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The Business of Climate Change: An Analysis of Carbon Trading in Kenya

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1. Introduction

The Climate Change phenomenon continues to put the world on edge with several intervention measures being put into place as attempts to arrest its negative effects remain on course. One of the most significant intervention measures which the global community has put into place is the concept of carbon trading. Carbon trading remains a popular although sometimes a controversial phenomenon, more so, between the developed versus the developing countries' dichotomy.

This article analyses the business of carbon trading in the context of Kenya's legal framework. In order to undertake this task, the article would be organised into various interrelated sections. This first section offers introductory remarks. The second explores over the climate change phenomenon. This would then examine the legal framework that underpins climate change into the Kenyan legal system. The third section would then provide an exposition of the concept of carbon trading and its various forms. The final section would then offer concluding remarks to the discussion.

2. Climate Change

Climate Change is the response of the planet's climate system to the altered concentration of the greenhouse gases (hereinafter GHGs) within the global atmosphere.[1] It entails changes of climate which are attributed either directly

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or indirectly to human activities that alter the composition of the global atmosphere and which are in addition to natural climate variability observed over comparable time periods.[2]

The Climate Change causes several effects on the environment. These include depletion of the ozone layer which provides a shield against harmful exposure to ultraviolet radiations from the sun and control over the temperature structure of the stratosphere.[3] It also causes acid rain and ecological harm which arise when acidic gases such as carbon dioxide, sulphur dioxide and nitrogen dioxide react with water vapour to form weak acidic solutions such as carbonic acid, sulphuric acid and nitric acid solutions in rainfall.[4] In addition, climate change also causes direct harm to human health which, especially, arises from changes in the concentration of gases in the atmosphere have been proven to cause respiratory problems, brain damage and cancer. As a result, there is more reduction of life expectancy as the climate worsens.

There are three principal causes of climate change. These include air and atmospheric pollution, anthropogenic sources, and the urban and transboundary air pollution.[5] Atmospheric pollution is the group of gases produced from combustion processes including carbon monoxide (CO),

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[1] Hunter, D., Salzman, J., and Zaelke, D., (eds.), *International Environmental Law and Policy*, Thomson West: Foundation Press, 2007, p. 631.

[2] Article 1 (2) of The United Nations Framework Convention on Climate Change defines Climate Change.

[3] Sivasakthivel T. and Reddy, K.K.S.K., "Ozone Layer Depletion and Its Effects: A Review", *International Journal of Environmental Science and Development*, Vol. 2, No.1, February 2011, p. 30.

[4] Njeru, M., *Comprehensive Secondary Chemistry*, Oxford University Press, Nairobi, 2002, p. 60.

[5] Fakana, S.T., "Causes of Climate Change: Review Article", *Global Journal of Science Frontier Research: (H) Environment & Earth Science*, Volume 20 Issue 2 Version 1.0 Year 2020, p. 8.

carbon (IV) oxide (CO_2), and oxides of nitrogen (NO_X).[6] Another source of atmospheric pollution is Sulphur dioxide (SO_2) which is released in the atmosphere from the combustion of fossil fuels that contain Sulphur.[7] A third source of atmospheric pollution arises from particles of Lead metal and other heavy metals that arise from combustion processes in motor vehicles, metal processing industries and waste incineration, particularly waste batteries.[8]

Aside from the above substances, another source of atmospheric pollution includes the very small particulate matter such as PM_{10} and $PM_{2.5}$ which arise from diesel engines. Further, the role of complex pollutants which are produced from the incomplete combustion of fuels can also not be gainsaid. These substances, which are highly toxic at small levels, include dioxins, furans, polyaromatic hydrocarbons (PAHs), polychlorinated biphenyls (PCBs).[9] Other sources include volatile organic compounds (VOCs) which are released from vehicle exhaust gases, either as unburnt fuels or combustion products, chlorofluorocarbons (CFCs), used in aerosol sprays, solvents, refrigerants, air-conditioning units etc. CFCs and hydrochlorofluorocarbons (HCFCs) which are inert in the lower atmosphere do undergo a significant reaction within the upper atmosphere and do destroy stratospheric ozone. The last group of atmospheric pollutants is methane which is emitted during the production and transportation of coal, natural gas and oil.[10]

[6] Njeru *supra*, p. 52.
[7] Twoli, N., and Mungai, D., *School Certificate Chemistry*, East African Educational Publishers, Nairobi, 2004, p. 142
[8] Njeru, *supra*, p. 190.
[9] Bhargava, A., Dlugogorski, B.Z., and Kennedy, E.M, "Emission of Polyaromatic Hydrocarbons, Polychlorinated Biphenyls and Polychlorinated Dibenzo-p-dioxins and Furans from Fires of Wood Chips," *Fire Safety Journal*, Volume 37, Issue 7, October 2002, p. 659.
[10] Rojas-Downing, M.M, Nejadhashemi, A.P., Harrigan, T., and Woznicki, S.A., "Climate Change and Livestock: Impacts, Adaptation, and Mitigation," *Climate Risk Management*, 2017, Volume 16, p. 145.

On its part, anthropogenic activities have increased the concentrations of the gases in the atmosphere.[11] Examples of human activities spearheading change in concentrations of gases include increased use of fossil fuels deforestation, increasing livestock farming leads to increase in methane, farming using artificial fertilizers, use of equipment that produce fluorinated gases such as refrigerators, air conditioning systems and heat pumps, fire extinguishers, solvents and aerosol propellants, foam agents etc. Transboundary air pollution emerged after the effects of large-scale industrialisation and intensive development such as nuclear testing, air pollution from ships and aeroplanes became evident.[12] The Trail Smelter Case was the first major international dispute over transboundary air pollution.[13]

3. Legal Framework Governing Climate Change

3.1 International Legal Framework

3.1.1 The Vienna Convention for the Protection of the Ozone Layer 1985[14]

The Vienna Convention for the Protection of the Ozone Layer is a framework convention which lays down principles which have been agreed upon by many States Parties*with regard to the protection of the ozone layer. This treaty, which came into effect in 1988, was the very first convention to be signed by all countries involved and it reached universal ratification in

[11] Fakana, *supra.* See also, Trenberth, K.E., "Climate Change Caused by Human Activities is Happening and it Already Has Major Consequences", *Journal of Energy & Natural Resources Law*, 2018, Vol. 36(4), pp. 463-481.

[12] Bergin M.S., West J.J., Keating T.J, and Russell A.G., "Regional Atmospheric Pollution and Transboundary Air Quality Management", *Annual Review of Environmental Resources*, 2005, Vol. 30, pp. 1–37.

[13] Trail Smelter case, 16 April 1938, 11 March 1941, 3 RIAA 1907 (1941) *https://legal.un.org/riaa/cases/vol_III/1905-1982.pdf* (accessed 19/01/22). See also Wirth J.D., "The Trail Smelter Dispute: Canadians and Americans Confront Transboundary Pollution, 1927-41," *Environmental History*, April 1996, Volume 1, No. 2, p. 34.

[14] United Nations, Treaty Series, Registration No. No. 26164, Vol. 1513, p. 293.

2009.[15] The treaty does not however require countries to take control actions for the protection of the ozone layer. Kenya acceded to the treaty on 9th November 1988.[16] In terms of its operations, the States Parties meet once every three years in order to make decisions on important issues.

The convention establishes a framework for the adaptation of measures to protect human health and the environment against adverse effects resulting or likely to result from human activity which modify or are likely to modify the ozone layer.[17] It does not set targets or timetables for action but requires four categories of appropriate measures to be taken by parties in accordance with the means at their disposal and their capabilities and on the basis of relevant scientific and technical considerations.[18] The obligations are; first, co-operation on systematic observations; secondly, research and information exchange; thirdly, adaptation of appropriate legislative or administrative measures; finally, co-operation on policies to control, limit, reduce or prevent activities that are likely to have adverse effects resulting to modifications to the ozone layer and cooperation in formulation of measures, procedures and standards to implement the Convention.[19]

3.1.2 The Montreal Protocol on Substances that Deplete the Ozone Layer, 1987[20]

The Protocol sets forth specific legal obligations, including limitations and reductions on the determined levels of consumption and production of certain controlled ozone-depleting substances.[21] Kenya ratified this Protocol on 9th November 1988. It has since its inception been amended severally

[15] Albrecht, F., and Parker, C.F., "Healing the Ozone Layer: The Montreal Protocol and the Lessons and Limits of a Global Governance Success Story", in Hart, P., and Compton, M., (eds), Great Policy Successes, Oxford, 2019, p. 306.
[16] Kenya Law, "Vienna Convention For The Protection Of Ozone Layer, 1985", National Council for Law Reporting (Kenya Law), 2022, available at *<http://kenyalaw.org/treaties/treaties/81/Vienna-Convention-for-the-Protection-of-Ozone-Layer>* (accessed on 28th August 2022).
[17] Article 2(1).
[18] Article 2(1), (2) and (4)
[19] Article 2(2)(a)- (d)
[20] UN Treaty Registration No. 26369, Vol. I-26369
[21] Article 3,

including in 1990, 1992, 1995, 1997, 1999, 2007. The 1990 Amendments, among others, amended the Preamble to make reference to the need to take into account the developmental needs of developing countries, the provision of additional financial resources and access to relevant technologies and transfer of alternative technologies. The 1992 Amendments introduced changes to the timetable for phasing out substances under Article 2 (a) - (e), while also adding three new substances, together with new reporting requirements.

3.1.3 United Nations Framework Convention on Climate Change, 1992[22]

The Convention was adopted on 9th May 1992. The development of its text and ultimate adoption were the joint efforts of The World Meteorological Organization and the UNEP when they established the Intergovernmental Panel on Climate Change in 1988. The IPCC's first report in 1990 provided an assessment of the problem of global climate change. The Convention, i.e. UNFCCC, was then developed and adopted during the United Nations Conference on Environment and Development, i.e. Earth Summit held at Rio de Janeiro. Kenya ratified the Convention on 28th November 1994 as a Non-Annex I Party.

The Convention establishes commitments for stabilisation of greenhouse gas concentrations in the atmosphere at safe levels and for limiting emissions of GHGs by developed countries in line with soft targets and timetables. It also provides financial mechanism and a commitment by certain developed States Parties to provide financial resources to meet certain incremental costs and adaptation measures, the establishment of two subsidiary bodies to the Conference of the Parties (COP), among others. It integrates environmental consideration into economic development and defines rights and obligations the international community in the quest for sustainable development and protection of the global climate.

[22] UN Treaty Registration No. 30822

3.1.4 Kyoto Protocol to the United Nations Framework Convention on Climate Change, 1997[23]

This Protocol was adopted on 11th December 1997 and entered into force on 11th December 2005 with Kenya ratifying it on 25th February 2005. The Protocol sets mechanisms through which signatory industrialised countries follow in order to reduce greenhouse gas (GHG) emissions.[24] Taking into consideration the fact that developed countries are substantially responsible for much of the high levels of GHG emissions within the atmosphere, the Protocol places a heavier burden on such nations under the principle of "common but differentiated responsibilities".[25]

One of the most notable achievements of the Protocol is that it provides commitments for Annex 1 Parties to quantified emission reduction targets together with a timetable for their achievement. This is achieved through Article 3(1) of the text which provides that Annex 1 parties shall individually or jointly, ensure that their aggregate anthropogenic carbon (IV) oxide equivalent emissions of the GHGs listed in Annex A do not exceed their assigned amounts. The six GHGs targeted include carbon dioxide, methane, nitrous oxide, hydrofluorocarbons, perfluorocarbons and sulphur hexafluoride.

The Protocol identifies policies and measures that parties may implement to achieve their quantified limitation and emission reduction targets.[26] These, for example, include enhancement of energy efficiency, protection and enhancement of sinks, promotion of sustainable forms of agriculture, increased research on and use of new and renewable forms of energy, measures to limit or reduce emissions in the transport sector and the limitation or reduction of methane emissions.[27] It requires Parties to cooperate towards enhancing both the individual and combined effectiveness of their policies and measures by taking steps to share relevant experience

[23] UN Treaty Registration No. 30822
[24] Mwania, K.N., "Carbon Trading in Kenya: A Critical Review", *International Journal of Science, Environment and Technology*, Vol. 9, No 3, 2020, p. 314.
[25] *Ibid*.
[26] Article 2 of the Protocol.
[27] Article 2(1) (a) of the Protocol.

and information, including developing ways of improving the compatibility, transparency and effectiveness of policies and measures.[28]

Quite importantly, the Protocol introduces flexibility mechanisms that allow Annex 1 Parties to meet their commitments. Such mechanisms include emissions trading, joint implementation and the Clean Development Mechanism (CDM). These mechanisms are to be supplemental to domestic actions taken to achieve emission reductions. The idea of emissions trading permits countries to buy emission reduction credits representing greenhouse gas reductions in other countries. Article 6 provides for joint implementation by permitting Annex 1 Parties to transfer or acquire from any other Annex 1 Party States emission reduction credits. This can either be undertaken through projects which are aimed at reducing anthropogenic emission sources or by enhancing anthropogenic removals by sinks of GHGs.

The CDM enables Annex 1 Parties to gain emission reduction credits which assist them in achieving compliance with their specified respective quantified emissions limitation and reduction commitments. This is to be done through investment in emission reduction projects in other countries so as to achieve sustainable development.[29] Article 10 reaffirms the commitments of developing countries under Article 4 (1) of the Convention. Such commitments include cost effective national or regional programmes which improve the quality of local emission factors, activity data which reflect the social and economic conditions of each Party for the preparation and periodic updates of national inventories of emissions of GHGs, as well as measures to facilitate adequate adaptation to climate change.

3.1.5 The Paris Agreement, 2015[30]

This Agreement was adopted on 12th December 2015 during Conference of Parties (COP) 21 in Paris and entered into force on 4th November 2016.[31] It aims to, among others, limit global warming to well below 2°C above pre-

[28] Article 2(1) (b) of the Protocol.
[29] Article 12
[30] UN Treaty Registration No. No. 54113.
[31] The Paris Agreement 2015

industrial levels and pursuing efforts to limit the temperature increase to 1.5° C above pre-industrial levels, increasing the ability to adapt to the adverse impacts of Climate Change and foster climate resilience and low GHGs emissions development, in a manner that does not threaten food production and making finance flows consistent with a pathway towards low GHG emissions and climate resilient development.[32] It works on a 5-year cycle of climate action done by the countries then submitting their plans referred to as nationally determined contributions (NDCs) that showcase how they will reduce their greenhouse gas emissions to achieve the goals and also how they will build resilience to adapt to the impacts on Climate Change.[33]

There is also the requirement to submit long-term low GHG emissions development strategies (LT-LEDS) in a comprehensive and facilitative manner[34]. Besides, the Agreement provides a framework for financial[35], technical[36] and capacity building support[37] to those countries that need it by developed countries while also encouraging voluntary contributions[38] by other parties. The Agreement also establishes an enhanced transparency framework (ETF) which provides that as from 2024, States will be obligated to report on actions taken and progress in Climate Change mitigation, adaptation measures, international procedures for review of reports and support received or provided so as to build mutual trust and confidence.[39]

3.2 National Legal and Policy Framework

Kenya, although lacking a specific law on carbon trading, has various other laws that fill the gap. These include the Constitution of Kenya 2010, Energy Act No 12 of 2006, Energy Management Regulations 2012, Environmental Management and Coordination Act No 8 of 1999 and the Climate Change

[32] Article 2 of Paris Agreement
[33] Article 4(2) and (3)
[34] Article 14
[35] Article 9(1)
[36] Article 10
[37] Article 11
[38] Articles 6 and 9(2)
[39] Article 13

Act 2016. It is now proposed that these be examined in greater detail hereafter.

3.2.1 The Constitution of Kenya, 2010

This is the Grundnorm which provides a basis for the implementation of carbon trading within Kenya. It provides that every treaty and convention that Kenya is a signatory or party to is part of the law of Kenya.[40] This is therefore the basis upon which International Law, such as the ones examined herein-above, forms part of the Kenyan law. The Constitution entitles every person to a clean and healthy environment.[41] It also further provides for the protection of the environment for the benefit of future generations.[42] The Constitution has expressly provided for the protection of the environment and that includes protection from the adverse effects of Climate Change which can be achieved through carbon trading projects. The State is obligated to sustainably develop and conserve its natural resources. The obligation to conserve the natural resources presents an opportunity to earn carbon credits and trade them creating an incentive to do better and further conserve the environment.

3.2.2 Energy Act 2019[43]

Under sections 8-14, this Act provides that the Cabinet Secretary of Energy and petroleum be vested with powers to harness opportunities for the utilization of clean energy mechanisms and technologies. These provisions accord Kenya the opportunity to earn carbon credits and trade them. Section 44 (q) requires Rural Electrification and Renewable Energy Corporation to harness opportunities offered under clean development mechanism and other mechanisms including, but not limited to, carbon credit trading to promote the development and exploitation of renewable energy sources. Renewable energy projects form part of the projects under carbon trading in the clean development mechanisms. They reduce the use of fuels which causes pollution by replacing it with clean sources of energy such as wind and solar.

[40] Article 2(6)
[41] Article 42
[42] Article 69(1)
[43] Act No. 1 of 2019.

3.2.3 Environmental Management and Coordination Act 1999[44]

Under section 9, this Act establishes the National Environmental Authority (NEMA) which is tasked with the coordination of various environmental activities that are meant to guarantee the sustainable use of resources.[45] Aside from NEMA, section 125 of the Act also establishes the National Environmental Tribunal as a quasi-judicial body with jurisdiction to preside over disputes of environmental nature arising under the Act. The Act does not mention carbon credits but the provisions of the Act are applicable in the process of carbon trading and the projects undertaking since NEMA oversees all the projects that would have an environmental impact in the country.

3.2.4 Climate Change Act 2016[46]

This Act provides the regulatory framework for Kenya's response to Climate Change and for mechanisms and measures to achieve low carbon development. The Act is required to be applied in all sectors of the Kenyan economy for both the national and county governments. The Act, among others, provides incentives and obligations for private sector contributions towards the achievement of low carbon resilient development, promotion of low carbon technologies, improvement of efficiencies and reduction of emissions intensity by facilitating approaches and uptake of technologies that support low carbon, and climate resilient development, mobilising and transparent management of public and other financial resources for the National Climate Change Response.[47]

Further, it puts in place the structures and framework for the implementation of the Nationally Determined Contributions (NDCs). The Act establishes the National Climate Change Council, which is responsible for the overall coordination and advisory functions on matters relating to Climate Change, approving and overseeing implementation of the National Climate Change

[44] Chapter 387 Laws of Kenya
[45] Bondi, V., "Carbon Trading In Kenya in Hitchhiker's Guide To Law", 18th June, 2015. Available at <*https://vyonnabondi.wordpress.com/2015/06/18/carbon-trading-in-kenya-3/*> (accessed 15/2/22).
[46] Act No. 11 of 2016.
[47] Section 3(2)(f), (g) and (h)

Action Plan, among many other functions.[48] It also establishes the Climate Change Fund which is a climate financing mechanism.[49] The Act calls for National Climate Change Action Plans (NCCAPs) every five years formulated by the Cabinet Secretary which shall address all sectors of the economy and provide mechanisms for mainstreaming of the Plan into such sectors.[50] In the first such five-year plan, a Monitoring, Verification and Reporting (MRV+) system was proposed for Kenya to effectively measure, report and verify its climate actions.[51]

3.2.5 National Policy on Climate Finance, 2016[52]

This allows for the enhancement of Kenya's participation in the international carbon markets, generation of carbon units and access to carbon finance. It sets out how the governments will deliver on the climate finance aspects of the Act and Kenya's Nationally Determined Contribution (NDC) obligations. In this regard, the Policy notes that government has tools to generate carbon finance, including encouraging the generation and sale of carbon credits, putting a price on carbon, and establishing an emissions trading system [53] . It prioritises various interventions, including: government's development of new legislative instruments and carbon market initiatives; the identification and implementation of fiscal, taxation and other policy options (such as green bonds) in priority areas with high GHG emission abatement potential or high climate resilience benefits; and, the use of policies, laws and regulations to develop market-based and non-market-based mechanisms.[54]

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[48] Section 5(1) and (2)
[49] Section 25(1) and (2)
[50] Section 13(1) and (4)
[51] Government of Kenya, "Kenya National Climate Change Action Plan 2013-2017", Government of Kenya Vision 2030, page 130, available at *https://cdkn.org/sites/default/files/files/Kenya-National-Climate-Change-Action-Plan.pdf* (accessed 15/2/22).
[52] Government of The National Policy on Climate Finance pdf *http://www.environment.go.ke/wp-content/uploads/2018/05/The-National-Climate-Finance-Policy-Kenya-2017-1.pdf* (accessed 16/2/22)
[53] *Ibid* p. viii
[54] *Ibid* pp. 27 and 28

The Policy provides a framework to attract flows of climate finance and promote climate investment through financial and economic instruments, and cooperative approaches/market-based mechanisms, in which benefits and risks are distributed equitably, including specific interventions which have relevance for the carbon market. It acknowledges that trade could be negatively impacted by carbon taxes and obligations for emissions reduction effectively being countered by the promotion of low-carbon and green commodities and goods.[55] This acknowledgement leads to the submission that the Policy implicitly envisages Kenya's implementation of Carbon Pricing, in the form of a carbon tax, although there is no further reference, specifically, to carbon taxation in the Policy.

3.3 National Strategies, Plans and Annual Report documents

3.3.1 National Climate Change Response Strategy, 2010[56]

One of the components of this Strategy is the development of a National Wildlife Adaptation Strategy. This is to be achieved through a series of interventions including evaluation of the potential socio-economic impacts of remedial measures on Kenya's tourism sector. In this regard, for instance, carbon tax has been specifically mentioned as an example of a remedial measure.[57]

3.3.2 Ministry of Finance, the Economy and Investment Annual Report 2012[58]

There is a 2012 Ministry of Finance report on the National Policy on Carbon Investments and Emissions Trading. It outlines a strategy for the country where carbon trading was concerned. The policy document provided that carbon credit eligible projects in all sectors be implemented as per CDM as

[55] *Ibid*, p. 23
[56] National Treasury, "National Policy on Climate Finance", , Government of Republic of Kenya, 2016, available at http://www.environment.go.ke/wp-content/documents/complete%20nccrs%20executive%20brief.pdf (accessed on 16th February 2022).
[57] *Ibid*, p. 56
[58] Ministry of Finance, "Annual Report 2012 of Ministry of Finance", Government of the Republic of Kenya.

a means of facilitating their approval by the executive board of the UNFCCC and that carbon credits which were generated by these projects would be used for the recapitalisation of the projects and that they could only be traded with the direct approval of the Treasury.

3.3.3 National Climate Change Action Plan, 2013-2017[59]

The Action Plan 2013 inter alia provides for eight sub-components, representing long-term and integrated strategies for achieving key Climate Change goals, including Subcomponent 8: Finance which developed various financial mechanisms, including the Fund, an investment strategy and a carbon trading platform to position Kenya to access finances from various sources.

Among the Action Plan 2013's set of enabling actions to support the transition to a low carbon resilient development pathway, and financing of the Action Plan 2013, there is the recommendation to establish a carbon trading platform to market Kenya's carbon market activity [60]. The recommendation is for a primary platform, the purpose of which is described as being to "facilitate the origination of carbon credits from individual projects and their initial purchase from project developers". The European Union's Emission Trading Scheme is cited as an example of such an initiative.[61]

Three key options for the design of the platform were identified: a more efficient Designated National Authorities (DNA); an export promotion agency model where public resources are used to increase the supply of Kenyan credits and promote their sale in overseas markets; and, a brokerage model where a new body is created which looks to bring together buyers and sellers of credits and works on a commission basis. Either or both of the first

[59] Ministry of Environment and Forestry, "National Climate Change Plan 2013-2017", Government of the Republic of Kenya, available at https://cdkn.org/sites/default/files/files/Kenya-National-Climate-Change-Action-Plan.pdf (accessed 16th February 2022).
[60] *Ibid*, p. 41
[61] *Ibid*., p. 87

two options were indicated as likely to be the most appropriate for Kenya.[62] The Action Plan 2013's set of enabling actions also recommended the enactment of an overarching a standalone Climate Change law. An obvious, but unstated, element of a standalone Climate Change law would be the establishment of the legal regime and required administrative and institutional infrastructure to operationalize the proposed carbon trading platform.

3.3.4 National Climate Change Action Plan, 2018[63]

The Action Plan 2018 updates the Action Plan 2013 but, significantly, contains no mention of a carbon trading platform. The Action Plan 2018 continues and develops the Policy's theme of enhancing Kenya's participation in the international carbon markets, generation of carbon units and access to carbon finance, also addressing fiscal measures to support the National Climate Change Response and emphasising obtaining climate and carbon finance from a wide and diverse range of international sources, particularly the existing suite of funds.

It mentions the plan of attracting investment to support implementation of the National Climate Change Policy. It is interesting to note that, while the Policy mentions taxation as a policy option to support mitigation actions, without specifying the nature of such taxation, i.e., specifying that such taxation is anticipated to be applied, either as a means to price local greenhouse gas emissions which would constitute a disincentive for emitters or, incentivize climate-friendly initiatives in the form of tax-breaks for implementing emissions-reducing actions. The Action Plan's references to taxation are limited to the provision of tax incentives to support private sector investment, including attracting Foreign Direct Investment in the national economy.

[62] *Ibid*, p. 88
[63] Ministry of Environment and Forestry, "National Climate Change Action Plan 2018-2022", Volume 3: Mitigation Technical Analysis Report", 2018, available at http://www.environment.go.ke/wp-content/uploads/2020/03/NCCAP_2018-2022_ExecutiveSummary-Compressed-1.pdf (accessed 16th February 2022).

4. The Business of Carbon Trading

Carbon trading is defined as a flexibility mechanism that involves purchasing or acquiring credits representing greenhouse gas reductions in other countries.[64] The goal of carbon trading is to make it easier for companies and governments to meet emission reduction targets. It is usually undertaken in two main forms. These are, first, the 'cap and trade' form, and secondly, the 'offsetting' form.

4.1 Cap and Trade Form

This form of carbon trading is also known as the carbon market form. It occurs when a government or intergovernmental body sets an overall legal limit on emissions (the cap) over a specific period of time, and grants a fixed number of permits to those releasing the emissions.[65] The polluting entity must hold enough permits to cover the emissions it releases. In the event one polluter does not use all its permits, then it can trade the "surplus" permits with another entity that has already exhausted all its permits and needs more to continue emitting, without exceeding the legal limit[66]. This is the approach underlying the European Union's Emissions Trading Scheme (EU ETS), the world's largest carbon market, which was worth US$ 63 billion in 2008 and continues to expand rapidly.[67] The idea is that the availability of carbon permits will gradually be reduced, thereby ensuring scarcity, so that the

[64] Sands P., Peel J., Fabra A., MacKenzie R., *Principles of International Environmental Law*, 2018, 3rd Edition, Cambridge University Press, p 287

[65] Kaufman N., "Carbon Tax vs. Cap-and-Trade: What's a Better Policy to Cut Emissions?", *World Resources Institute*, 1st March, 2016.

[66] Kill J., Ozinga S., Pavett S., Wainwright R., Trading Carbon: How it Works and Why it is Controversial", *FERN*, 2022, available at *https://www.unredd.net/documents/redd-papers-and-publications-90/other-sources-redd-papers-and-publications/understanding-redd-climate-change-840/climate-change-850/2961-trading-carbon-how-it-works-and-why-it-is-controversial-2961.html* (accessed on 1st February 2022).

[67] World Bank, State and Trends of the Carbon Market 2009, World Bank, Washington DC, 2009, p.7 *https://openknowledge.worldbank.org/bitstream/handle/10986/13403/48998.pdf?sequence=1&isAllowed=y* (accessed 3/2/22)

market retains its value while at the same time forcing a reduction in the overall level of pollution.[68]

4.2 Offsetting Form

For this kind of carbon trading, instead of cutting emissions at source, companies, governments and individuals finance emissions-saving projects outside of the capped area.[69] The UN-administered Clean Development Mechanism (CDM) is the largest offsetting scheme with almost 1800 registered projects.[70] Although they are proposed as emissions reduction, they do not reduce emissions but merely move reductions to places where it is cheapest to make them.[71] The carbon savings are calculated according to how much less greenhouse gas is presumed to be entering the atmosphere than would have been the case without that project. Researcher Dan Welch sums up the difficulty by stating, "offsets are an imaginary commodity created by deducting what you hope happens from what you guess would have happened".[72] It occurs in two different contexts, first, the compliance market and, secondly, the voluntary offset market.

The CDM regulates projects located in countries that do not have emissions targets while the Joint Implementation allows for offset projects in countries with emissions targets. Before a carbon offset project can sell offset credits, it has to pass through a series of stages intended to establish the number of offset credits that can eventually be sold. This guide uses the CDM process as a reference to explain the different steps. The voluntary market uses a less

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[68] Gibertson, T., and Reyes O., "Carbon Trading: How It Works And Why It Fails, Dag Hammarskjold Foundation", *Uppsala*, 2009, available at *https://www.agrecol.de/files/Carbon%20trading%20-%20%20how%20it%20works%20and%20why%20it%20fails.pdf* p12 (accessed on 3rd February 2022).

[69] UNEP Risoe CDM/JI Pipeline Analysis and Database, 1 September 2009, http://cdmpipeline.org/overview.htm (accessed 3/2/22).

[70] *Ibid.*

[71] *Ibid.*

[72] Welch D., "A Buyer's Guide to Off Sets", *Ethical Consumer*, Issue No. 106, May/June 2007, available at *http://www.togetherworks.org.uk/index.php?q=node/156* (accessed on 3rd February 2022).

structured procedure with fewer independent assessments of the claims and calculations, and has no single agreed set of standards. It also lacks a central database comparable to the CDM's database that the UNFCCC Secretariat maintains to try and prevent the double selling of offset credits.[73]

4.3 The Business of Carbon Trading in Kenya

Kenya is amongst the countries regarded as being the most vulnerable to Climate Change due to a dependency on climate sensitive sectors such as its rain-fed agriculture.[74] The country's agricultural sector directly contributes to 24% of the GDP, tourism contributing 27% of the foreign exchange earnings and 12% to the GDP and hydro-electric energy generation contributing 50% of the total energy production.[75] These factors have increased the vulnerability of Kenya to Climate Change hence the use of climate resilient technologies and methodology as a buffering mechanism to adapt to the effects of the change in climate such as carbon trading.[76]

4.3.1 Carbon Trading Projects in Kenya

Carbon trading projects in Kenya fall under two categories. These are, first, the Clean Development Mechanism and, secondly, the Voluntary Carbon Market.

4.3.1.1 Clean Development Mechanism Projects

Through CDM projects, the investing entity earns Certified Emission Reduction Credits while achieving sustainable development in the developing nation. The projects are registered with a CDM Registry, a

[73]International Rivers, "Making Your Voice Heard: A Citizens Guide to the CDM', available at *https://archive.internationalrivers.org/resources/making-your-voice-heard-a-citizen-s-guide-to-the-cdm-3951*, (accessed on 3rd February 2022).

[74] Ogenga J., Mugalavai E., and Nyand N., "Impact of Rainfall Variability on Food Production under Rain-fed Agriculture in Homa Bay County, Kenya," *International Journal of Scientific and Research Publications*, August 2018, Volume 8, Issue 8

[75] UNEP, "Carbon Pricing Approaches In Eastern And Southern Africa Annexure A: Country Chapters A Report Submitted Under The Collaborative Instruments For Ambitious Climate Action (CI-ACA)", *UNEP*, April 2019, available at https://wedocs.unep.org/handle/20.500.11822/28250?show=full/ (accessed 15th February 2022).

[76] *Ibid*.

standardized electronic database that ensures accurate accounting of the issuance, holding and acquisition of CERs.[77] By the year 2016, nineteen CDM Projects were already registered in Kenya.[78] The first project was registered in 2008[79], Mumias Sugar Company Limited, with the support of Japan Carbon Finance Limited developed a 35-Megawatt (MW) sugarcane bagasse-based co-generation power plant[80]. So far, over $2.1 billion has been invested in these projects which are estimated to produce cumulative emissions savings in excess of 135 million tons of Carbon (IV) oxide offsets[81]. Kenya is often described as a market-friendly economy, but its deficits in security, governance and infrastructure constrain economic development, the diversity potential of CDM projects require scratching the surface on a sector-by-sector basis to understand barriers and success factors[82].

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[77] Kyoto Protocol to the United Nations Framework Convention on Climate Change, 11th December, 1997, 22, available at *https://unfccc.int/resource/docs/convkp/kpeng.pdf* (accessed on 22nd February 2022)

[78] National Environment Management Authority, "Component 3: Increasing resilience to the effects of rise in sea level and shoreline changes through Integrated Shoreline and Mangrove Ecosystem Management at Vanga and Gazi in the Coastal region of Kenya", National Environment Management Authority, 2022, available at *http://www.nema.go.ke/index.php?option=com_content&view=article&id=241:status-of-cdm-projects-in-kenya&catid=100:dna&Itemid=598* (accessed on 22nd February 2022).

[79] Government of Kenya Ministry of Environment & Mineral Resources, "Analysis of The Carbon Market Landscape In Kenya", Government of Kenya, 2012, available at *http://www.kccap.info/index.php?option=com_phocadownload&view=category&id=38&Itemid=45* (select the URL under "Annexe D – Carbon Markets in Kenya" (accessed 22nd February 2022).

[80] KEPSA, "Kenya's National Climate Change Action Plan and the Private Sector", *KEPSA*, 2014, available at *https://cdkn.org/wp-content/uploads/2015/04/Climate-Change-Action-Plan.pdf*. (Accessed on 22nd February 2022)

[81] UNFCCC, Project 1404: "35 MW Bagasse Based Cogeneration Project" by Mumias Sugar Company Limited (MSCL), *United Nations Framework Convention On Climate Change*, available at *http://cdm.unfccc.int/Projects/DB/TUEV-SUED1193228673.11/view* (accessed on 22nd February 2022).

[82] Hoch S., "Can Carbon Credits Help Kenya to Become "Green"?: The Relevance of the Clean Development Mechanism for Kenya", *Heinrich Boll Stiftung*, 2012, p. 13, available at

Power shortage was Kenya's greatest infrastructural challenge. It is therefore notable that grid-connected electricity generation constitutes the majority of the active CDM projects in Kenya. Others include biomass co-generation, geothermal, wind and hydro-power projects.[83] Energy institutions have been divided into two segments. These are the regulatory segment, which is undertaken by the Energy & Petroleum Regulatory Authority (EPRA). The second segment is that of operations. This is split into power generation, through Kenya Electricity Generating Company PLC (KenGen) and transmission and distribution through Kenya Power and Lighting Corporation (KPLC), and Kenya Electricity Transmission Company. The Geothermal Development Corporation was established to explore Kenya's geothermal potential in the Rift Valley.[84] The feed-in-tariff (FIT) was established in 2008 by the Ministry of Energy to include solar in 2010.[85]

4.3.1.2 Grid Connected Electricity

There are various grid connected electricity projects in Kenya including geothermal energy at Olkaria. Secondly, there is wind power such as the Lake Turkana Wind Power which is the largest wind farm in Africa.[86] It was implemented by a private consortium while carbon management is done by Carbon Africa with the support of African Carbon Asset Development Facility (ACAD), a public-private partnership between UNEP, Standard Bank and the German Federal Environment Ministry.[87] Other examples are

https://ke.boell.org/sites/default/files/can_carbon_credits_help_kenya_become_green.indd_.pdf (accessed on 22nd February 2022)

[83] Nyambura B., and Nhamo G., "CDM Projects and Their Impact on Sustainable Development: A Case Study from Kenya," *Environmental Economics*, Volume 5 (1), 27th March 2014.

[84] *Ibid.*

[85] Ministry of Energy, "Feed-in-tariffs Policy", Government of Kenya, *http://admin.theiguides.org/Media/Documents/FiT%20Policy%202012.pdf* (accessed 22nd February 2022).

[86] African Development Bank, *Lake Turkana Wind Power Project: The largest wind farm project in Africa*, African Development Bank, 17th September 2015, available at https://www.afdb.org/en/projects-and-operations/selected-projects/lake-turkana-wind-power-project-the-largest-wind-farm-project-in-africa-143, accessed on 24th August 2022).

[87] Hoch, *supra*.

the Corner Baridi wind farm which is located at Kinangop Wind Park Ltd, amongst others.

Hydropower, through the Tana Power Stations and Kiambere Hydro-power were the earliest to be registered show an output of 237k CERs and 477 CERs in 2020 respectively.[88] The Bagasse Co-generation projects produce electricity from the biomass residues of sugar production.[89] Mumias Sugar has been the pioneer as previously stated. There is the 6MW Muhoroni Sugar[90] and the 40MW West Sugar Ltd recently having their validation terminated.[91] BIDCO Company Limited has also recently submitted a biomass co-generation project, as well as a fuel-switch project at its crude edible oil refinery.[92]

4.3.1.3 Energy efficient measures

Some of these include KPLC's Green Light for Africa Project which distributed 900,000 Compact Fluorescent Lamps to Kenyan households,[93] solar power technologies such as the Barefoot Power's Lighting

[88] *Ibid* pg. 17
[89] Nyambura and Nhamo, *supra*.
[90] UNFCCC, "6 MW Bagasse Based Cogeneration Project by Muhoroni Sugar Company Limited", *UNFCCC*, available at *https://cdm.unfccc.int/Projects/Validation/DB/QNMHK5H4FTGJ4K1AQLHYTQPNCUIJ70/view.html* (accessed on 22nd February 2022).
[91] UNFCCC, "40MW Bagasse Based Cogeneration at West Kenya Sugar Limited", *UNFCCC*, available at *https://cdm.unfccc.int/Projects/Validation/DB/BMNRNLA6HT98AYZ0RAM1XMXNYRTY7G/view.html* (accessed on 22nd February 2022)
[92] UNFCCC, "Installation of Cogeneration plant by utilizing the Biomass based Boiler with a capacity of 20 TPH at BIDCO Oil Refineries Limited, Kenya", *UNFCCC*, 2022, available at *https://cdm.unfccc.int/Projects/Validation/DB/B35PMUXLFZL2CXBWW2CQA7HYSTBZ5O/view.html* (accessed on 29th August 2022).
[93] UNFCCC, "Green Light for Africa- KPLC Kenya", *UNFCCC,* https://cdm.unfccc.int/ProgrammeOfActivities/cpa_db/8AKC10ZORVUIESQ9GMT42FNLPXY6BJ/view (accessed on 22nd February 2022).

Programme,[94] Nuru Lighting Programme,[95] Tough Stuff International, and the TATS Solar Lantern.[96]

4.3.1.4 Voluntary Carbon Market Projects

Under the Voluntary Carbon Market, an entity can be motivated by a desire to reduce emissions. They volunteer to take part in projects by purchasing carbon credits generated through carbon projects[97]. Majority of these projects in Kenya are in the forestry sector. There are nine forestry sector voluntary projects in Kenya. These include Kasigau Corridor REDD Project Phases I (Rukinga Sanctuary) and II (Community Ranches),[98] International Small Group & Tree Planting Programme (TIST),[99] Aberdare Range/Mt Kenya Small Scale Reforestation Initiative,[100] the Forest Again Kakamega Forest and Mikoko Pamoja Mangrove.

Apart from forestry, voluntary carbon market projects have led to domestic energy efficiency in Kenya through cook stoves and water filters reducing the unsustainable consumption of non-renewable biomass. An example is the CO_2-Balance Efficient Cook Stove Programme. Top Third Ventures 'Top

[94] UNFCCC, "Barefoot Power Lighting Programme", *UNFCCC*, available at https://cdm.unfccc.int/ProgrammeOfActivities/poa_db/OXBV8QY1G0E5KFR96NDJTLHUMIPSAC/viewCPAs (accessed on 22nd February 2022).

[95] UNFCCC, "Nuru Lighting Programme", *UNFCCC*, available at https://cdm.unfccc.int/ProgrammeOfActivities/poa_db/OGTH5Q4J6CAWXUBLNM2RE7I1S3PY08/view (accessed on 22nd February 2022).

[96] UNFCCC, "TATS Solar Lantern Programme", *UNFCCC*, available at https://cdm.unfccc.int/ProgrammeOfActivities/poa_db/LIQZ0G17YPM5KWR9BFNOEX34HJ86AV/view (accessed on 22nd February 2022).

[97] Gold Standard, "Carbon Market FAQs", *Gold Standard*, 2022, available at http://www.goldstandard.org/frequently-asked-questions/carbon-market (accessed on 22nd February 2022)

[98] Forests, WILDLIFE WORKS, available at *http://www.wildlifeworks.com/saveforests/forests_kasigau.php* (accessed on 22nd February 2022).

[99] TIST, "The International Small Group & Tree Planting Program", *TIST*, 2020, available at http://www.tist.org/welcome/ (accessed on 22nd February 2022).

[100] UNFCCC, "Project 3207: Aberdare Range / Mt. Kenya Small Scale Reforestation Initiative Kirimara-Kithithina Small Scale A/R Project", *UNFCCC*, 2020, available at *https://cdm.unfccc.int/Projects/DB/JACO1260322919.16/view* (accessed 22/2/22).

Third Ventures Stove Programme,[101] Climate Pal's 'Kenya Improved wood stoves' project,[102] and Envirofit International's 'Improved Cooking Stoves Programme of Activities in Africa'[103].

Agricultural and soil carbon projects such as the Kenya Agricultural Carbon Project implemented by a Swedish NGO, Vi Agroforestry, with support from the World Bank and participation in carbon credits off-take from the World Bank's Bio-Carbon Fund.[104] In mid-2011, Kenya Airways, in conjunction with International Air Transport Association (IATA) Organization, launched a Carbon Offset Program for its passengers via pre-CDM voluntary emission reductions from geothermal projects in Kenya.[105]

5. Conclusion

Kenya has the legal capacity to a domestic realisation of its ambition of introducing Carbon Pricing by 2025. A number of existing legal mechanisms have been identified that can be used as vehicles for the implementation of Carbon Pricing and development of Carbon trading in general. The introduction of climate action policies in the form of Carbon Pricing mechanisms will likely induce deeper modifications in the way energy is produced and consumed in the country.

Therefore, there is need for a better understanding of how such profound transformations will affect society, and more research efforts should be dedicated to this subject.

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[101] UNFCCC, "Top Third Ventures Stove Programme", *UNFCCC*, available at *https://cdm.unfccc.int/ProgrammeOfActivities/poa_db/BSVR8KUNAXW0LI1PGC6H42Y3JD9EQ7/view* (accessed on 22nd February 2022)

[102] EcoAct, "Climate Pal: EcoAct Offsetting Partner", available at https://eco-act.com/climate-pal/ (accessed on 22nd February 2022).

[103] Envirofit, "Smarter Cooking Technology for Better Living", *Envirofit*, available at *https://envirofit.org/* (accessed on 22nd February 2022).

[104] The World Bank, "Kenya Agricultural Carbon Project", The World Bank, available at *https://projects.worldbank.org/en/projects-operations/project-detail/P107798* (accessed on 22nd February 2022).

[105] ClimateCare (2020) Kenya Airways; *https://climatecare.org/kenya-airways-encourage-their-customers-to-offset-flight-emissions/* (accessed 22/2/22)

With regards to the CDM relevance, it is expected to deliver sustainable development contributions as it encourages Kenya's shift towards renewable energy and embracing projects that will assist the environment and climate such as reforestation. However, it is noted that there is still a huge reliance on international expertise and finances. It is projected that biomass and oil products will remain two of Kenya's main sources of energy until at least 2030[106].

In order to help deal with some of the foregoing challenges, this paper makes four main recommendations. First, there is need for sensitisation on the use of carbon trading and finance among renewable energy developers in Kenya. Secondly, there is need for the create policies to promote carbon trading project deployment. Thirdly, it is also proposed that the country creates capacity within the local banking sectors and the capital markets to obtain carbon finance. Finally, it is also proposed that the role of the Designated National Authority (DNA) be reinforced while also establishing the human capacity and expertise needed to support developers to meet the requirements of the carbon markets.

[106] Longa F.D., and Van der Zwaan, B., "Do Kenya's Climate Change Mitigation Ambitions Necessitate Large-Scale Renewable Energy Deployment and Dedicated Low-Carbon Energy Policy?", *Renewable Energy: An International Journal*, 2017, 1559-1568.

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Critical Analysis of World Trade Organisation's Most-Favored Nation (MFN) Treatment: Prospects, Challenges and Emerging Trends in the 21st Century

By: ***Michael O. Okello*** *

1.0 Introduction

The paper focuses on the Most Favored Nation (MFN) Treatment within the context of regional integration and sustainable development in the 21st century. Its effect has evolved, since the Marrakesh Declaration when there was minimal active participation of developing states, to its adoption that has seen its benefits to a wider number of contracting under World Trade Agreements. However, there are emerging trends and case specific, regional scenarios that now renders it a not fit-for all purpose per se. Further, the premise of MFN and the participation of developing economies now depict major challenges, which may not have been either anticipated or considered in the very onset.

This paper critically analyses certain disparities and skewed aspects, some of which have pushed both developed and developing economies to react accordingly, to cushion themselves from the misgivings of MFN yet with ripple effects. This builds a case for reflection on salient gaps that the World Trade Agreements, the decision making and adjudicative organs need to timely address. Nevertheless, the paper highlights the rationale behind MFN treatment, while at the same time it pre-empts controversial debates in the near future, on the bilateral Investment treaty provisions (in retrospect). This will not only restate the vision of multilateral trade, but also to achieve equitable and special interventions with respect to trade in goods, services and trade related intellectual property rights in the affected states.

The paper recommends the necessity for protection sovereignty of states, upholding of the wider fundamental freedoms and inalienable rights from

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violations by developed economies, consensus on rules of interpretation of BITs clauses, qualification of 'equal treatment' in the sui generis cases. This will inter alia ensure non-discrimination *in fact* and foster local economies to grow and alleviate the emerging notion of marginalization of World Trade operation and its conflict with sub regional economic integration.

2.0 What is the Most Favored Nation (MFN) Treatment?

The Most Favored Nation (MFN) treatment is defined as the situation in which a state promises, usually by treaty, to trade with a particular partner on the most favorable tariff terms available to other parties to bilateral treaty with respect to like goods or services[1]. There might for example, be a policy in place of taxing the MFN nations imports at preferential rate[2]. Where a bilateral treaty (BIT) is signed, a MFN clause is provided, setting our terms that prohibit the host state from treating an investor from the other signatory state less favorably than any other foreign investor or a domestic investor, especially eliminating discrimination between them[3]. As a consequence MFN has an effect of enabling an (foreign) investor take advantage of more favorable provision found in a BIT between the host state and other favour states[4].

The operation of the MFN seeks to address through MFN clauses mischiefs of discrimination between states as well as against other countries, in the relevant markets involving dealings in goods, services and Intellectual property creations[5].

[1] Henry Campbell Black, 'Black's Law Dictionary'.
[2] Ibid.
[3] Turgut Aycan Özcan, 'Assessment of Most Favored Nation Clauses in Terms of Ejusdem Generis Principle and Its Impact over Some Bilateral Investment Treaties Executed by the Republic of Turkey in 1990s' (*Lexist*, 12 September 2018).
[4] United Nations, 'Marrakesh Agreement Establishing the World Trade Organization [Hereinafter Marrakesh Agreement]'.
[5] Patrick Anam, 'Most Favoured Nation Principle (MFN): Challenges and Opportunities' (23 July 2019).

It has been widely cited that MFN clauses are significant instrument of economic liberalization[6]. It removes entry barriers and distortions by guaranteeing foreign investors favorable treatments enjoyed by other domestic or foreign most favored customers or investors, owing from their economic or strategic influential negotiations with the countries where their investments take place [7].

3.0 WTO Agreements on MFN Treatment

The MFN status came forth between states since 11th century, and developed as a modern concept around 18th century, as a bilateral arrangement, where one country would grant another the status of "most favored nation." For instance, under the popular Jay Treaty of 1794, the United States accorded to Britain "most favored nation" trading status[8].

In the aftermath of the Second World War resulted to establishment of the General Agreement on Tariffs and Trade (GATT)[9]. The GATT came into force into force in 1948 and has various rules covering different areas of international trade and these rules are supposed to be adhered to by the contracting states. The Marrakesh Agreement, World Trade Organization (WTO) Agreement, General Agreement on Tariffs and Trade (GATT),

[6] Turgut Aycan Özcan (n 3).
[7] Kimberly Amadeo, 'Most Favored Nation Status: Pros and Cons' (*The Balance*, 20 April 2022).
[8] Jean Edward Smith and John Marshall, 'Definer of a Nation' (1998) 177 n The Treaty of Amity, Commerce, and Navigation, Between His Britannic Majesty and the United States of America, commonly known as the Jay Treaty. It was a treaty between the United States and Great Britain that averted war, resolved issues remaining since the Treaty of Paris of 1783 (which ended the American Revolutionary War), and facilitated ten years of peaceful trade between the United States and Britain in the midst of the French Revolutionary Wars, which began in 1792.
[9] GATT 1994: General Agreement on Tariffs and Trade 1994, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, 1867 U.N.T.S. 187, 33 I.L.M. 1153 (1994).

General Agreement on Trade in Services (GATS)[10] and Agreement on Trade Related Intellectual Property Rights (TRIPs Agreement)[11] are three main instruments that govern MFN operation with respect to goods, services and intellectual property items.

3.1 Marrakesh Agreement and World Trade Organization (WTO)

The origin of MFN Treatment and the National treatment are traced from the Marrakesh Declaration[12]. Trade agreements and tariffs were negotiated under provisions of the General Agreement on Tariffs and Trade (GATT), which later established the World Trade Organization (WTO) in 1995 pursuant to the Marrakesh Agreement[13].

The preamble of the WTO Agreement highlights 'elimination of discriminatory treatment in international trade relations" as one of main ways through which objectives of WTO may be attained. The organization aims inter alia to regulate international trade and boost relations between countries, through principles of most favored nation, national treatment[14].

The MFN widely covers and prescribes nondiscrimination in international trade[15], which among other principles hold the World Trade Organization together and fosters international relations[16]. Under MFN, there is a negative obligations under WTO Agreements on foreign states under and host countries not to discriminate against their trading partners. A special

[10] GATS: General Agreement on Trade in Services, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1B, 1869 U.N.T.S. 183, 33 I.L.M. 1167 (1994).
[11] Agreement on Trade Related Intellectual Property Rights, including Trade in Counterfeit Goods, 1994.
[12] United Nations (n 4).
[13] Turgut Aycan Özcan (n 3).
[14] 'Most-Favored-Nation Clause' <*https://corporatefinanceinstitute.com/resources/knowledge/economics/most-favored-nation-clause/*> accessed 27 May 2022.
[15] United Nations, 'Most-Favored Nation Treatment : UNCTAD Series on Issues in International Investment Agreements II' (United Nations 2010).
[16] Patrick Anam (n 5).

favour enjoyed by the most favored nation goes to the rest of WTO Agreement members (unilaterally) subject to exemptions[17].

3.2 General Agreement on Tariffs and Trade (GATT)

Most Favored Nation Treatment (MFN) is one of these rules and is covered under GATT 1994 Article 1[18]. GATT provides for unconditional, immediate equal treatment with respect to any advantage, favour, privilege or immunity granted by any contracting party to like products traded amongst the contracting parties. MFN is in covered under article 1 of GATT governing trade of goods, where paragraph 1 provides that[19]:-

> [w]ith respect to customs duties and charges of any kind imposed on or in connection with importation or exportation or imposed on the international transfer of payments for imports or exports, and with respect to the method of levying such duties and charges, and with respect to all rules and formalities in connection with importation and exportation, and with respect to all matters referred to in paragraphs 2 and 4 of Article III, any advantage, favour, privilege or immunity granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties.

3.3 General Agreement on Trade in Services (GATs)

The GATS governing instrument on trade in services (as defined under article 1), protects the MFN in order of priority as one of the key obligations and disciplines principles, under Part II'. Further, article II of GATs provides that:

1. 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

[17] 'Most-Favored-Nation Clause' (n 14).
[18] Patrick Anam (n 5).
[19] United Nations (n 15).

less favorable than that it accords to like services and service suppliers of any other country.

2. A Member may maintain a measure inconsistent with paragraph 1 provided that such a measure is listed in, and meets the conditions of, the Annex on Article II Exemptions.
3. The provisions of this Agreement shall not be so construed as to prevent any Member from conferring or according advantages to adjacent countries in order to facilitate exchanges limited to contiguous frontier zones of services that are both locally produced and consumed.

The GATs recognizes exceptions to the MFN principle under paragraph 2 of the article II above. It further construed that MFN applies to like services and like supplies which are accorded immediate, unconditional and equal treatment.

3.4 The Agreement on Trade Related Intellectual Property Rights (TRIPs)

The Agreement on Trade-Related Intellectual Property Rights (TRIPS) [20] is an agreement of international law between all WTO contracting states. It sets enforcement, dispute resolution mechanisms and minimum standards that regulate specific forms of intellectual property for the states. The principles of MFN on intellectual property items is governed by TRIPs under article IV, which provides that

> [w]ith regard to the protection of intellectual property, any advantage, favour, privilege or immunity granted by a Member to the nationals of any other country shall be accorded immediately and unconditionally to the nationals of all other Members. Exempted from this obligation are any advantage, favour, privilege or immunity accorded by a Member:

[20] Agreement on Trade Related Intellectual Property Rights, including Trade in Counterfeit Goods, 1994.

(a) deriving from international agreements on judicial assistance or law enforcement of a general nature and not particularly confined to the protection of intellectual property;
(b) granted in accordance with the provisions of the Berne Convention (1971) or the Rome Convention authorizing that the treatment accorded be a function not of national treatment but of the treatment accorded in another country;
(c) in respect of the rights of performers, producers of phonograms and broadcasting organizations not provided under this Agreement;
(d) deriving from international agreements related to the protection of intellectual property which entered into force prior to the entry into force of the WTO Agreement, provided that such agreements are notified to the Council for TRIPS and do not constitute an arbitrary or unjustifiable discrimination against nationals of other Members

The provision secures MFN principles but expressly cites exemptions with respect to IPR items covered in conventions and international agreements that came into force, pre-WTO Agreement, and which are not discriminatory, arbitrary or unjustifiable against the national members[21]

4.0 Prospects of Most Favored Nation Treatment

The Most Favored Nation Treatment and status is distinguished from the NT, as the latter only applies one a product, service or item of IP that has already the market *ex port*. Accordingly, any imposed duties and import taxes are not in violation of National Treatment Status even where the domestic

[21] Rudolf Adlung and Antonia Carzaniga, 'MFN Exemptions Under the General Agreement on Trade in Services: Grandfathers Striving for Immortality?' [2009] Journal of International Economic Law.

markets are exempted from such exactions[22]. Further, while the national treatment (NT) principle prohibits discrimination *against* other states, the MFN status prohibits discrimination *between* other contracting states with respect to *like products*[23]. In addition, under MFN status, any advantage, favour, privilege or immunity granted by any contracting party to any product, service or IP work or item originating in or destined for any other country shall be accorded immediately and unconditionally[24] .

In other words, the discrimination in national treatment relates to advantage given to domestic products against products from other countries, while in MFN treatment, the discrimination relates to advantage given to products originating in or destined for any other country against that of other countries. Therefore, as a general rule, a state lowers a trade barrier or opens up a market pursuant to a BIT, it has to do so for 'like products' unconditionally and with immediate effect with respect to goods, services and IP items, for all other WTO agreement contracting trading partners)[25].

5.0 Critical Analysis of Prospects and Challenges of the MFN Status

The MFN has come under scrutiny with respect to anti-trust laws regime; it is a type of vertical arrangement that would locally constitute a restrictive trade practice between suppliers and buyers. The Chicago school has seen potential noncompetition risks, especially where they are adopted under BIT or unilaterally by way of policy[26].

Further, questions have been raised on the efficiency rationale of MFN principle and whether it has shortcomings. This is in light of the emerging or subsisting peculiarities and circumstances of states. Does the principle favor all party states to WTO Agreement?

[22] Patrick Anam (n 5).
[23] Ibid.
[24] United Nations (n 15).
[25] Turgut Aycan Özcan (n 3).
[26] Baker, Jonathan B. and Chevalier, Judith A, 'The Competitive Consequences of Most-Favored-Nation Provisions' (2013) 27 Antitrust Magazine <https://ssrn.com/abstract=2251165>.

5.1 Imperatives of MFN Treatment and Clauses

It has been justified as efficiency rationale; that mitigates holding up problems and counteracts incentives to delays in contracting, and reduce negotiation and transaction costs. Further, MFN Status operates as a substitute of specific of terms of engagement that would be required between trading partners for specific transactions of services, goods or IP items. This cures issues of delays, transaction and negotiation costs, as it guarantees contracting parties opportunity to enjoy the best price, based on most favored customer arrangements[27].

Those countries, acceding to the WTO Agreement enjoy and exercise monopolies of economic development, free trade, fairness, predictability and nondiscrimination based on principles of MFN and NT. The above have an overall effect of expansion of international markets, reduce export costs, enhance competiveness. Advantage of equal treatment that is guaranteed to all WTO members and based on common grounds reached by the incumbent (MFC) hence guarantees permanent normal trade relations.

MFN principles cuts down red tape, differential tariffs and eliminates the need for customs authorities to calculated specific duties for each transaction among and between states, as they are "universal'. There is certainty and predictability and level play field, subject to exemptions.

Finally, MFN eliminates undesired trade protectionism and resultant complacency in domestic industries and fosters innovation. It hence boosts the market expansion and growing of smaller economies. Benefits of economies of large scale in turn lead to increase in export trade and economic growth and international relations[28].

[27] Ibid.
[28] Ibid.

5.2 Challenges facing the MFN Treatment

It is envisaged that MFN lowers costs on one side, while increases it on the other: as discussed in this paper, there is cost implication in monitoring, enforcement and litigating over matters linked to interpretation, exemptions and test of like products as well as claims of violation with respect to MFN clauses[29]. The contracting states benefit from the efforts borne by most favored nations that contracted the BITs for like goods, services and IPRS, hence incur no costs in negotiating the same, without a general mechanisms or compensation or actual reciprocity other than unilateral agreement based on international relations and comity of states that is based on the WTO obligations[30].

Further, other nations have no incentives to push further beyond the exiting terms enjoyed with MFNS. While the contracting states including developing countries economically benefit from MFNS terms, they may have almost no opportunity to monitor and enforce compliance to MFN or its clauses hence makes no competitive sense[31].

Economic viewpoints cites that classes of competitive collusive nature of MFNS; as it results to facilitatory coordination may raise sellers costs and enable players raise questions against rival undertakings on undertakings that make adjustments to fit in a competitive market. It has also potential exclusionary attribute where, rival and entrant investors may exit or face entry barriers, where foreign exports enjoy subsidies and sell at lower prices that host countries .

MFN clauses may enforce prohibitive effect on prices with respect to BIT that other states enjoy or operate under. Accordingly, where the prices and taxes are higher, it may lead undertakings in a relevant market to compete less as MFN clauses assist the incumbents to foreclose entry or expansion.

[29] Ibid.
[30] Patrick Anam (n 5).
[31] Baker, Jonathan B. and Chevalier, Judith A (n 26).

There will therefore be claims over abuse of dominance or non-competitiveness of trade between states[32].

Since all members are accustomed to same status and treatment for like goods, services, IP items, others may fall victim of unfair or restrictive practices. The new entrants and rival have no option but to adopt the terms already negotiated by incumbent. This may not reflect or be subject to deferential and unique circumstance of developing countries. Where such aspects are not addressed, through exemptions and drastic measures, the BITS may enforce and reinforce terms that result to disproportionate effect of high tariffs, entry barrier, lack of opportunity to negotiate or enforce MFN clauses or monitor compliance[33].

6.0 Salient Aspects of MFN and Emerging Trends

The discourses on MFN remain controversial one today, and has been a subject of claims and litigation in the global scape including in Africa[34]. The disputes have inter alia involved the test for 'like products', the interpretation of the MFN clauses or their violations. What happens when aspects of international law and jus cogens are violated by a state that enjoys MFN Status? Or in the absence of an express agreement but unilateral declarations to be acceded by contracting states? Do they have a say to renegotiate the terms[35]? Critical analysis African regional integration depicts challenges and opportunities[36], viz:-

6. 1 Question of the Test of 'like' products

The nature of MFN clauses is that they are unconditional, and general and extends privileges enjoyed by MFNs to other contracting state parties to WTO Agreement. In so doing, the status allows equal treatment in respect of import/export of "like products" such as uniform taxation regimes in imports, exports and international transfer of payments, without

[32] Ibid.
[33] Ibid.
[34] Turgut Aycan Özcan (n 3).
[35] Baker, Jonathan B. and Chevalier, Judith A (n 26).
[36] Patrick Anam (n 5).

discrimination and or giving one party on advantage over the other with respect to 'like products' i.e. products with similar characteristics in *Japan -Taxes An Alcoholic Beverages*, vodka was considered to be like good to *Schochu*, on basis of unsophisticated market test and considered, taste, appearance and use. It was held that Japanese *Schochu* and U.S made whisky cognac and white spirits were like products[37]. The exporters of spirits to japan complained that japan offered low tax to *Schochu* than whisky cognac and white spirits. The panel found japan in violation of article 3 (supra) of GATT by its inconsistent tax system, hereby considering both exported products from US and Japan *Schochu* as 'like products'[38]

6.2 General Systems of Preference and exemptions

There are exemptions under GATT, GATs and TRIPs, where counties that under a treaty on a free trade area or customs may be allowed to apply differential (higher) tariffs at differential to that imposed on nonmembers, and contrary to MFN principles. Further, the developed countries may be unilateral agreements extend zero duty, quota free exports to develop preference.

There is more leeway exploited in the exemptions to most favored nation (MFN) obligation with respect to services under article II of GATS than in trade of goods under GATT. States had one-off opportunity upon entry to force of GATs in 1995 or WTO accession, to retain the departures from MFN treatment within 10 years. The MFN exemptions were subject to relatively soft disciplines only. Further, the departures from MFN treatment, were not subject to time constraints, including for Economic Integration Agreements and recognition measures related to standards, certificates and the like.

The question is how the patterns of current exemptions, to different groups affect the services negotiations. Scholars admit that non-availability of new exemptions, including for measures that had escaped members' attention

[37] Ibid.
[38] Ibid.

(especially developing countries) accession time to the agreements, could have raised propensity to and popularity of potential substitutes (including Regional Trade Agreement and Economic Integration Agreements). This may have also promoted an excessively broad interpretation of existing exemptions and discouraged governments from rescinding those that had served their initial purpose better. A more flexible approach might thus be warranted[39].

6.3 Plight of local industries

Where host countries grants to all WTO members states same treatment, it may be unable to protect local industries from cheaper goods imported from foreign countries. At the same time, undertakings that may not adjust to the exclusionary effect of margin squeeze and due to abuse of dominant position may choose to exist market for failure to compete.

Where a host state encourages subsidies policies in the domestic market, this may result to cheap exports and resultant distortion to foreign markets and unfair practice. Accordingly, exemptions are only allowable under strict conditions such that where MFN is not qualified, the host county fails to put in place subsidies to counter imbalance, and there may be a result into economic breakdown[40]. In *US- Grass Guzzler case*; which concerns environmentally, friendly laws, panel determined that statutes that do not aim at protectionism are GATT compatible[41]. Exceptions help in playing safely nets, where through integration contracting parties such as developing/ poorest nations gross[42].

6.4 Jus cogens (peremptory norms) and MFN Status

The MFN status does not after all guarantee permanent normal trade relations, neither does it only restrict to tariffs but goes beyond to relations, non-restrictive or protectionist environment and human rights obligations. It is emerging today that the principle is not permanent or absolute, as it may

[39] Rudolf Adlung and Antonia Carzaniga (n 21).
[40] Patrick Anam (n 5).
[41] Ibid.
[42] 'Most-Favored-Nation Clause' (n 14).

be qualified on justified grounds. Even in light of military actions against Ukraine in 2022, Russia remained member of the World Trade Organization. Biden administration suspended normal trade relations (MFN) with Russia apart April 2022[43]. Later, the Trump administration begun imposing tariff on Chinese imports since 2018 on claims of unfair practices (intellectual theft). Unless members have statutes that allow abrogation of MFN, countries generally remain to enjoy MFN status. The Ukraine-Russia war has raised geopolitical debates where as a customary law rule, sovereignty, reciprocity, law of war and principle of international rules have led to many states isolating relations with Russia. US. Declared that Russia no longer have MFN status with respect to WTO BIT agreements. The war has resulted to ripple effect in oil crisis and foreign trade imbalances[44].

6.6 Principles of Construction of MFN clauses in BITs

There has been litigating over substantive MFN based BIT clauses which do not exist in the original BIT. This for examples are based on claims with respect to discrimination, fairness and security, full protection and equal treatment. According to Article 9 of the Draft Articles on Most Favored Nation Clause prepared by International Law Commission, e*jusdem genris* may be employed in construction of clauses. It expressly prescribes that when *Ejusdem Generis principle* is applied to MFN clauses existing in the BITs, the wording of each MFN may be imported from other BITs. The United Nations Conference on Trade and Development (UNCTAD)[45] on MFN concurs with the fact that "the ejusdem generis rule, is relevant to determine issues belonging to the same subject matter or category of subjects to which the MFN clause relates[46].

6.7 MFN Marginalization

There is increasing fear that the proliferation of regional trade agreements (RTAs) is continuing to cause marginalization of MFN status of countries that are non-members. The RTAs offer mutual benefits and preferential

[43] Kimberly Amadeo (n 7).
[44] Ibid.
[45] United Nations (n 15).
[46] Turgut Aycan Özcan (n 3).

treatments on customs, and economic zones that result to beneficial treatments among parties. The increase is expected to continue. The African Continent is not only realizing such RTAs but also working on a model AfRFTA that seeks to open even more benefits to members. The resultant effect is that other countries are excluded from these preferential treatment that are based on the RTAs as non-parties on basis of privity of the agreements, and enforcement between parties based on the laws of treaties. This in the end beats the purposes, where the excluded countries are share membership with the RTA members in the wider WTO Agreements regimes. This 'violates' the WTO non-discrimination principle enshrined in article 2 of GATs and article 1 for GATT and article 4 of the TRIPs respectively within the MFN clauses in other BITs. Yet the very states would want to enjoy equal treatment under MFN terms. This depicts hypocrisy and indifference[47].

7.0 Summary and Recommendations

The MFN and by extension, the National Treatment principle are important. However, it is emerging that MFN does not purely guarantee permanent normal trade relations in trade, services and IP rights under WTO regime. While WTO aims have achieved a balance and yielded benefits discussed in the paper including 'equal treatment', it is not obvious as a general rule. The MFN status is now a qualified one, owing to the exemptions and exceptional cases discussed above where litigation outcomes show unwillingness of adverse parties to comply.

Further, international law principle on grounds of violations of peremptory norms has made countries with that status defrocked of it. Further, the emergence of RTAs result to results to unequal field and undue advantage by countries that want to exploit both the gains coming from RTA terms as well as MFN clauses in BITs of most favored customers. While such exemptions and alternatives to permanent normal trade relations seem to offer remedies and lee-ways, they show that there are certain inadequacies

[47] Rudolf Adlung and Antonia Carzaniga (n 21).

found or not addressed under the WTO regimes. This constructively act as a source of its marginalization.

The WTO regime needs to be evaluated, not with respect to compliance with it by contracting state only, but in the context of its effectiveness of lack thereof. Given the creating of the regimes came before the liberalization and democratization of the third world in the 90s, it is been over three decades where regional integration and more awareness on international law and relations have depicted salient reforms both from national and regional level that may need to adjust to address what issues were not cured in the WTO agreement frameworks. Nonetheless, MFN principle has yielded benefits to less favored nations in international trade in merchandise, services and IPR protection as well as technology transfer.

The WTO and its partners should relook at the inadequacies and gaps in its framework without compromising violations of international rules and peremptory norms by its WTO treaty members against recognition of sovereignty as seen in Russia –Ukraine war case.

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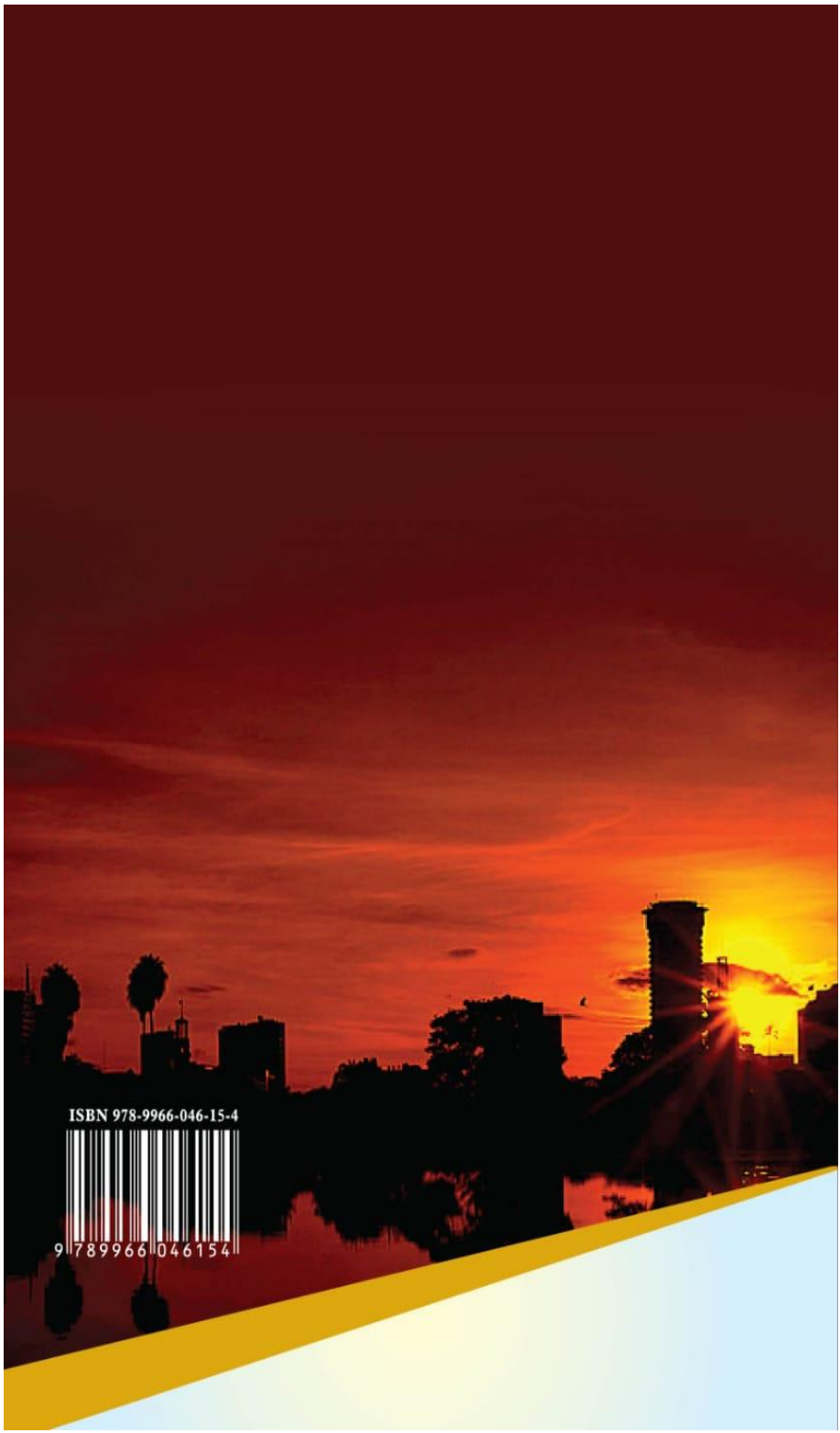

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