ESSENTIAL DISCIPLINES OF THE NATIONAL TREATMENT OBLIGATION UNDER NAFTA CHAPTER ELEVEN

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The purpose of this paper is to describe the scope and essential disciplines of the national treatment obligation in Chapter Eleven of the *North American Free Trade Agreement* "(NAFTA").[1] The emphasis of the paper will be upon identifying issues that arise when applying the national treatment obligation.

A. SCOPE AND ESSENTIAL ELEMENTS OF THE NAFTA NATIONAL TREATMENT OBLIGATION

(1) Articles 1102(1), (2), (3) and (4)

NAFTA Article 1102(1) applies to investors of other Parties and reads as follows:

> "Each Party shall accord to investors of another Party treatment no less favourable than that it accords, in like circumstances, to its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments."

NAFTA Article 1102(2), which is similarly worded and applies to investments of investors of other Parties, reads as follows:

> "Each Party shall accord to investments of investors of another Party treatment no less favourable than that it accords, in like circumstances, to investments of its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments."

NAFTA Article 1102(3) establishes a special rule when applying Article 1102(1) and 1102(2) to measures of subnational governments. NAFTA Article 1102(3) reads as follows:

> "The treatment accorded by a Party under paragraphs 1 and 2 means, with respect to a state or province, treatment no less favourable than the most favourable treatment accorded, in like circumstances, by that state or province to investors, and to investments of investors, of the Party of which it forms a part."

NAFTA Article 1102(4)(a) prohibits minimum equity requirements and Article 1102(4)(b) prohibits requiring an investor of another Party, by reason of its nationality, to sell or otherwise dispose of an investment. As Article 1102(4) addresses specific situations, it will not be considered in this paper.

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[1] References to "Chapters" and "Articles" in this paper are to Chapters and Articles of NAFTA, unless otherwise indicated.

(2) Scope and Essential Elements

1. Investors and Investments

The expressions "investor", "investor of a Party", "investment" and "investment of an investor of a Party" are all defined in Article 1139. The expression "investment" is broad and includes a wide range of items. The definition of "investment of an investor of a Party" is such that an "investment" can be indirectly held. For example, consider a U.S. corporation (an "investor of Party") that owns a wholly-owned subsidiary incorporated in Canada which in turn owns an office building in Canada. The subsidiary (an "enterprise" under (a) of the definition of "investment"), the shares of the subsidiary ("equity securities of an enterprise under (b) of the definition of investment") and the office building ("real estate" under (g) of the definition of "investment) all fall within the definition of "investment of an investor of a Party".

2. According Treatment With Respect to Investments

Each of Articles 1102(1) and (2) concern the according of treatment "with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments." The effect of the scope and coverage provision in Article 1101(1)(a) is that the treatment must be accorded through a "measure" that is adopted and maintained by a Party. [2] The effect of the scope and coverage provision in Article 1101(1)(b) is that:

(a) the "investment" with respect to which the treatment must be accorded under both Articles 1102(1) and (2) must be within the territory of the Party according the treatment; and

(b) the "investments of investors of another Party" referred to in Article 1102(2) to which treatment is accorded must also be within the territory of the Party according the treatment.

3. Treatment Accorded Must be No Less Favourable

Articles 1102(1) and 1102(2) each requires that the treatment accorded by a Party to investors of another Party (Article 1102(1)) or their investments (Article 1102(2)) must be no less favourable that the treatment that is accorded by the Party to its own investors (Article 1102(1)) or to "investments of its own investors" (Article 1102(2)). The "no less favourable" treatment language is similar to that found in other national treatment provisions, such as Articles 1202 (services) and 1405(1) and (2) (financial services), as well as those in Article III:4 of the *General Agreement on Tariffs and Trade 1994* ("GATT 1994") and Article XVII of the *General Agreement on Trade in Services* ("GATS"). There are a number of issues respecting the "no less favourable treatment" that are identified in item **(B3)** below.

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[2] In this connection however, note that Chapter Eleven Tribunals have tended to interpret the expression "measure" very broadly. See *Ethyl v Government of Canada* ("*Ethyl*"). In the Award on Jurisdiction, the Investor had delivered its Notice of Intent while the measure complained of (the MMT Act) was still a bill, and at the time that the Notice of Arbitration was served, the MMT Act still had not received Royal Assent. Despite the fact that Article 1120 expressly requires that "six months have elapsed since the events giving rise to a claim" before the claim is submitted, it was sufficient for the Tribunal that the MMT Act subsequently did receive Royal Assent. The logic of the Award (such as it is) suggests that somehow the events giving rise to the claim (which under Article 1120(1) must have occurred at least six months before the Notice of Arbitration was filed) must have been based on the unenacted MMT Act as a "measure".

4. In Like Circumstances

In order for the comparison in treatment in Articles 1102(1) and (2) between investors of another Party or their investments and a Party's own investors or investments to be required, the treatment must be accorded "in like circumstances". While the concept of "likeness" is common to all the "no less favourable treatment" obligations referred to above, its expression in Articles 1102(1) and (2) differs from its expression in Article III:4 of GATT 1994 and GATS Article XVII. Likeness in Article III:4 of GATT 1994 is expressed as "like products of national origin" and in GATS Article XVII as "its own like services and service suppliers". WTO jurisprudence on likeness respecting these differently worded provisions is difficult to apply to Articles 1102(1) and (2).

There are a number of issues in respect of the application of "in like circumstances" that are identified in item **B(2)** below.

B. ISSUES/PROBLEMS IN APPLICATION OF NATIONAL TREATMENT OBLIGATION

(1) Which comes first – like circumstances or comparison of treatment?

Lines of cases in WTO jurisprudence frequently establish a precise order in which a particular provision is analyzed.[3] No order of approach has been established in the jurisprudence respecting Article 1102. In *S.D. Myers, Inc. and Government of Canada* ("*Myers*") the Tribunal considered "in like circumstances" before addressing the issue of "no less favourable treatment"[4], while in *Pope & Talbot Inc. and The Government of Canada* ("*Pope & Talbot*") the Tribunal proceeded in the opposite order.[5] The Chapter Twenty Panel in *In the Matter of Cross-Border Trucking Services* ("*Trucking Services*")[6], in considering the national treatment obligation in Article 1202 respecting cross-border services, approached the question of treatment first. [7]

The logic of Articles 1102(1) and (2) suggests that there is no requirement that treatment being accorded to investors and investments be compared unless the treatment is being accorded "in like circumstances". This suggests that the question of "like circumstances" should be considered before the question of "no less favourable treatment" because if the circumstances are not "like", no obligation arises respecting the according of treatment. In *Trucking Services*, the treatment being accorded to cross-border service providers of Mexico was unequivocally less favourable so the only issue was whether a comparison of treatment was required by reason of the circumstances being "like". In *Pope & Talbot* however, while there were different levels of treatment with some more favourable than others, there was a major issue as to whether the less favourable treatment was being

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[3] For example, with Article XX of GATT 1994, the Appellate Body will *always* determine whether the measure falls within one of the specific exceptions set out in Article XX and whether it satisfies the qualifying language of that exception *before* considering whether the measure satisfies the requirements of the chapeau of Article XX.

[4] See Partial Award by majority ("Myers Partial Award"), paragraphs 243 to 251 (like circumstances) and paragraphs 252 to 257 (treatment).

[5] See Award on the Merits of Phase 2 ("Pope & Talbot Phase 2 Award"), paragraphs 33 to 72 (treatment) and 73 to 103 (like circumstances).

[6] Secretariat File No. USA-MEX-98-2008-01. This case involved cross-border services rather than investment but Article 1202 is similar in its structure to Articles 1102(1) and (2).

[7] Panel Report paragraph 248 *et seq*.

accorded to investors (or, at least, an investor) of the United States and more favourable treatment was being accorded to investors of Canada. The Tribunal's decision would have been much less confusing if it had approached the issue of "in like circumstances" before considering "treatment no less favourable".[8]

The balance of this paper will consider the issues arising respect of "in like circumstances" first and then will consider the issues respecting "no less favourable treatment".

(2) Issues respecting "in like circumstances"

1. Are the "circumstances" those of the investor or the investment or these of the according of the treatment?

Governments frequently treat businesses differently for a variety of reasons. Businesses in built-up or environmentally sensitive areas may be subject to more stringent environmental regulations (with resulting higher costs) than businesses in other areas. Businesses of under a certain size may be categorized as "small businesses" and may be entitled to tax or other concessions. Businesses that choose to operate in economically disadvantaged areas may receive advantages not available to businesses operating in other areas.

One question that arises in respect of "like circumstances" is whether the "likeness" pertains to the circumstances under which the treatment is being accorded (which can encompass a whole range of factors) or whether likeness is confined to the circumstances of the investors and the investments being compared. If the former, differences arising from, say, the region in which an investment is located can be accounted for as "unlike circumstances". The circumstances under which the treatment is accorded to a business in an environmentally sensitive area are different from the circumstances in which an otherwise identical business in a non-sensitive area are treated are different, so the obligation to compare the two different treatments does not arise. However, if the latter, the fact that the businesses operate in the same sector (both produce widgets) could be enough to establish that the circumstances are "like" and a comparison of the treatment of investors and investments is required.

The *Pope & Talbot* Tribunal adopted an expansive review of "in like circumstances", finding that any difference in treatment linked to a rational government policy not motivated by discrimination created a situation of unlike circumstances. However, the panel in *Trucking Services* noted that the Parties agreed that the phrase "in like circumstances" was intended to have a meaning similar to the phrase "like services and service providers" proposed by Canada and Mexico in the negotiations.[9] The *Trucking Services* approach was more in line with traditional GATT/WTO national treatment jurisprudence that compares like products. However, applying the *Trucking Services* approach to a situation of differential treatment arising from regional differences in environmental sensitivity would likely result in a finding of "like circumstances". The *Pope & Talbot* approach to "likeness" in this situation would have reached the opposite conclusion. It is submitted that the situation just described should never be subject to a claim under Article 1102. However, the approaches followed in two different cases considering virtually the same language lead to opposite conclusions when applied to this same hypothetical fact situation.

The foregoing notwithstanding, sector can be important in certain cases (where the measure complained of is sector-specific as opposed to one of general application) and the breadth of the identification of the sector can be

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[8] In fact, it was patently obvious in this case that the differing treatments were being accorded in circumstances that were not like, so that should have been the end of the matter.

[9] Panel Report paragraph 249

critical as to whether the circumstances are "like". For example, *Ethyl Corporation v. Government of Canada* ("*Ethyl*") involved a ban of cross-border trade in MMT. There were no producers of MMT in Canada.[10] If "like circumstances" were defined by the "MMT producers" sector, there would have been no investors or investments "in like circumstances". However, if the "like circumstances were defined by the "octane enhancer" sector, there were Canadian investors and investments in like circumstances because there were several Canadian producers of ethanol, which, like MMT, is used as an octane enhancer.

2. Aims and Effects of Government Policy

The issue here is the extent to which the motivation behind the measures at issue and the different treatment that they accord should be a relevant factor in the "like circumstances" analysis.

(a) Aims and Effects and the GATT/WTO Experience

Aims and effects has had a tortured history in GATT/WTO jurisprudence. Panels in several cases under the *General Agreement on Tariffs and Trade 1947* ("GATT 1947") used "aims and effects" to establish that products were not "like" and therefore the obligation to accord no less favourable treatment under Article III:4 of GATT 1947 did not apply. For example, the panel in *United States – Measures Affecting Alcoholic and Malt Beverages*[11] *("Malt Beverages")* was considering whether measures that treated strong beer less favourably than weak beer contravened Article III:4 of GATT 1947. The panel decided that as alcoholic content had not been singled out as a means of favouring domestic over foreign producers so the two varieties of beer did not have to be considered as "like". However, "aims and effects" has been rejected in WTO jurisprudence as an analytical basis for determining the consistency of measure with national treatment obligations.[12] In *European Communities – Measures Affecting Asbestos and Products Containing Asbestos*[13]("*Asbestos*"), the Appellate Body found that the asbestos-containing products were not "like" non-asbestos containing products used for similar purposes because the health risks shaped consumers' preferences and not for reasons relating to the purpose of the ban.

(b) The NAFTA Experience

Aims and effects has resurfaced in NAFTA jurisprudence. The *Pope & Talbot* Tribunal decided in Canada's favour in respect the national treatment claim on the basis that circumstances were not "like". After rejecting the arguments of all three NAFTA Parties that the basis of *de facto* discrimination must be discrimination on the basis of nationality, the Tribunal approached "like circumstances" on the basis it requires "addressing *any* difference in treatment, demanding that it be justified by showing that it bears a reasonable relationship to rational policies not motivated by preference of domestic over foreign owned investments".[14] The Tribunal followed this approach

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[10] Including Ethyl, which produced MMT in the United States and whose Canadian subsidiary only diluted and distributed MMT. However, that is another issue. See item **B(3)4** below.

[11] Adopted 19 June 1992, BISD 39S/206

[12] See for example, *Japan – Taxes on Alcoholic Beverages (Japan – Alcoholic Beverages)*, Panel Report WT/DS8/R, WT/DS10/R, WT/DS11/R 11 July 1996, Appellate Body Report WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R 4 October 1994 and *European Communities – Regime for the Importation, Sale and Distribution of Bananas ("EC-Bananas")*, Panel Report WT/DS27/R, Appellate Body Report WT/DS27/AB/R 9 September 1997.

[13] WT/DS135/R and WT/DS135/R/Add.1 18 September 2000, Appellate Body Report, WT/DS135/AB/R 12 March 2001

[14] Pope & Talbot Phase 2 Award paragraph 79.

throughout its analysis. For example, in respect of the different treatment in non-covered provinces, the Tribunal stated that this was "reasonably related to the rational policy of removing the threat of CVD actions" and could not "reasonably be said to be motivated by discrimination outlawed by Article 1102".

The issue of the motivation behind a measure as being relevant to the application of "in like circumstances" also arose in the *Trucking Services* case. The panel stated that "differential treatment should be no greater than is necessary for legitimate regulatory reasons such as safety".[15] This analysis was tied to the question of "in like circumstances", suggesting that the existence of legitimate regulatory reasons can form the basis for a finding of unlike circumstances. Consideration of the existence of "legitimate regulatory reasons" seems consistent with the *Pope & Talbot* "rational policy" approach to "in like circumstances". However, the Panel's view of "in like circumstances" and "legitimate regulatory reasons" was restrictive. This approach may have made sense in the circumstances of this particular case where the service providers of Mexico were unequivocally being treated less favourably than their U.S. counterparts, and the only question was whether the differential treatment was somehow justified. It certainly does not make sense from a broader perspective.

3. "In Like Circumstances" as an Exception

The panel in *Trucking Services* expressed the view that the "in like circumstances" language amounted to an exception and should be interpreted narrowly like other exceptions.[16] The suggestion that the "in like circumstances" language amounts to an exception raises burden of proof issues. WTO jurisprudence respecting burden of proof distinguishes between positive obligations and affirmative defences. If a complainant alleges a breach of a positive obligation, the complainant has the burden of establishing a *prima facie* case. If, however, the defendant asserts an affirmative defence, the burden of proof is upon the defendant to establish a *prima facie* case that the defence applies.[17] Exceptions such as those set out in Articles XI:2 and XX of GATT 1994 have been treated as affirmative defences in WTO jurisprudence. However, it seems very clear from the text of Articles 1102(1) and (2), as well as Article1202, the requirement that the treatment be accorded "in like circumstances" is a basic requirement of the substantive obligation.[18] The burden should be on the complainant to establish that this requirement is met (i.e. that the circumstances are "like"), rather than for the defending Party to establish that they are not. However, the decision in *Trucking Services* could be used as a basis for arguing the opposite. The ultimate outcome in *Trucking Services* was reasonable but the Panel chose an unfortunate means for reaching it in treating "in like circumstances" as an exception. It also follows that if the "in like circumstances" language in Articles 1102(1) and (2) is not an exception, it should not be subject to a narrow interpretation.

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[15] Panel Report paragraph 258.

[16] Panel Report paragraph 260.

[17] See *United States – Measures Affecting Imports of Woven Wool Shirts and Blouses from India*, Appellate Body Report WT/DS33/AB/R 25 April 1997. See also *Brazil – Export Financing Programme for Aircraft*, Panel Report WT/DS46/R 4 April 1999, Appellate Body Report WT/DS46/AB/R 2 August 1999.

[18] The Appellate Body finding in *Brazil – Export Financing Programme for Aircraft* is instructive. Canada maintained that Article 27.4 of the *Agreement on Subsidies and Countervailing Measures* ("SCM Agreement") was a conditional defence and that the burden of proof was on Brazil who was asserting it. The Appellate Body found that a developing country is entitled under SCM Article 27.2(b) to the non-application of SCM Article 3.1(a) provided that it complies with the specific requirements of SCM Article 27.4. These conditions are positive obligations of the developing country and not affirmative defences. Therefore, the burden in this case was on the complaining party (Canada) to establish non-compliance by Brazil with at least one of the elements of SCM Article 27.4.

4. Inappropriate Comparisons – Producers with Distribution Subsidiaries/Service Providers with Marketing Subsidiaries

As noted above, Article 1101(1)(b) requires that the "investment" with respect to which the treatment must be accorded under both Articles 1102(1) and (2) must be within the territory of the Party according the treatment. There have been two cases under Chapter Eleven in which the investor had an investment in Canada but the real adverse effect of the measure complained of was on investments of the investor in the United States.

In *Ethyl*, the complaining investor had a Canadian subsidiary that imported MMT, diluted it and distributed it but did not produce it. The real adverse effect of the MMT trade ban was upon the investor's U.S. facility, which did produce MMT. The investor was complaining that it was being treated less favourably than producers of octane enhancers in Canada. However, the investor did not produce MMT in Canada. Its Canadian subsidiary merely diluted and distributed MMT in Canada. The investor was making its claim based on a comparison of the treatment of its investment in Canada, an octane enhancer distributor, with domestic Canadian investors that were octane enhancer producers, when the entity of the investor that was truly comparable with the Canadian octane enhancer producers was the investors production investment in the United States. This case was settled before being considered on its merits.

The situation in *Myers* was similar. The investor's Canadian investment was a marketing subsidiary, and the investor's PCB destruction facility was located in the United States. The investor claimed that the PCB export ban diverted business from it to PCB destruction facilities located in Canada. These Canadian investments were not comparable with the investor's Canadian investment, which was a distributor, but with the investor's U.S. investment that was the PCB destruction facility. The Tribunal found circumstances to be "like" but did not address this issue of comparability. The Tribunal's decision is subject to judicial review.

Article 1101(1)(b) clearly indicates that Articles 1102(1) and (2) were not intended to have extraterritorial scope. The question that arises therefore, in each of *Myers* and *Ethyl,* is whether the treatment of the investor's investment in Canada, which was a distribution or marketing subsidiary only, was accorded "in like circumstances" to the treatment accorded to Canadian investors and investments that were producers or full service suppliers, when the investment of the investor that was really comparable with the Canadian investors and investments was located in the United States? It is submitted that the circumstances are not "like", because the effect of holding otherwise is to apply extra-territorial application to Articles 1102(1) and (2), which the NAFTA drafters did not intend. To hold otherwise would enable a U.S. investor to ensure full Article 1102 protection vis à vis laws of Canada for its U.S. production facility simply by incorporating a marketing subsidiary in Canada. The absurd result of this is that a U.S. producer with a small Canadian distribution subsidiary would have full Article 1102 protection vis à vis Canadian laws that adversely affected its U.S. production facility (including a right of direct action against the Canadian Government) while its counterpart without a distribution subsidiary would have no such protection.

Comparing the Canadian distribution subsidiary of a U.S. producer with a Canadian producer or the Canadian marketing subsidiary of a U.S. cross-border service supplier with a Canadian service supplier results in measures coming under Chapter Eleven scrutiny, such as import and export restrictions, that the Parties likely never intended be subject to Chapter Eleven. Such distributing or marketing subsidiaries should only be compared with Canadian-owned investments acting in a similar capacity, and not to Canadian-owned producers or service suppliers who are acting in a different capacity.

5. Sub-National Governments

The question that arises with subnational governments (provinces and states) as regards "in like circumstances" is whether the circumstances should be confined to those within the province or state or whether "like

circumstances" can be outside the territory of the province or state. While the extraterritorial rule in Article 1101(1) is not directed at the territories of provinces or states, Articles 1102(1) and (2) when applied to a province or state make sense only if the treatment accorded by the province or state to investors of other Parties or their investments is compared with the treatment accorded by that province or state to domestic investors and investments. Suppose that the Government of Newfoundland grants water extraction permits in Newfoundland to both Canadian and U.S.-owned investments but the Province of Ontario refuses such a permit to similar U.S.-owned investment, and the U.S investor complains about the Ontario treatment. The circumstances of the investments in Newfoundland, whatever their nationality, are irrelevant, because, as is clear from Article 1102(3), the treatment at issue is the treatment accorded by the Province of Ontario to investments and not the treatment that is accorded by the Province of Newfoundland.[19] The relevant issue in such a complaint is how the Province of Ontario treats domestic investors and investments regarding the issuance of water extraction permits as compared with its treatment of foreign-owned investors and investments.

Article 1102(3) requires one modification to the "like circumstances" analysis as regards sub-national governments in that the analysis of likeness is directed at the circumstances respecting the investors of the Party of which the province or state is a part that receive the most favourable treatment. Article 1102(3) was directed at the phenomenon that provincial and state governments sometimes treat investors of that province or state better than investors of other regions of the Party of which they form a part. However, as discussed in item **B(3) 2** below, Article 1102(3) has been applied by one Tribunal in support of the position that Articles 1102(1) and (2) impose a "best-in-jurisdiction" standard.

Article 1102 should apply to measures of local governments, such as municipalities, in the same manner in which it is applied to other levels of government. [20] The standard against which the treatment by that local government of foreign investors and investments is to be assessed is the treatment accorded by that local government to domestic investors and investments, and not the treatment accorded by some other local government. Suppose one municipality decides to privatize certain functions such as water supply and a second municipality chooses to retain public control of water supply and refuses to consider overtures by private concerns for privatization. The action of the first municipality is entirely irrelevant to assessing the treatment accorded by the second municipality to foreign investors and investments.

(3) Issues respecting "no less favourable treatment"

If circumstances are "like", Articles 1102(1) and (2) require Parties to accord to investors of other Parties and their investments treatment that is no less favourable than treatment accorded to their own investors and their investments. The "no less favourable" treatment standard is the classic formulation of a "national treatment" non-discrimination provision. Seemingly a violation must be based on some form of discrimination, where foreign investors are discriminated against on the basis of their nationality. However, the practical application of the non-discrimination national treatment obligations in Articles 1102(1) and (2) in the NAFTA case law to date is not that straightforward.

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[19] Note that Article 1102(3) expressly says "by that state or province". [emphasis added].

[20] Interestingly, while Articles 105 and 1102(3) refer to states and provinces only, the fact that Article 1108(1)(a)(iii) refers to Article 1102 not applying to "existing" measures of local governments implies that other measures of local governments (viz. those coming into existence after January 1, 1994) are subject to Article 1102.

1. Discrimination

(a) *De Jure* Discrimination

De jure discrimination is discrimination that occurs on the face of a measure. In terms of Articles 1102(1) and (2), the basis for *de jure* discrimination exists when a measure subjects foreign investors and their investments to a different regime of treatment than domestic investors and their investments. The only issue in this situation is whether the different treatment accorded to the foreign investors and their investments is less favourable. The GATT/WTO jurisprudence establishes a general principle that treatment may be different but must afford equal competitive opportunities.[21] Another GATT principle that will be applied is that less favourable aspects in some respects of treatment of foreign investors cannot be offset by more favourable aspects of treatment in other respects.[22]

(b) *De Facto* Discrimination

The GATT/WTO jurisprudence establishes that breaches of the various non-discrimination obligations in the WTO agreements (national treatment as well as most-favoured-nation treatment) can occur even if a measure is not discriminatory on its face. This is known as *de facto* discrimination. While the concept of *de facto* discrimination clearly exists in the GATT/WTO jurisprudence, it has been applied on a case by case basis. It is difficult from those cases to draw a clear set of principles as to when *de facto* discrimination exists and when it does not.

Governments have any number of valid reasons for treating different situations differently, with goods, services, investors and investments in some situations being less favourably treated than in others. The question is, absent discrimination on the face of a measure providing for differential treatment, when does that differential treatment amount to discrimination that breaches a national treatment obligation and when does it not.

The fact situation in *Pope & Talbot* illustrates the difficulties in applying the concept of *de facto* discrimination. In *Pope & Talbot*, lumber exported from covered provinces (one of which was British Columbia, where the investment was located) were subject to a charge[23] while lumber exported from non-covered provinces were not subject to charges. The charge levied on B.C. exports was higher than the charges exported from other covered provinces. The treatment of producers exporting from British Columbia was clearly less favourable than

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[21] Equality of competitive opportunities is expressly referenced in Article 1405(5) in respect of the financial services national treatment obligation in Article 1405. While a panel or tribunal could conceivably conclude that the specific reference to equality of competitive opportunities in Article 1405(5) and the absence of a reference to competitive opportunities in Article 1102 means that some other test applies, the more likely approach would be that the references to equality of competitive opportunities in Article 1405(5) reinforces its status as the test to be applied. Differences in wording like this that are not clearly intended add to uncertainty.

[22] *United States – Section 337 of the Tariff Act of 1930 ("Section 337")* Adopted 7 November 1989, BISD 36S/345. The *Pope & Talbot* Tribunal managed to treat what was unequivocally a *de jure* case as a *de facto* case in that they used this case to refute Canada's position on *d facto* discrimination. See *Pope & Talbot* Award Second Phase paragraph 68.

[23] The charges were levied on exports over certain volumes which were determined by export quotas which were allocated to lumber producers. The fact situation presented here is just one of the fact situations that was before the Tribunal in *Pope & Talbot*, but the theme throughout all the various fact situations in *Pope & Talbot* was pretty much the same.

producers exporting from non-covered provinces (no charge) or from the other covered provinces (a lower charge).

Canada argued that for *de facto* discrimination to exist, the less favourable treatment (that in the covered provinces, particularly in British Columbia) had to fall disproportionately on foreign investors, as would be the case if most of the investments in British Columbia were foreign-owned and most of the investments in the non-covered provinces were domestically-owned. As there was no evidence whatsoever that this was in fact the case, there was no *de facto* discrimination. This position is most strongly supported by the Panel and Appellate Body decisions in *EC-Bananas*.[24] The decision of the *Myers* Tribunal also supports this position.

The investor argued that *de facto* discrimination existed when a single foreign-owned investment (such as its investment in British Columbia) was less favourably treated than a single domestically-owned investment (such as an investment in a non-covered provinces) even though domestically-owned investments in British Columbia also received the less favourable British Columbia treatment and the foreign-owned investments in non-covered provinces also received the non-covered province treatment. This view of *de facto* discrimination is supported by a number of fact situations in the *Malt Beverages* case.[25]

The Tribunal accepted the investor's position and rejected that of Canada. However, as indicated above, the Tribunal found in Canada's favour on "like circumstances" by holding that any difference in treatment was acceptable (i.e. represented a situation of unlike circumstances) if it "bears a reasonable relationship to rational policies not motivated by preference of domestic over foreign owned investments".

Where does *Pope & Talbot* leave us as regards *de facto* discrimination? Canada's position seems intuitively correct and was supported by the other two Parties. The measures in *Pope & Talbot* clearly did not discriminate against U.S. investors in any sense that the Parties could have had in mind when they agreed to the text of Article 1102. However, given that there is a concept of *de facto* discrimination, what is there in the NAFTA text or in the case law that says that Canada's position was correct and that adopted by the Tribunal was wrong?[26] Also, suppose that the facts had been that most of the producers in British Columbia just happened to be U.S.-owned and most of the producers in the non-covered provinces just happened to be Canadian-owned?[27] Would there have been *de facto* discrimination, even though there was a total absence of a discriminatory motivation? Also, what is disproportionate? Would 60% U.S. ownership in British Columbia versus 60% Canadian-ownership in the non-covered provinces be disproportionate? Or would it have to be 70% or 80%?

The situation was saved in *Pope & Talbot* only because the Tribunal ignored the WTO "aims and effects" jurisprudence and introduced a concept of discriminatory motivation into its analysis of "in like circumstances". If the Tribunal had adopted the view of "in like circumstances" applied by the Panel in *Trucking Services* (i.e. that it is an exception to be narrowly interpreted), Canada would have lost.

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[24] Notwithstanding the Tribunal's curious spin on this case. See *Pope & Talbot* Award Phase 2 paragraphs 46 to 57.

[25] The Tribunal also cited the *Section 337* case as supporting this view, in apparent disregard of the fact that *Section 337* was unequivocally a *de jure* situation.

[26] The Tribunal misinterpreted both *Section 337* and *EC-Bananas*, but they could have come to the same conclusion without making these errors.

[27] This would have been unlikely in *Pope & Talbot* because there were a relatively large number of producers. However, this is a very real possibility when differential treatment is applied in an industry where there are few producers. See item **B(3)3** below.

2. Best in Jurisdiction Treatment

The decision in *Pope & Talbot* leads to the question as to whether Articles 1102(1) and (2) impose a best-in-jurisdiction treatment obligation. The Tribunal in *Pope & Talbot* held that Articles 1102(1) and (2) do impose this obligation[28] and used the "most favourable treatment" language in Article 1102(3) to support this conclusion.[29] Under the best-in-jurisdiction interpretation, in any situation in which there is different levels of treatment, the foreign investor is entitled to the best treatment even though the different levels of treatment fall even-handedly on both[30] domestic investors and foreign investors.

The best-in-jurisdiction theory raises the issue as to how governments can provide in their laws for different levels of treatment for legitimate policy reasons having nothing to do with the nationality of investors or investments without breaching Article 1102. The answer of the *Pope & Talbot* Tribunal to this question was that any difference in treatment that was linked to a rational government policy and was not motivated by discrimination on the basis of nationality created a situation of unlike circumstances. This solution seems perfectly acceptable so long as it is consistently applied from case to case. However, an untenable situation would arise if a best-in-jurisdiction approach to *de facto* discrimination is coupled with a narrow interpretation of "in like circumstances".

The other way of approaching the issue of *de facto* discrimination is to reject the best-in-jurisdiction theory and adopt the position that there can be no *de facto* discrimination unless there is discrimination on the basis of nationality. In a curious way, the decision in *Pope & Talbot* supports this position. Following the Tribunal's logic, in order for there to be discrimination, there must be a difference in treatment. The Tribunal found, in effect, that a difference in treatment linked to a rational government policy and was not motivated by discrimination was a situation of unlike circumstances. On this logic, "like circumstances" can only exist with a difference in treatment that is not linked to a rational government policy and is motivated by discrimination.

3. Aims and Effects

The foregoing discussion brings us back to aims and effects. As noted earlier, the *Pope & Talbot* made discriminatory motivation (or the absence of it) the basis for their "like circumstances" analysis. Absence of discriminatory motivation would seem an equally reasonable basis for a finding that there was no *de facto* discrimination. The difficulty that WTO panels and the Appellate Body have had with the concept of "motivation" or "intent" is that ascertaining the intention of a government in enacting a measure may difficult, and in any event it is the effect of the measure that should matter and not the intention behind the measure. However, basing *de facto* discrimination on the effect of the measure alone can have its problems. Suppose, for example, that there are only two producers of a particular product. One producer, which is U.S. owned, is located in an environmentally sensitive area and is subject to certain stringent environmental controls, with a resulting higher cost structure. The Canadian producer is not located in such an area and is not subject to those controls. On these facts, 100% of the foreign investors are subject to less favourable treatment than 100% of domestic

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[28] See *Pope & Talbot* Award Phase 2 paragraph 42, where the Tribunal expressly states this.

[29] *Pope & Talbot* Award Phase 2 paragraph 41.

[30] This question is obviously of concern to government, and should be of equal concern to the governments of all three NAFTA countries, as well as to governments of provinces and states. The more hawkish supporters of investor rights would take issue with this and argue that governments should simply be made to pay for any measure that inconvenience investors i.e., imposes on an investor's investment any cost structure that is higher than the lowest cost structure.

investors. However, foreign ownership has no relevance whatsoever to the application of the measure or the motivation for its being enacted.[31] The situation would be exactly the same if the ownership were reversed.

Basing de *facto* discrimination on the effects of a measure alone may be appropriate with goods because there will usually be many goods and situations such as that just described will not arise. However, in applying national treatment obligations to investors and investments, application of a pure "effects" approach to *de facto* discrimination will result in situations being characterized as *de facto* discrimination that were never intended by the NAFTA Parties.

4. Sub-National Governments

As indicated above, the most favourable treatment language in Article 1102(3) was intended to address the phenomenon that provincial and state governments sometimes treat investors and investments from other provinces and states within the same country less favourably than their own investors and investments. The "most favourable treatment" language sets the standard at the level of treatment of domestic investors and investments within the province or state, and not at the standard applied to domestic investors and investments of other provinces or states.[32]

As discussed above, the *Pope & Talbot* Tribunal adopted a different view, and used Article 1102(3) to support its best-in-jurisdiction interpretation. The one observation in this regard made by the Tribunal that was correct was the view that the national treatment standard cannot be different for provinces and states than it is for federal governments.[33] The Tribunal used the "most favourable" language in Article 1102(3) to support its best-in-jurisdiction finding respecting the national treatment obligations of federal levels of governments. The Tribunal's reasoning can be applied to reach the opposite conclusion, namely that since it is clear from Articles 1102(1) and (2) that a best-in-jurisdiction treatment standard was not intended, the same applies to provincial and state measures under Article 1102(3).

The one other question that arises with respect to provinces and states is the extent, if any, to which treatment by other provinces and states can set a standard of treatment that must be observed by other provinces and other states. Consider the Newfoundland/Ontario water example described above under item **B(2)5** above. Does the Newfoundland standard of allowing water extraction permits set the standard so that a breach of Article 1102 occurs when Ontario does not grant such permits? The answer must clearly be that it does not. As described above in item **B(2)5**, the comparison of treatment that Articles 1102(1) and (2), when read together with Article 1102(3) is the treatment accorded by "that state or province" i.e., Ontario, and not the treatment accorded by some other province, such as Newfoundland. The same observation applies to measures of local governments. In the example described in item **B(2)5** above, the action of the first municipality in deciding to privatize water supply does not set the standard for the second municipality that chooses retain public control.

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[31] Note also the view of the *Pope & Talbot* Tribunal as regards singularity expressed in paragraph 56 of the Pope & Talbot Phase 2 Award .

[32] While Article 1102(3) does not say this, it is probably a safe assumption that if there is a difference in treatment by a province or state of domestic investors and investments, the province or state will accord the more rather than the less favourable treatment to its own investors and investments rather than those of other provinces or states.

[33] Pope & Talbot Phase 2 Award paragraphs 40-41.

C. CONCLUDING REMARKS

As is apparent from the foregoing, the meaning of Article 1102 is not clear. The problem with applying Article 1102 is compounded by the completely *ad hoc* approach that has developed in NAFTA Chapter Eleven jurisprudence, with each Tribunal believing itself free to adopt whatever view it sees fit of the Chapter Eleven provision at issue.

The concept of "in like circumstances" is much more difficult to apply than the concept of "like products" in Article III:4 of GATT 1994.[34] It is not a simple matter of looking at consumer preferences, tariff classifications, substitutability and the like. The *Pope & Talbot* concept of linkage to rational government policy and an absence of discriminatory motivation makes a great deal of sense in addressing the issue of "like circumstances". However, a NAFTA Chapter Eleven tribunal could easily adopt the view of the Appellate Body that motivation should be disregarded.[35]

As indicated above, while from the relevant GATT/WTO jurisprudence it is clear that *de facto* as well as *de jure* breaches of non-discrimination obligations based on national treatment can occur, the case law has approached *de facto* breach on a case-by-case basis. In any event, such principles as have developed in the GATT/WTO case law on *de facto* breach apply to goods and services and probably have limited relevance to consideration of differences in treatment of investments.

It is clear that the NAFTA Parties never intended that Article 1102 establish a best-in-jurisdiction treatment standard. However, the *Pope & Talbot* Tribunal found that Articles 1102(1) and (2) impose just such a standard. If the Tribunal had not gone on to link the concept of discriminatory motivation to "like circumstances" but rather, had accepted the narrow view of "like circumstances" advanced by the investor (and which would have been supported by the Panel decision in *Trucking Services* had such decision been available at the time the case was argued) the result would have been intolerable.

The NAFTA Parties should address these issues before a Tribunal in some future Chapter Eleven case renders a decision that none of the NAFTA Parties can live with.

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[34] The concept of "like service suppliers" in the GATS could be much more problematic. To the extent that the GATS applies to the delivery of services through a commercial presence, the GATS is, in effect, an investment treaty.

[35] The decision of the panel in *Malt Beverages* on laws according more strenuous (and hence less favourable) treatment to strong beer rather than weak beer made perfect sense, because there was no discriminatory intent. How would the Appellate Body approach this situation today? The finding of unlike products was relatively easy in *Asbestos* because extreme endangerment to health probably does affect consumer tastes and therefore creates an "unlike product". But on what basis is 3.3% beer a product that is unlike beer that is 3.0% when the cut-off is 3.1%?