but helps Canadian companies that produce substitutes. Finally, Chemtura charged that the Canadian government, by banning the use of lindane after July 1, 2001, has “expropriated” the company’s property in violation of NAFTA Article 1110. Based on these allegations, Chemtura demanded $100 million in damages from the Canadian government to compensate for these NAFTA violations.

The NAFTA tribunal found that Canada acted within its state police powers when it banned lindane's use as a pesticide taking into consideration its worldwide treatment. The tribunal noted that "it was not its task to determine whether certain uses of lindane were dangerous … the rule of Chapter 11 tribunal is not to second-guess the correctness of the science-based-decision making of highly specialized national regulatory agencies." The tribunal added, however, that "it could not ignore the fact that lindane has raised increasingly serious concerns both in other countries, and at the international level since the 1970s." Further, the Tribunal found no facts

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272Chemtura Corporation v. Canada, Claimant's Memorial, 2 June 2008, supra note 252, pp. 3-4.
275Ibid, para. 365.
276Chemtura Corporation v Canada, Notice of Intent, 6 November 2001, supra note 252, para. 49.
277Ibid.
278Ibid para. 49.
279Chemtura Corporation v Canada, NAFTA/UNCITRAL, Award, 2 August 2010, supra note 252, para. 266.
280Ibid, para. 134.
281Ibid, para. 135.
in the conduct of the Respondent that would even come close to the type of treatment required for a breach of the FET standard.\textsuperscript{282} It was ruled that the review process conducted by the Canadian Pest Management Regulatory Agency (PRMA) was thorough, fact intensive, and inclusive of Chemtura’s concerns. The decision to ban lindane was neither hasty nor arbitrary and was based on widely accepted data recognizing lindane as a dangerous chemical.\textsuperscript{283} Even though Canada was successful, a significant amount of resources had to be expended to defend against a challenge to a decision with a significant public purpose taken by a democratically elected government. Chemtura was ordered to cover the entire cost of the arbitration, however it was found responsible for only 50\% of Canada’s associated legal costs not related to the direct operation of the tribunal. \textsuperscript{284}

4.4 Reasons to Purge ISDS from NAFTA

As explained above, the investor-state dispute settlement mechanism was ultimately designed to provide aggrieved investors with a forum that would take their disputes out of the domestic sphere of the state which, in investors' eyes, was seen as an important guarantee to have their claims adjudicated through a swift, flexible and neutral process.

However, the actual functioning of this mechanism under NAFTA has led to concerns about systemic deficiencies in the regime to the extent that it was even criticized by NAFTA supporters. This mechanism lacks any domestic safeguards including an appeal process, and a standing roster of neutral judges. The said deficiencies have surely been well documented in literature and need only be summarized here in a manner that serves the purpose of the present dissertation.

ISDS procedures under NAFTA create a special privileged status for nobody but investors. The critical character of the ISDS can be found in its rules and procedures – being a closed and unaccountable process. It is hard to conclude that the advent of NAFTA brought about domestic

\textsuperscript{282}Ibid, para. 236.
\textsuperscript{283}Ibid, paras. 150-153.
\textsuperscript{284}Ibid, part V "Decision".
environmental and health laws being undermined, better treatment for foreign investors, and
opening the states' treasury to new demands from them.

4.4.1 Legitimacy– Are foreign investors allowed to Evade Legal liability?

Although ISDS system has sparked serious criticism and undoubtedly these critical voices vary in the specific points they raise, they have fueled a considerable amount of literature implying that there is a "legitimacy crisis" in investment arbitration. From a State's perspective, ISDS is a necessary means of attracting foreign direct investment – especially developing countries. Despite this fact, there have been some contemporary withdrawals of some Latin-American states from investment treaties and the ICSID Convention.

While from investors' perspective, ISDS works as an incentive for them to resist attempts to work out reasonable settlements with the prospect that any domestic court orders or damages could be evaded using NAFTA – a privilege that is not allowed to national investors. The Loewen Group, Inc. and Raymond L. Loewen v. United States of America is a manifest application of the mentioned scenario. The Mississippi jury trial in O'Keefe v. Loewen Group, Inc resulted in a $500million damage award against the Vancouver-based funeral conglomerate. Loewen Group sought damages for the alleged injuries arising out of the

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289 Supra note 71.


291 Supra note 85, at 451.
litigation that took place in Mississippi state courts\textsuperscript{292} and so it filed a claim under the ICSID Additional Facility Rules and requested damages in excess of $600 million.\textsuperscript{293}

Loewen alleged violations of three provisions of NAFTA - the anti-discrimination principles set forth in Article 1102, the minimum standard of treatment required under Article 1105, and the prohibition against uncompensated expropriation set forth in Article 1110.\textsuperscript{294} On June 26, 2003, the tribunal dismissed the claims against the United States in their entirety ruling that "they found nothing in NAFTA to justify the exercise by this Tribunal of an appellate function parallel to that which belongs to the courts of the host nation".\textsuperscript{295} However, looking into the Tribunal's award it appears that it actually examined the trial and verdict and established that they cannot be squared with minimum standards of fair international law and fair and equitable treatment.\textsuperscript{296} This opens the door for characterizing the failure by a nation to provide adequate means of remedy for a judicial wrong as an international wrong making it a legitimate target of a corporate suit under NAFTA. It has not even placed any limits on what types of court decisions could be open to challenge.\textsuperscript{297}

\section*{4.4.2 Transparency – Public Disputes, Private Tribunals}

To date, information disclosed about Chapter 11 arbitrations has been minimal\textsuperscript{298}, and this lack of disclosure can extend to the final awards of arbitral panels. Despite not covered by this paper, the legal analysis of the procedural rules in NAFTA and in the other arbitration forums that can be used under Chapter 11 reveal that transparency is absolutely absent.\textsuperscript{299} The level of secrecy

\begin{footnotesize}
\begin{enumerate}
\item\textsuperscript{293}Loewen Group, Inc. v. United States, supra note 71, Loewen Corp.’s First Memorial on Merits 18 October 1999, para. 263.
\item\textsuperscript{294}William S. Dodge, "Loewen Group, Inc. v. United States. ICSID Case No.ARB(AF)/98/3 and Mondev International Ltd. v. United States, ICSID Case No. ARB(AF)/99/2," The American Journal of International Law, January, 2004 98 A.J.I.L. 155.
\item\textsuperscript{295}Loewen Group, Inc. v. United States, supra note 71, Award 26 June 2003, para. 242.
\item\textsuperscript{296}Loewen Group, Inc. v. United States, supra note 71, Award 26 June 2003, para. 137.
\item\textsuperscript{299}For details, see Asean Studies Center (2010), the Global Economic Crisis, Implications for ASEAN, Institute of Southeast Asian Studies, Report No. 10, 121 ff.
\end{enumerate}
\end{footnotesize}
that extends on all sides of the initiation and conduct of investor-state disputes raises additional concerns concerning the overall nature and appropriateness of this process.\textsuperscript{300} The lack of transparency was even labeled by one of Canada’s leading newspapers as “NAFTA’s Cone of Silence”, and as "NAFTA's Powerful Little Secret" by another American newspaper.\textsuperscript{301} On the contrary, in a national court system there is a minimum level of transparency and accountability brought on by the public pleadings where governments are sometimes parties to litigation. This lack of transparency contributes to a significant loss of democratic legitimacy as there is only little factual knowledge of the case available to the public, eliminating any democratic checks and balances.

Since an array of public interest regulations have been challenged as violating NAFTA, the public must have a stake in disputes between investors and states especially that it is their tax dollars that may one day be awarded to a an investor that is demanding millions in compensation. Despite this compelling rationale, the process in ICSID and UNCITRAL has traditionally been confidential, closed and unaccountable one, logically to protect the commercial interests in mind. For instance, in Methanex v. US,\textsuperscript{302} a California law phasing out a gasoline additive, namely MTBE, found to be contaminating the water table and posing health risks to humans.\textsuperscript{303} Canada-based Methanex sued the United States for $1 billion alleging that California's ban constitutes a violation of NAFTA.\textsuperscript{304} While this ban must have been issued by virtue of a new law which was created over several years using an open process and which the citizens of the state must have supported at the time, those citizens have no formal role in the case filed under NAFTA, cannot be party to it, and are not even entitled to have access to case documents or proceedings or decisions produced in the course of the arbitration.

\textsuperscript{302}Methanex v. United States of America, UNCITRAL (NAFTA), Final Award 3 August 2005.  
At a minimum, ICSID has a website\textsuperscript{305} that provides an enhanced research tool which should include case details pertaining to pending and concluded cases administered by ICSID while UNCITRAL does not provide even this basic information.\textsuperscript{306} Moving to awards, neither institution is permitted to release information about final awards without the consent of both parties.\textsuperscript{307} ICSID often posts information about final awards on its website, but UNCITRAL does not. Also, ICSID Additional Facility rules state that “the deliberations of the Tribunal shall take place in private and remain secret”.\textsuperscript{308} Even other arbitration institutions, such as the Permanent Court of Arbitration, the International Chamber of Commerce which often administer their cases in accordance with UNCITRAL Rules do not have a comprehensive public register pertaining to pending and concluded cases, thus expectedly only minimal information is available to the public about cases. More notoriously, investors opt for closed hearings under the ICSID or UNCITRAL Rules particularly in cases concerning public policy.

Further, submission of amicus curiae briefs by NGOs is a topic that NAFTA is silent on\textsuperscript{309}, leaving it to be governed by the rules of the arbitral bodies. Normally, this procedure would require that the NGOs have access to sufficient accurate information on the case to make such submissions in an informed manner. Consequently, this would collide with the secretive process of an arbitration claim under the investor-state mechanism.

Looking at NAFTA rules in this regard, it allows experts to be appointed by a tribunal at the request of a disputing party or on their own initiative unless both disputing parties disapprove.\textsuperscript{310} This provision is quite specific to environmental issues, and is also limited to experts giving factual or scientific information and subject to terms and conditions as the disputing parties may

\begin{itemize}
\item \textsuperscript{305}See: https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&reqFrom=Main&actionVal=ViewAllCases
\item \textsuperscript{308}Rules Governing the Additional Facility for the Administration of Proceedings by the Secretariat of the International Centre for Settlement of Investment Disputes (Additional Facility Rules), Article 23.
\item \textsuperscript{310}NAFTA, supra note 25, Article 1133.
\end{itemize}
agree.\textsuperscript{311} The arbitration bodies also provide for the use of expert witnesses if required by a tribunal, or as required by a party.\textsuperscript{312} The Rules of Arbitration of the UNCITRAL forum, for example, allow the tribunal to determine if a party may submit additional written materials beyond the statements of claim and defence set out in the Rules. They also allow the tribunal to seek any other expert reports in writing as they deem necessary.\textsuperscript{313} The ICSID and ICSID Additional Facility rules include a reference to the pleadings and submissions of the disputing parties, without setting any limitations on what might be included.\textsuperscript{314}

Decision of the WTO Appellate Body in the Shrimp-Turtle case\textsuperscript{315} serves as a commendable model that is worthy of adoption. The AB Decision states that "we consider that the attaching of a brief or other material to the submission of either appellant or appellee, no matter how or where such material may have originated, renders that material at least prima facie an integral part of that participant's submission."\textsuperscript{316} This is a precedent that should be used to entitle tribunals to receive amicus briefs on their own authority, or alternatively allows the parties to append NGO briefs or submissions to their own pleadings and submissions.\textsuperscript{317} Based on the provisions of NAFTA and arbitral bodies discussed above, there does not appear to be any obstacle to adopting the same process for Chapter 11 disputes. This should, of course, be preceded by securing the right to access litigation materials by anyone other than the disputing parties as well as to the oral hearings.

This lack of transparency, as identified above, has been an enticing avenue for investors to abuse. Investors may bring multiple\textsuperscript{318} or frivolous\textsuperscript{319} claims at the same time before different tribunals

\textsuperscript{311}Ibid.
\textsuperscript{312}UNCITRAL Arbitration Rules, Articles 27, 22, 15(2), The ICSID Arbitration Rules (Rules of Procedure for Arbitration Proceedings), Articles. 34-36; ICSID Additional Facility Arbitration Rules (Schedule C), Articles. 41-43.
\textsuperscript{313}UNCITRAL Arbitration Rules, Articles 22, 27.
\textsuperscript{314}The ICSID Arbitration Rules (Rules of Procedure for Arbitration Proceedings), Articles 31, 32, 34; ICSID Additional Facility Arbitration Rules (Schedule C), Articles 38, 39, 41.
\textsuperscript{316}Ibid, para 89.
\textsuperscript{317}Ibid, concluded from paras. 90-91.
and for the same set of facts constituting the breach and most importantly against the same respondent state as long as the public opinion is not involved due to the traditional rules and procedures of ISDS. As explained earlier in Chapter Two, it remains that under Chapter 11, each holding company in a long chain of ownership could file its own separate claim against the host State for the same treaty breach. Nothing would prevent, for example, shareholders holding a very small percentage of the total numbers of shares\textsuperscript{320} or whose investments are indirectly made through multiple layers of intermediate corporations from pursuing their own claims or a shareholder from filing a claim as an individual and another one under the corporation in which he invested.\textsuperscript{321}

A clear non-NAFTA example of this theoretical possibility is the CME/Lauder v. Czech Republic\textsuperscript{322} where Lauder, a US national – and the controlling shareholder in an investment made in CME in Czech Republic\textsuperscript{323} – brought arbitration under the US – Czech Republic BIT in accordance with UNCITRAL Rules.\textsuperscript{324} Six months later, CME itself started its own proceeding before a different arbitral tribunal under the Netherlands –Czech Republic BIT. Both claims arose from the same facts and the result was two contradictory awards.\textsuperscript{325} However, if we assume that both awards were issued in favor of the investors, it would have been a potential path for double recovery by Mr. Lauder to be paid by one Respondent state.

There are other more striking examples where filing parallel claims, in the above mentioned private investment forums, can be driven by political motives and ideologies under the pressure of transnational economic sectors with a view to dismantling a State's national sovereignty, especially developing countries, which will eventually face the prospect of having to pay billions to disgruntled successful claimants. Regrettably, those politically motivated cases are looming large in light of the darkness caused by the lack of transparency and openness of the ISDS mechanism and they can proceed for years without the public being aware of them.

\textsuperscript{321} Ibid.
\textsuperscript{322} CME Czech Republic B.V. v. The Czech Republic, UNCITRAL, Final Award 14 March 2003.
\textsuperscript{323} Herdegen, supra note 306, at 156.
\textsuperscript{324} Ibid.
\textsuperscript{325} Ibid.
So given the public interest in the cases, the public deserves to have access to the case documents public and to proceedings allowed in any domestic court. Some would contend that this flies in the face of the essence of the protection bestowed by ISDS mechanism, but transparency might be the price to be paid for the privilege of using the ISDS.

4.4.3 Review of Arbitral Awards

Where a defeated Party is dissatisfied with the arbitral tribunal’s award, it must be provided with equitable remedies for rectification of awards, such as annulment or appeal. Review of arbitral awards, whatever the form of review is, is a guarantee designed to preserve the interests of the Parties. Unlike in the realm of trade disputes, there is no such unified appellate body\textsuperscript{326} to ensure the consistency of how international investment law and its instruments are interpreted and applied.

Any given panel is expressly not bound by the interpretation of NAFTA provisions adopted or by precedents laid down by another tribunal, but can set out a different and even completely opposing view in its award.\textsuperscript{327} This entails dissimilar legal interpretations of identical treaty provisions, let alone, issuing several awards, addressing the same facts, with diverging conclusions. Two issues amplify this concern. The first is that investment tribunals often adjudicate public policy issues and important questions of law which cannot be perceived without a possibility of effective review. The second one is the legal fact that some challenges may not even be known to the public under the applicable procedural rules and so final awards may not be disclosed to the public, who may include members of a subsequent panel.

We will touch on the possible ways of revising an award according to the rules of the three arbitration bodies included in NAFTA Chapter 11. Starting with the ICSID, it provides for annulment of ICSID awards by an ad hoc Annulment Committees\textsuperscript{328} and thus preventing

\textsuperscript{327}This is clearly stipulated in Article 1136(1) of NAFTA.
\textsuperscript{328}Articles 50-52 of ICSID. It is worth noting that this annulment process is not equivalent to an appeal on the merits of an arbitration panel decision, as one now has in the WTO process.
domestic courts from reviewing any of its awards. Annulment of ICSID awards is confined to five specific grounds as provided by Article 52 of the ICSID Convention that do not involve merit-based grounds. This accentuates the deliberate desire of ICSID drafters to have final awards that are governed by ICSID provisions only. An ICSID annulment committee may find itself unable to annul or correct an award, even after having identified “manifest errors of law”.

Moving to revision of awards under ICSID Additional Facility and UNCITRAL Rules, they both give a prominent role to national courts under national arbitration laws and the New York Convention provisions. ICSID Additional Facility rules apply to certain categories of proceedings between States and nationals of other States that fall outside the scope of the ICSID Convention. It is clear that the ICSID Additional Facility was created to extend the availability of ICSID arbitration to certain types of proceedings – that still involve investment disputes in some cases regardless the parties are signatories to the Convention or not. Moreover, The Additional Facility is not a separate institution as the same secretary serves both of the ICSID and its Additional Facility. Despite of that, the provisions of the ICSID Convention, including provisions on recognition and enforcement of awards, do not apply to the Additional Facility proceedings although many of the guiding principles are similar as per article 3 of the Rules. Accordingly, awards of the ICSID Additional Facility are subject to the supervisory jurisdiction of national courts of the country where arbitration is held. This explains the requirement in Article 19 that proceedings be held only in States parties to the New

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330 ICSID post-award remedy involves "annulment" excluding errors of law or fact as opposed to "appeal" which might result in the modification by requiring a tribunal to modify its mistakes or substituting an appellate body decision for that of the first tribunal.
331 See CMS Gas Transmission Company v. The Republic of Argentina, ICSID Case No. ARB/01/8, Decision of the ad hoc Committee on the application for annulment, 25 September 2007, paras. 97, 127, 136, 150, 157-159. Article 52(1) of the ICSID Convention enumerates the following grounds for annulment: (a) improper constitution of the arbitral Tribunal; (b) manifest excess of power by the arbitral Tribunal; (c) corruption of a member of the arbitral Tribunal; (d) serious departure from a fundamental rule of procedure; or (e) absence of a statement of reasons in the arbitral award.
332 Article 1136 of NAFTA and Article V (1) (e) of New York Convention.
333 ICSID Additional Facility Rules, Article 2.
334 ICSID Additional Facility Rules, Article 2 (a).
336 NAFTA, supra note 25, Article 1136.
York Convention and also means that awards will be subject to the reasons for non-enforcement listed in Article V of the New York Convention.

As for UNCITRAL, it should first be noted that some procedural aspects of UNCITRAL rules for the arbitration proceedings are quite similar to those of ICSID\textsuperscript{337}, similarity of the selection of arbitrators rules is an example. However, and as previously mentioned, UNCITRAL does not collect or compile a record of basic information about pending and concluded cases. Further, the UNCITRAL rules do not provide for the right of appeal within its own system as there is in ICSID. That being said, arbitration process under UNCITRAL Rules could theoretically be less transparent than under the ICSID rules. This is reflected in UNCITRAL Article 32(2) which provides that the "award .... shall be final and binding on the parties. The parties undertake to carry out the award without delay".

However, the only way of having an award set aside under UNCITRAL is attainable when seeking to enforce an award in accordance with Article IV of the New York Convention. The burden of proof of the existence of one or more of the grounds listed in Article V of the New York Convention then shifts to the party against whom the enforcement is sought\textsuperscript{338}. Article V(1) enumerates certain procedural deficiencies according to which the enforcement of the award may be refused while Article V (2) provides two grounds which allows the enforcing court to examine the subject matter of the dispute and the substance of the award in deciding where there are valid grounds to refuse enforcement.

This is a system that lacks a reasonable and objective justification; how can we envisage that awards rendered in traditional commercial arbitration are open to appeal on different grounds and exercised by national courts while awards in disputes involving issues of public interest are blindly considered free from defects with no right to appeal on the merits?

By way of conclusion on this point, I point out some loopholes that arise when attempting to theoretically assess the actual functioning of the ICSID mechanism. First, given that Mexico is not a party to the ICSID Convention\(^{339}\), ordinary ICSID arbitration under the ICSID Convention is thus not an option between Mexico and Canadian or American investors on the one hand and between Mexican investors and US or Canada on the other hand. According to NAFTA, they can only be filed under ICSID Additional Facility or the UNCITRAL Rules. This does not cope with the general impression expressed in literature that ICSID system is self-contained and delocalized as one of the advantages of investment arbitration is to be governed by international standards and procedures rather than these of the host state and its domestic courts. The above-mentioned presumption is one case where Canadian and American investors (who are signatories to the ICSID Convention) will be deprived of the ICSID privileges. This means that NAFTA has fallen short of achieving one of its Chapter 11 objectives by providing no legal security for international investments made in the region and eventually resorting to international commercial arbitration i.e. UNCITRAL or to mechanisms that render awards equated with ordinary international commercial arbitration awards i.e. ICSID Additional Facility.

Second, investment disputes should be treated differently and adjudicated in private tribunals that render final binding awards – a notion has that has been developing as far back as the late 1960s with the establishment of ICSID and certainly an objective that Chapter 11 of NAFTA intended to serve and achieve by resorting to ICSID. Peculiarly, NAFTA provides aggrieved investors with two alternative practicable avenues where investment disputes based on bilateral investment treaties may be decided through international commercial arbitration proceedings, namely: UNCITRAL Rules (originally designed for international commercial arbitration disputes) and ICSID Additional Facility (a system that does not appertain to ICSID by any means, rather, is at least partially subject to an international commercial arbitration instrument i.e. New York Convention.)

Lastly, it has been argued that ICSID in its current form has achieved a certain level of uniformity which should be extended at the review level by creating an Additional Annullment

\(^{339}\)Available at: https://icsid.worldbank.org/ICSID/FrontServlet?requestType=ICSIDDocRH&actionVal=ShowDocument&language =English
Facility that could be used as an adjunct to whatever arbitration rules are applicable.  

For the given reasons above, I argue that the ad hoc annulment committee of ICSID is surrounded by several drawbacks that are sufficient to deprive its member countries from the legitimately expected protection for their investments under NAFTA and standing in sharp contrast to what is found in the Parties’ domestic systems of justice. Perhaps the proposal should be the other way around by extending the jurisdiction of national courts to ICSID awards too to achieve fairness, consistency and uniformity.

4.4.4 Independence and Impartiality of Arbitrators

As explained earlier, whether the ICSID or UNCITRAL rules are chosen, an investment arbitral tribunal will have three members: one chosen by the investor, one chosen by the state and a third one to be the presiding arbitrator that is mutually agreed upon by the Parties and which is a good reason to lead to bias and potential conflict of interest.

Barristers, professors, retired judges are frequently appointed as arbitrators and conceivably an individual may act as an arbitrator in one case and as a lawyer defending a respondent or a claimant in another. This fact is also problematic as they may ‘consciously or unconsciously’ issue decisions as arbitrators that will foster their client’s interests in another case. The panelists themselves are not selected from a permanent consistent record of arbitrators and certainly disputants are notionally tempted to choose arbitrators whose jurisprudence and views support their positions. On the other hand, arbitrators themselves might be interested in being re-appointed in prospective cases for how they are rewarded for their services; compared to court judges for instance. Establishing a permanent roster of arbitrators would at least guarantee neutrality, transparency and consistency of the process and issued awards. It is crucial to understand whether investor-state arbitral tribunals are sufficiently equipped to assess and make

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340 Idea proposed by Jan Paulsson, in the Investment Committee's consultation with BIAC, TUAC, and NGOs in December 2004.


decisions taken by States in highly sensitive environmental matters especially in cases when conclusive scientific evidence is lacking.

The cumulative impact of these factors is important from an environmental perspective as they all lead to the anarchic ability of investors to obtain compensation or damages for new environmental measures adopted by a NAFTA party. This ability is corroborated by the main features of investor-state dispute mechanism as illustrated above leading to forcing governments to pay money to defend its right to protect the environment. This constitutes a significant deviation from the Polluter Pays principle, an international environmental law custom that is defined by OECD and greatly supported by many countries.
CONCLUSION

Are the NAFTA and its environmental side agreement (NAAEC) up to dealing with the immediate looming environmental challenges that have become clearer in the past twenty years? Do they provide the adequate policy space for NAFTA governments to lead a transition to become nations that give priority to the environment protection even at the risk of curbing economic growth? The evidence is scant that they are.

The NAFTA thrust the United States, Canada, and Mexico into a realm of new rules that have liberalized trade and investment by rolling back different obstacles. This liberalization covers a wide range of areas including trade in goods and services, government procurement and foreign investment. NAFTA was a landmark trade agreement in terms of linking trade and environment. Significance of NAFTA in this regard is driven by the inclusion of environmental provisions through a side agreement, and establishing the CEC which fostered an unprecedented level of tri-national environmental diplomacy and cooperation among parties to the agreement. These achievements have been positive, but limited.

Chapter 11, in particular, provides investors with rights and protections unprecedented in a multilateral trade agreement. The investor now possesses an increased set of rights relative to domestic law that could prove to be highly problematic by encouraging investor to override carefully planned environmental government regulation. For instance, investors may challenge any governmental measures claiming that such laws were “tantamount to expropriation,” or that they were in violation of the “minimum standards of treatment” accorded to foreign investors under NAFTA. As arbitral tribunals vary in their adjudication of cases involving environmental measures under Chapter 11, governments are doomed to pay the price every time a claim is filed. One case may result in the reverse of an environmental law if investor's claims are accepted such as Ethyl Corporation v. Government of Canada, and another one may result in the dismissal of investor's claims against environmental regulations as the tribunal did in Chemtura Corporation v. Government of Canada. To put it simply, as long as governments say "no" to environmentally destructive practices, it will have to pay whether for compensating investors if it is found to be in
violation of investor protections or the legal costs of defending its government policies from corporate attack.

Contributing to this situation is the fact that Chapter 11 offers adjudicative bodies that in many cases grant more leniency than domestic courts of NAFTA countries. Even though Chapter 11 has been praised by some as a model after which future trade agreements should form dispute resolution systems, it is haunted by inconsistency in its application and the ability of investors to exploit the system to secure broader rights than intended by the drafters of NAFTA. There is a visible trend of favoring foreign investors by NAFTA tribunals over host country governments, which can be easily demonstrated through the decisions in cases like Ethyl Corporation v. Government of Canada and S.D. Myers, Inc. v. Government of Canada. Also, in Chemtura Corporation v. Government of Canada and despite the ruling was in Canada's favor, the decision did not secure the power of the state regulatory system vis-à-vis the investor.

The vague language of major NAFTA provisions leaving a wide range of interpretations open to arbitrators and the somewhat closed nature of the process contributes to public distrust in these tribunals deliberating over important issues brought forth by investors in their claims against host governments. This is exacerbated by the absence of effective review or appeal processes. As a result, prior tribunal decisions carry little weight in the eyes of the international community and future tribunals are not pressured to follow their decisions.

This evolution of investor state arbitration has led to significant implications. By threatening to initiate a NAFTA suit before the law was even passed and by circumventing domestic avenues for challenging a law or regulation, as in the Ethyl case, is considered a blatant attempt to intimidate a legislative body from taking action. Canada agreed to settle the case by any way before the final NAFTA tribunal ruling in an effort to avoid a large damage award. The NAFTA tribunal’s decision to accept the claim and allow it to proceed constitutes a significant and potentially dangerous new limit on the exercise of basic government functions. Governments must maintain the ability to regulate because of environmental or public health concerns without having to pay a corporation for the right to exercise its normal function.
A continuous record of similar threats of challenges against environmental measures using Chapter 11 will have a negative effect on prospective public interest policies and innovations in public policy being considered by governments and will often result in governments preemptively conceding and changing a policy to avoid a trade challenge.

NAFTA is a model that brings along irrevocable damages to the environment by establishing a system that is biased towards the interests of investors at the expense of the public interest. This pattern of cases is likely to continue under the current rules of NAFTA if no amendments are adopted. Repairing NAFTA’s ability to enhance environmental sustainability throughout North America and to tackle trade-related environmental issues in the region will require comprehensive changes throughout the treaty. This needs a regime that gives all three governments the policy space to regulate environmental matters within its borders.
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