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THE CHALLENGE OF TREATY STRUCTURE: THE CASE OF NAFTA AND THE ENVIRONMENT

*By Tseming Yang**

My remarks will focus on the challenge that treaty structure poses to addressing the tension between trade, investment, and environment. The question I ask is whether trade, investment, and environment are closed boxes not only to each other, but also to non-state participants, especially members of civil society. I will use the NAFTA Environmental Side Agreement¹ to illustrate this issue.

My main point is that treaty structure creates biases in how trade and environment issues are resolved. With treaty structure I refer to the design of treaties either primarily as contractual arrangements or more like public regulatory regimes. Trade treaties tend to resemble the former, while environmental agreements are being configured increasingly to resemble the latter. By their design, public regulatory regimes tend to be better at promoting civil society involvement and vindicating public values than contractual arrangements.

A BRIEF OVERVIEW OF THE NORTH AMERICAN AGREEMENT ON ENVIRONMENTAL COOPERATION AND ITS CITIZEN SUBMISSIONS PROCESS

The environmental side agreement was intended to promote environmental cooperation and ensure that NAFTA states would not regress in their environmental protection efforts because of increased competitive pressures.

Under the side agreement, the parties are required to ensure high levels of environmental protection² and to “effectively enforce” their environmental law.³ The agreement also contains a citizen submission process through which anybody, including private individuals, NGOs, and corporations, can complain about a NAFTA party’s failure “to effectively enforce its environmental law.” The submissions process is well-known, and I will skip the details. In broad outline, there are five basic steps:

- (1) a petition or submission to the Commission for Environmental Cooperation alleging a failure to effectively enforce environmental laws;
- (2) review and a decision by the secretariat that the submission is essentially non-frivolous, and a request for a response from the target state;
- (3) a decision by the Council, made up of the environmental ministers of the NAFTA countries, on whether to develop a factual record;
- (4) Commission preparation of a factual record, which may take from months to years;
- (5) Council vote on whether to release the final report to the public; a two-thirds majority vote is required for public release.

At this point, the process has run its course. There is no substantive remedy at the end. The outcome is a report documenting the facts underlying the enforcement failure allegations.

The side agreement, however, does contain a bilateral dispute settlement process in Part V. The standard for triggering that process is that a country must have engaged in “a

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¹ Formally known as the North American Agreement on Environmental Cooperation, Sept. 14, 1993, Can.-Mex.-U.S., 32 ILM 1480 (1993) [hereinafter NAAEC].

² NAAEC, Art. 3.

³ NAAEC, Art. 5.

persistent pattern of failure to . . . to effectively enforce its environmental law.”⁴ The standard is thus higher than for triggering of factual records. Theoretically, however, the Article 14 factual records could provide the factual predicates for such a dispute settlement proceeding.

To date, the Secretariat has received fifty-three submissions; eleven are pending, and another eleven have resulted in factual records. The rest never made it to the factual record stage. There have been no Part V proceedings.

THE IMPORTANCE OF STRUCTURE: THE CHALLENGE OF CONTRACT FOR PROMOTING PRIVATE AND PUBLIC VALUES

Why is treaty structure important? Structure creates biases in how issues are resolved. Contractual arrangements are fundamentally designed to advance individual, private interests to the extent that they are mutually compatible. In contrast, public regulatory regimes are designed to promote public norms and shared values. The result is a bias of treaty outcomes toward private or public values depending on the structure of the treaty.

For trade agreements, which are largely based on the contract model, outcomes are biased against public values like environmental quality and toward private interests. In other words, they advance the individual interests of the party states. Public values are much harder to vindicate.

The side agreement is a hybrid in its structure, and its effectiveness varies accordingly. Three examples are illustrative. First, there is the issue of individual, party control vs. institutional control over acts that happen within the treaty scheme. For example, the fact that publication decisions of factual records requires only a two-thirds majority reflects an institutional approach—the interested party, the target of the factual record, cannot single-handedly block publication of the factual record. In contrast, actual enforcement of breaches under Part V of the side agreements remains largely based on a private contract model. Like traditional contract enforcement, it requires initiation and is controlled by one of the treaty parties.

The contrast in the outcomes is striking. So far, the CEC has always voted to make factual records prepared by the secretariat available to the public, resulting in eleven published factual records. By comparison, in over ten years of the side agreement, there has never been a part V dispute settlement proceeding.

A second example is the shape and form of non-compliance remedies. The remedy available under the side agreement for Part V proceedings is first a compliance plan;⁵ if that fails, then a monetary assessments;⁶ and if that is not paid, trade sanctions, or suspension of benefits, that will allow for the collection of the monetary assessment through tariffs.⁷

The assessment is not a compensation award for the other party, since it is paid to the Commission. Instead, it is more like a penalty that is used to remediate potential harm to the environment resulting from the treaty breach. Most of the time, such harm is likely to have occurred within the culpable state itself. As a result, the payment will usually benefit the environment of the offending state itself. In this aspect, the side agreement reflects a public regulatory approach.

⁴ NAAEC, Arts. 22(1).

⁵ NAAEC, Arts. 31(2)(c), 33, 34(4)(a).

⁶ NAAEC, Arts. 34(4)(b), annex 34.

⁷ NAAEC, Art. 36.

Finally, the citizen submission process allows for the involvement of the public and civil society. The submissions process enables individuals or groups to circumvent the monolithic nature of states under international law and to participate in international processes directly. They can help to promote environmental values that are embodied in the treaty even if the state as a whole may not want to be involved for reasons of national self-interest or interest group politics. After all, trade advocates and the business lobby constitute a set of powerful national interests. By helping to vindicate public values in spite of such obstacles, the submissions process reflects a public regulatory approach.

For the WTO, the problem of structure should be obvious. Even if it has evolved significantly from its GATT predecessor, its structure still resembles much of a contractual arrangement. For example, it continues to be driven by individual parties with respect to its enforcement processes. NGOs may submit amicus briefs in such proceedings, but they are allowed no substantive role. And the resulting remedies are designed to primarily “compensate” or otherwise advance the individual interests of the parties. With respect to the environment or other such public values, the WTO, of course, still provides no affirmative remedy. In essence, the process reflects a strictly contractual model of treaties.

CONCLUSION

There is a simple underlying reason that drives treaty structure toward a contractual model: the doctrine of state sovereignty. It is a difficult challenge to overcome. However, the challenge is not a problem of law. It is a problem of how the politics of trade, development, and the environment affect the structure of international agreements. As a result, change does not require fundamental legal change but rather change in the politics and discourse on these issues.

REMARKS BY DONALD McRAE*

I am going to focus on the interaction of investment regulation and environmental concerns. As in the trade field, the problem has risen to prominence because of the existence of dispute settlement. We have provisions in investment agreements that are being interpreted and applied by tribunals and those decisions are binding on governments. The concern started to arise in dispute settlement under NAFTA Chapter 11, but it is more pervasive now with the proliferation of investment disputes under bilateral investment agreements that are being resolved under the ICSID procedure.

What is the problem from an environmental point of view? I will mention two. (1) Are the protections for foreign investors in these agreements written in such a way that governments will be inhibited from regulating in the public interest to support environmental objectives (regulatory chill)? (2) Will the provisions be interpreted through the dispute settlement process in a way that preserves the ability to governments to legislate in the public interest?

If we look at the agreements on investment that have been concluded so far, there are three models for approaching the investment/environment interface. The first model is to ignore it. That was the approach in traditional bilateral investment agreements. The second model is investment within a so-called “green trade agreement.” This was NAFTA Chapter 11. Finally, there is the current round of investment agreements and investment provisions

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in regional trade agreements which go beyond NAFTA and contain explicit provisions to limit the scope of investment protections in so far as they relate to national environmental or other public policy measures.

There is now a fourth model; the Draft Model Agreement on Investment for Sustainable Development that has been proposed by the International Institute for Sustainable Development (IISD).¹

There is nothing much to say about the traditional investment agreements. Under those agreements, whether regulation that had environmental or other public policy objectives but which diminished the value of an investment constituted expropriation was to be decided in accordance with international law.

Under NAFTA, things looked different but it is not clear that they really were. Deference is paid to environmental issues in the Preamble to NAFTA and in specific provisions of the Agreement (Article 104) including the investment provisions themselves (Article 1114). However, the provisions relating to the rights of investors do not contain specific exclusions in respect of environmental measures adopted by governments. The basic protections for investors—national treatment, MFN treatment, the international minimum standard, and compensation in the event of expropriation—make no mention of environmental justifications for actions by the NAFTA governments that contravene any of these provisions. Thus, the NAFTA model, too, relied on customary international law.

The approach in the new investment agreements can be illustrated by the exchange of letters attached to U.S.-Singapore FTA which provides: “Except in rare circumstances, non-discriminatory regulatory actions by a Party that are designed and applied to protect legitimate public welfare objectives, such as public health, safety, and the environment do not constitute indirect expropriations.”²

In a sense, this is a fairly minimal intervention into the investment regime. These agreements do not provide a comprehensive framework for the incorporation of ideas of sustainable development. Rather, they seek to fill in what were perceived to be gaps identified from the NAFTA Chapter 11 jurisprudence.

The IISD Model International Agreement on Investment for Sustainable Development by contrast has the explicit objective of promoting sustainable development (Preamble) and of promoting foreign investment that supports sustainable development. The draft agreement provides not only for protections for foreign investors but also establishes both pre and post-investment obligations on foreign investors and sets out rights for states. Failure by a foreign investor to live up to its obligations may result in a loss of its right to pursue a claim against the host state or may be relevant to mitigate any damages claim.

However, when it comes to defining the ambit of expropriation, the IISD draft is not significantly different from the new investment agreement carve-out in respect of environmental regulation. It provides: “non-discriminatory regulatory measures taken by a Party that are designed and applied to protect or enhance legitimate public welfare objectives, such as public health, safety and the environment, do not constitute an indirect expropriation under this Article.”³

¹ INTERNATIONAL INSTITUTE FOR SUSTAINABLE DEVELOPMENT, IISD MODEL INTERNATIONAL AGREEMENT ON INVESTMENT FOR SUSTAINABLE DEVELOPMENT (2005), at <http://www.iisd.org/investment/model_agreement.asp>.

² United States-Singapore Free Trade Agreement, Jan. 15, 2003, at <http://www.ustr.gov/assets/Trade_Agreements/Bilateral/Singapore_FTA/Final_Texts>.

³ *Id.*, Art. 8 (I).

The question is whether these new model investment agreements and the new IISD model will make a difference. In this regard, it is useful to look at the most recent decision under NAFTA Chapter 11—the Methanex case.⁴

The case involved a claim against the US by a Canadian company Methanex arising out of a ban imposed by California on a gasoline additive called MTBE because of its potential harm to drinking water supplies and human health. Methanex produces methanol which is a component of MTBE and Methanex claimed that it had been denied national treatment, that there had been a breach of the international minimum standard of treatment and that the effect of the California ban was tantamount to the expropriation of its investment. In an earlier decision the tribunal rejected a large part of Methanex's claim and in its decision in August last year it dismissed the balance of Methanex's claims.

There are two aspects to this most recent decision to be noted. First, Methanex argued that it was denied national treatment because, producers of ethanol, which Methanex saw as a competitor of methanol, were not subject to the ban. Thus, to use the language of NAFTA Article 1102, Methanex claimed that it was getting less favorable treatment than the producers of methanol who were in "like circumstances" to producers of ethanol. The tribunal rejected this argument. In deciding who were in "like circumstances" to Methanex as a producer of methanol the tribunal looked for the closest "like" comparator which was the American producers of methanol who had been equally affected by the MTBE ban. Methanex had thus been accorded no less favourable treatment than them. Since American producers of methanol were identical to Methanex they were in "like circumstances." Ethanol producers were in less like ones.

What are the implications of this? If in searching for "likeness" one is looking for factors that show "identity," then a less polluting product would not be "like" a more polluting product and their producers would not be in "like circumstances." This is analogous to the reasoning in the WTO *Asbestos* decision.⁵ Moreover, the *Methanex* tribunal suggested that there was more flexibility in the interpretation of "like circumstances" than in the interpretation of "like products" under the WTO. But how far does this go? In this regard, *Methanex* probably raises more questions than it answers.

The second aspect of *Methanex* involves the expropriation claim. Here the tribunal was quite peremptory. It simply said: "as a matter of general international law a non-discriminatory regulation for a public purpose, which is enacted in accordance with due process is not deemed expropriatory and compensable. . . ."⁶ It went on to make an exception for cases where a government had given specific commitments to a foreign investor. No such commitments had been given to Methanex. The tribunal then concluded that "from the standpoint of international law, the California ban was a lawful regulation and not an expropriation."⁷ In short, with a single sentence, the tribunal achieved what many environmentalists had thought was lacking in NAFTA Chapter 11—a carve-out from the concept of expropriation for general regulatory measures that have a public purpose. It appears to suggest, too, that what is being said in the new investment agreements reflects customary international law in any event.

⁴ *Methanex Corp. v. United States, Jurisdiction and Merits* (NAFTA Ch. 11 Arb. Trib. Aug. 3, 2005), at <<http://www.state.gov/documents/organization/51052.pdf>>.

⁵ Appellate Report, *European Communities—Measures Affecting Asbestos and Asbestos-Containing Products*, WT/DS135/AB/R (Mar. 12, 2001) (adopted Apr. 5, 2001).

⁶ *Methanex*, pt. 4, ch. D, para. 7.

⁷ *Id.*, para. 15.

It seems that we have two polar extremes. The IISD draft is predicated on the idea that investment rules have to be interpreted in a specific context, that of sustainable development and of the particular rights and obligations of both the investor and the receiving state. *Methanex* would suggest that the existing law is able to accommodate potential clashes between investment and the environment without surrounding the language of the agreements with references to sustainable development.

Can we rely on *Methanex* as an indication of a change in the way the environment will be dealt with in the interpretation of investment agreements? Or is *Methanex* just an easy case where the environmental purpose of the regulation was clear and claims to discriminatory treatment just not plausible? I think that is an open question. Moreover, in a system where investment agreements are interpreted by ad hoc tribunals with no provision for any wide-ranging subsequent review or for an appellate process it is a pattern of decision-making rather than individual decisions that count. Thus, the answer to this question lies in the future.