



---

# THE JEAN MONNET PROGRAM

*Professor J.H.H. Weiler*  
*European Union Jean Monnet Chair*

Jean Monnet Working Paper 05/05

Fernando Gonzalez Rojas

**The Notion of Discrimination in Article 1102 of NAFTA**

NYU School of Law • New York, NY 10012

All rights reserved.  
No part of this paper may be reproduced in any form  
without permission of the author.

ISSN 1087-2221  
© Fernando Gonzalez Rojas 2005  
New York University School of Law  
New York, NY 10012  
USA

New York University  
School of Law

Jean Monnet Seminar: Advanced Research in the Law and Policy of the EU, NAFTA, and  
WTO

---

**THE NOTION OF DISCRIMINATION IN ARTICLE 1102 OF NAFTA**

Director: Joseph H.H. Weiler

**Fernando Gonzalez Rojas**

•

New York, N.Y.  
Spring 2005

---

## THE NOTION OF DISCRIMINATION IN ARTICLE 1102 OF NAFTA

I.	Introduction.....	1
II.	Defining the Type of Discrimination Prohibited by Article 1102 .....	3
II.1.	The ‘Objective’ Approach .....	3
II.1.1.	The Absence of a General Exceptions Provision in NAFTA Chapter 11... 3	3
II.1.2.	Article 1114 Does Not Provide for a ‘Rule-Exception Regime’ .....	4
II.1.3.	Other Exception-establishing Provisions in NAFTA and GATT Do Not Apply to Investment-related Measures .....	6
II.2.	The “Purpose & Effect” Approach .....	10
II.2.1.	The Purpose: Protectionist Intent.....	11
II.2.2.	The Three-step Procedure of the ‘Effect & Purpose’ Method.....	12
II.2.3.	The Role of the ‘Like Circumstances’ Requirement in the ‘Effect & Purpose’ Method.....	14
II.2.4.	The Notion of Discrimination Under the ‘Effect & Purpose’ Method .....	15
II.2.5.	The Burden of Proving the Subjective Element .....	16
II.2.6.	The Rules of Justification Under the ‘Effect & Purpose’ Method.....	20
II.2.7.	The Effect: Less Favorable Treatment.....	23
II.2.7.1.	<i>Does NAFTA Article 1102 require the ‘most favourable treatment’?..</i> <i>25</i>	
II.2.7.2.	<i>The threshold of unlawful differential treatment .....</i>	26
II.2.7.3.	<i>The burden of proof in relation to the less favourable treatment .....</i>	29
II.3.	The Alternative Comparator Approach .....	30
II.3.1	‘Like Circumstances’ .....	33
II.3.1.1.	<i>Competition as the relevant comparator .....</i>	35
II.3.1.2.	<i>The ‘like products’ standard as the relevant comparator .....</i>	36
II.3.1.3.	<i>The ‘treatment’ determines the relevant comparators.....</i>	37
II.3.1.4.	<i>The national treatment clause v. the non-discrimination principle .....</i>	41
II.3.1.5.	<i>The ‘accordion’ of ‘like circumstances’ .....</i>	42
II.3.1.6.	<i>Whose circumstances? .....</i>	44
II.3.2	Less Favorable Treatment.....	45
II.3.3.	The Rules of Justification under the ‘Alternative Comparator’ Method ..	46
II.3.3.1.	<i>Reasonable relationship with a reasonable policy .....</i>	46
II.3.3.2.	<i>Consistency with the investment liberalizing objectives of NAFTA..</i>	53
III.	Conclusions.....	53

---

## THE NOTION OF DISCRIMINATION IN ARTICLE 1102 OF NAFTA

### I. INTRODUCTION

The principle of non-discrimination has long been recognized as part of the corpus of customary international law.<sup>1</sup> In its most simple form this principle requires the absence of discrimination.<sup>2</sup> Discrimination in general means treating equals in an unequal manner. The principle of non-discrimination is not absolute.<sup>3</sup> For centuries it has been accepted that “equality among unequals may be inequitable and that differential treatment may be essential for real equality.”<sup>4</sup> Therefore, it has been consistently accepted that the principle of non-discrimination, as a rule of international and domestic law, cannot provide for unrestricted equality.<sup>5</sup> The implementation of this principle as a rule of law, requires the determination of a category of subjects (the *equals*) among which certain differentiations (the *unequal*) must not be made. In many areas of the law, this

---

<sup>1</sup> See Burns H. Weston, *The Charter of Economic Rights and Duties of States and the Deprivation of Foreign-owned Wealth*, 75 Am. J. Int'l. L. 437, 441 (1981); see also W.A. McKean, *The Meaning of Discrimination in International and Municipal Law*, 44 BRIT. Y.B. INT'L L. 177, 277 (1970) (arguing that the non-discrimination principle should be considered as *ius cogens*); see also Kaj Hober, *Investment Arbitration in Eastern Europe: Recent Cases on Expropriation*, 14 AM. REV. INT'L ARB. 377, 385 (2003) (arguing that the principle of non-discrimination is a rule of customary law in the field of foreign investment, specifically in that of expropriation).

<sup>2</sup> See W.A. McKean, *supra* note 1, at 185-86.

<sup>3</sup> Advisory Opinion on the Minority Schools in Albania 1935 P.C.I.J. (ser. A/B) No. 64.

<sup>4</sup> OSCAR SCHACHTER, *SHARING THE WORLD'S RESOURCES*, cited in A.F.M. Maniruzzaman, *Expropriation of Alien Property and the Principle of Non-Discrimination in International Law of Foreign Investment: An Overview*, 8 J. TRANSNAT'L L. & POL'Y 57, 62 (1988).

<sup>5</sup> Oscar Chinn (Belg. v. Gr. Brit.), 1934 P.C.I.J. (ser. A/B) No. 63; Italian Government v. E.E.C. Commission European Court of Justice Case 13/63, [1963] 2 C.M.L.R. 289; RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 711 (1986); SIR HERSCH LAUTERPACHT, *THE DEVELOPMENT OF INTERNATIONAL LAW BY THE INTERNATIONAL COURT* 265 (1958).

---

categorization has been frequently established by treaty.<sup>6</sup> In the realm of investment, Article 1102 (National Treatment) of the North Free Trade Agreement (NAFTA)<sup>7</sup> is one example of this. As a contractual manifestation of the non-discrimination principle Article, NAFTA does not outlaw *all* kinds of discrimination, but only that which *aims at* protectionism. Article 1102 therefore, does not require *absolute* equality and as I will endeavor to demonstrate in this paper, it allows for the adoption and enforcement of *legitimate regulatory distinctions* among foreign and domestic investments and investors.

My objective is to identify the ‘*notion*’ of *discrimination* prohibited by Article 1102 by describing the different *methods* of interpretation of this provision, as drawn from the available NAFTA Chapter 11 jurisprudence. This task includes the description of the different steps that may be taken to establish a *prima facie* violation of Article 1102 and those which must be taken –in the opposite direction– to justify a legitimate measure under each one of these methods (I will call these latter steps the “rules of justification”).

Finally, I do not intend to identify all the different interpretative possibilities that might be applied to Article 1102, but rather only those which have been clearly defined in the published Chapter 11 disputes. In performing this task, my analysis is strongly influenced by similar works relating to Article III of the General Agreement on Tariffs and Trade (GATT).<sup>8</sup>

---

<sup>6</sup> A.A. Fatouros, *Towards an International Agreement on Foreign Direct Investment?*, 10 ICSID REV. FOREIGN INV. L.J. 181, 196 (1995).

<sup>7</sup> North American Free Trade Agreement, Dec. 17, 1992, U.S.-Mex.-Can., 32 I.L.M. 605.

<sup>8</sup> Henrik Horn & Joseph H.H. Weiler, *European Communities – Measures Affecting Asbestos and Asbestos-Containing Products* in THE WTO CASE LAW OF 2001 13 (Henrik Horn & Petros C. Mavroidis eds., 2004).

---

## II. DEFINING THE TYPE OF DISCRIMINATION PROHIBITED BY ARTICLE 1102

### II.1. THE ‘OBJECTIVE’ APPROACH

#### II.1.1. The Absence of a General Exceptions Provision in NAFTA Chapter 11

NAFTA Chapter 11 does not embody a provision, similar to Article XX of GATT, expressly establishing general exceptions to the national treatment clause, nor does it do so for all the substantive disciplines of Chapter 11.

Article 1108, entitled ‘Reservations and Exceptions,’ establishes very specific exceptions to the application of the NAFTA Chapter 11 provisions which do not address the issue of legitimate regulatory measures.<sup>9</sup> Does this mean then that the national treatment

---

<sup>9</sup> Article 1108 establishes:

“Article 1108: Reservations and Exceptions

“1. Articles 1102, 1103, 1106 and 1107 do not apply to:

“(a) any existing non-conforming measure that is maintained by

“(i) a Party at the federal level, as set out in its Schedule to Annex I or III,

“(ii) a state or province, for two years after the date of entry into force of this Agreement, and thereafter as set out by a Party in its Schedule to Annex I in accordance with paragraph 2, or

“(iii) a local government;

“(b) the continuation or prompt renewal of any non-conforming measure referred to in subparagraph (a); or

“(c) an amendment to any non-conforming measure referred to in subparagraph (a) to the extent that the amendment does not decrease the conformity of the measure, as it existed immediately before the amendment, with Articles 1102, 1103, 1106 and 1107.

“2. Each Party may set out in its Schedule to Annex I, within two years of the date of entry into force of this Agreement, any existing nonconforming measure maintained by a state or province, not including a local government.

“3. Articles 1102, 1103, 1106 and 1107 do not apply to any measure that a Party adopts or maintains with respect to sectors, subsectors or activities, as set out in its Schedule to Annex II.

“4. No Party may, under any measure adopted after the date of entry into force of this Agreement and covered by its Schedule to Annex II, require an investor of another Party, by reason of its nationality, to sell or otherwise dispose of an investment existing at the time the measure becomes effective.

---

rule to which the NAFTA Parties subjected themselves is an absolute rule? Or that any other measure that accords differential treatment to foreign investors or their investments, not expressly provided in the very limited list of Article 1108, should be deemed as unlawful even if motivated by a legitimate purpose? If we admit that the proposition that the national treatment rule does not allow the Parties to adopt legitimate regulatory measures is indefensible, where can we find the normative elements to support the opposite view?

One possibility –explored later–, is to identify the limits of the national treatment exigency in the language of Article 1102 itself. Another option is to try to find express support for an exception regime in the body of NAFTA or even in the provisions contained in different treaties. Some controversy has arisen in relation to this option.<sup>10</sup> In this subsection we will explore whether there are indeed provisions contained in Chapter 11, other parts of NAFTA or GATT which may be used to develop such a regime.

### **II.1.2. Article 1114 Does Not Provide for a ‘Rule-Exception Regime’**

---

“5. Articles 1102 and 1103 do not apply to any measure that is an exception to, or derogation from, the obligations under Article 1703 (Intellectual Property National Treatment) as specifically provided for in that Article.

“6. Article 1103 does not apply to treatment accorded by a Party pursuant to agreements, or with respect to sectors, set out in its Schedule to Annex IV.

“7. Articles 1102, 1103 and 1107 do not apply to:

“(a) procurement by a Party or a state enterprise; or

“(b) subsidies or grants provided by a Party or a state enterprise, including government supported loans, guarantees and insurance.

“8. The provisions of:

“(a) Article 1106(1)(a), (b) and (c), and (3)(a) and (b) do not apply to qualification requirements for goods or services with respect to export promotion and foreign aid programs;

“(b) Article 1106(1)(b), (c), (f) and (g), and (3)(a) and (b) do not apply to procurement by a Party or a state enterprise; and

“(c) Article 1106(3)(a) and (b) do not apply to requirements imposed by an importing Party relating to the content of goods necessary to qualify for preferential tariffs or preferential quotas.”

<sup>10</sup> See e.g. *United Mexican States v. United States of America*, Final Report of the Panel in the Matter of Cross-Border Trucking Services, Secretariat File No. USA-MEX-98-2008-01 (Feb. 6, 2001) ¶ 293 [hereinafter *Cross-Border Trucking Services*]; see also Reply of Claimant Methanex Corporation to United States Amended Statement of Defense (*Methanex Co. v U.S.*) (Feb. 19, 2004) ¶¶ 188-197 [hereinafter *Methanex’s Reply*].

---

Article 1114 of NAFTA establishes:

*Article 1114: Environmental Measures*

1. Nothing in this Chapter shall be construed to prevent a Party from adopting, maintaining or enforcing any measure otherwise consistent with this Chapter that it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to environmental concerns.

2. The Parties recognize that it is inappropriate to encourage investment by relaxing domestic health, safety or environmental measures. Accordingly, a Party should not waive or otherwise derogate from, or offer to waive or otherwise derogate from, such measures as an encouragement for the establishment, acquisition, expansion or retention in its territory of an investment of an investor. If a Party considers that another Party has offered such an encouragement, it may request consultations with the other Party and the two Parties shall consult with a view to avoiding any such encouragement.

Does the inclusion of this provision in Chapter 11 mean that legitimate regulatory measures are allowed only when they address environmental concerns? In any event, did the Parties intend this provision to function as a general exception to the Parties' obligations under Chapter 11, at least in relation to environmental measures? The language of Article 1114 seems to suggest something different. The inclusion of the expression "otherwise consistent with this Chapter" apparently precludes any possibility that this provision may be opposable as a true environmental exception to the application of Article 1102 or any other substantial provision in Chapter 11. The use of terms such as "inappropriate" *vis-à-vis* 'unlawful' or 'illegal,' or "should not waive" instead of 'shall not' seems to reinforce this idea.

In the disputes publicly known, no serious attempt has been made to argue based on Article 1114, that a measure should be exempted from the national treatment rule. On the

---

contrary, investors have clearly expressed their view that Article 1114 does not establish any exception to the obligations of the Parties under Chapter 11.<sup>11</sup>

In any event, even if Article 1114 established a general exception for environmental measures, this would be insufficient to preserve the regulatory autonomy of the Parties in all the other non-environment related areas.

Therefore, Article 1114 of NAFTA does not provide sufficient normative basis to implement a method of interpretation of Article 1102 that would allow the Parties to justify their legitimate regulatory measures as *exceptions* to the national treatment principle.

### **II.1.3. Other Exception-establishing Provisions in NAFTA and GATT Do Not Apply to Investment-related Measures**

NAFTA Article 2101 entitled “General Exceptions” contained in Chapter 21 (Exceptions), expressly calls for the applicability of Article XX of GATT to several parts of NAFTA and makes express reference also to the adoption or enforcement by any Party of measures “necessary to secure compliance with laws or regulations ... including those relating to health and safety and consumer protection.”

Paragraph 1 of Article 2101 establishes

*Article 2101: General Exceptions*  
1. For purposes of:

---

<sup>11</sup> See e.g. *Methanex’s Reply supra* note 10, ¶ 188 n. 285.

---

(a) Part Two (Trade in Goods), except to the extent that a provision of that Part applies to services or **investment**, and

(b) Part Three (Technical Barriers to Trade), except to the extent that a provision of that Part applies to services,

GATT Article XX and its interpretative notes, or any equivalent provision of a successor agreement to which all Parties are party, are incorporated into and made part of this Agreement.

The Parties understand that the measures referred to in GATT Article XX(b) include environmental measures necessary to protect human, animal or plant life or health, and that GATT Article XX(g) applies to measures relating to the conservation of living and non-living exhaustible natural resources (emphasis added).

Although a plain reading of this provision would lead us to conclude that Article XX of GATT does not apply to investment related measures, the language used in this paragraph seems to leave some room for doubt. For example, does the fact that paragraph 1(a) refers to “services or investment” and paragraph 1(b) refers only to services mean that measures that affect –or *apply to* – investors or their investments and that take the form of technical barriers to trade (*e.g.* a ban on the importation of PCB’s such as in the *S.D. Myers* case) may be justified through Article XX of GATT? This confusion may explain why some investors have felt the necessity to argue as part of their pleadings the non-applicability of Article XX or that if Article XX is applicable, that it would be for the Parties to prove that their measures are strictly justified under one of the exceptions enunciated therein.<sup>12</sup>

Paragraph 2 of Article 2101 on the other hand establishes:

---

<sup>12</sup> *Id.* at ¶ 188. In this document the claimant stated:

“There is no provision in NAFTA Chapter 11 explicitly permitting environmental exceptions to the national treatment obligation. The closest general exception in the NAFTA is Article 2101, which specifically incorporates the standards of Article XX of the GATT. GATT and WTO case law clearly places on the U.S. the burden of proof regarding the validity of an environmental measure that denies national treatment.

“[...]

“The WTO provides an exception to its national treatment regime for environmental measures, but it is a very narrow exception. Under the WTO regime, the U.S. must prove that the measures were “necessary” to protect human, animal, or plant life or health. Then, it must prove that, in order to achieve California’s objective, there existed no alternative that was less restrictive with respect to other NAFTA investors and their investments.”

---

2. *Provided that such measures are not applied in a manner that would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail or a disguised restriction on trade between the Parties, nothing in:*

- (a) Part Two (Trade in Goods), to the extent that a provision of that Part applies to services,*
- (b) Part Three (Technical Barriers to Trade), to the extent that a provision of that Part applies to services,*
- (c) Chapter Twelve (Cross-Border Trade in Services), and*
- (d) Chapter Thirteen (Telecommunications),*

*shall be construed to prevent the adoption or enforcement by any Party of measures necessary to secure compliance with laws or regulations that are not inconsistent with the provisions of this Agreement, including those relating to health and safety and consumer protection.*

This provision also raises several questions. Should this paragraph be interpreted as implying that the adoption or enforcement of measures relating to health and safety and consumer protection is permissible only in relation to trade in goods, technical barriers to trade, cross-border trade in services and telecommunications? This extreme conclusion seems hard to accept. Why did the Parties not consider it appropriate to include Chapter 11 measures in this paragraph? Was it because they considered that a similar result in relation to measures affecting investment could be achieved by other means?

Other provisions of NAFTA establish exceptions to the application of specific obligations or define language that if applied to Chapter 11, would be of great significance. For example, Article 915 of NAFTA defines 'legitimate objective' for the purposes of Chapter 9 (Standards-related Measures).<sup>13</sup> The question here is whether these provisions

---

<sup>13</sup> Article 915 expressly establishes:

“Article 915: Definitions

“1. For purposes of this Chapter:

“[...]

“legitimate objective includes an objective such as:

“(a) safety,

“(b) protection of human, animal or plant life or health, the environment or consumers, including matters relating to quality and identifiability of goods or services, and

“(c) sustainable development,

“considering, among other things, where appropriate, fundamental climatic or other geographical factors, technological or infrastructural factors, or scientific justification but does not include the protection of domestic production;”

---

may be seen as part of the context of Article 1102 and other disciplines in NAFTA Chapter 11 and therefore arguably influence their interpretation. This possibility seems rather remote.

In the first place, even if these provisions were taken, for interpretative purposes, as part of the context of the Chapter 11 disciplines, it is unclear whether their interpretative influence could rise to the level of true exceptions to the applicability of the national treatment clause or other Chapter 11 obligations. The rules of interpretation of Article 31 of the Vienna Convention on the Law of Treaties do not seem to provide support for such a proposition.

Moreover, in a previous decision, a NAFTA panel expressed the view that in the absence of an express reference in the treaty, no general or specific exceptions may be opposed to the national treatment rule:

*The applicability of Chapter Nine of NAFTA to this proceeding has been discussed in the Services section, supra. It is sufficient to note here that Chapter Nine does not apply to measures affecting investment, and there is no provision of Chapter Nine that could be read as either incorporating or overriding the national treatment obligation for investment. Similarly, the general exceptions contained in Article 2101(2) apply only to trade in goods (Part Two), technical barriers to trade (Part Three), cross-border trade in services (Chapter Twelve) and telecommunications (Chapter Thirteen), and thus cannot affect the U.S. obligations under Chapter Eleven (footnote omitted).<sup>14</sup>*

Therefore, there seems to be no textual support to sustain that the Parties intended to establish a set of measures or categories of measures similar to those of Article XX in GATT which would operate as exceptions to the application of the national treatment clause to preserve their regulatory autonomy powers. Consequently, the ‘general rule-exception’

---

<sup>14</sup> *Cross-Border Trucking Services supra* note 10, ¶ 293.

---

method of interpretation (*objective*) that may be used to allow legitimate measures in the context of Article III of GATT does not appear to be suitable for the interpretation of Article 1102 of NAFTA. And if we are to persist in our conviction that the notion of discrimination prohibited in Article 1102 does not entail a total renunciation of such a regulatory capacity other methods of interpretations must be explored.

## **II.2. THE “PURPOSE & EFFECT” APPROACH**

The language of Article 1102 makes no express reference to any *intention* test as a necessary component of a breach of the national treatment clause. Article 1102 of NAFTA, contrary to GATT Article III, does not include an expression similar to “as to afford protection” that might indicate the necessity to prove a *protectionist intent*. The structure of Article 1102 seems to call instead for the application of a two-step objective standard; determining **(i)** whether foreign investors or their investments have been accorded less favorable treatment in relation to domestic investors or investments, and **(ii)** whether the domestic and foreign investors or investments were in like circumstances. In other words, it seems that for a violation of Article 1102 to be proved, it is necessary to demonstrate that the application of a measure upon an objectively identifiable context, namely, investors or investments in like circumstances, produces the effect, objectively identifiable as well, of according less favorable treatment to foreign investors or their investments. Once both objective situations have been verified, there is a violation to Article 1102, regardless of whether the intention of the Party applying such measure was protectionist or not.

---

Not infrequently however, discussion about intent is present in the disputes involving the application of Article 1102 of NAFTA. Some claimants have endeavored to prove the existence of a subjective element, consisting of the aim of economically protecting nationals. The same subjective component has sometimes been required by tribunals in order to declare the existence of a breach of Article 1102. The panel in *S.D. Myers* for instance, expressly recognized that “intent is important” when deciding on an alleged violation of Article 1102.<sup>15</sup> But when does ‘intent’ become relevant in the analysis of an Article 1102 claim? Where in the language of this provision is there a plea for proving the purpose, motive or intent of the Party taking the measure? What is the exact content of this ‘intent’? When drafting Article 1102, was the intention of the Parties to rely on an inquiry of real purpose of their governments to distinguish between legitimate and unlawful discrimination? How can the will of a Party be proved, especially in the case of disguised protectionism? Does the investor bear the burden of proving this intent? Or is it the Party who must offer evidence that its measure is motivated by something different to protectionism? We will address these questions in the following pages.

### **II.2.1. The Purpose: Protectionist Intent**

As we noted above, a reasonable understanding of Article 1102 should lead us to conclude that this provision does not prohibit every action that results in less favorable treatment for foreign investors or their investments; but rather, that what Article 1102 really outlaws is *protectionism* in the realm of investment. As one commentator noted “a Chapter 11 panel

---

<sup>15</sup> *S.D. Myers, Inc. v. Canada, Partial Award on the Merits* (Nov. 13, 2000) ¶ 254 [hereinafter *S.D. Myers Award*].

---

must focus on whether there is sufficient evidence of economic protectionism (or, conversely, whether a State interest unrelated to economic protectionism may be found).”<sup>16</sup>

Protectionism under the ‘effect and purpose’ doctrine means according less favorable treatment to foreign investors or their investments, primarily as a result of their *nationality*. Therefore, this method of interpretation looks for two things: evidence of differential treatment between foreign and domestic investors or investments in like circumstances –what is called *discrimination*–<sup>17</sup> and evidence that this differentiation is *motivated* by the *nationality* of the investors or investments involved.<sup>18</sup>

As the panel in *Marvin Feldman* stated: “[i]t is clear that the concept of national treatment as embodied in NAFTA and similar agreements is designed to prevent *discrimination on the basis of nationality* or ‘*by reason of nationality*’ (emphasis added).”<sup>19</sup>

### **II.2.2. The Three-step Procedure of the ‘Effect & Purpose’ Method**

The ‘effect and purpose’ method finds explicit support for its objective component –less favorable treatment– in the language of Article 1102 itself. This provision however, does not expressly require that the difference in treatment must be motivated by the nationality of the investor or investment. One distinctive characteristic of this method is that it does not

---

<sup>16</sup> Ari Afilalo, *Meaning, Ambiguity and Legitimacy: Judicial (Re-) Construction of NAFTA Chapter 11*, 25 NW. J. INT’L L. & BUS. 279, 304-305 (2005).

<sup>17</sup> Submission of the Government of Canada Pursuant to NAFTA Article 1128 (Loewen Group, Inc. & Raymond L. Loewen v. U.S.) (Nov. 19, 2001) ¶ 7.

<sup>18</sup> Forth Submission of the Government of Canada Pursuant to NAFTA Article 1128 (Methanex Corp. v. U.S.) (Jan. 30, 2004) ¶ 5.

<sup>19</sup> *Marvin R. Feldman v. Mexico*, Award on the Merits (Dec. 16, 2002) ¶ 181.

---

use the ‘like circumstances’ requirement to support its position that a breach of Article 1102 requires a measure motivated by the nationality of the investors or investments. Rather, the ‘effect and purpose’ method considers that the combination of the two elements present in the wording of Article 1102, ‘less favorable treatment’ and ‘like circumstances’, gives rise to a *presumption* that the measure is *motivated* by the nationality of the investors or investments affected.

In the words of the *Marvin Feldman* tribunal:

*[I]t is not self-evident, as the Respondent argues, that any departure from national treatment must be **explicitly** shown to be the result of the investor’s nationality. There is no such language in Article 1102. Rather, Article 1102 by its terms suggests that it is sufficient to show less favorable treatment for the foreign investor than for domestic investors in like circumstances. In this instance, the evidence on the record demonstrates that there is only one U.S. citizen/investor, the Claimant, that alleges a violation of national treatment under NAFTA Article 1102, and at least one domestic investor (Mr. Poblano) who has been treated more favorably. For practical as well as legal reasons, the Tribunal is prepared to **assume** that the differential treatment is a result of the Claimant’s nationality, at least in the absence of any evidence to the contrary (emphasis added and references to the transcript omitted).<sup>20</sup>*

It is worth noting that the tribunal does not say that the subjective element is not needed for a violation to be proved, but rather that it can be *presumed*. This method of interpretation therefore, calls for a three-step procedure to establish a violation of Article 1102. *First*, a demonstration that there are foreign and domestic investments in like circumstances. *Second*, proof that they have been accorded differential treatment. And *third*, a failure to rebut the presumption thereby generated that the *motive* of the measure is the nationality of the foreign investors or investments involved.<sup>21</sup>

---

<sup>20</sup> *Id.* ¶ 181.

<sup>21</sup> See e.g. the Article 1102 analysis of the tribunal in *Marvin Feldman* included the following subsections: “In Like Circumstances”, “Existence of Discrimination” and “Discrimination as a Result of Nationality,” *id.* ¶¶ 170-80.

---

It is important to emphasize that according to this method, the analysis of the motivation of the Parties is one actually calling for the determination of a subjective element.

As the arbitrators in *Marvin Feldman* sustained:

*Also, as the Respondent argues, if the **motives** for the government's actions should not be examined, there is effectively no way for the Claimant or this Tribunal to make the **subjective determination** that the discriminatory action of the government is a **result of the Claimant's nationality**, again in the absence of credible evidence from the Respondent or a **different motivation**. If Article 1102 violations are limited to those where there is explicit (presumably de jure) discrimination against foreigners, e.g., through a law that treats foreign investors and domestic investors differently, it would greatly limit the effectiveness of the national treatment concept in protecting foreign investors.<sup>22</sup>*

### II.2.3. The Role of the 'Like Circumstances' Requirement in the 'Effect & Purpose' Method

This method seems to perceive the 'like circumstances' analysis and the 'motivation' analysis as two separated, although somehow related, matters. For this reason, for the *Marvin Feldman* tribunal, "which domestic investors, if any, are in 'like circumstances' with the foreign investor" and "the extent to which differential treatment must be demonstrated to be a result of the foreign investor's nationality"<sup>23</sup> are two different questions.

Therefore, under this method, it is legally possible for a Party to accord less favorable treatment to foreign investors in relation to domestic investors in like circumstances, and yet be in compliance with Article 1102, if it proves that the difference in treatment is not *motivated* by the difference in nationality.

---

<sup>22</sup> *Supra* note 19, ¶ 183.

<sup>23</sup> *Id.* ¶ 166.

---

Hence, an interpretation of Article 1102 based on this method, may use very broad criteria to determine whether two or more investors are in *like circumstances*. Categories as generic as those proposed by the Organisation for Economic Co-operation and Development (OECD)<sup>24</sup> –and followed by some tribunals–<sup>25</sup> such as ‘sector’ may be sufficient under this method to identify investors or investments in like circumstances. The ultimate ‘filter’ to distinguish between unlawful and legitimate measures will reside not in the like circumstances analysis, but in the capacity of the Parties to demonstrate that their measures are not *motivated* by the investors’ nationality.

#### **II.2.4. The Notion of Discrimination Under the ‘Effect & Purpose’ Method**

According to the ‘effect and purpose’ method the notion of discrimination prohibited by Article 1102 is the *discrimination motivated by the nationality of the investors or the investments*. Discrimination here takes a very ordinary meaning. The most ordinary notion of discrimination implies distinguishing among otherwise undistinguishable things. Under the ‘effect and purpose’ doctrine discrimination means making differences between potentially non-discernable investors. The requirement of *like circumstances* then simply provides a very flexible basis for the logical construction of discrimination: as long as there is a not absolutely unreasonable set of criteria under which two investors or investments may be considered in like circumstances, even if very remotely, the requirement of like circumstances will be satisfied.

---

<sup>24</sup> *Declaration on International and Multinational Enterprises* OECD (June 21, 1976 revised in 1993) available at [http://www.oecd.org/document/53/0,2340,en\\_2649\\_34887\\_1933109\\_119672\\_1\\_1\\_1.00.html](http://www.oecd.org/document/53/0,2340,en_2649_34887_1933109_119672_1_1_1.00.html).

<sup>25</sup> See e.g. *S.D. Myers Award*, ¶ 250, see also *Pope & Talbot, Inc. v. Canada, Award on the Merits of Phase 2* (Apr. 10, 2001) ¶ 78 [hereinafter *Pope & Talbot Award II*].

---

## II.2.5. The Burden of Proving the Subjective Element

As we noted above, under the ‘effect and purpose’ method, once the investor has established a *prima facie* case of discrimination, the burden of proving that the measure is not motivated by the nationality of the investors lies on the respondent. The panel in *Marvin Feldman* explained the convenience of this procedural solution:

*More generally, requiring a foreign investor to prove that discrimination is based on his nationality could be an insurmountable burden to the Claimant, as that information may only be available to the government. It would be virtually impossible for any claimant to meet the burden of demonstrating that a government’s motivation for discrimination is nationality rather than some other reason.<sup>26</sup>*

If this is true why has the investor in *Methanex* been left with the *entire* burden of proving that the aim of the Government of California when adopting the ban on methyl tertiary butyl ether (MTBE) was to protect Methanex’s domestic competitors?<sup>27</sup> Does this decision not conflict with reasoning and outcome of the *Marvin Feldman* tribunal’s award?

A possible answer to this question and a solution for these apparently conflicting positions is that the presumption identified by the tribunal in *Marvin Feldman* does not find its normative support in Article 1102 only but rather that it is the result of the combined

---

<sup>26</sup> *Supra* note 19, ¶ 182.

<sup>27</sup> *Methanex Corp. v. United States*, Preliminary Award on Jurisdiction and Admissibility (Aug. 7, 2002) ¶ 172. Thereby the tribunal ordered:

“As regards part of Methanex’s Amended Statement of Claim (as subsequently supplemented by its written and oral submissions), the Tribunal decides that certain allegations relating to the “intent” underlying the US measures could potentially meet the requirements of Article 1101(1) NAFTA, thereby allowing part of Methanex’s case to fall within the jurisdiction of the Tribunal. “It is impossible for the Tribunal now to make a ruling on jurisdiction in regard to this part of Methanex’s case without a fresh pleading from Methanex accompanied by evidential materials...”

---

effect of several provisions of NAFTA Chapter 11 or at least of Article 1101 and Article 1102.

Indeed, the tribunal in *Methanex* found itself without jurisdiction to adjudicate on the matter<sup>28</sup> because there was no “legally significant connection” between the investor and the measures taken by the Party,<sup>29</sup> as required by the expression “relating to” contained in Article 1101 of NAFTA.<sup>30</sup> According to the tribunal, the measure was directed to those who produced and commercialized MTBE and not to their methanol suppliers, such as Methanex.

Methanex contended that the phrase “relating to” should be interpreted broadly, in light of liberalizing objectives of NAFTA Chapter 11.<sup>31</sup> According to Methanex, the threshold provided by Article 1101(1) means nothing more than “affecting.”<sup>32</sup> On the other hand, the United States argued that “relating to” means that “there must be a legally significant connection between the measure and the investor or the investment.”<sup>33</sup> Using its prerogatives under Article 1128 of NAFTA, Mexico intervened in this dispute and expressed that:

---

<sup>28</sup> *Id.* ¶ 150.

<sup>29</sup> *Id.* ¶ 147.

<sup>30</sup> Article 1101(1) of NAFTA establishes:

“Article 1101: Scope and Coverage

“1. This Chapter applies to measures adopted or maintained by a Party relating to:

“(a) investors of another Party;

“(b) investments of investors of another Party in the territory of the Party; and

“(c) with respect to Articles 1106 and 1114, all investments in the territory of the Party (emphasis added).”

<sup>31</sup> *Supra* note 27, ¶ 137.

<sup>32</sup> *Id.* ¶ 137.

<sup>33</sup> *Id.* ¶ 139.

---

*Mexico agrees with the position of the United States, and disagrees with Methanex's contention that measures that merely "affect" investors or investments are covered by Chapter Eleven... The phrase "relating to" must be given its distinct meaning, particularly in light of the how [sic] the NAFTA and other international trade agreements distinguish between the terms "relating to" and "affect" ....*

*The significance of this distinction to Chapter Eleven tribunals is that measures that "relat[e] to" investors or investments have a closer degree of connection than measures that merely "affect" them. Under the GATT jurisprudence, the test adopted for the measure to be found to be "relating to" was that of being "**primarily aimed at**". The test adopted for the purposes of Article 1101 must reflect the NAFTA drafters' intent to require a more direct nexus between the measure and the investor or its investment than mere effect, as evidenced by the text's considered use of "relating to" (emphasis added and footnotes omitted).<sup>34</sup>*

The panel decided that the "phrase 'relating to' in Article 1101(1) NAFTA signifies something more than the mere effect of a measure on an investor or an investment and that it requires a legally significant connection."<sup>35</sup> The panel never clearly explained what the exact meaning of 'legally significant connection' is but, drawing from its comments on the *Pope & Talbot* decision, it apparently means something more than 'affect' but something less than 'primarily directed'.<sup>36</sup>

The disputing parties agreed however that "[i]f the purpose of the measure is an **intent** to harm foreign owned investors or investments on the basis of nationality, then the measure relates to the foreign-owned investor or investment" (emphasis added).<sup>37</sup> Based on this agreement, the panel decided that in order for Methanex to have a valid claim under

---

<sup>34</sup> United Mexican States' Submission Pursuant to Article 1128 of NAFTA (Methanex Corp. v. U.S.) (Apr. 30, 2001) ¶¶ 7-8 [hereinafter *Mexico's Submission in Methanex*].

<sup>35</sup> *Supra* note 27, ¶ 147.

<sup>36</sup> *Id.* ¶ 142. The tribunal set forth:

"In *Pope & Talbot*, Canada contended that a measure could only relate to an investment if it was "primarily directed" at that investment and, in particular, that an allocation quota was not related to an investor whose trade was nevertheless directly affected by that quota. As is clear from paragraphs 33-34 of the award, the tribunal did not reject Canada's argument that it was insufficient that a measure "affect" an investor. The tribunal did reject the contention that the measure must be primarily directed at the investment; but this is not what the USA now contends; and the case is therefore only of limited assistance to Methanex's submissions."

<sup>37</sup> *Id.* ¶ 152.

---

Chapter 11, it had to submit new fresh pleadings along with all the evidence aimed at demonstrating such an intention.<sup>38</sup>

What conclusion should we draw from this decisions? How does the operation of Article 1101 affect that of Article 1102? Are the decisions of the panels in *Marvin Feldman* and *Methanex* on the allocation of the burden of proof inconsistent? One commentator believes that:

*[O]ne should not conclude that just because Methanex appears to have been told that to succeed in its claim it must prove the existence of discriminatory intent behind California's measures, that all future claimants will be required to do the same.... Methanex finds itself in this position because it and the USA agreed that if such specific intent existed to harm Methanex or firms like it, Methanex would meet the test of the measure "relating to" its investment, as required under Article 1101. For most investors, meeting the Article 1101 threshold is automatic....*<sup>39</sup>

Shall we then conclude that in cases where a measure *directly affecting* foreign investors or their investments results in *less favorable treatment* for them in relation to similarly situated (in *like circumstances*) domestic investors or investments, the burden of proving a non-nationality related intent is for the Party? And that if one of the elements of this equation changes so does the burden of proof? In other words, that the presumption upon which the *Marvin Feldman* tribunal rests its decision is the result not only of the combination of the normative elements embodied in Article 1102 but also of the ‘synergy’ provided by passing the Article 1101 threshold?

Even if we were to accept, as the referred commentator does, that both the agreement of the parties and the tribunal’s decision based on it in *Methanex* lack practical

---

<sup>38</sup> *Id.* ¶ 172.

<sup>39</sup> Todd Weiler, I NAFTA NEWS II (Sept. 21, 2002) at <http://www.naftaclaims.com/News/NN%2001-02.pdf>.

---

relevance, from the doctrinal observational stand point, it is of some significance to determine how the conjoint operation of Articles 1101 and 1102 works. Is it sound to say for example, that the less *direct* the measure is, the greater the need to prove *less favorable treatment*? How does the ‘relating to’ and ‘like circumstances requirement’ relate to each other? If strong evidence of discrimination motivated by nationality may ‘patch-up’ a deficient claim under Article 1101, is the same effect in the opposite direction possible as well?

We can anticipate at least some debate as to the practical effects of this decision. In its latest communication on the merits to the tribunal, Methanex contended “to the extent that an intent requirement exists under Article 1101, it is the United States, not Methanex, that bears the burden of proving that California, in violating national treatment standards, had no intent to discriminate or act in an arbitrary manner.”<sup>40</sup> Is this position sound?

#### **II.2.6. The Rules of Justification Under the ‘Effect & Purpose’ Method**

If under the ‘effect and purpose’ method it is for the Parties to demonstrate that their measures are not motivated by the nationality of the investors involved, then how can they discharge this burden? Is it sufficient to prove that their measure was motivated by whatever other reason as long as it is not nationality? What exactly does ‘motivated by nationality’ mean? Does it mean xenophobic hatred? If so, does it have to be a kind of animosity officially embraced by the government or are the personal prejudices of the decision makers what matters? What if the measure is not motivated by arborescence

---

<sup>40</sup> *Methanex’s Reply supra* note 10, ¶ 196.

---

towards foreigners but by the economic or political benefits resulting from discriminating against them? Is there any difference for the purposes of Article 1102?

In its collateral participation in the *Loewen* dispute, Mexico asserted:

*[W]hen applying the national treatment rule, the **only** relevant issue of status is the investor's nationality. In other words, discrimination based on race or economic class cannot constitute a breach of Article 1102, even if the affected person happens to be a non-national (bolds in italics in the original).*<sup>41</sup>

Does this mean that under the 'effect and purpose' doctrine a Party may justify its conduct on the basis of 'naked' racism for example? Is there a set of 'legitimate motivations' for the Parties to adopt a measure? Or should we conclude that legitimate measures are all those which are not motivated by the *nationality* of the investor?

The position advanced by Mexico and by the United States, respondent in this dispute, was finally adopted by the tribunal which declared that:

*We agree also with Professor Bilder when he says that Article 1102 is directed only to nationality-based discrimination and that it proscribes only demonstrable and significant indications of **bias and prejudice on the basis of nationality**, of a nature and consequence likely to have affected the outcome of the trial (emphasis added).*<sup>42</sup>

In this decision, should we interpret "bias and prejudice on the basis of nationality" as meaning xenophobic intent? Such an interpretation somehow sounds inconsistent with the object and purposes of NAFTA in general and with those of Article 1102 itself. As we stated above, the national treatment clause in Chapter 11 is concerned with outlawing

---

<sup>41</sup> United Mexican States' Submission Pursuant to Article 1128 of NAFTA, (*Loewen Group, Inc. & Raymond L. Loewen v. U.S.*) (Nov. 9, 2001) 15, *see also Mexico's Submission in Methanex supra* note 34, ¶ 16 (supporting the same position).

<sup>42</sup> *Loewen Group, Inc. & Raymond L. Loewen v. United States of America*, Award (June 26, 2003) ¶ 139.

---

protectionism and not with promoting equality in the world. On the other hand, it is hard to conceive that a measure entirely motivated by xenophobic feelings that creates a competitive disadvantage for foreign investors would not violate Article 1102, even if their enforcers are completely unaware that they are thereby favoring their nationals.

Moreover, what if the less favorable treatment is the result of an individual's personal prejudices but not an official policy? Let us think for example of the case in which a judge renders a completely unlawful decision resulting in denial of justice, based on his or her own xenophobic sentiments. This should not matter under the rules of state responsibility as long as such an individual formally or *de facto* exerts public power. However, when the tribunal in *Mondev* 'incidentally' expressed its opinion on the validity of the claimant's arguments on the merits, it seemed to have disregarded the claimant's allegations on discrimination based on Boston official's remarks indicating anti-Canadian animus –officials suggesting that *Mondev* go back to Canada– because of lack of evidence of 'systemic bias.'<sup>43</sup>

On this same issue, the tribunal in *Mondev* made the following statement:

*In any event, the statements in question were all made well before NAFTA's entry into force.... Moreover there were reasons, independent of LPA's Canadian parentage, for the positions taken by the City and BRA in relation to the Tripartite Contract. It does not matter for the purposes of Article 1102 whether those reasons were or were not discreditable, or whether they involved an intention to breach or assist in the breach of a contract. The Tribunal does not think they were discriminatory, and this conclusion is supported by the City's and BRA's subsequent treatment of Campeau, also a Canadian corporation. As Mondev itself stressed, Campeau rather rapidly obtained the various permissions required for its Boston Crossing project.... One reason Campeau had no difficulty in obtaining BRA's consent for the project – and it may be the crucial reason – was that it was prepared to pay the market price for the Hayward Parcel, unlike Mondev, which*

---

<sup>43</sup> *Mondev International Ltd. v. United States*, Award (Oct. 11, 2002) ¶ 64. The tribunal declared: "As to Article 1102, *Mondev* complained of certain remarks by officials of Boston and BRA which, it maintained, indicated a certain anti-Canadian animus. The United States sought to explain these as *de minimis* or incidental, and it argued that they had and could have had no effect on the outcome of the dispute. It also noted that LPA achieved a striking verdict before a Boston jury, notwithstanding its Canadian ownership."

---

*understandably was willing to pay no more than the Tripartite Agreement specified.... In the circumstances these allegations of breaches of Article 1102 would clearly fail on the merits.*<sup>44</sup>

The tribunal seemed to acknowledge that the Government of Boston mistreated the claimant in order to obtain an economic benefit. The panel apparently also considered this situation irrelevant under Article 1102. In the opinion of one commentator, the tribunal believed the Government of Boston acted in breach of the contract “not out of anti-Canadian bias, but out of a desire to receive greater compensation for the property than allowed by the option price in the Agreement.”<sup>45</sup> What if the economic advantage of mistreating Mondev would not have been directly for the government, but for the domestic economy in general? What if the advantage was not economical but political? Would that type of discrimination be irrelevant under Article 1102 as well? Taking the facts dealt with by the tribunal, but reducing the universe of investors to one national and one foreigner, would discrimination against the latter that produces, such as in the Mondev case, an economic benefit for the government, violate Article 1102?

As we can see, the ‘effect and purpose’ method of interpretation of Article 1102 poses many questions that have not been clarified by the existent jurisprudence. Some of these questions are the result of certain ‘flaws’ of this interpretative method and may be dissipated by using an alternative one, as we will discuss in section II.3. But now, let us briefly discuss the second element of this method: the effect.

### **II.2.7. The Effect: Less Favorable Treatment**

---

<sup>44</sup> *Id.* ¶ 65.

<sup>45</sup> Dana Krueger, *The Combat Zone: Mondev International, Ltd. V. United States And The Backlash Against NAFTA Chapter 11*, 21 B.U. INT’L L.J. 399, 407-408 (2003).

---

While the requirement of a specific *intent* is not expressly contained in Article 1102 of NAFTA, this provision does make clear reference to a particular *effect* that the measure must produce: *less favorable treatment*. The very denomination of the ‘effect and purpose’ method suggests the existence of a material manifestation of the measure in the world.

As the tribunal in *S.D. Myers* highlighted:

*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 [sic] 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... (emphasis added).*<sup>46</sup>

Under the ‘effect and purpose’ method, the ‘less favorable treatment’ component serves two purposes, it is the objective element in the formula ‘*effect plus intent equals violation*’; and at the same time, it provides evidential support for the development of a *presumption* of intent. Establishing the existence of a ‘less favorable treatment’ therefore, under the ‘effect and purpose’ method may come *before* or *after* proving intent, depending on the need to demonstrate the latter through a presumption.

However, what does ‘less favorable treatment’ exactly mean? Does it mean the best or the most favorable treatment in the jurisdiction? Does Article 1102 of NAFTA contain something similar to a ‘most favored investor’ clause? And if it does, does any departure from that level of treatment give rise to a violation of Article 1102?

---

<sup>46</sup> *Supra* note 15, ¶ 254.

---

**II.2.7.1. Does NAFTA Article 1102 require the ‘most favourable treatment’?**

As acknowledged by the *Marvin Feldman* tribunal:

*NAFTA is on its face unclear as to whether the foreign investor must be treated in the most favorable manner provided for any domestic investor, or only with regard to the treatment generally accorded to domestic investors, or even the least favorably treated domestic investor. There is no “most-favored investor” provision in Chapter 11, parallel to the most favored nation provision in Article 1103, that suggests that a foreign investor must be treated no less favorably than the most favorably treated national investor, if there are other national investors that are treated less favorably, that is, in the same manner as the foreign investor. At the same time, there is no language in Article 1102 that states that the foreign investor must receive treatment equal to that provided to the **most** favorably treated domestic investor, if there are multiple domestic investors receiving differing treatment by the respondent government (bolds in italics in the original).*<sup>47</sup>

The tribunal in this opportunity declined to decide on this particular matter, arguing that “in the absence of evidence to this effect presented by Mexico – the only party in a position to provide such information – the Tribunal need[ed] not decide whether Article 1102 requires treatment equivalent to the best treatment provided to *any* domestic investors” (emphasis in the original).<sup>48</sup>

Prior to this decision, the panel in *Pope & Talbot* determined that although Article 1102(3) –that establishes that less favorable “treatment means treatment no less favorable than the most favorable treatment”– applies to states and provinces only,<sup>49</sup> it may provide

---

<sup>47</sup> *Supra* note 19, ¶ 185.

<sup>48</sup> *Id.* ¶ 186.

<sup>49</sup> Article 1102(3) establishes:

“Article 1102: National Treatment

“[...]

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

---

interpretative bases for the proposition that ‘less favorable treatment’ in Article 1102(1) and 1102(2) also means “treatment no less favorable than the most favorable treatment.”<sup>50</sup>

The tribunal determined that accepting that ‘less favorable treatment’ means something less than the most favorable treatment would lead to the rather bizarre conclusion that the drafters of NAFTA intended to “restrain states and provinces more vigorously than the NAFTA Parties themselves.”<sup>51</sup>

Therefore, the panel interpreted: **(i)** “the treatment required by Articles 1102(1) and 1102(2), on the one hand, and 1102(3) on the other, to be identical, save for the limitations to states and provinces”; **(ii)** “both standards to mean the right to treatment equivalent to the ‘best’ treatment accorded to domestic investors or investments in like circumstances”; and that **(iii)** “‘no less favorable’ means equivalent to, not better or worse than, the best treatment accorded to the comparator.”<sup>52</sup>

As a matter of fact, recent Chapter 11 claims show that investors have consistently adopted the position that the treatment they are entitled to is nothing else but the *best* available in the relevant jurisdiction.<sup>53</sup>

### **II.2.7.2.        *The threshold of unlawful differential treatment***

---

<sup>50</sup> *Supra* note 25, ¶¶ 39-42.

<sup>51</sup> *Id.* ¶ 42.

<sup>52</sup> *Id.* ¶ 42.

<sup>53</sup> *See e.g.* Notice of Arbitration (Grand River Enterprises Six Nations, Ltd. v. U.S.) (Mar. 10, 2004) ¶ 64 [hereinafter *Grand River*], *see also* Notice of Arbitration (Terminal Forest Products Ltd. v. U.S.) (Mar. 30, 2004) ¶ 31, *also* Second Amended Statement of Claim (Methanex Corp. v. U.S.) (Nov. 5, 2002) ¶ 308, *see also* Notice of Intent to Submit a Claim to Arbitration (Doman Indus. v. U.S.) (May 1, 2002) ¶ 16.

---

Now we turn to the question whether Article 1102 incorporates a *minimis* exception for the prohibition of differential treatment. Even the minimal differential treatment between foreign investors and their domestic most favored counterparts is sufficient to trigger a violation of Article 1102?

On this issue the interpretations provided by the Chapter 11 panels have been ambiguous. We may identify three different positions that identify three different levels of 'less favorable treatment' for an Article 1102 violation to arise.

The first position maintains that any difference in treatment may amount to a violation of the national treatment clause. Even more, they consider that in fact no real negative impact is necessary. This position was adopted by the NAFTA Chapter 20 panel interpreting Articles 1102 and 1102 of NAFTA in the *The Matter of Cross-Border Trucking Services*. Drawing analogies with the GATT-WTO jurisprudence, the panel determined that "it is well-established that parties may challenge measures mandating action inconsistent with the GATT regardless of whether the measures have actually taken effect."<sup>54</sup>

Based on this premise the tribunal decided:

*Because the United States expressly prohibits the above mentioned investment, this Panel finds such prohibitions as inconsistent with NAFTA, even if Mexico cannot identify a particular Mexican national or nationals that have been rejected. A blanket refusal to permit a person of Mexico to establish an enterprise in the United States to provide truck services for the transportation of international cargo between points in the United States is, on its face, less favorable than the treatment accorded to U.S. truck service providers in like circumstances, and is contrary to Article 1102. Where there have been direct violations of NAFTA, as in this case, there is no*

---

<sup>54</sup> *Supra* note 10, ¶ 289.

---

*requirement for the Panel to make a finding that benefits have been nullified or impaired; it is sufficient to find that the U.S. measures are inconsistent with NAFTA.*<sup>55</sup>

Should this decision be interpreted as admitting that a violation of Article 1102 requires no treatment at all? Shall we derive from this passage that the minimal difference in treatment, even if *nominal* or *hypothetical* is sufficient to find a breach of Article 1102? Or should we conclude that this passage is in fact unrelated to the *minimis* exception issue, since it leaves open the question of how unfavorable the treatment must be –even if it is only reflected ‘in letter’– in order to trigger a violation?

A second position maintains that for a violation to arise the foreign investors or investments have to experience *actual* negative impacts. This position was adopted for example by the *Loewen* tribunal’s award. The panel in this case determined:

*For there to be denial of national treatment, de jure or de facto discrimination (i.e., the according of less favourable treatment) by a Party against a foreign investment or against a foreign investor in respect of its investment must be proven. Proof of mere intention to discriminate does not establish a breach of Article 1102. The Tribunal must determine whether the treatment accorded resulted in **actual discrimination** (emphasis added).*<sup>56</sup>

This decision however, also leaves the *minimis* exception question unresolved, because even if Article 1102 requires an unfavourable treatment *actually* reflected in the facts, there is still uncertainty as to how unequal this treatment must be.

Finally, a third position claims that not only does the measure have to produce actual effects upon the investor or the investments, but also that this effect has to reach a certain level of egregiousness. This was the view of the panel in *S.D. Myers*:

---

<sup>55</sup> *Id.* ¶ 292.

<sup>56</sup> *Supra* note 17, ¶ 7.

---

*The Tribunal takes the view that, in assessing whether a measure is contrary to a national treatment norm, the following factors should be taken into account:*

*whether the practical effect of the measure is to create a **disproportionate** benefit for nationals over non nationals; (emphasis added)<sup>57</sup>*

As we mentioned earlier, the panel in *Mondev* disregarded some evidence on discrimination essentially because it was not persuaded that they had a relevant impact in the outcome of the dispute. Some commentators have identified the decisions in *S.D. Myers*<sup>58</sup> and *Mondev*<sup>59</sup> as two examples of a position requiring “a high threshold of impropriety before international liability will attach to state conduct.”

In the same direction, in a passage of the *Loewen* decision already commented, the arbitrators considered that Article 1102 forbids “only demonstrable and significant indications of bias and prejudice” (emphasis added).<sup>60</sup>

### **II.2.7.3.      *The burden of proof in relation to the less favourable treatment***

Being part of the process of proving protectionist intent, the burden of producing evidence as to the existence of less favorable treatment should be borne primarily by the claimant.

Confirming this supposition, the tribunal in *ADF Group* considered that the evidence provided by the investor in relation to the existence of less favorable treatment was “scant”

---

<sup>57</sup> *Supra* note 15, ¶ 252.

<sup>58</sup> *Krueger*, *supra* note 45, at 407-408.

<sup>59</sup> *Id.* at 409.

<sup>60</sup> *Supra* note 42, ¶ 139.

---

and that therefore, the investor “did not sustain its burden” of proving less favorable treatment *vis-à-vis* similarly situated domestic steel fabricators.<sup>61</sup>

Consistently, the panel in *Marvin Feldman*, relying again on its powers to draw presumptions, determined that the claimant had the burden of proving only a *prima facie* case that its investment had been treated in a less favorable manner than several Mexican owned cigarette resellers. On this basis, the tribunal also decided that Respondent “failed to introduce any credible evidence into the record to rebut that presumption.”<sup>62</sup>

### **II.3. THE ALTERNATIVE COMPARATOR APPROACH**

Notwithstanding the frequent reference to the issue of intent in the publicly known Chapter 11 disputes, some experts consider that in order to prove a violation of NAFTA Article 1102, a claimant must demonstrate that a measure has accorded differential treatment to competing domestic and foreign investors or investments, “regardless of whether there was any intent on the part of the Government to provide less favorable treatment because the investor or investment was foreign (or, conversely, to provide better treatment to a local competitor because it is local).”<sup>63</sup>

Indeed, there is a method of interpretation of Article 1102 that allegedly –we will further discuss the accuracy of this view– does not require any specific intent on the part of the government adopting the measure. This method limits its interpretative tools to the

---

<sup>61</sup> ADF Group Inc. v. United States, Award (Jan. 9, 2003) ¶ 157.

<sup>62</sup> *Supra* note 19, ¶ 177.

<sup>63</sup> Todd Weiler, *The Treatment of SPS Measures Under NAFTA Chapter 11: Preliminary Answers to an Open-Ended Question*, 26 B.C. INT'L & COMP. L. REV. 229, 240 (2003).

---

normative elements expressly established in Article 1102: ‘less favorable treatment’ and ‘like circumstances.’ The differences between this method and the ‘effect and purpose’ approach are subtle and frequently elusive –as evidenced by some shifting from one to another in the available jurisprudence.

The core difference between these two methods lies on the steps that one needs to take to establish a violation. Whereas the ‘effect and purpose’ method comprises three steps, the third being the establishment of a specific motivation (discriminate on the basis of nationality), the ‘alternative comparator’ method requires only two steps in the following order: **(i)** proving that the foreign investor or investment is in like circumstances with domestic investors or investments, and **(ii)** that the former has received less favorable treatment than the latter.

While it is true that under the ‘effect and purpose’ method the third step is established *prima facie* by proving the first two elements, the third step is, as we have noted above, an *independent* element which theoretically may be rebutted without disproving the other two. On the other hand, the ‘alternative comparator’ approach uses the ‘like circumstances’ requirement to avoid the question of intent. When applying this method, the disputing parties and the arbitrators analyze all the *variables* (circumstances) that may place two or more investors or investments in the same category.

This approach is based on the premise that two objects may be similar or dissimilar depending on the *comparator* used to make such an assessment. Therefore, the users of this method believe that by observing the *comparators* that a Party used to determine that foreign

---

and domestic investors belonged to *different categories* and that consequently they deserved different treatments, it is possible to conclude whether the measure is protectionist or not.

Therefore, the ‘alternative comparator’ method uses the like circumstances analysis to distinguish between legitimate and protectionist measures. Presented with a situation where differential treatment has been accorded to apparently similarly situated investors or investments, it poses the following question: nationality let alone, is there any other *comparator* (alternative comparator) under which these investors or investments belong to different categories and which may justify the differentiation in treatment?

What we call here the ‘alternative comparator’ approach –using the language of previous studies on GATT Article III–<sup>64</sup> was first enunciated in the NAFTA context by the *Pope & Talbot* tribunal as follows:

*In one respect, this approach echoes the suggestion by Canada that Article 1102 prohibits treatment that **discriminates on the basis of the foreign investment’s nationality**. The other NAFTA Parties have taken the same position. However, the tribunal believes that the approach proposed by the NAFTA Parties would tend to excuse discrimination that is not facially directed at foreign owned investments. A formulation **focusing on the like circumstances question**, on the other hand, will require addressing any difference in treatment, **demanding** that it be **justified** by showing that it bears a **reasonable relationship to rational policies** not motivated by preference of domestic over foreign owned investments (emphasis added).<sup>65</sup>*

Although the language used by the panel might be confusing, especially without the guidance provided by the context of the entire decision, it contains all the elements of the ‘alternative comparator’ approach, as envisaged by this tribunal. We will discuss these elements in the following pages. By now, it is sufficient to highlight that a radical difference

---

<sup>64</sup> See generally Weiler & Horn *supra* note 8.

<sup>65</sup> *Supra* note 25, ¶ 79.

---

between this decision and the *Marvin Feldman* award is that the arbitrators in *Pope & Talbot* consider that the question whether the measure was “motivated by preference of domestic over foreign owned investments” resides in that of whether such investments were in like circumstances.

### II.3.1 ‘Like Circumstances’

As we have indicated before, there is some support to sustain that two or more investors or investments are in *like circumstances* if they operate in the same *sector*.<sup>66</sup> We mentioned earlier as well, that this blatantly broad comparator was adopted by the tribunals in *S.D. Myers* and *Pope & Talbot* as the foundation for their analyses in relation to the ‘like circumstances’ question.<sup>67</sup>

As to the exact meaning of the word sector for the purposes of Article 1102 of NAFTA, the panel in *S.D. Myers* took the view that “the word ‘sector’ has a wide connotation that includes the concepts of ‘economic sector’ and ‘business sector’.”<sup>68</sup>

Both tribunals seemed however, to accept that the use of ‘sector’ as the relevant comparator was merely “a first step,”<sup>69</sup> suggesting that the use of other comparator or

---

<sup>66</sup> *Supra* note 24.

<sup>67</sup> See e.g. *supra* note 15, ¶ 250, see also *Pope & Talbot Award II supra* note 25, ¶ 78.

<sup>68</sup> *Supra* note 15, ¶ 250.

<sup>69</sup> See e.g. *Pope & Talbot Award II supra* note 25, ¶ 78. The arbitrators established:  
“In evaluating the implication of the legal context, the tribunal believes that, as a first step, the treatment accorded a foreign owned investment protected by Article 1102(2) should be compared domestic investments in the same business or economic sector...”

---

comparators –presumably more specific– would follow. The tribunal in *S.D. Myers* for instance declared:

*The Tribunal considers that the interpretation of the phrase “like circumstances” in Article 1102 must take into account the general principles that emerge 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. The assessment of “like circumstances” must also take into account circumstances that would justify governmental regulations that treat them differently in order to protect the **public interest...**” (emphasis added).<sup>70</sup>*

Notwithstanding such a policy-sensitive remark, and having admitted that there existed a *legitimate* environmental *purpose* for the measure,<sup>71</sup> it seems that the tribunals decided the ‘like circumstances’ question based exclusively on an economically-oriented comparator:

*From the **business perspective**, it is clear that SDMI and Myers Canada were in “like circumstances” with Canadian operators such as Chem-Security and Cintec. They all were engaged in providing PCB waste remediation services. SDMI was in a position to attract customers that might otherwise have gone to the Canadian operators because it could offer more favourable prices and because it had extensive experience and credibility. 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 (emphasis added).<sup>72</sup>*

The problem is that whereas the use of the comparator ‘sector’ has been uniformly accepted, there is much uncertainty as to what other comparators should be brought to the discussion of ‘like circumstances.’ How deep must a tribunal go in the consideration of more specific comparators? More interestingly, when and why should they do it? The problematic related to the limitation of the regulatory autonomy of the NAFTA Parties, resides in the answer to these questions.

---

<sup>70</sup> *Supra* note 15, ¶ 250. This was consistent with the view expressed by the OECD, who declared that “[m]ore general considerations, such as the *policy objectives of Member countries* could be taken into account to *define the circumstances in which comparison* between foreign-controlled and domestic enterprises *is permissible*” (emphasis added), see The OECD Declaration on International and Multinational Enterprises, June 21, 1976, as revised in 1993.

<sup>71</sup> *Id.* ¶ 255.

<sup>72</sup> *Id.* ¶ 251.

---

### II.3.1.1. *Competition as the relevant comparator*

Some have interpreted the *S.D. Myers* decision as establishing that if two or more investors or their investments compete for the same business, they are in “like circumstances.”<sup>73</sup> Strongly relying on GATT-WTO jurisprudence, Methanex argued that Article 1102 provides equality of competitive conditions for foreign investments in relation to domestic investments. In its reply to Mexico’s and Canada’s Article 1128 interventions Methanex contended that “the fact that the investments compete directly should be a deciding factor because the NAFTA was drafted to promote equality of competition between foreign and domestic investments.”<sup>74</sup>

It seems clear that if we were to adopt Methanex’s view, some legitimate distinctions between foreign and domestic investors or investments would contravene Article 1102, conclusion that we should again deny for being unreasonable.

Moreover, some panels have adopted different approaches privileging other comparators over *competition*, when making their conclusions on the ‘like circumstances’ question. The *Loewen* tribunal for example, determined that –as we will further explain– the claimants and the O’Keefe family’s companies, claimants’ American competitors, were not in like circumstances.<sup>75</sup> In the same manner, the tribunal in *Marvin Feldman* determined that the claimant was in like circumstances with Mexican cigarette resellers,

---

<sup>73</sup> Second Amended Statement of Claim (Methanex Corp. v. U.S.) (Nov. 5, 2002) ¶ 303.

<sup>74</sup> *Supra* note 10 ¶ 6.

<sup>75</sup> *Supra* note 42, ¶ 140.

---

but not in relation to Mexican cigarette producers, although all of them were potential competitors in the cigarettes exportation business.<sup>76</sup>

### **II.3.1.2.      *The ‘like products’ standard as the relevant comparator***

Methanex’s arguments as stated in its reply to the United States’ amended statement of defense are essentially based on the proposition that the GATT-WTO ‘*like products*’ standard is incorporated in the ‘*like circumstances*’ requirement. This is understandable since Methanex needs to persuade the tribunal that the appropriate comparison in treatment must be made between Methanex and the American producers of ethanol (a competing product of methanol) and not between Methanex and American methanol producers, who have been equally affected by the measure.<sup>77</sup>

As a response, the United States argued in its amended statement of defense that “Article 1102 does not set out a “like products” test and, therefore, Methanex’s argument is legally unsound.”<sup>78</sup> In further communications with the tribunal, they reaffirmed their position, claiming that the national treatment provision of Article 1102 “does not address discrimination based on the origin of goods” and that all three NAFTA Parties agree “that jurisprudence interpreting provisions governing the national treatment of *goods* in the GATT is inapposite in ascertaining whether an *investor* or an *investment* has been

---

<sup>76</sup> *Supra* note 19, ¶ 172.

<sup>77</sup> *Supra* note 10, ¶ 184. Methanex argues that:

“The U.S. response is correct, however, in that the GATT “like products” standard is a narrower test than the NAFTA Article 1102 “in like circumstances” standard. Because methanol and ethanol are “like” for purposes of the GATT’s narrow test, they necessarily must be “in like circumstances” for purposes of the NAFTA’s broad Article 1102 test.”

<sup>78</sup> Amended Statement of Defense (Methanex Corp. v. U.S.) (Dec. 5, 2003) ¶ 308.

---

accorded less favorable treatment within the meaning of Article 1102 of the NAFTA” (emphasis in the original).<sup>79</sup>

Moreover, the United States argues that “such an agreement among all of the Parties to a treaty ‘shall be taken into account’ in the interpretation of the meaning of the treaty’s terms” (footnote omitted).<sup>80</sup>

### II.3.1.3. *The ‘treatment’ determines the relevant comparators*

In Methanex, the United States sustains that the tribunal must take into consideration the “activities and operations of the respective investments or investors, and the nature of the goods involved and the services provided” and in short “the circumstances in which the treatment is accorded, as indicated by the plain words of Article 1102.”<sup>81</sup>

This proposition seems to suggest that the ‘in like circumstances’ determination should not be made ‘in abstract’, exploring all the variables under which two investors or investments may be in like or unlike circumstances. Rather, we must look first at the content and scope of the measure and then determine upon these bases, **(i)** the universe of investors or investments whose circumstances must be compared; and **(ii)** which comparators become relevant in light of such content and scope. In other words, the *treatment* determines the relevant *circumstances* (comparators).

---

<sup>79</sup> Rejoinder of Respondent United States of America (Methanex Corp. v. U.S.) (Apr. 23 2004) ¶ 164.

<sup>80</sup> *Id.* ¶ 165.

<sup>81</sup> *Supra* note 18, ¶ 10.

---

This is consistent with some Chapter 11 decisions. As mentioned before, the tribunal in *Loewen* dismissed the comparison between the claimants and their competitors and looked for American investors or investments that have been treated more favorable in a judicial procedure similar to that of the claimants. Since the claimant identified none, the tribunal decided that they did not have an example of ‘the most favorable treatment accorded, in like circumstances’ by a Mississippi court to investors and investments of the United States. The tribunal stated:

*Claimants submit that the treatment accorded O’Keefe is an appropriate comparator, that Loewen and O’Keefe were “in like circumstances” because they were litigants in the same case. But their circumstances as litigants were very different and it is not possible to apply Article 1102(3) by reference to the treatment accorded to O’Keefe. What Article 1102(3) requires is a comparison between the standard of treatment accorded to a claimant and the most favourable standard of treatment accorded to a person in like situation to that claimant. There are no materials before us which enable such a comparison to be made.*<sup>82</sup>

Therefore, instead of looking at the funeral home and funeral insurance business sector in Mississippi as the relevant universe to determine likeness, the tribunal looked at the universe of litigators who *could have been treated* as the claimant and who were nevertheless treated more favorably. The O’Keefe’s situation was therefore irrelevant because for instance, they did not file an appeal and consequently they could not possibly have been required to submit an appeal bond or denied a petition for the reduction of such bond.

Similarly, in *Marvin Feldman*, the tribunal concluded that *the claimant was* in “like circumstances” with Mexican owned resellers of cigarettes for export, but not with Mexican

---

<sup>82</sup> *Supra* note 42, ¶ 140.

---

cigarette producers, notwithstanding that: **(i)** both categories competed in the cigarette export market (at least they could); and **(ii)** Mexico adopted measures that discriminated between both –measures which by the way were considered unconstitutional by the Mexican courts. The arbitrators decided:

*In the Tribunal's view, the "universe" of firms in like circumstances are those foreign-owned and domestic-owned firms that are in the business of reselling/exporting cigarettes. Other Mexican firms that may also export cigarettes, such as Mexican cigarette producers, are not in like circumstances. While the Claimant's Amparo decision held discrimination between producers and resellers of alcohol and tobacco products (at least as to the availability of the 0% tax rate for exported goods) to be unconstitutional, such discrimination is effectively reinstated by the 1998 IEPS law that limits IEPS tax rebates to the first sale, excluding any subsequent purchaser/exporter from the benefit, and has effectively been upheld in the other litigation brought by the Claimant in 1998, also discussed earlier. The Tribunal also notes that Article 1102 says nothing regarding discrimination among different classes of a Party's own investors.<sup>83</sup>*

*Accordingly, the Tribunal holds that the companies which are in like circumstances, domestic and foreign, are the trading companies, those in the business of purchasing Mexican cigarettes for export....<sup>84</sup>*

Shall we interpret this decision as determining likeness entirely on the basis of the categories created by the measures? Did the tribunal conclude that Mexican and foreign resellers were in like circumstances whereas Mexican resellers and producers were not, simply because it decided to look at the measures that discriminated between resellers but not at those which discriminated between resellers and producers? In other words, did the tribunal determine *first* the existence of differential treatment (as in 'less favorable treatment') and *secondly* 'like circumstances' under the bases provided by the *categories* created by such a differential treatment? We believe that the answer to this questions is *no* and that the tribunal determined 'likeness' first and only then, the existence of 'less favorable treatment.'

---

<sup>83</sup> *Supra* note 19, ¶ 171.

<sup>84</sup> *Id.* ¶ 172.

---

This analysis however, must be looked for in a different section of the award, specifically in that relative to the expropriation issue.

Here then the question arises whether the Parties may manipulate the categories for the ‘like circumstances’ analysis through the discriminating measures themselves. For instance, if the measure recognize and ‘legalize’ a *de facto* disadvantage for foreign investors or investments, then it would allegedly not be covered by Article 1102 because the investors or investments in question were not in like circumstances when the measure was adopted. Moreover, the measure may accentuate or ‘perpetuate’ such disadvantages. This is a question that has been frontally explored by the GATT-WTO jurisprudence.<sup>85</sup> In the NAFTA context however, this question has not been thoroughly discussed. In *Pope & Talbot* for example the panel recognized that previous measures of Canada had created certain disadvantages for certain players in the Canadian softwood lumber industry. The tribunal also acknowledged that the final allocation of exportation quotas continued these disadvantages. The arbitrators concluded however, that the challenged measure did not “create” the categories of advantaged and disadvantaged investors, but rather that it stuck to it. The tribunal said:

*The special nature and character of the new entrant provisions required that allocations be made based upon where the qualified new entrants were located, and their locations were necessarily inconsistent with a tidy percentage distribution among the covered provinces. The effects of the decision to set aside quotas were shaped by those economic factors, but the Regime did not create them. Consequently it cannot be fairly asserted that the Regime accentuated or otherwise enhanced the underlying effects of the economic changes. It was the underlying economics of the softwood lumber industry in Canada that placed the*

---

<sup>85</sup> See e.g. Korea – Measures Affecting Imports of Fresh, Chilled And Frozen Beef WT/DS161/AB/R (Dec. 11 2000).

---

*Investment and other and other producers in B.C. in unlike circumstances to those in the other covered provinces....*<sup>86</sup>

Another consequence of using the content and scope of the measure (*treatment*) to determine the universe of investors or investments whose circumstances must be compared, is that the ‘significant legal connection’ threshold allegedly contained in Article 1101 becomes irrelevant. Indeed, as Methanex noted:

*Article 1102’s “like circumstances” requirement serves a key gatekeeper function. It forecloses the possibility that a remote supplier to a damaged producer could establish a national treatment violation. A truly remote supplier is not in like circumstances with a favored producer because remote suppliers do not compete with such producers.*<sup>87</sup>

The point that Methanex seems to miss is that a remote supplier of MTBE producers would be in like circumstances with other remote suppliers of producers producing substitutes of MTBE. Therefore, if we expand the ‘like circumstances’ comparison to that level, remote suppliers could successfully bring an Article 1102 claim, but for the Article 1101 threshold. On the contrary, if we limit the ‘like circumstances’ comparison only to the universe of those investors or investments *directly* affected by the measure, then indeed a remote supplier would not be in like circumstances with a favored producer.

#### **II.3.1.4.      *The national treatment clause v. the non-discrimination principle***

One point should not be missed. The national treatment requirement as embodied in NAFTA Article 1102 is a *non-discrimination* provision. However, it only proscribes a certain

---

<sup>86</sup> *Supra* note 25, ¶ 93.

<sup>87</sup> *Supra* note 10, ¶ 169.

---

type of discrimination, namely, that created by a protectionist measure. As we saw earlier, a protectionist measure for the purpose of Article 1102 is that which accords differential treatment to foreign investments or investors in like circumstances based on their nationality. Therefore, the operation of the national treatment clause *always* requires a comparison between foreign and national investors or investments.

An apartheid measure for instance, according more favorable treatment to Caucasian investors (foreign or nationals) as unreasonable as it is, would not contravene Article 1102 of NAFTA. Similarly, differential treatment between one foreign investors and another foreign investor is irrelevant under Article 1102. Therefore, the *non-discrimination principle* and the *national treatment rule* must at all times be distinguished: the latter is a specific kind of the former.

For this reason, whatever comparator is used for the ‘like circumstances’ analysis, it always has to be referenced to the primordial categories *nationals* and *foreigners*.

### **II.3.1.5.      *The ‘accordion’ of ‘like circumstances’***

Using the vocabulary of the WTO Appellate Body,<sup>88</sup> the ‘accordion’ of like circumstances may be ‘stretched’ and ‘squeezed’ according to the particularities of the case. Unlawful discrimination is easily detectable for example when under all the comparators but nationality, foreign and domestic investors are identical. However, Chapter 11 tribunals will most likely never be presented with this ‘dream scenario’, nor does Article 1102 seem to

---

<sup>88</sup> Japan - Taxes on Alcoholic Beverages WT/DS8/AB/R (Oct. 4, 1996) [http://www.wto.org/english/tratop\\_e/dispu\\_e/dispu\\_e.htm](http://www.wto.org/english/tratop_e/dispu_e/dispu_e.htm).

---

require such proximity in circumstances. As one claimant noticed, ‘like’ in Article 1102 means ‘similar’ not ‘identical.’<sup>89</sup>

More realistically, the panels will have to engage in situations where the circumstances of domestic and foreign investors may be similar and yet not similar enough to trigger an Article 1102 violation. The language used by the panel in *GAMI Investments* exemplifies this dilemma: “[t]he Arbitral Tribunal has not been persuaded that GAM’s circumstances were demonstrably **so** “like” those non-expropriated mill owners that it was wrong to treat GAM differently (emphasis added).”<sup>90</sup>

But if the ‘accordion’ in its most compact form means *identical*, what would its most expanded version be? It is hard to accept that this limit could be, as one investor suggests, one that admits a comparison between the treatment accorded to the claimant and that “offered to virtually every other person conducting business in the U.S.A.”<sup>91</sup>

An interesting question is whether the ‘likeness accordion’ in Article 1102 contains something like a most similar investor or investment requirement. Or in the Appellate Body ‘argot’, should the accordion be expanded *only* up to the limit of the most similarly situated investor or investment? In other words, once the tribunal identifies the existence of two distinguishable categories, one formed by similarly situated investors and another comprising less similarly situated investors, should it limit its analysis to the first category? The United States seems to answer this question in the positive:

---

<sup>89</sup> *Supra* note 10, ¶ 173.

<sup>90</sup> *Gami Invs. v Mexico*, Final Award (Nov. 15, 2002) ¶ 114.

<sup>91</sup> See *Grand River supra* note 63 ¶ 63.

---

*The function of addressing nationality-based discrimination is served by comparing the treatment of the foreign investor to the treatment accorded to a domestic investor that is most similarly situated to it. In ideal circumstances, the foreign investor or foreign-owned investment should be compared to a domestic investor or domestically-owned investment that is like it in all relevant respects, but for nationality of ownership. When nationality is the only variable, such a comparison serves the Article's purpose of ascertaining whether the treatment accorded differed on the basis of nationality of ownership.*<sup>92</sup>

The United States further sustains that adopting a different view would:

*[C]ompel a tribunal to ignore the treatment accorded the identical domestic investor and investment and, instead, compare a foreign investor's treatment to the treatment accorded a less similar group that is in some respects arguably "like" the foreign investor. This reading of Article 1102 would prevent a NAFTA Party from according different treatment to distinct groups of its own nationals whenever an investor or investment of another NAFTA Party forms part of one of those groups.*<sup>93</sup>

### **II.3.1.6. Whose circumstances?**

As Methanex pointed out, the location of the expression "in like circumstances" in the body of Article 1102 bears some relevance.<sup>94</sup> It is worth noticing that Article 1102 does not use the expression "investments or investors in like circumstances", although this is a common interpretation of the 'like circumstances' requirement in Article 1102. According to Methanex, this expression qualifies *both*, the investors or investments and the treatment.

---

<sup>92</sup> *Supra* note 79, ¶ 152.

<sup>93</sup> *Id.* ¶ 155.

<sup>94</sup> *Supra* note 78, ¶ 301. Methanex contends that:

"The use of the phrase 'in like circumstances,' as well as its placement in the provision so that it could modify either the treatment accorded or the investor or the investments, indicates that Article 1102 contemplates that broad account be taken of the circumstances of the treatment, the investor and the investment."

---

This interpretation raises several interesting questions. If the expression ‘like circumstances’ qualifies both the *measure* and its *recipients*, should circumstances such as social values, consumers habits and the political situation of the Party adopting the measure also be incorporated to the ‘like circumstances’ analysis? By observing the circumstances surrounding the measure, may the financial situation of the government or the well-marching of the economy be contemplated as well? Does the deceptively simple design of Article 1102 incorporate notions as complex as *force majeure*, ‘acts of God’ or ‘state of necessity’?

### **II.3.2 Less Favorable Treatment**

In relation to the use and interpretation of the less favorable treatment requirement under the ‘alternative comparator’ method, there is not much left to say. The questions are essentially the same under both methods of interpretation and we have already mentioned that under the ‘alternative comparator’ method the order in determining ‘less favorable treatment’ and ‘like circumstances’ has apparently a greater relevance.

One more issue probably deserves comment. The ‘stretching-squeezing’ character of the ‘like circumstances’ requirement may have a direct impact on the threshold of differential treatment. The more *like* the circumstances are, the less *difference* in treatment may be needed to establish a breach of Article 1102, and the other way around.

---

### II.3.3. The Rules of Justification under the ‘Alternative Comparator’ Method

The panel in *Pope & Talbot* established:

*Differences in treatment will presumptively violate Article 1102(2), unless they have a rational nexus to rational government policies that (i) do not distinguish, on their face or the facts, between foreign owned and domestic companies, and (2) do not otherwise undermine the investment liberalizing objectives of NAFTA.*<sup>95</sup>

In light of this critical language of the *Pope & Talbot* decision and considering it in the context of the rest of the award and other Chapter 11 decisions, we believe that in order to demonstrate that a measure is consistent with Article 1102 of NAFTA, a Party must take the following steps.

#### II.3.3.1. ***Reasonable relationship with a reasonable policy***

Earlier in this paper, we referred to the part of the *Pope & Talbot* award where the panel expressed its opinion that a formulation focusing on the ‘like circumstances’ question, demands that it be justified by “showing that it bears a *reasonable relationship* to *rational policies* not motivated by preference of domestic over foreign owned investments” (emphasis added).<sup>96</sup>

I interpret this language as meaning that a Party must prove that the difference in treatment is the result of the application of a comparator or set of comparators *different* to

---

<sup>95</sup> *Supra* note 25, ¶ 78.

<sup>96</sup> *Id.* ¶ 79.

---

*nationality*, under which foreign and domestic investors or investments may be considered as pertaining to different *categories*, in pursuance of a *reasonable* public objective. In other words, the Party must demonstrate that **(i)** it has set an objective –different to protectionism– as a matter of public policy; **(ii)** in pursuance of this objective, the categories of individuals, products, assets, activities, etc. are acknowledged or established, and **(iii)** that each one of these categories deserves a different treatment.

I believe that the expression ‘reasonable policy’ refers to the first one of these steps, whereas that of ‘reasonable relationship’ relates to the second and third.

The term ‘policy’ necessarily implies the existence of a *public objective*. Although the word may suggest the idea of a highly elaborated governmental plan, I think that it may include governmental action as simple as building a new road and as complex as undertaking a land reform. Does the expression then mean that the tribunal must engage in assessing the reasonableness of the public objective itself? This issue is reminiscent of the GATT-WTO discussion of the “admissible level of risk.” Unfortunately, this question once again, has not been as explored in the NAFTA jurisprudence as it has been in the GATT-WTO context.

However, as a matter of fact, Chapter 11 tribunals have engaged in the evaluation of the reasonableness and legitimacy of the Party’s policy. In *S.D. Myers* for example, the tribunal concluded that Canada’s objective “to maintain the ability to process PCBs within Canada in the future” was a “legitimate goal, consistent with the policy objectives of the Basel Convention.”<sup>97</sup>

---

<sup>97</sup> *Supra* note 15 ¶ 255.

---

Similarly, the panel in *GAMI Investments* decided that Mexico’s “measure was plausibly connected with a legitimate goal of policy (ensuring that the sugar industry was in the hands of solvent enterprises).”<sup>98</sup>

In *Marvin Feldman*, the tribunal concluded that there were some policy objectives that may justify according different treatments to the categories cigarette producers and cigarette resellers.<sup>99</sup> However, the tribunal considered that no such objectives existed in relation to foreign and domestic resellers. The panel decided:

*[T]here does not appear to be any rational justification in the record for SHCP’s less favorable de facto treatment of CEMSA other than the obvious fact that CEMSA was owned by a very outspoken foreigner, who had, prior to the initiation of the audit, filed a NAFTA Chapter 11 claim against the Government of Mexico. Certainly, the action of filing a request for arbitration under Chapter 11 could only have been taken by a person who was a citizen of the United States or Canada (rather than Mexico), i.e., as a result of his (foreign) nationality.*<sup>100</sup>

Here, the question arises whether there are certain impermissible objectives under Article 1102. Which criteria should be used to determine the reasonableness of the objective? Some goals may be reasonable for the government embracing them and yet be unfair, immoral or even illegal under other Chapter 11 provisions.

---

<sup>98</sup> *Supra* note 90, ¶ 114.

<sup>99</sup> *Supra* note 19, ¶ 170. The tribunal reasoned that:

“...there are at least some rational bases for treating producers and re-sellers differently, e.g., better control over tax revenues, discourage smuggling, protect intellectual property rights, and prohibit gray market sales, even if some of these may be anti-competitive. Thus, as discussed in the expropriation section, the Tribunal does not believe that such producer – reseller discrimination is a violation of international law.”

<sup>100</sup> *Id.* ¶ 182.

---

The borderline between legitimate and illegitimate objectives is not always clear. For example, in its Article 1128 submission in *Methanex* –trying to support the position of the United States– Canada expressed its view that providing favorable conditions for ‘starting-up’ business only was a legitimate measure. Canada declared:

*If the determination of whether treatment is accorded in “like circumstances” were to be based on a single criterion, it would expand the scope of Article 1102 in manifestly unreasonable ways and conflict with the ordinary meaning of the provision. To give a single example, well-established foreign-owned companies would be entitled to the privileges granted to start-up businesses offering similar products or services in the same sector – privileges granted specifically because they are start-ups.*<sup>101</sup>

As a collateral answer to this remark, Methanex replied:

*Moreover, were Canada to give its infant industries “start up” privileges in order to protect it from foreign-owned industries that are directly competitive, that would itself be a violation of Article 1102, unless some specific treaty exemption exists. Thus, Canada’s example is inapposite.*<sup>102</sup>

^This situation raises the question whether the Parties agreed to this second guessing in the use of their police powers or if it should be considered an impermissible limitation of their regulatory autonomy. However, in the absence of a catalogue of ‘legitimate objectives’ and having the need to make Article 1102 operational against disguised protectionism, there seems to be no option but to rely on a ‘reasonableness’ parameter.

Once the existence of a reasonable or legitimate objective has been set, it is necessary to prove that its achievement requires distinguishing between different *categories* of subjects or objects. For instance, alleging the pursuance of an environmental objective, the United States proceeded to the following categorization in *Methanex*:

---

<sup>101</sup> *Supra* note 18, ¶ 8.

<sup>102</sup> Claimant Methanex Corporation’s Reply to the Article 1128 Submissions of the Governments of Canada and Mexico (*Methanex Corp. v. U.S.*) (Apr. 23, 2004) ¶ 11.

---

*Because of its very potent odor and taste at low levels, widespread MTBE contamination has rendered water sources throughout California undrinkable. MTBE has thus been deemed a threat to public health and the environment. By contrast, ethanol has not been proven to cause, and is not expected to cause, such drinking water contamination (footnotes omitted).*<sup>103</sup>

This step is also subject to the ‘reasonable test’ according to the *Pope & Talbot* decision. As we have mentioned before, Canada’s categorization among softwood lumber producers was proved reasonable and therefore consistent with Article 1102.<sup>104</sup> Indeed the panel determined:

*[T]he tribunal finds that the decision to implement the SLA through a regime affecting controls only against exports to the United States from covered provinces was reasonably related to the rational policy of removing the threat of CVD actions. Since the decision affects over 500 hundred Canadian owned producers precisely as it affects the Investor, it can not reasonably be said to be motivated by discrimination outlawed by Article 1102.*<sup>105</sup>

Probably the most interesting step is that which aims at justifying the discrimination; this is to say, that which tries to *rationalize* the difference in treatment in itself.

For Methanex for example, the categorization and the decision to allocate different treatments to each one of the categories must be based on ‘valid risk assessment.’<sup>106</sup> On the contrary, the panel in GAMI Investments was satisfied just with some indications that Mexico’s categorization and allocation of differential treatment seemed rational on its face according to the Mexican government’s perception:

*Mexico perceived that mills operating in conditions of effective insolvency needed public participation in the interest of the national economy in a broad sense. The Government **may have been misguided**. That is a **matter of policy***

---

<sup>103</sup> *Supra* note 78 ¶ 332.

<sup>104</sup> *Supra* note 25, ¶ 93.

<sup>105</sup> *Id.* ¶¶ 87-88.

<sup>106</sup> *Supra* note 10, ¶ 194.

---

*and politics.... The arbitrators are satisfied that a reason exists for the measure which was not itself discriminatory. That measure was **plausibly** connected with a legitimate goal of policy (ensuring that the sugar industry was in the hands of solvent enterprises) and was applied neither in a discriminatory manner nor as a disguised barrier to equal opportunity” (emphasis added).<sup>107</sup>*

Similarly, in *The Matter of Cross-Border Trucking Services* the tribunal concluded:

*Accordingly, the Panel determines that in connection with investments by Mexican nationals in U.S. companies established to provide trucking services for the transportation of international cargo between points in the United States, **no circumstances exist that would justify differential treatment from U.S. (or Canadian) investors and investments under NAFTA's Chapter Eleven national treatment and most-favored-nation obligations.***<sup>108</sup>

Finally, we must ask whether this final step embodies a ‘least restrictive measure’ requirement. This may be apparent from the *S.D. Myers* decision. There, Canada’s defense collapsed precisely in the evaluation of this step. The panel decided:

*CANADA was concerned to ensure the economic strength of the Canadian industry, in part, because it wanted to maintain the ability to process PCBs within Canada in the future. **This was a legitimate goal**, consistent with the policy objectives of the Base1 Convention. There were a **number of legitimate ways by which CANADA could have achieved it**, but preventing SDMI from exporting PCBs for processing in the USA by the use of the Interim Order and the Final Order was not one of them. 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.*<sup>109</sup>

This position has been seconded by subsequent claims. In *Methanex* for example, the claimant argued that:

---

<sup>107</sup> *Supra* note 90, ¶ 114.

<sup>108</sup> *Supra* note 10, ¶ 294.

<sup>109</sup> *Supra* note 15, ¶ 255.

---

*[T]he suitability of a measure to its purported purpose will shed light on whether the measure was based on some improper motive. Evidence that a better solution was available, but not implemented, can indicate the presence of illicit intent (footnotes omitted).<sup>110</sup>*

A question arises however, is it possible that Article 1102 requires step one and two but not step three? If it is determined that there was a legitimate *objective*, that the achievement of this objective required certain *categorization* and that under this categorization the investors or investments in question fell within different categories, should a panel still proceed to the analysis of whether the measure was the least restrictive? If the respondent proves that the investors or investments belong to different categories, should it also prove that the treatment accorded to these different categories is the least restrictive in order to achieve the alleged objective? As the Government of Canada has expressed: “[t]he expression ‘in like circumstances’ is in Article 1102 to make it clear that all treatment accorded in unlike circumstances is to be disregarded.”<sup>111</sup>

What is undeniable is that new Chapter 11 claims have incorporated the language and method of the *Pope & Talbot* decision.<sup>112</sup>

Finally, the ‘reasonableness test’ brings about the question: in determining reasonableness for the purpose of Article 1102, may the tribunals look at the reasonable standards developed in the customary rules on treatment of aliens. And if this is so, what would the difference be between a violation of Article 1102 and Article 1105?

---

<sup>110</sup> *Supra* note 10, ¶ 154.

<sup>111</sup> *Supra* note 18, ¶ 11.

<sup>112</sup> *See e.g. Grand River supra* note 63, ¶ 65.

---

**II.3.3.2. Consistency with the investment liberalizing objectives of NAFTA**

I believe that the *Pope & Talbot* panel's reference to the consistency with the liberalizing objectives of NAFTA aimed at addressing the enforcement of the measure, rather the design of it.

It is doubtful however, that such a broad and consequential requirement may be incorporated into the mechanics of Article 1102 without express normative support. It might be expected that such an adventurous movement would ultimately follow the fate of the *Metalclad* panel's decision on the application of the transparency objective to the Article 1105 evaluation.

**III. CONCLUSIONS**

1. Article 1102 prohibits discrimination *aimed* at protectionism.
2. The notion of discrimination embodied in Article 1102 is therefore, that which distinguishes on the basis of *nationality*.
3. There are at least *two* methods of interpretation of Article 1102 that may distinguish between *protectionist discrimination* and *legitimate measures*.

---

4. One of these methods requires evidence of *protectionist intent*, whereas the other requires evidence of a *reasonable link with reasonable policies*.

5. The relevance of applying one of these methods or the other depends on the *facts* of each case.