

1-1-2004

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Recommended Citation

Paul Guy, "Throwing Caution to the Wind: The Precautionary Principle, NAFTA and Environmental Protection in Canada" (2004) 13 Dal J Leg Stud 187.

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THROWING CAUTION TO THE WIND: THE PRECAUTIONARY PRINCIPLE, NAFTA AND ENVIRONMENTAL PROTECTION IN CANADA

PAUL GUY[†]

ABSTRACT

According to the precautionary principle, the lack of full scientific certainty should not preclude measures to prevent environment degradation. This principle has been incorporated into numerous international instruments and is approaching the status of customary international law. Moreover, the Canadian government has embraced the principle and the Supreme Court of Canada recently confirmed it as a basis of environmental policy in 114957 Canada Ltée (Spraytech, Société d'arrosage) v. Hudson (Town).

This paper examines the ability of the precautionary principle to actually function as a guide for environmental policy in light of Canada's international trade obligations. In particular, it considers Canada's commitments under NAFTA. Under NAFTA a wide array of possible government activity can be deemed a "trade barrier" and, under the Chapter II investment provisions, governments who enact such barriers are subject to binding commercial arbitration. The author critically analyzes the reasoning and implications that follow from two recent Chapter II cases: Ethyl Corporation v. Canada and Metalclad Corporation v. Mexico. Overall, the author concludes that despite its embrace by the international community, the Canadian government and the Supreme Court, Canada's commitments under NAFTA effectively undercut the ability of the precautionary principle to serve as a basis of environmental policy.

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I. INTRODUCTION

Governments around the world are currently confronted with environmental dangers that, while exceedingly difficult to quantify to the degree of certainty demanded by formal science, pose potentially catastrophic dangers to life on Earth.¹ Climate change, ozone depletion, acid rain, water pollution, deforestation—the list goes on. Canada is not immune to these threats. In fact, Canada is faced with truly unique challenges because of its vegetational diversity, northern climate, abundant inheritance of natural resources and vast expanse of land, bordered on three of its four sides by oceans. Moreover, because of the country's economic dependence on its natural resource base, particularly the forestry and fisheries industries, ensuring environmental health and vitality is of the utmost importance for all Canadians.

Canada's relative economic strength, its stable and developed political and legal systems, and its position as an influential middle power enable Canada to play a leadership role in the global struggle to meet these challenges. Yet despite its enviable position, Canada's environmental record is far from inspiring. For instance, a 2001 study comparing Canada's environmental record with those of the twenty other nations in the Organization for Economic Co-operation and Development (OECD) showed that Canada ranked only above the United States, and was among the worst when ranked by per-capita measurements of greenhouse gases and acid-rain causing sulphur-oxide emissions, water use, energy consumption and the generation of nuclear waste.²

Canadian courts have recognized the need to mitigate these problems. According to some, the 2001 decision of the Supreme Court of

¹ In 1992, a statement entitled "World Scientists' Warning to Humanity" — which was signed by more than sixteen hundred senior scientists from seventy-one countries, including over half of all Nobel Prize winners—warned:

Human beings and the natural world are on a collision course. Human activities inflict harsh and often irreversible damage on the environment and on critical resources. If not checked, many of our current practices put at serious risk the future that we wish for human society and the plant and animal kingdoms, and may so alter the living world that it will be unable to sustain life in the manner that we know.... A great change in our stewardship of the Earth and life on it is required, if vast human misery is to be avoided and our global home on this planet is not to be irretrievably mutilated.

Quoted in D. Suzuki, *The Sacred Balance* (Vancouver: Greystone Books, 1997) at 3-4.

² M. Mittelstaedt "Environment report ranks Canada near bottom of OECD," *The Globe and Mail* (11 April 2001).

Canada in *114957 Canada Ltée (Spraytech, Société d'arrosage) v. Hudson (Town)*³ (hereinafter *Spraytech*) marked a pivotal turning point in terms of environmental protection in Canada in that it affirmed the power of governments to enact legislation designed to protect public and environmental health and, most importantly, endorsed the “precautionary principle” (i.e., that lack of full scientific certainty should not preclude measures to prevent environmental degradation) as a basis for these policies. Despite this optimism, however, there are several reasons to question the positive impact that *Spraytech*, with its endorsement of the precautionary principle, will have on environmental protection in Canada. One of the most important considerations in this regard is the pressure exerted on Canada by the process of economic globalization and the international trade obligations Canada has incurred through its participation in the World Trade Organization (OECD)⁴ and treaties such as the North American Free Trade Agreement (NAFTA).⁵

This paper critically examines the efficacy of the precautionary principle as a basis of environmental policy in light of Canada’s international trade obligations. In particular, it considers Canada’s commitments under NAFTA’s Chapter 11 investment provisions. Under NAFTA a wide array of possible government activity could be seen as a “trade barrier” and, because of Chapter 11, governments who enact such barriers are subject to binding arbitration designed to guarantee the right of private moneylenders and investors a return on their investment. Focusing on NAFTA and its Chapter 11 investment provisions vis-à-vis environmental protection is presently necessary for two reasons. First, NAFTA is arguably the most important of the current institutional arrangements driving the process of economic globalization in that, with few exceptions, it goes farther than any other agreement to protect the interests of pri-

³ *114957 Canada Ltée (Spraytech, Société d'arrosage) v. Hudson (Town)*, [2001] 2 S.C.R. 241 [*Spraytech*].

⁴ See *Agreement Establishing the World Trade Organization*, 15 April 1994, 33 I.L.M. 1144 (entered into force 1 January 1995).

⁵ *North American Free Trade Agreement Between the Government of Canada, the Government of Mexico and the Government of the United States*, 17 December 1992, Can. T.S. 1994 No. 2, 32 I.L.M. 289 (entered into force 1 January 1994) [NAFTA]. For a detailed consideration of international trade law and Canada’s obligations see M.J. Trebilcock & R. Howse, *The Regulation of International Trade*, 2d ed. (New York: Routledge, 1999); and J.G. Castel *et al.*, *The Canadian Law and Practice of International Trade*, 2d ed. (Toronto: Emond Montgomery, 1997).

vate investors and advance the cause of trade liberalization.⁶ As a result, NAFTA currently serves as a template for ongoing negotiations aimed at a new hemispheric trade agreement—the Free Trade Area of the Americas (FTAA). Second, several cases involving Chapter 11 have recently been decided or resolved. These cases provide an excellent basis upon which to analyze the environmental impact of NAFTA and its effects on public policy.

In short, the argument of this paper is that despite the Supreme Court's decision in *Spraytech*, Canada's commitments under Chapter 11 effectively vitiate the precautionary principle as a basis of environmental policy. To support this argument, the paper is divided into four sections. The first provides an overview of the Supreme Court's decision in *Spraytech*. The second section considers the precautionary principle in more detail—including its history, its scope and its status at international law. In the third section, the fundamental principles and obligations that Canada agreed to by signing NAFTA are discussed. This section provides an analysis of Chapter 11's investor-state dispute settlement provisions and concludes with a review of two Chapter 11 cases: *Ethyl Corporation v. Canada* (hereinafter *Ethyl*) and *Metalclad Corporation v. Mexico* (hereinafter *Metalclad*).⁷ In the final section the efficacy of the precautionary principle is critically analyzed in light of Canada's

⁶ The proposed Multilateral Agreement on Investment (MAI) would have gone further. However, in April 1998, the OECD decided to suspend efforts to conclude the MAI negotiations within the OECD and to pursue agreement and institutionalization of multilateral investment measures within the WTO.

⁷ *Mexico v. Metalclad Corp.* (2001), 89 B.C.L.R. (3d) 359 [*Metalclad*] and supplementary judgment *Mexico v. Metalclad Corp.* (2001), 95 B.C.L.R. (3d) 169 (B.C.S.C.) [*Metalclad supplementary*]. It should be noted that these two cases are not isolated incidents. Because of the secrecy that surrounds the Chapter 11 process there is no way of knowing exactly how many Chapter 11 disputes have actually taken place. However, in a recent report Murray Dobbin indicates that, as of 2001, fifteen cases had been made public. (M. Dobbin, Briefing Paper, "NAFTA's Big Brother: The Free Trade Area of the Americas and the Threat of NAFTA-style 'Investor-State' Rules" (2001) at 3.) For a comprehensive review of the Chapter 11 cases that have been made public see Public Citizen Global Trade Watch & Friends of the Earth, Briefing Paper, "NAFTA Chapter 11 Investor-to-State Cases: Bankrupting Democracy" (Washington, September 2001) ["Bankrupting Democracy"]. It should also be noted that many of the pending cases that have come to light involve potentially astronomical damage awards. The Santa Barbara, California based company Sun Belt Water Inc., for instance, has commenced a claim against the Canadian government for \$14 billion, ("Bankrupting Democracy," above) on the grounds that the provincial ban on the bulk export of water enacted by the government of British Columbia in 1993 eliminated any opportunity that the company had to capitalize on the water-export business in the province.

Chapter 11 obligations—considering in particular the legal ramifications of the *Ethyl* and *Metalclad* cases.

II. THE SUPREME COURT OF CANADA’S DECISION IN *SPRAYTECH*

The case began in 1991 when the Town of Hudson, Québec, located just west of Montreal, adopted By-law 270, restricting the use of pesticides to specific locations and essential non-aesthetic situations. Spraytech and Chemlawn are both landscaping and lawn care companies who operating mostly in the Montreal area. Each provides services to commercial and residential clients and both regularly utilize a variety of pesticides — all of which are approved by the federal *Pest Control Products Act*.⁸ In addition, each company held the requisite licences to use the pesticides under the provincial *Pesticides Act*.⁹

In 1992 Spraytech and Chemlawn were charged with using pesticides in violation of By-law 270. The companies brought a motion asking the Court to declare By-law 70 *ultra vires* the Town and/or inoperative on account of its conflict with federal and provincial legislation. The motion was denied.¹⁰ On appeal, the decision was affirmed by the Québec Court of Appeal.¹¹

At the Supreme Court of Canada the original decision was again affirmed.¹² The Court held that the By-law was not rendered inoperative because of the alleged conflict with federal and provincial legislation. Moreover, the Court reasoned that based upon the distinction between “essential” and “non-essential” uses of pesticides, the Town’s purpose in enacting the By-law was to promote the health of its inhabitants. This purpose fell squarely under the power granted the Town under the Québec *Cities and Towns Act*.¹³ Further, the Court found that any restrictions on the appellants’ businesses were necessary incidents to the

⁸ R.S.C. 1985, c. P-9.

⁹ R.S.Q. c. P-9.3.

¹⁰ *114957 Canada Ltée (Spraytech, Société d’arrosage) v. Hudson (Town)* (1993), 19 M.P.L.R. (2d) 224.

¹¹ *114957 Canada Ltée (Spraytech, Société d’arrosage) v. Hudson (Town)*, [1998] A.Q. no 2546.

¹² *Supra* note 3.

¹³ R.S.Q. c. C-19.

exercise of this power. The Court also noted that reading the *Cities and Towns Act* in such a way as to permit the Town to regulate pesticide use within its territory was consistent with principles of international law and policy—and most notably, with the precautionary principle.

III. THE PRECAUTIONARY PRINCIPLE

In simplest terms, the precautionary principle embodies the notion that when dealing with potential threats to public and environmental health, “it’s better to be safe than sorry.” As such, it recognizes the ability of governments to take measures designed to protect the environment from potentially serious risks *in the absence of scientific certainty regarding those risks*. As P.S. Puttagunta notes, the basic premise underlying the principle is that science cannot sufficiently predict all possible environmental outcomes of human activity and that society cannot afford to wait to find out if certain activity carries with it irreversible harm.¹⁴

The principle was first articulated in 1968 in the new German air pollution Act, *Bundesimmissionsschutzgesetz*, which came to be a centerpiece of German environmental policy in the 1980’s as the government faced the realization that vast tracts of the country’s forests were dying.¹⁵

The Canadian government recently noted in a discussion paper on the topic that “two federal statutes, two provincial statutes and several proposed laws make specific reference to the precautionary principle.”¹⁶ In the words of the discussion paper, the precautionary principle “recognizes that the absence of full scientific certainty shall not be used as a reason to postpone decisions where there is a risk of serious or irreversible harm.”¹⁷

Since its first appearance in Germany in the late 1960’s the principle has sparked an enormous amount of literature and debate. This conver-

¹⁴ P.S. Puttagunta, “The Precautionary Principle in the Regulation of Genetically Modified Organisms” (2000) 9 Health L. Rev. 27 at para. 3.

¹⁵ K. von Moltke, “The Dilemma of the Precautionary Principle in International Trade” (1999) 3 Bridges (ICTSD) 6, online: International Institute for Sustainable Development <<http://www.iisd.org/pdf/precaution.pdf>>.

¹⁶ Government of Canada, *A Canadian Perspective on the Precautionary Approach/Principle – Discussion Document* (Ottawa: Government of Canada, 2001), at 11 [*Discussion Document*].

¹⁷ *Ibid.* at 2.

sation is revealing important variations in terms of the exact contours of the principle itself. For example, according to T. O’Riordan and J. Cameron, the precautionary principle has evolved to encompass a cluster of basic ideas—including, *inter alia*, the propositions that:

- Early preventive action is appropriate even in the absence of a scientifically documented need when delay would impose increased costs and greater risks of environmental harm;
- It is important that human activities leave the environment with wide margins of tolerance to permit natural adaptation to human interference. Pushing the edge of the envelope is not a good idea; and
- The onus of proof to demonstrate the environmental feasibility of the proposals should be placed upon those who propose initiatives, innovations and activities whose environmental impact is questionable. In other words, parties seeking to engage in potentially harmful activity are faced with a rebuttable presumption that the activity should be prohibited.¹⁸

Many commentators object to some of the specifics offered by O’Riordan and Cameron.¹⁹ What is uncontroversial, however, is the fact that the most widely recognized statement of the precautionary principle is Principle 15 of the *Rio Declaration*,²⁰ which states:

In order to protect the environment, the precautionary approach shall be widely applied by States according to their capabilities. Where there are threats of serious or irreversible damage, lack of full scientific certainty shall not be used as a reason for postponing cost-effective measures to prevent environmental degradation.

¹⁸ T. O’Riordan & J. Cameron, *Interpreting the Precautionary Principle* (London: Earthscan Publications, 1994) at 16-18.

¹⁹ For example, the Canadian Chemical Producers’ Association (CCPA) objects to the notion that the precautionary principle entails a rebuttable presumption that the activity in question should be prohibited. See “CCPA Response to ‘A Canadian Perspective on the Precautionary Approach/Principle Discussion Document – September 2001’” at 6 ff. Online: CCPA <<http://www.ccpa.ca/english/position/enviro/PrecautionaryPaper-Response.doc>>.

²⁰ Annex I of the Report of the United Nations Conference on Environment and Development, Rio de Janeiro, 3-14 June 1992, A/CONF.151/26 (Vol. I) (12 August 1992).

As noted in a recent discussion document on the precautionary principle, the Canadian government supports the statement in Principle 15 of the 1992 *Rio Declaration*.²¹ Furthermore, it notes:

[The] language, and the approach it [Principle 15] represents, is consistent with Canadian practice in the field of environmental protection, and the approach is increasingly reflected in Canadian environmental legislation, such as the *Canadian Environmental Protection Act*. Canada also has a long-standing history of implementing the precautionary approach in science-based programs of health and safety, and natural resources conservation.²²

Based upon Principle 15, the following three propositions could be said to form the essential core of the precautionary principle:

- (1) If the expected harm from an action or product is serious or irreversible; and
- (2) If the scientific forecasting of the expected harm is reasonably uncertain; then
- (3) Cost-effective measures to anticipate and/or prevent the harm are justifiable.²³

1. The Status of the Precautionary Principle at International Law

As will be discussed below, dispute settlement mechanisms contained in Chapter 11 do not permit NAFTA Tribunals to make reference to the domestic laws of the parties involved. As a result, any recourse to the precautionary principle in a Chapter 11 dispute would have to be made relying upon the principle's status at international law.

The most frequently cited authority on the sources of international law is Article 38 of the *International Court of Justice Statute* which stipulates, *inter alia*, that "international law" is comprised of: (1) general and particular international conventions that establish rules expressly

²¹ *Discussion Document*, *supra* note 16 at 2.

²² *Discussion Document*, *supra* note 16 at 2.

²³ Even with these three core principles there is still plenty of room for disagreement regarding the exact meaning of phrases such as "serious or irreversible," "reasonably uncertain," and "cost-effective."

recognized by the contesting states; (2) international custom, as evidence of a general practice accepted as law; (3) the general principles of law recognized by civilized nations; and (4) as subsidiary means for the determination of rules of international law, judicial decisions and the teachings of the most highly qualified publicists of the various nations.

The two most important sources of international law are undoubtedly international conventions and international custom. As far as conventional law is concerned, the precautionary principle has appeared in over twenty international laws, treaties, protocols and declarations as of 2000²⁴—including the 1987 *Protocol in Substances that Deplete the Ozone Layer* (“the Montreal Protocol”), the 1984 *Conference on the Protection of the North Sea*, the 1992 *Framework Convention on Climate Change*, the United Nations’ *Agreement on Straddling and Highly Migratory Fish Stocks*, the 1990 *Bergen Ministerial Declaration on Sustainable Development in the Economic Commission for Europe Region*, the 1992 *Convention on Biological Diversity*, the 1990 *Bangkok Declaration on Environmentally Sound and Sustainable Development in Asia and the Pacific*, and the 1992 *Rio Declaration on Environment and Development*.²⁵ Indeed, Freestone and Hey have documented the principle’s inclusion “in virtually every recently adopted treaty and policy document related to the protection and preservation of the environment.”²⁶

While the precautionary principle is found in many international documents, there are three important qualifications that need to be noted for the purposes of this paper. First, of the more than twenty documents that invoke the precautionary principle, many “declarations” (e.g., the *Rio Declaration*) do not create binding international legal obligations *per se*. Second, unlike customary international law, conventional international law is only binding on those states that have signed and ratified

²⁴ K.J. Barrett, *Canadian Agricultural Biotechnology: Risk Assessment and the Precautionary Principle* (Doctoral Thesis, Botany, University of British Columbia, 1999) [unpublished] at 51. Cited in Puttagunta, *supra* note 14 at para. 3.

²⁵ *Ibid.* at para. 5.

²⁶ D. Freestone & E. Hey, “Origins and Development of the Precautionary Principle” in D. Freestone & E. Hey, eds., *The Precautionary Principle and International Law* (The Hague: Kluwer Law International, 1996) at 41.

the treaty in question. And, finally, in the case of NAFTA itself, the precautionary principle is nowhere mentioned in the text of the treaty.²⁷

Customary international law, in contrast, creates much wider legal obligations in that it is binding on each and every state.²⁸ In order to establish that a given rule is binding as customary international law it must be established that (a) there is general and uniform state practice upholding the rule; (b) this practice is accompanied by *opinio juris* (i.e., the conviction by states that their actions are required as a matter of law).

According to most commentators, the precautionary principle is approaching the status of an international customary norm, but still falls short due to insufficient state practice.²⁹ For example, as noted by the Supreme Court in *Spraytech*, the Supreme Court of India considers the precautionary principle to be a customary international norm.³⁰ Yet Canada's position is just the opposite.

The precautionary principle/approach appears in a large number of international instruments, and Canada's obligations in that regard are governed by its expression in those instruments. Due to an absence of clear evidence of uniform State practice and *opinio juris*, Canada does not yet consider the precautionary principle to be a rule of customary international law.³¹

Interestingly, L'Heureux-Dubé J., for the majority in *Spraytech*, came very close to accepting that the principle was a customary norm. She

²⁷ Chapter 21 of NAFTA states that the General Exceptions contained in Article XX of the *General Agreement on Tariffs And Trade [GATT]* 30 October 1947, 58 U.N.T.S. 187, Can. T.S. 1947 No. 27 (entered into force 1 January 1948) apply. Article XX (b) states that nothing in the *GATT* shall be construed to prevent the adoption or enforcement of any measure necessary to protect human, animal or plant life or health. Nonetheless, the precautionary principle is mentioned nowhere in the *GATT* and the case law suggests that it does not fall under the Article XX(b) exception.

²⁸ States can, of course, always declare that they object to a particular customary rule. The effect of such a declaration is a complex question that is beyond the scope of this paper. Suffice to say that, like customary international itself, the answer will depend, in large part, upon the reaction of other states.

²⁹ Cf., for example, O. McIntyre & T. Mosedale, "The Precautionary Principle as a Norm of Customary International Law" (1997) 9:2 *J. Environ. L.* 221.

³⁰ *A.P. Pollution Control Board v. Nayudu*, 1999 S.O.L. Case No. 53, at p.8; and *Vellore Citizens Welfare Forum v. Union of India*, [1996] Supp. 5 S.C.R. 241. Cited by the S.C.C. in *Spraytech*, *supra* note 3 at para. 32.

³¹ *Discussion Document*, *supra* note 16 at 10.

wrote: “As a result, there *may be* ‘currently sufficient state practice to allow a good argument that the precautionary principle is a principle of customary international law.’”³² In their concurring opinion, the minority simply ruled that references to international sources had “little relevance” to the questions at issue.³³

IV. NAFTA’S CHAPTER 11 INVESTMENT PROVISIONS

1. NAFTA’S Fundamental Principles

Chapter 11 of NAFTA deals with “investment” and covers a much broader range of economic activity than what conventionally would fall under the rubric of “international trade.” As opposed to “trade,” “investment” has no necessary connection to the export or import of any good or service. Under NAFTA, “investment” is a very broad category that includes things such as incorporated and non-incorporated businesses, shareholdings, loans made to foreign companies for more than three years, real estate, intellectual property and goodwill.³⁴ Furthermore, investment refers not only to present property interests, but also includes those that are merely expected so that both present and projected profits are included.³⁵

In short, NAFTA’s investment provisions establish a set of legally enforceable rules that make it safer and easier for foreign investors to ensure return on their investments. In doing so, Chapter 11 takes several of the key principles of trade liberalization that are typically applied to

³² *Spraytech*, *supra* note 3 at para. 32 [emphasis added]. One of the reasons behind the majority’s reluctance to endorse the precautionary principle as a binding rule at customary international law was no doubt the fact that under Canadian constitutional law an adoptionist approach is taken vis-à-vis customary international law whereby it is presumptively part of the common law unless there is an explicit legislative intention to the contrary. *Reference Re Powers Of Ottawa (City) and Rockcliffe Park*, [1943] S.C.R. 208 (*sub nom. Foreign Legations Case*). As noted by the federal government in its discussion document, *Discussion Document*, *supra* note 16 at 10: If the precautionary principle were to attain such a status [i.e., a rule of customary international law], it would automatically become part of Canadian domestic law, unless a contrary domestic statute exists. To what extent this would significantly affect current Canadian law, either as a substantive and/or an interpretive rule, is unclear and should be considered further.

³³ *Spraytech*, *supra* note 3 at para. 48.

³⁴ NAFTA, *supra* note 5 at Article 1139.

³⁵ NAFTA, *supra* note 5 at Article 1139(g).

trade in goods and services—principles that were first recognized in the international arena in the GATT³⁶ — and applies them to foreign investment.³⁷ These principles include:

National Treatment: Foreign investors and investments must be treated no less favourably than domestic ones. Thus both formal and substantive rules cannot be structured to give an advantage to local companies. Any form of discrimination between domestic and foreign investors is prohibited unless there is a specific exemption contained in NAFTA.³⁸

Most Favored Nation Treatment: The best treatment that is given to any investor from a non-NAFTA country must also be given to all NAFTA country investors.³⁹

Minimum International Standards of Treatment: NAFTA governments must ensure that basic international rights (e.g., following treaty obligations in good faith and providing due process and equitable treatment) are afforded to all investors and investments.⁴⁰

Strict Limitations on Performance Requirements: Performance requirements, which encompass a broad array of possible government regulatory activity designed to benefit a particular area or group (e.g., local hiring quotas or requiring that firms use a minimum level of local materials or services) are strictly limited and in many cases prohibited.⁴¹

Protection Against Expropriation: Expropriation refers to any act where a government denies a human or corporate person any benefit of a property holding. NAFTA guarantees that full, swift and fair compensation will

³⁶ *Supra* note 27.

³⁷ These principles are primarily articulated in NAFTA, *supra* note 5 at Articles 1102-1113.

³⁸ NAFTA, *supra* note 5 at Article 1102.

³⁹ NAFTA, *supra* note 5 at Article 1103.

⁴⁰ NAFTA, *supra* note 5 at Article 1105.

⁴¹ NAFTA, *supra* note 5 at Article 1106.

⁴² NAFTA, *supra* note 5 at Article 1110.

be paid to all affected parties after any expropriation occurs.⁴² Furthermore, NAFTA includes an expansive definition of “expropriation.”⁴³

In signing on to NAFTA, Canada, the U.S. and Mexico agreed to protect international investments and investors by upholding these principles. Furthermore, under the agreement all these obligations apply to national governments, sub-national governments (e.g., state, provincial and local)⁴⁴ and all government entities. To ensure that these obligations will be upheld, the three countries also agreed to implement a completely unique investor-state dispute settlement process.

2. Investor-State Dispute Settlement Under Chapter 11

All NAFTA investors are entitled to dispute any “measure” (i.e., “any law, regulation, procedure, requirement or practice”⁴⁵) enacted by a foreign government that is party to the agreement that violates a NAFTA provision. Based upon the particular facts in each dispute, and the wishes of the aggrieved investor, arbitration panels established under Chapter 11 are governed by the arbitration mechanisms set out by one of the World Bank’s International Centre for the Settlement of Investment Disputes

⁴³ According to its standard legal definition, “expropriation” is normally limited to the government power of “eminent domain,” namely, “[t]he power of a government entity to convert privately owned property, especially land, to public use, subject to reasonable compensation for the taking.” *Black’s Law Dictionary (Pocket Edition)*, 1996, s.v. “eminent domain.” As a result of corporate pressure, however, this standard definition was slowly modified in the U.S. by a series of decisions handed down by the U.S. Supreme Court. Using the Fifth Amendment (which, *inter alia*, protects against the taking of private property for public use without just compensation), the Court has held that “expropriation” also includes “regulatory takings” — which covers any law, regulation, rule or policy that reduces the commercial value of an investment or the expected profits from the investment. See M. Dobbin, Briefing Paper, “NAFTA’s Big Brother: The Free Trade Area of the Americas and the Threat of NAFTA-style ‘Investor-State’ Rules” (2001) at 2. And while “expropriation” is not explicitly defined in NAFTA, Article 1110 refers to “direct expropriation,” “indirect expropriation” and “measures tantamount to expropriation” — language which indicates that the wider U.S. conception of “expropriation” has been incorporated into the agreement. This interpretation was confirmed by the B.C.S.C. in the recent appeal of the Tribunal decision in *Mexico v. Metalclad Corp.*, *supra* note 7.

⁴⁴ For a recent discussion of the constitutionality of Chapter 11 panel awards levied against provinces see M.A. Luz, “NAFTA, Investment and the Constitution of Canada: Will the Water-tight Compartments Spring a Leak?” (2000-2001) 32 *Ottawa L. Rev.* 35. Overall, Luz argues that a province could be legally compelled under Canadian law to pay an arbitration award if that province were found responsible for the treaty violation—this despite the fact that the provinces (or other sub-national entities) are not party to NAFTA.

⁴⁵ NAFTA, *supra* note 5 at Article 201.

(ICSID),⁴⁶ the ICSID Additional Facility⁴⁷ or the United Nations Commission on International Trade Law (UNCITRAL) Arbitration Rules.⁴⁸ Regardless of the arbitration rules employed, however, the process is conducted under the legal framework set out in NAFTA and tribunals make no reference to the statutory or constitutional laws of the targeted nation.

NAFTA tribunals typically have three trade lawyers appointed as panelists. Normally the aggrieved investor and the foreign government each nominate a panelist, and then the two appointees jointly select the third member. All aspects of the subsequent arbitration are kept completely secret and access to all documents, transcripts and proceedings is strictly limited to the two disputing parties. Furthermore, governments that are party to NAFTA but not involved in the dispute do not have the automatic right to appear before the tribunal. Instead, a government must apply for intervenor status if it wishes to participate. In general, no one other than the disputing investor and the NAFTA parties have any right to take notice of a foreign investor claim, access pleadings or evidence, provide input, or even observe, the proceedings. Even publication of the final award is not guaranteed. Governments have the discretion to release a tribunal's final award, but they are not under any obligation to do so. The only way that concerned citizens or the press can attend tribunal hearings is if all the parties to the dispute consent—something that has not yet happened.

Once the tribunal makes a decision it can award monetary damages to an aggrieved investor. While a Chapter 11 panel cannot strike down NAFTA-inconsistent measures directly, it can order a country to change any infringing measure. Finally, there is no appeal procedure for disputing a tribunal award and all awards can be directly enforced through the domestic courts of all state parties.⁴⁹

⁴⁶ *Convention on the Settlement of Investment Disputes between States and Nationals of Other States*, 19 March 1965, 575 U.N.T.S. 159, 4 I.L.M. [*ICSID Convention*].

⁴⁷ Online: World Bank <<http://www.worldbank.org/icsid/facility/facility.htm>> (date accessed 5 November 2002). These rules apply in cases where only one party to the dispute is a signatory to the *ICSID Convention*. Mexico is currently not a signatory.

⁴⁸ UN GAOR, 31st Sess., Supp. No. 17, U.N. Doc. A/31/17 (1976) at 46.

⁴⁹ See e.g., J.A. VanDuzer, "Investor-State Dispute Settlement Under NAFTA Chapter 11: The Shape of Things to Come?" (1997) *Can. Y.B. Int'l L.* 263 at 276-289.

3. Two Chapter 11 Cases

i. Ethyl Corporation v. Canada

In April 1997 Parliament passed the *Manganese-based Fuel Additives Act*⁵⁰ which imposed a ban on the import and interprovincial transport of the gasoline additive methylcyclopentadienyl manganese tricarbonyl (MMT) – an additive that had been used in gasoline in Canada since 1977. MMT is put into gasoline to enhance its octane level, improve fuel combustion and reduce engine “knocking.” The ban was enacted in response to public health concerns: scientific evidence suggests that MMT is a neurotoxin that enters the body through the lungs and causes nerve damage which can lead to psychosis, memory loss and premature death.⁵¹ Not surprisingly, MMT had been banned for use in reformulated gasoline in the United States and in Europe, and in 1997 Canada was the only country in which MMT was still being used.

In 1997 the only remaining producer of MMT was the Virginia-based Ethyl Corporation, which exported to its Canadian subsidiary, Ontario-based Ethyl Canada Inc., where MMT was mixed and then sold to Canadian gasoline refiners. Six months before the ban was enacted, while parliamentarians were still debating its merits, Ethyl filed a notice of intent to submit a claim under Chapter 11 if a ban were imposed. Furthermore, Ethyl claimed that various statements made by the Minister of the Environment, the Parliamentary Secretary to the Minister and other unnamed individuals during the public debate that had taken place over the safety of MMT had already “created distrust of Ethyl, Ethyl Canada and the product MMT within the environmental groups and the media thereby damaging Ethyl’s goodwill around the world.”⁵²

⁵⁰ S.C. 1997, c. 11. The Act was first introduced in June 1995, received Royal Assent on April 25, 1997 and came into force on June 24, 1997. See section 21 of the Act.

⁵¹ See e.g., J. McEachern & C. Shaw, “MMT – NAFTA’s Potentially Lethal Legacy: Lifting of MMT Ban is Not Justified by Lack of Scientific Proof” *The CCPA [Canadian Centre for Policy Alternatives] Monitor* (November 1998); Council of Canadians, News Release, “Gasoline Additive and NAFTA Threaten Canadians’ Health, Scientists and Groups Warn” (4 November 1998).

⁵² *Ethyl Corporation v. Government of Canada*, (Notice of Intent) at paras. 10, 16, 17, 20 and 21; *Ethyl Corporation v. Government of Canada*, (Notice of Arbitration) at paras. 59 and 60. Because of the secrecy surrounding Chapter 11 tribunals these two notices are not publicly available. However, they are cited in *Ethyl Corporation v. Government of Canada*, (Statement of Defence) at 7, online: “NAFTA Cases: Ethyl Corporation,” Appleton & Associates International Lawyers <<http://www.appletonlaw.com/4b1ethyl.htm>>.

Five days after the ban was enacted Ethyl filed a claim against the Canadian government for US\$251 million in damages—which was, according to the ICSID, the highest claim for damages ever filed in an investor-state proceeding.⁵³ Ethyl's action marked the first time that a NAFTA investor had used Chapter 11's investor-state provisions directly to challenge regulatory action of a foreign government. In its claim Ethyl alleged that the Canadian ban was an illegal restriction on the company's business and expected profits. Specifically, Ethyl argued that Canada breached its obligations under three NAFTA provisions: Article 1102 (national treatment), Article 1106 (ban on performance requirements) and Article 1110 (protection against expropriation).

In July 1998 the Government, worried about the very real possibility of losing the case and the millions of dollars that could potentially be awarded by a NAFTA tribunal, settled the dispute with Ethyl out of court. According to the terms of the settlement, the government revoked the ban on MMT, paid US\$13 million in damages and legal fees, and issued a statement for later use in Ethyl advertising saying, contrary to scientific studies and the existence of bans already in place in the U.S. and Europe, that it lacked any evidence that MMT was dangerous to human health.

ii. Metalclad Corporation v. Mexico

In 1993 California-based Metalclad Corporation bought an abandoned hazardous waste disposal site in Guadalupe, an impoverished and remote area with no developed infrastructure and limited resources in the Mexican state of San Luis Petosí. The company planned to expand and re-open the facility and then haul toxic waste and other hazardous materials to the dump—despite the fact that the site had a history of contaminating the local water supply and that more than 20,000 tons of waste had already been illegally dumped at the site without proper treatment.

After it purchased the facility, however, Metalclad's plans were thwarted when the state government informed the company that it could not expand or re-open the dump without municipal and state approval. In May 1994, ignoring the state warning, Metalclad began work on the site's expansion. In June and November of 1994 Metalclad ignored of-

⁵³ Public Citizen Global Trade Watch, Briefing Paper, "Ethyl Corporation vs. Government of Canada: Now Investors Can Use NAFTA to Challenge Environmental Safeguards" (1997) at 2.

ficial orders to cease construction. Finally, in January 1997 negotiations resulted in an agreement that permitted the company to operate a non-hazardous waste disposal facility on the site, but with the stipulation of ongoing public consultations and negotiations.

Throughout the period of 1993-1997 hundreds of local residents, still worried about previous water contamination, protested against re-opening the facility. In September 1997 an environmental impact assessment revealed that the site was situated atop an ecologically sensitive underground alluvial stream. This confirmed earlier suspicions that the facility was responsible for the widespread contamination of the local water supply. In response to this finding the state declared the site part of a special 600,000-acre ecological zone—a move that effectively prevented Metalclad from re-opening the dump. As a result, the company used Chapter 11 to sue the Mexican government for US\$ 90 million—a figure that was more than the combined annual income of all the residents in the surrounding community. In its claim Metalclad argued that the actions of the municipal and state governments violated the company's right to future profits on its investment (Article 1110 of NAFTA) and its right to treatment according to minimum international standards (Article 1105 of NAFTA).

In August 2000 a NAFTA tribunal awarded US\$ 16,685,000 in damages against the national government of Mexico, ruling, *inter alia*, that (1) it was improper for the local and state governments to deny Metalclad a permit to operate the facility based on environmental or public health considerations, public opposition or the past performance of the facility; and (2) the national government was liable for the damage award. In so doing, the tribunal ruled that Mexico had unjustifiably expropriated Metalclad's investment even though construction on the site was never finished and the facility itself was never operational.

While there is no appeal procedure provided under Chapter 11, it is possible, depending upon the location chosen for the arbitration, to apply for limited third party judicial review of international commercial arbitration awards. Since Vancouver was selected to host the arbitration

in this instance, Mexico applied to have the tribunal's decision reviewed by the British Columbia Supreme Court.⁵⁴

In May 2001 the Court upheld the tribunal's award. In his decision, Tysoe J. commented that the tribunal, in ruling that the Mexican state of San Luis Petosi expropriated Metalclad's investment in the facility when the state created the protected ecological preserve, implied an "extremely broad definition of expropriation."⁵⁵ However, due to the very limited scope of the review, Tysoe J. held that the Court had no authority to overturn the expropriation finding since it was not "patently unreasonable."⁵⁶

V. NAFTA'S CHAPTER 11 AND THE PRECAUTIONARY PRINCIPLE

Both the *Ethyl* and *Metalclad* cases vividly demonstrate, on a number of levels, the extent to which Chapter 11 effectively undercuts use of the precautionary principle as a basis for public policy. In short, the precautionary principle dictates that when faced with expected serious or irreversible harm, governments should enact cost-effective measures to anticipate and/or prevent that harm. In many instances, however, as in the *Ethyl* and *Metalclad* cases, such measures will be deemed an unjustified expropriation of international investors' NAFTA-guaranteed rights to profit from the use of environmentally harmful products and practices.

Chapter 11 has, in other words, resulted in a massive restriction on the ability of governments to legislate in ways that protect human health and ensure environmental vitality and sustainability. Government action that infringes on the rights of private investors to receive returns on their investment is deemed expropriatory and therefore illegal under the agreement. Simply put, using the precautionary principle to ensure a healthy, clean and safe environment does not enable private investors to maximize return on their investments. As a result, such policies

⁵⁴ See *Metalclad*, *supra* note 7; *Metalclad supplemental*, *supra* note 7. The *Metalclad* decision was the first Chapter 11 tribunal decision to ever be subjected to third party judicial review. Nonetheless, neither Mexico nor *Metalclad* challenged the jurisdiction of the B.C.S.C to conduct the review. *Metalclad*, *supra* note 7 at para 39.

⁵⁵ See *supra* note 43.

⁵⁶ *Metalclad*, *supra* note 7 at para 100.

are deemed “trade restrictive” and therefore prohibited. This follows in perfect conformity to the logic of economic globalization underlying NAFTA. As University of Manitoba economics professor Robert Chernomas explains:

For the vast majority of firms not engaged in profit-making from this sector, health care [or environmental protection] is an input without any output. It is an expense that does not serve the ‘bottom-line,’ like adding more steel to the car or workers to the assembly line than are necessary to produce the standard industry car.⁵⁷

It is also striking to note that in both the *Ethyl* and *Metalclad* cases there is an underlying presupposition that private corporations and investors have a pre-existing claim on public property. In the *Ethyl* case there is an assumption that Ethyl has property claims over the environment and the actual physical bodies of people in Canada. It is undisputed that when MMT is used in gasoline it is emitted into the air and then absorbed into the bodies of those who come into contact with the emissions, resulting in potentially severe health complications.⁵⁸ Yet Ethyl was able to recover damages in the case because the Canadian government recognized that under NAFTA, by virtue of its investment, Ethyl suddenly had an enforceable property claim over the use and control of both the environment and the bodily health of the Canadian public.

Similarly, in the *Metalclad* case the company was assumed, simply on account of its investment, to have a property claim to the underground alluvial stream, the far-reaching areas that the stream serves and, again, the physical and environmental health of the people in the local community. These cases would not have unfolded as they did without the key assumption that private ownership, by virtue of private investment, extends to things which most people would agree are either inviolable (e.g., their own bodies) or clearly public property (e.g., the environment). Most importantly, the assumption that private investment can carry with it ownership rights over things such as the environment

⁵⁷ R. Chernomas, *The Social and Economic Causes of Disease* (Ottawa: The Canadian Centre for Policy Alternatives, 1999) at 15-16.

⁵⁸ See e.g., J. McEachern & C. Shaw, “MMT – NAFTA’s Potentially Lethal Legacy: Lifting of MMT Ban is Not Justified by Lack of Scientific Proof” *The CCPA [Canadian Centre for Policy Alternatives] Monitor* (November 1998); Council of Canadians, News Release, “Gasoline Additive and NAFTA Threaten Canadians’ Health, Scientists and Groups Warn” (4 November 1998).

necessarily entails that application of the precautionary principle be severely constrained.

Another troubling aspect of these two cases is that NAFTA stipulates this extraordinary extension of private ownership to foreign investors be granted cost-free. For example, Metalclad had to make an initial capital investment in the Guadalcazar site as a precondition to launching a Chapter 11 action. However, once the environmental assessment was completed and the environmental consequences associated with the site made clear, there was absolutely no question as to whether Metalclad retained a claim to the profits it expected from its investment. This was, in effect, the bottom line of the case: under NAFTA, Metalclad's claim on its anticipated profits was in no way affected by the subsequent finding that its investment was going to have an enormously negative impact on the surrounding environment. There was no suggestion that since Metalclad was permitted to enjoy a property entitlement over the disposal site, alluvial stream, surrounding environment and bodily health of the local residents, that Metalclad should be forced to pay for this right or held liable for any health or environmental problems that resulted from its investment.

Similarly, Ethyl Corporation was allowed to produce and sell MMT, which is directly damaging to human and environmental health, without having to contribute towards paying the associated costs. As a foreign company, Ethyl will not contribute to the tax revenues that undoubtedly will be required to clean up the environment and address the health problems caused by MMT. Instead, the Canadian public will pay for all the resulting damage. Thus, not only does NAFTA afford private investors a massive cost-free expansion of property entitlements, but the effects of this recognition are paid for by the same public that is injured. In the end, all the benefits which result from NAFTA's Chapter 11 investment provisions protect and enable private investors to make cost-free returns on investment, with absolutely no liability attached for any of the ensuing negative consequences for public health or the environment.

Finally, it is important to note that several commentators have predicted that these two cases will have a "chill effect"⁵⁹ Private investors and corporations can use Chapter 11 lawsuits, and the threat of such law-

⁵⁹ See e.g., T. Clarke & M. Barlow, *The Multilateral Agreement on Investment and the Threat to Canadian Sovereignty* (Toronto: Stoddart, 1997) at 42.

suits, to constrain the policy options of democratically-elected lawmakers. Many governments inevitably will become increasingly unwilling to enact a wide range of public policies (e.g., measures aimed at protecting human and environmental health on the basis of the precautionary principle) on account of the potential liability that those policies could attract under the new rules of international trade law, including NAFTA's Chapter 11. This chill effect will constrain government action despite the fact that affected measures are intended to protect the public interest or may have been central to the government's electoral success.

The *Ethyl* case is a quintessential example of the chill effect. Yet in response to criticism, David Wilson, President of Ethyl Canada, denied that the chill effect was a problem and stated: "Obviously the government can do what it wants to do, but when something is being taken away from you, there should be some form of compensation."⁶⁰ This sentiment was echoed in the *Metalclad* case by Clyde C. Pearce, the lawyer representing Metalclad: "[T]here is nothing stopping these governments from [enacting a NAFTA-inconsistent public policy] as long as they pay for it."⁶¹

Despite these reassurances, however, these rejoinders to the threat posed by the chill effect are misplaced for two reasons. First, as discussed above, they unjustifiably presuppose that private investors have a right to the exclusive, cost-free benefit of public property, and that this right should be protected at the expense of any others. Second, they fail to account for the fact that by demanding multi-million (and even billion⁶²) dollar compensation packages, Chapter 11-type claims effectively tie the hands of governments whose budgets cannot accommodate the possibility of such large damage awards.

It is difficult accurately to assess the extent to which this program of self-censorship has already befallen NAFTA governments, since draft legislation can be dropped or amended long before the public takes no-

⁶⁰ Appleton & Associates International Lawyers, News Release, "U.S. Company Files Notice to Seek \$200 Million in Claim Against the Government of Canada" (7 October 1996).

⁶¹ A. DePalma "Mexico Is Ordered to Pay a U.S. Company \$16.7 Million" *New York Times*, (31 August 2000).

⁶² California-based Sun Belt Water Inc. has launched an action against the Canadian government for \$14 billion in damages—on the grounds that a British Columbia ban on bulk water exports constituted illegal expropriation under the terms of NAFTA. See e.g., "Bankrupting Democracy", *supra* note 7.

tice. What is clear, though, is that the possibility of this chill effect is very real. In fact, attorneys representing Ethyl were quite frank about the precedent the case established for future Chapter 11 actions against NAFTA governments: “[T]he potential for lawsuits under this process [*i.e.*, Chapter 11] is far-reaching since it could be used by more than 350 million individuals and corporations throughout the NAFTA countries.”⁶³

As proof of the chill effect international trade obligations are having on the Canadian government, all proposed legislation and/or regulation now undergoes routine “trade screening” to ensure compliance with NAFTA and OECD provisions.⁶⁴ This is clear evidence that international trade agreements are impacting directly on public policy making. According to some proponents of globalization, this effect has been embraced and trumpeted as a good thing—as “the Golden Straightjacket,” according to *New York Times* columnist Thomas Friedman.⁶⁵ Yet from an environmental perspective, such an effect can only be negative. With no meaningful reference or legal recognition in any existing international trade agreement to the precautionary principle,⁶⁶ screening draft legislation for its compliance with international trade obligations can only reduce the ability of the principle to serve as a basis of environmental policy.

⁶³ Appleton & Associates, Press Release, “First-Ever Lawsuit Against Canadian Government Using NAFTA Investor-State Process Brought,” (9 October 1996).

⁶⁴ M. Lee, Briefing Paper, “Inside the Fortress: What’s Going on at the FTAA Negotiations” (Ottawa: The Canadian Centre for Policy Alternatives, April 2001) at 20.

⁶⁵ “The myths about globalization (4)” *The Globe and Mail* (16 April 2001) A10.

⁶⁶ NAFTA does contain several references which provide *prima facie* support for environmental protection in general — e.g., Article 2101 (exceptions dealing with the environment) and Article 1114 (investment and the environment: parties should not lower their environmental standards to attract investment). Upon examining state practice, however, these provisions have proven to be little more than rhetoric. Similarly, acting on pressure to fulfill a major electoral promise, former U.S. President Clinton did initiate negotiation of two NAFTA “side agreements” after the original deal had been signed: *The North American Agreement on Environmental Cooperation* (NAAEC) and *The North American Agreement on Labour Cooperation* (NAALC). However, while both of these side agreements are often trumpeted as evidence that NAFTA recognizes human rights based concerns, neither side agreement changed the scope of any of the original NAFTA provisions; neither required the establishment of common environmental or labour standards; neither required any state party to pass new legislation to bring domestic policy into line with internationally recognized standards; nor did either side agreement provide for the establishment of any supranational institution(s) to oversee these areas.

VI. CONCLUSION

While the Supreme Court of Canada's decision in *Spraytech* does, on its face, provide support for the precautionary principle and its use in environmental policy, those who claim that the decision is a turning point for environmental protection in Canada ignore a critical factor, namely, Canada's international trade commitments under agreements such as NAFTA. As this paper has illustrated, NAFTA and its Chapter 11 investment provisions effectively undercut the ability of legislators to utilize the precautionary principle when designing and implementing environmental policy—a fact that, tragically, can only be a harbinger of further environmental degradation both within and beyond Canada's borders.