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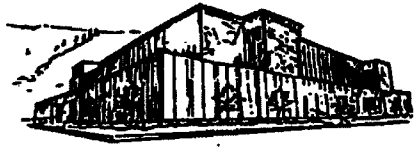
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Emissions Trading Under the Kyoto Protocol:
NAFTA and WTO Concerns

By

Sikina Jinnah

B.A. University of California, Berkeley, 1999

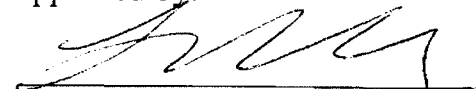
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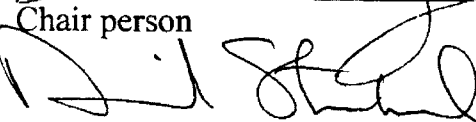
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Emissions Trading Under the Kyoto Protocol: NAFTA and WTO Concerns

Director: Len Broberg LB

In response to international concern surrounding the effects of global climate change the Kyoto Protocol to the United Nations Framework Convention on Climate Change was drafted in 1998 at the third meeting of the Conference of Parties (COP-3). The Kyoto Protocol is aimed at reducing greenhouse gas emissions which cause global warming.

Conflicts may arise between multilateral environmental agreements (MEAs), such as the Kyoto Protocol, and international trade agreements, such as the General Agreement on Trade and Tariffs (GATT)/World Trade Organization (WTO) and the North American Free Trade Agreement (NAFTA). Member trade obligations under GATT/WTO and NAFTA may restrict freedom to participate in the Kyoto Protocol. Concern arises about the ability of a country that is member both to the WTO or the NAFTA, as well as to the Kyoto Protocol, to place trade restrictions on ERUs created in countries that are member to the WTO or the NAFTA but *not* party to the Kyoto Protocol. This paper will focus on such situations, with emphasis on the case of Canada and the United States (U.S.).

The manner in which member obligations under the WTO and/or NAFTA will affect the success of the emissions trading system under the Kyoto Protocol will depend largely on how the emission reduction units created by the Kyoto Protocol are *classified* under the WTO and the NAFTA. The classification will dictate which rules apply to trade in emission reduction units, and more importantly, which exemptions to these rules will apply. This paper will briefly review the relevant treaties involved, discuss the relationship between MEAs and general principles of International Law, and then proceed to examine Canada's options under three possible classification scenarios (goods, services, and non-violation). This paper will then shift focus to discuss how the NAFTA Environmental Side Agreement may hold the potential to protect Canada's environmental laws (i.e. the Kyoto Protocol) from a U.S. challenge under the NAFTA. Lastly, this paper will touch on some alternative potential trade conflicts which may arise under the Kyoto Protocol's emissions trading system.

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I. Introduction

In response to international concern surrounding the effects of global climate change the Kyoto Protocol¹ to the United Nations Framework Convention on Climate Change² was drafted in 1998 at the third meeting of the Conference of Parties (COP-3). Global warming is caused by the presence, and continued release of large quantities of greenhouse gasses into the atmosphere. The Kyoto Protocol is aimed at reducing emissions of these gasses.

The Kyoto Protocol requires nations that are party to the treaty to reduce greenhouse gas emissions to approximately 5% below 1990 levels by the year 2012. The Kyoto Protocol is currently undergoing a continued drafting process with anticipation of ratification by 2007. The Protocol will take effect 90 days after at least 55 countries ratify, and 55% of 1990 CO₂ (or CO₂ equivalent) emissions are accounted for. In light of the negotiations surrounding the ratification of the Kyoto Protocol, a number of concerns are arising surrounding the associated emission reduction credit trading mechanism contained therein.

Conflicts may arise between multilateral environmental agreements (MEAs), such as the Kyoto Protocol, and international trade agreements, such as the General Agreement on Trade and Tariffs (GATT)/World Trade Organization (WTO) and the North American Free Trade Agreement (NAFTA). Member trade obligations under GATT/WTO and

¹ *Conference of the Parties to the Framework Convention on Climate Change: Kyoto Protocol*, December 10, 1997, U.N. Doc. FCCC/CP/1997/L.7/Add.1, 37 I.L.M. 32 [hereinafter *Kyoto Protocol*].

² *United Nations Conference on the Environment and Development: Framework Convention on Climate Change*, May 9, 1992, 32 I.L.M. 849 (entered into force March 21, 1994) [hereinafter *UNFCCC*].

NAFTA may restrict freedom to participate in the Kyoto Protocol. Members to GATT/WTO and NAFTA are restricted in their ability to place quantitative barriers to trade (i.e. quotas, sanctions, taxes, etc.) affecting products or services from other member nations. Additionally, under the Kyoto Protocol, member nations may only use emission reduction units (ERUs) created in other Kyoto Protocol member nations for the purposes of accounting under the Protocol. Concern arises about the ability of a country that is member both to the WTO or the NAFTA, as well as to the Kyoto Protocol, to place trade restrictions on ERUs created in countries that are member to the WTO or the NAFTA but *not* party to the Kyoto Protocol. This paper will focus on such situations, with emphasis on the case of Canada and the United States (U.S.). Canada and the U.S. are both party to both GATT/WTO and NAFTA. However, because the current President of the United States, George W. Bush, has refused to ratify the Kyoto Protocol,³ Canada may have reason to be concerned about the trade implications associated with their own anticipated ratification of the Kyoto Protocol.

The NAFTA and/or the WTO may become a barrier to the best available multilateral solution to global warming. The fear is that because the economic risk associated with ratifying the Kyoto Protocol is so great,⁴ Canada may be forced to abandon the Kyoto Protocol entirely. If these questions are eventually decided by a NAFTA panel it will have serious implications and ramifications for the future of market

³ President Bush issued a letter to several senators voicing the rejection. See letter from George W. Bush to Senator Chuck Hagel, et. al. (March 13, 2001) available at <http://www.whitehouse.gov/news/releases/2001/03/20010314.html>

⁴ Some authors argue that "no [other] MEA has had the potential to impact so many sectors of the economy, so many economic interests and such high volumes of trade in products and services." See Jacob Werksman, *Greenhouse Gas Emissions Trading and the WTO*, 8 *Review of European Community & International Environmental Law* 3:251 (1999)

based incentives as solutions to global environmental problems, particularly through the use of MEAs.

The manner in which member obligations under the WTO and/or NAFTA will affect the success of the emissions trading system under the Kyoto Protocol will depend largely on how the emission reduction units created by the Kyoto Protocol are *classified* under the WTO and the NAFTA. The classification will dictate which rules apply to trade in emission reduction units, and more importantly, which exemptions to these rules will apply. This paper will briefly review the relevant treaties involved, discuss the relationship between MEAs and general principles of International Law, and then proceed to examine Canada's options under three possible classification scenarios. The first scenario will assume that emission reduction units are classified as "goods" under the WTO, and therefore subject to the requirements of the GATT and NAFTA rules pertaining to trade in goods. This section will examine related past conflicts reviewed by WTO dispute resolution panels, and attempt to reconcile the potential conflict described above between the NAFTA and/or WTO, and the Kyoto Protocol by exploring the option of a Canadian unilateral sanction⁵ on U.S. created emission reduction units.⁶ The second scenario will assume that emission reduction units are classified as "services," and are therefore subject to the requirements of the General Agreement on Trade in Services (GATS) under the WTO and the NAFTA equivalent rules. This section will discuss

⁵ Because the Kyoto Protocol does not recognize ERUs created in non-Party nations, if Canada were to incorporate the Kyoto Protocol into domestic legislation through a statute, it would effectively be placing a sanction on ERUs created in any non-Party nation. This will be discussed in more detail below.

⁶ Note this paper will also discuss the relationship between Multilateral Environmental Agreements and their relationship to international trade laws particularly the case of inconsistencies between these two types of agreements.

possible sectors of classification and compare the GATS and GATT stipulations with respect to exemptions. The last scenario will present an argument for why emission reduction credits should not be classified as neither “goods,” nor “services,” therefore falling outside the jurisdiction of the WTO and the NAFTA. This paper will then shift focus to discuss how the NAFTA Environmental Side Agreement may hold the potential to protect Canada’s environmental laws (i.e. the Kyoto Protocol) from a U.S. challenge under the NAFTA. Lastly, this paper will touch on some alternative potential trade conflicts which may arise under the Kyoto Protocol’s emissions trading system.

II. Summary of Relevant Treaties

A. The Kyoto Protocol

1. Overview

The objective of the Kyoto Protocol is to achieve stabilization of greenhouse gas concentrations⁷ in the Earth’s atmosphere at levels that will reduce the likelihood of adverse effects from climate change.⁸ Countries that are party to the treaty are divided into Annex B and non-Annex B⁹ parties. Annex B contains 39 members and includes those parties that were members of the Organization for Economic Cooperation and

⁷ The Kyoto Protocol does not aim to control the release of greenhouse gasses covered under the *United Nations: Protocol on Substances that Deplete the Ozone Layer*, September 16, 1987, 26 I.L.M. 1541 (entered into force January 1, 1989) (hereinafter *Montreal Protocol*). Greenhouse gasses controlled under the Kyoto Protocol include Carbon Dioxide (CO₂) and CO₂ equivalents. CO₂ equivalents include Methane (CH₄), Nitrous Oxide (N₂O), Hydrofluorocarbons (HFCs), Perfluorocarbons (PFCs), and Sulphur hexafluoride (SF₆) [Annex A to Kyoto Protocol].

⁸As defined in UNFCCC *note 5* art. 1(1) “adverse effects of climate change” are defined as “changes in the physical environment or biota resulting from climate change which have significant deleterious effects on the composition, resilience, or productivity of natural and managed ecosystems or on the operation of socio-economic systems or on human health and welfare.”

⁹ Annex I refers to the Annex I of the UNFCCC Charter. Annex B refers to Annex B of the Kyoto Protocol. The difference is slight but significant in some cases. See www.CO2e.com for more details.

Development (OECD) in 1992, as well as those countries in Eastern Europe whose economies were in transition to a market economy at that time. These countries were deemed to be “developed” in 1992 and subjected to legally binding obligations under the Kyoto Protocol. Non-Annex B parties include the developing economies of the G-77.¹⁰ As mentioned above, the Kyoto Protocol will come into effect 90 days after fifty-five parties to the United Nations Framework Convention on Climate Change have ratified the Protocol. Additionally, those 55 member signatures must account for at least 55% of the total Annex B CO₂ emissions for 1990.¹¹ Considering the emissions data for 1990, two of the three largest emitters, the European Union, the Russian Federation, and the United States, will likely have to ratify the Kyoto Protocol for it to take effect.¹²

2. Emission Reduction and Domestic Policy Requirements

The first commitment period for the Kyoto Protocol will be 2008-2012. During this time frame the overall goal is to reduce greenhouse gas¹³ emissions from Annex B countries to 5% below 1990 levels. Eastern European, Annex B countries which are in transition to a market economy¹⁴ will be allowed to use an alternate base year to

¹⁰ For a full list of Annex B countries see Appendix A, for explanation of the additional financial obligations for Non-Annex B countries see *supra* note 1 art. 11.

¹¹ *supra* 1 art. 25(1)

¹² James T. Bryce, *Controlling the Temperature: An Analysis of the Kyoto Protocol*, 62 Saskatchewan Law Review 379 (1999). As of September 2002 the European Union and the Russian Federation have ratified the Kyoto Protocol. Therefore, the Protocol has met its prerequisite and may, theoretically, enter into force.

¹³ *supra* note 1

¹⁴ These countries include Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Russian Federation, Slovakia, Slovenia, and Ukraine.

determine emission baselines. Emissions from this base year shall be multiplied by five¹⁵ to determine required emission reduction commitments.

The Kyoto Protocol requires parties to promote “sustainable development” through incorporation of various domestic policy measures into future planning and development. These measures include commitments to enhance energy efficiency, protect and create greenhouse gas sinks,¹⁶ promote sustainable agriculture, research and promote renewable energy and CO₂ sequestration technologies, reduction and phase out of market imperfections¹⁷ that run counter to the objectives of the UNFCCC, encourage policies aimed at greenhouse gas reductions, limit or reduce greenhouse gases emitted by the transportation sector, and limit or reduce methane emissions through recovery and use in waste management. The Kyoto Protocol also requires parties to share information with other members of the UNFCCC with respect to meeting their emission reduction commitments.

3. Flexibility Mechanisms

The Kyoto Protocol allows for three distinct flexibility mechanisms to assist Annex B parties in meeting their quantitative emission reduction commitments. The first of these flexibility mechanisms is joint implementation.¹⁸ Under this mechanism two

¹⁵ The text of the Kyoto Protocol does not indicate how the number five was determined.

¹⁶ *supra* note 2 defines a sink as “any process or activity or mechanism which removes a greenhouse gas...[from the atmosphere]” i.e. oceans and forests

¹⁷ i.e. “fiscal incentives, tax and duty exemptions, and subsidies on all greenhouse gas emitting sectors that run counter to the objective” of the UNFCCC.

¹⁸ *supra* note 1 art. 4

Annex B parties may jointly fulfill their commitments through a regional economic integration organization,¹⁹ such as the European Economic Community (EEC), or by engaging jointly in projects aimed at reducing emissions. These projects involve one Annex B party transferring or acquiring emission reduction units (ERUs) created through these emission reduction activities in the partner country.²⁰

The second flexibility mechanism allowed for under the Kyoto Protocol is closely related to the projects allowed for under joint implementation. This flexibility mechanism is emissions trading²¹ between Annex B nations. The premise of an emissions trading system is that such a system will create market incentives for parties to reduce emissions beyond their commitment levels through both domestic policy changes as well as through technology development. Additionally, an emissions trading system may reduce compliance costs, and create incentives for new technology development. The Kyoto Protocol will set a cap, or “assigned amount” to each Party which will dictate their emission reduction requirements. Annex B parties that reduce their CO₂, or CO₂ equivalent, emissions beyond their commitments under the Kyoto Protocol, can sell that difference to another Annex B party in an open market system. The unit of such an emission reduction is called an assigned amount unit (AAU). These “projects” must create reductions in greenhouse gasses that are supplemental to domestic action. The Kyoto Protocol does not articulate any other significant differences between AAUs

¹⁹ a “regional economic integration organization” is defined by UNFCCC *supra* note 2 as “an organization constituted by sovereign States of a given region which has competence in respect to matters governed by this Convention or its protocols and has been duly authorized, in accordance with its internal procedures, to sign, ratify, accept, approve, or accede to the instruments concerned.”

²⁰ Japan and Russia have already participated in such a “project.” See *Bootleggers, Baptists, and the Global Warming Battle*, 26 Harvard Environmental Law Review 177 at 224.

²¹ Kyoto Protocol Article 17

created through emissions trading and ERUs created through “projects” other than the specification of the method through which the credit was created.²²

Lastly, the Kyoto Protocol allows for a Clean Development Mechanism (CDM). The CDM allows for non-Annex B parties²³ to create certified emission reductions (CERs) from projects which reduce greenhouse gas emissions. These CERs can be used to offset emissions in Annex B nations in order to help Annex B nations to meet emission reduction commitments under the Kyoto Protocol. The CDM is essentially the same as a “project” except that it involves an Annex B party acquiring CERs from a non-Annex B party.

2. Trade Restrictions Embedded in Trading Rules

The Kyoto Protocol itself does not lay out detailed rules surrounding the implementation of the above mentioned flexibility mechanisms, although the COP is currently negotiating these details. The Marrakech Accords²⁴ outline many of the rules with respect to emissions trading. The Kyoto Protocol does specify, however, that Annex B parties may trade emission reduction units among themselves, and may trade in CERs with countries not included in Annex B that are parties to the Kyoto Protocol.²⁵ Implicit

²² At COP6 the Parties agreed that ERUs and AAUs are fully fungible (see UNCTAD – Greenhouse Gas Trading –DRAFT), therefore the term AAU will be used throughout this paper to imply both ERUs and AAUs with respect to trading restrictions.

²³ Non-Annex B parties engaging in CDM transactions must be party to the Kyoto Protocol. *Supra* note 1

²⁴ The Marrakech Accords were negotiated at COP6 in 2000

²⁵ *Supra* 1 art. 6(1). Note that some authors speculate that the Kyoto Protocol will not prohibit Parties from selling AAUs to non-Party nations, only that they cannot buy AAUs from non-Party nations. See Bodansky, Daniel, *Linking U.S. and International Climate Change Strategies*, Pew Center on Climate Change at 4, Baron, Richard and Pershing, *Trading Greenhouse Gases Outside Kyoto*, International

in this language is that Annex B parties may not trade with any non-parties to meet commitments under the Kyoto Protocol. It is anticipated that the final emissions trading rules will, as negotiated in the Marrakech Accords, explicitly mirror this restriction.

B. The General Agreement on Tariffs and Trade (GATT)²⁶/ World Trade Organization (WTO)

1. Overview

The General Agreement on Tariffs and Trade was negotiated by the Conference of Parties in 1947. The goal of this agreement was to encourage economic development by easing restrictions and liberalizing trade among contracting parties. Central to the agreement are three core principles; Most Favored Nation, National Treatment, and Prohibition on Import/Export Restrictions. Article I of the GATT outlines the Most Favored Nation (MFN) principle. Under the MFN principle each party agrees to accord unconditional equal treatment to all other member nations.²⁷ Therefore, no party may grant any privilege with respect to any imported product to any other party without giving those same privileges, with respect to “like products”²⁸ to all other GATT/WTO parties. Article III of the GATT outlines the national treatment principle which requires that foreign goods imported to member states be treated in the same manner as “like

Energy Agency, at 2, and Diringer, Elliot, *Two Scenarios: Linking U.S. and International Climate Change Efforts*, Pew Center on Global Climate Change, at 3

²⁶ General Agreement on Tariffs and Trade, 55 U.N.T.S. 187 (1947) [hereinafter GATT].

²⁷ Specifically the text of the GATT outlining the MFN principle states that:

any advantage, favor, privilege, or immunity, granted by any contracting party to a product originating in...any other country shall be accorded immediately and unconditionally to the like products originating...in all other contracting parties.

²⁸ “like products” are not defined in the GATT

products” produced domestically. In other words, this provision limits and/or eliminates economic advantages for domestically produced products over imported products.²⁹ Lastly, Articles XI and XIII of the GATT govern the prohibition on import/export restrictions. Articles XI and XIII prohibit the use of quantitative “prohibitions or restrictions,” such as bans, quotas and import licenses, on imports from member countries.³⁰

In 1995 the World Trade Organization (WTO) was established, and signed by over 100 member countries at the Uruguay Round of GATT negotiations. Many new agreements were negotiated as annexes to the WTO. These annexes include multilateral agreements dealing with trade in goods,³¹ services, and intellectual property.³² These annexes include the General Agreement on Tariffs and Trade of 1994. The GATT 1994 incorporated many but not all of the provisions of the GATT 1947. The WTO was established to “implement and administer the operations, and further the objectives”³³ of the agreements defined therein. Additionally, the WTO must resolve disputes under its agreements,³⁴ and must review all trade policy of member nations.

²⁹ Specifically the text of GATT outlining the national treatment principle states that the imports from any contracting party:

be accorded treatment no less favorable than that to like products of national origin in respect to all laws, regulations, and requirements affecting their internal sale.

³⁰ GATT Article XI(1) specifically states:

No prohibitions or restrictions other than duties, taxes or other charges, whether made effective through quotas, import, or export licenses, or other measures, shall be instituted or maintained by any other contracting party on the importation of any product of the territory of any other contracting party.

³¹ WTO Committees on Trade and the Environment, Sanitary and Phytosanitary Measures, and Technical Barriers to Trade.

³² As covered by General Agreement on Trade in Services [hereinafter *GATS*] and Trade Related aspects of Intellectual Property [hereinafter *TRIPS*]

³³ Ralph Folsom, *International Trade and Investment in a Nutshell*, at 67

³⁴ It is important to note that only the governments of WTO members have standing to request dispute settlement and participate in the adjudicative process. Additionally, WTO dispute settlement panel hearings and negotiations are done behind closed doors and are not open to the public.

2. *Exceptions to Trade Restriction under the GATT*

Article XX Sections (b) and (g) of the GATT provide some exceptions to allow trade restrictions under specific conditions relating to environmental conservation and protection.³⁵ Article XX provides a legal pathway for trade measures that would otherwise be in conflict with GATT obligations, to deviate from those obligations. The following conditions must be met in order for GATT Article XX to apply to a particular trade restriction:

- It is necessary to protect human, animal, or plant life or health³⁶ or;
- they relate to the conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption,³⁷

Trade measures meeting the above conditions may be exempt from conflicting GATT obligations as long as they do not constitute:

- a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail; or
- a disguised restriction on international trade.³⁸

³⁵ Although the word “environment” is never actually used

³⁶ *supra* note 26 art.XX(b)

³⁷ *supra* note 26 art. XX(g)

³⁸ These requirements are called for in the chapeau to GATT Article XX

Unfortunately, as will be discussed below, in the event of conflict, GATT/WTO tribunals have tended to favor the interests of free trade over those of environmental protection.

C. The North American Free Trade Agreement³⁹

1. Overview

Free trade negotiations between the U.S. and Canada dates back to the Elgin-Marcy Treaty of 1854. The Elgin-Marcy Treaty established free trade between the two countries for virtually all products as well as opened up access to mutual fisheries. In 1866 the U.S. pulled out of the Elgin-Marcy Treaty and trade negotiations between the two countries was put on hold for nearly 70 years. President Roosevelt was the first to resume negotiations, but he was unsuccessful in his attempt to negotiate a free trade agreement between the two countries.⁴⁰ The two countries did, however, participate in the GATT of 1947. This agreement served as an alternative until the Canada-United States Free Trade Agreement⁴¹ went into effect on January 1, 1989. The CFTA both borrowed from the existing GATT of 1947,⁴² as well as helped lay the groundwork for the NAFTA.

³⁹ North American Free Trade Agreement, Dec 17, 1992, Can-Mex.-U.S., 32 I.L.M. 289, 605 (1993) [hereinafter *NAFTA*].

⁴⁰ Although Congress passed the Reciprocal Trade Agreements Act in 1935, under which tariffs were substantially reduced between U.S.-Canadian trade, Canadian Prime Minister King declined to support the agreement.

⁴¹ hereinafter *CFTA*

⁴² i.e. CFTA transposed GATT's art. XX exceptions into it's text

The NAFTA, negotiated by President George Bush in the early 1990s, then modified and signed into law by President Bill Clinton on January 1, 1994, was developed to create a free trade area between the United States, Canada, and Mexico. It was designed to integrate the economies of Mexico, Canada, and the U.S. while keeping the political barriers firmly in place.⁴³ The treaty was closely modeled after the GATT/WTO⁴⁴ in its central goals of decreasing quantitative restrictions to trade through the decrease and elimination of trade barriers such as tariffs, taxes, and import licenses. The elimination of the risk of U.S. imposed taxes and tariffs on imported goods was particularly attractive to Mexico at the time due to their heavy economic reliance on market access to the U.S. with 75% of their export market going to U.S. consumers.⁴⁵

The NAFTA contains several core objectives as defined in Article 102. They include the following:

- Reduction and/or elimination of trade barriers (i.e. sanctions, taxes, tariffs)
- Creation of conditions of regional fair competition
- Increase investment opportunities
- Protection and enforcement of intellectual property rights
- Procedures for the implementation and application of the NAFTA, including methodology for settlement of disputes; and
- Framework for further regional and multilateral cooperation to enhance the benefits of the NAFTA

⁴³ see Ralph Folsom, *NAFTA in a Nutshell*, West Law 1999

⁴⁴ see Table 1 below

⁴⁵ *supra note 41*

Immediately following the implementation of the NAFTA in 1994, trade and foreign investment between the three countries increased dramatically. The economic boost is particularly evident in the case of trade between the U.S. and Mexico. U.S. exports to Mexico increased by 21.1%, imports from Mexico were up 24% in 1994, and in 1995 U.S. investment in Mexico reached an all time high.⁴⁶ However, despite its economic advantages, like the GATT/WTO, the agreement has been widely criticized for its lack of social and environmental protection measures.⁴⁷ For example, after the passage of the NAFTA many U.S. based companies moved to Mexico to take advantage of the lower labor costs and standards as well as more lenient environmental protection regulations relative to the U.S. equivalents. Prior to the NAFTA, import restrictions made this method of production less profitable.

⁴⁶ see David Gantz, *Implementing the NAFTA Rules of Origin: Are the Parties Helping or Hurting Free Trade?* 12 Arizona Journal of International Comparative Law 367 (1995)

⁴⁷ However, in some political spheres, the NAFTA has been recognized as having taken a step forward from the GATT/WTO with respect to environmental provisions. For a more detailed discussion of this issue, see Richard Steinberg, *Trade-Environment Negotiations in the E.U., NAFTA, and WTO: Regional Trajectories of Rule Development*, 91 American Journal of International Law 231 (1997). Steinberg also advocates, using the WTO, NAFTA, and the European Union as an example, that the closer the economic integration achieved in an international trade agreements the more environmentally friendly the resulting regulations will be:

The extent to which the rules and institutions of organizations are environment friendly correlated with the rank-ordering of the depth of integration in the trade organizations examined. An analysis of the process of trade-environment rulemaking in each of the three trade organizations has confirmed that the deepening of integration has increased the salience of trade-environment issues for richer, greener states and has led to demands by those states for more environment-friendly rules and institutions.

By this reasoning if the NAFTA's trade measures moved towards even more liberalization of trade, the U.S. being the richest, "greenest" party would subsequently be able to demand more stringent environmental regulations. Unfortunately, under the current administration I would argue that this is highly unlikely.

NAFTA	WTO
Chapter 3: Trade in Goods	GATT 1994, Agreement on Textiles and Clothing
Chapter 4: Rules of Origin	Agreement on Rules of Origin
Chapter 5: Customs Procedures	No parallel but see Customs Valuation Code
Chapter 6: Energy and Basic Petrochemicals	No parallel
Chapter 7: Agriculture and SPS Measure	Agreement on Agriculture, Agreement on SPS Measures
Chapter 8: Emergency Action	Agreement on Safeguards
Chapter 9: Product and Safety Standards	Agreement on Technical Barriers to Trade
Chapter 10: Procurement	Agreement on Government Procurement
Chapter 11: Investment	Agreement on Trade Related Investment Measures
Chapter 12: Cross-Border Trade in Services	General Agreement on Trade in Services (GATS)
Chapter 13: Enhanced telecommunications	See GATS, Basic Telecommunications Covered
Chapter 14: Financial Services	See GATS
Chapter 15: Competition Policy, Monopolies, and State Enterprises	No parallel, but see Understanding on Interpretation of GATT Article XVII
Chapter 16: Temporary Entry for Business Persons	No parallel
Chapter 17: Intellectual Property	Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs)
Chapter 18: Administrative Provisions	Not applicable
Chapter 19: Antidumping and Countervailing Duty Dispute Settlement	No parallel, but see DSU and Agreement on Implementation of GATT Article VI
Chapter 20: Dispute Settlement	Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU)
Chapter 21: Exceptions	See GATT Articles XX, Xxi and Understanding on GATT Balance of Payment Provisions
Agreement on Environmental Cooperation	No parallel
Agreement on Labor Cooperation	No parallel

Table 1 Comparison of NAFTA and WTO Requirements⁴⁸

⁴⁸ This table was taken directly from Folsom (1999) pgs 73-74

2. Trade-Environment Conflicts Under the NAFTA

With respect to trade-environment conflicts under the NAFTA, four categories have gained significant attention in recent years;⁴⁹

- *Domestic health, safety and environmental protection* – Governments are restricted in their ability to impose domestic standards on imported goods to protect the public health or the environment.⁵⁰
- *Extrajurisdictional activity: endangered species, foreign pollution, and the “race to the bottom”* – Governments are concerned about their ability to place restrictions on imports based on their commitments to address environmental concerns through other treaties,⁵¹ or as determined by production processes.⁵² Additionally, many sectors are concerned about the effect of the “race to the bottom”⁵³ which describes competition among nations to loosen environmental regulations, and labor standards in order to attract investment from foreign companies.
- *Transboundary Remediation*– As free trade increases, product transportation traffic increases in border regions. In efforts to minimize costs, border regions

⁴⁹ *ibid* at 234

⁵⁰ see GATT dispute panel report, United States – Restrictions on Imports of Tuna, 33 I.L.M. 839 (1994) [hereinafter *Tuna/Dolphin II*].

⁵¹ i.e. Convention on International Trade in Endangered Species of Wild Flora and Fauna, March 3, 1973, 27 UST 1087, 993 UNTS 243 [hereinafter *CITES*]

⁵² i.e. freedom to utilize the concept of a pollution tax – taxing products based on the amount of pollution created during production- is restricted.

⁵³ see Daniel Etsy, *Greening the GATT: Trade, Environment and the Future* (1994)

become areas of high industrial activity. Thus border regions see extremely high levels of environmental degradation in countries with loose environmental standards. This problem has been highlighted in the case of the U.S.- Mexico border maquiladora⁵⁴ region.

- *Trade- Environment Institutions-* International trade agreements often create or modify existing institutions to analyze and/or adjudicate⁵⁵ issues relating to environmental concerns.⁵⁶ As liberalization of trade increases, the ability of these institutions to perform their duties in compliance with the trade agreements that created them comes into question.

3. Exceptions to Trade Restrictions Under the NAFTA

The NAFTA allows for many of the same exceptions, allowing for trade restrictions under specific circumstances, as the WTO/GATT. However, the NAFTA has been considered more environment-friendly than the WTO/GATT because it adds additional allowances for environmental protection related exemptions. The sections of NAFTA that may potentially address environmental issues are covered in NAFTA

⁵⁴ The maquiladora program was established by the Mexican government in 1965 and allows duty-free imports of manufacturing components to Mexico for processing or assembly of products that must subsequently be exported from Mexico. For more detailed discussions of the maquiladora program see Leonard Novaro, *Border Towns Mired in Toxic Waste*, 11 Pac. Mtn. Network News 2-3 (Rural Community Assistance Corp., Sacramento, CA) (Aug. 1993); Kristi Fettig *Criminal and Civil Remedies for Transboundary Water Pollution*, 15 Transnational Law 117 (2002); and Lesley J. Wiseman *A Place for "Maternity" in the Global Workplace*, 28 Ohio N.V.L. Rev. 195 (2001).

⁵⁵ Note that like the WTO dispute resolution process, with the exception of NAFTA Chapter 11 dealing with foreign investment, for all other issues, the NAFTA only grants standing to member governments, and deliberations are not open to the public.

⁵⁶ i.e. WTO Committees on Trade and the Environment, Sanitary and Phytosanitary Measures, and Technical Barriers to Trade, and NAFTA's Commission for Environmental Cooperation (CEC)

Chapter 21, Chapter 1 (art. 104), and the North American Agreement for Environmental Cooperation. Each of these is described below:

- *NAFTA Chapter 21*- The text of Chapter 21 of the NAFTA defers specifically to Article XX of the GATT/WTO. It says that for the purposes of trade in goods, with the exception of provisions relating to services and investment:

GATT Article XX and its interpretive notes, or any equivalent provision of a successor agreement to which all Parties are party, are incorporated into and made part of this Agreement. The Parties understand that the measures referred to in GATT Article XX(b)⁵⁷ include environmental measures necessary to protect human, animal, or plant life or health, and that GATT Article XX(g)⁵⁸ applies to measures relating to the conservation of living and non-living exhaustible natural resources.

The chapeau to GATT Article XX dictates that these provisions apply as long as they are applied in a manner that does not:

constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail or a disguised restriction on international trade between the Parties.

Historically, these exceptions have been interpreted very narrowly.⁵⁹

⁵⁷ GATT art. XX(b) states that trade may be restricted when “necessary to protect human, animal, or plant life or health.”

⁵⁸ GATT art. XX(g) states that trade may be restricted “relating to the conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption.”

⁵⁹ Thomas, Schoenbaum, *International Trade and Protection of the Environment: the Continuing Search for Reconciliation*, 91 *American Journal of International Law* 268 (1997)

- *NAFTA Chapter 1- Article 104* of NAFTA Chapter 1 includes exemptions unique to the NAFTA. It specifies that in the event of any inconsistency between the NAFTA and any other such agreement, the NAFTA will prevail *except* when one of the listed Multilateral Environmental Agreements (MEAs) exists. Additionally, Article 104.1 sets out that additional MEAs may be added to the list provided that it is agreed upon in writing by the parties involved. The currently listed MEAs include: (a) CITES;⁶⁰ (b) the Montreal Protocol on Substances that Deplete the Ozone Layer;⁶¹ (c) the Basel Convention on the Control of Transboundary Movements of Hazardous Wastes and their Disposal;⁶² (d) the agreements set forth in Annex 104.1. Article 104 specifies that these conditions will prevail when inconsistencies arise provided that “where a Party has a choice among equally effective and reasonably available means of complying with such obligations, the Party chooses the alternative that is least inconsistent with the other provisions of this Agreement.”
- *North American Agreement on Environmental Cooperation.*⁶³ The NAAEC, also known as the environmental side agreement, was negotiated by the Clinton Administration to gain support for the NAFTA from environmental organizations.⁶⁴ The NAAEC requires member countries to effectively enforce

⁶⁰ *supra* note 51

⁶¹ signed in Montreal on September 16, 1987, amended 1990 [hereinafter *the Montreal Protocol*]

⁶² signed in Basel on March 22, 1989 [hereinafter *the Basel Convention*] (the U.S. has not yet ratified this agreement)

⁶³ Implemented with the NAFTA on January 1, 1994 [hereinafter *NAAEC*]

⁶⁴ The environmental community was markedly split in its support of the NAFTA with organizations such as the National Wildlife Federation, the World Wildlife Fund, the Environmental Defense Fund, the Natural Resources Defense Council, the National Audubon Society firmly in favor and other organizations such as the Sierra Club, Friends of the Earth, Greenpeace, the Humane Society, Clean Water Action,

their own environmental laws, prohibits them from lowering their environmental standards, and requires them to try to improve them. It also created the Commission for Environmental Cooperation (CEC) through which citizens have standing to have their complaints heard with regard to a party's failure to enforce its environmental regulations. The text prohibiting parties from lowering their environmental regulations to attract industry is not subject to panel review and therefore has not proven to be very effective. The CEC can reject a complaint by a two-thirds vote, and similarly will only release the Secretariat's report to the public on a heard complaint by a two-thirds vote. Lastly, the agreement provides for sanctions against any country that is found to have engaged in a "persistent pattern of failure to effectively enforce its environmental laws."⁶⁵ Although the NAAEC deserves mention as a small step forward with respect to environmental protection under international trade agreements, to date it has not proven particularly effective in its goals. However, it does create the potential for a safe harbor in which Canada may impose environmental protection measures related to climate change protected under the NAAEC. This will be discussed in greater length in Section VII below.⁶⁶

Rainforest Action, the American Society for the Prevention of Cruelty to Animals, Environmental Action and many other strongly opposed to the treaty. See Andres Rueda, *Tuna, Dolphins, Shrimp, & Turtles: What About Environmental Embargoes Under NAFTA?* 12 *The Georgetown International Environmental Law Review* 647 (2000)

⁶⁵ John Knox, *NAFTA's Environmental Provisions: What Problems were they Intended to Address?* 23 *Canada-U.S. Journal* 403 (1997)

⁶⁶ For further discussion about the NAAEC see *ibid*, and David S. Baron, *NAFTA and the Environment-Making the Side Agreement Work*, 12 *Arizona Journal of International and Comparative Law* 603 (1995)

III. MEAs vs. International Trade Agreements

Although to date there have not been any documented disputes surrounding conflicting obligations under International Trade Agreements and MEAs, the potential for such a conflict has made this issue the subject of much discussion.⁶⁷ Besides the Kyoto Protocol, a number of MEAs have called for trade measures that may be deemed in conflict with the provisions of GATT/WTO and/or NAFTA. These include the CITES,⁶⁸ the Basel Convention,⁶⁹ and the Montreal Protocol.⁷⁰ Neither the WTO/GATT nor NAFTA have rules governing the mode of dispute resolution under such circumstances presumably because until recently they had not been pressured to do so.⁷¹

A. The Vienna Convention on the Law of Treaties⁷²

In the event of a conflict between an International Trade Agreement and a MEA, the Vienna Convention on the Law of Treaties offers some direction.

⁶⁷ see Charles Fletcher, *Greening World Trade: Reconciling GATT and Multilateral Environmental Agreements within the Existing World Trading Regime*, 5 *Journal of Transnational Law and Policy* 341; Chris Wold, *Multilateral Environmental Agreements and the GATT: Conflict and Resolution?*, 26 *Environmental Law* 841; and Ryan Winter, *Reconciling the GATT and WTO with Multilateral Environmental Agreements: Can we Have our Cake and Eat it Too?*, 11 *Colorado Journal of Environmental Law and Policy* 223 (2000)

⁶⁸ *supra* note 51; CITES restricts the import and export of endangered species

⁶⁹ *supra* note 62; The Basel Convention regulates the import and export of hazardous wastes.

⁷⁰ *Supra* note 61; The Montreal Protocol regulates the trade of substances that deplete the ozone layer.

⁷¹ GATT created bodies such as the Group in Environmental Measures and International Trade (GEMIT) and the Committee on Trade and the Environment (CTE) have thus far failed in their efforts to establish rules clearly governing how to resolve conflicts between MEAs and GATT. See Bill O'Connor, *Trade and the Environment: An Update on the GATT Agenda*, 4 *Eur. Env'tl. L. Rev.* 20, and Report of the WTO Committee on Trade and the Environment November 14, 1996 PRESS/TE 014 (1996)

⁷² Vienna Convention of the Law of Treaties, May 23, 1969, 1155 U.N.T.S. [hereinafter the Vienna Convention or the Convention]

Article 30 of the Vienna Convention states the rules for two broad scenarios. The first involves a conflict between two nations that are both party to the International Trade Agreement and to the MEA. Under this scenario, the terms of the most recent agreement will prevail over the earlier agreement.⁷³ Furthermore, under this scenario, the Vienna Convention contains the rule of *lex specialis*, which allows for a more specific treaty to supercede a less specific treaty when the two relate to the same issue, irrespective of the date of the two treaties.⁷⁴ The second scenario is one in which both countries involved in a dispute belong to one agreement but only one party belongs to the second agreement. The Vienna Convention is clear that under such conditions the agreement to which both nations are member will govern.⁷⁵ Clearly, the second scenario describes the rule which would govern the issue addressed in this paper. Therefore, the following discussion will cover how such a dispute would be analyzed from the position of a WTO or NAFTA dispute resolution panel.⁷⁶

IV. Emission Reduction Units Classified as “Products”

Predicting the WTO and/or NAFTA classification of ERUs is a daunting task. There is no precedent for classification of AAUs or any similar instrument under the

⁷³ The Vienna Convention does not stipulate how to determine the official “date” of an agreement in the case of amendments made to one or more of the conflicting agreements.

⁷⁴ See Winter *supra* note 67

⁷⁵ See *id.* at 238

⁷⁶ Per the rules described above, in the case of a trade dispute between the U.S. and Canada, NAFTA will supercede the WTO. However, due to the lack of case law on similar issues under NAFTA, as well as due to the potential breath of this discussion as it applies to other WTO member nations which are non-Kyoto Protocol members this paper will cover WTO/GATT case law as it relates to NAFTA requirements.

WTO or the NAFTA.⁷⁷ The limited published work on the topic⁷⁸ reveals arguments both in favor of and against the classification of AAUs as “products.” Werksman recognizes the potential for their classification as “products” because AAUs will have a market value and may therefore be considered a “commodity.” However, he goes on to argue that this classification is unlikely because historically WTO panels have interpreted “products” to be “tangible goods.”⁷⁹ Other authors repeatedly refer to AAUs as tradable ‘commodities’ but do not offer any guidelines for use of this term.⁸⁰ Nevertheless, because the possibility does exist for AAUs to be classified as “products,” this paper will nevertheless discuss the potential implications of such a classification. Specifically, this paper will discuss the potential for Canada to exclude non-Kyoto Protocol nation derived AAUs from Canada’s domestic trading market through statutory authority or exclusion. The following section will focus on the possibility for legal statutory exclusion of non-Party derived AAUs by way GATT and NAFTA exemptions.

A. Historical Dispute Resolution: Statutory Exclusion

In the event that Canada ratifies the Kyoto Protocol, it is likely that Canada will incorporate the Protocol into domestic law through statute. If this is to occur, the trade restrictions contained in the Kyoto Protocol, limiting use of, and trade in AAUs from non-Party nations, may be effectively viewed as a unilateral trade sanction. Unilateral

⁷⁷ See *supra* note 4 at 255

⁷⁸ See *supra* note 4 and Tania Voon, *Sizing Up the WTO: Trade-Environment Conflict and the Kyoto Protocol*, 10 *Journal of Transnational Law and Policy* 1 (2000) at 93 However, I will not refer to Tania Voon’s argument because she incorrectly represents Werksman’s argument in her citation of his work (at 93), leading me to question her authority on this topic.

⁷⁹ *supra* note 4 at 255

⁸⁰ See Rosenweig et. al., *The Emerging International Greenhouse Gas Market*, Pew Center on Global Climate Change, at iv, 2, 3, and Diringer at 3

trade sanctions refer to internal regulations or trade barriers imposed by one country that affect the importation of goods or services of one or more other countries. At first glance it would appear that such a sanction would be impermissible under NAFTA or the GATT/WTO rules. However, it is possible for a unilateral sanction to be placed on an exporting party's goods if the conditions fall under one of the NAFTA or GATT/WTO exemptions described in Section II.(B) and (C)⁸¹ above, i.e. those restrictions do not constitute arbitrary, or unjustifiable discrimination, they are necessary for the protection of human, animal or plant life or health, or they relate to the conservation of an exhaustible natural resource under NAFTA Chapter 21.

In the case of a trade dispute between Canada and the U.S., a NAFTA panel would likely hear the case rather than a WTO panel.⁸² However, a NAFTA panel has yet to rule on a trade dispute based on imposition of a unilateral trade sanction. Therefore, because the relevant environmental provisions are identical under NAFTA and the GATT/WTO, the following discussion will focus on how these types of disputes have been historically decided by WTO panels.

Dispute resolution panels will tend to employ similar methodology in interpreting GATT Article XX(b) and (g). In interpreting Article XX(b) the panel will often ask three questions in order to determine applicability:⁸³ (1) Is the substance of the measure in

⁸¹ NAFTA also provides exceptions for National Security protection and Canadian and Mexican Cultural Industries. These will not be discussed in this paper.

⁸² As governed by the Geneva Convention on Treaties, in the case of a discrepancy between two multilateral agreements, the later treaty to which all parties involved in the dispute are signatories shall be given deference.

⁸³ *supra* note 59 at 276

question the protection of human, animal, or plant life or health?; (2) Is the measure *necessary* to protect human, animal, or plant life or health?; and (3) Is the measure applied in such a manner so as to avoid arbitrary or unjustifiable discrimination and/or a disguised restriction on international trade? The operative language is the word “necessary,” which can be interpreted in one of two ways. First, “necessary” can take the “protection of human, animal, or plant life or health” as its object, and therefore be interpreted to mean that the measure taken is necessary for the protection of that object. Alternatively, it can be interpreted to mean that the measure is a necessary *departure* from the GATT because it “entails the least degree of inconsistency with other GATT provisions.” The latter of these two interpretations has been favored by recent GATT panels.⁸⁴

Mirroring the methodology employed in interpreting Article XX(b), interpretation of GATT Article XX(g) has often been carried out by dispute resolution panels based on the following analysis: (1) Is the measure related to the conservation of exhaustible natural resources?; (2) Does the specific measure *relate to* the protection of exhaustible natural resources?; (3) Are the invoked measures made in conjunction with identical domestic measures or restrictions?; and (4) Are the measures applied in accordance with the chapeau of Article XX?⁸⁵ In answering these questions, the phrase “relating to” has sometimes been interpreted to mean that the measure is “primarily aimed at”⁸⁶

⁸⁴ i.e. Thailand- Restrictions on Importation of and Internal Taxes on Cigarettes, November 7, 1990 30 I.L.M. 1122

⁸⁵ *supra* note 59 at 277

⁸⁶ see Canada – Measures Affecting Exports of Unprocessed Herring and Salmon, March 22, 1988 GATT B.I.S.D. (35th Supp.) 98 (1988)

conservation. However, as seen below in the U.S. Gasoline Standards⁸⁷ panel decision, the scope of this interpretation has also been significantly limited through an alternate more narrow interpretation of the phrase “relating to” to mean “necessary or essential.”

In addition to direct interpretations of GATT Article XX(b) and (d), the question of extraterritoriality has also been subject to review and interpretation with respect to unilateral trade sanctions. The history of this interpretation will be discussed in relation to the conflicting interpretations of the panels that heard Tuna /Dolphin I⁸⁸ and II⁸⁹ as discussed below.

Cases taken to WTO dispute resolution panels⁹⁰ have challenged unilateral sanctions imposed by member nations which claimed that the imposed measures fell under one or more of the exceptions described above. Five of these cases are described below. Panel decisions are not binding on future panels, and therefore do not offer concrete guidelines or arguments for future dispute settlement. However, they do offer a glimpse at the trends in interpretation of the law that we can expect under similar circumstances. One such circumstance may be a Canadian sanction on U.S. created AAUs.

1. Tuna / Dolphin I and II Cases

⁸⁷ United States – Standards for Reformulated and Conventional Gasoline, 35 I.L.M. 274 (1996) [hereinafter *U.S. Gasoline Standards*]

⁸⁸ United States – Restrictions on Imports of Tuna, 30 I.L.M. 1598 (1992) [hereinafter *Tuna/Dolphin I*]

⁸⁹ United States – Restrictions on Imports of Tuna, 33 I.L.M. 839 (1994) [hereinafter *Tuna/Dolphin II*]

⁹⁰ To date, parallel disputes have not been decided by a NAFTA panel, however because the same exceptions being challenged above also apply under NAFTA these decisions can be assumed to be indicative of a NAFTA panel decision as well. However, it is important to note that dispute resolutions are not formally binding to future panel decisions under GATT/WTO or NAFTA.

i) Historical Overview

The “purse-seine” method is commonly used by fishing fleets worldwide to fish for tuna. The method involves the release of a large net, up to a mile long⁹¹ that traps tuna and whatever else happens to be in the vicinity. Because dolphins tend to follow tuna, fishermen commonly search out the more visible dolphins to determine where to throw their nets. As a result, thousands of dolphins⁹² are trapped and killed in the nets each year. In response to citizen concern over the fate of dolphins and other marine mammals the U.S. Congress enacted the Marine Mammal Protection Act of 1972⁹³ (MMPA). The MMPA was designed to protect dolphins by regulating domestic fishing techniques and imposing an embargo on foreign countries that did not conform to these regulations. The MMPA placed an embargo on tuna and tuna products from foreign nations that were harvested in a manner that is harmful to dolphins until such time as the Secretary of Commerce certifies that the incidental kill rate of dolphins for a particular nation is in compliance with U.S. standards.⁹⁴ The MMPA also placed an embargo on intermediary nations⁹⁵ that imported tuna or tuna products from a country that harvests

⁹¹ *supra* note 64

⁹² An average of 300,000 dolphins are killed by fishermen each year by U.S. fishing fleets alone. See *supra* note 64 at 648. In the 1950's at the height of the use of the purse-seine method millions of dolphins were netted and killed along with tuna. See Joseph Urgese, *Dolphin Protection and the Mammal Protection Act Have Met Their Match: The General Agreement on Tariffs and Trade*, 31 Akron Law Review 457 (1998) at 464

⁹³ 16 U.S.C. §1361-1407 (1985) [hereinafter *MMPA*], as amended by the International Dolphin Conservation Program Act, 111 Stat. 1122 (1997) [hereinafter *IDCPA*]

⁹⁴ 16 U.S.C. §1371(a)(2)(B)(ii)(I) (1997) provides that “the average rate of incidental taking by vessels of the harvesting nation is no more than 2.0 times that of United States vessels during the same period by the end of the 1989 fishing season and no more than 1.25 times that of United States vessels during the same period by the end of the 1990 fishing season and thereafter.” See *supra* note 92 at 465

⁹⁵ “[T]he term ‘intermediary nation’ means a nation that exports yellowfin tuna or yellowfin tuna products to the United States and that also imports yellowfin or yellowfin tuna products that are subject to a direct ban on importation into the United States pursuant to section 1371(a)(2)(B) of this title.” See MMPA § 1362(5)

tuna in a manner that is harmful to dolphins. The unilateral sanctions imposed by the MMPA have been challenged a number of times under GATT/WTO. As seen in the discussion below, the challenges were made citing GATT law that is replicated under the NAFTA. Therefore, the panel interpretations of the law are noteworthy in analyzing the potential for a Canadian sanction against U.S. created AAUs to fall under one of the corresponding NAFTA exceptions.

ii) Tuna/Dolphin I Dispute

In 1991 Mexico requested that a GATT Dispute Resolution Panel be assembled⁹⁶ to reconcile the disparity between the sanctions imposed by MMPA and U.S. trade obligations under GATT. Mexico claimed that MMPA conflicted with the GATT Article III (“national treatment obligation” of imported “like products”), and Article XI (prohibiting quantitative restrictions). Additionally, Mexico claimed that the MMPA did not fall under any of the Article XX exceptions. Mexico argued that Article XX(b) did not apply, this meant that the embargo was not “necessary” to the protection of dolphin life and health because alternative means, such as international cooperation through MEAs, consistent with the GATT, were available to protect dolphin life and health. Additionally, Mexico argued that Article XX(g) was inapplicable because the U.S. was not primarily concerned with the protection of dolphins, and that the measure was designed to create a disguised barrier to international trade.

⁹⁶ Pursuant to their rights under GATT Article XXII:2

The panel found Article III inapplicable because it only applies to “products,” not “processes.”⁹⁷ They argued that tuna taken by purse-seine methods are the same as tuna taken by any other method and are therefore “like products” which cannot be discriminated between. Therefore, because the MMPA was regulating “process” of harvesting tuna and not the “product” itself, the Act did not fall into the scope of Article III. Furthermore, the Panel found that the MMPA did not qualify for exemption under any of the Article XX provisions. Their decision hinged on the interpretation of two key issues. The first was the use of the word “necessary,” as discussed above. The panel interpreted the “necessary” requirement of Article XX(b) to “refer to the trade measures requiring justification under Article XX(b), [and] not...to the life or health standard chosen by the contracting party.”⁹⁸ Effectively this meant that a nation can impose unilateral sanctions to protect the life and health of humans, animals, or plants *only* it has exhausted all other alternatives. The panel decided that the U.S. had not done this, and therefore the policy measure was not “necessary.”⁹⁹

The second issue of interpretation related to the ability of a nation to apply unilateral sanctions extraterritorially, or the ability of the U.S. to impose regulations that were effective outside U.S. geographical jurisdiction.¹⁰⁰ The panel ruled that although these were not disguised trade restrictions, natural resources and living

⁹⁷ Although the panel did not officially rule on Article III it stated that even if the U.S. had solely regulated the sale of tuna products internally, it still would have been in violation of Article III(4)’s national treatment mandate based on inconsistencies between requirements for domestic and foreign vessels.

⁹⁸ *supra* note 92 at 477

⁹⁹ Some argue that this decision ignored the fact that the U.S. had been engaged in negotiations to establish an MEA to protect dolphin life and health for approximately forty years. See Steve Charnovitz, *Dolphins and Tuna: An Analysis of the Second GATT Panel Report*, 24 Environmental Law Reporter (1994)

¹⁰⁰ Not to be confused with extrajurisdictionality see ?????Shoenberg? LOOK UP LATER

things¹⁰¹ could only be protected under those provisions which were within the geographical jurisdiction of the country concerned. Similarly, in its interpretation of Article XX(g), the panel ruled that a party can impose “trade measures primarily aimed at conservation of exhaustible natural resources solely within their own jurisdiction.”¹⁰² This meant that the U.S. was unjustified in imposing unilateral sanctions aimed at conserving dolphins in areas under Mexican jurisdiction. Because Article XX did not apply the panel ruled that the U.S. was in violation of Article XI of the GATT.¹⁰³ The panel stated that although parties can impose regulations affecting the internal sale of products, they could not place restrictions on the processes by which those products were produced.

iii) Tuna/Dolphin II Dispute

In 1992 the European Economic Community (EEC), later joined by the Netherlands, filed a request for a WTO panel to review a similar issue with respect to EEC and Dutch fishing fleets. The EEC and the Netherlands challenged the intermediary nation embargo contained in §1371(a)(2)(C) of the MMPA.¹⁰⁴ They claimed that it violated Article XI of GATT,¹⁰⁵ and that it was not an internal regulation permitted under GATT Article III. Thirdly, the EEC and the Netherlands

¹⁰¹ i.e. humans, animals, and plants pursuant to GATT Article XX(b)

¹⁰² However, as we will see in Tuna/Dolphin II there is no language that limits the scope of a parties actions to their own territories.

¹⁰³ This panel decision was never carried out due to political reasons surrounding the anticipated adoption of the NAFTA. Mexico’s rejection of the decision was widely viewed as a diplomatic measure aimed at urging U.S. Congress to pass the NAFTA. The U.S. and Mexico independently negotiated terms of an agreement surrounding the tuna/dolphin issue.

¹⁰⁴ As described above, the intermediary nation clause of MMPA placed an embargo on all nations that imported tuna or tuna products from a nation that may be subject to the direct U.S. tuna embargo.

¹⁰⁵ Article XI of GATT prohibits quantitative restrictions on imported goods from member nations.

argued that GATT Article XX was inapplicable because the measures were taken outside U.S. jurisdiction. The U.S. claimed that the embargo was protected under GATT Articles XX(b),(g), and (d).¹⁰⁶

The panel found that the intermediary nation embargo was not a justifiable measure “relating to the enforcement at the time or point of importation of an internal law, regulation, or requirement that applied equally to the imported product and the like domestic product.”¹⁰⁷ Therefore, the panel ruled that the intermediary embargo was in violation of GATT Article III. The panel further ruled that because the embargo was in violation of Article III, it also violated Article XI’s quantitative restriction prohibition.

The panel’s analysis of Article XX is of particular interest. In its analysis of Article XX(g), the panel imposed a three prong analysis similar to that described above in Section IV (A). First, the panel affirmed that dolphins are in fact an exhaustible resource and that the U.S. policy was indeed a measure designed at conserving that resource. Mirroring the argument adopted by Mexico in Tuna/Dolphin I, the EEC and the Netherlands argued that even if dolphins are an exhaustible natural resource, the U.S. could not impose its regulations extraterritorially to protect them. Unlike the decision in Tuna/Dolphin I, the panel disagreed and ruled that there was nothing in the text of the GATT to limit the scope of a protective measure to a nation’s own jurisdiction,¹⁰⁸ finding “no valid reason for

¹⁰⁶ Article XX(d) as amended in 1994 states that nothing in the GATT agreement shall prevent parties from imposing measures:

necessary to secure compliance with laws or regulations which are not consistent with the provisions of this Agreement, including those relating to the customs enforcement, the enforcement of monopolies..., the protection of patents, trade marks and copyrights, and the prevention of deceptive practices.”

¹⁰⁷ see GATT Article III

¹⁰⁸ This decision was reinforced by general international law principles which state that with respect to natural resources outside their territory “states are not in principle barred from regulating the conduct of their nationals.”

supporting the conclusion [reached by the Tuna/Dolphin I WTO dispute resolution panel] that the provisions of Article XX(g) apply only to...the conservation of exhaustible natural resources located within the territory of the contracting party invoking the provision.”¹⁰⁹ They did rule, however, that this extraterritoriality could only be applied with respect to the countries’ own nationals and vessels. Nonetheless, this is a landmark decision opening the door for the first time to the validation of extraterritorial measures aimed at protecting a natural resource.

Second, the panel examined the issue of whether the embargo was applied “in conjunction” with domestic restrictions and policies and if those policies were *primarily aimed*¹¹⁰ at the conservation of dolphins. In its analysis, the panel noted that the intermediary embargo restricted the importation of tuna products from affected nations, regardless of whether the tuna was harvested in a manner harmful to dolphins. Therefore, the policy was not “primarily aimed” at the conservation of dolphins. The panel also ruled that because the primary embargo was not held against nations harvesting tuna in accordance with U.S. standards, even if their method *was* harmful to dolphins, the measure was not applied equally,¹¹¹ and therefore violated the GATT. Furthermore, the panel ruled that because the U.S. embargoes could not effectively conserve dolphins unless other nations changed their own domestic conservation policies in accordance with those of the U.S., the primary

¹⁰⁹ *supra* note 89

¹¹⁰ The panel chose to adopt the interpretation of previous panels. They interpreted the phrase: “related to the conservation of exhaustible resources” to mean “primarily aimed at the conservation of exhaustible natural resources.”

¹¹¹ It would be interesting to note if the panel took into account that there may be other methods, that are not in accordance with U.S. standards, of harvesting tuna without harming dolphins. i.e. as in the Shrimp/Turtle case described in Section IV(A)(2).

and intermediary nation embargoes were not permissible under the GATT. Lastly, the panel ruled that based on the above analysis, the U.S. embargoes were also in violation of the chapeau to Article XX.¹¹²

The analysis of Article XX(b) mirrored much of the panel's reasoning in its interpretation of Article XX(g). The EEC and the Netherlands did not challenge the MMPA on the grounds that it was not designed for "the protection of human, animal, or plant life or health," therefore the panel did not address this issue. Instead, the EEC and the Netherlands again argued the issue of extraterritoriality. In accordance with its interpretation of Article XX(g), the panel ruled that nothing in GATT limits the scope of a nation's unilateral policies as such. Second, the panel analyzed whether the embargoes were "necessary" to protect dolphin life and health. Again, in accordance with its analysis of Article XX(g), the panel ruled that it was not "necessary" because the policies could not accomplish their objectives without forcing domestic policy changes in the affected nations.

Lastly, in response to the U.S. claim that the embargo fell under the exception in Article XX(d),¹¹³ the panel ruled that because the primary nation embargo was inconsistent with GATT Article XI(1), it could not be justified under this exception.

2. Shrimp / Turtle Cases

¹¹² The chapeau to Article XX states the following:

Subject to the requirements 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...

¹¹³ *supra* note 106

i) Historical Overview

A similar dispute was brought before the WTO dispute resolution panel in 1997 by India, Malaysia, Pakistan, and Thailand.¹¹⁴ This dispute involved unilateral trade sanctions imposed by the U.S. upon countries whose shrimp harvesting methods result in the killing of high numbers of incidental sea turtles. One such method is the use of driftnets, or “curtains of death.”¹¹⁵ Driftnets,¹¹⁶ are huge fishing nets up to thirty miles long and forty feet wide¹¹⁷ which are left to move freely with ocean currents and ensnare whatever comes into their path. The United Nations has called for a moratorium on the use of driftnets.¹¹⁸ A second method, the use of shrimp trawlers, also causes high levels of incidental sea turtle takings. National Marine Fisheries Service (NMFS) studies have shown that up to 48,000 sea turtles are killed annually by U.S. fishing fleets off of the Gulf of Mexico and the South Atlantic,¹¹⁹ other studies show that close to 125,000 turtles die each year worldwide as a result of shrimp trawling and tuna harvesting activities.¹²⁰ In response to these studies, the NMFS developed the Turtle Excluder Device (TED), which significantly decreased the numbers of sea turtles taken during shrimp harvesting operations.¹²¹ In 1989

¹¹⁴ Other WTO members also challenged the import ban with oral arguments. Including: Australia, Ecuador, El Salvador, the European Union, Guatemala, Hong Kong, Japan, Nigeria, Philippines, Singapore, and Venezuela. See Susan Sakmar, *Free Trade and Sea Turtles: The International and Domestic Implications of the Shrimp-Turtle Cases*, 10 Colorado Journal of International Environmental Policy and Law 347 at 357

¹¹⁵ Paul Stanton Kibel, *Justice for the Sea Turtle: Marine Conservation and the Court of International Trade*, 15 UCLA Environmental Law and Policy 57 at 60

¹¹⁶ Driftnets are outlawed for use by U.S. fishing fleets see High Seas Driftnet Moratorium Protection Act, 16 U.S.C § 1826 (1999)

¹¹⁷ *supra* note 64 at 649

¹¹⁸ see *Large-scale Pelagic Driftnet Fishing and its Impact on the Living Marine resources of the World's Oceans and Seas*, G.A. Res. 215, U.N. GAOR, 46th Sess. 79th plen. mtg., U.N. Doc. A/Res/46/215 (1991)

¹¹⁹ *supra* note 64 at 649

¹²⁰ *supra* note 115 at 59

¹²¹ TED's can free up to 97% of incidentally taken sea turtles and can be installed for approximately U.S. \$50-600 per boat. See *supra* note 64 at 649.

Congress passed Section 609 of Public Law 101-162, an appropriations act that amended the Endangered Species Act.¹²² Section 609 prohibits the importation of shrimp from countries whose shrimp harvesting methods fail to meet U.S. standards through the use of TEDs or other comparable protection measures.

ii) WTO Panel Decision

In arguing this case, the complainants contended that they already had domestic conservation plans in place aimed at the conservation of sea turtles, and that use of a TED was not the only shrimp harvest method effective in avoiding the incidental takings of sea turtles. In response, the U.S. argued that because the use of trawling nets caused the highest number of incidental mortality of sea turtles, use of a TED on trawling vessels was necessary for the conservation of the species.¹²³ The U.S. argued that the conservation measures taken by the complainants to protect sea turtles were ineffective. In turn, the complainants argued that the use of TEDs was cost prohibitive and/or not entirely effective for use on shrimp trawlers. Additionally, two non-governmental organizations (NGOs) had submitted documentation concerning sea turtle ecology to the panel for review under Article 13 of the Dispute Settlement Understanding.¹²⁴ The panel ruled that because the documents were unsolicited they were not permitted to take them into account. However, the panel did invite either party to include the documents as part

¹²² 16 U.S.C. § 1533(d) (1994)

¹²³ see *Report of the Panel on United States – Import Prohibition on Certain Shrimp and Shrimp Products*, May 15, 1998, 37 I.L.M. 832 [hereinafter *Panel Report*]

¹²⁴ Understanding on Rules and Procedures Governing the Settlement of Disputes, Apr. 15, 1994, 33 I.L.M. 112 (1994) [hereinafter *DSU*] Additionally, the Dispute Settlement Body (DSB) is established by the DSU to assist in dispute resolution between parties.

of its own submissions. Specific to GATT requirements, the plaintiffs argued that the U.S. had violated GATT Article XI¹²⁵ and that the embargo was not justified under GATT Article XX exemptions.

The U.S. did not dispute that the embargo violated GATT Article XI(1), instead they argued that since the embargo was justified by Articles XX(b), (g) and (d), the violation was irrelevant. Accordingly, the panel concurred that the embargo was in violation of GATT Article XI(1).

The complainants argued that Article XX did not justify the embargo because the U.S. could not invoke a measure to protect turtles outside of its jurisdiction. In evaluating the applicability of Article XX, the panel focused on the Article chapeau.¹²⁶ The panel chose to interpret the term “unjustifiable” in the context of the overall object and purpose of the GATT: to promote economic development through free trade. The panel stated that a member is only justified in using Article XX exemptions to deviate from the requirements of GATT when done in a way not to undermine the objective of the agreement. Based on this interpretation, the panel ruled that Section 609 did not fall within the scope of Article XX and therefore, the U.S. was “unjustified” in using Article XX exemptions to qualify the embargo.¹²⁷

iii) WTO Appellate Body Decision

¹²⁵ *supra* note 30

¹²⁶ *supra* note 112

¹²⁷ The panel also noted that in efforts associated with environmental protection, MEAs are a preferred method to unilateral sanctions. See *supra* note 123 para 7.50

Under political pressure from environmental groups and other politicians, President Bill Clinton appealed the WTO panel decision. The dispute was brought to a WTO Appellate Body in 1998. The U.S. appealed the panel decision on two grounds: (1) The panel erred in finding that it could not review unsolicited information from NGOs; and (2) The panel erred in finding that Section 609 did not fall within the scope of Article XX.

The Appellate Body found that the panel had indeed erred in its interpretation of Article 13 of the DSU. The Appellate Body ruled that the panel had the “discretionary authority either to accept and consider or to reject information and advice submitted to it, whether requested by the panel or not.”¹²⁸

Regarding the second issue, the Appellate Body ruled that the panel had erred in its interpretation of the chapeau. It ruled that the panel “did not inquire specifically into how the application of Section 609 constitutes a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade.”¹²⁹ Additionally, the Appellate Body rejected the panel’s chapeau down approach. The Appellate Body stated that the appropriate way to interpret Article XX, was primarily by justifying or rejecting its applicability under Sections (b), (g) or (d), followed by justification or rejection under the conditions in the chapeau.

¹²⁸ see Report of the Appellate Body United States – Import Prohibition of Certain Shrimp and Shrimp Products, October 12, 1998.

¹²⁹ see *ibid.* at para. 114.

In its analysis of Article XX(g), the Appellate Body addressed the issue of whether Section 609 applied to an “exhaustible natural resource.” In accordance with past panel decisions, it ruled that sea turtles are indeed an exhaustible natural resource. Next, it examined whether Section 609 is “related to the conservation” of sea turtles. The Appellate Body found that based on the amount of scientific evidence provided to the panel regarding the mortality rate associated with shrimp trawling and the effectiveness of TEDs, the measure was indeed “related to conservation” of sea turtles. Lastly, the Appellate Body examined whether Section 609 was a “measure made effective in conjunction with restrictions on domestic” harvesting of shrimp. The Appellate Body found that indeed it was, as the U.S. had corresponding regulations affecting domestic fishing vessels.

Having justified Article XX(g)’s applicability to Section 209, the Appellate Body turned to the chapeau of Article XX. It examined the issues of “unjustifiable discrimination,” and “arbitrary discrimination” as they relate to Section 609 requirements. First, in examining the issue of “unjustifiable discrimination,” the Appellate Body ruled that the U.S. was indeed in violation. It found four reasons: (1) the U.S. embargo was aimed at forcing other member nations to adopt policy changes; (2) the embargo did not permit imports of shrimp from vessels using TEDs if those shrimp originated in waters under the jurisdiction of nations not certified under Section 609;¹³⁰ (3) the U.S. failed to engage in multilateral negotiations to solve the problem before

¹³⁰ Similar to the requirements under MMPA, Section 609 required that nations’ shrimp harvesting methods be certified by the U.S.

implementing the embargo; and (4) the U.S. gave differential treatment to different affected member nations through the application of phase-in periods and transfer of TED technology. Next, the Appellate Body looked at the issue of “arbitrary discrimination.” It found that the “rigidity and inflexibility” of the certification process under Section 609 constituted “arbitrary discrimination.” It referenced the fact that in order for a nation to receive certification, Section 609 essentially requires it to adopt shrimp harvesting policies identical to those of the U.S. The Appellate Body also found that the lack of “transparency” involved in the certification process not only amounted to “arbitrary discrimination,” but was also violated the GATT Article III(3).¹³¹ The Appellate Body noted the lack of opportunity for a nation to respond or argue against a negative certification decision.

Based on the above analysis, the Appellate Body ruled that despite the applicability of Article XX(g) to Section 609, this appropriations act failed to meet the requirements of the chapeau of GATT Article XX. They recommended that the U.S. bring its policies into compliance with its obligations under the GATT. Despite the final Appellate Body decision, this ruling is significant in that it opens the door for member nations to impose unilateral sanctions on other member nations provided that certain requirements are met.

¹³¹ GATT Article III(3) provides that:

Each member shall administer in a uniform, impartial and reasonable manner all its laws, regulations, decisions, and rulings...Each member shall maintain, or institute as soon as practicable, judicial, arbitral, or administrative tribunals or procedures for the purpose, *inter alia*, of the prompt review and correction of administrative action relating to customs matters.

GATT Article XXIV defines transparency guidelines for member nations.

3. U.S. Gasoline Standards Case¹³²

i) Historical Overview

The Clean Air Act Amendments of 1990 established programs for reformulated and conventional gasoline. The programs required changes in the composition of gasoline sold to consumers. A baseline year of 1990 was established by the U.S. Environmental Protection Agency (EPA), which affected domestic and foreign companies in different ways. Domestic companies were permitted to establish individual baselines based on their own 1990 data. Foreign companies, however, were not given similar liberty, and were required to use a statutory baseline set by the EPA. The WTO dispute resolution panel concluded that this restriction was (1) not consistent with Article III:4 of the GATT which outlines the National Treatment Principle;¹³³ and (2) could not be justified by any Article XX exceptions. The case was subsequently taken to an Appellate Body which reached the same final conclusion, although through vastly different reasoning, as discussed *infra*.

ii) Appellate Body Decision

Although the WTO panel decided that the conditions of the sanction placed on foreign gasoline did not satisfy the requirements of the GATT Article XX(g), the Appellate Body decided that those requirements were indeed satisfied. However, the

¹³² Report of the Appellate Body in the United States – Standards for the Reformulation and Conventional Gasoline, May 20, 1996, 35 I.L.M. 603

¹³³ Discussed in II(B)(1) above

Appellate Body also decided that the measure constituted “unjustifiable discrimination,” and a “disguised restriction on international trade.” The Appellate Body added that:

[T]he kinds of considerations pertinent in deciding whether the application of a particular measure amounts to “arbitrary or unjustifiable discrimination,” may also be taken into account in determining the presence of a “disguised restriction” on international trade. The fundamental theme is to be found in the purpose and object of avoiding abuse or illegitimate use of the exceptions to substantive rules available in Article XX.¹³⁴

The Appellate Body stated that the U.S. could have avoided violating GATT Article III:4 by allowing equal treatment to foreign and domestic companies. This could have been done in one of two ways; (1) allowing foreign companies to establish their own baselines; or (2) imposing a statutory baseline on domestic companies. The Appellate Body further stated:

These two omissions go well beyond what was necessary for the Panel to determine that a violation of Article III:4 had occurred in the first place. The resulting discrimination must have been foreseen, and was not merely inadvertent or unavoidable.¹³⁵

The Appellate Body was justified in its analysis of the U.S.’s use of “unjustifiable discrimination” between nations with respect to establishing baselines and therefore its violation of GATT Article III. This decision highlights the necessity of vigilant analysis

¹³⁴ United States – Standards for Reformulated and Conventional Gasoline, Appellate Body Report 35 I.L.M. 603 (1996)

¹³⁵ *ibid* at 628

of GATT provisions to avoid clear violations as was evident in the U.S. Gasoline Standards Case.

4. Asbestos Case¹³⁶

i) Historical Overview

In the Asbestos Case, the Canadian government challenged a French ban on imports of asbestos or asbestos-containing products. The decision in the landmark case represents the first time that a WTO panel found that a trade measure in conflict with the substantive obligations of the GATT justified under GATT Article XX. The case subsequently went to an appellate body, which, while upholding the Panel's overall conclusion, chose not to rely on Article XX but instead focused on GATT Articles III:4¹³⁷ and XI.¹³⁸ The Appellate Body ruled that the trade measure in question did not represent a violation of Article III and was therefore permissible under GATT.

ii) Panel Decision

The Canadian government contended that the French ban violated GATT Article III because the asbestos products it exported to France were "like products" to substitute products manufactured in France. France claimed that the ban fell within the exemptions allowed for in GATT Article XX. In order to determine whether Canadian asbestos was indeed a "like product" to the French alternative product, the Panel employed a three prong analysis. It analyzed: 1) the end uses of the products; 2) consumers' tastes and

¹³⁶ WTO Panel Report on European Communities – Measures Affecting Asbestos and Asbestos-Containing Products, WT/DS135/R (Sept. 18, 2000), at <http://www.wto.org> [*hereinafter* Asbestos Panel Report]

¹³⁷ outlining the National Treatment Principle

¹³⁸ prohibiting any quantitative restrictions on imports

habits; and 3) the products' properties, nature, and quality.¹³⁹ The Panel ruled that the Canadian and French products were "like products" because they had similar end uses and were therefore subject to the scrutiny, and in violation of the GATT Article III. Therefore, the Panel found that the French ban was in violation of the GATT Article III. However, the panel found the ban justified under GATT Article XX(b) as well as the GATT Article XX chapeau.

The panel ruled that the ban fell within the scope of GATT Article XX(b) because asbestos presented a significant risk to human health. It reached this decision despite Canada's claims that because the asbestos was encapsulated in cement products it did not present a human health risk due to exposure.¹⁴⁰ The panel went on to rule that the ban was indeed "necessary," because there does not exist an alternative method to protect human health which is "less inconsistent" with the requirements of the GATT.¹⁴¹ Next, the panel turned to the Article XX chapeau and examined the issue of "arbitrary or unjustifiable discrimination." It ruled that because France imposed the ban against all asbestos products regardless of their country of origin, the ban did not constitute "arbitrary or unjustifiable discrimination." Lastly, the panel examined whether or not the ban constituted a "disguised restriction on international trade." It defined "disguised" to mean "conceal[ed] beneath deceptive appearances, counterfeit, alter so as to deceive."¹⁴²

¹³⁹ Laura Yavitz, *The World Trade Organization Appellate Body Report, European Communities – Measures Affecting Asbestos and Asbestos-Containing Products, March 12, 2001, WT/DS135/AB/R*, 11 Minn. J. Global Trade 43

¹⁴⁰ Expert testimony was taken into account to come to this decision.

¹⁴¹ The panel examined and rejected the method of "controlled use" of asbestos in order to make this determination. See *supra* note 139 at 54.

¹⁴² *supra* note 139 at 56

The Panel concluded that because the sanction was published and the WTO was notified of the measure was not “disguised.”

iii) Appellate Body Decision

This landmark decision, allowing an exception under Article XX, was subsequently appealed to a WTO/GATT Appellate Body.¹⁴³ The Appellate Body also reached a landmark decision that was not simply an upholding of the original Panel’s ruling. The Appellate Body found the French measure *consistent* with French obligations under the GATT. It concluded that the ban did not violate GATT Article III’s National Treatment principle, and therefore the Article XX exceptions did not apply. Its method of analysis is described below.

In reaching their decision, the Appellate Body focused on the definition of “like products.” It stated that the Panel had not analyzed the term “like products” thoroughly because the Panel had not taken into account the “risk”¹⁴⁴ factor in its analysis. The Appellate Body also noted that products competitive with one another are considered “like products.”¹⁴⁵ In its analysis, the Appellate Body used the same framework criteria as the Panel. Namely, it used a market-based approach examining: 1) physical properties; 2) end uses; and 3) tariff classification. Additionally, the Appellate Body noted that these

¹⁴³ It is interesting to note that in making its decision the Appellate Body chose to prohibit the submission of any documentation from NGOs. This is in stark contrast to the decision made by the Shrimp/Turtle Appellate Body.

¹⁴⁴ *supra* note 139

¹⁴⁵ *supra* note 139 at 59

criteria simply served as a framework for analysis and other aspects could be included.¹⁴⁶ The Appellate Body compared the “physical properties” of the Canadian asbestos to the French alternative product. It noted that the “physical properties” must be analyzed in light of the effect that differences in such properties may have on the marketability of the products.¹⁴⁷ It went on to write that the health risk should be included in the analysis of “physical properties,” as well as with respect to “consumer taste,” because the health risk may have significant impact on these two issues. Based on these facts the Appellate Body found that the Canadian asbestos and the French substitutes were not “like products” because the Canadian products had an associated health risk while the French substitute did not. The Appellate Body went on to clarify its decision by stating that for “likeness” to be determined, a member nation must provide two things: 1) evidence of unlikeness based on different end uses; and 2) a showing that the number of similar applications outweighs the number of dissimilar applications.¹⁴⁸ Based on its findings described above, the Appellate Body declined to review criteria based on “consumer taste and habits,” or “tariff classification.”¹⁴⁹

B. Under What Conditions Would a Canadian Imposed Trade Sanction on U.S. Derived AAUs Be Permissible Under WTO/GATT and NAFTA?

¹⁴⁶ *supra* note 139 at 59

¹⁴⁷ WTO Appellate Body Report on European Communities – Measures Restricting Asbestos and Asbestos-Containing Products, WT/DS135/AB/R at www.wto.org [*hereinafter* Appellate Body Report] at para 114

¹⁴⁸ *supra* note 139 at 61

¹⁴⁹ Canada also challenged the French ban under other sections of the GATT including Article 2 of the TBT Agreement, GATT Article XXIII:1(b), and GATT Article XI. Because these arguments are not relevant to GATT Article XX exemptions, they will be not be discussed in this paper.

A close analysis of the decisions made in the cases described above, as well as some additional inquiry, must be employed before attempting to answer this question. Furthermore, the lack of formal binding precedent set by WTO panels on future WTO panel decisions, and on future NAFTA panel decisions, eliminate the guarantee with any degree of certainty that the conclusion reached by one Panel would be followed by another. However, an examination of the facts at hand can provide insight into what would likely transpire *if* past interpretations of the law made by WTO panels are taken into account by future NAFTA panels. As noted above in Section II(C)(3), NAFTA Chapter 21 defers explicitly to GATT Article XX. Therefore, references to, and the language of, GATT Article XX will be used in the following discussion. The reader is advised that GATT Article XX is effectively the same as NAFTA Chapter 21 for the purposed of this analysis.

1. Would a Canadian Unilateral Sanction Fall Under the Scope of Article XX?

The very nature of a unilateral sanction, or ban, conflicts with member obligations under WTO/GATT and NAFTA, as it places a quantitative restriction on products imported from other member nations, and thereby also favors like products created domestically. Therefore, a Canadian unilateral sanction imposed against U.S. created AAUs would likely violate the NAFTA and the GATT's most favored nation (MFN), and/or national treatment principles, as well as their prohibitions on quantitative restrictions placed on imports from other member countries.¹⁵⁰ However, GATT Article

¹⁵⁰ *supra* notes 27, 29, and 30

XX¹⁵¹ allows for exceptions to these requirements under specific conditions. Therefore, if the Canadian sanction can be justified under GATT Article XX it may, nonetheless, be permissible under GATT and NAFTA. It is important to note however, that to qualify for Article XX exemptions ERUs must be deemed “products” under GATT and NAFTA.

This assumption has been made below.

Based on the cases discussed above, there are a number of requirements that must be met in order for a unilateral Canadian sanction against U.S. created AAUs to fall under the scope of Article XX. Each of these questions is examined below.

i) Article XX(b)

Article XX(b) requires us to ask the question: is such a measure related to the conservation of human, animal, or plant life or health? This is a difficult question to answer in that the sanction itself only protects Canada from economic loss as a result of not being able to account for U.S. created AAUs under the rules of the Kyoto Protocol. Certainly the sanction does *indirectly* protect human health in that it removes one potential barrier preventing Canada from participating in the Kyoto Protocol. The Kyoto Protocol in itself certainly pertains to, and is arguably necessary, to the conservation of human, animal and plant life and health for a number of reasons. Among the threats to human health, scientific literature cites a number of problems in response to increased global temperature including increased death rate among the “very young, very old, and sick” populations, introduction of and increase of tropical diseases such as malaria,

¹⁵¹ and corresponding NAFTA Chapter 21

cholera, Lyme disease, and encephalitis, increases in air and water borne parasites, and loss of habitation due to increased sea level as polar ice caps melt.¹⁵² Animal life and health is also threatened by the effects of global warming. One, of many examples includes Thai tropical fish populations. Tropical fish are extremely sensitive to small increases in water temperature. Experts anticipate that even a one to two degree temperature increase in sea water will increase fish susceptibility to various diseases.¹⁵³ Lastly, scientific literature also suggests that plant life and health will suffer as a result of global warming. According to one peer reviewed journal article:

Indirect effects of elevated CO₂ on trees and forests are likely to be as, or more important than their direct effects on photosynthesis. For example, elevated CO₂ can decrease N[itrogen] concentrations and increase nonstructural carbohydrates and secondary metabolites, all of which can alter tree resistance to pests and herbivores...¹⁵⁴

It is unclear how a NAFTA panel may interpret an indirect link between the sanction and the requirements of Article XX(b). However, based on the historical trend of WTO/GATT dispute resolution panels to favor free trade over environmental and human health issues whenever possible, it is unlikely that a NAFTA panel will be able to jump the gap and find a connection between the sanction and requirements of Article

¹⁵² see Fiona Godlee, *Health Implications of Climate Change*, British Medical Journal, v303 n12 p 254 (Nov, 1991) and McMichael, Anthony and Haines, Andrew, *Global Climate Change: the potential effects on health*. British Medical Journal, v315 n7111 p805 (Sept, 1997) For additional information about the effects on human populations due to global warming see Norman Myers, *Environmental Refugees in a Globally Warmed World*, BioScience v43 n11 p752 (1993)

¹⁵³ Jordan Gold, *Thai Fish Industry in Hot Water*, Alternatives Journal, v28 i2 p3 (Spring, 2002)

¹⁵⁴ John Aber et. al. *Forest Processes and Global Environmental Change: Predicting the Effects of Individual and Multiple Stressors*, BioScience v51 i9 p735 (Sept 2001)

XX(b). Nevertheless, for the sake of argument suppose a NAFTA panel does indeed find that the sanction is related to the protection of human health. In this case, the necessity of the sanction must be analyzed in conjunction with the policy the sanction is designed to protect.

Therefore, the next question is: whether the sanction and/or the Kyoto Protocol are “necessary” for the protection of human health. Depending on how one interprets the meaning of “necessary,” as discussed in the above cases, the U.S. could use two broad arguments to assert that a sanction is not necessary: (1) There is a lack of scientific evidence on global climate change to justify that a reduction in greenhouse gas emissions are necessary to protect human health, and (2) The sanction and/or the Kyoto Protocol are not necessary due to the availability of other options that are “less inconsistent” with member obligations under NAFTA.¹⁵⁵ First, one must look at the interpretation of “necessity” as it relates to the protection of human health. The United States participation in the UNFCCC serves as an acknowledgement of the global warming problem. Furthermore, U.S. participation in the Montreal Protocol¹⁵⁶ is evidence to the fact that the methods undertaken by the Kyoto Protocol to slow down the effects of global warming and ozone layer depletion have been accepted by the U.S. in the past. Additionally, participation in negotiations leading up to the drafting of the Kyoto Protocol, as well as George W. Bush’s proposal of an alternative to the Kyoto Protocol relying on similar, but

¹⁵⁵ As noted in WTO document S/WPPS/W/9, The Relevance of the Disciplines of the Agreements on Technical Barriers to Trade (TBT) and on Import Licensing Procedures to Article VI:4 of the General Agreement on Trade in Services (11 September, 1996, p. 5), “A measure that has the effect of restricting trade can be considered “necessary” only if there is no alternative measure less disruptive of trade which a Member may reasonably be expected to employ to achieve the same policy objective.” –WTO web site found 5/26/02

¹⁵⁶ The Montreal Protocol controls the release of certain other greenhouse gases not addressed in the Kyoto Protocol for the purposes of slowing down depletion of the ozone layer

voluntary, measures also serves as a U.S. acknowledgement of the necessity for the emission reductions called for by the Kyoto Protocol. Lastly, the U.S. Environmental Protection Agency recently released a report acknowledging that climate change is a problem that we should be concerned about.¹⁵⁷ The economic implications relating to the case where Canada is forced to accept U.S. created AAUs is outside the scope of this paper. Therefore, this paper assumes that the sanction is necessary from an economic standpoint for Canadian participation in the Kyoto Protocol.

Regarding the second potential interpretation of the term “necessary,” claiming that there are other options that would not require the use of a sanction forcing Canada to deviate from its obligations under NAFTA, there are a number of issues to consider. *First, and foremost, it is absolutely imperative that before employing a unilateral sanction, Canada engage in extensive discussions with the U.S. in attempts to solve the problem multilaterally.* As seen in the Tuna/Dolphin cases, as well as in the Shrimp/Turtle case, the panels strongly emphasized the importance of attempting to resolve conflicts between international trade agreements and MEAs through the multilateral agreement rather than resorting to unilateral action. The NAFTA itself, in Chapter 21 Section 104, permits for amendment to the agreement in order to list additional MEAs, such as the Kyoto Protocol, as exempt from the obligations of the agreement. If this outlet were not properly exhausted before the implementation of a unilateral sanction, the results would likely be catastrophic to Canada’s case.

¹⁵⁷ See “The Third National Communication on Climate Change U.S. Climate Action Report” (2002) Available at www.epa.gov

For the purpose of discussion, assuming the U.S. refuses to amend Section 104 to include the Kyoto Protocol, the burden still remains on Canada to demonstrate that it has exhausted all other options to resolve the problem of global climate change without causing them to deviate from their obligations under NAFTA. If such a demonstration is made, the Kyoto Protocol, and thus the sanction protecting it, may qualify as “necessary” under this second interpretation of the term. Evidence that all options have been exhausted will be found in the extent to which the international community, including the U.S., has been involved in negotiations surrounding the problem of climate change since the inception of the UNFCCC. The mere existence of the UNFCCC, and the series of negotiations and discussions that have been undertaken, is further evidence to the fact that other options have been explored and rejected, justifying the necessity of the Kyoto Protocol in combating the problem. Lastly, George W. Bush’s widely criticized alternative to the Kyoto Protocol and its rejection by the international community as a viable alternative, could be evidence to the fact that all other options have been explored and rejected. Therefore, Canada should be able to argue successfully that a unilateral sanction on U.S., and all other non-party nation, derived ERUs falls within the scope of Article XX(b) and/or the NAFTA equivalent.

ii) Article XX(g)

Article XX(g) requires asking the question of whether a measure relates to the conservation of an exhaustible resource. Answering this we are left with the same predicament. Although the Kyoto Protocol is related to the protection of many

exhaustible natural resources (i.e., island nations, coastal habitats, polar ice caps, fishing industry resources, etc.), the sanction itself is a form of economic protection, and not in itself *directly* related to the protection of these resources.

For the sake of argument, assume that a NAFTA panel accepts the fact that, although not directly linked, because the sanction is a necessary precursor to Canadian participation in the Kyoto Protocol, it is in fact “related to” the conservation of exhaustible resources. This raises the question of whether the measure being invoked is made in conjunction with domestic measures or restrictions. The answer to this question will ultimately lie in the wording of the sanction itself. The sanction must be framed so as to affect participation in the Kyoto Protocol’s emissions trading system at an individual, corporate, national, and international level equally. If it fails to do so, the sanction would not have a direct effect on domestic Canadian industry, and may therefore be found to violate National Treatment principle. In the absence of an explicit reference, it may be argued that the sanction is not being invoked in conjunction with domestic measures. Simple testimony to Canada’s participation in the Protocol may not be enough. Canadian policy must explicitly affect any emitter, Canadian or not, who is not in compliance with, or working towards meeting Kyoto Protocol commitments.

iii) Article XX Chapeau

Assuming that the sanction and the associated Kyoto Protocol are justified under either Article XX(b) or (g), the panel would then turn to analysis of the chapeau of

Article XX. The chapeau first requires examination of whether the measures represent arbitrary or unjustifiable discrimination against international trade. Assuming the sanction affects all nations equally, i.e., any individual, corporation, or nation not in compliance with Kyoto Protocol commitments, the sanction is not arbitrary discrimination but equally imposed, calculated discrimination. Under these circumstances, the Canadian government has carefully chosen who will be affected by the ban and has presumably given good reason for the ban, i.e. the ban excludes those who chose not to participate in the protection of the human, animal and plant life and health through membership under the Kyoto Protocol.

The question of whether the sanction is “justifiable discrimination” is a bit more complicated. Clearly, Canada is justified in its concern that if forced to accept U.S. created AAUs, it will not be able to account for them in order to meet Canadian requirements under the Kyoto Protocol.¹⁵⁸ However, the Tuna/Dolphin I and II panels ruled against the U.S. because they interpreted their unilateral trade sanction to be unjustifiable in that they were forcing domestic policy changes on other member nations in order for those nations to gain access to U.S. markets. This appears to be the critical issue. It is quite likely that a unilateral Canadian sanction on non-Kyoto Protocol member created AAUs will be viewed as a sanction designed to force policy changes, i.e., the adoption of the Kyoto Protocol, by NAFTA or WTO member nations who are not party to the Protocol at the time of implementation of the sanction. The Tuna/Dolphin II

¹⁵⁸ *supra* note 1

panel explicitly stated that unilateral measures¹⁵⁹ attempting to influence policy changes in other member nations is simply not acceptable under GATT.¹⁶⁰ On the other hand, other GATT panels, such as the Appellate Body reviewing the Shrimp/Turtle case, recognized that unilateral sanctions are inherently designed to influence policy changes in nonconforming nations, and that in some cases, and under certain conditions this may be justified. They approach recognition of the fact that a unilateral sanction is initially imposed to account for differences in domestic policy, and by establishing this as an unconditionally unjustifiable conflict with GATT or NAFTA, the Article XX exemptions are essentially self defeating. Specifically, the Appellate Body states:

Conditioning access to a Member's domestic market¹⁶¹ on whether exporting Members comply with, or adopt, a policy or policies unilaterally prescribed by the importing Member may, to some degree, be a common aspect of measures falling within the scope of one or another of the exceptions (a) to (j) of Article XX. Paragraphs (a) to (j) comprise measures that are recognized as exceptions to substantive obligations established in the GATT 1994, because the domestic policies embodied in such measures have been recognized as important and legitimate in character.¹⁶²

The Appellate Body added:

¹⁵⁹ i.e. the unilateral sanction protecting Canadian economic interests under the Kyoto Protocol, NOT the Protocol itself.

¹⁶⁰ *supra* note 50

¹⁶¹ In this case, I am referring to Canada's implementation of a unilateral sanction, mirroring it's obligations under the multilateral Kyoto Protocol, which would restrict U.S. access to Canadian AAU markets. An alternative argument can be made by Canada that it is actually the Kyoto Protocol that calls for these restrictions on trade, and because the Kyoto Protocol is a multilateral agreement which the U.S. opted not to take part in, a Canadian unilateral sanction designed to protect Canadian interests under the Kyoto Protocol should not be subject to the intense scrutiny generally imposed by WTO/GATT panels on unilateral sanctions. However, the Geneva Convention on Treaties clearly states that in the case of conflict between two international/multilateral treaties, that which is later in date *and signed by all parties involved*, shall take precedence. Canada has essentially given up it's right to partake in any international agreements that conflict with NAFTA and/or GATT unless all parties involved in these previous agreements consent. Therefore, it would seem that the only way for Canada to restrict access to AAU markets under the Kyoto Protocol is to prove that trade in ERUs falls within an exception to GATT and/or NAFTA or that they are not subject to NAFTA and/or GATT restrictions in the first place. This paper will examine both of these alternatives.

¹⁶² *supra* note 123

We have not decided that the sovereign nations that are Members of the WTO cannot adopt effective measures to protect endangered species, such as sea turtles. Clearly, they can and should.

Unfortunately, the Appellate Body does not clarify specifically how a member nation can do this without being in violation of WTO or NAFTA restrictions. Therefore, it is necessary to look at specifics of their interpretations for direction. Although this is a step in the right direction, because WTO panel decisions are not binding on future WTO or NAFTA panels, one is left with uncertainty as to how any particular panel will interpret the law at hand. However, the above analysis provides some direction as to how AAUs, and policy actions designed to protect a market in AAUs, may circumvent NAFTA and/or WTO restrictions.

V. Emission Reduction Credits: Classified as “Services”

Another, arguably more likely, possibility is that the WTO and/or the NAFTA will classify AAUs as “services.” If AAUs are indeed classified as “services” they will be subject to the rules contained in the GATS. The GATS contains many of the same stipulations as the GATT including clauses mirroring the Most Favored Nation Principle,¹⁶³ and the National Treatment Principle.¹⁶⁴

¹⁶³ GATS Article II states:

With respect to any measure covered by this Agreement, each Member shall accord immediately and unconditionally to services and service suppliers of any other Member treatment no less favorable than it accords to like services and service suppliers of any other country.

¹⁶⁴ GATS Article XVII states:

In sectors inscribed in its Schedule, and subject to any conditions and qualifications set out therein, each Member shall accord to services and service suppliers of any other Member, in respect of all

Additionally, the GATS contains a clause dictating that domestic market access be accorded equally to all member nations.¹⁶⁵ Therefore, member obligations to these principles may conflict with obligations under the Kyoto Protocol emissions trading system in the same way as discussed in Section IV, above.¹⁶⁶ In the event that AAUs are classified as “services,” and a Canadian unilateral sanction is challenged by a WTO or NAFTA member nation,¹⁶⁷ a WTO or NAFTA tribunal would hear the case. Irrespective of ERU classification (i.e., goods or services), the same rules would apply (i.e., MFN and national treatment). Therefore, it is likely that a similar line of reasoning would be employed as discussed in Section IV(B) cases above. The following section will examine the key differences between the GATT and the GATS as they relate to trade in AAUs. Furthermore, this section will discuss how these differences may affect trade in AAUs under the Kyoto Protocol.

A. GATS Exceptions

1. General Exceptions

measures affecting the supply of services, treatment no less favorable than it accords its own like services and service suppliers.

¹⁶⁵ GATS Article XVI (1) states that:

With respect to market access through the modes of supply identified in Article I, each Member shall accord services and service suppliers of any other Member treatment no less favorable than that provided for under the terms, limitations and conditions agreed and specified in its Schedule.

¹⁶⁶ Section IV discusses the potential for ERUs to be classified as ‘goods’ and the associated WTO/NAFTA conflicts.

¹⁶⁷ That is a non-Party to the Kyoto Protocol

GATS Article XIV contains a similar, albeit more narrow, environmental exception to the GATT. GATS Article XIV states:

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 *like conditions* [Emphasis added] prevail, or a disguised restriction on trade in services, nothing in this Agreement shall be construed to prevent the adoption or enforcement of any measures:

- (a) necessary to protect public morals or to maintain public order;
- (b) necessary to protect human, animal, or plant life or health;
- (c) necessary to secure compliance with laws or regulations which are not inconsistent with the provisions of this Agreement...¹⁶⁸

Although this clause is almost identical to that found in the GATT Article XX, looking carefully at the language reveals one key difference. The GATT requires that for this exemption to be used, “same conditions,” i.e. identical conditions, must exist in the two countries involved. The GATS solely requires that “like conditions,” i.e. similar conditions, exist in the two countries involved.¹⁶⁹ This shift in language clearly broadens the coverage of the GATS agreement in comparison to the GATT. Such language will make it more difficult to exempt trade in AAUs between U.S. and Canada based on differences in the “conditions” in the two countries. Moreover, it is difficult to predict how a WTO dispute resolution panel would interpret this exemption with respect to the emissions trading system established by the Kyoto Protocol, because to date this provision has yet to be interpreted by such a panel.

¹⁶⁸ GATS Article XIV (b) and (c)

¹⁶⁹ The potential implications of this shift in language will be discussed further in Section VI

2. Exempted Services

The GATS differs most significantly from the GATT in that, like the GATT, it is not *entirely* inclusive of all services. Whereas the GATT strictly controls all trade related to goods among members, the GATS does offer some options for exclusion with respect to trade in services. Member nations have two options to restrict application of the GATS to specific service sectors. The first of which lies within the text of GATS Article XX.¹⁷⁰ Article XX requires each Party to designate which specific service sectors are subject to GATS compliance. All service sectors accept those named therein must fully comply with the GATS market access and national treatment requirements. These choices are documented in each Member's GATS Schedule of Commitments. Therefore, parties may impose quantitative restrictions and restrict market access to trade in specific services with respect to market access and national treatment obligations.

Second, each party has the opportunity to exempt from GATS restrictions specific measures which would otherwise violate its obligations under the Most Favored Nation Principle.¹⁷¹ This exemption only applies to the restricted service for a limited period of time, generally not to exceed 10 years.¹⁷² These options

¹⁷⁰ GATS Article XX specifically states:

Each Member shall set out in a schedule the specific commitments it undertakes under Part III of this Agreement. With respect to sectors where such commitments are undertaken, each Schedule shall specify:

(a) terms, limitations and conditions on market access
(b) conditions and qualification on national treatment

¹⁷¹ GATS Annex on Article II Exemptions

¹⁷² GATS Annex on Article II Exemptions (6)

may provide an avenue to exempt trade in AAUs from the provisions outlined in the GATS agreement. Exploring this possibility requires asking: 1) If AAUs are classified as “services,” which sector of services they will belong to; (2) Whether Canada has fully liberalized that service sector, thereby subjecting trade in AAUs to GATS national treatment and market access obligations; and (3) If so, whether there is a way to list trade in AAUs as an exempted service. Each of these questions are discussed below.

i) Service Sector Classification

Jacob Werksman suggests that AAUs might be covered by the GATS Fifth Protocol on Financial Services.¹⁷³ He suggests the possibility that AAUs may be considered “negotiable instruments,” and therefore subject to GATS¹⁷⁴ trade restrictions.¹⁷⁵ As defined by Black’s Law Dictionary, a “negotiable instrument” is:

A written instrument¹⁷⁶ that (1) is signed by the maker or drawer, (2) includes an unconditional promise or order to pay a specified sum of money, (3) is payable on demand or at a definite time, and (4) is payable to order or bearer (UCC § 3-104(a))

¹⁷³ As defined in GATS, Annex on Financial Services, para 5(a)(x), “financial services” include: trading for own account or for account customers, whether on an exchange, in an over-the-counter-market, or otherwise... derivative products including, but not limited to, futures and options... transferable securities... other negotiable instruments and financial assets.

¹⁷⁴ Note Chapter 14 of the NAFTA outlines the Financial Services obligations, however, due to the potential breath of implication, this paper will focus primarily on the text of the GATS.

¹⁷⁵ *supra* note 4

¹⁷⁶ Where an “instrument” is defined as:

a written document that defines rights, duties, entitlements, or liabilities, such as a contract, will, promissory note, or share certificate.

If the international emissions trading system guidelines are designed in a manner similar to that of established U.S. systems, it is likely that AAUs will be documented in both electronic and paper certificate form. It is unlikely that these certificates will contain all three requirements listed above to be considered “negotiable instruments.” Although the certificate itself may indeed have the signature of the maker or drawer (i.e., government agencies responsible for creating them), it is unlikely that it will also state an unconditional promise to pay a specified sum of money on its face. As is the case in U.S. domestic markets, a contract associated with the sale of an AAU will likely contain this information. Therefore, perhaps the contract negotiated to purchase or sell a specified quantity of AAUs may be considered a “negotiable instrument.” However, because the contract is once removed from the AAU certificate, (i.e., it merely facilitates the trade, and is not itself the object of the trade), it is difficult to determine whether the AAU certificate would be considered a “negotiable instrument.”

The GATS Annex on Financial Services also subjects trading in all “other financial assets” to GATS provisions. Some may argue that a certificate documenting ‘ownership’ is not a financial asset, but instead a permit allowing a particular activity. However, an AAU certificate indeed appears to be a “financial asset” because it can be bought and sold in an open market system. Assuming that international emissions trading markets work in a similar manner to U.S. emissions trading markets, one does not have to be an affected source to participate and/or profit from trading activities. In other words, there are no

existing provisions preventing traders¹⁷⁷ or other unaffected profiteers from participating in the market. Therefore, because one can profit from the market without having any need for an actual “permit” to pollute, an AAU certificate should indeed be considered a “financial asset.”

Another alternative would treat AAUs as “securities,” and thus trade in this service would be regulated by the GATS. A “security” is defined to include:

...any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, or, in general, any interest or instrument commonly known as a ‘security,’ or any certificate of interest or participation in, temporary or interim certificate for receipt for, guarantee of, or warrant or right to subscribe or to purchase, any of the foregoing.¹⁷⁸

It is possible that an AAU certificate may be considered a “transferable share,” because (1) it is transferable from one person or government to another person or government; and (2) it represents the ownership of a portion of total allowable carbon dioxide, or carbon dioxide equivalent, emissions.¹⁷⁹ If an AAU certificate were considered a “security” it would

¹⁷⁷ “Traders” buy high and sell low, as opposed to “brokers” who negotiate trades for clients but do not generally take title to the credits.

¹⁷⁸ Securities Act of 1933 § 2(a)(1)

¹⁷⁹ Black’s Law Dictionary defines a ‘share’ in part as : “an allotted portion owned by, controlled by or due to someone”

certainly apply to the AAU certificate itself and not the contract negotiated for the sale of such a certificate as may be the case if AAUs are classified as “negotiable instruments.”

If an AAU were considered a “negotiable instrument,” a “financial asset,” or a “security,” it still remains unclear whether that “negotiable instrument,” “financial asset,” or “security” is itself considered a “service,” or alternatively if this simply applies to the process by which they are traded. A more pertinent issue may thus be the effects of allowing market access into an international emissions trading system to non-Kyoto Protocol member nations. As described above, a financial service includes “trading for own account or for account of customers,...negotiable instruments and financial services.”¹⁸⁰ Therefore, if AAUs are considered “negotiable instruments,” “financial assets,” or “securities,” the process by which they are traded¹⁸¹ will likely be subject to GATS provisions. Brokerage houses that broker client AAU trades may be considered ‘service suppliers’ because they provide the ‘service’ of trading a financial asset, even if that particular financial asset is not covered by the GATS.¹⁸²

¹⁸⁰ GATS Annex on Financial Services 5(a)(x)(F)

¹⁸¹ i.e. the ‘service’ is the trading, not the AAUs themselves.

¹⁸² Please refer to the text of the GATS Annex on Financial Services in Appendix B. Note that the Annex does not state that all ‘financial assets’ are considered ‘services,’ and therefore subject to GATS provisions, but solely that *trade* in ‘financial assets’ is considered a ‘service’ subject to GATS provisions. Furthermore, GATS Article I(2) clarifies the scope and definition of the agreement in stating:

For the Purposes of this Agreement, trade in services is defined as the *supply of a service* [Emphasis added]:

- (a) from the territory of one Member into the territory of any other Member;
- (b) in the territory of one Member to the service consumer of any other Member;
- (c) by a service supplier of one Member, through the presence of natural persons of a Member in the territory of any other Member.

If this is the case, it is likely that Canada will be forced to allow U.S. brokerage houses to participate in a Canadian AAU market. In other words, Canada could not restrict market access to these U.S. financial service providers. The GATS does not restrict financial service providers with respect to client nationality, therefore, U.S. brokerage houses may be able to provide legal market access to U.S. corporations and/or investors. These U.S. organizations and/or individuals could potentially profit from AAU trading system, regardless of the fact that they may not have taken on the economic burden of mandatory, legally binding emission reductions at home. This foreign participation could potentially drive up the cost of AAUs¹⁸³ to the point of making them inaccessible to Canadian companies.

ii) Implications of Canada's Schedule of Commitments

In order to ascertain which sectors of its services are fully subject to these agreements we must look to Canada's Schedule of Commitments¹⁸⁴ under the GATS and the NAFTA. Canada has not liberalized all sectors of trade in financial services under the GATS.¹⁸⁵ Although, they have set a number of reservations and requirements for foreign financial service suppliers, none are likely to affect a U.S. owned brokerage house engaging in brokerage of AAUs,

¹⁸³ For a detailed analysis of market and policy implications of U.S. participation in the Kyoto Protocol emissions trading system see Baron, Richard et. al., *Kyoto Without the U.S.: Market and Policy Implications-DRAFT*, International Energy Agency

¹⁸⁴ The section of this Schedule of Commitments that pertains to trade in financial services under the GATS can be found in Appendix D. The full text of Canada's Schedule of Commitments under NAFTA can be found in Appendix C.

¹⁸⁵ With the exception of some Provincial exceptions, which will not be discussed in this paper.

particularly if the company has an office located within Canada with Canadian employees.

Furthermore, under the NAFTA, Canada has fully liberalized trade, except with respect to cross-border trade in securities. Canada has reserved the right to adopt any measure relating to cross-border trade in securities services that derogates from Article 1404(1)¹⁸⁶ or, with respect to the U.S., from Article 1406.¹⁸⁷ Therefore, only if AAUs are classified as “securities” will it be possible for Canada to restrict U.S. participation in a Canadian AAU market. Otherwise, it is likely that the WTO and/or the NAFTA may prohibit Canada from imposing restrictions on either the country of origin of AAUs or on countries allowed market access.

Werksman suggests that although a Party may not be able to place quantitative restrictions on the “import” of these services, once the service has been ‘imported’ GATS cannot prohibit Canada from refusing to recognize the validity of these services.¹⁸⁸ In other words, if that WTO/NAFTA member is not also Party to the Protocol, GATS does not prohibit Canada from prohibiting use of those allowances to meet Kyoto Protocol commitments. Furthermore, neither the GATS nor the NAFTA will require Canada to purchase any specific quantity

¹⁸⁶ NAFTA Article 1404(1) states that:

No Party may adopt any measure restricting any type of cross-border trade in financial services by cross-border service providers of another Party that the Party permits on the date of entry into force of this Agreement, except to the extent set out in Section B of the Party’s Schedule to Annex VII.

¹⁸⁷ NAFTA Article 1406 outlines the Most-Favored-Nation Treatment guidelines

¹⁸⁸ Jacob Werksman and Jurgen Lefevere, *WTO Issues Raised by the Design of an EC Emissions Trading System*, FIELD (Scoping Paper No. 3) (1999) at 10

of AAUs from the U.S. This means that although brokers and other private entities in Canada may be free to purchase allowances from any WTO or NAFTA member nation, the credits may nonetheless be worthless once they have entered the country. A well organized accounting system and registry for AAUs is imperative under this scenario and will likely ensure protection of Kyoto Protocol member nation derived AAUs from economically unfair trading practices.

iii) Altering the Schedule of Commitments Coverage

It is possible for Canada to alter which services are covered under its Schedule of Commitments. If Canada were to go through the process of specifically excluding AAUs from its Schedule of Commitments, Canada could reduce the likelihood of encountering U.S. opposition to any access restriction with respect to the emissions trading market. GATS Article XXI stipulates the conditions and process by which a Member nation may modify and/or alter its Schedule of Commitments. The relevant text from Article XXI is below.

GATS Article XXI

1. (a) A Member (referred to in this Article as the "modifying Member") may modify or withdraw any commitment in its Schedule, at any time after three years have elapsed from the date on which that commitment entered into force, in accordance with the provisions of this Article.

(b) A modifying Member shall notify its intent to modify or withdraw a commitment pursuant to this Article to the Council for Trade in Services no later than three months before the intended date of implementation of the modification or withdrawal.

2. (a) At the request of any Member the benefits of which under this Agreement may be affected (referred to in this Article as an "affected Member") by a proposed modification or withdrawal notified under subparagraph 1(b), the modifying Member shall enter into negotiations with a view to reaching agreement on any necessary compensatory adjustment. In such negotiations and agreement, the Members concerned shall endeavour to maintain a general level of mutually advantageous commitments not less favourable to trade than that provided for in Schedules of specific commitments prior to such negotiations.

(b) Compensatory adjustments shall be made on a most-favoured-nation basis.

3. (a) If agreement is not reached between the modifying Member and any affected Member before the end of the period provided for negotiations, such affected Member may refer the matter to arbitration. Any affected Member that wishes to enforce a right that it may have to compensation must participate in the arbitration.

(b) If no affected Member has requested arbitration, the modifying Member shall be free to implement the proposed modification or withdrawal.

4. (a) The modifying Member may not modify or withdraw its commitment until it has made compensatory adjustments in conformity with the findings of the arbitration.

(b) If the modifying Member implements its proposed modification or withdrawal and does not comply with the findings of the arbitration, any affected Member that participated in the arbitration may modify or withdraw substantially equivalent benefits in conformity with those findings. Notwithstanding Article II, such a modification or withdrawal may be implemented solely with respect to the modifying Member.

5. The Council for Trade in Services shall establish procedures for rectification or modification of Schedules. Any Member which has modified or withdrawn scheduled commitments under this Article shall modify its Schedule according to such procedures.

VI. Fleshing Out the GATT/GATS and the Possibility of Non-Violation¹⁸⁹

It is possible that Article XX of the GATT, and/or Article XIV of the GATS will fail to justify a Canadian unilateral sanction imposed upon U.S. created AAUs by the reasoning discussed in the preceding sections. With this in mind, it is prudent to flesh out the text of the GATT and the GATS more completely and examine alternative points of argument that may not as yet have been explored. Additionally, it is possible that, as in the Asbestos Appellate Decision, a WTO and/or NAFTA tribunal may find that trade in AAUs is in accordance with the GATT, the GATS, and the NAFTA. In order to explore the possibility of this option, the two core principles, common to all three agreements must be examined. Lastly, it is possible that trade in AAUs will not fall within the scope of the GATT/GATS or the NAFTA. The following section will first look to alternative arguments based on subtleties of semantics in the trade agreements, as well as the possibility for the U.S. to utilize the non-violation provisions of the GATT/GATS or the NAFTA. It will then turn to a close examination of the most favored nation, and national treatment principles, and discuss the conditions necessary to escape violation of these principles within an international emissions trading system. Lastly, this section will touch on the possibility of AAUs falling outside the scope of these agreements.

A. Alternative Arguments

¹⁸⁹ The arguments described below will be briefly introduced and explored in this paper, however as most issues have not been interpreted by a WTO/NAFTA dispute resolution panel, detailed analysis of how such a panel would rule on these issues will not be undertaken by the author.

The discussions in the preceding sections analyzed the possibility for a Canadian ban on U.S. created AAUs to fall within the scope of the GATT, the GATS, or the NAFTA environmental exemptions. However, thus far this paper has only looked at this possibility based on arguments used in case law. It is possible that the text of these environmental exemptions, in particular the chapeau to Article XX, can be broken down further in search of a valid argument. Furthermore, it is possible that the U.S., or other non-Kyoto WTO member nations will utilize the “non-violation” clause contained in the GATT and the GATS. The following section will discuss these two scenarios.

1. The Chapeau

An alternative argument requires looking back at the GATT Article XX chapeau.¹⁹⁰ The chapeau states:

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...[Emphasis added]

As discussed in Section IV(B)(1)(iii) above, based on past panel decisions, a Canadian sanction will likely be viewed by a NAFTA dispute resolution panel as “unjustifiable discrimination.” This is because the sanction may be seen to force policy changes in NAFTA member nations in order for the affected nation to gain market access into the

¹⁹⁰ NAFTA Chapter XXI Article 2101 defers to the GATT Chapter XX chapeau which states that the exemptions to GATT compliance as discussed above shall apply as long as they do not constitute: a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail

Canadian emissions trading market. However, the conditional part of the chapeau states that the sanction must meet this justifiable requirement “in countries where the same conditions prevail.” Therefore, one must now examine whether or not “the same conditions prevail” in the U.S. and Canada.¹⁹¹ It can be argued that because, unlike the U.S., Canada is undergoing significant changes in its industrial sector to reduce CO₂ and CO₂ equivalent emissions to 1990 levels pursuant to its obligations under the Kyoto Protocol, the “same conditions” do not “prevail” in the two nations. Under these conditions the sanction would meet the exemption requirements of NAFTA Chapter XXI, and corresponding GATT Article XX. As discussed in Section V(A)(1) above, it is interesting to note the shift in language between the GATT and the GATS with respect to this particular clause. The GATT requires that the “same conditions” prevail to meet the conditions of the clause, while the GATS only requires that “similar conditions” prevail. Clearly, this shift in language expands the scope of the GATS provisions and narrows the room for exception to these provisions under the agreement. It is difficult to ascertain how this argument would be interpreted as it pertains to the GATS because it has yet to be heard in such a context. It is unclear what conditions are sufficient to categorize conditions in two separate countries as “like” as opposed to “same.” Furthermore, it is unclear whether this difference in the use of words will be viewed as a mere semantics.

2. Nullification or Impairment

¹⁹¹ Pursuant to NAFTA Chapter XXI Article 2101(2):

Provided such measures are not applied in a manner that would constitute a means of arbitrary or unjustifiable discrimination between countries where *the same conditions prevail* or a disguised restriction on trade between Parties

[Emphasis added]

The GATT Article XXII and the GATS Article XXIII contain language intended to further protect the member benefits under these two Agreements. These Articles allow a Party to file a complaint against another Party if the former believes that its benefits under the GATT/GATS have been nullified or impaired. This clause allows for a complaint to be filed regardless of whether the “offending” Party has violated any GATT¹⁹² or GATS¹⁹³ provisions. These proceedings can result in one Party being authorized to “suspend the application to any other contracting party or parties of such concessions or other obligation under [the GATT],”¹⁹⁴ or in the “modification or withdrawal of the measure.”¹⁹⁵ Three specific elements must be present in order to establish an Article XXIII claim: 1) The existence of an applied measure by a WTO Member; 2) The existence of a benefit accruing under the relevant agreement; and 3) Nullification or impairment of the benefit as a result of the measure.¹⁹⁶

Under Article XXIII of the GATT/GATS, the U.S. may have standing to seek compensation for a Canadian measure excluding their participation in an AAU market.

¹⁹² GATT Article XXIII states that:

If any contracting party should consider that any benefit accruing to it directly or indirectly under this Agreement is being nullified or impaired or that the attainment of any objective of the Agreement is being impeded as a result of...

b) the application by another contracting party of any measure, whether or not it conflicts with the provisions of this Agreement...

the contracting party may, with a view to the satisfactory adjustment of the matter, make written representations or proposals to the other contracting party or parties which it considers to be concerned....

¹⁹³ GATS Article XXIII(3) states that:

If any Member considers that any benefit it could reasonably have expected to accrue to it under a specific commitment of another Member under Part III of this Agreement is being nullified or impaired as a result of the application of any measure which does not conflict with the provisions of this Agreement, it may have the recourse to the DSU...

¹⁹⁴ GATT Article XXIII(2)

¹⁹⁵ GATS Article XXIII(3)

¹⁹⁶ James P. Durling, and Simon N. Lester, *Original Meanings and the Film Dispute: The Drafting History, Textual Evolution, and Application of the Non-violation Nullification or Impairment Remedy*, 32 *George Washington Journal of International Law and Economics* 211 at 240

Two requirements must be met for a GATT Article XXIII complaint to be filed.¹⁹⁷ First, “the measure in question cannot have reasonably been anticipated by the complaining party at the time the concession was negotiated.”¹⁹⁸ Second, “the measure in question must have damaged the competitive position of the imported product concerned.”¹⁹⁹

The U.S. will likely be able to meet the second requirement, because it is likely that the market value of U.S. created AAUs will be very dependent on access to, and verification under, the Kyoto Protocol emissions trading system. Furthermore, past disputes under this issue have demonstrated²⁰⁰ that a party need not prove definitive changes in trade flow before and after a measure was instituted. A party need merely prove that an “abstract adverse change in competition”²⁰¹ has occurred. One author argues that GATT/GATS Articles XXIII provide a “panacea” for invalid complaints.²⁰² Although the laws and drafting of history may dictate a strict correlation between result and causation, the panels have not always interpreted the law in accordance with this standard.²⁰³ The method by which a WTO dispute resolution panel analyzed and ruled on such issues is exemplified in the following landmark case involving a film manufacturing industry in Japan.

i) Fuji / Kodak Case

¹⁹⁷ See Sung-joon Cho, *GATT Non-Violation Issues in the WTO Framework: Are they the Achilles' Heel of the Dispute Settlement Process*, 39 *Harvard International Law Journal* 311 (1998) at 316

¹⁹⁸ *id.* at 316

¹⁹⁹ *id.* at 317

²⁰⁰ *Treatment by Germany of Imports of Sardines*, October 31, 1952, GATT B.I.S.D. (1953)

²⁰¹ *supra* note 196 at 318

²⁰² *id.* at 324

²⁰³ See Durling *supra* note 196 at 250

In 1995, the U.S. filed a complaint against Japan regarding the Japanese film manufacturing market. The U.S. contended that even if Japan had not violated any of the GATT provisions, some benefits to the U.S. as a GATT 1994 Member was nonetheless nullified or impaired. The U.S. claimed that Japan had performed actions to: 1) Create an exclusive distribution sector; 2) Restrict the growth of large stores; and 3) Restrict the use of sales promotions.²⁰⁴ The panel eventually found the U.S. claims unfounded because the U.S. could not prove that the measures caused any nullification or impairment. However, this panel's four step analysis of GATT Article XXIII is noteworthy because it set guidelines for future panels on how to interpret this Article.

a) Actionable Measure

First, the panel looked at the issue of what constitutes an actionable "measure" under Article XXIII. It clarified that the scope of a "measure" was greater than merely a 'subsidy' and could include virtually any type of government measure. In fact, it went so far as to allow for actions originating in the private sector that are actually "quasi-governmental" in nature.²⁰⁵

b) Reasonable Anticipation of Benefits

Next, the panel analyzed what it means for a benefit to be "reasonably anticipated." It ruled, in accordance with past GATT panels,²⁰⁶ that for benefits accruing from a measure to be legitimate, the challenged measure must not have been "reasonably anticipated" at the time that the tariff concession was

²⁰⁴ *id.* at 260

²⁰⁵ *id.* at 263

²⁰⁶ *id.* at 263

negotiated. Furthermore, the panel noted that in order for a measure to be “reasonably anticipated” the measure must have been introduced prior to the closing of the most recent round of tariff negotiations. However, not all cases are linked to tariff concessions. These types of cases are called “independent mode” cases, for which there is little history on how to base correct interpretation of this standard.²⁰⁷

c) Nullification or Impairment as a Result of the Measure

Thirdly, the Panel examined the relationship between the alleged “nullification or impairment” and the applied measure in question. The Panel stated that it is imperative for the measure to have made more than a “*de minimis*”²⁰⁸ contribution to the alleged nullification or impairment. In making this decision the panel set a fairly loose standard of causation.

d) Detailed Justification Standard

Lastly, the Panel examined the evidentiary standard which a Party must meet to show injury. Past Panels had used the “detailed justification standard,” requiring a Party to show “detailed justification” that the measure has caused nullification or impairment of a reasonably anticipated benefit. The Panel veered from this interpretation and accepted U.S. claims that “detailed justification” was solely a pleading requirement rather than an evidentiary standard.²⁰⁹

²⁰⁷ For a more detailed discussion of “independent mode” cases see Cho *supra* note 197 at 323-326

²⁰⁸ See Durling *supra* note 196 at 265

²⁰⁹ For a detailed legal analysis describing why the Panel was incorrect in this interpretation See Durling *supra* note 196 at 268

If future Panel decisions follow the lead of the Fuji-Kodak Panel the U.S. will potentially feel justified in bringing a nullification or impairment suit before a WTO panel. Based on the four part analysis detailed above, it is likely that a measure restricting market access to a Canadian emissions trading market will constitute an actionable measure under GATT/GATS Article XXIII. It is also likely that there will be an economic impairment to the U.S. emissions trading market if the U.S. is not allowed access. Thirdly, if “detailed justification” is interpreted as solely a procedural pleading requirement, it should not be a difficult hurdle to overcome. Lastly, because of the lack of case law dictating guidelines for interpretation in “independent mode” cases,²¹⁰ the question of whether the U.S. is justified in reasonably anticipating benefits from Canadian emissions trading system is difficult to ascertain. It would seem that based on the market access provisions in the GATS and the Nation of Origin provisions under the GATT, the U.S. would be justified in anticipating the benefits of market access to this trading system. However, without legal precedent on which to base this analysis, comment here would be purely speculative.

B. Non-Violation

There are two pathways by which a Canadian sanction on U.S. derived AAUs would withstand a GATT/GATS or NAFTA challenge. The first of these pathways is if the sanction is found to be consistent with Canada’s obligations under the GATT/GATS and/or the NAFTA. Specifically, the sanction would have to be consistent with the most

²¹⁰ i.e. one not involving tariff concessions

favored nation and national treatment principles of these agreements. The second way in which the sanction could withstand a GATT/GATS and/or NAFTA challenge is if AAUs were determined to be out of the scope of these agreements. This would be the case if AAUs were determined to be neither goods nor services, and therefore trade in these entities would not be subject to Member obligations under these agreements. These two alternatives will be discussed in the following sections.

1. MFN and National Treatment Principles

The WTO Asbestos Appellate Body decision²¹¹ reflects a landmark decision in its ruling for the first time that a unilateral sanction excluding certain products from the French market, did not violate the most favored nation or national treatment principles.²¹² As discussed above, the Appellate Body focused on the term “like product,” and reached the conclusion that asbestos products manufactured in Canada were not “like products” to the substitute products manufactured in France. The WTO defines the term “like product” as “a product which is identical, i.e., alike in all respects to the product under consideration or, in the absence of such a product which, although not alike in all respects, has characteristics closely resembling those of the product under consideration.”²¹³ The Appellate Body classified “like products” based on the following

²¹¹ As discussed in Section IV(A)(4) above

²¹² The most favored nation principle states that no contracting Party shall procure:
any advantage, favor, privilege, or immunity, granted by any contracting party to an
product originating in...any other country shall be accorded immediately and
unconditionally to the like products originating...in all other contracting parties.

The national treatment principle states that no contracting Party shall :
be accorded treatment no less favorable than that to like products of national origin in
respect to all laws, regulations, and requirements affecting their internal sale.

²¹³ www.wto.org Found 5/26/02

criteria: 1) physical properties of the products; 2) the end uses of the product; 3) consumers' tastes and habits; 4) tariff classification; and (5) the risk associated with the product.²¹⁴ It is possible that through similar analysis Canadian and U.S. created AAUs also be found not "like products."

i) Physical Properties of AAUs

If AAUs are classified as products, the physical properties of AAUs created in the U.S. versus those created in Canada will remain virtually identical. One cannot distinguish between carbon emissions on a physical basis, therefore this point will not likely carry any weight in establishing a significant difference between AAUs created in Canada versus those created in the U.S.

ii) End Uses of AAUs

The end uses of AAUs created in the U.S., in contrast to those created in Canada, provide a platform to argue that these products/services are "like." AAUs created in Canada, or any other Kyoto Protocol member nation, will be used to meet emission reduction obligations under the Kyoto Protocol. Even if Canada is forced to accept AAUs created in the U.S., or any other non-Kyoto Protocol member nation, into a Canadian market these AAUs will likely not be permitted for use to meet these obligations. Therefore, the end uses of these two products/services are fundamentally disparate.

²¹⁴ *supra* note 139

iii) Consumer Tastes and Habits

Consumer tastes and habits also provide a platform on which to argue that AAUs created in the U.S. and Canada are not “like” products/services. Based on the author’s experience brokering emission reduction credits domestically in the U.S., there are two major issues governing consumer tastes and habits with respect to purchasing emission reduction credits. The first concern consumer’s have is; will the appropriate regulatory body recognize the credits for the purposes of compliance with appropriate regulations? Consumers will likely prefer to purchase AAUs that are certain to be recognized by the Canadian government. Furthermore, when the Canadian government is the consumer, it is even more likely that the consumer will prefer to purchase AAUs that can be used to meet Canadian obligations under the Kyoto Protocol. The second concern consumers often have with respect to purchase of emission reduction credits is the price of the credits. AAUs created in the U.S. would likely cost less because of the associated risk that the credits may not be recognized by the Canadian government. However, because of the cost associated with creating emission reduction credits, this price differential will likely not be enough to override the risk factor. Therefore, consumer tastes and habits may indicate that U.S. and Canadian created AAUs are not “like” products/services.

iv) Tariff Classification of AAUs

For all intents and purposes, apart from meeting obligations under the Kyoto Protocol, all AAUs are identical. Therefore, this paper will assume that AAUs created in

the U.S. and those created in Canada will be similarly classified with respect to tariffs.

Under this assumption, tariff classification does not support the argument.

v) Risk Associated With Use of AAUs

As discussed above, in conjunction with ‘consumer tastes and habits,’ the primary risk associated with the use of U.S. created AAUs is that the credits will not be recognized by the Canadian government for the purposes of compliance with domestic and/or international obligations. If consumers purchase credits that cannot be used for compliance, they face the risk of economic loss through penalties and/or the necessity to purchase valid credits that *can* be used for compliance. The Asbestos Appellate Body decided that a French ban on Canadian asbestos products was justified because the Canadian product had an associated health risk. In the case of a Canadian ban on U.S. created AAUs, the risk is economic, not health related.

If by the reasoning above, AAUs created in non-Kyoto Protocol member nations are not considered “like” products/services to those created within a Kyoto Protocol member nation, trade in AAUs will likely fall outside the scope of the GATT, the GATS, and the NAFTA national treatment and most favored nation principles. Therefore, if a U.S. created quantified emission reduction is not a “like” product/service to a Kyoto Protocol approved AAU, it would likely not be subject to equal treatment under NAFTA,

which prohibits quantitative restrictions on “like, directly competitive, or substitutable products” from member nations.²¹⁵

2. AAUs: Not Within the Scope of the WTO or NAFTA

Although the literature on this topic is sparse, those who have written on the topic of AAU classification²¹⁶ find it very possible that AAUs will not be considered neither “goods” nor “services” under the WTO or the NAFTA. The UNCTAD suggests that the WTO may view AAUs as neither goods nor services because AAUs “exist by virtue of an international agreement and their sole use is for meeting sovereign obligations under that agreement.”²¹⁷ Under this scenario, restricting trade in AAUs to Kyoto Protocol member nations would not be subject to WTO or NAFTA rules. However, these authors also recognize that “in the absence of a WTO ruling, the risk remains that WTO rules apply [to trade in AAUs].”²¹⁸ AAUs represent a completely new “commodity,” which could warrant a completely new category of classification under the WTO and/or the NAFTA. Furthermore, since AAUs are proving so difficult to classify, this uncertainty could leave room for a politically motivated decision, one therefore even more difficult to predict.

²¹⁵ Pursuant to NAFTA Chapter III Articles 301,302 and 309

²¹⁶ See Werksman, Petsonk, Parker, Amin et.al., and UNCTAD

²¹⁷ See UNCTAD *supra* note 22 at 63

²¹⁸ UNCTAD *supra* note 22 at 63

VII. Can the NAAEC Protect Canadian Climate Change Policy?

With regard to a potential NAFTA conflict between Canada and the U.S. (or Mexico) over AAU trading, the North American Agreement on Environmental Cooperation (NAAEC) may hold the solution. The NAAEC requires that NAFTA member nations *enforce and improve* their environmental standards and policies. Under these requirements, Canada may be able to institute domestic policy restrictions on trade in AAUs so long as the policy is clearly designed to protect the environment. The NAAEC protects domestic environmental legislation. Therefore, it probably does not matter if AAUs are classified as “products” or “services.”

The NAAEC may offer protection for Canada if the trade restrictions embedded in the Kyoto Protocol²¹⁹ come under attack by non-Kyoto Protocol parties that are member to the NAFTA.²²⁰ The following section will provide a detailed description of the environmental protection measures provided for in the NAAEC, discuss the process by which those environmental protection measures can be enforced, and finally discuss how Canada may be able to use this agreement to justify domestic implementation of the trade restrictions mandated by the Kyoto Protocol.

A. NAAEC: Environmental Protection Provisions

²¹⁹ i.e. restrictions on trade in ERUs, AAUs, CERs, and RMUs to Kyoto Protocol Party nations

²²⁰ Note, the WTO does not have a congruent agreement to the NAAEC, therefore this argument applies only non-compliance charges brought forth by the U.S. or Mexico.

As discussed in Section II(C)(3) above, the NAAEC was negotiated by the Clinton Administration to gain political support for the passage of the NAFTA. The NAAEC clearly sets the stage for the pro-environmental protection standpoint detailed in the preamble of the Agreement. The NAAEC contains measures allowing for the: (1) enhancement of domestic environmental policies; (2) investigation of charges involving inadequate enforcement of domestic environmental policies; (3) arbitration of environmental disputes; and (4) sanctioning of members found to be in violation of NAAEC requirements.²²¹ Additionally, the NAAEC established a new body known as the North American Commission for Environmental Cooperation (NACEC) to ensure that the NAAEC requirements are met, and to handle dispute resolution under these requirements. The specific stipulations are cited below.

- *NAAEC Preamble*

The preamble emphasizes the importance of sustainable development and intergenerational equity to the protection of the environment. It links the importance of environmental protection to sustained economic growth. The preamble stresses the “importance of the conservation, protection, and enhancement of the environment,” as well as the “essential role of cooperation [among parties] in achieving sustainable development for the well-being of

²²¹ David S. Baron, *NAFTA- Making the Side Agreement Work*, 12 Arizona Journal of International and Comparative Law 603 (1995)

present and future generations.”²²² These statements do not equivocate in their purpose of environmental protection.

- *Enforcement of Domestic Environmental Policy*

The NAAEC goes on to state specifically that all member nations must “enhance compliance with, and enforcement of environmental laws and regulations.”²²³ Additionally, ‘interested persons’ have the right to request action in response to a violation of this stipulation by instigating administrative, quasi-judicial, or judicial proceedings.²²⁴ Again, as in the preamble, the text is clearly biased towards protection of national sovereignty in the case of domestic environmental policy.

- *Enhancement of Domestic Environmental Policy*

The NAAEC not only requires that member nations effectively enforce their environmental policies already in place, but also uses the harmonization principle to require member nations to *improve* on these policies. Harmonization ensures that the country with the least stringent environmental protection regulations does not become the common denominator. The NAAEC states that members must “foster the protection and improvement of the environment,” they

²²² *supra* note 63 at preamble

²²³ *supra* note 63 at Article 1(g)

²²⁴ Sandra Le Priol-Vrejan, *The NAFTA Environmental Side Agreement and the Power to Investigate Violations of Environmental Laws*, 23 Hofstra Law Review 483 (1994)

must “better conserve, protect, and enhance the environment,” they must “ensure that its laws and regulations provide for a high level of environmental protection, and shall strive to continue to improve those laws and regulations.” Additionally, each Party must “effectively enforce its environmental laws and regulations through appropriate governmental action.”²²⁵

- *Creation of the CEC*

Central to the NAAEC is the creation of the Commission for Environmental Cooperation (CEC). Among other duties, the CEC provides a forum through which Parties, individuals, or NGOs, can resolve disputes surrounding a Party’s failure to enforce its environmental regulations.

- *Arbitration on Environmental Disputes*

When disputes arise surrounding the requirements of the NAAEC, any Party may commence formal consultation with any other Party accused of being in violation. If Parties are unable to reach resolution through this consultation process, the Council can choose to defer the issue to a five member arbitral Panel.²²⁶ This process will be discussed in more detail in Section VI(C) below.

²²⁵ *supra* note 63 at Article 1(a), (c), Article 3, and Article 5

²²⁶ Each Party involved in the dispute chooses two of the five panelists from an existing list prepared by the Council. The fifth panelist, the Chair, is agreed upon by both Parties or else chosen for the Parties by a third uninvolved party. *See supra* note 198 at 606.

B. Options for Enforcement: Potential for Protection

Based on the requirements described above, the NAAEC may permit for Canada to ratify the Kyoto Protocol and incorporate its policies into Canadian law without breaching its NAFTA obligations. This could happen in one of two ways. First, NAAEC rules allowing for the improvement of environmental regulations among member nations may be employed to justify the rules contained in the Kyoto Protocol. Second, the NAAEC rules requiring member nations to enforce their environmental regulations may be employed to uphold the rules contained in the Kyoto Protocol. Each of these arguments will be explored below.

The NAAEC permits member nations to *improve* their domestic environmental policy. The Kyoto Protocol is indeed a policy designed to protect and *improve* the quality of the environment.²²⁷ Therefore, if Canada chooses to adopt and incorporate the Protocol into its own legislation, the trade measures included therein may be protected by NAAEC Articles 1(a), 1(c), 3, and 5²²⁸ allowing for improvement of environmental regulations.

The CEC can only hear cases related to the failure of a member government to enforce its environmental regulations. Therefore, if the Canadian government chooses to accept U.S. derived AAUs in hopes of avoiding such a

²²⁷ See discussion in Section II(A) above.

²²⁸ Additionally, Article 2(1) requires that each Party shall “promote the use of economic instruments for the efficient achievement of environmental goals.” This may provide safe harbor for the use of an international emissions trading system.

U.S. challenge, any resident or resident organization of Canada, the U.S., or Mexico may be in a position to challenge this decision. Any such party could claim that Canada would not be enforcing its environmental policies as dictated by the Kyoto Protocol in allowing U.S. derived AAUs into the Canadian market. Article V of the Kyoto Protocol specifies that AAUs can be transferred among Kyoto Protocol Party nations:

Any emission reduction units, or any part of an assigned amount, which a Party acquires from another Party in accordance with the provisions of Article 6 or of Article 17 shall be added to the assigned amount for the acquiring Party...

Any emission reduction units, or part of an assigned amount, which a Party acquires transfers to another Party in accordance with the provisions of Article 6 or of Article 17 shall be subtracted from the assigned amount for the transferring Party.

Furthermore, Article 17 of the Kyoto Protocol stipulates:

Parties included in Annex B may participate in emissions trading for the purposes of fulfilling their commitments under Article 3. *Any such trading* [emphasis added] shall be supplemental to domestic actions for the purposes of meeting quantified emission limitation and reduction commitments under that Article.

These statements can be interpreted in one of two ways. On the one hand, if the U.S. is not a Kyoto Protocol member nation, engaging in international emissions trading as defined by the Kyoto Protocol will clearly not be “supplemental to domestic actions for the purposes of meeting...commitments under” Article 3.

Therefore, it can be inferred that by engaging in emissions trading with the United States, Canada would be engaging in an illegal trade as defined by the Kyoto Protocol. On the other hand, although the Kyoto Protocol explicitly states who a Party nation *can* trade with, it does not necessarily state who a Party *cannot* trade with. Articles 3 and 6 of the Kyoto Protocol state the following:

Article 3

10. Any emission reduction units, or any part of an assigned amount, which a Party acquires from another Party in accordance with the provisions of Article 6 or of Article 17 shall be added to the assigned amount for the acquiring Party.

11. Any emission reduction units, or any part of an assigned amount, which a Party transfers to another Party in accordance with the provisions of Article 6 or of Article 17 shall be subtracted from the assigned amount for the transferring Party.

In addition, Article 6 states as follows:

Article 6

1. For the purpose of meeting its commitments under Article 3, any Party included in Annex I²²⁹ may transfer to, or acquire from, any other such Party emission reduction units resulting from projects

²²⁹ Annex I of the UNFCCC generally corresponds to Annex B of the Kyoto Protocol

aimed at reducing anthropogenic emissions by sources or enhancing anthropogenic removals by sinks of greenhouse gases in any sector of the economy, provided that:

- (a) Any such project has the approval of the Parties involved;
- (b) Any such project provides a reduction in emissions by sources, or an enhancement of removals by sinks, that is additional to any that would otherwise occur;
- (c) It does not acquire any emission reduction units if it is not in compliance with its obligations under Articles 5 and 7; and
- (d) The acquisition of emission reduction units shall be supplemental to domestic actions for the purposes of meeting commitments under Article 3.

Article 3 clearly stated that a Party can account for ERUs or AAUs acquired from, or transferred to, another Party. However, Article 3 does not state that a Party may *not* account for ERUs or AAUs acquired from, or transferred to, a non-Party. Similarly, Article 6 stipulates that Parties may acquire or transfer ERUs resulting from 'projects' from any other Party. Again, it does not stipulate that Party nations may not engage in such actions with non-Parties. Articles 6 (c) and (d) stipulate that in order to participate in this process, Parties must comply with Articles 5 and 7, and also that any such actions must be supplemental to domestic actions. However, because the U.S. will presumably not be a Party to the Kyoto Protocol, it is not bound by these rules.

Furthermore, the Kyoto Protocol does not hold Parties responsible for the compliance obligations of their trading partners. Therefore, since neither the Kyoto Protocol, nor the Marrakesh Accords *specifically* prohibit Party nations from trading with non-Party nations, Canada's obtaining AAUs from the U.S. may not be seen as an example of a failure to enforce Canadian environmental regulations. In any event, this challenge may allege the failure of a NAFTA member government to enforce its environmental laws and under these circumstances would therefore be heard by the CEC. The process involved in such a hearing is described below.

C. Dispute Resolution Under the CEC: Process and Procedures

Dispute resolution surrounding a NAFTA member nation's failure to enforce its environmental regulations is handled exclusively by the CEC. The CEC is made up of a Council, a Secretariat, and a Joint Public Advisory Committee (JPAC). The Council is the governing body, the Secretariat is the administrative body, and the JPAC is a public advisory body to the two aforementioned groups.²³⁰

As mentioned above, Article 14 of the NAAEC is unique in that it grants standing to public citizens and non-governmental organizations (NGOs) to file complaints against the government of any member nation for the latter's alleged

²³⁰ *supra* note 221 at 606

failure to enforce its environmental regulations. Public citizens and NGOs must submit a complaint to the Secretariat detailing how the accused party has failed to enforce its environmental laws effectively. Complainants must meet a number of procedural requirements for a submission to the Secretariat to be approved and reviewed.²³¹ If these requirements are met, the Secretariat may then decide to dismiss the complaint, or request a response from the Party in violation.²³² In making this decision, the Secretariat must examine and “be guided by”²³³ the following criteria: (1) the party submitting the complaint must allege harm; (2) the submission must raise issues that will further the purposes of the Side Agreement; (3) private remedies under the Party’s law must have been previously pursued; and (4) the submission must be drawn exclusively from mass media reports.²³⁴

Based on the requirements described above, it is likely that the Secretariat will be justified in requesting a response from the Canadian government if a complaint is filed due to Canada’s failure to enforce the requirements of the Kyoto Protocol.²³⁵ Subsequently, the Secretariat may seek approval from the Council to file a “factual record” to document the allegations. Alternatively, the Secretariat may choose to dismiss the complaint if certain criteria are not met.

²³¹ For a list of these requirements see *supra* note 221 at 607. Additionally, for an excellent discussion of the entire dispute resolution system under the NAAEC see John Knox, *A New Approach to Compliance with International Environmental Law: The Submissions Procedure of the NAFTA Environmental Commission*, 28 Ecology Law Quarterly 1 (2001).

²³² If a complaint is initiated by a NAFTA Party, an individual or an NGO, the CEC has limited powers of investigation. However, the scope of the CEC’s investigative powers is unclear in that the NAAEC does not specify what materials the CEC may request from a Party nor does it dictate that the member Party must surrender such materials when requested. See *supra* note 184 at 500.

²³³ *supra* note 63 at Article 14.2.

²³⁴ *supra* note 63 Article 14.2.

²³⁵ If those requirements are implemented domestically by statute.

For example, the Secretariat may dismiss a claim if the failure to enforce an environmental law²³⁶ reflects “a reasonable exercise of official discretion in investigatory, prosecutorial, regulatory, or compliance matters.”²³⁷ The Secretariat may also dismiss a charge if it relates to occupational safety and health laws or to laws primarily aimed at the management of natural resources.²³⁸ Additionally, the Secretariat has refused to permit Article 14 submissions challenging any legislative action that diminishes environmental law enforcement.²³⁹ If the creation of a “factual record” is approved by the Council,²⁴⁰ it may lead to further investigation by the Secretariat, comment by the Parties involved,²⁴¹ and potentially the public release of the “factual record” if such a release is approved

²³⁶ Article 25(2)(b) of the NAAEC defines an environmental law as any law whose:

primary purpose... is the protection of the environment, or the prevention of a danger to human life or health, through,

- (i) the prevention, abatement, or control of the release, discharge, or emission of pollutants or environmental contaminants,
- (ii) the control of environmental hazardous or toxic chemicals, substances, materials, and wastes, and the dissemination of information related thereto, or
- (iii) the protection of wild flora or fauna, including endangered species, their habitat, and specially protected natural areas...

²³⁷ *supra* note 43 at 211. For additional discussion of the criteria see *supra* note 66 at 608

²³⁸ *supra* note 43 at 211. This stipulation raises an interesting rift between the NAAEC and the general exemptions of NAFTA Chapter 21. The NAFTA Chapter 21 exemptions require that in order for an exemption to be invoked, the measure in question must be primarily aimed at the conservation of a natural resource. In contrast, the NAAEC stipulated the opposite, it's ‘exemptions’ may be dismissed in cases where the law in question *is* related to the management of a natural resource. Therefore, it may be the case that because of this difference in verbiage, arguments related to NAAEC ‘exemptions’ could not be used in conjunction with arguments citing the provisions of the NAFTA Chapter 21 exemptions to build a case protecting Canadian implementation of the Kyoto Protocol. In other words, in it's defense to a U.S. challenge under NAFTA, Canada may not be able to argue protection under the NAAEC as well as under Chapter 21 for domestic policy aimed at environmental protection. Canada would be forced to chose to argue either that the Kyoto Protocol was a law designed to protect natural resource under Chapter 21, or that the Kyoto Protocol is not primarily aimed at the management of natural resources and thereby fair game to be heard by the NAAEC.

²³⁹ *supra* note 43 at 212. For examples of dismissed cases based on this criteria see SEM-95-001 and SEM-95-002. In these cases the CEC dismissed charges challenging Canadian suspension of enforcement of the U.S. Endangered Species Act and the elimination of private sector remedies to review U.S. salvage logging sales.

²⁴⁰ The NAAEC does not provide guidelines under which the Council must make it's decision as to this matter.

²⁴¹ The Secretariat maintains discretion over whether or not to incorporate these comments into the final document. See *supra* note 61 at Article 15(6).

by the Council.²⁴² However, in the case of a citizen or NGO challenge of a member nation's failure to enforce environmental policy, this release of information is the only "sanction" available against the party at fault.²⁴³ Additionally, as the name implies, the "factual record" is simply a statement of facts involved in the case, and does not issue any binding ruling ordering the Party at fault to enforce their environmental regulations effectively. Some authors argue that the ability of the CEC to function effectively as a regulatory body is severely limited.²⁴⁴

IIX. Alternative Potential for Trade Conflict

Despite the uncertainty surrounding the classification of AAUs, there are other aspects of the Kyoto Protocol which may lead Parties to take actions in conflict with their WTO or NAFTA obligations. Each Party will be responsible for the allocation of allowances or permits domestically. Depending on the method of allocation in each member nation, it is possible that the allocation of allowances or emission permits may conflict with member obligations under these trade agreements. Additionally, the manner in which countries enforce permit requirements could potentially conflict with NAFTA and/or WTO obligations. These two scenarios are described below.

²⁴² As of the publication of Knox *supra* note 190 (2001), the Council had only permitted the public release of two factual records.

²⁴³ *supra* note 43 at 214. There are however additional sanctions available as a result of the NAAEC arbitral process. Under this process, the government of any member nation may request the establishment of an arbitral panel to hear a dispute concerning any other member nations' "persistent pattern of failure" to enforce its environmental laws. If a Party is found guilty of this charge monetary penalties may be imposed on the offending Party.

²⁴⁴ *supra* note 224

A. Allocation and Enforcement

If allocation of AAUs are made in such a way as to constitute an ‘actionable subsidy’²⁴⁵ or a ‘regulatory measure that confers financial benefit,’ the Party may violate the WTO Agreement on Subsidies and Countervailing Measures. This Agreement prohibits government subsidies with very few exemptions.²⁴⁶ The UNCTAD has indicated that if allowances are allocated to certain entities in such a way as to confer a surplus (i.e. in excess to what is needed for operation), this surplus may be construed as a ‘financial contribution’ from the government, and therefore potentially in violation of the Agreement.²⁴⁷

Alternatively, a Party may find itself in violation of WTO and/or NAFTA rules depending on where it decides to impose the ‘point of enforcement.’ Broadly speaking, Parties have three choices with respect to the ‘point of enforcement.’ They can require surrender of allowances (1) upstream, at the point of fossil fuel extraction, sale or transport; (2) downstream, at the point of emission or; (3) utilize a hybrid of these two systems. UNCTAD has indicated that if

²⁴⁵ The WTO Subsidies Agreement defines an ‘actionable subsidy’ as ‘(1) a non-*de minimis* ‘financial contribution’ that (2) is bestowed on ‘specific’ enterprises or industries; and (3) causes or threatens ‘injury’ or ‘serious prejudice’ to foreign manufacturers or like products” See Richard R. Parker, *Designs for Domestic Carbon Emissions Trading: Comments on WTO Aspects*, The H. John Heinz Center for Science, Economics, and the Environment, June 1990 at 2 Parker explains that a non- *de minimis* financial contribution is one that yields a benefit, directly or indirectly, that is greater than one percent of the receiving firm’s total sales of all products or, if the subsidy is limited to certain products, one percent of the firm’s total sales of the subsidized products.

²⁴⁶ A prohibited subsidy is defined in the agreement as a “financial contribution that confers a benefit on a specific enterprise or industry or group of enterprises or industries” (UNCTAD *supra* note 22 at 63)

²⁴⁷ For a more detailed discussion of this issue see *supra* note 22 at 64

allowances for fossil fuels are demanded upstream, or 'at the border,' this may account for a quantitative restriction on trade.²⁴⁸

Additionally, this scenario raises the question of how to allow market access to non-Kyoto Protocol Party exporters; and how non-Parties can acquire and account for AAUs required for surrender at the border. If AAU surrender is required at the border, and non-Kyoto Protocol Parties are not allowed market access, Kyoto Protocol Parties can only trade in energy related goods and services (i.e. fossil fuels) with other Kyoto Protocol Parties. It is very likely that under this scenario Parties would be in conflict with their obligations under the GATT, the GATS, or the NAFTA. On the other hand, if non-Parties are allowed market access, it is unclear whether they also create AAUs domestically and trade them on the open market. If so, this will create a huge disincentive for countries to ratify the Kyoto Protocol. Under this scenario, non-Parties can reap the economic benefits of an emissions trading system without the economic hardship associated with fulfilling other Kyoto Protocol emission reduction requirements.

The second alternative, downstream surrender, is more likely avoid WTO and/or NAFTA conflicts. However this approach limits the scope of total carbon emissions covered. This system can only cover approximately half of all carbon

²⁴⁸ This argument would obviously only apply if AAUs are classified as goods or services and therefore subject to NAFTA requirements.

emissions.²⁴⁹ Mobile sources, such as private passenger vehicles, are difficult to regulate and would likely fall outside of the extent of coverage.

The third model, the hybrid system, combines various aspects of the two aforementioned systems. The hybrid system is similar to a downstream approach in that utilities and large industrial sources are required to hold allowances to account for their emissions. However, the hybrid system borrows from the upstream approach in that domestic fuel distributors must also hold allowances for small fuel users such as private passenger vehicles.²⁵⁰ The idea behind this approach is that fuel distributors will pass the cost associated with holding allowances onto the consumer/emission source by raising gas prices, thereby pressuring consumers to switch to less carbon intensive fuel sources.²⁵¹ Although the hybrid system incorporates aspects of the upstream system, it diminishes the need for quantitative control 'at the border.' Therefore, this system is less likely to come into conflict with GATT obligations. Additionally, by requiring fuel suppliers to hold allowances this system is far more inclusive of the entire scope of carbon emissions.

²⁴⁹ *Supra* note 22 at 78

²⁵⁰ This system would also fall short of accounting for cross border traffic. i.e. passenger vehicles buying gasoline in the U.S. and driving into Canada.

²⁵¹ See Zhong Xiang Zhang, *Greenhouse Gas Emissions Trading and the World Trading System*, 32(5) *Journal of World Trade* 219 (1998)

IX. Conclusions

Given the lack of precedent, it is difficult to determine with any degree of certainty how the WTO or the NAFTA may classify AAUs. Some analysts may argue that because the trade restrictions under other MEAs such as the Montreal Protocol, the Basel Convention and CITES have not been challenged, it is unlikely that a similar challenge will arise under the Kyoto Protocol. However, because the potential economic impact associated with the Kyoto Protocol is far greater than that associated with any of its predecessor MEAs, it is likely to attract more attention from the international community. Therefore, it is prudent to analyze all possible grounds for conflict with existing trade agreements and prepare for such conflicts before they arise.

Specifically, it is imperative that negotiations be held between the U.S. and Canada with the intention of placing the Kyoto Protocol on the list of exempted MEAs in NAFTA Chapter 1, Article 104. Some may argue that because the U.S. is not a party to the Kyoto Protocol, it will not be willing to exempt the Kyoto Protocol from NAFTA obligations. However, the U.S. has agreed to exempt other MEAs, such as the Basel Convention, from NAFTA obligations to which the U.S. is also a non-party. Nevertheless, the U.S. will likely reject such an exemption based on its interest in taking part in the international emissions trading market. The Bush Alternative to the Kyoto Protocol is an indication of such an interest. It seems that the creation of the

alternative agreement was not only an effort to save face in front of the international community but also an attempt to participate in an economically viable emissions trading market. It is possible that this half hearted attempt at a national alternative may provide access to an international emissions trading market.²⁵² In fact, a pilot project called the Chicago Climate Exchange is already underway establishing a domestic greenhouse gas market with hopes of eventually expanding to international trade.

Lastly, albeit not ideal, if non-Kyoto Protocol member nations with domestic trading systems comparable to those contained in the Kyoto Protocol are simply allowed market access, it is possible that NAFTA and/or WTO challenge may be avoided altogether. However, currently there does not exist a comparable system with *legally binding* emissions reduction commitments. If the U.S. establishes a parallel trading system and attempts to take part in the emissions trading system established under the Kyoto Protocol without committing to legally binding emission reduction targets, it is likely that member nations will strongly oppose such an action. One author argues however, that 'real' emission reductions created in non-Kyoto Protocol party nations are preferable, from an environmental standpoint, to 'hot air' credits.²⁵³ Additionally, this author argues that by allowing U.S. participation in the market, lower cost credits created in the U.S. would drive down the price of AAUs to make them more accessible to

²⁵² This option may provide the U.S. with the argument for an option which is "less inconsistent" with Member obligations under the NAFTA and the WTO.

²⁵³ Some authors predict that without U.S. participation, the emissions trading market will largely be based on "hot air." See Hagen, Cathrine et. al., *From Small to Insignificant: Climate Impact of the Kyoto Protocol with and without U.S.*, Center for International Climate and Environmental Research, at 5

European companies.²⁵⁴ Some suggest that even in the absence of binding commitments, it is likely that based on “expectations regarding future regulatory requirements,” U.S. emissions in 2010 may be lower than its normal baseline.²⁵⁵ Others warn of the danger of double counting and/or overselling if multiple trading systems attempt to overlap.²⁵⁶

The question of whether Canada will be forced to allow non-Kyoto Protocol nations that are Party to WTO and/or NAFTA, market access to the Canadian greenhouse gas emissions trading system is very difficult to answer. Many factors require consideration, and there are no concrete legal guidelines to answer the question. This paper has attempted to show some potential scenarios under which Canada may come into conflict with its obligations under the WTO and NAFTA by restricting market access to the U.S. (or any other NAFTA or WTO member nation). Additionally, this paper has suggested some harbors which may provide protection for Canada from a WTO and/or NAFTA challenge. Once the WTO has officially classified AAUs, or rejected them from the trading system, this discussion can be markedly more pointed, or perhaps not necessary at all. However, in the meantime, it provides an interesting and relevant point of discussion, as well as highlights some of the inconsistencies and weaknesses of the system designed to address AAUs.

²⁵⁴ See Diringir at 2

²⁵⁵ See Manne, Alan et. al., *U.S. Rejection of the Kyoto Protocol: The Impact on Compliance Costs and CO₂ Emissions*, AEI-Brookings Joint Center for Regulatory Studies (2001)

²⁵⁶ See Nordhaus, Robert, et. al., *International Emissions Trading Rules as a Compliance Tool: What is Necessary, Effective, and Workable?* Environmental Law Reporter (2000)

Appendix A

Annex B Parties to the Kyoto Protocol

Australia

Austria

Belgium

Bulgaria*

Canada

Croatia*

Czech Republic*

Denmark

Estonia*

European Community

Finland

France

Germany

Greece

Hungary*

Iceland

Ireland

Italy

Japan

Latvia*

Liechtenstein

Lithuania*

Luxembourg

Monaco

Netherlands

New Zealand

Norway

Poland*

Portugal

Romania*

Russian Federation*

Slovakia*

Slovenia*

Spain

Sweden

Switzerland

Ukraine*

United Kingdom of Great Britain and Northern Ireland

United States of America

* Countries that are undergoing the process of transition to a market economy.

Appendix B

GATS Annex on Financial Services

1. Scope and Definition

(a) This Annex applies to measures affecting the supply of financial services. Reference to the supply of a financial service in this Annex shall mean the supply of a service as defined in paragraph 2 of Article I of the Agreement.

(b) For the purposes of subparagraph 3(b) of Article I of the Agreement, "services supplied in the exercise of governmental authority" means the following:

(i) activities conducted by a central bank or monetary authority or by any other public entity in pursuit of monetary or exchange rate policies;

(ii) activities forming part of a statutory system of social security or public retirement plans; and

(iii) other activities conducted by a public entity for the account or with the guarantee or using the financial resources of the Government.

(c) For the purposes of subparagraph 3(b) of Article I of the Agreement, if a Member allows any of the activities referred to in subparagraphs (b) (ii) or (b) (iii) of this paragraph to be conducted by its financial service suppliers in competition with a public entity or a financial service supplier, "services" shall include such activities.

(d) Subparagraph 3(c) of Article I of the Agreement shall not apply to services covered by this Annex.

2. Domestic Regulation

(a) Notwithstanding any other provisions of the Agreement, a Member shall not be prevented from taking measures for prudential reasons, including for the protection of investors, depositors, policy holders or persons to whom a fiduciary duty is owed by a financial service supplier, or to ensure the integrity and stability of the financial system. Where such measures do not conform with the provisions of the Agreement, they shall not be used as a means of avoiding the Member's commitments or obligations under the Agreement.

(b) Nothing in the Agreement shall be construed to require a Member to disclose information relating to the affairs and accounts of individual customers or any confidential or proprietary information in the possession of public entities.

3. Regulation

(a) A Member may recognize prudential measures of any other country in determining how the Member's measures relating to financial services shall be applied. Such recognition, which may be achieved through harmonization or otherwise, may be based upon an agreement or arrangement with the country concerned or may be accorded autonomously.

(b) A Member that is a party to such an agreement or arrangement referred to in subparagraph (a) , whether future or existing, shall afford adequate opportunity for other interested Members to negotiate their accession to such agreements or arrangements, or to negotiate comparable ones with it, under circumstances in which there would be equivalent regulation, oversight, implementation of such regulation, and, if appropriate, procedures concerning the sharing of information between the parties to the agreement or arrangement. Where a Member accords recognition autonomously, it shall afford adequate opportunity for any other Member to demonstrate that such circumstances exist.

(c) Where a Member is contemplating according recognition to prudential measures of any other country, paragraph 4(b) of Article VII shall not apply.

4. Dispute Settlement

Panels for disputes on prudential issues and other financial matters shall have the necessary expertise relevant to the specific financial service under dispute.

5. Definitions

For the purposes of this Annex:

(a) A financial service is any service of a financial nature offered by a financial service supplier of a Member. Financial services include all insurance and insurance-related services, and all banking and other financial services (excluding insurance) . Financial services include the following activities:

Insurance and insurance-related services

(i) Direct insurance (including co-insurance) :

(A) life

(B) non-life

(ii) Reinsurance and retrocession;

(iii) Insurance intermediation, such as brokerage and agency;

(iv) Services auxiliary to insurance, such as consultancy, actuarial, risk assessment and claim settlement services.

Banking and other financial services (excluding insurance)

(v) Acceptance of deposits and other repayable funds from the public;

(vi) Lending of all types, including consumer credit, mortgage credit, factoring and financing of commercial transaction;

(vii) Financial leasing;

(viii) All payment and money transmission services, including credit, charge and debit cards, travellers cheques and bankers drafts;

(ix) Guarantees and commitments;

(x) Trading for own account or for account of customers, whether on an exchange, in an over-the-counter market or otherwise, the following:

(A) money market instruments (including cheques, bills, certificates of deposits) ;

(B) foreign exchange;

(C) derivative products including, but not limited to, futures and options;

(D) exchange rate and interest rate instruments, including products such as swaps, forward rate agreements;

(E) transferable securities;

(F) other negotiable instruments and financial assets, including bullion.

(xi) Participation in issues of all kinds of securities, including underwriting and placement as agent (whether publicly or

privately) and provision of services related to such issues;

(xii) Money broking;

(xiii) Asset management, such as cash or portfolio management, all forms of collective investment management, pension fund management, custodial, depository and trust services;

(xiv) Settlement and clearing services for financial assets, including securities, derivative products, and other negotiable instruments;

(xv) Provision and transfer of financial information, and financial data processing and related software by suppliers of other financial services;

(xvi) Advisory, intermediation and other auxiliary financial services on all the activities listed in subparagraphs (v) through (xv) , including credit reference and analysis, investment and portfolio research and advice, advice on acquisitions and on corporate restructuring and strategy.

(b) A financial service supplier means any natural or juridical person of a Member wishing to supply or supplying financial services but the term "financial service supplier" does not include a public entity.

(c) "Public entity" means:

(i) a government, a central bank or a monetary authority, of a Member, or an entity owned or controlled by a Member, that is principally engaged in carrying out governmental functions or activities for governmental purposes, not including an entity principally engaged in supplying financial services on commercial terms; or

(ii) a private entity, performing functions normally performed by a central bank or monetary authority, when exercising those functions.

Second annex on Financial Services [Back to top](#)

1. Notwithstanding Article II of the Agreement and paragraphs 1 and 2 of the Annex on Article II Exemptions, a Member may, during a period of 60 days beginning four months after the date of entry into force of the WTO Agreement, list in that Annex measures relating to financial services which are inconsistent with paragraph 1 of Article II of the Agreement.

2. Notwithstanding Article XXI of the Agreement, a Member

may, during a period of 60 days beginning four months after the date of entry into force of the WTO Agreement, improve, modify or withdraw all or part of the specific commitments on financial services inscribed in its Schedule.

3. The Council for Trade in Services shall establish any procedures necessary for the application of paragraphs 1 and 2.

Appendix C

Canadian Schedule of Commitments Under NAFTA

Sector:	Aboriginal Affairs
Sub-Sector:	
Industrial Classification:	
Type of Reservation:	National Treatment (Articles 1102, 1202) Most-Favored-Nation Treatment (Articles 1103, 1203) Local Presence (Article 1205) Performance Requirements (Article 1106) Senior Management and Boards of Directors (Article 1107)
Description:	<u>Cross-Border Services and Investment</u> Canada reserves the right to adopt or maintain any measure denying investors of another Party and their investments, or service providers of another Party, any rights or preferences provided to aboriginal peoples.
Existing Measures:	<i>Constitution Act, 1982</i> , being Schedule B of the Canada Act 1982 (U.K.), 1982, c. 11
Sector:	All Sectors
Sub-Sector:	
Industrial Classification:	
Type of Reservation:	National Treatment (Article 1102)
Description:	<u>Investment</u> Canada reserves the right to adopt or maintain any measure relating to residency requirements for the ownership by investors of another Party, or their investments, of oceanfront land.
Existing Measures:	<i>Constitution Act, 1982</i> , being Schedule B of the Canada Act 1982 (U.K.), 1982, c.11
Sector:	Communications
Sub-Sector:	Telecommunications Transport Networks and Services, Radiocommunications and Submarine Cables
Industrial Classification:	CPC 752 - Telecommunications Services CPC 7543 - Connection Services CPC 7549 - Other Telecommunications Services Not Elsewhere Classified (limited to telecommunications transport networks and services)
Type of Reservation:	National Treatment (Article 1102) Most-Favored-Nation Treatment (Article 1103) Senior Management and Boards of Directors (Article 1107)
Description:	<u>Investment</u> Canada reserves the right to adopt or maintain any measure relating to investment in telecommunications transport networks and telecommunications transport services, radiocommunications and submarine cables, including ownership restrictions and measures concerning corporate officers and directors

and place of incorporation.

This reservation does not apply to providers of enhanced or value-added services whose underlying telecommunications transmission facilities are leased from providers of public telecommunications transport networks.

Existing Measures:

Bell Canada Act, S.C. 1987, c. 19

British Columbia Telephone Company Special Act, S.C. 1916, c. 66

Teleglobe Canada Reorganization and Divestiture Act, S.C. 1987, c. 12

Telesat Canada Reorganization and Divestiture Act, S.C. 1991, c. 52

Radiocommunication Act, R.S.C. 1985, c. R-2

Telegraphs Act, R.S.C. 1985, c. T-5

Telecommunications Policy Framework, 1987

Sector: Communications

Sub-Sector: Telecommunications Transport Networks and Services, Radiocommunications and Submarine Cables

Industry Classification: CPC 752 - Telecommunications Services (not including enhanced or value-added services)
CPC 7543 - Connection Services
CPC 7549 - Other Telecommunications Services Not Elsewhere Classified (limited to telecommunications transport networks and services)

Type of Reservation: National Treatment (Article 1202)
Most-Favored-Nation Treatment (Article 1203)
Local Presence (Article 1205)

Description: Cross-Border Services

Canada reserves the right to adopt or maintain any measure relating to radiocommunications, submarine cables and the provision of telecommunications transport networks and telecommunications transport services. These measures may apply to such matters as market entry, spectrum assignment, tariffs, intercarrier agreements, terms and conditions of service, interconnection between networks and services, and routing requirements that impede the provision on a cross-border basis of telecommunications transport networks and telecommunications transport services, radiocommunications and submarine cables.

Telecommunications transport services typically involve the real-time transmission of customer-supplied information between two or more points without any end-to-end change in the form or content of the customer's information, whether or not such services are offered to the public generally. These services include voice and data services by wire, radiocommunications or any other electromagnetic means of transmission.

This reservation does not apply to measures relating to the cross-border provision of enhanced or value-added services.

Existing Measures:

Bell Canada Act, S.C. 1987, c. 19

British Columbia Telephone Company Special Act, S.C. 1916, c. 66
Railway Act,

R.S.C. 1985, c. R-3

Radiocommunication Act, R.S.C. 1985, c. R-2 *Telegraphs Act*, R.S.C. 1985, c. T-5

Telecommunications Policy Framework, 1987

Telecommunications Decisions, C.R.T.C., including (85-19), (90-3), (91-10), (91-21), (92-11) and (92-12)

Sector: Government Finance
Sub-Sector: Securities
Industry Classification: SIC 8152 - Finance and Economic Administration
Type of Reservation: National Treatment (Article 1102)
Description: Investment

Canada reserves the right to adopt or maintain any measure relating to the acquisition, sale or other disposition by nationals of another Party of bonds, treasury bills or other kinds of debt securities issued by the Government of Canada, a province or local government.

Existing Measures: *Financial Administration Act*, R.S.C. 1985, c. F-11

Sector: Minority Affairs
Sub-Sector:
Industrial Classification:
Type of Reservation: National Treatment (Articles 1102, 1202)
Local Presence (Article 1205)
Performance Requirements (Article 1106)
Senior Management and Boards of Directors (Article 1107)
Description: Cross-Border Services and Investment

Canada reserves the right to adopt or maintain any measure according rights or preferences to socially or economically disadvantaged minorities.

Existing Measures:

Sector: Social Services
Sub-Sector:
Industrial Classification:
Type of Reservation: National Treatment (Articles 1102, 1202)
Most-Favored-Nation Treatment (Article 1203)
Local Presence (Article 1205)
Senior Management and Boards of Directors (Article 1107)
Description: Cross-Border Services and Investment

Canada reserves the right to adopt or maintain any measure with respect to the provision of public law enforcement and correctional services, and the following services to the extent that they are social services established or maintained for a public purpose: income security or insurance, social security or

insurance, social welfare, public education, public training, health, and child care.

Existing Measures:

Sector: Transportation
Sub-Sector: Air Transportation
Industry Classification: SIC 4513 - Non-Scheduled Air Transport, Specialty, Industry
Type of Reservation: National Treatment (Article 1102)
Most-Favored-Nation Treatment (Article 1103)
Senior Management and Boards of Directors (Article 1107)

Description: Investment

Canada reserves the right to adopt or maintain any measure that restricts the acquisition or establishment of an investment in Canada for the provision of specialty air services to a Canadian national or a corporation incorporated and having its principal place of business in Canada, its chief executive officer and not fewer than two-thirds of its directors as Canadian nationals, and not less than 75 percent of its voting interest owned and controlled by persons otherwise meeting these requirements.

Existing Measures: *Aeronautics Act*, R.S.C. 1985, c. A-2
Air Regulations, C.R.C. 1978, c. 2
Aircraft Marking and Registration Regulations, SOR/90-59

Sector: Transportation
Sub-Sector: Water Transportation
Industrial Classification: SIC 4129 - Other Heavy Construction (limited to dredging)
SIC 4541 - Freight and Passenger Water Transport Industry
SIC 4542 - Ferry Industry
SIC 4543 - Marine Towing Industry
SIC 4549 - Other Water Transport Industries
SIC 4552 - Harbour and Port Operation Industries (limited to berthing, bunkering and other vessel operations in a port)
SIC 4553 - Marine Salvage Industry
SIC 4554 - Piloting Service, Water Transport Industry
SIC 4559 - Other Service Industries Incidental to Water Transport (not including landside aspects of port activities)

Type of Reservation: National Treatment (Articles 1102, 1202)
Most-Favored-Nation Treatment (Articles 1103, 1203)
Local Presence (Article 1205)
Performance Requirements (Article 1106)
Senior Management and Boards of Directors (Article 1107)

Description: Cross-Border Services and Investment

Canada reserves the right to adopt or maintain any measure relating to investment in or provision of maritime cabotage services, including:

(a) the transportation of goods or passengers by vessel between points in the territory of Canada and in its Exclusive Economic Zone;

(b) with respect to waters above the continental shelf, the transportation of goods or passengers in relation to the exploration, exploitation or transportation of the mineral or non-living natural resources of the continental shelf; and

(c) the engaging by vessel in any maritime activity of a commercial nature in the territory of Canada and in its Exclusive Economic Zone and, with respect to waters above the continental shelf, in such other maritime activities of a commercial nature in relation to the exploration, exploitation or transportation of mineral or non-living natural resources of the continental shelf.

This reservation relates to, among other things, local presence requirements for service providers entitled to participate in these activities, criteria for the issuance of a temporary cabotage license to foreign vessels and limits on the number of cabotage licenses issued to foreign vessels.

Existing Measures:

Coasting Trade Act, S.C. 1992, c. 31
Canada Shipping Act, R.S.C. 1985, c. S-9
Customs Act, R.S.C. 1985, c. 1 (2nd Supp.)
Customs and Excise Offshore Application Act, R.S.C. 1985, c. C-53

Sector:

Transportation

Sub-Sector:

Water Transportation

Industry Classification:

SIC 4541 - Freight and Passenger Water Transport Industry
SIC 4542 - Ferry Industry
SIC 4543 - Marine Towing Industry
SIC 4549 - Other Water Transport Industries
SIC 4551 - Marine Cargo Handling Industry
SIC 4552 - Harbour and Port Operation Industries
SIC 4553 - Marine Salvage Industry
SIC 4554 - Piloting Service, Water Transport Industry
SIC 4559 - Other Service Industries Incidental to Water Transport

Type of Reservation:

National Treatment (Articles 1102, 1202)
Most-Favored-Nation Treatment (Articles 1103, 1203)
Local Presence (Article 1205)
Performance Requirements (Article 1106)
Senior Management and Boards of Directors (Article 1107)

Description:

Cross-Border Services and Investment

Canada reserves the right to adopt or maintain any measure denying service providers or investors of the United States, or their investments, the benefits accorded service providers or investors of Mexico or any other country, or their investments, in sectors or activities equivalent to those subject to Schedule of the United States, Annex II, page II-U-9.

Existing Measures:

Sector:

Transportation

Sub-Sector:

Water Transportation

Industry Classification:

SIC 4541 - Freight and Passenger Water Transport Industry
SIC 4542 - Ferry Industry
SIC 4543 - Marine Towing Industry
SIC 4549 - Other Water Transport Industries
SIC 4551 - Marine Cargo Handling Industry
SIC 4552 - Harbour and Port Operation Industries
SIC 4553 - Marine Salvage Industry
SIC 4554 - Piloting Service, Water Transport Industry
SIC 4559 - Other Service Industries Incidental to Water Transport

Type of Reservation: Most-Favored-Nation Treatment (Article 1203)

Description: Cross-Border Services

Canada reserves the right to adopt or maintain any measure relating to the implementation of agreements, arrangements and other formal or informal undertakings with other countries with respect to maritime activities in waters of mutual interest in such areas as pollution control (including double hull requirements for oil tankers), safe navigation, barge inspection standards, water quality, pilotage, salvage, drug abuse control and maritime communications.

Existing Measures: *United States Wreckers Act, R.S.C. 1985, c. U-3*

Various agreements and arrangements, including:

(a) Memorandum of Arrangements on Great Lakes Pilotage;

(b) Canada - United States Joint Marine Pollution Contingency Plan;

(c) Agreement with the United States on Loran "C" Service on the East and West Coasts; and

(d) Denmark - Canada Joint Marine Pollution Circumpolar Agreement.

Appendix D

Canadian Schedule of Commitments Under the GATS- Financial Services Sector

WORLD TRADE

ORGANIZATION

GATS/SC/16/Suppl.4/Rev.1

6 June 2000

(00-2236)

Council for Trade in Services

CANADA

Schedule of Specific Commitments

Supplement 4

Revision

(This is authentic in English and French only)

Revision of the Canadian Schedule of Commitments for GATS - Financial Services

Modes of supply: 1) Cross-border supply 2) Consumption abroad 3) Commercial presence 4) Presence of natural persons

Sector or Sub-sector

Limitations on Market Access

Limitations on National Treatment

Additional Commitments

7. FINANCIAL SERVICES

Measures applicable to all Sectors in Financial Services

1. Commitments in this Chapter are undertaken in accordance with the Understanding on Commitments in Financial Services ("Understanding").

2. For greater certainty, market access commitments with respect to the "cross-border" and "consumption abroad" supply of services (as described in paragraphs 2(a) and 2(b) of Article 1 of the General Agreement on Trade in Services) apply only to the transactions indicated in paragraphs 3 and 4 of Market Access of the Understanding. It is understood that paragraph 4 of that section of the Understanding does not impose any obligation to allow non-resident financial services suppliers to solicit business.

3. The commitments on "commercial presence" are bound according to the Understanding.

4. The commitments on "presence of natural persons" are scheduled in accordance with the Understanding and bound according to the general limitations applicable to all sectors in this schedule (Part I).

5. Otherwise, the commitments in this Chapter are subject to the general conditions or limitations applicable to all sectors in this schedule.

(1), (2) None

(1), (2) None, other than:

(i) Certain supplies between members of a closely-related group of corporations which includes a financial institution may be treated as exempt supplies under value-added taxes. Imported supplies do not qualify for this treatment.

(ii) Supplies between resident and non-resident branches or representative offices of a financial institution are treated as supplies between separate persons for the purposes of value-added taxes.

(3) None, other than:

Federally-regulated financial institutions having capital in excess of \$750 million are required, within five years of having reached the threshold, to have 35 per cent of their voting shares widely-held and listed and posted for trading on a Canadian Stock Exchange.

(3) None, other than:

(i) Certain supplies between members of a closely-related group of corporations which includes a financial institution may be treated as exempt supplies under value-added taxes. Imported supplies do not qualify for this treatment.

Foreign-owned federally regulated institutions (i.e. insurance, banks and trust and loan): A controlling number of shares of a Canadian subsidiary must be held directly by the foreign company incorporated in the jurisdiction where the foreign company, either directly or through a subsidiary, principally carries on business.

(ii) Supplies between resident and non-resident branches or representative offices of a financial institution are treated as supplies between separate persons for the purposes of value-added taxes.

Federally regulated institutions (i.e. insurance, banks and trust and loan): A minimum of one half of directors must be either Canadian citizens ordinarily resident in Canada or permanent residents ordinarily resident in Canada.

The Government of Ontario Management Board Directive and Industrial Development Review Process provides for a price preference of up to 10 per cent for Canadian content based on value-added in Canada for certain government purchases. The Management Board Directive applies on the basis of the nationality of the individual service provider.

(4) See paragraph 4 of headnote on Financial Services.

(4) See paragraph 4 of headnote on Financial Services.

A. Insurance and Insurance-Related Services

(CPC 812* + 814)

(a) Life, accident and health insurance services (CPC 8121)

(1) None, other than:

Direct insurance (federal): Services must be supplied through a commercial presence with the exception of marine insurance.

(1) None

(b) Non-life insurance services (except deposit insurance and similar compensation schemes) (CPC 8129)

(All provinces): Services must be supplied through a commercial presence.

(c) Reinsurance and retrocession (CPC 81299*)

Reinsurance and retrocession (federal): Services must be supplied through a commercial presence.

(All provinces, excluding Alberta and New Brunswick): Services must be supplied through a commercial presence.

(2) None, other than:

Reinsurance and retrocession (federal, Alberta and Newfoundland): The purchase of reinsurance services by a Canadian insurer, other than a life insurer or a reinsurer, from a non-resident reinsurer is limited to no more than 25 per cent of the risks undertaken by the insurer purchasing the reinsurance.

(2) None, other than:

Direct insurance other than life, personal accident, sickness or marine insurance (federal): An excise tax of 10 per cent is applicable on net premiums paid to non-resident insurers or exchanges in regard to a contract against a risk ordinarily within Canada, unless such insurance is deemed not to be available in Canada.

Direct insurance (Alberta): A fee payable to the province of 50 per cent of the premium paid and regulatory notification are required on insurance of risks in the province by unlicensed insurers.

(Saskatchewan): A fee payable to the province of 10 per cent of the premium is required on insurance of risks in the province by unlicensed insurers.

(3) None, other than:

Direct insurance and reinsurance and retrocession (federal): The solicitation of insurance services in Canada can only be effected through:

(i) a corporation incorporated under federal or provincial laws;

(ii) a corporation incorporated by or under the laws of another jurisdiction outside Canada (i.e., a branch of a foreign corporation);

(iii) an association formed on the plan known as Lloyds; and

(iv) reciprocal insurance exchanges.

(3) None, other than:

Direct insurance and reinsurance and retrocession (Ontario): Capital requirements for mutual insurance companies do not apply to certain mutual insurance companies incorporated in Ontario.

(Quebec): Three quarters of directors must be Canadian citizens and a majority must reside in Quebec.

A branch of a foreign insurance company must be established directly under the foreign insurance company incorporated in the jurisdiction where the foreign insurance company, either directly or through a subsidiary, principally carries on business.

(All provinces): Insurance activities can only be provided through:

- (i) a corporation incorporated under provincial statutes;
- (ii) an extra-provincial insurance corporation, i.e., an insurer incorporated by, or under the laws of another jurisdiction (including a federally-authorized branch of a foreign corporation);
- (iii) an association formed on the plan known as Lloyds;
- (iv) (excluding Quebec and Prince Edward Island): Reciprocal insurance exchanges.

(Quebec): Every insurer not incorporated under an Act of Quebec has, in respect of the activities it carries on in Quebec, the rights and obligations of an insurance company or mutual association incorporated under Acts of Quebec as the case may be. It can also exercise additional activities provided for in the law. However, the activities of such corporation will be limited to those allowed under its constituting legislation.

(Alberta and Prince Edward Island): Subsidiaries of foreign insurance corporations must be federally authorized.

(Quebec): Non-residents can not acquire, without ministerial approval, either directly or indirectly, more than 30 per cent of the voting rights attached to shares of a Quebec-chartered insurance company or of its controlling entity.

(Quebec): Upon any allotment or transfer of voting shares of the capital stock insurance company "SSQ, Société d'assurance-vie inc" or of the holding company "Groupe SSQ inc", the minister may ask such companies to prove that the shares were offered by preference to Quebec residents and subsequently to other Canadian residents, but that no offer was made or was acceptable.

(Federal): The purchase of reinsurance services by a Canadian insurer, other than a life insurer or reinsurer, from a resident reinsurer is limited to no more than 75 per cent of the risks undertaken by the insurer purchasing the reinsurance.

(British Columbia): Incorporation, share acquisition or application for business authorization, where any person controls or will control 10 per cent or more of the votes of the company, is subject to ministerial approval.

Motor vehicle insurance (Quebec, Manitoba, Saskatchewan and British Columbia):
Motor vehicle insurance is provided by public monopoly.

(4) See paragraph 4 of headnote on Financial Services.

(4) See paragraph 4 of headnote on Financial Services.

(d) Services auxiliary to insurance (including broking and agency services) (CPC 8140)

(1) None, other than:

Intermediation of insurance relating to maritime shipping, commercial aviation, space launching, freight (including satellites) and goods in international transit (all provinces): Services must be supplied through a commercial presence in the province in which the service is provided.

(1) None, other than:

(Saskatchewan): Fire or hail insurance contracts have to be signed or countersigned by a licensed agent who resides in the province. Where there is disagreement concerning hail insurance, such damages are to be estimated by an appraiser who is a taxpayer of the province.

(Ontario and Prince Edward Island): Non-resident individual adjusters are prohibited from being adjusters in the province.

(Manitoba): Licenses to act as insurance agents and brokers are not issued to non-residents of Canada.

(New Brunswick): Licenses shall not be issued to a corporation whose head office is outside Canada.

(Alberta and Manitoba): A license to act as a special broker authorized to place insurance coverage with unlicensed insurers is restricted to residents of the province, as the case may be.

(British Columbia): Licenses for general insurance shall be issued only to residents of the province.

(Prince Edward Island): Licenses to act as insurance agent or adjusters are not issued to non-resident of the province.

(2) None

(2) None, other than:

Intermediation of insurance relating to commercial aviation, space launching, freight (including satellites) and goods in international transit (federal): An excise tax of 10 per cent is applicable on net premiums paid to non-resident insurers or exchanges in regard to

a contract against a risk ordinarily within Canada, unless such insurance is deemed not to be available in Canada. The excise tax is also applicable on net premiums payable with regard to a contract entered into, through a non-resident broker or agent, with any insurer authorized under the laws of Canada or of any province to carry out the business of insurance.

(3) None, other than:

(New Brunswick): Licenses shall not be issued to a corporation whose head office is outside Canada.

(Ontario and Prince Edward Island): Non-resident individual adjusters are prohibited from being adjusters in the province.

(3) None, other than:

(Saskatchewan): Fire or hail insurance contracts have to be signed or countersigned by a licensed agent who resides in the province. Where there is disagreement concerning hail insurance, such damages are to be estimated by an appraiser who is a taxpayer of the province.

(Ontario): No licence is provided to a corporation to act as an insurance broker, agency or adjuster if the majority of the voting rights are in shares owned by non-residents. A corporate agency or adjuster or insurance broker which is majority non-resident-owned and licensed as a result of grand-fathering cannot expand through purchase of assets or business or merger or amalgamation with any other broker, agent or adjuster. No licence is provided to a corporation or partnership which is an insurance agency or adjuster if the head office is outside Canada or if any partner is resident outside Canada.

(Manitoba): Licenses to act as insurance agents and brokers are not issued to non-residents of Canada.

(Alberta and Manitoba): A license to act as a special broker authorized to place insurance coverage with unlicensed insurers is restricted to residents of the province, as the case may be.

(British Columbia): Licenses for general insurance shall be issued only to residents of the province.

(Prince Edward Island): Licenses to act as insurance agent or adjusters are not issued to non-resident of the province.

(4) See paragraph 4 of headnote on Financial Services.

(4) See paragraph 4 of headnote on Financial Services.

B. Banking and Other Financial Services

(excl. insurance)

(1) None

(2) None

(3) None, other than:

(1) None

(2) None

(3) None, other than:

(a) Acceptance of deposits and other repayable funds from the public (CPC 81115-81119)

Banks: To undertake the business of banking in Canada, a foreign bank must:

(i) incorporate a bank subsidiary under the Bank Act; or

(b) Lending of all types, including inter alia, consumer credit, mortgage credit, factoring and financing of commercial transactions (CPC 8113)

(ii) establish a bank branch under the Bank Act,

In order to establish a bank branch, a foreign bank must be authorised under the Bank Act and must be incorporated by or under the laws of another jurisdiction outside Canada (i.e., an authorised foreign bank).

(c) Financial leasing (CPC 8112)

A bank branch must be established directly under the authorised foreign bank incorporated in the jurisdiction where the authorised foreign bank principally carries on business.

An authorised foreign bank can establish only one of two types of bank branches:

(i) a full service bank branch (i.e., a Schedule III, Part 1, authorised foreign bank); or,

(ii) lending bank branch (i.e., a Schedule III, Part 2, authorised foreign bank).

Full service bank branches and lending bank branches cannot engage in the activities in which a specialised financing corporation, as defined in the Bank Act, may engage.

Full service bank branches and lending bank branches cannot be member institutions of the Canada Deposit Insurance Corporation.

A full service bank branch can only accept deposits in amounts less than \$150,000 and payable in Canada if the sum of all deposits below \$150,000 amounts to less than one percent of total deposits payable in Canada.

A lending bank branch can only accept deposits or otherwise borrow money by means of financial instruments from, or guarantee any securities or accept any bills of exchanges that cannot be subsequently sold to or traded with:

(i) financial institutions, other than a foreign bank; or,

(ii) a foreign bank whose principal activity is the provision of services that would be permitted by the Bank Act if they were provided by a bank in Canada; and, that is regulated as a bank in the country under whose laws it was incorporated or in any country in which it carries on business.

A lending bank branch cannot be a member of the Canadian Payments Association.

An authorised foreign bank cannot establish a lending bank branch in conjunction with a full service bank branch, a bank subsidiary, a loan company, or a trust company that accepts deposits.

No one person (Canadian or foreign) may own more than 10 per cent of any class of shares of a Schedule I bank

(d) All payment and money transmission services

(CPC 81339*)

Trust and loan companies (federal

and all provinces, excluding British Columbia): Federal or provincial incorporation is required.

Trust and loan companies

(Alberta): At least three quarters of the directors must be ordinarily resident in Canada.

(e) Guarantees and commitments (CPC 81199*)

(Ontario, Quebec and Manitoba):

The direct or indirect acquisition of Canadian-controlled companies by non-residents is restricted to 10 per cent individually and 25 per cent collectively.

(Saskatchewan): Individual and collective foreign ownership of Canadian-controlled and provincially incorporated companies can be no more than 10 per cent of shares

(British Columbia): Incorporations, share acquisition or application for business authorization, where any person controls or will control 10 per cent or more of the votes of the company, are subject to ministerial approval.

(New Brunswick): At least two of the directors must be resident in new Brunswick.

(Nova Scotia): A majority of directors must be resident in Canada and at least two resident in Nova Scotia.

(Manitoba and Ontario): Foreign persons may not exercise the voting rights attached to shares if they are not registered as shareholders in respect of the shares.

(Manitoba): Majority of directors must be resident in Canada.

(Quebec): Three quarters of the directors must be Canadian citizens and a majority must reside in Quebec.

(Ontario, New Brunswick and Nova Scotia): Incorporation or registration will be refused unless authorities are satisfied that there exists a public benefit and advantage for an additional corporation.

(Ontario): Consent to change in control or transfers of 10 per cent or more of voting shares may be refused if it would be in the public interest to do so.

Credit unions, caisses populaires and associations or groups thereof (all provinces): Must incorporate in the jurisdictions in which they operate.

Credit unions and caisses populaires (Ontario): Directors of credit unions must be Canadian citizens or permanent resident.

(British Columbia): Directors and subscribers of credit unions must be residents of the province

Mortgage brokers (Ontario): Must incorporate under the laws of Canada, Ontario or of another province. Ownership of a corporation by foreign persons must not exceed 10 per cent individually and 25 per cent collectively of the total number of equity shares.

(All provinces except British Columbia, Ontario and Quebec): Credit unions and caisses populaires are exempt from the corporate capital tax.

(Nova Scotia): Must incorporate under the laws of Canada or Nova Scotia.

(Alberta): Directors of credit unions must be Canadian citizens or permanent residents of Canada and three quarters must at all times be ordinarily resident in the province.

(Saskatchewan): Must maintain a business office in the province.

(Manitoba, Nova Scotia and Saskatchewan): Directors of credit unions must be Canadian citizens

(Quebec): Founding members of caisses populaires must have a residence, place of business or employment in the territory mentioned in the caisse's statutes.

Community bonds corporations (Manitoba, New Brunswick and Saskatchewan): Directors of Community Bonds corporations must be resident of the province.

Loan and investment companies (Quebec): Federal or provincial incorporation.

Co-operative corporations (Newfoundland and Ontario): Must incorporate under the law of the applicable province or under federal law.

Venture capital corporations (federal and all provinces): Measures that result in a different tax treatment with respect to an investment in a venture capital corporation as prescribed pursuant to the Income Tax Act of Canada and provincial laws.

Lending of all types (Nova Scotia): Must incorporate under the laws of Canada or Nova Scotia.

Acceptance of deposits (Quebec): The acceptance of deposits of public and para-public institutions is provided by a public monopoly.

(4) See paragraph 4 of the headnote on Financial Services, and:

Mortgage brokers (Ontario): Must be Canadian citizens or permanent residents of Canada and ordinarily resident in Canada.

(Nova Scotia): Must be resident in the province.

(4) See paragraph 4 of the headnote on Financial Services, and:

(f) Trading for own account or for account of customers whether on an exchange, in an over-the-counter market or otherwise, the following:

- money market instruments (cheques, bills, certificate of deposits, etc.) (CPC 81339*);
- foreign exchange

(CPC 81333*);

(1) None, other than:

Advisory and auxiliary financial services (Alberta, British Columbia, Nova Scotia, Ontario, Quebec and Saskatchewan): Services must be supplied through a commercial presence in the jurisdiction in which the adviser is providing advice.

Asset management (Alberta, British Columbia, Nova Scotia, Ontario, Quebec and Saskatchewan): Services must be supplied through a commercial presence in the jurisdiction in which the service is provided.

(1) None

- derivative products including but not limited to, futures and options (CPC 81339*)

(Quebec): The management of pension funds of public and para-public institutions in Quebec is provided by public monopoly.

Custodial services (All provinces): Mutual funds which offer securities in Canada must use a resident custodian. A non-resident sub-custodian may be used if it has shareholders equity of at least \$100 million.

- exchange rate and interest rate instruments, including products such as swaps, forward rate agreements, etc. (CPC 81339*)

(2) None, other than:

Trading in securities and commodity futures - persons (all provinces): There is a requirement to register in order to trade through dealers and brokers that are neither resident nor registered in the province in which the trade is effected.

(2) None

- transferable securities

(CPC 81321*)

- other negotiable instruments and financial assets, including bullion

(CPC 81339*)

(3) None, other than:

Securities dealers and brokers (British Columbia, Ontario, Saskatchewan, Yukon): Must be incorporated, formed or continued under federal, provincial or territorial laws

(Quebec): Only brokerage firms incorporated under federal, provincial or territorial laws may be members of the Montreal Exchange.

(3) None, other than:

Trading in securities and commodity futures and advisory and auxiliary financial services - dealers, brokers, and advisers: (Alberto, Ontario, Newfoundland, Nova Scotia, Manitoba and Saskatchewan): A director or officer of an applicant firm must have been a resident of Canada for a period of at least one year prior to the application.

Advisory and auxiliary financial services and Asset Management (Nova Scotia and Quebec): The establishment must be managed by a resident of the province.

Custodial services (All provinces): Mutual funds which offer securities in Canada must use a resident custodian. A non-resident sub-custodian may be used if it has shareholders equity of at least \$100 million

(Quebec): The responsibility for opening up accounts is to be managed by a Quebec resident.

(g) Participation in issues of all kinds of securities, including underwriting and placement as agent (whether publicly or privately) and provision of service related to such issues (CPC 8132)

Advisory and auxiliary financial services (British Colombia): Must be incorporated, formed or continued under federal, provincial or territorial laws.

Asset management (Quebec): The management of pension funds of public and para-public institutions in Quebec is provided by a public monopoly. </P**The file is too large for this option. Only the first 30000 characters will be displayed**

(h) Money broking (CPC 81339*)

(4) See paragraph 4 of the headnote on Financial services, and

(4) See paragraph 4 of the headnote on Financial services, and:

(i) Asset management, such as cash or portfolio management, all forms of collective investment management, custodial, depository and trust services (CPC 8119*, 81323*).

(Quebec): Only Canadian residents may be individual members of the Montreal exchange.

Trading in securities and commodity futures and advisory and auxiliary financial services - dealers, brokers and advisers: (all provinces except British Columbia, New Brunswick and Quebec): An individual applicant for registration is required to have been a resident

of Canada for a period of at least one year prior to the application and a resident of the province in which he/she wishes to operate at the date of application.

(j) Settlement and clearing services for financial assets, incl. securities, derivative products, and other negotiable instruments (CPC 81339*, 81319)

(Quebec): An individual acting as a representative of a dealer or adviser, subject to certain exemptions, must be a resident of the province

(k) Advisory, intermediation and other auxiliary financial services on all the activities listed in Article 5(a)(v) through (xv) of the Annex on Financial Services, incl. credit reference and analysis, investment and portfolio research and advice, advice on acquisitions and on corporate restructuring and strategy (CPC 8131*, 8133*)

(l) Provision and transfer of financial information, and financial data processing and related software by providers of other financial services (CPC 8131*, 842*, 843*, 844*)

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Article II Exemptions

WORLD TRADE GATS/EL/16/Suppl.2

26 February 1998

ORGANIZATION

(98-0690)

Trade in Services

CANADA

List of Article II (MFN) Exemptions

Supplement 2

(This is authentic in English and French only)

This text replaces the Financial Services section contained in pages 2 and 3 of document GATS/EL/16.

CANADA - LIST OF ARTICLE II (MFN) EXEMPTIONS

Modes of supply: (1) Cross-border supply (2) Consumption abroad (3) Commercial presence (4) Presence of natural persons

Sector or subsector

Description of measure

indicating its inconsistency

with Article II

Countries to which the measure applies

Intended duration

Conditions creating the need for the exemption

Insurance

Intermediation:

Agency Services

Financial Services, including lending of all types and trading for own account of certain securities by loan and investment companies.

Preferential access to the Ontario insurance services market is provided to non-resident individual US insurance agents.

Preferential treatment in Quebec for allocation of licences is provided by the Province of Quebec to loan and investment companies incorporated under the laws of the Parliament of the United Kingdom and Ireland for purposes of obtaining a licence to carry on business.

All states in the United States

Great Britain and Northern Ireland, Republic of Ireland

Indeterminate

Indeterminate

Reciprocity

Maintenance of existing historical preference

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