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From 'non-discrimination' to 'reasonableness': a paradigm shift in international economic law?

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Executive summary

From 'non-discrimination' to 'reasonableness': a paradigm shift in international economic law?

Among the few basic legal instruments employed in international economic law for the promotion of trade and investment, the National Treatment (NT) principle and the reasonableness principle constitute the two predominant ones.

While both norms deal principally with national measures of legislative, administrative or judicial nature taken to regulate the internal market (so called 'internal measures'), they appear to represent two quite different legal paradigms. By requiring each member to treat products and investors of the other member (at least) as well as it treats its own products and investors, the NT principle provides for a "relative" standard of treatment. In other words, the NT principle does not guarantee a specific level of protection or that foreign products or investors will receive a "fair" or "reasonable" treatment. It simply guarantees against States affording foreign products and investors less favorable treatment compared to that granted to domestic products and investors. On the other hand, the reasonableness principle provides for an "absolute" standard of treatment, in as far as it requires States to recognize to foreign products and investors a certain (minimum) level of treatment, the determination of which does not have to depend on the treatment afforded to domestic products and investors. Although the concept of reasonableness may be given potentially a broad range of meanings, it usually refers to both substantive and procedural requirements, including concepts such as 'suitability', 'necessity', 'proportionality', 'transparency' and 'participation'.

Accordingly, the reach of the reasonableness principle appears to be quite broad compared to that of the NT principle and the normative standards imposed on States by the former seem to bite deeper than those imposed by the latter. It may also be said that the level of intrusiveness into national regulatory prerogatives of an international legal regime providing for the reasonableness principle as its core normative standard (i.e., rationality-based regime) is on its face higher than that stemming from a regime based on the NT principle (i.e., non-discrimination-based regime).

By focusing specifically on the experience of the WTO and NAFTA in promoting trade and investment across countries through the NT principle and the reasonableness principle (i.e., Articles III/XX GATT and 1102 NAFTA; Articles 2 TBT and 1105 NAFTA), this paper tries, first of all, to show that the two norms under consideration do not represent two completely different legal paradigms. On the contrary, the overlap between non-discrimination and reasonableness is quite broad and, depending on the actual drafting, it may even be total. Secondly, and without arguing for the total abandonment of the concept of nationality discrimination as an instrument for global economic governance, the paper argues that in terms of overall legitimacy, there are several reasons supporting the claim that a rationality-based regime should be favored to one based on non-discrimination.

From 'non-discrimination' to 'reasonableness': a paradigm shift in international economic law?

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Introduction

In the last fifty years, one of the core objectives of economic cooperation among States has been the promotion of transnational trade and foreign investment. This was premised on the belief that such cooperation would be instrumental, at a minimum, in the economic growth and development of each participating State, and, in certain cases, in the process of political integration among nations.[1]

While the difference in the long-term goals might have played a role in the pattern and extent of such cooperation, it is undisputed that in order to accomplish the above mentioned core objective (the promotion of trade and investment), a few basic legal instruments have been employed by many international agreements concluded at the bilateral, regional or multilateral level.[2]

Two of these basic legal instruments are, for example, the National Treatment (NT) principle and the reasonableness principle. In their general stance, the NT principle seems to require that a nation treat within its own borders, goods, services, investors, etc., originating from outside its borders, in the same manner as it treats those which are of domestic origin, and the reasonableness principle seems to mandate a certain level of rationality in the conduct of States, involving an examination of the relationship between the conduct of the State and the objective pursued by that State through such conduct. While both norms deal principally with national measures of legislative, administrative or judicial nature taken to regulate the internal market (so called 'internal measures') and are mostly managed by the 'judiciary',[3] they appear to represent two quite different legal paradigms.

By requiring each member to treat products and investors of the other member (at least) as well as it treats its own products and investors, the NT principle provides for a "relative" standard of treatment.[4] This may be shown, for example, by a prohibition of

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[1] More fundamentally, the non-economic function of such cooperation might encompass friendship, peace, good relations, etc. as evidenced, for example, in early Friendship, Commerce and Navigation Treaties, the 1947 General Agreement on Tariffs and Trade (GATT) and the European Economic Community (EEC).

[2] Cf. Joseph HH Weiler (ed.), *The EU, the WTO and the NAFTA: Towards a Common Law of International Trade?* (Oxford, OUP, 2000); Joel Trachtman, "Trade and … Problems, Cost-Benefit Analysis and Subsidiarity", *EJIL* (1998); Federico Ortino, *Basic Legal Instruments for the Liberalisation of Trade: A Comparative Analysis of EC and WTO Law* (Oxford, Hart Publishing, 2003).

[3] Contrary to common understanding, it is believed that both the NT principle and reasonableness principle, as employed in international economic law, should be characterized, in light of their general nature, as instruments of "judicial positive integration", rather than as instruments of "negative integration". Contrary to rules restricting or prohibiting Member States' use of specific types of governmental measures (like tariffs or quotas), the principal function of the non-discrimination and reasonableness principles is indeed to provide for a *positive* criterion (or standard) which Member States must comply with when exercising their regulatory authority. In other words, and taking the example of products, as long as States do not treat imported products less favorably than domestic products, or treat imported products unreasonably, they are at liberty to adopt, implement and enforce *any* type of measure regulating any aspect of the life of a product, from (a) the manner in which a product is manufactured or produced (process standards), (b) its characteristics (product standards) and (c) the way in which it is sold in the marketplace (marketing standards). Ortino, *Basic Legal Instruments*, supra, at 24-27.

[4] Sherif H. Seid, *Global Regulation of Foreign Direct Investment* (Aldershot, Hampshire, England: Ashgate, 2002) at 44; Paul E. Comeaux & N. Stephan Kinsella, *Protecting Foreign Investment under International*

country X on the capture and sale of shrimps caught with turtles-unfriendly nets on the basis of environmental/animal health protection. As long as the ban applies to all shrimps, whether imported or domestically-produced, in the same manner, the NT principle will not be violated, even though a neighboring country may believe that such a ban is unreasonable and that it constitutes a severe restriction on its own exports. In other words, the NT principle does not guarantee a specific level of protection or that foreign products or investors will receive a "fair" or "reasonable" treatment. It simply guarantees against States affording foreign products and investors less favorable treatment compared to that granted to domestic products and investors.

From this basic feature, one additional consideration should be emphasized. The NT principle does not by itself pursue the harmonization of national regulatory regimes. Such principle permits members to choose the policies and the level of protection they wish to pursue, as well as the instruments they believe more appropriate to reach such goals, as long as they do not afford more favorable treatment to their own products and investors. To take the shrimp example once again, there is no "right" policy on turtle protection stemming from the NT principle. Thus, a member may decide to prohibit completely the sale of shrimps caught with turtles-unfriendly nets, allow it without any restriction or allow it but only under certain conditions and specifications, without, in such a way, breaching the obligation to treat foreign products less favorably than domestic ones.

On the other hand, the reasonableness principle provides for an "absolute" standard of treatment, in as far as it requires States to recognize to foreign products and investors a certain (minimum) level of treatment, the determination of which does not have to depend on the treatment afforded to domestic products and investors. The above mentioned law in country X prohibiting the sale of shrimps caught with turtles-unfriendly nets on grounds of environmental or animal health protection, while it may not appear to discriminate between imported and domestic products, it could be found to be unreasonable on several grounds: for example, because the measure might be ineffective in protecting turtles, or because there may be other means of pursuing the same goal which are not so detrimental to foreign exporters of shrimps, or because the objective itself might be thought to be unreasonable since it may have an excessive impact on the interests of foreign fishermen. It may even be argued that such a ban is unreasonable because country X has promulgated its measure in a non-transparent manner or without consulting, or taking into account the views of, other interested States.

While the imposition of the reasonableness principle does not *sic et sempliciter* bring about harmonization between national regulatory regimes, it certainly appears to be striving in that direction, in particular where the principle is interpreted to cover the

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Law: Legal Aspects of Political Risk (Dobbs Ferry, New York: Oceana Publications Inc., 1997) at 44 and 106. Cfr. M. Sornarajah, *The International Law on Foreign Investment* (Cambridge, CUP, 2004) and Peter Muchlinski, *Multinational Enterprises and the Law* (Oxford, Blackwell Publishers, 1999).

reasonableness of the policy objectives pursued by the State and where the function of adjudicating such reasonableness is attributed principally to one central, sovra-national institution.

In these terms, the reach of the reasonableness principle appears, without doubt, to be quite broad compared to that of the NT principle. The normative standards imposed on States by the former seem to bite deeper than those imposed by the NT principle. Consequently, it may be said that the level of intrusiveness into national regulatory prerogatives of an international legal regime providing for the reasonableness principle as its core normative standard (i.e., rationality-based regime) is on its face higher than that stemming from a regime based on the NT principle (i.e., non-discrimination-based regime).

By focusing specifically on the experience of the WTO and NAFTA in promoting trade and investment across countries through the NT principle and the reasonableness principle, this paper tries, first of all, to show that the two norms under consideration do not represent two completely different legal paradigms. On the contrary, the overlap between non-discrimination and reasonableness is quite broad and, depending on the drafting of the latter, may even be total. Secondly, and without arguing for the total abandonment of the concept of nationality discrimination as an instrument for global economic governance, the paper argues that in terms of overall legitimacy (as measured by the general acceptability and soundness of the outcomes in applying a certain mechanism) there are a few reasons supporting the claim that a rationality-based regime should be favored to one based on non-discrimination. Paraphrasing the words of Thomas Kuhn, these two related arguments may be summed up by stating that the shift from non-discrimination to reasonableness represents "progress *without* revolution".[5]

Our comparison is both across "legal instruments" and across "legal systems". The NT provisions under consideration in the present analysis are, on the one hand, Article III:4 GATT (together with Article XX GATT, which provides for the exception) and, on the other hand, Article 1102 NAFTA. The reasonableness provisions are, on the one hand, Article 2 of the Agreement on Technical Barriers to Trade (TBT Agreement) and Article 1105 NAFTA on the "Minimum standard of treatment".

In part I, the paper looks at the principle of National Treatment describing the concept of nationality discrimination (A) and the applications of the NT provisions within the context of the WTO and NAFTA (B). Part II focuses instead on the reasonableness principle highlighting its basic features and its application in WTO and NAFTA case-law. In part III, the two interrelated arguments of the paper are laid out.

[5] Thomas S. Kuhn, *The Structure of Scientific Revolutions* (Chicago and London, University of Chicago Press, 1962).

I. The National Treatment (NT) principle

A. Delineating the concept

While the underlying objective of the NT principle has been the promotion of trade and investment, its basic function has focused more strictly on protecting foreign products (or merchants) and investors vis-à-vis internal regulation affording more favorable treatment to domestic products (or merchants) and investors. This is evidenced in early treaties of friendship, commerce and navigation,[6] in the GATT 1947,[7] as well as in international investment agreements (IIAs) of the 21st century.[8]

In order to ensure the protection of foreign products and investors, international economic agreements prohibit discriminating products and investors on the basis of their origin or nationality. Thus, the NT principle is simply an application of the better known general prohibition of discrimination based on nationality (or more simply the prohibition on 'nationality discrimination').

Before moving to the analysis of its normative content, one preliminary point, which in the legal debate over the prohibition on 'nationality discrimination' or the NT principle appears to go relatively unnoticed, should be here emphasized. At least in

[6] The 1667 Treaty of Peace and Friendship between Great Britain and Spain "[…] it is likewise agreed, that for the merchandise which the subjects of the King of Great Britain shall buy in Spain […] and shall carry in their own ships […] no new customs, toll, tenths, subsidies, or other rights or duties whatsoever, shall be taken or increased, other than those which, in the like case, the natives themselves, and all other strangers are obliged to pay; and the subjects aforesaid, buying, selling, and contracting for their merchandise, as well in respect of the prices as of all duties to be paid, shall enjoy the same privileges which are allowed to the natural subjects of Spain; […]". See Great Britain, *Handbook of Commercial Treaties & C., between Great Britain and Foreign Powers* (London: Printed & Pub. by H.M. Stationary, 1924) at 732. See also the 1826 Convention of Commerce and Navigation between Great Britain and France, where the two contracting parties were "[…] equally animated by the desire of facilitating the commercial intercourse between their respective subjects; […]". Id. at 184.

[7] Article III:1 states in part that "internal … laws, regulations and requirements … should not be applied to imported or domestic products so as to afford protection to domestic production". While the claim that the NT principle in Article III GATT was aimed at the protection of the concessions granted through tariff negotiations may have some historical credibility, it does not capture fully the role that this basic norm has played within the GATT/WTO system. One should simply refer to the Report of the Working Party on *Brazilian Internal Taxes* which stated that "a contracting party was bound by the provisions of Article III whether or not the contracting party in question had undertaken tariff commitments in respect of the goods concerned". GATT/CP3/42, adopted on 30 June 1949, II/181, at para. 4. Cf. Henrik Horn & Petros Mavroidis, "Still Hazy after All These Years: The Interpretation of National Treatment in the GATT/WTO Case-law on Tax Discrimination", 15 *European Journal of International Law* 1 (2005).

[8] In this light, "liberalization" of national trade and investment regimes (i.e., the lowering of regulatory barriers to trade and investment) should be seen as a mere consequence (whether purposefully pursued or not) of the imposition of such a principle. However, as it will be illustrated below, the liberalization "effects" of the NT principle change greatly depending on the actual scope given to such a principle by the legislator or the interpreter. Cf. Grainne de Burca, "Unpacking the concept of discrimination in EC and international trade law", in Catherine Barnard and Joanne Scott (eds.), *The Law of the Single European Market: Unpacking the Premises* (Oxford: Hart Publishing, 2002) at 188 *et seq*. With regard to investment, moreover, liberalization also depends on the scope of application of the NT principle: while traditional IIAs have limited the application of the NT obligation to the post-establishment phase of the investment, a few more recent agreements (such as United States, Canadian BITs and FTAs) also extent the pre-establishment phase of the investment within the scope of protection of the NT principle.

theoretical terms, the NT principle does not equate to the principle of equality. While the two principles share several common features, contrary to the broad principle of equality, which requires, in very simple terms, that equal be treated in equal manner and unequal in unequal manner, the NT principle rests on the prohibition of using *nationality* or *origin* (of the product or investor) as the explicit or implicit regulatory criterion. At this stage, I am simply content with underlying the conceptually more limited nature of the NT principle compared to the equality principle. Requiring that equal products be treated equally is more than simply requiring that *foreign* products be treated as favorable as like *domestic* products.[9] The "national" element in the latter proposition is supposedly what shapes and defines the concept of *national* treatment (similarly, a ban on sex discrimination does not mean a ban on all discrimination but simply those based on sex). Accordingly, I will refer to the NT principle also as the prohibition on "nationality discrimination" to distinguish it from the broader prohibition of (any) discrimination.[10]

However, having made this theoretical distinction, it is also fair to note that, in practical terms, the line between the principle of equality and the NT principle does not appear to be so clearly marked. When one moves from explicit forms of nationality discrimination to more covert and indirect ones, the two principles seem to be susceptible of similar applications: instead of focusing on whether *foreign products* are treated less favorably than similar *domestic products*, one may focus more simply on whether a *foreign product* is treated less favorably than a similar *domestic product*, which means almost the same thing as whether similar products are treated equally. As it will be emphasized in the following analysis, this is exactly what has at times happened to the NT principle in international economic jurisprudence.[11] In the present analysis, I will try to be theoretically rigorous and keep the NT principle as a subcategory of the principle of equality, highlighting, whenever possible, the points of intersection.

1. Language, effect, inherence and intent: different ways of understanding nationality discrimination

What does one mean by granting NT? How far does the concept of nationality discrimination go (and thus the provision prohibiting it)? Although there may be several ways in which this concept may be understood, one could capture most of them by focusing on four possible key features of an allegedly discriminatory measure: language,

[9] In this respect, 'mandating no less favorable treatment' or 'prohibiting discrimination' should be viewed simply as the two sides of the same coin: the 'positive' and 'negative' functions of the principle at hand.

[10] It should be clear that a prohibition on nationality discrimination fits well in a construct aimed at the promotion of international trade and foreign investment. In political terms, it is a precondition for multilateralism and, in economic terms, it guarantees the competitive conditions between foreign and domestic production and capital. On the other hand, the principle of equality (or of non-discrimination *tout court*) is premised more profoundly on the notion and value of justice, which, at least up until today, does not appear to be at the core of international economic relations. Cf. Lothar Ehring, "De Facto Discrimination in WTO Law: National Treatment and Most-Favoured-Nation Treatment—or Equal Treatment?", *Jean Monnet Working Paper* (NYU School of Law, 2002) and 36 *Journal of World Trade* (2002) 921-977.

[11] See *infra* section II on NAFTA Chapter 11 case-law.

effect, inherence and intent. Even though dimensions of all four features may be used cumulatively, disaggregation is useful in order to clarify each distinct feature.

The first concept is based on the discriminatory "language" of the national measure under review, more commonly known as formal or *de jure* discrimination. It has been hinted, quite appropriately, that the NT principle appears to have been developed in international economic law with formal discrimination in mind.[12] Formal discrimination on grounds of nationality may occur when a measure *explicitly* divides on the basis of the nationality of the product or investor. In other words, the measure is said to breach the NT principle because it employs the prohibited factor (nationality) as *the* differentiating criterion. For example, a domestic fiscal regime which requires foreign companies to pay 20% corporate tax, while domestic companies need only pay 10% would presumptively be caught by the prohibition of nationality discrimination since companies are subject to differential taxation expressly on the basis of their nationality.

In light perhaps of the limited reach of formal discrimination, the prohibition of nationality discrimination has been extended to cover notions of substantial or material discrimination. In other words, formally *different* treatment may not in itself constitute unequal treatment, if the different treatment is predicated on grounds of substantial equality between foreign and domestic products or investors (e.g., taxing domestic and foreign companies differently in order to avoid double taxation). Similarly, formally *identical* treatment does not guarantee by itself equal treatment, if the identical treatment has a detrimental effect or impact on foreign vis-à-vis domestic products or investors (e.g., requiring all investors a particular qualification or authorization, only available domestically, will have, to a very large extent, the same dividing effect as a rule excluding foreign investors, although the rule formally contains no reference to the nationality of the investor). This is material or *de facto* discrimination on grounds of nationality.[13] The thorny questions surrounding the concept of material discrimination relate to the *determination* of the products or investors whose treatment should be compared, as well as the *type* and *amount*[14] of detrimental effect which is necessary to establish *de facto* discrimination.

While discrimination based on the mere "detrimental impact" or "adverse effect" on foreign products or investors is perhaps the concept that captures the broadest spectrum of nationality discrimination, there are other ways in which the prohibition on nationality discrimination may be understood. One is based on the *inherent* discriminatory character of the national measure under review. For example, regulatory measures which treat residents and non-residents differently are perhaps the best known cases of this type of

[12] Robert Hudec, "GATT/WTO constraints on national regulation: requiem for an 'aim and effects' test", 32 *International Lawyer* (1998) 619 at 622.
[13] See Gareth Davies, *Nationality Discrimination in the European Internal Market* (The Hague/London/New York: Kluwer Law International, 2003) at 10-11.
[14] This is where a broad interpretation of what constitutes material discrimination on grounds of nationality may equate in practical terms to the principle of equality.

discrimination.[15] Since most residents are nationals and most non-residents are not nationals, this type of regulatory requirement or distinction may be said to be inherently discriminatory vis-à-vis foreigners. One could be inventive and include also regulatory requirements/distinctions based on language (i.e., only lawyers that speak Swedish can practice law in Sweden), religion (i.e., only catholic teachers may be employed in Italian public schools), geographical differences (i.e., only wine above 15% in alcohol content may be sold in Malta as wine), and so forth.[16] It is obvious, however, that defining when a national measure is inherently discriminatory may constitute a rather difficult task,[17] and depending how rigorous or loose such concept is defined, the reach of the NT principle changes dramatically.

A further possible way to understand nationality discrimination is based on the discriminatory *intent* of the national legislator. This view seems to be premised essentially on the objective of eradicating protectionism. Although discriminatory or protectionist intent may be said to be more or less objectively identified, it seems that the fundamental feature of this strand resides on attributing relevance to the policy purposes of the national measure under review. In other words, in order to detect discriminatory or protectionist intent, an inquiry over the policy reasons underlying the national measure needs to be carry out.[18] If a valid argument can be made that the measure under question has been taken to pursue a legitimate public policy, this can be used as evidence disproving the existence of protectionist intent. To take the examples given above, while a qualification requirement available only domestically may be said to have discriminatory effects (or detrimental impact) vis-à-vis foreign investors, there will not be a protectionist *intent* if the qualification is deemed to be somehow related to, or justified by, the pursuit of a legitimate regulatory purpose such as consumer protection.

2. Nationality discrimination and public policy justification

The other question which needs to be addressed is whether and to what extent the policy reasons underlying the discriminatory treatment of foreign products or investors play any role in the functioning of the NT principle. In other words, may a measure that has, for example, detrimental impact (or adverse effect) on foreign vis-à-vis domestic products or

[15] See ECJ jurisprudence on free movement of services and Piet Eeckhout, "Constitutional concepts for free trade in services", in Grainne de Burca & Joanne Scott (eds.) *The EU and the WTO: Legal and Constitutional Aspects* (Oxford: Hart Publishing, 2001) at 233-34, who calls this type of discrimination "indirect" discrimination to distinguish it from a purely factual or effects-based discrimination.

[16] See also Robert Howse and Elisabeth Tuerk, "The WTO impact on internal regulations: a case study of the Canada-EC Asbestos dispute", in de Burca & Scott (eds.) *The EU and the WTO*, supra, at 283; Markus Krawjeski, *National Regulation and Trade Liberalization in Services* (The Hague/London: Kluwer Law International, 2003) at 108-14.

[17] Grainne de Burca, "Unpacking the concept of discrimination in EC and international trade law", supra, at 189.

[18] On the relevance of protectionist intent, see Hudec, "GATT/WTO Constraints on Domestic Regulation", supra, at 625-26; Donald Regan, "Regulatory Purpose and "Like Products" in Article III:4 of the GATT", 36 *Journal of World Trade* (2002) at 443-44; M Danusso and R Denton, "Does the European Court of Justice look for a protectionist motive under article 95?", *LIEI* (1990).

investors be said to discriminate even though, on balance, it is a sensible measure? For example, a rule allowing insurance to be sold only by licensed companies may be a necessary requirement in order to protect consumers, but may also hinder foreign insurance providers which are disadvantaged by such a requirement.

The question here deals with the relationship between discrimination and the policy justification underlying the measure at issue. This relationship changes depending on what one means by 'discrimination'. If one takes the effect-based notion of discrimination (does the measure have discriminatory effects, or, to be more precise, does it have detrimental impact on foreign products or investors?), than it might be said that the issue of justification (is the measure, nonetheless, a sensible rule?) is distinct from a finding of discrimination. This seems to be true also for the criteria based on 'inherence' and 'language'. One can deal with these types of prohibition on nationality discrimination (i.e., defined on the basis of 'language', 'inherence' or 'effect') by saying that some kinds of discrimination are justified, thus adopting a sort of two-step analysis:

Step 1	Step 2
discriminatory language *or* *inherently discriminatory character* *or* *detrimental impact vis-à-vis foreign products/investors* = *violation of the NT principle,*	*unless it is* *justified*

However, as seen in the preceding section, if one focuses on protectionist 'intent' (is the purpose of the measure to protect domestic production or capital?), an inquiry over the policy reasons underlying the national measure might be said to become an almost indispensable tool in order to determine whether the measure discriminates on grounds of nationality. Accordingly, in the case of a national measure which, despite its disparate impact vis-à-vis imported products or foreign investors, is justified on policy grounds, one can say that discrimination does not exist at all. This is the so called one-step analysis, where 'justification' considerations are entangled within, and are part of, an assessment of 'discrimination':

Step 1
unjustified detrimental impact on foreign products/investors = *protectionist intent* = *violation of the NT principle*

This is not simply a structural issue (i.e., in order to appreciate detrimental effects, one does not need to take into account policy justifications, while, in order to identify protectionist intent, one does). The fundamental point in the relationship between 'discrimination' and 'justification' deals with the normative choice made by the 'legislator' when imposing, or the 'interpreter' when applying, the NT principle. On one extreme, the prohibition of nationality discrimination may simply mean that *only* formal discrimination based on the nationality of products or investors is not permitted (option 1). This prohibition may either be supplemented by a clause according to which formally discriminatory measures may be justified on public policy grounds (option 1A), or be an absolute rule with no possibility to take into account public policy considerations (option 1B). On the other extreme, the same prohibition may be extended to reach all national measures with mere detrimental impact on foreign products or investors (i.e., material discrimination; this is option 2). Again, such a prohibition may either be accompanied by a justification provision (option 2A) or be an absolute rule (option 2B). Options 1B and 2B (the absolute rule) stress the normative relevance of the discriminatory 'language' or 'effect' of national measures. There is no possibility of justifying such language and effect on public policy grounds. By adding a justification provision (options 1A and 2A), the normative relevance of the discriminatory 'language' and 'effect' somehow diminishes, since there are other values and interests that need to be taken into account.[19]

Two further points should be emphasized. First, on a practical level, it is not too difficult to appreciate that, while option 1B (absolute ban on discriminatory language) could be accepted, option 2B (absolute ban on discriminatory effect) would encounter serious problems. As seen before, there is a great proportion of national measures with a detrimental impact on foreign interests, which are nonetheless sensible and necessary rules. Should they all be prohibited?

Second, while in option 1A (ban on discriminatory language with possibility of justification) the normative balance between 'discrimination' and 'justification' appears to remain clearly tilted in favor of the former (that is, in most cases, formal discrimination will be difficult to justify), in option 2A (ban on discriminatory effect with possibility of justification) this balance seems at least to be evenly distributed among the two competing values. Possibly, and this is what it will be argued here, when the NT principle is extended to cover national measures with detrimental impact (on foreign products/investors), the normative focus of the principle is not on the detrimental impact *per se*, rather on whether the measure (with detrimental impact) is related to a legitimate regulatory purpose (i.e., is justified on public policy grounds).[20] The fact that the national measure has detrimental impact becomes almost a secondary issue (a sort of 'threshold' question), where the justification analysis is the real normative test. Independently of whether one defines

[19] There will also be a normative difference if public policy considerations come into play as part of the finding of discrimination (one-step analysis) or at the stage of justifying such discrimination (two-step analysis).

[20] It is not relevant here whether justification is addressed separately from, or is part of, the determination of discrimination.

nationality discrimination on the basis of 'effect' and thus uses the two-step approach or one defines nationality discrimination on the basis of 'intent' using the one-step approach, in both cases the relevant (normative) inquiry appears to be the determination of whether the measure at issue is justified on public policy grounds.

B. Comparative experience: Articles III:4/XX GATT and 1102 NAFTA

The two NT provisions under examination are similarly worded. Article III GATT provides in relevant part as follows:

> 1. The Contracting Parties recognize that […] laws, regulations and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution or use of products, […] should not be applied to imported or domestic products so as to afford protection to domestic production.
> […]
> 4. The products of the territory of any contracting party […] shall be accorded treatment no less favourable than that accorded to like products of national origin in respect of all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use. […]"

Similarly, Article 1102 NAFTA states that:

> 1. Each Party shall accord to investors of another Party treatment no less favorable 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.[21]

Interestingly enough, while the GATT provides for a general exception provision (Article XX), no general exception is included in NAFTA Chapter 11 on investment. Article XX GATT states in part as follows:

> Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade, nothing in this Agreement shall be construed to prevent the adoption or enforcement by any contracting party of measures:
> (a) necessary to protect public morals;
> (b) necessary to protect human, animal or plant life or health;
> […]
> (g) relating to the conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption;

[21] The second paragraph of Article 1102 NAFTA affords NT protection to 'investments' of investors. It states as follows: "Each Party shall accord to investments of investors of another Party treatment no less favorable 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."

[…]

Although the practical application of the NT principle may revolve around several key concepts,[22] whose exact interpretation is still subject to much debate,[23] the two indispensable pillars of the NT principle are (1) nationality discrimination and (2) public policy justification. Independently of its formal structure—two separate provisions setting out the non-discrimination rule and the public policy exception (such as Articles III and XX GATT) or one provision *de facto* incorporating both (such as Article 1102 NAFTA)—the NT principle has so far been envisioned in the two systems under consideration as a two-step analysis: the adjudicator needs to determine, first, the existence of "nationality discrimination" and, second, the existence of a "public policy justification". Accordingly, this is how this section is subdivided.

At this stage it is perhaps useful to highlight the principal findings of the comparative analysis of the NT principles in NAFTA and WTO law, which I will undertake in this section. From a structural point of view, there is a difference in the nature of the analysis of "nationality discrimination" and that of "public policy justification": the former deals mostly with the detrimental impact of the national measure at issue *vis-à-vis* foreign products or investors; the latter deals with the legitimacy and reasonableness of the national measure in light of the public policy objective pursued by the Member. More specifically, (i) the concept of nationality discrimination has been defined on the basis of discriminatory 'effect'(thus it focuses on whether the origin-neutral internal measure has a detrimental impact vis-à-vis foreign products or investors) and (ii) the review of the public policy justification has focused principally on a review of the measure's substantive and procedural reasonableness. From a more evaluative perspective, (iii) the dichotomy between the "non-discrimination rule" and the "public policy exception" appears to

[22] These include principally: (a) the relationship between products or investors, (b) the national measure's adverse impact on foreign products or investors vis-à-vis domestic ones, (c) the legitimate policy objective justifying the national measure at issue, and (d) the relationship between the measure and the relevant policy objective. These four concepts, which might be found explicitly in the text of the NT provisions or simply stem from their interpretation by the relevant judicial bodies, play different or multiple roles in the two regimes under consideration.

[23] Henrik Horn & Petros Mavroidis, "Still Hazy After all these years: The interpretation of National Treatment in the GATT/WTO case-law on tax discrimination", 15 *EJIL* (2004); Henrik Horn & Joseph HH Weiler, "EC-Asbestos: European Communities -- Measures Affecting Asbestos and Asbestos-Containing Products", in Henrik Horn & Petros C. Mavroidis (eds) *The WTO Case Law of 2001: The American Law Institute Reporters' Studies* (Cambridge University Press, 2004); Donald H. Regan, "Further Thoughts on the Role of Regulatory Purpose Under Article III of the General Agreement on Tariffs and Trade -- A Tribute to Bob Hudec", 37 *Journal of World Trade* 4 (2003) 737–760; Amelia Porges and Joel P. Trachtman, "Robert Hudec and Domestic Regulation: The Resurrection of Aim and Effects", 37 *Journal of World Trade* 4 (2003) 783–799; Ole K. Fauchald, "Flexibility and Predictability Under the World Trade Organization's Non-Discrimination Clauses", 37 *Journal of World Trade* 3 (2003), 443–482; Donald Regan, "Regulatory Purpose and "Like Products" in Article III:4 of the GATT", 36 *Journal of World Trade* 3 (2002), 443–478; Lothar Ehring, "De Facto Discrimination in WTO Law: National and Most-Favored-Nation Treatment—or Equal Treatment?", 36 *Journal of World Trade* 5 (2002), 921; Gaetan Verhoosel, *National Treatment and WTO Dispute Settlement* (Oxford, Hart Publishing, 2002); Thomas Cottier & Pedros Mavroidis (eds.), *Regulatory Barriers and the Principle of Non-Discrimination in World Trade Law* (Ann Arbor, University of Michigan Press, 2000); D Martin, "'Discrimination', 'entraves' et 'raisons impérieuses' dans le traité CE: trois concept en quête d'identité", 34 *CDE* (1998) 261.

establish a ranking of values where trade liberalization or investment protection represents the fundamental policy and other legitimate policy objectives are relegated to the status of secondary or exceptional policies. Moreover, there exist (iv) a correlation between the scope of the nationality discrimination test and the scope of the public policy justification (i.e., while a narrow justification exception usually tends to correspond to a narrow discrimination requirement, a broad justification avenue usually tends to correspond to a broad discrimination test).

3. Existence of nationality discrimination

The interpretation of the two NT provisions under consideration shows clearly that the NT principle has been extended beyond formally discriminatory (origin-based) measures to include also materially discriminatory (origin-neutral) measures. Accordingly, nationality discrimination in these two contexts has been defined not just on the basis of discriminatory 'language', but on the basis of discriminatory 'effect' or 'detrimental impact' on foreign products or investors.

This has usually followed from the general understanding that the NT provision should guarantee not simply *formal* but mostly *effective* equality of opportunities for imported and domestic products and investors. As clearly noted in the *Section 337* GATT panel report, "there may be cases where application of *formally* identical legal provisions would *in practice* accord less favourable treatment to imported products and a contracting party might thus have to apply different legal provisions to imported products to ensure that the treatment accorded them is *in fact* no less favourable."[24] Moreover, the emphasis on effective equality between domestic and foreign products and investors has not meant that a determination of nationality discrimination needs to be made on the basis of an examination of the *actual* or *past* application of the measure under review. On the contrary, since the NT principle is understood as protecting equality of "opportunities" or "expectations" on the competitive relationship between domestic and foreign products and investors, *potential* or *future* discriminatory application of the national measure at issue is enough for purposes of a finding of an NT violation.[25]

Thus, the jurisprudence applying the two NT provisions under consideration to cases of allegedly *de facto* nationality discrimination shows a similarity of approaches. Nationality discrimination in NAFTA and GATT case-law focuses on a relatively structured analysis of the discriminatory/protectionist *effect* of the measure under review

[24] Panel Report on *United States—Section 337 of the Tariff Act of 1930* (*Section 337*), L/6439, adopted on 7 Nov 1989, BISD 36S/345, para.5.11 [emphasis added].

[25] In the investment portion of the *Mexican Trucking* case, the NAFTA Tribunal made a clear reference to the long-established doctrine under the GATT and WTO holding that where a measure is inconsistent with a Party's obligations, it is unnecessary to demonstrate that the measure has had an impact on trade. *Mexican Trucking*, para. 289. Although this dispute involved a case of *de jure* discrimination, the obligation to afford national treatment may be interpreted to address both actual and potential negative effects on foreign investors independently of whether the measure is deemed to be formally or materially discriminatory.

involving the following three key elements: "likeness", "less favourable treatment", and "nationality imbalance". Let us briefly examine them in turn.

A. Likeness

Although the concept of 'likeness' may play multiple roles in the operation of the NT principle, within the analysis of nationality discrimination a determination of likeness has focused principally on the nature and extent of the *competitive relationship* between products or investors. In line with the function of the NT principle, which is to address discriminatory or protectionist measures, only products or investors that are in a competitive relationship in the marketplace can be affected by the less favourable treatment accorded to a sub-category of those products or investors.[26]

Accordingly, in the context of Article 1102 NAFTA violation claim, NAFTA tribunals may need to identify the domestic entities whose treatment should be compared with that accorded to the investor (or investment) alleging such violation.[27] Pointing at the potentially broad meaning of the term "like circumstances", NAFTA tribunals have concluded that the relevant comparison involves, first of all, investors and investment in the "same business or economic sector". In particular, they have looked, albeit in a very summarily manner, at the competitive relationship between the corporate entities involved in the dispute. For example, in *Myers*, the Tribunal noted that the foreign and domestic investors involved in the dispute were engaged in providing the same service (PCB waste remediation) and that the foreign investor "was in a position to attract customers that might otherwise have gone to the domestic operators because it could offer more favorable prices and because it had extensive experience and credibility."[28]

In the GATT context, review of origin-neutral regulation under Article III:4 has usually included a rather extensive determination of the relationship between domestic and imported products. This is due to the fact that claims against origin-neutral regulation under Article III have mostly been based on the argument that an apparent origin-neutral differentiation between two allegedly similar products constituted hidden or material discrimination on the basis of the origin of the products (what I have defined as a case of "formally different treatment of similar products with allegedly *de facto* discriminatory

[26] The term "like circumstances" has also a second meaning or function which deals with whether the differentiation is justified on public policy grounds. This second meaning will be analyzed below.

[27] The "likeness" issue is not relevant in cases of formally discriminatory measures (since the measure itself does not distinguish among investors except on the basis of their nationality) and in cases of formally *identical* treatment of *identical* investors (or products) with *de facto* discriminatory effects on imported investors (or products).

[28] The Tribunal added that: "It was precisely because SDMI was in a position to take business away from its Canadian competitors that Chem-Security and Cintec lobbied the Minister of the Environment to ban exports when the U.S. authorities opened the border." (Myers, 2000, para. 251). In *ADF*, the Investor claimed that it was in like circumstances since it operated in the same sector, sold the same product and competed for the same customers as the domestic investors. It bought the same input, treated that input the same way and delivered the same fabricated steel to the same clients. *ADF*, para. 64. See also, *Feldman*, para. 172.

effects on imported products").[29] A recent dispute of this kind is the *Asbestos* dispute,[30] where Canada claimed that the differential treatment by France of two allegedly similar products (chrysotile fibre—also known as asbestos—was banned, while substitute fibres, such as PVA, cellulose or glass fibres, were permitted) altered the conditions of competition between Canadian production of asbestos (and asbestos-products) and French production of allegedly similar substitute fibres (and related products).[31] The Appellate Body Report in the *Asbestos* dispute focused extensively on the heavily-litigated issue of whether (banned) chrysotile fibres and (permitted) substitute fibres were "like" for purposes of Article III GATT. While it noted the need to examine, in each case, *all* of the pertinent evidence,[32] including first of all the four general criteria that had been followed in previous GATT/WTO jurisprudence (physical properties, end-uses, consumers' tastes and habits, and tariff classification),[33] the AB emphasized that, under Article III:4, the term 'like products' is concerned with competitive relationships between and among products.[34] Notwithstanding the fact that the AB rejected the Panel's finding of likeness, it is worth noting the dissent of one of the AB members as evidence of a certain uneasiness with a broad interpretation of likeness within the context of Article III and origin-neutral measure.

B. Less favourable treatment

In establishing whether a measure affords "less favorable treatment" to foreign investors or products, NAFTA and WTO tribunals focus on the incriminated measure's "adverse effect" on foreign investors (and their investments) or on foreign products, while intent does not seem to be an indispensable element.[35] In *Myers*, the NAFTA Tribunal stated as follows:

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[29] There have also been cases where Members have argued that a formally origin-neutral measure violated the NT obligation on the basis that such measure *de facto* upset the competitive relationship between domestic and imported "identical" products. I have referred to this type of claim as the case of "formally *identical* treatment of *identical* products with *de facto* discriminatory effects on imported products". See infra *Japan—Measures Affecting Consumer Photographic Film and Paper* (*Kodak—Fuji*) (WT/DS44).

[30] *European Communities – Measures Affecting Asbestos and Asbestos-Containing Products* (*EC – Asbestos*), WT/DS135.

[31] Panel Report on *EC – Asbestos*, paras. 3.12 and 8.151.

[32] Appellate Body Report on *EC – Asbestos*, para. 102.

[33] See Report of the Working Party on *Border Tax Adjustments*, L/3464, adopted on 2 December 1970, BISD 18S/97. Cf Appellate Body Report on *EC – Asbestos*, para. 101.

[34] Moreover, the AB seems to suggest that for a finding of likeness *all* of the relevant criteria, not only have to be taken into account, but they need to point overall to 'likeness'. The Appellate Body confirms this impression by emphasizing that, if *any* of the relevant criteria suggests that the products are not like, the burden of proving likeness becomes quite heavy. In other words, in line with the relevant burden of proof, the Appellate Body appears to make more difficult the case for 'likeness' than that for 'unlikeness'. Appellate Body Report on *EC – Asbestos*, paras. 117-18. For a different interpretation see Robert Howse & Lisi Tuerk, "The WTO Impact in Internal Regulations—A Case Study of the *Canada—EC Asbestos* Dispute", supra, at 304.

[35] This is what Horn & Weiler term the "objective approach" to the interpretation of Article III GATT: "The yardstick for determining whether 'less favorable treatment' has been rendered does not take into account any rationale for differential treatment, such as differences in health impact, but only captures the effect of the measure." Henrik Horn & Joseph Weiler, "EC-Asbestos: European Communities -- Measures Affecting Asbestos and Asbestos-Containing Products", supra, at 21-22.

> Intent is important, but protectionist intent is not necessarily decisive on its own. The existence of an intent to favour nationals over non-nationals would not give rise to a breach of Chapter 1102 of the NAFTA if the measure in question were to produced no adverse effect on the non-national complainant. The word "treatment" suggests that practical impact is required to produce a breach of Article 1102, not merely a motive or intent that is in violation of Chapter 11.[36]

The relevance of this statement by the majority in *Myers* should be emphasized in light of the separate opinion submitted by the third arbitrator, Dr. Schwartz, which had focused primarily on an assessment of protectionist intent.[37] However, in line with the function recognized to the NT principle of protecting equality of opportunities or expectations, this statement should not be read to require a demonstration of "actual" adverse effect; rather "potential" adverse effects are sufficient.[38]

The nature of the examination of the measure's "adverse effect" does not change depending on the type of material discrimination claim advanced by the Member (whether based on the alleged illegitimate *equal* treatment of two *different* situations or based on the alleged illegitimate *different* treatment of two *similar* situations). The aim is always to establish whether the national measure (either treating all products or investors equally or treating similar products or investors differently) upsets the competitive relationship between domestic and imported products/investors.

The only WTO report that dealt with this issue in a case of an origin-neutral regulation is the *Kodak—Fuji* case. In that dispute, the United States claimed that the application by the Japanese government of several liberalisation 'countermeasures' (*taisaku*) had for more than 30 years *de facto* inhibited the distribution and sale of imported consumer photographic film and paper in Japan.[39] The Japanese measures under review included: (1) distribution 'measures', which allegedly encouraged and facilitated the creation of a market structure for photographic film and paper in which imports were excluded from traditional distribution channels;[40] (2) restrictions on large retail stores,

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[36] *Myers*, para. 254. In Pope & Talbot, the Tribunal also seems to look at the effects in determining whether the Canadian measure at issue afforded less favorable treatment to the foreign investor. See, for example, *Pope & Talbot*, para. 102.

[37] See separate opinion by Dr. Bryan Schwartz on 12 November 2000, which clearly (and unfortunately) constituted the basis for the drafting of the majority opinion.

[38] In *Feldman*, the Tribunal found that on balance the US investor had been treated in a less favorable manner compared to domestically owned reseller/exporters of cigarettes (a *de facto* discrimination by the Mexican Ministry of Finance) in violation of Mexico's obligations under Article 1102 based on a very simple two-pronged conclusion. First, no cigarette reseller-exporter (i.e., the relevant category identified for purposes of the comparison) could legally have qualified for the tax rebates, since none would have been able to obtain the necessary invoices stating the tax amounts separately as required for the tax rebates. Second, the US investor was denied the rebates at a time when at least three other companies in like circumstances (all of Mexican nationality) were granted them. *Feldman*, para. 176.

[39] Panel Report on *Japan – Measures Affecting Consumer Photographic Film and Paper* (*Kodak – Fuji*), WT/DS44/R, circulated 31 March 1998, adopted 22 April 1998.

[40] The essence of the US claim in respect of this type of distribution 'countermeasures' was that Japan created vertical integration and single-brand distribution in the Japanese film and paper market through

which allegedly restricted the growth of an alternative distribution channel for imported film;[41] and (3) promotion 'measures', which allegedly disadvantaged imports by restricting the use of sales promotion techniques.[42] The US claim that the distribution 'measures' were inconsistent with Article III:4 of the GATT, was based on two arguments: first, vertical integration or single-brand distribution in the photographic film and paper sector in Japan negatively affected imports more than domestic products; second, the Japanese Government was responsible for promoting and facilitating such vertical integration and single-brand distribution.

Emphasizing the consistent focus of GATT/WTO jurisprudence on ensuring effective equality of competitive opportunities between imported and domestic products, the *Kodak—Fuji* Panel noted that even formally identical treatment of domestic and imported products may constitute less favourable treatment for imported products for the purpose of Article III:4.[43] The Panel stated, however, that in such circumstances, the complaining party is called upon to make a detailed showing of any claimed "disproportionate impact" on imports resulting from the origin-neutral measure, and the burden of demonstrating such impact may be significantly more difficult where the relationship between the measure and the product is questionable.[44] Following a thorough analysis, the Panel found in favour of Japan on all counts on the ground that the United States had not been able to show that the various 'measures' at issue had indeed upset the competitive relationships between domestic and US film and paper in the Japanese market.[45]

It may be useful here to note briefly the direction taken by the Appellate Body in applying the prohibition of *de facto* discrimination to fiscal charges under Article III:2 GATT. In determining whether a tax has been applied to protect domestic production, the Appellate Body has emphasized the relevance of the objective features of the measure under review, its design, architecture and structure,[46] showing a willingness to limit as much as possible the risks involved in applying a pure effects-based analysis. Thus, while the principal aim of the "protective application" calculation under Article III:2 appears to be the determination of the protectionist *effect* of the fiscal measure under review, this

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standardization of transaction terms, systemization and limitations on premiums to businesses. *Ibid*., para. 10.204.

[41] The United States asserted that the application of the Large Stores Law had negatively affected the relative competitive position of imported film in the Japanese market because it restricted the spread of large stores, which the United States claimed, on the basis of survey evidence, were more likely to carry imported film. *Ibid*., paras. 10.224-226.

[42] *Ibid*., para. 10.22.

[43] *Ibid*., para. 10.379, "[The] standard of effective equality of competitive conditions on the internal market is the standard of national treatment that is required, not only with regard to Article III generally, but also more particularly with regard to the "no less favourable treatment" standard in Article III:4."

[44] *Ibid*., para. 10.85.

[45] *Ibid*., paras. 10.204-10.208 and 10.381. Although the Panel was not really convinced by the US argument that single-brand distribution discriminated against imported products, the United States lost its case principally by failing to establish a cause-and-effect connection between the Japanese measures under review and the allegedly discriminatory market structure for photographic film and paper.

[46] Appellate Body Report on *Japan—Taxes on Alcoholic Beverages* (*Japan—Alcohol II*), WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, circulated 4 October 1996, adopted 1 November 1996, at 32.

calculation must principally be focused on the protectionist (and thus also discriminatory) *features* of that measure. This same cautious approach with regard to the notion of "less favourable treatment" may be also extended in the future to the interpretation of Article III:4 GATT.

C. Nationality imbalance

A clear difference between the nationality discrimination analysis under NAFTA Chapter 11 and the GATT deals with the type of "nationality imbalance" required by the dispute settlement organs in the two systems.

From the few cases so far decided under NAFTA Chapter 11 dispute settlement mechanism, a violation of the NT obligation may be established by showing that the national measure under review affords less favorable treatment to the foreign investor (that has brought the claim) compared to the treatment afforded to at least one domestic investor operating in the same business sector. In other words, nationality discrimination is established simply by showing that *one foreign* investor has been treated less favorably than at least *one domestic* competitor (or investor operating in the same sector).

In *Pope & Talbot*, for example, the Tribunal noted that a breach of NAFTA Article 1102 is presumptively established "once a difference in treatment between a domestic and a foreign-owned investment is discerned."[47] Canada had argued in its defense that in cases of alleged *de facto* discrimination, a violation of the NT obligation can be found only if the measure in question "disproportionately disadvantages" the foreign owned investments or investors.[48] According to the tribunal, to apply this test, it would be necessary to determine

> "whether there are any Canadian owned investments that are accorded the same treatment as the Investor […]. Then, the size of that group of Canadian investments must be compared to the size of the group of Canadian investments receiving more favourable treatment than the Investment. Unless the disadvantaged *Canadian* group (receiving the same treatment as the Investor) is smaller than the advantaged group, no discrimination cognizable under Article 1102 would exist."

The tribunal rejected Canada's "disproportionate disadvantage" approach based on its unwillingness to weaken the NT obligation and the objectives of NAFTA.[49] The tribunal noted that "the recognition that the NT obligation can be violated through *de facto* measures has always been based on an unwillingness to allow circumvention of that right by skillful or evasive drafting" and that such a "result would be inconsistent with the investment objectives of NAFTA, in particular Article 102(l)(b) and (c), to promote conditions of fair competition and to increase substantially investment opportunities." Furthermore, the tribunal emphasized the "practical implications" of Canada's

[47] *Pope & Talbot*, para. 79.
[48] See also Canada Statement of defense in *Ethyl*, paras. 80-81.
[49] *Pope & Talbot*, paras. 69-71.

suggestion,[50] how "unwieldy" it would be to show disproportionate disadvantage and "how it would hamstring foreign owned investments seeking to vindicate their Article 1102 rights."

As noted above, this approach to the issue of "nationality discrimination", focusing simply on the treatment afforded to *a* foreign investor compared to that granted to *a* domestic investor, has the effect of moving the concept of national treatment very close to the principle of equality. Practically, instead of comparing the different treatment of two similarly-situated investors as it would occur under an examination of equality, this interpretation of the NT principle requires a comparison between one *foreign* and one *domestic* entity operating in the same business sector.[51]

In the recent *Asbestos* dispute, the Appellate Body seemed to have rejected the view, followed by NAFTA Tribunals, that in order to establish nationality discrimination it is enough to show that *one foreign* product has been treated less favorably than at least *one domestic* like product. This was the approach that the *Asbestos* Panel had taken adopting what Ehring has recently termed the "diagonal test" for the "less favourable treatment" requirement of Article III:4.[52] The Panel found that the French ban on asbestos treated Canadian asbestos products less favourably than like domestic substitutes without considering the "symmetric impact" of the French ban on French asbestos production or on Canadian production of substitute fibres.[53] Reversing the Panel's approach, the Appellate Body, albeit in an *obiter dictum*, clearly rejected the simple diagonal test noting that after a determination of likeness "a complaining Member must still establish that the measure accords to the group of 'like' *imported* products 'less favourable treatment' than it accords to the group of 'like' *domestic* products."[54] Accordingly, if the adverse impact on the *group* of like imported products as a whole is equivalent to or less than the negative

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[50] The Investor would need "to ascertain whether there are any other American owned lumber producing companies among the more than 500 softwood lumber quota holders operating in Canada. If so, the treatment accorded those companies as a whole would have to be measured and then weighed against the predominant treatment, whatever that might mean, accorded Canadian companies operating in like circumstances. A violation of Article 1102 could then only be found if the differing treatment between the class of American investments and their Canadian competitors in like circumstances is "disproportionately" in favour of the domestic investments, whatever that might mean." *Pope & Talbot*, para. 71.

[51] On one level, it may be argued that this approach is unconsciously spurred by the nature of the dispute settlement mechanism devised by NAFTA Chapter 11: a mechanism that recognizes to individual investors the right to directly vindicate the obligations assumed by the three State parties. However, on a deeper level, it appears that this approach is not at all unconscious. The language in the *Pope & Talbot* award rejecting a stricter reading of the NT principle (where the comparison involves the *groups* of advantaged and disadvantaged investors) shows, on the contrary, a rigorous understanding of the function of the NAFTA in general, and of the NT obligation in particular: the promotion of conditions of fair competition and the increase of substantially investment opportunities through the recognition and enforcement of investors' rights.

[52] Ehring, "De Facto Discrimination in WTO Law", supra, at 921 ss.

[53] At least potentially, the French measure was adversely affecting both Canadian and French production of asbestos, as well as favouring both French and Canadian production of substitute fibres.

[54] "[A] Member may draw distinctions between products which have been found to be 'like', without, for this reason alone, according to the group of 'like' *imported* products 'less favourable treatment' than that accorded to the group of 'like' *domestic* products." Appellate Body Report on *EC – Asbestos*, para. 100 [emphasis original].

impact on the *group* of like domestic products as a whole, then there is clearly no breach of the NT obligation.[55] In other words, in *Asbestos* the Appellate Body believed that, in order to establish "nationality" imbalance, it is not enough to consider whether there is any imported product that is treated less favourably compared to any "like" domestic product (diagonal comparison), rather it is necessary to examine the *overall* impact on *all* domestic and imported like products (aggregate comparison).[56] Once again, the AB *dictum* in *Asbestos* with regard to the issue of nationality imbalance shows a willingness to limit the reach of the NT provision, which does not appear in the corresponding NAFTA case-law.[57]

4. Justification on public policy grounds

The analysis under the NT obligation does not end with a finding of nationality discrimination. A finding of nationality discrimination may always be justified on public policy grounds. Before examining the two main conditions prescribed by NAFTA and WTO tribunals for allowing such public policy justification (whether the public policy is *admissible* and the relation between the measure and the public policy is *reasonable*), it is relevant to inquire in to the relationship between nationality discrimination and public policy justification.

A. Relationship between discrimination and justification

As mentioned above, there is a formal difference between the public policy justification in NAFTA Chapter 11 and in the GATT. In the context of NAFTA Chapter 11 on Investment, notwithstanding the lack of a provision expressly permitting States to justify on public policy grounds their national measures that afford less favorable treatment to foreign investors, NAFTA tribunals have interpreted the "in like circumstances" language in Article 1102 as a *de facto* public policy justification mechanism. Accordingly, if the less favorable treatment afforded to a foreign investor vis-à-vis a domestic one may be justified on the basis that such origin-neutral differentiation is related to a legitimate public policy, then there is no violation of the NT obligation. This is the *second* function of the phrase "in like circumstances" in Article 1102 (the first being the determination of

[55] The Appellate Body's use of italics to emphasize the origin of goods further supports a reading that the burden must specifically affect *imported* products more than *domestic* products, so that it is possible to conclude that the formally origin-neutral regulation does indeed indirectly or *de facto* discriminate on the basis of the product's origin.

[56] Ehring, "De Facto Discrimination in WTO Law", supra, at 921. This is where a claim of *de facto* discrimination differs from one of *de jure* discrimination. In the case origin-based measure, the defending State may not plead that in *some* circumstances imported products are afforded no less favourable treatment: in such a case, the defending State may avoid a finding of 'less favourable treatment' *only if* it demonstrates that in *all* circumstances imported products are not afforded less favourable treatment. On the contrary, when one is faced with a case of an origin-neutral measure, in order for the measure to be deemed to constitute indirect or *de facto* discrimination against imported products, the complaining State will need to show that *as a whole* imported products are afforded less favourable treatment than like domestic products.

[57] For a recent broad application of the NT provision in the context of an investment dispute based on the BIT between the United States and Ecuador, see UNCITRAL Award between *Occidental Exploration and Production Company v. The Republic of Ecuador*, LCIA Case No. UN2467 (1 July 2004).

whether the two investors compete in the same sector). In *Myers*, for example, the tribunal expressly noted that "the assessment of 'like circumstances' must also take into account circumstances that would justify governmental regulations that treat them [i.e., a foreign investor and a domestic investor competing in the same business sector] differently in order to protect the public interest."[58] According to the tribunal, such interpretation conforms with the general principles emerging from the legal context of the NAFTA, including both its concern with the environment and the need to avoid trade distortions that are not justified by environmental concerns.[59]

On the other hand, in the context of the GATT and despite several attempts to interpret the NT provision otherwise,[60] WTO case law has so far taken the view that the public policy justification option is found outside the NT provision. Article XX, the "General exception" provision of GATT, lists, in an apparently exhaustive manner, the policy objectives, as well as the necessary conditions, on the basis of which a finding of violation of the NT provision may be justified.

Accordingly, the contraposition between the rule (prohibition on nationality discrimination) and the exception (public policy justification option) is textually starker in GATT compared to NAFTA Chapter 11. There may be at least two possible consequences following the different construction of the relationship between nationality discrimination and public policy justification. On a broad, normative level, differentiating between the two steps may be an indication of a ranking of interests that favors investment protection/liberalization over other legitimate policy interests. On a stricter, procedural level, such differentiation may also have a consequence in the allocation of the burden of proof in terms of who should establish the existence or lack there of a public policy justification.

However, despite this formal, structural difference, the two systems do not differ so much in practice for the following two reasons. First, in the context of the GATT, the Appellate Body has mellowed the stark contraposition between the non-discrimination 'rule' in Article III:4 and the public policy 'exception' in Article XX. Following its understanding that the provisions of the WTO Agreements represent a carefully negotiated

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[58] *Myers*, para. 250. See also the Panel's decision in the *Mexican Trucking* dispute where reference was made to the "immediate source" for the 'in like circumstances' language, the United States-Canada FTA: "The United States has referred to elaborating language in the FTA on the national treatment obligation to support the interpretation of the phrase used in NAFTA to permit differential treatment where appropriate to meet legitimate regulatory objectives." Paras. 284-286.

[59] *Myers*, paras. 247-250.

[60] Most notably the so called 'aims & effects' doctrine proposed in a few GATT Panel Reports (not all of them adopted by GATT contracting parties) at the beginning of the 1990s, when panels began to be confronted with claims that apparently origin-neutral measures were indeed in violation of the NT principle. This doctrine attempted to define the "like product" concept in Article III GATT having regard to the purpose of the National Treatment principle, which is to ban protectionist measures. Thus, in determining whether two products subject to different treatment are "like products" for purposes of Article III, it would be necessary to consider whether such product differentiation is being made "so as to afford protection to domestic production". See Panel Report on *Malt Beverages*, DS23/R, adopted 19 June 1992, BISD 39S/206 and Panel Report on *US-Taxes on Automobiles*, DS31/R, unadopted, reprinted in 33 ILM 1397. Cf. Hudec, "GATT/WTO Constraints on Domestic Regulation", supra, at 619 ss.

'balance of rights and obligations' that must be respected, the Appellate Body has referred to the public policy justification in Article XX as a Member's "right to invoke an exception", which exercise needs to be balanced with the "substantive treaty rights" provided for in the Agreement.[61]

Secondly, within the NAFTA Chapter 11 context, albeit the analysis of the public policy justification is formally carried out within the analysis of the existence of a violation of the NT provision, it appears that on balance NAFTA Tribunals have shown a preference for characterizing the public policy justification as a *de facto* exception to the duty to afford national treatment, thus keeping the two steps separate. In *Pope & Talbot*, the Tribunal stated that:

> However, that first step [investors compete in the same sector] is not the last one. Differences in treatment will *presumptively* violate Article 1102(2), unless they have a reasonable nexus to rational government policies that (1) do not distinguish, on their face or de facto, between foreign-owned and domestic companies, and (2) do not otherwise unduly undermine the investment liberalizing objectives of NAFTA.[62]

Although this understanding of the NT principle comes close to the concept of 'nationality discrimination' as defined on the basis of protectionist 'intent' (according to the one-step analysis mentioned above), it still appears to conceptually draw a line between a finding of nationality discrimination based on effects (first step) and an examination of the existence of a public policy justification (second step).

B. Admissible public policies

There exists perhaps a further difference in how the public policy justification option has been interpreted in the context of Article 1102 NAFTA and in the context of Article XX GATT. While the list of public policies in Article XX GATT has so far been interpreted as

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[61] This was in *Shrimp/Turtle*, when, in the context of describing the Chapeau to Article XX GATT, the Appellate Body said the following: "Exercise by one Member of its right to invoke an exception, such as Article XX(g), if abused or misused, will, to that extent, erode or render naught the substantive treaty rights in, for example, Article XI:1, of other Members." Appellate Body Report on *Shrimp/Turtle*, at para. 156. Cf. Lorand Bartels, Comment on Davey, Conference in Vienna 2003 and M Hilf, "Power, Rules and Principles—Which Orientation for WTO/GATT Law?", 4 *JIEL* (2001) 111 at 128.

[62] *Pope & Talbot*, para. 78 [emphasis added]. However, the *Pope & Talbot* Tribunal seemed to contradict itself in the following paragraph: "[O]nce a difference in treatment between a domestic and a foreign-owned investment is discerned, the question becomes, are they in like circumstances? *It is in answering that question that the issue of discrimination may arise*." *Pope & Talbot*, para. 79 [emphasis added]. See *Mexican Trucking*, para. 260, where the Panel interpreted the second function of the "like circumstances" language as an exception to the NT obligation, quite clearly placing the relevant burden of proof on the defending State. See also *Feldman*, where the Panel took up the reference by both parties (Mexico and the United States) to Article 1402 of the FTA between Canada and the United States, which constitutes the immediate source of the "in like circumstances" language in NAFTA. It noted that paragraph 3 of Article 1402 expressly interprets the "in like circumstances" language as providing for a public policy justification, and that paragraph 4 of Article 1402 imposes the burden of establishing the consistency of the differential treatment with the public policy requirements on the party according different treatment. *Feldman*, paras. 181-182. Cf. *Myers*, separate opinion by Schwartz, para. 129.

an exhaustive list, there appears to be no quantitatively and qualitatively limitation on the types of public policies that may be taken into account for purposes of justifying less favorable treatment *vis-à-vis* foreign investors within the context of Article 1102 NAFTA.[63]

The *de facto* exception in Article 1102 NAFTA being an open-ended list, the only general condition imposed with regard to the range of admissible public policies is perhaps that they be "legitimate" or "rational". However, there has not been much discussion on the issue of the legitimacy of the public policies underlying a national measure affording less favorable treatment to foreign investors. In the few cases so far decided by NAFTA Tribunals under Chapter 11, the following public policies have been considered "legitimate": (a) to ensure the economic strength of the domestic PCB processing industry in order to maintain the ability to process PCBs within the country in the future;[64] (b) to remove the threat of countervailing duty actions[65] and to provide for new entrants[66] in the lumber industry; (c) to ensure road safety in the trucking services sector;[67] (d) to better control over tax revenues, discourage smuggling, protect intellectual property rights, and prohibit gray market sales.[68]

Aware of the potentially serious concerns with interpreting Article XX as a closed list of admissible public policies (thus leaving outside the coverage of the exception a host of other important or legitimate policy goals),[69] the Appellate Body has tried, to some extent, to expand the reach of Article XX at least in two ways: first, and more explicitly, by adopting an 'evolutionary' reading of the term "exhaustible natural resources" in sub-lett (g) of Article XX, which now embraces both living and non-living resources (thus endangered animal species such as sea turtles).[70] Secondly, the Appellate Body has hinted, albeit only implicitly, that an 'extensive' interpretation of the exception provided in Article XX(d) for measures "necessary to secure compliance with laws or regulations" not inconsistent with other GATT provisions could provide another avenue for expanding the reach of the public policy justification in GATT. In its Report on *Korea-Beef*, the Appellate Body confirmed the broad interpretation of the term "to secure compliance"

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[63] There is neither an exhaustive or closed list of public policies that may justify differential treatment nor a requirement that such policies be of a non-economic character.

[64] *Myers*, para. 255 ("This was a legitimate goal, consistent with the policy objectives of the Basel Convention.")

[65] *Pope & Talbot*, paras. 87 and 102.

[66] *Pope & Talbot*, para. 78.

[67] *Mexican Trucking*, para. 257.

[68] *Feldman*, para. 170 (dicta). Related to the issue of the admissibility of the public policies considered within an Article 1102 analysis, it is the requirement that the national policy at issue be "not motivated by preference of domestic over foreign owned investments." *Pope & Talbot*, paras. 87, 93 and 103. See also *Feldman*, para. 182, where the tribunal excluded the existence of "any rational justification" for Mexico's less favorable *de facto* treatment of CEMSA noting that the US investor was owned by a very outspoken foreigner, who had filed a NAFTA Chapter 11 claim against the Government of Mexico.

[69] For example, Frieder Roessler, "Diverging Domestic Policies and Multilateral Trade Integration", in J Bhagwati and Robert Hudec (eds.), *Fair Trade and Harmonization: Prerequisites for Free Trade? Volume 2: Legal Analysis* (Cambridge, MA, MIT Press, 1996) at 30.

[70] Appellate Body Report on *Shrimp/Turtle*, at para. 130.

contained in Article XX(d) given by the Panel noting that such provision is susceptible of application in respect of a wide variety of laws and regulations to be enforced.[71]

C. Relation between the measure and the public policy

Before a measure affording less favorable treatment in violation of the NT provisions contained in Article 1102 NAFTA or Article III:4 GATT may be said to be related to, or justified on, a relevant public policy,[72] it is required that such relation or justification be somehow "reasonable". In *Pope & Talbot*, for example, the NAFTA tribunal expressly required that there be a "reasonable nexus between the measure and a rational, non-discriminatory government policy".[73]

The relevant question in this context is defining under which condition a measure may be said to be *reasonably related to* a public policy. In NAFTA Chapter 11 case law, the intensity of the inquiry over the reasonableness of such relationship varies among the existing decisions: while some tribunals seem to perform a 'minimal relationship test' which inquiries simply on the *suitability* of the measure at issue to pursue its policy objective, others require that the measure under review be *necessary* to pursue its policy objective, i.e., it is the 'least trade restrictive alternative'. An example of the former approach may be found in *Pope & Talbot* where the tribunal found that the application by Canada of the export control regime for softwood lumber only to certain provinces (determining differential treatment among a foreign investor operating in one of these provinces and those company operating in the non-covered provinces) was "reasonably related" to the rational policy of removing the threat of countervailing duty (CVD) actions by the United States. Since the United States had never made a final CVD determination against producers in the non-covered provinces, there was no need for Canada to apply the control regime to those provinces.[74]

On the other hand, the stricter necessity test was applied, for example, by the *Myers* tribunal. Having conceded that Canada was pursuing a legitimate goal (i.e., to ensure the economic strength of its PCB processing industry), the NAFTA tribunal noted that there were a number of legitimate ways by which Canada could have achieved its goal and that the export ban was not one of them.[75] The same tribunal made reference to NAFTA Article 104 (on the relation between NAFTA and environmental and conservation agreements) which provides that "where a Party has a choice among equally effective and reasonably available means of complying" with environmental and conservation

[71] Appellate Body Report on *Korea-Beef*, paras. 1581-62 (citing the Panel Report on *Korea-Beef*, para. 658). Cf. Gaetan Verhoosel, *National Treatment and WTO Dispute Settlement*, supra, at 35.

[72] That is, a 'legitimate' public policy for NAFTA tribunals and one of the public policies 'listed' in Article XX GATT for WTO tribunals.

[73] *Pope & Talbot*, paras. 78 and 81.

[74] *Pope & Talbot*, paras. 84-88.

[75] *Myers*, para. 255. "The indirect motive was understandable, but the method contravened Canada's international commitments under the NAFTA. Canada's right to source all government requirements and to grant subsidies to the Canadian industry are but two examples of legitimate alternative measures. The fact that the matter was addressed subsequently and the border re-opened also shows that Canada was not constrained in its ability to deal effectively with the situation." Id. para. 255.

agreements (including the Basel Convention), the Party is obliged to choose "the alternative which is the least inconsistent with other provisions of [the NAFTA]."[76]

The Appellate Body has structured the justification inquiry under Article XX GATT in two different stages, thus laying down a two-tiered justification test: first, 'provisional justification' by reason of characterization of the measure under one of the paragraphs of Article XX taking into account the varying connections between the regulation and the regulatory objective specified therein; second, 'further appraisal' of the measure under the introductory clauses of Article XX, the so-called Chapeau.[77]

In light of the fact that the language qualifying the connection between 'measure' and 'objective' varies widely between stricter terms such as 'essential' or 'necessary' and looser terms such as 'involving' or 'relating to',[78] there appears to be a similar diversity, as noted in NAFTA case law, in the intensity of the inquiry over the required 'relationship' between the measure and the public policy.[79] The 'relating to' connection in Article XX(g), for example, has been interpreted by the Appellate Body as requiring a sort of 'minimal relationship' between the measure at issue and the public policy pursued by the Member. Despite the reference to a wide range of concept in defining the type of relationship between measure and policy,[80] it appears that the Appellate Body's review under Article XX(g) is basically limited to a determination of whether the measure at issue is *suitable* or *capable of* pursuing the chosen policy objective.[81]

On the other hand, the 'necessary' connection in Article XX(b) and (d), for example, has been interpreted as requiring, not just that the measure is capable of pursuing the relevant public policy, rather that the measure under examination is the *least-trade restrictive* measure which is reasonably available to pursue such public policy.[82] In the

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[76] *Myers*, para. 215. Canada had claimed that its action was consistent with Canada's other international obligations, including the Base1 Convention and Transboundary Agreement and that these prevail over Chapter 11 obligations in the circumstances to the extent of the inconsistency. *Myers*, para., 150. For a strict version of the test, see also the *Mexican Trucking* case where the panel made reference to the NT provision in the 1988 FTA between Canada and the United States which specified the conditions for complying with such provision (Article 1202, paragraph 3, stated as follows: "[T]he treatment a Party accords to persons of the other Party may be different from the treatment the Party accords its persons provided that: a) the difference in treatment is *no greater than that necessary* for prudential, fiduciary, health and safety, or consumer protection reasons; b) such different treatment is equivalent in effect to the treatment accorded by the Party to its persons for such reasons; and c) prior notification of the proposed treatment has been given in accordance with Article 1803.). *Mexican Trucking*, para. 259.

[77] Appellate Body Report on *United States – Standards for Reformulated and Conventional Gasoline*, para. 21.

[78] This difference appears to reflect the broader or stricter scope of the policy included in each sub-paragraphs.

[79] It should be noted that, with the exception of the *Asbestos* case, so far all the cases where the Appellate Body has gone through an Article XX analysis have been cases of formal discrimination.

[80] In its Report on *Shrimp/Turtle*, the Appellate Body noted that the relationship between the US measure and the policy goal of protecting sea turtles was deemed to be "direct", "reasonable", "close", "real" and "substantial". See paras. 140-142. Ortino, *Basic Legal Instruments*, supra, at 224-225.

[81] See Appellate Body Report in *Reformulated Gasoline*, at 19 and Appellate Body Report on *Shrimp/Turtle*, at paras. 140-142.

[82] GATT Panel Report on *Section 337*; Appellate Body Report on *Korea-Beef*, at paras. 163-166; and Appellate Body Report on *Asbestos*, at paras. 166-168.

context of Article XX(d), the Appellate Body noted in *Korea—Beef* that an inquiry over the 'necessity' or 'least-trade restrictiveness' of a national measure involves a process of *weighing and balancing* a series of factors which include the contribution made by the compliance measure to the enforcement of the law or regulation at issue, the importance of the common interests or values protected by that law or regulation, and the accompanying impact of the law or regulation on imports or exports.[83] Though a clear sign of the Appellate Body's attempt to balance the need for flexibility and the need for legal certainty, it is believed that such language does not open the door for a full-blown cost/benefit analysis[84] under Article XX. The several factors referred to by the Appellate Body are all to be employed in order to determine whether there exist an alternative measure that (1) is less restrictive than that found to violate one of the obligations of the GATT and (2) may equally secure compliance with the relevant 'laws or regulations'.[85]

However, despite the textual difference in the relevant connectors of Article XX, WTO case law shows that the 'further appraisal' stage under the Chapeau of Article XX—assessing whether the measure constitutes "arbitrary discrimination", "unjustifiable discrimination" and "disguised restriction on international trade"—has been employed as a tool to 'harmonize' the degree of connection between the challenged measure and the regulatory objective. For example, in its review of the US regulation of gasoline (adopted to deal with air pollution) under the Chapeau of Article XX, the Appellate Body appeared to perform a very similar version of the "necessity" test noting that "there was more than one alternative course of action available to the United States in promulgating regulations implementing the Clean Air Act.".[86] However, upon closer examination, the Appellate Body's assessment of the compatibility of the US gasoline regulation with the requirements of the Chapeau appear to reveal a different type of review, one that goes to the appropriateness of the "regulatory process", rather than simply the "regulatory result". While it refers to the *existence* of less restrictive measures that could attain the (desired level of) environmental protection pursued by the Clean Air Act, the Appellate Body appears to base its findings principally on the *deficiencies* in the regulatory process that brought the United States to adopt a measure in violation of the National Treatment obligation. Indeed, the Appellate Body concluded that the US gasoline measure did not comply with the requirements of the Chapeau on the grounds that (a) the United States had not tried to pursue cooperation agreements with the interested governments which would have possibly enable the United States to extend the more favorable individual baselines methods also to foreign gasoline and thus avoided discrimination, and (2) the United States had not taken into account the interests of foreign refiners when it implemented the statutory baseline methods.[87]

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[83] Appellate Body Report on *Korea-Beef*, para. 164.
[84] See *infra* section II on the reasonableness principle.
[85] Ortino, *Basic Legal Instruments*, supra, at 204-207.
[86] Appellate Body Report on *Reformulated Gasoline*, at 24.
[87] Appellate Body Report on *Reformulated Gasoline*, at 25-26. Cf. Ortino, *Basic Legal Instruments*, at 216-218.

The evident ambivalence in the reasoning underlying the *Reformulated Gasoline*'s findings is indicative of the Appellate Body's preference for a more flexible approach, which leaves open different interpretative options that may be employed in future disputes in order for the adjudicator to prevent any abuse or misuse of the general exception provision of Article XX.[88] Such flexibility is required since the dividing line between a review of the substance and a review of the process may not so easily be drawn.

The Appellate Body Report on *Shrimp/Turtle* provides a perfect illustration of this ambivalence. In that case, the Appellate Body's ultimate finding that the US measure taken to protect sea turtles failed the requirements of the Chapeau of Article XX may be said to have been premised essentially on the 'excessive' and 'avoidable' unilateralism of the US approach: *excessive* because the US measure showed no real sensitivity to the peculiar conditions characterizing foreign markets and thus the appropriateness of the regulatory programs in those exporting countries (this is the argument based on the 'lack of flexibility'); *avoidable* because there was an alternative course of action reasonably open to the United States for securing the legitimate policy goal of its measure, a course of action other than the unilateral and non-consensual procedures of the import prohibition under Section 609 (this is the argument based on the alleged 'failure to negotiate an international agreement' with the interested countries). In both the Appellate Body's findings of 'lack of flexibility' and 'failure to negotiate an international agreement', there is a dual emphasis on both the measure's 'substantive features' and 'regulatory process'.[89] With regard to the finding of 'lack of flexibility', the Appellate Body's arguments appear to imply a lack of reasonableness in both the *character* of the US measure and the *regulatory process* that brought to life the shrimp import prohibition. The absence of a degree of discretion or flexibility in certification standards,[90] the failure to take into account other specific policies and measures adopted in exporting countries for the protection of sea turtles[91] and the general lack of any real consideration for the conditions prevailing in those exporting countries[92] may be taken at the same time as constituting forms of *unnecessary* less favorable treatment vis-à-vis foreign products (a sort of equivalence test *à la Cassis de Dijon*) as well as serious *deficiencies* in the domestic regulatory process.

Similarly, with regard to the finding concerning the 'failure to negotiate an international agreement', the Appellate Body's arguments appear to include both that the

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[88] See also the Appellate Body Report on *Shrimp/Turtle*, para. 160, "[T]he standards of the Chapeau, in the Appellate Body's view, project both substantive and procedural requirements." Cf. Grainne de Burca & Joanne Scott, "The Impact of the WTO on EU Decision-Making" in de Burca and Scott (eds.), *The EU and the WTO*, supra, at 18.

[89] Grainne de Búrca & Joanne Scott, "The Impact of the WTO on EU Decision-Making", supra, at 18 ss, noting that "there is a tension inherent in the AB report. It shifts somewhat uneasily between recourse to standards which are not predicated upon an assessment of comparative treatment—basic fairness, just treatment, reasonableness—to notions of discrimination which by definition require a comparative perspective.

[90] Appellate Body Report on *Shrimp/Turtle*, *supra*, para. 161.

[91] *Ibid*., para. 163.

[92] *Ibid*., paras. 164-5.

US measure is not the *least-trade restrictive* measure reasonably available to achieve the specific public policy goal[93] and that the unilateral manner in which the measure came about underscores the unreasonableness of its regulatory process.[94]

[93] Focusing on the measure's 'design and structure' (i.e., whether the measure is *necessary* to achieve the policy objective), the Appellate Body appears to perform the type of analysis which is required, for example, in subparagraphs (b) and (d) of Article XX. The Appellate Body observed in this regard that the Inter-American Convention provides convincing demonstration that an *alternative* course of action was *reasonably* open to the United States in order to secure the legitimate policy goal of its measure. Appellate Body Report on *Shrimp/Turtle*, *supra*, para. 171.

[94] Focusing on the measure's 'regulatory process', the Appellate Body emphasizes the principal consequence of the failure to engage several Members exporting shrimp in serious across-the-board negotiations, that is "the resulting unilateralism evident in the application of Section 609." In particular, the Appellate Body noted that: "the policies relating to the necessity for use of particular kinds of TEDs in various maritime areas, and the operating details of these policies, are all shaped by the Department of State, *without the participation* of the exporting Members. The system and processes of certification are established and administered by the United States agencies *alone*. The decision-making involved in the grant, denial or withdrawal of certification to the exporting Members, is, accordingly, also *unilateral*. The unilateral character of the application of Section 609 heightens the disruptive and discriminatory influence of the import prohibition and underscores its unjustifiability." *Ibid*., para. 172.

II. The "reasonableness" principle

A. Basic features

In international economic law, the concept of reasonableness may be used to protect foreign products and investors *vis-à-vis* unjust or irrational treatment afforded to them by the importing/host country through internal measures. In other words, reasonableness functions as a normative yardstick to control the exercise of discretionary powers by States that may have an adverse impact on the flows of goods and capital across States. Accordingly, the reasonableness principle may be seen as a principle of 'administrative validity' to protect the rights of (foreign) citizens against *abuses* by the State of its (administrative, legislative and judicial) powers, as well as a 'liberalization instrument' imposing certain general requirements on the ability of Member States to adopt national regulations which *restrict* trade or investment in the name of legitimate public policy objectives.

While the reasonableness principle may be given a broad range of meanings, it is at least possible to distinguish between 'substantive' and 'procedural' reasonableness. In very general terms, substantive reasonableness may be used to signify certain requirements of fairness that go to the *substance* of the governmental measure under consideration (which, as noted above, can include measures by the legislator, the administration or the judiciary). Procedural reasonableness refers, on the other hand, to certain requirements of fairness in the *process* leading up to the taking of the same governmental measure.[95] In the next two sections, the paper tries to highlight the main features of a few of these requirements in the two mentioned general categories. One point should be emphasized at this stage. Each of the requirements falling within the concept of reasonableness may be slightly modified through appropriate qualifications (for example, a governmental conduct may be deemed to violate the reasonableness principle only if it is found to be *grossly* unfair). Rather than changing the nature of the specific requirement, these qualifications simply increase (or sometimes reduce) the necessary threshold for a finding of violation.

1. Substantive reasonableness

Current scholarly debate over what may constitute requirements of substantive reasonableness shows that there are at least three sets of tests which may be employed in order to evaluate whether the conduct or omission of the State may be deemed to comply with the principle of reasonableness: (a) means/ends or suitability test, (b) cost

[95] See George Bermann, "The Principle of Proportionality", 26 *American Journal of Comparative Law* (1977-1978) 415 at 416 who also refers to substantive and procedural due process.

effectiveness or necessity test, and (c) cost/benefit or proportionality test.[96] As correctly noted by legal scholars, these three tests constitute an ascending series in terms of the intensity and intrusiveness of the review of national regulation.[97]

Under a 'means/ends' or 'suitability' test, the relevant inquiry focuses on whether the governmental measure under review is *suitable* or *effective* to achieve its purported aim, or in other words, whether the 'means' employed by the governmental authority are rationally related to the 'ends' pursued by such authority. For example, in the case of a measure prohibiting, on grounds of public health protection, the manufacture and sale of products containing a specific fiber which is thought to be carcinogenic, the relevant inquiry would be whether the prohibition (means) is capable of pursuing the protection of public health (end). In this sense, a means/ends test is said to be principally aimed at evaluating the existence of the relevant *relationship* between a measure and its objective, without inquiring over the *strength* of such relationship. Moreover, the means/ends test may also be employ to perform an inquiry over both the formal and substantial *legitimacy* of the aim. An inquiry over the formal legitimacy of the aim focuses on the issue of whether the pursuance of the aim itself is formally permitted (i.e., is health protection a permitted aim?). On the other hand, an inquiry over the substantial legitimacy of the aim deals with the question of whether in light of the measure adopted and the particular circumstances at hand there exist a real concern for the public policy pursued by the governmental authority through the measure at issue (i.e., is the banned product really carcinogenic?).

Under a 'cost effectiveness' or 'necessity' test, the relevant inquiry focuses on whether the governmental measure under review is *necessary* to achieve its purported aim, or, in other words, whether there exist other less costly means capable of pursuing that same aim. Employing the same example of a ban on products containing carcinogenic fibers, the relevant inquiry under a cost effectiveness test would be whether the ban is the least costly measure to protect public health. An important issue in this type of inquiry deals with how costs are defined. In light of their principal function, the main relevant cost is usually determined taking into account the level of trade- or investment-restrictiveness of the measure at hand (in our example, is there an alternative measure capable of protecting public health without restricting *trade* to the same extent as the ban under consideration?) While the adverse effects on trade or investment flows may be the main relevant cost at issue under a cost effectiveness test, it is evident that other costs, incurred

[96] See generally Trachtman, "Trade and … Problems, Cost-Benefit Analysis and Subsidiarity", supra; K Saito, "Yardsticks for 'Trade and Environment': Economic Analysis of the WTO Panel and the Appellate Body Reports regarding Environment-oriented Trade Measures", *Jean Monnet Paper* 14/01; Grainne de Búrca, "The Principle of Proportionality and its Application in EC law", 13 *YEL* (1994) 105 at 113; E Ellis (ed.), *The Principle of Proportionality in the Laws of Europe* (Oxford, OUP, 1999); N Emiliou, *The Principle of Proportionality in European Law: A Comparative Study* (London, Kluwer, 1996) at 23 ss; Andrea Morrone, *Il custode della ragionevolezza* (Milano: Giuffrè Editore, 2001) at 186 ss.

[97] Jan Jans, "Proportionality Revisited", 27 *Legal Issues of Economic Integration* (2000) 239 at 241.

by both public and private parties, may be brought into the equation. These may deal, for example, with administrative costs incurred by the public authority in implementing the alternative measure, compliance costs of private business, or even costs imposed on other public policies. Thus, the scope of the costs brought into the analysis over the necessity of a measure will influence the outcome of the analysis itself.

Two further points should be noted with regard to the cost effectiveness or necessity test. First, a necessity test as explained above (i.e., whether there exist other less costly means to achieve the same level of protection) may go as far as to require an inquiry into whether the regulatory protections of the country of origin are *functionally equivalent* to those of the host country. For example, to require imported products to comply strictly and exactly with the provisions or technical requirements laid down for products manufactured in the state of importation when those imported products (conforming with similar standards required in the state of manufacture) afford users the *same level of protection* would be contrary to the necessity test since those measures are not indispensable to pursue the public policy at hand.[98] Second, a cost effectiveness test takes for given the extent to which public authority sets the level of public health protection. Accordingly, an investigation of whether there exists other less costly means must be performed having regard to the *level of protection* chosen by the relevant public authority. Although it may be difficult to determine, such level of protection should not be put into question under a cost effectiveness or necessity test.

Under a 'cost/benefit' or 'proportionality' test, the relevant inquiry focuses on whether the governmental measure under review has an *excessive* or *disproportionate* impact on the applicant's interests, or in other words, whether the costs of such a measure exceed its benefits. In our public health protection example, the relevant inquiry would be whether the costs of the ban on products containing carcinogenic fibers in terms of the negative impact on trade or investment flows (as well as those other costs mentioned above) exceed its benefits in terms of the positive impact on the protection of public health. In the context of international economic law, contrary to the previous test, what is at stake with the cost/benefit or proportionality test is whether the chosen level of public policy protection (and thus the measure chosen to reach it) is out of proportion compared with the aim of promoting trade and investment: the *costs* imposed on one value (promotion of trade or investment) are excessive or disproportionate compared to the benefits accrued to another value (e.g., environmental protection). This is the true balancing exercise of differing values or policies.[99] With regard to national regulatory

[98] Joseph HH Weiler, "The Constitution of the Common Marketplace: Text and Context in the Evolution of the Free Movement of Goods" in Paul Craig & Grainne de Búrca (eds.), *The Evolution of EU Law* (Oxford, OUP, 1999) at 365. It should be noted however that the notion of 'functional equivalence' applies principally to *trade* (in goods and services), while it is less relevant with regard to the *investment* field.

[99] As starkly noted by one author in the field of military intervention, the crucial difference between necessity and proportionality is one between tactical and strategic proportionality: "Tactical proportionality asks that a commander minimize civilian casualties, given the military objective. Strategic proportionality asks that civilian casualties be weighed against the justification for using force in the first place." Ruth

prerogatives, this is potentially the more intrusive and thus problematic form of review, since it focuses on assessing the relative *values* of, on the one hand, certain public policy objectives (such as public health, consumer protection or environmental protection), and, on the other, the aim of promoting trade and investment flows across countries.

2. Procedural reasonableness

While the debate over procedural reasonableness in international economic law is perhaps more recent,[100] at least two different sets of procedural requirements seem to be emerging in the field: (a) transparency requirements and (b) participation requirements. Although the former are often instrumental to the latter, it may be worthwhile keeping them apart in order to highlight the different implications in terms of international and national governance structures stemming out from these two sets of procedural requirements.

Transparency usually refers to both general and specific requirements to make laws, regulations and procedures dealing with international trade and investment clear and predictable to all interested parties, whether State or private parties. The underlying rationale for such requirements may include the promotion of a rule-based approach to economic policy and measures at the national level, the provision of information to economic actors as well as to other parts of civil society, and the monitoring of compliance with other substantive obligations.[101] Transparency requirements include provisions on *consultation* and/or *exchange of information* between parties and provisions requiring parties to make information public, usually by means of *publication*.[102] Transparency requirements also include provisions requiring parties to *answer specific questions* or *provide information upon request*, for example through the establishment of permanent enquiry or contact points charged with the duty to provide information on relevant matters. Transparency requirements may also provide for *notification procedures*, aimed at monitoring parties' compliance with regard to substantive obligations contained in IIAs. These provisions, for example, may oblige State parties to provide information to

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Wedgwood, "Proportionality and Necessity in American National Security Decision Making", 86 *American Society of International Law Proceedings* (1992) 58 at 59.

[100] See generally Joanne Scott, "On Kith and Kine (and Crustaceans): Trade and Environment in the EU and WTO", *Jean Monnet Working Paper* (Harvard Law School, 1999) at 30 ss; Miguel Maduro Poiares, *We, the Court: The ECJ and the European Economic Constitution* (Oxford, Hart Publishing, 1998) at 169 ss; Armin von Bogdandy, "Legitimacy of International Economic Governance: Approaches to WTO Law and Prospects of its Proceduralization" in Stephan Griller (ed.) *International Economic Governance and Non-Economic Concerns* (Wien-New York, Springer 2003); Joost Pauwelyn, "Deference or Interference" in Cottier, Mavroidis and Blatter (eds.), *The Role of the Judge in International Trade Regulation* (Ann Arbor, University of Michigan Press, 2003) at 189-90.

[101] OECD, *Trade in Services: Negotiating Issues and Approaches* (Paris, OECD, 2001) at 95-96.

[102] Publication mechanism may also be used in order to impose on countries an obligation to disclose draft laws and regulations with the aim of affording other interested parties the possibility to comment on such proposals before they are formally adopted. As noted in the section on participatory requirements, this type of advance publication requirements is more exceptional and represents a greater degree of intrusion in to members' regulatory prerogatives.

a central agency with regard to actions taken by each party in respect of trade or investment-related matters. This notification requirement does not usually exist in lieu of a duty to publish information, rather the duty to notify and the duty to publish information are frequently perceived as complementary means of promoting transparency.[103] Transparency requirements may also refer to an obligation to *clarify* (i.e., to make transparent) *the criteria according to which discretionary powers are exercised* by a governmental authority, or an obligation *to give reasons* for an administrative or judicial decisions.

Procedural reasonableness may also take the form of certain participation requirements, which are principally aimed at ensuring that the needs and interests of all interested parties are taken into consideration within national regulatory processes. These requirements may include both *active* and *passive* participation provisions: where the former focuses on allowing (foreign) interested players to participate directly in the relevant decision-making process, and the latter focuses on requiring national decision-makers to take into account (foreign) interests and/or concerns. Active participation requirements, for example, are those provisions allowing time for (foreign) interested parties to make written comments on draft laws or regulation of a State which may have an effect on these parties' interests, as well as requiring the State receiving such written comments to discuss them with the relevant interested parties. Passive participation requirements, for example, are those provisions requiring the State receiving such comments to take both the comments and the results of these discussions into account in finalizing the relevant laws and regulations.

Similar provisions may be applicable, not just to the *pre-adoption* stage and to *legislative* decision-making, but also to the *implementation* and *enforcement* stages as well as to *administrative* and *judicial* proceedings (e.g., right to a hearing).

B. Comparative experience: Articles 2 TBT and 1105 NAFTA

Given the potentially broad meaning of the concept of reasonableness, there are several instances where this concept is used in NAFTA and WTO law. For purposes of this analysis, I will only look at Article 2 TBT dealing with the "Preparation, Adoption and Application of Technical Regulations by Central Governmental Bodies" and Article 1105 NAFTA dealing with the "Minimum Standard of Treatment".

Article 2 TBT provides for a detailed in relevant part as follows:

[103] UNCTAD, *Transparency—Series on Issues in International Investment Agreements* (New York-Geneva, United Nations, 2004); WTO, "Transparency: note by the secretariat", Working Group on the Relationship between Trade and Investment, doc. WT/WGTI/W/109, 27 March 2002.

2.2 Members shall ensure that technical regulations are not prepared, adopted or applied with a view to or with the effect of creating unnecessary obstacles to international trade. For this purpose, technical regulations shall not be more trade-restrictive than necessary to fulfil a legitimate objective, taking account of the risks non-fulfilment would create. Such legitimate objectives are, inter alia: national security requirements; the prevention of deceptive practices; protection of human health or safety, animal or plant life or health, or the environment. In assessing such risks, relevant elements of consideration are, inter alia: available scientific and technical information, related processing technology or intended end-uses of products.
[…]
2.5 A Member preparing, adopting or applying a technical regulation which may have a significant effect on trade of other Members shall, upon the request of another Member, explain the justification for that technical regulation in terms of the provisions of paragraphs 2 to 4. […]
[…]
2.7 Members shall give positive consideration to accepting as equivalent technical regulations of other Members, even if these regulations differ from their own, provided they are satisfied that these regulations adequately fulfil the objectives of their own regulations.
[…]
2.9 […] if the technical regulation may have a significant effect on trade of other Members, Members shall:

2.9.1 publish a notice in a publication at an early appropriate stage, in such a manner as to enable interested parties in other Members to become acquainted with it, that they propose to introduce a particular technical regulation;

2.9.2 notify other Members through the Secretariat of the products to be covered by the proposed technical regulation, together with a brief indication of its objective and rationale. Such notifications shall take place at an early appropriate stage, when amendments can still be introduced and comments taken into account;

2.9.3 upon request, provide to other Members particulars or copies of the proposed technical regulation and, whenever possible, identify the parts which in substance deviate from relevant international standards;

2.9.4 without discrimination, allow reasonable time for other Members to make comments in writing, discuss these comments upon request, and take these written comments and the results of these discussions into account.

[…]
2.11 Members shall ensure that all technical regulations which have been adopted are published promptly […].
2.12 Except in those urgent circumstances referred to in paragraph 10, Members shall allow a reasonable interval between the publication of technical regulations and their entry into force in order to allow time for producers in exporting Members, and particularly in developing country Members, to adapt their products or methods of production to the requirements of the importing Member.

Article 1105 NAFTA provides in relevant part as follows:

1. Each Party shall accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security.

It is evident that Article 2 TBT provides for a more detailed discipline compared to Article 1105 NAFTA. As examined below, Article 2 TBT *expressly* includes the main

reasonableness requirements described above: suitability, necessity, transparency, participation and perhaps, as suggested by some, even proportionality. Article 1105 NAFTA, on the other hand, makes a general reference to international law and in particular to the concept of 'fair and equitable treatment'. Before we proceed further, it may be useful to spend a few words to introduce Article 1105 NAFTA.

Under customary law, foreign investors are entitled to a certain level of treatment, and any treatment which falls short of this level, gives rise to responsibility on the part of the State. This is usually referred to as the customary 'international minimum standard' for the treatment of alien-owned property and investments stemming from the 1926 decision on the *Neer* case, where it was stated that:

> "the propriety of governmental acts should be put to the test of international standards...the treatment of an alien, in order to constitute an international delinquency should amount to an outrage, to bad faith, to wilful neglect of duty, or to an insufficiency of governmental action so far short of international standards that every reasonable and impartial man would readily recognize its insufficiency. Whether the insufficiency proceeds from the deficient execution of a reasonable law or from the fact that the laws of the country do not empower the authorities to measure up to international standards is immaterial."[104]

The concept of 'fair and equitable treatment', on the other hand, has been developed in treaty law, especially in BITs. Today it is still controversial whether this standard should be identified as one of the elements of the minimum standard (covering in particular the administration of justice, the treatment of aliens under detention and the requirement of full protection and security) required by customary international law, or as an independent principle which, while encompassing the customary standard, it goes beyond it.[105] While in early NAFTA case-law the latter opinion had prevailed giving Article 1105 a broad interpretation,[106] a binding interpretation rendered by the NAFTA Free Trade Commission in 2001 (the so called FTC interpretation) has espoused the more

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[104] This claim was presented to the US Mexico Claim Commission by the United States on behalf of the family of Paul Neer, who had been killed in Mexico in obscure circumstances. The claim held that the Mexican Government had shown lack of diligence in prosecuting those responsible and that it ought to reimburse the family. The Commission found that the failure by the Mexican authorities to apprehend or punish those guilty of the murder of the American citizen did not *per se* violate the international minimum standard on the treatment of aliens. United Nations, *Reports of International Arbitral Awards,* 1926, IV, pp. 60ff.

[105] Cf. F.A. Mann, "British Treaties for the Formation and Protection of Investment", 24 *British Yearbook of International Law* 244 (1981); Peter Muchlinski, *Multinational Enterprises and the Law* (Oxford, Blackwell Publishers, 1999); UNCTAD, "Fair and equitable treatment", *Series on issues in international investment agreements* (United Nations, 1999); OECD, Fair and Equitable Treatment Standard in International Investment Law, *Working Papers on International Investment* (OECD, 2004/3), M. Sornarajah, *The International Law on Foreign Investment* (Cambridge, CUP, 2004), Maria Rosaria Mauro, *Gli accordi bilaterali sulla promozione e la protezione degli investimenti* (Torino, Giappichelli, 2003).

[106] In the 2001 *ADF* merits award, for example, it was noted that: "…the Tribunal interprets Article 1105 to require that covered investors and investments receive the benefits of the fairness elements under ordinary standards applied in the NAFTA countries, without any threshold limitation that the conduct complained of be 'egregious', 'outrageous' or 'shocking' or otherwise extraordinary." Para. 118.

limited view equating such a provision to the customary international minimum standard.[107] In any event, recent NAFTA Tribunals, while abiding to the FTC interpretation, have clearly emphasized that the 'international minimum treatment' standard is not a "static photograph" of the minimum standard of treatment of aliens as it stood in 1927 when the *Neer* award was rendered.[108] In *Mondev*, the NAFTA Tribunal noted the following:

> In particular, both the *substantive* and *procedural* rights of the individual in international law have undergone considerable development. In the light of these developments it is unconvincing to confine the meaning of 'fair and equitable treatment' and 'full protection and security' of foreign investments to what those terms—had they been current at the time—might have meant in the 1920s when applied to the physical security of an alien. To the modern eye, what is *unfair* or *inequitable* need not equate with the outrageous or the egregious. In particular, a State may treat foreign investment unfairly and inequitably without necessarily acting in bad faith.[109]

Accordingly, while it is bound to customary international law, the minimum standard of treatment in Article 1105 NAFTA in principle includes both substantive and procedural protection against unfair and inequitable treatment. Perhaps due to the particular features of an investor-State dispute settlement process within the context of foreign direct investment, Article 1105 complaints have mainly dealt with claims of procedural deficiencies (in both judicial and administrative proceedings) rather than claims of violation of substantive requirements.[110]

Following the discussion in the previous section, the analysis in this section will focus mainly on the following five 'reasonableness' requirements: suitability, necessity, proportionality, transparency and participation.

3. Suitability (or means/ends test)

[107] The interpretation states as follows: "Article 1105 (1) prescribes the customary international law minimum standard of treatment of aliens as the minimum standard of treatment to be afforded to investments of investors of another Party. The concepts of 'fair and equitable treatment' and 'full protection and security' do not require treatment in addition to or beyond that which is required by the customary international law minimum standard of treatment of aliens. A determination that there has been a breach of another provision of the NAFTA, or of a separate international agreement, does not establish that there has been a breach of Article 1105 (1)."

[108] 2003 *ADF* Damages award, para. 179.

[109] 2002 *Mondev* Merits award, para. 116, [emphasis added]. See also 2004 *Waste Management*, Merits award, paras. 93-98.

[110] One dispute where the investor based its claim of violation of Article 1105 on the lack of both substantive and procedural reasonableness is the pending *Methanex* dispute, where the investor, drawing from WTO law and practice, argued that (1) the Californian authority, in banning the MTBE as an additive in gasoline, did not act reasonably and in good faith and (2) the ban was unreasonable since alternative methods existed to deal with the problem of MTBE pollution in the drinking water. See C Kirkman, "Fair and equitable treatment: *Methanex v. United States* the narrowing scope of NAFTA Article 1105", in 34 *Law and Policy in International Business* 1 (Fall 2002), p 343-92.

The first substantive obligation imposed by Article 2 TBT on WTO Members is the requirement that any technical regulation or standard must be capable of contributing to a *legitimate* public policy goal. Contrary to the SPS Agreement,[111] under the TBT Agreement a Member may take any technical measure necessary to achieve any legitimate objectives. Article 2.2 TBT simply provides for a non-exhaustive list of legitimate objectives including national security requirements, the prevention of deceptive practices, the protection of human health or safety, animal or plant life or health, or the environment. Accordingly, under the TBT Agreement the legitimacy of the objective of a technical measure can be called into question and is thus the first substantial requirement to be met by a technical regulation or standard. However, besides the principal inquiry into whether a stated objective is indeed legitimate,[112] it will also be necessary to determine whether there is a 'rational relationship' between the adopted measure and the legitimate public policy objective, or, in short, whether the measure is *suitable* to or *capable* of contributing to its stated goal. Without an inquiry into such a relationship, there would be no sense in requiring that the measure's objective be legitimate. Moreover, the suitability requirement in the TBT is not articulated in much detail and it is thus left to the 'judiciary' to attribute to it the appropriate meaning. It would seem in this regard wise to employ the concept of suitability as simply requiring a minimum level of 'reasonableness' in the relation between the regulatory instrument and the legitimate public policy objective pursued by the Member.[113]

It may be noted that suitability comes into play also in the harmonization provision of Article 2.4 TBT, in order to establish whether an international standard would be "an ineffective or inappropriate means for the fulfillment of the legitimate objective pursued". It is interesting to note that, in *Sardines*, the Panel's finding is premised on an inquiry over the 'substantial legitimacy' of the aim pursued by the EC (consumer protection). In other words, the Panel has to tackle the question whether in light of the factual circumstances of the case there exists a real concern for the consumer. The Panel finds that the justification for the EC regulation (allocating the use of the term "sardines" exclusively to *Sardina pilchardus*), was based on an incorrect factual representation since (most) European consumers do not associate the term "sardines" exclusively with *Sardina pilchardus*. On the contrary, from the evidence presented to the Panel, it would seem that, while *Sardina pilchardus* is commonly associated with the term "sardines", other types of fish are also

[111] The legitimacy of the public policy purpose of an SPS measure—the protection of human, animal, or plant life or health—is *not* put into question. The question there deals with whether a measure *is* an SPS measure (i.e., whether a domestic measure has been taken for the purpose of protecting human, animal or plant life or health).

[112] Gabrielle Marceau & Joel Trachtman, "The Technical Barriers to Trade Agreement, the Sanitary and Phytosanitary Measures Agreement, and the General Agreement on Tariffs and Trade: A Map of the World Trade Organization Law of Domestic Regulation of Goods", in 36 *JWT* (2002) 811 at 836 inquiring into the issue of determining the legitimacy of the public policy objective.

[113] The jurisprudence on Article XX GATT interpreting the connector 'relating to' should provide valuable 'know-how' for future application of the TBT.

associated with the term "sardines", although usually together with other terms, like the country or the geographical area of origin, etc. Accordingly, in light of the Panel's factual findings relating to the public concern underlying the EC measure under review, the international standard at issue in that case was deemed to be suitable (i.e., not an 'ineffective or inappropriate means) to protect consumers.[114]

4. Necessity (or cost-effectiveness test)

The principal function of the requirement in Article 2.2 TBT that "technical regulations are not prepared, adopted or applied with a view to or with the effect of creating *unnecessary* obstacles to international trade," is to impose on Members a duty to adopt the *least-trade restrictive* measure.[115] As noted above, this requirement involves an inquiry into whether, among the several regulatory instruments capable of achieving the public policy objective pursued by the Member, the chosen regulatory instrument is no more trade-restrictive than necessary to fulfil a legitimate public policy objective. This is why the 'necessity' requirement is usually also known as the 'least-trade restrictive' requirement.

It has been suggested that in light of the similar wording in the SPS Agreement (Articles 2.2 and 5.6),[116] a similar three-limbed test should be used to review a measure's consistency with the necessity requirement in Article 2.2 TBT.[117] Thus, in order to show a violation of Article 2.2 TBT, one would have to prove that there is another measure which (1) is reasonably available taking into account technical and economic feasibility, (2) fulfils the Member's legitimate objective and (3) is significantly less trade restrictive than the chosen measure.[118]

I share this suggestion for at least two reasons. First, this approach would have the advantage of interpreting the 'necessity' or 'least-trade restrictive' obligations in the SPS and TBT Agreements in a uniform manner, thus increasing their normative value. Secondly, the interpretation advanced in the footnote to Article 5.6 SPS conforms almost exactly to the

[114] Panel Report on *Sardines*, paras. 7.132-7.138. Though not stated, the Panel implicitly believed that the international standard at issue was more reasonable, effective or accurate than the EC regulation. However, in order to find a violation of Article 2.4 TBT, the claimant needs only to prove that there exist an international standard suitable to achieve the relevant policy objective.

[115] The second of Article 2.2 states that "For this purposes, technical regulations shall not be more trade-restrictive than necessary to fulfil a legitimate objective".

[116] Article 2.2 states that: "Members shall ensure that any sanitary or phytosanitary measure is applied only to the extent necessary to protect human, animal or plant life or health […]." Article 5.6 states that: "[…] when establishing or maintaining sanitary or phytosanitary measures to achieve the appropriate level of sanitary or phytosanitary protection, Members shall ensure that such measures are not more trade-restrictive than required to achieve their appropriate level of sanitary or phytosanitary protection, taking into account technical and economic feasibility."

[117] Axel Desmedt, "Proportionality in WTO Law", 5 *JIEL* (2001) 441 at 459. A footnote to Article 5.6 SPS states as follows: "For purposes of paragraph 6 of Article 5, a measure is not more trade-restrictive than required unless there is another measure reasonably available taking into account technical and economic feasibility, that achieves the appropriate level of sanitary or phytosanitary protection and is significantly less restrictive to trade."

[118] Cf Desmedt, "Proportionality in WTO Law", supra, at 459.

'necessity' principle as it has been developed under Article XX GATT. The only relevant difference is the addition of the requirement that the alternative measure needs to be *significantly* less trade-restrictive. If this addition is interpreted as a *de minimis* requirement, according to which national regulators enjoy a certain minimum leeway in selecting the appropriate technical regulation, there should not be any major problems in extending the detailed definition of 'necessity' contained in the SPS Agreement to the corresponding obligation of Article 2.2 of the TBT Agreement. It should also noted that both reference to 'technical and economic feasibility' and the qualification that the alternative measure be 'significantly' less trade-restrictive would seem to leave some flexibility to the regulating Member in evaluating the overall costs connected with a specific regulatory measure.

Once again looking at the Appellate Body's interpretation of the obligation in Article 5.6 SPS, it may be said that so far such interpretation conforms to the traditional function of the 'necessity' requirement. While 'necessity' is employed to impose on Members the duty to choose the regulatory instrument with the least restrictive effects on trade, it should not be used to pass judgment on the *appropriateness of the level of protection* that each Member wishes to achieve. In other words, under the 'necessity' requirement there is no balancing of different competing interests.[119] At the same time, however, each Member's prerogative to choose its own level of protection should not render such requirement 'nugatory'. Accordingly, an importing Member is not free to determine its level of protection with such vagueness or equivocation that the application of the 'necessity' test becomes impossible. Where this is the case, it will be up to WTO tribunals to establish the appropriate level of protection on the basis of the level of protection reflected in the measure itself.[120] It is clear that the prerogative of WTO Members in choosing their level of protection should not be overestimated, since "it does not represent a *carte blanche*" for legitimizing regulatory measures.[121] In any event, future disputes will certainly demonstrate the difficulty for Panels of determining the 'appropriate level of protection', which constitutes an indispensable step in assessing the 'necessity' of a regulatory measure.[122]

Before concluding this section on the 'necessity' requirement, it is worth commenting briefly on the 'equivalence' provisions of the TBT Agreement. Article 2.7 TBT provides that "Members shall give positive consideration to accepting as equivalent technical regulations of other members, even if these regulations differ from their own, provided they are satisfied that these regulations adequately fulfil the objectives of their own regulations."[123] Leaving aside the fundamental question of the binding force of this provision, the doctrinal issue of the relationship between the 'equivalence' requirement and

[119] Desmedt, "Proportionality in WTO Law", supra, at 457.
[120] Appellate Body Report on *Australia – Salmon*, *supra*, para. 205-207.
[121] Desmedt, "Proportionality in WTO Law", supra, at 458.
[122] See *supra* the discussion over the Appellate Body Report on *Korea – Measures Affecting Imports of Fresh, Chilled and Frozen Beef* (*Korea – Beef*), WT/DS161/AB/R and WT/DS169/AB/R, circulated 11 December 2000, adopted 10 January 2001, para. 178, where the same issue was dealt with by the Appellate Body in a somewhat unclear manner.
[123] See also the similar provision in the SPS Agreement (Article 4).

the 'necessity' test needs to be addressed. Equivalence obligations (which may also be defined as 'mutual recognition' or 'functional parallelism')[124] may be interpreted as a "very conservative and fully justified" application of the principle of necessity: "[f]or a Member State to insist on a specific technical standard even if a different standard is functionally parallel in achieving the desired result, is to have adopted a measure which is not the least restrictive possible."[125] Since I agree with Weiler's doctrinal point, a possible reason for the TBT to separate 'equivalence' (Article 2.7) from 'necessity' (Article 2.2) is perhaps to highlight this fundamental aspect of necessity which has gone much unnoticed in GATT/WTO practice (except perhaps in some of the arguments advanced by the Appellate Body in its Chapeau analysis in *Shrimp/Turtle*).[126]

5. Proportionality (or cost/benefit test)

The question whether the TBT Agreement contains the requirement of proportionality (or the so called cost/benefit analysis) has lately been at centre stage in both academic and diplomatic circles. As noted earlier, the requirement of proportionality involves an assessment of whether the negative effects of a measure (principally on trade) are *out of proportion* with its benefits in terms of a legitimate public policy objective. Contrary to the two previous requirements which deal with the question whether the regulatory *measure* is 'suitable' and 'necessary' to achieve a determined public policy objective, the review of proportionality focuses on the 'reasonableness' of the regulatory *objective* itself. Allowing for a true balancing of differing competing interests, this latter requirement is thus capable of influencing the level of protection that Members are allowed to pursue. A particular objective or level of protection is deemed to violate the requirement of proportionality if it is found to have disproportionately negative effects on international trade.

While the TBT Agreement does not include the requirement of proportionality, it has been suggested that there is language in Article 2.2 which seems to imply a proportionality requirement. The second sentence of Article 2.2 TBT specifies that an analysis over the least-trade restrictiveness of a technical regulation needs to be carried out "*taking account of the risks non-fulfilment would create*". It has been suggested that this language impose an

[124] See ECJ case law on Article 28 EC.
[125] JHH Weiler, "Epilogue: Towards a Common Law of International Trade" in JHH Weiler (ed.), *The EU, the WTO and the NAFTA: Towards a Common Law of International Trade?* (Oxford, OUP, 2000) at 221.
[126] See *supra* discussion on the 'relation between measure and policy objective' within the context of the 'public policy justification' leg of the NT principle. Some commentators have, however, noted the somewhat different nature of the 'equivalence' requirements *vis-à-vis* the more traditional 'least-trade restrictive' obligation. While in the latter the regulating Member is required to choose the measure, among the several regulatory options reasonably available, with the least restrictive effects on trade, in the former the Member also needs to examine the regulatory situation in the country where the foreign good is produced and determine whether the exporting Member's regulation is capable of achieving in equally effective manner the objectives or the level of protection set by the importing Member. Cf P Eeckhout, *The European Internal Market and International Trade: A legal Analysis* (Oxford, Clarendon 1994) at 78 ss.

additional requirement on the defending Member.[127] Not only does the measure have to be the least trade-restrictive available, it also must be *proportional*, which is to say that the marginally greater risk of a less trade restrictive measure would need to be balanced against the degree to which the measure is less trade restrictive. As noted by Desmedt,

> [u]nder the TBT Agreement, when taking into account the risks of non-fulfilment of a legitimate objective, a panel could arguably find that the obstacle to international trade outweighs those risks […] a technical measure could be considered disproportionate even though an alternative less trade-restrictive measure is not really available.[128]

One may disagree with this reading for two sets of reasons. First, as examined in the previous section, Article 2.2, second sentence, of the TBT Agreement incorporates the necessity requirement (i.e., that technical regulation not be more trade restrictive than necessary to achieve a legitimate objective). The reference to the 'risks of non-fulfilment' should be read in this perspective: rather than an *additional* inquiry into the proportionality of the measure, this reference is a specification of one of the several elements to be assessed in order to determine its *necessity*. When a panel is deciding whether the adopted measure is the least-trade restrictive among the several regulatory alternatives 'capable' of achieving a legitimate public policy objective, it also needs to take into account risks of non-fulfilment, i.e., the risks of not fulfilling that specific legitimate objective. It would appear that this specification makes the 'necessity' requirement of Article 2.2 TBT possibly less rigid, since the one element which is expressly included in that Article for purposes of the 'necessity' assessment is, rather than the negative effects on trade, the risks of not fulfilling the specific public policy objective.

The second argument excluding a proportionality requirement in Article 2.2 comes from the express recognition in the preamble to the TBT Agreement that:

> no country should be prevented from taking measures necessary to ensure the quality of its exports, or for the protection of human, animal or plant life or health, of the environment, or for the prevention of deceptive practices, *at the levels it considers appropriate*. [emphasis added]

This would seem to exclude that the reasonableness principle in the TBT Agreement interferes with the ability of WTO Members to determine their own appropriate level of (human health, environment and consumer) protection.[129]

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[127] R Hudec, "GATT Constraints on National Regulation: Requiem for an 'Aim and Effects' Test", 32 *The International Lawyer* (1998) 623. More cautiously, Desmedt, "Proportionality in WTO Law", supra, at 459.
[128] Desmedt, "Proportionality in WTO Law", supra at 459-60.
[129] Cf Robert Howse & Elisabeth Tuerk, "The WTO Impact on Internal Regulations—A Case Study of the Canada-EC Asbestos Dispute", in Grainne de Búrca & Joanne Scott (eds.), *The EU and the WTO: Legal and Constitutional Aspects* (Oxford, Hart, 2001) at 317, footnote 91. Cf Desmedt, "Proportionality in WTO Law", supra, at 459; "The Uruguay Round's Technical Barriers to Trade Agreement" (WWF International Research Report, January 1993).

6. Transparency

While the transparency requirements provided for in Article 2 TBT and specifically incorporating publication obligations (Article 2.9.1), duty to provide information upon request (Articles 2.5 and 2.9.3), notification procedures (Article 2.9.2) have not been subject to much litigation,[130] it appears that lack of transparency constitutes perhaps the main claim of violation so far advanced by NAFTA investors under Article 1105 NAFTA on the Minimum standard of treatment. Although the standard in Article 1105 is composed of both substantive and procedural elements, mostly the latter appear in many of the findings of NAFTA Chapter 11 Tribunals.

For example, the *Metalclad* Tribunal, presided by Sir Eli Lauterpacht, noted that governments fail to provide 'fair and equitable' treatment to investments when they do not regulate in a transparent manner; when they make decisions on the basis of irrelevant factors or with insufficient evidence; or when they frustrate the legitimate expectations of investors in respect of how their investment should be treated (when such expectation are raised as a result of previous government conduct). The Tribunal felt in that case that Article 1105 was violated since "Mexico failed to ensure a transparent and predictable framework for Metalclad's business planning and investment […], demonstrat[ing] a lack of orderly process and timely disposition in relation to an investor of a Party acting in the expectation that it would be treated fairly and justly in accordance with the NAFTA."[131] In this sense, transparency seems to include an obligation to clarify both the criteria for, and the exercise of, discretionary powers by a governmental authority.[132]

Even after the FTC interpretation, lack of transparency in the treatment of foreign investors (whether at the legislative, administrative or judicial levels) constitutes a fundamental underpinning of Article 1105 standard. The recent *Waste Management* Tribunal, presided by Prof. James Crawford, having reviewed the decisions of former NAFTA tribunals (such as *S.D. Myers*, *Mondev*, *ADF* and *Loewen*) noted the following:

> […] this survey shows, despite certain differences of emphasis a general standard for Article 1105 is emerging. Taken together, [these] cases suggest that the minimum standard of treatment of fair and equitable treatment is infringed by conduct attributable to the State and harmful to the claimant if the conduct is arbitrary, grossly unfair, unjust or indiosyncratic, is

[130] The TBT Committee has, however, adopted a number of recommendations and decisions concerning notification procedures for draft technical regulations and conformity assessment procedures relating to Article 2.9. See G/TBT/1/Rev.7, p. 11, 28 November 2000. In the SPS field, see the recent decision by the Committee on Sanitary and Phytosanitary Measures "Procedure to Enhance Transparency of Special and Differential Treatment in favour of developing country members", G/SPS/33, 2 November 2004.

[131] 2000 *Metalclad* Merits award, paras. 99-101.

[132] "The absence of a clear rule as to the requirement or not of a municipal construction permit, as well as the absence of any established practice or procedure as to the manner of handling applications for a municipal construction permit, amounts to a failure on the part of Mexico to ensure the transparency required by NAFTA." Ibid., para. 88.

> discriminatory and exposes the claimant to sectional or racial prejudice, or involves a lack of due process leading to an outcome which offends judicial propriety–as might be the case with a manifest failure of natural justice in judicial proceedings or a complete lack of transparency and candour in an administrative process."[133]

Without doubt, the breath of the *Waste Management* language leaves open great margin for discretion. More concretely, in *Pope & Talbot*, the Tribunal found a violation of Article 1105 NAFTA, inter alia, on the basis that the relevant Canadian administrative authority (Softwood Lumber Division of the Department of Foreign Affairs and International Trade, SLD) had not provided the US investor an explanation for some of its requests in connection with an audit initiated shortly after the investor had filed its notice of arbitration against the Canadian government.[134]

7. Participation

Article 2 TBT, though to a more limited extent, also contains participation requirements. Article 2.9.4 provides that Members shall "allow reasonable time for other Members to make comments in writing, discuss these comments upon request, and take these written comments and the results of these discussions into account." These requirements have clearly the interrelated, dual aim of (i) improving the participation of foreign parties in national decision-making processes and (ii) making sure that such foreign 'voices' be taken into account within such domestic processes. It is relevant to note how this requirement only applies where the proposed technical regulation "may have a significant effect on trade of other Members."

Both active and passive participation requirements may also seem to come out of the NAFTA Chapter 11 case-law addressing Article 1105. In *Metalclad*, the Tribunal found a violation of the 'minimum standard of treatment', inter alia, referring to the Mexican local authorities' failure to provide the US investor with a fair hearing in connection with the denial of a permit for the construction of a waste landfill. The Tribunal noted that:

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[133] Merits award on *Waste Management, Inc. v. The United Mexican States*, ICSID Case No. ARB(AF)/00/3, issued on 30 April 2004, para. 98. The Tribunal also noted that "A basic obligation of the State under Article 1105(1) is to act in good faith and form, and not deliberately to set out to destroy or frustrate the investment by improper means." *Ibid*., para. 138.

[134] 2001 *Pope and Talbot* Merits award, paras. 172-174: "A major sticking point on verification was the unwillingness of the SLD to conduct its review at the place where the documents were located. […] The SLD simply advised the Investment that the proposal to conduct verification in Portland [the investor's headquarters] was 'not acceptable,' but gave no reasons why. […] As noted, the Investment was initially willing to undergo a verification review in Portland; however, in correspondence after the SLD rejected that approach, the Investment began to ask whether the SLD had the authority to require verifications in the first place. The SLD refused to provide any kind of legal justification, relying instead on naked assertions of authority […]."

> "the permit was denied at a meeting of the Municipal Town Council of which Metalclad received no notice, to which it received no invitation, and at which it was given no opportunity to appear."[135]

In *Pope & Talbot*, one of the additional deficiencies in the administrative conduct attributed by the Tribunal to the Canadian government focused on the fact that the relevant administrative authority (the SLD), in denying the US investor's request to perform the verification at its headquarters in Portland, "made no effort to deal with the problem with an intent to alleviate the admitted burden that verification in Canada would cause to the Investment."[136] Along these same lines, the Tribunal in *Waste Management* found no violation of Article 1105 on the ground that the conduct of the Mexican local authority, though in breach of the concession contract with the US investor, could not be deemed "wholly arbitrary" or "grossly unfair" since such authority "performed part of its contractual obligations, […] it was in a situation of genuine difficulty, […] it sought alternative solutions to the problems both parties faced, without finding them."[137]

[135] 2000 *Metalclad* Merits award, para. 91
[136] 2001 *Pope & Talbot* Merits award, para. 173.
[137] 2004 *Waste Management* Merits award, para. 115.

III. Moving from NT to reasonableness: progress without revolution

As mentioned in the introduction, the present analysis is aimed at investigating the fundamental features of the NT and reasonableness principles employed as instruments of global economic governance in order to determine whether or not these two principles really belong to two different legal paradigms as it is usually believed they do. The paper first argues that the two concepts at issue are not qualitatively different, in the sense that when the NT principle is employed to review formally origin-neutral internal measures, such principle enters the ambit of, and effectively turns into, the principle of reasonableness. In other words, there is no 'revolution' in moving from NT to reasonableness. Secondly, the paper argues that, within the similar normative underpinning, there exist several reasons supporting the claim that an approach to global economic governance squarely based on reasonableness may indeed be superior in legitimacy terms compared to one based on non-discrimination. In other words, the move from NT to reasonableness represents 'progress'.

1. NT and reasonableness as overlapping concepts

Despite the apparent widespread belief that the two norms under consideration—NT and reasonableness—represent two completely different legal paradigms, it is argued here that the overlap between non-discrimination and reasonableness is quite broad and may even be total. This is especially true with regard to the level of intrusiveness into national regulatory prerogatives of the two instruments at hand. More specifically, once taken beyond 'formal' discrimination, the NT principle effectively turns into an analysis of the reasonableness of the national measure at issue. In a way, rather than from non-discrimination to reasonableness, the real shift may be said to occur when the NT principle is defined not simply on the basis of discriminatory 'language', but on the basis of discriminatory 'effect'. In other words, a greater shift takes place when the NT principle is employed not simply as a prohibition of *de jure* discrimination, but as a tool to review origin-neutral regulations with *de facto* discriminatory or protectionist features. Let me explain such a claim.

When the NT principle is defined simply on the basis of discriminatory 'language' (i.e., nationality as the prohibited regulatory criterion) or of a limited notion of 'inherent' discrimination (i.e., 'residence', 'religion', 'language' as the prohibited regulatory criteria), the prohibition of internal measures based on such formal regulatory criteria will be deemed to be in general an acceptable and reasonable *rule*. While such (prohibited) measures might be justified on public policy grounds, this would happen only in *exceptional* circumstances. This 'limited' version of the NT principle would function on the basis of the legal and policy assumption that internal measures based on such closed list of regulatory criteria should not in general be justified as a legitimate exercise of regulatory prerogatives.

On the other hand, when the NT principle is defined on the basis of a larger concept—such as discriminatory 'effect'—the normative balance between 'rule' and 'exception' changes dramatically. For example, a prohibition of origin-neutral measure with discriminatory effects *vis-à-vis* imported products or investors may not on its own represent a legitimate norm. Without an inquiry into the public policy justification (and in particular into the relationship between the measure and its policy objective), the NT principle would simply be lacking the necessary normativity. There is no general assumption at work in this situation. Without taking into account the "public policy justification" side of the NT equation, a prohibition on discriminatory 'effect' has practically no normative strength. Under a different perspective, the issue of whether the origin-neutral measure has discriminatory effects *vis-à-vis* foreign products or investors simply becomes a sort of 'threshold' question, necessary simply to determine the scope of application of the public policy justification analysis.[138]

This claim finds empirical support, first of all, in the types of arguments employed, on the one hand, in order to justify a (preliminary) finding of nationality discrimination (based on the measure's effects) and, on the other hand, in order to determine whether a measure complies with the principle of reasonableness.

Our comparative analysis shows that the normative standards or disciplines employed in the application of both the NT principle and the reasonableness principle are basically the same. An apparently origin-neutral measure adopted in order to pursue a legitimate public policy will be found to violate the NT principle (Article III GATT or Article 1102 NAFTA) or the reasonableness principle (Article 2 TBT and Article 1105 NAFTA) usually because the measure (a) is not suitable, effective or appropriate to achieve its policy objective, (b) is not the least-trade restrictive option reasonably available in order to achieve its policy objective, or (c) does not conform to certain minimum procedural requirements such as transparency or participation obligations. In other words, both violations are ultimately premised and justified on a finding of substantive and/or procedural unreasonableness. Cases such as *Shrimp/Turtle*,[139] *Sardines*, *Myers* and *Metalclad* clearly show this basic claim.

The second empirical support for our claim is in the relationship between the scope of the nationality discrimination test, on the one hand, and the scope of the public policy justification, on the other, in the two NT provisions examined in this study.

Our comparative analysis shows first of all that nationality discrimination has been defined on the basis of discriminatory 'effect' and thus focuses on whether the origin-neutral internal measure has a detrimental impact vis-à-vis foreign products or investors. However, the analysis also shows that, while a narrow justification exception usually tends

[138] Cf. Joel Trachtman, "Trade and … Problems", *supra*, text at footnotes 117-119
[139] For the argument that the *Shrimp/Turtle* dispute should have been examined under Article III:4 rather than Article XI GATT, see Ortino, *Basic Legal Instruments*, chapter 2.

to correspond to a narrow discrimination requirement, a broad justification avenue usually tends to correspond to a broad discrimination test. Although NAFTA Tribunals have given a very broad interpretation of what constitutes *de facto* discrimination, they have also allowed for an open-ended list of both economic and non-economic policies to be taken into account in order to justify *de facto* discriminatory measures. Recent WTO jurisprudence shows how a narrow public policy exception (as Article XX GATT has so far been interpreted) is unavoidably accompanied by a narrow reading of the nationality discrimination requirement. In this sense, in its report on *Asbestos* the Appellate Body's stricter interpretation of both the issue of 'likeness' (especially in the powerful dissenting opinion) and the issue of 'nationality imbalance' (in the famous paragraph 100) may be explained as a progressive understanding by WTO dispute settlement organs of the 'normative imbalance' inherent in extending the NT principle to cover origin-neutral internal measures without providing for a sufficiently broad public policy justification mechanism.[140] It is the scope of the justification on public policy grounds that shapes, to some extent, the scope of the prohibition of nationality discrimination.[141]

In light of these two observations, it is understandable that the current debate over the correct interpretation of the NT provision, in particular in WTO law, seems to indicate a preference for defining nationality discrimination on the basis of protectionist 'intent'.[142] As noted earlier, the fundamental feature of this type of interpretation resides on attributing relevance to the policy purposes of the national measure under review. Accordingly, in order to detect discriminatory or protectionist intent, an inquiry over the policy reasons underlying the national measure becomes indispensable. If a valid argument can be made that the measure under question has been taken to pursue a legitimate public policy, this can be used as evidence disproving the existence of protectionist intent.

I agree with this general willingness to rebalance the competing forces of the NT principle. However the point I would like to stress is another one, and to a certain extent it applies whether or not one defines 'nationality discrimination' on the basis of 'intent' or

[140] "This willingness to apply the principles of Article III:1 in Article III:4 leaves behind the hyper-formalism that Hudec deplored in the *Japan—Alcoholic Beverages* and *EC—Bananas* decisions." Trachtman & Porges, "Robert Hudec and Domestic Regulation: The Resurrection of Aim and Effects", 37 *Journal of World Trade* 4 (2003) 783, at 795-796.

[141] Moreover, the relationship between a finding of 'nationality discrimination' and one of 'justification on public policy grounds' in NAFTA Article 1102 seems to be more evenly balanced compared with the same relationship in GATT (between Article III and Article XX).

[142] See Henrik Horn & Petros Mavroidis, "Still Hazy After all these years: The interpretation of National Treatment in the GATT/WTO case-law on tax discrimination", 15 EJIL (2004); Henrik Horn & Joseph HH Weiler, "EC-Asbestos: European Communities -- Measures Affecting Asbestos and Asbestos-Containing Products", in Henrik Horn & Petros C. Mavroidis (eds) *The WTO Case Law of 2001: The American Law Institute Reporters' Studies* (Cambridge University Press, 2004); Donald H. Regan, "Further Thoughts on the Role of Regulatory Purpose Under Article III of the General Agreement on Tariffs and Trade -- A Tribute to Bob Hudec", 37 *Journal of World Trade* 4 (2003) 737–760; Amelia Porges and Joel P. Trachtman, "Robert Hudec and Domestic Regulation: The Resurrection of Aim and Effects", 37 *Journal of World Trade* 4 (2003) 783–799; Donald Regan, "Regulatory Purpose and "Like Products" in Article III:4 of the GATT", 36 *Journal of World Trade* 3 (2002), 443–478.

'effect'. As one moves away from a concept of nationality discrimination based on language (formal discrimination), the normative balance between discrimination and justification moves, too. Accordingly, if the focus of an NT analysis becomes whether or not the national measure is pursuing a legitimate policy objective in a reasonable manner, then the only reason for going through a preliminary determination of discriminatory effect or intent relates with the willingness to *limit* the scope of the review over whether the measure at hand is truly based on the pursuit of a legitimate public policy objective. Only those measures that show discriminatory effect or intent *vis-à-vis* foreign products or investors will be subject to the reasonableness review.[143] Discriminatory effect or intent thus functions as the *threshold question* and reasonableness becomes the true *normative content* of the general legal norm regulating international economic activities. Following this understanding, however, there should be no doubt that one could not be talking about non-discrimination any longer: this would simply be a different norm, one based on the reasonableness of States' internal measures. This is how some commentators have interpreted the non-discrimination rule in EC law following the ECJ decision in *Keck*. In the words of Maduro:

> protectionism is not a substantive criterion upon which a review of national measures can be based, but is rather a factor of legitimation for the Court in applying a balance test. The protectionism test does not tell us which measures are acceptable and which are not. Rather, it determines which measures are to be subject to balance and which are not.[144]

Perhaps to highlight this point, it may be useful to confront the NT principle embodied in Articles III and XX of GATT with Article 5.5 of the SPS Agreement, which provides in relevant part that "[…] each Member shall avoid *arbitrary* or *unjustifiable* distinctions in the levels [of SPS protection] it considers to be appropriate in different situations, if such distinctions result in *discrimination* [...]". This latter provision is a typical example of a rule based on 'reasonableness' whose scope of application is nevertheless limited by reference to discrimination (i.e., a limited reasonableness approach). In other words, an unreasonable distinction in the level of SPS protection will not breach Article 5.5 SPS if such distinction does not have any discriminatory effect. While discrimination functions as the threshold question, reasonableness constitutes the

[143] This structure appears to be very similar to the EC doctrine developed in the *Dassonville-Cassis de Dijon* jurisprudence according to which any measure hindering, directly and indirectly, actually and potentially, intra-Community trade, must be reasonably or proportionately related to a legitimate public policy objective: although formally the *Dassonville-Cassis de Dijon* doctrine is formulated in terms of a "ban" on trade-restrictive measures and a "justification" on public policy grounds, I believe that the ECJ jurisprudence on Articles 28-30 shows that the issue of whether the measure under review "hinders trade" functions in practice as the *threshold question* in order to limit the scope of application of the proportionality review on the basis of the 'mandatory requirements' doctrine. This means that, at least with regard to indistinctly applicable measures (formally origin neutral measures), the *normative content* of the rule is "reasonableness" or "proportionality" and certainly not a prohibition on all trade-restrictive measures.

[144] M P Maduro, "Reforming the Market or the State? Article 30 and the European Constitution: Economic Freedom and Political Rights" 3 *European Law Journal* (March 1997) 55 at 69.

normative content of the SPS provision. It is believed that, albeit only implicitly, this categorization is fundamentally true also for the norm stemming out of the interpretation of the NT provision in GATT/WTO jurisprudence.[145]

Following this line of argument, it should not be too difficult to appreciate how the NT principle does not fundamentally differ from a rule explicitly based on reasonableness whose scope is *not* limited to discriminatory measures only (i.e., an unlimited reasonableness approach, such as Article 2 of the TBT Agreement). While it is true that they would differ in scope of application, both rules would be grounded on the same key normative underpinning—the measure's reasonableness in public policy terms.[146]

2. From NT to reasonableness: a small step in the right direction

Having found that the principle of NT (interpreted as going beyond formal discrimination) and the principle of reasonableness are *qualitatively* grounded on the same normative underpinnings (with the potentially relevant difference in their scope of application, i.e., the 'threshold question'), my next question deals with whether there are any further lessons that can be drawn from the comparison of these two approaches to regulating international trade and investment. In particular, this section focuses on determining the level of "substantive legitimacy" of the two instruments under consideration, as measured on the basis of the general acceptability of the outcomes stemming out of the application of such instruments both in terms of economic liberalization and social justice. For such exercise, I borrow the non-constitutional model of global subsidiarity developed by Howse and Nicolaidis according to which the workings of the WTO should be stirred by three basic principles: institutional sensitivity (deference to the states and to other issue-area regimes), political inclusiveness (expand representation/participation of interested parties within national and international policy making processes) and top-down empowerment (proactive approach to help states reap maximum benefits from economic liberalization).[147]

It is argued here that the reasonableness approach (whether 'limited' or 'unlimited' in scope of application) may indeed be superior in legitimacy terms to an approach

[145] It should be noted that a rule or discipline based on reasonableness may also be limited by a concept which is unrelated to the concept of nationality discrimination, such as, for example, the magnitude of the negative effect of the measure *vis-à-vis* trade or investment. See the approach advocated by AG Jacobs in the context of EC law.

[146] Two practical lessons may be drawn from the argument regarding the broad overlap between non-discrimination and reasonableness: at a minimum, the list of public policies 'protected' under Article XX GATT needs to be expanded, or even better, a finding of nationality discrimination in Article III:4 GATT should be based on an assessment of discriminatory 'intent', which should be premised on an investigation of the policy reasons underlying the national measure under review. Adjudicatory organs appear to be the most likely recipients of these lessons.

[147] Robert Howse and Kalypso Nikolaidis, "Why Constitutionalizing the WTO is a Step Too Far" in Cottier, Mavroidis and Blatter (eds.), *The Role of the Judge in International Trade Regulation* (Ann Arbor, University of Michigan Press, 2003), at 331 ss.

expressly based on non-discrimination. Let us put forward a few reasons justifying this statement.

First of all, it appears that the way the NT principle is drafted and understood tends to set up a ranking of values where economic freedoms figure as the primary norm or fundamental policy and other public policy objectives as the secondary norm or exceptional policies. While this ranking may be warranted in certain circumstances (discrimination based on 'language' or 'inherence', for example), it may not in (many) others.

Our comparative analysis has evidenced that, despite interpreting the prohibition of nationality discrimination to cover both formally and materially discriminatory measures, the structure of the NT principle has remained unaltered. First, and independently of its formal structure, the NT norm has been envisioned in the two systems under consideration as a two-step analysis including "nationality discrimination", dealing with the detrimental impact of the national measure vis-à-vis foreign products or investors, and "public policy justification", focusing on the legitimacy and reasonableness of the national measure in light of the public policy objective pursued by the Member. Second, the formal relationship between these two steps is generally one of "rule" and "exception". This dichotomy between the "non-discrimination rule" and the "public policy exception", which is clearly evidenced in the structure of Articles III and XX GATT, but which is also reflected in the judicial application of NAFTA Article 1102, implicitly tends to establish a ranking of values where trade liberalization or investment protection represents the fundamental policy and other legitimate policy objectives are relegated to the status of secondary or exceptional policies.[148]

The practical consequence of this value-ranking surfaces in different places. First of all, in the context of the NT principle, given the rule/exception relationship between the prohibition of nationality discrimination and the public policy justification, the burden of proving the reasonableness of the measure at hand is usually imposed on the defending State, that is the *regulating* State. Attributing the key burden of proof plays without doubt a relevant role in shaping the outcome of a 'reasonableness' determination and consequently the final decision on violation. Moreover, related to the issue of the burden of proof, the question of the standard of scrutiny should also be mentioned. Depending on the perceived relevance of the values underlying the 'rule' vis-à-vis the exception, there might be differences in the standard employed by the judiciary to determine whether a national measure *de facto* discriminates and whether such measure complies with the reasonableness principle.[149] Again, this may influence the final outcome of an economic dispute.

[148] On a more general level, it may even be argued that this hierarchy of values is reflected not only in the NT obligations but in the entire structure of the WTO and the NAFTA.

[149] Cf. the Appellate Body Report on *Korea – Beef*, WT/DS161and 169/AB/R, adopted on 10 January 2001, para. 162. On the topic see Yutaka Arai-Takahashi, *The Margin of Appreciation Doctrine and the Principle of Proportionality in the Jurisprudence of the ECHR* (Oxford, Intersentia, 2002).

Secondly, other consequences of the above mentioned ranking may more subtly be found in the manner in which claims are brought by States or private parties as well as in the manner in which the review by dispute settlement organs of the public policy justification is carried out. Claims of (*de facto*) discrimination are usually framed without much consideration for the public policy reasons behind the national measure that has detrimental impact on foreign products or investors.[150] The unlawful conduct is allegedly premised on the mere existence of discriminatory effect *vis-à-vis* foreign goods or investors, rather than on the existence of a reasonable connection between the measures and its public policy objective. Moreover, in the inevitable, delicate balancing performed in order to assess the reasonableness of an origin-neutral measure under the public policy justification mechanism, the mere existence of an (albeit preliminary) finding of violation of the non-discrimination rule may play a certain role in the balancing itself. While a 'presumption' of unreasonableness is justified in the case of formally discriminatory measures, such a presumption appears not to be warranted in the case of only materially discriminatory measures.

Moreover, an approach based on reasonableness, where the "normative emphasis" is placed squarely on the soundness/reasonableness of the national regulation under review rather than on its discriminatory effects *vis-à-vis* foreign products or investors, appears to be superior in legitimacy terms since it is capable of better performing the basic function of the NT principle.

National regulators by definition pursue national interests. This is perhaps the key dilemma which characterizes international law. And this is what the NT principle also tries to avoid. At its core, the NT principle has been employed to recognize a voice to "foreign" interests (whether exporters or investors) in the "host" domestic policy and decision making processes. The NT principle tries to afford protection to foreign manufacturers and investors who feel that their interests are not taken into consideration by domestic authorities. In other words, the principle is premised on a condemnation of the pursuit of purely "national" economic interests. Perhaps this was not its original purpose, but from a study of the disputes involving trade and investment, this appears to be the underlying *leit motive* of its application.

However, if the underlying function of the NT obligation is to protect foreign products and investors by prohibiting Members to pursue purely "national" economic interests, it is clear that the principle is simply just too rudimental an instrument. Firstly, non-discrimination focuses principally and mainly on what Members should not do and

[150] For example, a recent controversy between US-based Noble Energy and the government of Ecuador in relation to government measures impacting the operations carried out by the US-based investor of a power generation plant in Machala, Ecuador shows how NT claims may be formulated in disregard of the public policy dimension of domestic regulation. Noble has voiced concerns about recent subsidies introduced for consumers of electricity produced from residual fuel (a by-product of refining gasoline and diesel). The US-based investor alleges that these subsidies put its gas-fired plant at a competitive disadvantage, in violation of the guarantees against discrimination contained in the US-Ecuador BIT. Cf. Luke Eric Peterson, INVEST-SD News Bulletin, Sept. 29, 2004.

lacks more precise, positive disciplines to make the principle operational. Second, any positive and operational features of the NT principle are lost or hidden in the public policy justification. It is clear that the NT principle cannot simply take away the prerogative of national governments to pursue their interests without substituting it with something else, such as, for example, attributing regulatory authority to a supranational entity pursuing global or regional policies. Since such a supranational entity is practically non-existent in the two systems under consideration and in any event it will not take over completely (even in the EU context, the supranational government has taken over only certain competences on an exclusive basis), there is a need to find a corrective tool or alternative to tackle the same preoccupations underlying the NT principle. Clearly, the 'public policy exception' leg of the NT provision serves this purpose: instead of simply prohibiting protectionist measures, the prohibition applies only to those measures which do not pursue *legitimate* public policy goals in a *reasonable* manner, where 'legitimate' means that the public policy goals be not protectionist (for example, the protection of domestic steel producers) and 'reasonable' means that the measure adopted by the State be an appropriate, necessary and transparent attempt to pursue that public policy goal.

Taking away the normative relevance of the concept of 'nationality discrimination' based on effects and squarely focusing instead on a review of the measure's public policy justification seems to represent a more advanced way to accomplish the underlying function of this type of general discipline, that is protecting the interests of foreign products and investors. Two reasons have already been mentioned for moving towards an approach to global economic governance based more squarely on reasonableness: first, the move would imply no fundamental change in paradigm, since the real normative criteria would practically be the same; secondly, it would realign the hierarchy of values involved in international disciplines dealing with trade and investment.

There are, however, further reasons that seem to predicate such a move. First of all, being clear and direct about what are the policy priorities and regulatory disciplines is generally a wise approach especially at the international level. Although similar arguments have been made within the context of the 'public policy justification' leg of the NT principle (in particular by the Appellate Body in its Article XX jurisprudence), adopting an approach based squarely on reasonableness will promote the emphasis and further elaboration of the reasonableness discipline based on both substantive and procedural requirements. Focusing, in the realm of international trade and investment, on such regulatory disciplines, in particular those incorporating procedural requirements, may particularly be beneficial to those countries (usually developing countries) which do not have a strong tradition of the rule of law, since it will have positive spillovers in other areas of national governance. In Howse and Nicolaidis' global subsidiarity model, this argument would further both the need for top-down empowerment and the need for political inclusiveness (at the national level).

Moreover, and possibly even more fundamentally, a move to reasonableness would embrace a more holistic approach to global economic governance. Contrary to the approach based on the non-discrimination 'rule' and the public policy 'exception', an approach based on reasonableness would not be premised on a stark contraposition of values such as 'trade versus environment', 'investment versus labor standards', etc., which seems to be characterizing not simply the current debate on the legitimacy of the WTO and NAFTA as institutions for global *economic* governance, but the broader debate on global governance itself. For purposes of the global subsidiary model, this line of reasoning incorporates the principle of institutional sensitivity, in the sense of attributing deference to other issue-area regimes.[151]

It should be emphasized once again that the shift of focus towards disciplines based on reasonableness does not have to mean abandonment of the concept of nationality discrimination. First of all, the NT principle could still be employed to tackle formally or inherently discriminatory measures. Second, the concept of material discrimination could be retained as one possible instrument in order to limit the scope of a reasonableness-based discipline (like in the example indicated above of Article 5.5 SPS). In this regard, the choice of the 'limited' or 'unlimited' version of the reasonableness approach will depend on factors such as the level of national sensitivity of the topic areas involved (i.e., compare public morality or religion with consumer protection or public health) as well as the willingness of the membership to adopt broader disciplines. Third, the concept of nationality discrimination may also function as a criterion to determine the legitimacy of the public policy underlying the State measure under review.

[151] In this regard, see Joost Pauwelyn, *Conflict of Norms in Public International Law: How WTO Law Relates to Other Rules of International Law* (Cambridge, CUP, 2003); Clive George & Colin Kirkpatrick, "Trade and Development: Assessing the Impact of Trade Liberalisation on Sustainable Development", *Journal of World Trade* 38 (2004) 441. Following a similar approach see the recent Draft Model Agreement on International Investment Agreement for Sustainable Development (Consultations Draft, January 2005) prepared by the International Institute for Sustainable Development (IISD), www.iisd.org.

Conclusion

The relevance in terms of socio-economic impact as well as public scrutiny of any supranational discipline purporting to regulate international trade and investment and thus limiting national States' regulatory prerogatives has grown exponentially in the last two decades. The need for these disciplines to embody 'clear' and 'sound' normative standards has become of paramount importance. The current emphasis in several of these disciplines on the non-discrimination 'rule', as accompanied by a limited public policy 'exception', does not seem to appropriately satisfy these needs. This paper has examined and compared the NT principle and the reasonableness principle as they have been employed in the contexts of WTO and NAFTA as instruments for economic governance. The two related arguments advanced by the paper are as follows: (i) the two concepts under consideration are not qualitatively different, in the sense that the overlap between the NT principle and the reasonableness principle is broad and, depending on the drafting of the latter, may even be total; (ii) without arguing for the total abandonment of the concept of nationality discrimination, in terms of overall legitimacy, there are a few reasons supporting the claim that a rationality-based regime is to be favored to one based on non-discrimination.

Although it is not a paradigm shift in the sense above mentioned, the move from NT to reasonableness may have nonetheless further implications. It is perhaps useful to note two in this context. First, a move towards the reasonableness principle may encourage a review of the merits or legitimacy of the public policy pursued by the Member and/or a review of the level of protection chosen by the Member, even without incorporating proportionality *stricto sensu* into the reasonableness test. In light of the difficulty in determining the exact level of protection pursued, a necessity test may soon and (even) unknowingly become an instrument to review whether the chosen level of public policy protection (and thus the measure chosen to reach it) is out of proportion compared with the aim of promoting trade and investment. As seen above, this will lead to a higher level of intrusiveness into Members' regulatory autonomy.

Second, focusing expressly on the merits or soundness of a national measure through the lenses of the reasonableness principle may represent the first step toward introducing additional approaches to the regulation of international trade and investment. In particular, such a non-revolutionary shift from NT to reasonableness may spur the need for a more legislative approach to global economic governance (i.e., through instruments of "positive integration"), rather than one based merely on general principles (so called, instruments of "judicial integration"). To a certain extent this is already visible in the "harmonizing" provisions of the WTO new generation Agreements such as the TBT and SPS Agreements.

It is not sure whether a move to "open" reasonableness will entail such consequences and whether these will be seen as positive or negative developments in the system of global economic governance. Perhaps, I should limit myself by noting that these

issues are embedded both in an approach based on reasonableness and on non-discrimination, the difference being that in the latter they are kept underwater while in the former they eventually come to the surface.