The Legislator's Guide to International Trade Law

Legislating for Environmental Protection and Consumer Welfare

International Environmental Law Project
April 2012

This Guide was written by Ariel Blackthorne, Greg Block, Matthew Clark, Ellie Dawson, Rahna Epting, Rebecca Hoyt, Megan Lemire, Siwon Park, Lauren Posten, Lucus Ritchie, Brenda Roberts, Debby Scott, Lay-Ping Tan, and Chris Wold. Many others contributed their valuable editorial assistance, including Shannon Anderson, Erica Lyman, and Eric Walts.

The International Environmental Law Project (IELP), established in 1994 as the international environmental clinic at Lewis & Clark Law School, has two primary goals: 1) to develop, implement, and enforce international environmental law through legal research and advocacy and representation of governments, international institutions, and non-governmental organizations; and 2) to train and educate law students through direct participation in complex international environmental processes. IELP has worked on an array of international wildlife and trade conservation issues, including turtles, polar bears, African elephants, migratory birds, and whales. It also prepared a petition to the Commission for Environmental Cooperation of the NAFTA alleging that the United States is failing to enforce a law to protect migratory birds.

For more information about IELP, please contact:

Chris Wold Professor of Law & Director
International Environmental Law Project
Lewis & Clark Law School
10015 SW Terwilliger Blvd.
Portland, OR 97219 USA
TEL +1-503-768-6734
FX +1-503-768-6671
E-mail: wold@lclark.edu
law.lclark.edu/org/ielp

Citation: International Environmental Law Project, *The Legislator's Guide to International Trade Law: Legislating for Environmental Protection and Consumer Welfare* (2012).

A Legislator's Guide to International Trade Law

Glossary

Chapter 11. Chapter 11 refers to a section of the North American Free Trade Agreement (NAFTA) that establishes rules for treatment of foreign investors and investments. It protects investors from specified governmental actions and allows investors to seek redress from those actions before international arbitral panels.

GATT. The General Agreement on Tariffs and Trade (GATT) establishes the core rules for international trade in products among Members of the World Trade Organization.

GPA. The World Trade Organization's (WTO) Agreement on Government Procurement (GPA) establishes rules for government purchasing of goods and services. Other free trade agreements, such as NAFTA and CAFTA–DR, also include rules relating to government procurement.

Measure. A "measure" refers to any law, regulation, tax, charge, duty, judicial order, or other governmental action. For trade purposes, a measure may be either a tariff measure concerning the tax imposed on products as a condition of import or export or a non-tariff measure such as import quotas, subsidies, licensing requirements, and technical regulations laying down specifications for a product.

NAFTA. The North American Free Trade Agreement (NAFTA) is a regional free trade agreement for Canada, Mexico, and the United States. It establishes rules similar to those found in the GATT and other WTO Agreements. However, the NAFTA creates rules for trade that are more liberal than those provided by the WTO agreements. For example, tariffs (taxes imposed on a good at the time of importation) are lower for trade among NAFTA parties than they are for imports of goods from other countries.

Tariffs. Tariffs, also known as duties, are taxes imposed on imported or, less frequently, exported products based on the value of the product, the number of items imported or exported, or the weight or measure of the product.

TBT Agreement. The Agreement on Technical Barriers to Trade (TBT Agreement) is an agreement of the WTO that establishes rules for the adoption and implementation of "technical regulations." Technical regulations are those mandatory laws and regulations that establish product characteristics. For example, the U.S. requirement that automobiles have a catalytic converter is a technical regulation; the product characteristic is the catalytic converter.

SPS Agreement. The Agreement on Sanitary and Phytosanitary Measures (SPS Agreement) is an agreement of the WTO that establishes rules for the adoption and implementation of laws and regulations relating to contaminants, diseases, additives, pests that may affect human, animal, or plant life or health. For such laws, called "sanitary and phytosanitary measures," the SPS Agreement requires the preparation of a risk assessment. The risk determines the types of restrictions a WTO Member may adopt relating to contaminants, diseases, additives and pests.

WTO. The World Trade Organization (WTO) is the international organization charged with developing rules for the liberalization of trade. The WTO's Dispute Settlement Body, which resolves trade disputes among WTO Members parties, is perhaps the most well-known aspect of the WTO.

Chapter 1

An Introduction to the Guide

Why is this Guide important?

Globalization has become the defining ideology of the post-Cold War era. Globalization has many elements to it, including political negotiations within the United Nations and social communication through the Internet. The economic elements of globalization, however, are perhaps most widely thought of as the face of globalization. In 2008, the last full year for which robust data are available, global trade in products approached US$15.8 trillion, a 250 percent increase from the US$6.3 trillion trade in 2002, which was almost double the value of trade in 1990. World trade in services rose to US$3.7 trillion, more than doubling since 2002. These recent trends are consistent with the entire 1950–2007 period during which world trade grew on average by about 6 percent per year, far higher than the growth in world output. In short, the proportion of the world's products and services that crosses a border is now much higher than it was 10 years ago, much less 60 years ago.[1]

Trade has fundamental importance to the economies of some countries. For example, exports of products alone account for 35 to 40 percent of Canada's gross domestic product (GDP). Total trade (exports and imports) is well over 100 per cent of GDP for many countries. Even for the United States, with its huge internal market, total trade accounted for about 25 percent of GDP in 2009. The flow of investments across national borders is similarly vast, though more volatile. Worldwide, foreign direct investments—that is, investments in physical and commercial assets—totaled more than US$1.7 trillion in 2008, down from nearly US2.0 trillion in 2007.[2]

The agreements administered by the World Trade Organization (WTO), including the General Agreement on Tariffs and Trade (GATT), as well as regional free trade agreements, such as the North American Free Trade Agreement (NAFTA), are powerful engines of economic globalization. By establishing rules for trade in products and services, as well as for foreign investments, these agreements' rules affect a government's use of ecolabels, levels of acceptable pesticide residue on imported fruits and vegetables, and procurement of products and services by governmental agencies, among other things. They also remove disputes over important public policy matters from domestic courts, instead requiring confidential dispute settlement proceedings that are inaccessible to the public and policymakers.

The actual impact on the environment due to liberalized trade is difficult to generalize. In some cases, trade rules may help protect the environment, such as through the reduction or elimination of subsidies that fuel unsustainable fishing. At other times, however, trade rules may limit the regulatory choices available to protect the environment, such as prohibitions against the use of taxes and regulations to discriminate against products that are produced in environmentally harmful ways.

Regardless of the positive or negative nature of the impacts of trade rules, this growing body of global and regional trade rules has significant implications for state, provincial, and local policies and regulations, such as those relating to ecolabeling, food safety, and government procurement. Although trade rules are negotiated at the international level and bind national governments, the rules may also bind local and state policy-makers and thus govern local and state regulations. Consequently, foreign countries and investors may be able to challenge state, provincial, and local regulations

in arbitral tribunals where the state, provincial, and local governments that enacted the challenged regulations may not be allowed to defend or explain specific policy choices. Similarly, NGOs may not be allowed to participate. Among other things, this Guide explains when trade rules apply directly or indirectly to state, provincial, and local governments.

What is the purpose of this Guide?

This Guide is written for state, provincial, and local lawmakers, legislative staff, state attorneys general, and NGOs involved in drafting or advocating legislation and regulations concerning consumer, trade, and environmental issues.

This Guide is intended to help those involved in creating, strengthening, and implementing state and local law to understand the relationship between environmental regulations and the expanding scope of trade law in order to ensure regulations and legislation effectively achieve their goals. The technicalities of trade agreements and decisions of trade dispute settlement panels are not always easy to understand. They are also sometimes shrouded in myth and misperception. This Guide clarifies key issues, dispels myths, and highlights areas of real concern.

What does this Guide cover?

This Guide explains the main substantive trade rules that could affect state, provincial, and local laws and regulations, as well as the procedural rules for dispute resolution. By informing the public about how the rules operate, this Guide helps build capacity for state, provincial, and local governments to develop effective legislation that also avoids trade challenges. In particular, it covers WTO and NAFTA rules relating to:

- trade in products;
- technical barriers to trade, including ecolabels;
- sanitary and phytosanitary measures, including rules relating to food safety;
- subsidies;
- investment and the treatment of foreign investors; and
- government procurement, including programs such as "buy local" or "buy American" requirements.

This Guide is non-exhaustive. Although it identifies the main aspects of trade agreements and trade jurisprudence that should be taken into account when developing environmental policy and law, it does not identify each and every issue. Trade law has become a very complex, fact-specific inquiry with new challenges arising weekly, making an exhaustive study almost impossible.

Chapter 2

An Overview of the GATT and the Global Trading System

The WTO, as the only global international organization dealing with the rules of trade between nations, is a very influential institution that has the power to decide that nationally enacted environmental and labor laws are inconsistent with international trade rules. What are the rules that make it so influential and powerful? How could a trade dispute settlement panel (hereinafter trade panel or panel) determine that U.S. efforts to protect endangered sea turtles violate WTO rules but then later decide that they did not? How could a trade panel rule that the European Union's import ban on meat products containing bovine growth hormones violated WTO rules? This section helps answer these questions.

What Are the Rules of the Global Trading System?

The WTO includes a number of agreements that establish rules for trade in products as well as services, such as telecommunications or shipping. Separate WTO agreements limit the types of subsidies that WTO Members may use, establish rules for product standards (for example, what constitutes a "sardine" or a 200-thread-count sheet), and create minimum standards for intellectual property rights.

The General Agreement on Tariffs and Trade (GATT) provides the core obligations with respect to international trade. The GATT itself only governs trade in products, but its core rules form the bases for subsequent agreements relating to trade in services, investments, and intellectual property, among other topics. GATT rules have also been incorporated into the NAFTA, the U.S.–Central America–Dominican Republic Free Trade Agreement (CAFTA–DR), and other free trade agreements, including the Treaty of Lisbon, which governs trade among the members of the European Union.

The GATT emerged from the ruins of World War II to reduce tariffs—taxes imposed on products as the price of entry into a country—and to create rules for trade in products. By all accounts, the GATT has been successful at reducing tariffs. Since the end of World War II, tariffs on non-primary products (i.e., manufactured goods) have fallen from about 40 percent of the cost of a product to about 4 percent.

The GATT's non-tariff rules have generated most of the controversy. The GATT imposes three important rules to end discrimination against products. First, GATT Article I requires Members of the WTO to tax and regulate imported products "no less favorably" than "like" products—products having similar characteristics and end uses—imported from another WTO Member. This principle is known as the *most favored nation (MFN) principle*. The MFN principle is designed to ensure that similar products from different countries are taxed and regulated the same and to prevent importing countries from favoring one foreign trading partner over another. For example, Brazil must tax and regulate solar panels from the United States the same as solar panels from Germany and China.

Second, GATT Article III prohibits a WTO Member from imposing taxes on foreign products "in excess of those applied to domestic "like" products. Similarly, it requires a WTO Member to regulate foreign products "no less favorably" than "like" domestic products. Known as the *national treatment* principle, this obligation is designed to ensure that countries do

not protect their products and industries from foreign competition. Thus, the United States, as a WTO Member, must tax and regulate tuna from Mexico no less favorably than tuna from the United States.

Third, GATT Article XI, commonly known as *the prohibition against quantitative restrictions*, bans the use of other types of restrictions on products, such as quotas and licensing schemes, because these types of restrictions are thought to distort trade by changing the conditions of competition between foreign and domestic products. Trade panels have interpreted this ban broadly. For example, even unenforced quotas violate Article XI because foreign producers may make business decisions based on the quota.[3]

Which Products Must Be Taxed and Regulated "No Less Favorably"?

A central question for trade policy is when the MFN and national treatment non-discrimination obligations apply. No one questions that fundamentally different products may be taxed and regulated differently. Thus, governments may tax and regulate wind turbines differently from automobiles and coal differently from solar panels.

At some point, however, products become so similar that trade rules demand equal tax and regulatory treatment to ensure fair competition in the global marketplace. The GATT and other free trade agreements thus apply the MFN and national treatment obligations to "like products." In other words, imported "like products" from one WTO Member must be taxed and regulated "no less favorably" than "like products" from another WTO Member or "like products" produced in the importing country.

The issue of "like products" raises difficult questions; deciding which products are "like products" is not always easy. While it may be easy to understand that all red wines are essentially "like" products, are red wines "like" white wines or sparkling wines? Is a genetically modified tomato "like" a conventionally grown tomato? Is electricity from coal the same as electricity from wind power? Are hybrid, electric, and traditional gas-powered automobiles "like" products? If yes, then a WTO Member must tax and regulate these products in the same way.

Trade panels have traditionally compared products based on a four-part test that reviews the products' 1) physical characteristics, 2) end uses, and 3) tariff classification as well as 4) consumer preferences for the products being compared.[4] Based on this test, trade panels have found all "brown" liquors to be "like" (scotch, bourbon, and rum)[5] as well as coffee deriving from different varieties of coffee beans.[6] However, a trade panel ruled that carcinogenic asbestos fibers and non-carcinogenic cellulose fibers, even when used for the same purpose, were not "like products."[7] In that case, the carcinogenic properties of asbestos were considered sufficiently different from non-carcinogenic cellulose fibers to permit France to ban the import and domestic sale of asbestos and asbestos-containing products while permitting the import and domestic sale of non-carcinogenic products that had end uses similar to asbestos.

An important aspect of the "like product" analysis is that, when differences in tax or regulatory treatment are permissible, those differences must relate directly to a product's characteristics. Thus, France could regulate asbestos products differently from non-asbestos products because the ban related to characteristics of the products (whether they contained asbestos or not). However, the method for producing a product is not considered a characteristic of that product. Thus, a trade panel ruled that the United States could not prohibit the importation from Mexico of tuna caught by encircling and killing dolphins in violation of the U.S. Marine Mammal Protection Act (MMPA), while simultaneously allowing the importation of tuna caught in accordance with the MMPA's dolphin-safe regulations.[8]

According to the panel, the capture method does not affect the tuna as a product. Thus, the

capture method cannot be used to justify different tax or regulatory treatment. As a result, the panel ruled that the U.S. tuna embargo against Mexico constituted a quantitative restriction on trade in violation of GATT Article XI. On the other hand, the United States may tax or regulate tuna "in oil" differently from tuna "in water" and canned tuna differently from tuna filets because these characteristics 1) relate to the product as a product and 2) distinguish the products sufficiently such that they are not considered "like" products.

What Are The Exceptions to These Rules?

GATT Article XX exempts certain measures (e.g., taxes, regulations, laws, and judicial opinions) from GATT rules. Article XX is divided into two parts. The first part, known as the "chapeau," establishes three general requirements that all measures must meet: they must not constitute "arbitrary or unjustifiable discrimination" in trade and they must not constitute a "disguised restriction" on trade. The second part of Article XX enumerates ten specific exceptions, including two relating to the environment.

The first environmental exception, known as the "Article XX(b) exception," allows measures that are "necessary" for the protection of human, animal, or plant life or health. Trade panels have established a balancing test to determine when a measure is "necessary." Under this test, a trade panel assesses (1) the relative importance of the interests or values furthered by the challenged measure, (2) the contribution of the measure to the realization of the ends pursued by it, and (3) the restrictive impact of the measure on international commerce. If this analysis yields a preliminary conclusion that the measure is necessary, then a trade panel must confirm the measure's necessity by comparing the measure with less trade restrictive alternatives that still provide an equivalent contribution to the achievement of the objective pursued.[9]

In the *Asbestos* dispute, a trade panel concluded that France's import ban on carcinogenic asbestos products was necessary to protect human health.[10] Another trade panel concluded that Brazil's ban on retreaded tires was necessary to protect human health from malaria, yellow fever, and other mosquito-borne illnesses (mosquitoes breed in water that collects in improperly disposed tires).[11]

The second environmental exception, the "Article XX(g) exception," allows measures "relating to" the conservation of an exhaustible natural resource, provided that similar restrictions are imposed on domestic production or consumption of that resource. Trade panels have found that "relating to" requires a "substantial relationship" between the measure and the objective pursued.[12] In addition, this exception specifically requires that similar measures apply to domestic production or consumption. Trade panels have said that this is simply a requirement of "even-handedness."[13]

In the *Shrimp/Turtle* dispute, for example, a trade panel ruled that U.S. import restrictions on shrimp from countries that did not adopt sea turtle conservation measures for their shrimp fisheries related to the conservation of sea turtles.[14] Similarly, a trade panel concluded that U.S. rules for establishing baseline levels of pollutants in gasoline related to the conservation of clean air—an exhaustible natural resource.[15]

While trade panels have interpreted these exceptions broadly enough that environmental measures routinely are found to meet the requirements of the relevant exception, very few environmental measures have been found to meet the general requirements of the "chapeau" of GATT Article XX. In order for a country to establish that its trade measures qualify as an exception to the general GATT rules, those measures must be applied in a way that avoids "arbitrary or unjustifiable discrimination" in trade, and they must not constitute a "disguised restriction" on trade.

The *Shrimp/Turtle* dispute provides an excellent illustration of how the "chapeau" operates. In the *Shrimp/Turtle* dispute, a WTO panel ruled

that the United States could not prohibit the importation of shrimp from several Asian countries just because those countries did not use turtle excluder devices (TEDs)—equipment that permits sea turtles to escape from a shrimp net. As in the *Tuna/Dolphin* dispute, the panel ruled that the import ban violated GATT Article XI, because the United States distinguished shrimp based on the way it was caught, not on characteristics of the shrimp itself. The panel then ruled, pursuant to Article XX(g), that the U.S. shrimp embargo related to the conservation of exhaustible natural resources—turtles were clearly an exhaustible natural resource, and the United States imposed sea turtle conservation measures on its own shrimpers.[16]

However, the panel concluded that the shrimp embargo did not meet the requirements of the Article XX chapeau. The panel ruled that the shrimp embargo constituted arbitrary and unjustifiable discrimination, because the United States required the exporting country to "adopt essentially the same policies and enforcement practices" as those applied to, and enforced on, domestic producers. In other words, because the United States did not take into account the unique environmental and other circumstances of the shrimp fisheries in foreign countries, it unfairly discriminated against some of its trading partners. The panel also concluded that the United States arbitrarily discriminated against Asian countries by not attempting to negotiate an international agreement to resolve shrimp-turtle issues with them, which the United States had done with Latin American countries. Also, the failure of the United States to provide countries with a formal process for appealing decisions to ban the importation of shrimp amounted to arbitrary discrimination.

In contrast, a trade panel found that the United States did meet the requirements of the chapeau in a subsequent shrimp/turtle dispute. The panel based its conclusion on three main points. First, after the panel's decision in the first shrimp/turtle dispute, the United States had attempted good-faith international negotiations to resolve the issue with shrimp-producing countries. Second, the United States had revised its requirements for importing shrimp. Instead of requiring essentially the same sea turtle conservation policies, the United States required exporting countries to adopt a program *comparable in effectiveness* to the U.S. program. The panel found that this requirement allowed sufficient flexibility to avoid "arbitrary or unjustifiable discrimination." Third, the United States adopted formal procedures for foreign countries to challenge the findings of the United States.[17]

While the GATT includes two environmental exceptions, it does not provide any exceptions for labor conditions unless the product is produced with prison labor. As a result, WTO Members cannot tax at higher rates or impose an import ban on products produced with child labor, without a minimum wage, or because labor conditions are poor in the exporting country. Under trade rules, shirts are shirts and shoes are shoes, regardless of whether the minimum wage is $1.00 a day or $10.00 an hour or whether a 12 year-old child works 60 hours a week to produce the product.

Why Did GATT Members Want the WTO?

The GATT has provided the rules for trade in products since 1947, but GATT members realized that lower tariffs and the GATT's non-discrimination rules were insufficient to open markets adequately. As a result, they initiated negotiations called "rounds" to develop rules for subsidies and other non-tariff barriers to trade. These early rules for non-tariff measures proved largely ineffective and members finally agreed to a comprehensive set of negotiations to develop several new agreements and to create a more effective dispute settlement body. These negotiations, called the Uruguay Round, culminated in the creation of the World Trade Organization (WTO).

Because the WTO incorporates the GATT, the basic non-discrimination rules still apply.

However, while the GATT applies these rules only to products, new agreements under the WTO's auspices apply them to intellectual property rights, agriculture, and services, among other things. Another WTO agreement establishes science-based rules for food safety laws. Several of these new agreements are discussed in this Guide.

How Does the WTO Resolve Disputes?

Perhaps the most important aspect of the WTO is its dispute settlement body. Although the disputing parties must first attempt to resolve their dispute through confidential consultations, many disputes are resolved only through court-like dispute settlement proceedings before a trade panel. A panel comprises three panelists, unless the parties mutually agree to a panel of five. The Secretariat, the WTO's administrative body, chooses panel members from a list of candidates. The candidates may be individuals from any WTO Member or from a governmental agency or non-governmental organization (NGO). Panelists must possess some relevant expertise, although trade expertise is of most importance.

The dispute settlement rules expressly state that panel deliberations "shall be confidential." Unlike court systems in most countries, citizens cannot watch the hearings and they generally do not have the right to obtain information about the proceedings. Citizens may submit their own briefs to a panel (*amicus curiae* briefs), but a panel is not required to read them.

WTO dispute settlement proceedings have become somewhat transparent. For example, the WTO now publishes all decisions and many other documents on its website (http://www.wto.org). In rare circumstances, the public may view dispute settlement proceedings. In addition, in the United States, due to a lawsuit brought by the group Public Citizen, citizens can obtain WTO-related documents, including all briefs in a dispute, submitted by the United States through the Office of the United States Trade Representative (USTR), the agency responsible for U.S. trade policy. USTR now places its submissions to the WTO dispute settlement body on its website (http://www.ustr.gov).

Once the panel issues its decision, WTO Members automatically adopt the panel's report, unless one of the disputing parties appeals the decision to the Appellate Body, a permanent appeals body comprising seven persons appointed by WTO Members. The WTO Members may decide not to adopt a panel or Appellate Body decision, but only by consensus and this has never happened.

If the panel or Appellate Body determines that a WTO Member has violated WTO rules, then the Member has three options. Under the first and preferred option, the Member may repeal or amend its offending measure to conform to the conclusions of the panel. Second, if the Member refuses to comply with the decision, then the disputing WTO Members may negotiate trade sanctions.

Third, if the disputing Members cannot agree on appropriate trade sanctions, then the complaining Member may impose economic sanctions on the non-complying Member. The sanctions may include higher tariffs on products from the non-complying Member or a suspension of other trade benefits, such as non-recognition of intellectual property rights. The sanctions, however, may not exceed the lost trade value of the products affected by the WTO-inconsistent measure. For example, a WTO panel found the European Union's prohibitions against the importation of meat products containing bovine growth hormones to be inconsistent with WTO rules. Because the EU refused to repeal the ban, the United States imposed high tariffs on certain beef products, flowers, mineral water, and other products from EU Member States in an amount equivalent to lost U.S. beef exports to the EU resulting from the ban.

How Do These Rules Affect State, Provincial, and Local Governments?

International trade rules do not apply directly to state, provincial, and local governments. However, WTO agreements typically direct the national government to take all measures necessary to ensure compliance with trade rules by state, provincial, and local governments. In addition, a state, provincial, or local government measure can still be subject to a WTO dispute. In such a case, the national government defends the measure in the dispute. If a trade panel concludes that a state, provincial, or local measure violates a WTO agreement, then the national government is responsible for bringing the state, provincial, or local government into compliance or negotiating sanctions with the prevailing WTO Member.

Some agreements, on the other hand, expressly exempt local laws from trade rules. For example, the NAFTA's rules relating to government procurement do not apply to local governments.

Separate sections of this Guide explain whether or not the rules of a specific WTO agreement apply to state, provincial, and local governments.

If the WTO Governs Global Trade, Why Do We Need Regional Free Trade Agreements Such As NAFTA?

At times, trading partners want to create more beneficial conditions for trade than provided for under WTO rules. They may also want to adopt institutions to address environmental and labor concerns that are not found in WTO agreements. To accomplish these goals, they negotiate bilateral or regional free trade agreements. NAFTA, for example, establishes rules for trade in foreign investments that are much more specific than those found in the WTO's Agreement on Trade-related Investment Measures. When Mexico, the United States, and Canada negotiated NAFTA, they also negotiated a separate "environmental side agreement" that creates the Commission for Environmental Cooperation, a tri-national body that establishes priorities for cooperation on environmental matters. Among other things, environmental side agreement allows citizens of Canada, Mexico, and the United States to file submissions alleging that one of the three governments is failing to enforce its environmental laws effectively.

Is It Possible to Establish Rules to Protect Human Health and the Environment and Not Violate Trade Rules?

Yes, it is possible to protect human health and the environment even when the full range of trade rules apply. However, trade rules clearly constrain the policy choices available to legislators. The goals of environmental protection and free trade need not conflict, yet they sometimes do. This Guide helps policymakers find measures that are supportive of environmental protection and consistent with the rules of international trade. For that reason, each section of this Guide describes laws and regulations that are clearly inconsistent with trade rules, as well as laws and regulations that are consistent with those rules. This Guide also provides a checklist of questions to answer to help ensure that a law or regulation is consistent with trade rules.

Chapter 3

Ecolabeling and the Agreement on Technical Barriers to Trade

Background

Product standards are essential economic tools that define and ensure a product's quality, shape, size, and other characteristics. Product standards apply to virtually every product in today's markets and most nations employ them to ensure products meet health, safety, and other requirements. Typical product standards include motor vehicle safety regulations, fuel economy standards, energy efficiency requirements for appliances, and requirements to use specific materials to prevent flammability or toxicity of products.

While recognizing the importance of product standards, the international trade community also recognizes that they may increase costs to manufacturers when different nations impose different standards for the same product. For example, producers of electronics incur higher production costs to accommodate different voltage and plug types in different countries. If the costs of meeting the different standards of various countries are sufficiently high, manufacturers may avoid certain markets.

The international trade community has responded to these concerns by adopting the WTO's Agreement on Technical Barriers to Trade, known as the TBT Agreement. The TBT Agreement affirms the right of WTO Members to adopt mandatory product standards—known as "technical regulations"—as well as voluntary product standards, which are known simply as "standards." To encourage competition and uniformity, however, WTO Members must base their technical regulations and standards on those adopted by international bodies, such as the International Organization for Standardization (ISO), unless those standards are "ineffective or inappropriate" for that specific country. This practice of seeking uniformity of standards and technical regulations is known as "harmonization."

Through harmonization, producers reduce their costs by meeting a single product standard rather than adjusting production to meet the product standards of multiple countries. Consumers also benefit from harmonization of certain features of competing products, such as screw threads, compact discs, and many other products, because harmonization widens competition and facilitates the interchangeability of products.

In addition, product standards are often designed to maintain public health, conserve natural resources, or promote other important social values. Ecolabels, for example, are designed to promote environmental sustainability by allowing or requiring manufacturers to display certain product characteristics on a product's packaging. These characteristics may be inherent to the product, such as the energy efficiency of refrigerators, the nutritional value of a food, or the toxicity of kitchen cleaners. They may also identify the method of production, such as shade-grown coffee, dolphin-safe tuna, or pasteurized milk.

Because an ecolabel may be a technical regulation or standard, the TBT Agreement could bar WTO Members from using ecolabels that do not meet the requirements of the TBT Agreement. Harmonization through use of international standards is one of those requirements. This has caused serious concern among environmental advocates who worry that a requirement to use international standards will drive environmental and human health standards downward, at least in those countries that have

been environmental leaders. They are also concerned that a trade panel may conclude that the label is discriminatory.

This chapter describes the rules of the TBT Agreement. Because the application of the TBT Agreement to certain types of ecolabels is not yet known, this chapter also takes a close look at how the TBT Agreement may apply to ecolabels.

Key Questions and Concerns

Which technical regulations and standards does the TBT Agreement cover?

The TBT Agreement defines a "technical regulation" as a "document" (e.g., a law or regulation) that "lays down product characteristics or their related processes and production methods," with which compliance is mandatory. A technical regulation may also deal with terminology, symbols, packaging, marking, or labeling requirements as they apply to a product, process, or production method (PPM). A "standard" is defined similarly, except that compliance with a standard is voluntary.

Trade panels have interpreted this definition of "technical regulation" as including the following three elements:

- the document applies to and affects an identifiable product or group of products;
- the document establishes one or more product characteristics; and
- compliance with the product characteristics is mandatory.

Trade panels have interpreted these elements quite broadly. In *EC — Asbestos*, for example, Canada challenged France's ban on the import and sale of asbestos fibers and all products containing asbestos. The WTO's Appellate Body concluded that a technical regulation includes laws and regulations that identify the characteristics that a product must possess as well as those the product must not possess, such as the French ban on products containing asbestos. Moreover, the Appellate Body concluded that the document does not need to expressly identify specific products that must possess certain characteristics; generally applicable rules may also constitute technical regulations. For example, the Appellate Body determined that a ban on all products containing asbestos sufficiently identified the products that must possess the relevant product characteristic.[18]

The *EC — Sardines* dispute reinforced a broad interpretation of "technical regulation." In this case, Peru challenged a regulation of the European Communities (now known as the European Union (EU)) that allowed only preserved sardines from the species *Sardinia pichardus Walbaum* to be marketed as "sardines." Peru complained that Codex Alimentarius, an organization that establishes international standards, allowed the use of the term "sardines" for preserved *Sardinops sagax sagax* and 20 other fish species if a label indicates where the species were caught. For example, *Sardinops sagax sagax* caught in Peruvian waters could be labeled as "Peruvian sardines." The EU argued that the regulation was merely a "naming" rule and did not establish product characteristics. The Appellate Body disagreed, concluding that the EU's law defined a product characteristic—what constitutes a "sardine." It also identified the products to which it applied—sardines and other sardine-like fish.[19]

Trade panels have also ruled that voluntary measures might be considered "mandatory" within the meaning of the TBT Agreement. In *US — COOL*, the panel concluded that a voluntary measure could be considered mandatory in fact if it has the effect of prescribing or imposing one or more product characteristics.[20] In *US — Tuna/Dolphin III*, a

Common "Environmental" Technical Regulations

Fuel Economy Standards. Many countries establish fuel economy standards for vehicles. In the United States, for example, the passenger and non-passenger automobile fleet must achieve, on average, 35 miles per gallon by 2020. 49 U.S.C. § 32902. These standards are mandatory and clearly define a particular characteristic for a product—automobiles.

Energy Efficiency Standards. Many countries require appliances to meet certain minimum energy efficiency requirements. The United States, for example, requires standard-size dishwashers manufactured after January 2010 to not exceed 355 kWh/year and 6.5 gallons of water per cycle. 42 U.S.C. § 6295.

Housing and Handling Requirements for Cats and Dogs. Many countries have minimum standards for the humane handling, housing, and transport of wildlife. The United States, for example, establishes a number of conditions for transporting wildlife relating to the size and strength of enclosures, the provision of air and water, temperature in the enclosure, and other things. 50 C.F.R. §§ 101–72.

panel concluded that the voluntary dolphin-safe label was mandatory because it was the only method by which producers could inform consumers that the tuna was caught without harming dolphins.[21]

Taken together, these decisions define "technical regulation" very broadly. The WTO's Appellate Body notably left open the question of whether a "technical regulation" includes a ban on a product in its natural state, such as raw asbestos or unworked elephant ivory, rather than a ban on products containing a prohibited substance or modified products. The Appellate Body's conclusions in *Sardines* suggest that any time a government names a product that is subject to a mandatory ban or regulation, the government has identified a product characteristic (i.e., the product or species subject to the ban or regulation) and has thus established a technical regulation. Because the definitions of "technical regulation" and "standard" are nearly identical, these decisions should also be read as defining "standard."

What are the rules of the TBT Agreement for establishing technical regulations and standards?

The TBT Agreement sets out a few basic requirements for central governments, such as the U.S. federal government, to follow when they prepare and apply technical regulations and standards. These requirements include harmonization, non-discrimination, and avoidance of unnecessary obstacles to trade.

Harmonization. As described above, technical regulations must be based on international standards adopted by international standardizing bodies. The TBT Agreement does not identify which specific institutions make the international standards, although it does require that the membership of such a body be open to "the relevant bodies of at least all Members." Nonetheless, it is understood that Codex Alimentarius (Codex) and the International Organization for Standardization (ISO) are recognized international standardization bodies. Codex sets pesticide and other standards for

food and food safety. ISO facilitates harmonization of industrial and other standards.

In addition, the requirement to base technical regulations and standards on those set by international bodies includes a major exception. When an international standard will be "ineffective or inappropriate" for fulfilling a country's legitimate objectives, a WTO Member may adopt a technical regulation or standard different from the international body's standard. The TBT Agreement appears to provide WTO Members with wide latitude to adopt their own technical regulations by defining "legitimate objectives" broadly to include, *inter alia*, national security; the prevention of deceptive practices; and the protection of human health and safety, animal or plant life or health, or the environment. The Appellate Body in *Sardines* made clear that this list was not exhaustive,[22] thus opening the door to a broader range of legitimate objectives that may warrant technical regulations and standards different from standards set by an international body.

Non-Discrimination Obligations. The non-discrimination obligations of the TBT Agreement require Members to treat products of national origin and foreign origin similarly (the "national treatment" principle), as well as products originating from different foreign countries (the "most favored nation" principle). These are common rules of international trade law and are found in several agreements, such as the GATT (*See* Chapter 2 for a discussion of these obligations). They are designed to ensure that an importing country does not favor the products of one country over the products of another country when the products are the same. Panels have made clear that technical regulations and standards that are facially neutral—e.g., they do not expressly favor domestic over imported products—can violate MFN and national treatment obligations if they have the effect of doing so by creating conditions of competition detrimental to imported products.[23] The Appellate Body has made clear, however, that the MFN and national treatment obligations do not prohibit regulatory distinctions between all products found to be like. When a technical regulation discriminates against imported products, a panel must determine whether the detrimental impacts stem exclusively from a legitimate regulatory distinction or discrimination against the group of imported products.[24] For example, the United States tried to justify a prohibition against flavors, including cloves, in cigarettes while exempting menthol cigarettes from the ban by claiming that millions of menthol cigarette smokers would be affected by withdrawal symptoms. The Appellate Body did not agree that this constituted a legitimate regulatory distinction because menthol cigarette smokers could simply switch to regular cigarettes, which remain legal to sell.[25]

No "unnecessary obstacles to international trade." WTO Members must also ensure that their technical regulations and standards do not create unnecessary obstacles to international trade. The TBT Agreement further defines this obligation for technical regulations only, providing that technical regulations must not be more trade-restrictive than "necessary" to fulfil their legitimate objective. Therefore, governments can help protect their technical regulations and standards from challenge by adopting regulations that do not discriminate against products from identified countries or types of countries such as "tropical countries." They should also not choose a complete ban if a regulatory program is sufficient to meet the country's legitimate objective.

U.S. free trade agreements, such as U.S.–Peru Free Trade Agreement, often explicitly incorporate the rules of the TBT Agreement. Others, such as NAFTA and CAFTA–DR, include provisions very similar to those found in the TBT Agreement.

Do the rules for technical regulations and standards apply to ecolabels?

Certain components of ecolabels clearly meet the definition of a "technical regulation" or "standard" because ecolabels "include or deal exclusively with terminology, symbols, packaging, marking or labelling requirements." Mandatory ecolabels that describe the characteristics of the product itself, such as the energy efficiency or toxicity of a product, are clearly "technical regulations." Similarly, mandatory labeling rules relating to processes and production methods (PPMs) that affect the characteristics of the product are clearly covered. For example, mandatory labeling of products as "pasteurized" or "non-pasteurized" would constitute a technical regulation because the process of pasteurization changes the characteristics of the product.

What is less clear is whether the definition applies to ecolabels relating to the PPMs that do not affect the characteristics of the product. Trade panels have consistently distinguished PPMs that relate to a product, such as pasteurization of milk, from PPMs that do not relate to the product itself, such as the manner in which tuna or shrimp are harvested. Unlike pasteurization of milk, the method of harvesting tuna or shrimp does not affect the product. Under the GATT, WTO Members may not regulate tuna or shrimp differently based on the way they are produced unless a relevant exception exists (*See* Chapter 2, pages 4–5 for a discussion of this issue). Whether this is also true under the TBT Agreement has not yet been settled. A panel decision currently being appealed suggests that ecolabels that include PPM characteristics unrelated to the product itself, such as dolphin-safe tuna, are covered by the TBT Agreement.[26] A clearer understanding will emerge once the appeal is complete.

When are ecolabels discriminatory or trade-restrictive within the meaning of the TBT Agreement?

From a trade perspective, advocates of ecolabels consider ecolabels non-discriminatory, because the same standards apply to products regardless of their country of origin. They also consider ecolabels as a mechanism for providing consumers with information—consumers are not required to buy products with an ecolabel, but the ecolabel allows them to base their purchasing choices on factors other than price. However, many countries, particularly developing countries, believe that ecolabels discriminate against their products in the following ways:

- Developing countries and their businesses are frequently not notified about a pending proposal for an ecolabel. Because they have not participated in developing the criteria, the ecolabel criteria often favor producers from the country or region where the criteria are developed.

- Even if foreign governments and businesses are notified, they may find it difficult to participate due to cultural and language differences. Accurate translation of documents and interpretation at meetings can be prohibitively expensive.

- Ecolabels may not account for ecological differences. Should, for example, dioxin emission limits be the same in the United States, where the paper and pulp industry is concentrated, as in Brazil, where the industry is spread out over a much larger geographic area? Developing countries would answer "no."

- Ecolabel criteria, sometimes intentionally and often unintentionally, target products from developing countries. This can happen simply as a result of a country's development stage or because the developing country has yet to institute its own comprehensive standards. For example, a German NGO designed ecolabels that specifically targeted Colombian flower

producers, because the Colombian flower industry was known for using pesticides restricted as health hazards in other countries. Colombia complained that such requirements should apply to all flower producers and that the Colombian flower industry had established its own criteria for improving standards.

What are the rules for determining when a product meets the requirements of a technical regulation or standard?

After a technical regulation or standard is in place, the TBT Agreement also establishes rules for testing, verifying, inspecting, and certifying whether products comply with technical regulations or standards. These procedures are known as *conformity assessment procedures*. The TBT Agreement requires WTO Members to apply these procedures in a transparent manner to avoid protectionism.

They must also prepare, adopt, and apply conformity assessment procedures consistent with their most favored nation and national treatment obligations for "like products" in "comparable situations." In other words, WTO Members must apply the same procedures for all dishwashers regardless of their country of origin just as the technical regulations themselves must apply equally to all dishwashers regardless of their country of origin. Members must also ensure that conformity assessment procedures do not create unnecessary obstacles to trade; that is, they may not be "more strict" or applied more strictly than is necessary to give the importing Member adequate confidence that products conform to applicable technical regulations or standards.

What happens when the importing country and the exporting country have different technical regulations, standards, and conformity assessment procedures for the same product?

The TBT Agreement establishes rules relating to the recognition of other countries' technical regulations and conformity assessment procedures. Through a concept known as "equivalence," the TBT Agreement requires Members to give "positive consideration" to accepting another Member's technical regulations as equivalent to their own, even if those regulations differ from their own. However, a country should grant such "positive consideration" only if the other Member's technical regulations adequately fulfil the objectives of their own technical regulations.

A related concept is "mutual recognition," which requires a Member to accept the results of another Member's conformity assessment procedures, even when those procedures differ from their own. However, the other Member's procedures must offer an assurance of conformity with applicable technical regulations or standards equivalent to the importing Member's procedures. It is possible then, for example, that Mexico could approve tuna as "dolphin-safe" for use in the U.S. market if its conformity assessment procedures were similar to those of the United States.

Does the TBT Agreement apply to state, provincial, and local governments and NGOs? If so, how does it apply?

No, the rules of the TBT Agreement do not apply directly to the preparation of technical regulations and standards by state, provincial, and local governments and NGOs. Similarly, the rules for conformity assessment, equivalence, and mutual recognition do not apply to non-central governments or to NGOs. The TBT Agreement applies directly only to bodies subject to the control of the central government, such as regulatory agencies like the U.S.

Environmental Protection Agency.

However, the central government must take "such reasonable measures as may be available" to ensure that state, provincial, and local governments, as well as NGOs, comply with the TBT Agreement. What the phrase "reasonable measures" means is an issue not yet resolved. Scholars predict that it would be very difficult to challenge a central government for failing to take "reasonable measures" against state, provincial, or local governments or NGOs. The challenging party will likely face strong defenses, such as freedom of speech.

It is also worth emphasizing that state, provincial, and local governments are not required to abide by, recognize, or harmonize technical regulations or standards with those of any other non-central government. For example, Missouri is not required to follow standards of other non-central government bodies, such as New York, when adopting standards for the composition and performance characteristics of underground storage tanks.

Looking Forward

Ecolabels provide a valuable means for informing consumers about the environmental impacts of the products they buy. At the same time, ecolabels may unintentionally discriminate against the products of other countries. Even with the uncertain applicability of the TBT Agreement to certain ecolabels, governments and NGOs can take several steps to ensure that their ecolabel criteria are non-discriminatory and meet the other requirements of the TBT Agreement while at the same time achieving their environmental objectives.

For example, ecolabel creators should increase the transparency of their programs. Because increased transparency of all technical regulations was a significant goal for the drafters of the TBT Agreement, it includes a number of provisions requiring Members to notify other Members of their technical regulations. The TBT Agreement also requires standardizing bodies to publish their work programs, make standards available for comment, take into account any comments received, and publish the final standard. Moreover, Members must establish an "enquiry point" to answer questions from other Members with respect to technical regulations, standards, and conformity assessment procedures.

Nevertheless, foreign producers often have

Best Practices Checklist

- ✓ Notify all potential producers that may be affected by the ecolabel or other technical regulation. Notify the public for whom the ecolabel is designed to inform of the process for establishing ecolabel criteria.
- ✓ Ensure that ecolabel criteria do not target products from specific countries or regions.
- ✓ Ensure that ecolabel criteria are not designed to protect local producers from competition.
- ✓ Check to see if any international standards exist. While non-federal and NGOs are not required to use them, if such standards meet the objectives of the label, then the use of those criteria helps promote interchangeability of products, which benefits consumers.

difficulties obtaining information concerning mandatory and voluntary ecolabeling programs of other countries. Notifying all potentially affected parties of the world is almost impossible. Even if the TBT Agreement's rules on transparency do not apply to non-central governments and NGOs, governments and NGOs should make all reasonable efforts to notify relevant producers of their intent to design an ecolabel. In this way, they can better ensure that they create fair and effective ecolabels.

In addition, in a global economy, accounting for differing ecological conditions and PPMs is a serious challenge for ecolabels. What looks reasonable in one locale may be completely unreasonable in another due to differences in environmental conditions. For example, an eco-label that penalizes harvesting from old growth forests will favor European and U.S. producers because the old growth forests from those regions were cut long ago. In Brazil and other places, however, abundant old growth forest remains. The challenge for those designing such ecolabels is to establish criteria so that timber products from tropical Brazil and temperate Sweden may be eligible for the same label. To the maximum extent possible, governments and NGOs should design ecolabel criteria to be broadly applicable to avoid unintentional discrimination.

Ecolabels:
Informative or Discriminatory?

It is often difficult to determine whether an ecolabel is purely informative or trade-restrictive. Consider whether the following ecolabels are discriminatory under the TBT Agreement.

"Made From Tropical Timber." Austria required labeling of all tropical timber and tropical timber products as "Made From Tropical Timber" or "Containing Tropical Timber." This label could have violated the TBT Agreement's most favored nation and national treatment obligations because it required labels based on the origin of products—a tropical country—and it excluded products from Austria and other countries producing timber from temperate and boreal forests. Austria repealed this requirement before developing countries could challenge it.

"Energy Star." The United States allows manufacturers of appliances and other household goods to label their products with the "Energy Star" label if their product meets minimum energy efficiency standards. The TBT Agreement's rules relating to standards apply to this voluntary label because a product's energy efficiency relates directly to the product itself. This label is very likely consistent with the TBT Agreement: it is available to all producers regardless of their country of origin and does not somehow target products from particular countries. Products not meeting Energy Star standards may be imported and sold. Thus, the label is non-discriminatory and not more trade restrictive than necessary.

"Dolphin-Safe" Tuna. The United States maintains criteria for the voluntary labeling of tuna as "dolphin safe." A principal criterion for the label is whether purse seine fishing techniques were used to encircle dolphins to catch the tuna swimming beneath them. The U.S. criteria differ from the applicable criteria created by the Inter-American Tropical Tuna Commission ("IATTC"). Mexico has initiated a WTO dispute against the United States to determine whether the U.S. dolphin-safe label violates the TBT Agreement. The dispute should decide whether the IATTC, an organization comprising only 16 full member countries, can establish "international standards." It will most likely also determine whether the TBT Agreement applies to non-product related PPMs, such as fishing techniques. The label is otherwise non-discriminatory, because it treats all tuna caught with particular methods the same. It also treats tuna for labeling purposes on a boat-by-boat basis, rather than a country-by-country basis, a fact that suggests the label is non-discriminatory. Moreover, because dolphin-safe tuna may be sold without the label, the label is "not more trade-restrictive than necessary to fulfill the legitimate objective."

"Taste of Iowa." This marketing program of the Iowa Department of Economic Development promotes Iowa food and agricultural products. A Taste of Iowa® logo means the food product is Iowa-grown and processed. "Locally grown" labels such as this one are becoming increasingly popular among local governments and producers. As a state government program, it is not covered directly by the TBT Agreement, but the U.S. federal government must take reasonable measures to ensure that the program complies.

"Bird friendly", shade grown, and "fair trade" coffee. A number of NGOs have created voluntary labels to promote coffee that protects habitat or supports living wages for coffee producers. As with state and local government labels, the TBT Agreement does not apply directly to NGO labels, but the federal government must take reasonable measures to ensure that the program complies.

Chapter 4

Food Safety and the WTO's Agreement on Sanitary and Phytosanitary Measures

Background

Perhaps no WTO issue arouses more passion than the application of WTO rules to food safety. Citizens want governments to set standards that are rigorous enough to protect human health from the dangerous effects of pesticide residues on food and want governments to ensure that producers comply with those standards. With the globalization of the food supply system, consumers want assurances that imported food meets the same standards as imposed on domestic producers, while domestic producers want to protect their crops from diseases and pests that may be imported along with food products. Governments have responded to these concerns by adopting standards for pesticide residues on food, among many other food safety standards, to protect both human health and the environment, but importers frequently believe these standards are designed to protect domestic industries, not human health.

The WTO's Agreement on the Application of Sanitary and Phytosanitary Measures (SPS Agreement) governs the many measures that governments apply to protect human and animal life or health from risks related to additives; contaminants; toxins; and disease-causing organisms in foods, beverages, or feedstuffs, as well as measures to protect human, animal, or plant life or health from the risk of introduction or spread of pests and diseases. Measures subject to the SPS Agreement, known as SPS measures, include such common regulations as limits on pesticide residues on fresh fruits and vegetables, animal quarantine requirements to prevent the introduction of diseases, restrictions on imports of certain fruits from certain countries to prevent introduction of insects that threaten domestic agriculture, and laws prohibiting the use of certain additives in food products. The WTO's SPS Agreement (as well as the very similar SPS provisions of NAFTA) is designed to ensure that governments have valid scientific reasons for imposing such measures and to prevent governments from using health and safety as a rationale for discriminatory trade barriers. In so doing, WTO Members have made science the "neutral" arbiter of whether an SPS measure is permissible.

Because the possible spread of pests or diseases or the possible human health effects from food contaminants or additives are fundamentally scientific questions, it is not illogical that the SPS Agreement disciplines SPS trade measures through a set of scientific principles and requirements. But because the scientific evidence in this field can be unclear or indefinite, issues of food or environmental safety and human health protection are often hotly contested regulatory issues within countries.

Many consumer and environmental advocates vehemently criticize the elements of the SPS Agreement that give the WTO authority to review and possibly overrule national decisions regarding health and safety at the behest of a foreign government in the name of removing barriers to trade. For these advocates, high profile WTO disputes, including the successful challenge by the United States and Canada to the European Union's ban on meat products produced with growth hormones, show the pro-trade tendencies of the WTO. This chapter explores the continuing controversy over the SPS Agreement and the interplay between the essentially scientific process of assessing risk and the more policy-influenced decisionmaking about whether or how to manage the risk.

Key Questions and Concerns

What is a Sanitary or Phytosanitary Measure?

The SPS Agreement defines four categories of SPS measures. An SPS measure is any measure that may affect "international trade" applied

- to protect animal or plant life or health within the territory of a Member from risks arising from the entry, establishment or spread of pests, diseases, disease-carrying organisms or disease-causing organisms;

- to protect human or animal life or health within the territory of a Member from risks arising from additives, contaminants, toxins or disease-causing organisms in foods, beverages or feedstuffs;

- to protect human life or health within the territory of a Member from risks arising from diseases carried by animals, plants or products thereof, or from the entry, establishment or spread of pests; or

- to prevent or limit other damage within the territory of a Member from the entry, establishment or spread of pests.

SPS measures may include laws and regulations relating to processes and production methods, testing and certification schemes, quarantine treatments, transport requirements, methods of risk assessment, and packaging and labeling requirements directly related to food safety.

Common Types of SPS Measures

✓ The United States has established tolerances for residues of the herbicide, plant regulator, and fungicide 2,4-D (2,4-dichlorophenoxyacetic acid) in or on a wide range of food products, including strawberries (0.05 parts per million) and asparagus (5.0 parts per million). 40 C.F.R. §180.142. This regulation is an SPS measure designed to protect human life from risks arising from a toxin in foods.

✓ China requires poultry meat to be treated by heating before exportation to China if the exporting country (or zone) has not been recognized as free from Newcastle Disease by the exporting country's competent authority. The heat treatment shall induce a core temperature in the meat products of 70℃ for at least 30 minutes, or 80℃ for at least 9 minutes, or 100℃ for at least 1 minute, or by other heating method to assure the complete destruction of the Newcastle Disease virus. Quarantine Requirements for the Importation of Poultry Meat, art. 4 (entry into force on May 16, 2011). This SPS measure is designed to protect human life from risks arising from disease-causing organisms in foods.

✓ The United Kingdom prohibits the use of food coloring in foods unless that additive has been declared a "permitted colour." The law also bars the use of other food additives and sweeteners unless otherwise permitted. The Food Additives (England) Regulations 2009, 2009 No. 3238. This SPS measure is designed to protect human life from risks arising from additives in foods.

Does the SPS Agreement apply to state, provincial, and local laws?

Yes, any SPS measure that may directly or indirectly affect international trade must be in accordance with the SPS Agreement. Thus, the SPS Agreement applies to state, provincial, and local laws. As with the GATT, the federal government, not the state, provincial, or local government, will defend the measure.

How does the SPS Agreement work?

The SPS Agreement imposes a number of science-based and trade-based requirements on the adoption and maintenance of SPS measures by WTO Members. The trade-based requirements are similar to those found in the GATT and TBT Agreement and are relatively uncontroversial. For example, Members must ensure that their SPS measures do not constitute a disguised restriction on trade or "arbitrarily or unjustifiably discriminate" among Members where "identical or similar conditions prevail." SPS measures may be applied "only to the extent necessary to protect human, animal or plant life or health."

Conspicuously absent from the SPS Agreement's requirements are the non-discrimination obligations of the GATT and TBT Agreement. The SPS Agreement excludes the national treatment and most favored nation obligations to ensure that WTO Members only impose trade restrictions on those food and other products from specific countries where SPS-related problems are known or likely to exist.

For example, when hoof-and-mouth swept through the United Kingdom several years ago, the United States and other countries restricted imports of cattle only from the United Kingdom. If the United States was required to implement restrictions without discrimination, then it would have been required to restrict cattle imports from countries that were unaffected by hoof-and-mouth disease. In other words, the SPS Agreement recognizes the right of WTO Members to protect human health and the environment from threats originating in specific countries.

When may WTO Members apply a discriminatory SPS measure?

The SPS Agreement recognizes the right of WTO Members to adopt and apply SPS measures. When Members do so, they must base their SPS measures on international standards when they exist. For example, if Codex Alimentarius has established pesticide residue levels for apples, then WTO Members must use them. The SPS Agreement presumes that an SPS measure that conforms to international standards is "necessary to protect human, animal or plant life or health."

However, the SPS Agreement allows the use of standards different from international standards if there is "scientific justification" for doing so or if a Member determines that the relevant international standards are "not sufficient to achieve [the Member's] appropriate level of sanitary or phytosanitary protection." In either case, Members have the obligation to base their SPS measures on a risk assessment. Under the SPS Agreement, a risk assessment evaluates the scientific evidence to identify 1) the likelihood of the entry or spread of a pest or disease or 2) the potential for adverse human or animal health arising from additives, contaminants, or disease-causing organisms. These science-based requirements have been controversial.

What must be included in a risk assessment?

When conducting a risk assessment, Members must take into account the available scientific evidence, sampling and testing methods, and ecological and environmental considerations. In determining the appropriate SPS measure to apply, the SPS Agreement requires Members to take into account various factors, such as economic factors, the spread of the pest or disease, the costs of containing the pest or disease, and the cost-effectiveness of other approaches to limiting risks. The SPS Agreement encourages Members to minimize trade effects when enacting their SPS measures and requires Members to avoid "arbitrary or unjustifiable distinctions" in the levels of protection it offers. More specifically, the risk assessment consists of two parts: an analysis of the potential for harm and an evaluation of specific risks posed by a specific agent, such as a disease, pest, or pesticide.

Potential for harm. A risk assessment must evaluate 1) the likelihood of entry or spread of a pest or disease and the associated consequences or 2) the potential for adverse effects arising from the presence of additives, contaminants, toxins, or disease-carrying organisms in food. In analyzing that likelihood or potential, a risk assessment must go beyond establishing that risk as a "mere possibility," because "theoretical uncertainty" is not the kind of risk to be assessed; instead, the risk to be evaluated must be an "ascertainable risk."[27] The Appellate Body has stated that this analysis could be quantitative or qualitative. However, in the *Salmon* dispute, in which Canada challenged Australia's prohibition on salmon imports to prevent diseases from harming Australia's salmon aquaculture industry, the Appellate Body concluded that Australia's analysis was deficient in part because it assessed risks "in a textual form and [did] not assign any probabilities."[28] Also, "some" evaluation of the likelihood of entry is not enough to satisfy the risk assessment requirements, such as when the evaluation contains only "general and vague" statements of the possibility of adverse effects.[29]

Specificity. Trade panels have required a risk assessment to include a high correlation between the scientific studies used to evaluate risk and the specific risk being regulated. As the Appellate Body has noted, the specificity requirement has two elements: the risk assessment must be "sufficiently specific" in terms of the harm concerned and the precise agent that may possibly cause the harm.[30]

For example, in *Hormones I*, the European Union defended its import ban on meat products produced by cows injected with growth hormones, claiming that studies showed that growth hormones in general cause cancer in humans. The Appellate Body concluded that this was inadequate because the studies "do not focus on and do not address the particular kind of risk here at stake—the carcinogenic or genotoxic potential of the residues of those hormones found in meat derived from cattle to which the hormones had been administered for growth promotion purposes."[31] In other words, the risk assessment must be tailored to the specific use of the particular substance, as opposed to general information regarding a class of chemicals.

The issue of a risk assessment's specificity also arose in the *Apples* dispute. In this case, Japan justified its import restrictions on apples by asserting they were safeguards against fire blight, a bacterium well-known for damaging apples, pears, and other fruits. Japan's risk assessment, however, analyzed the risks of fire blight from apples together with risks from other fruits. Because the risk of fire blight varied significantly from fruit to fruit, the Appellate Body affirmed the panel's conclusion that the risk assessment was not sufficiently specific.[32] According to the Appellate Body, Japan must assess the risks of the entry, establishment and spread of fire blight specifically in apples as opposed to other fruits. While Japan may evaluate risks from a variety of vectors (e.g., different fruits) for a single disease, it must attribute the likelihood of entry or spread of that disease to each specific vector separately.[33]

How must the risks relate to the trade measures adopted?

The actual SPS measure adopted by a WTO Member must bear a rational relationship to the risk identified in the risk assessment. For example, if the risk is extremely low, then a complete trade ban may not be warranted. In addition, if an SPS measure includes several different requirements, each requirement must bear a rational relationship to the risk.

For example, in *Apples*, Japan's measure to prevent the entry of fire blight via imported apples contained ten requirements, including that apples originate from designated orchards; those orchards be surrounded by a 500-meter blight-free buffer zone; the orchards be inspected three times a year; and the apples, containers and packing facilities be treated with chlorine. The panel found that because fire blight was unlikely to spread from imported apples to Japan's orchards, the extensive requirements imposed by Japan were clearly disproportionate to the risk and thus did not bear a rational relationship between the risk and the measures.

Are there exceptions to the risk assessment requirement?

Yes, where "relevant scientific evidence is insufficient," WTO Members may "provisionally adopt" SPS measures "on the basis of available pertinent information." Under these circumstances, Members have an obligation to obtain additional information to conduct a more objective assessment and review the provisional SPS measure "within a reasonable period of time.

Scientific evidence is considered to be insufficient "if the body of scientific evidence does not allow, in quantitative or qualitative terms, the performance of an adequate assessment of risks."[34] The existence of scientific controversy or scientific uncertainty is different from the question of whether scientific evidence is insufficient; it may be possible to perform a valid risk assessment even when divergent views exist in the scientific community concerning a particular risk. However, when a qualified and respected scientific view questions the relationship between the relevant scientific evidence and the conclusions relating to risk that prevent the objective assessment of risk, then it may be that the scientific evidence is insufficient.[35]

The *Apples* case illustrates the difference between scientific uncertainty and insufficient scientific evidence. In that case, Japan implemented strict measures on the importation of apples to prevent the entry of fire blight, arguing that these measures qualified as provisional measures due to insufficient scientific evidence. Japan claimed that certain aspects of how fire blight was transmitted were subject to scientific uncertainty. The panel, however, noted the existence of a large quantity of high-quality data describing the risk of transmission of fire blight through apples as negligible. While certain aspects of transmission were subject to uncertainty, the overall process was well known.[36] Thus, Japan was not entitled to apply a provisional measure, because it had available to it sufficient data on which to prepare a risk assessment.

Hormones II is also illustrative. In that case, the European Union argued that even though an international body had prepared a risk assessment for five hormones injected into cattle for growth promotion purposes, new information cast doubt on that risk assessment. As such, the European Union claimed that scientific evidence was now insufficient. The disputing parties and the Appellate Body agreed that evidence from a risk assessment could become insufficient at a later time due to new scientific evidence. The Appellate Body also concluded that new scientific evidence did not need to result in a paradigm shift in the scientific understanding of an issue in order to render as insufficient the evidence in an existing risk assessment.[37]

Based on these cases, it is difficult to describe exactly when scientific evidence becomes insufficient; at some point, however, the body of scientific evidence does not allow, in quantitative or qualitative terms, the performance of an adequate risk assessment. When that point is reached, a Member may adopt a provisional SPS measure.

What if there is scientific uncertainty?

As noted above, the WTO's Appellate Body has held that scientific uncertainty differs from insufficient scientific evidence.[38] Scientific uncertainty alone is not a valid reason for adopting a provisional measure. This conclusion makes sense, because some degree of scientific uncertainty will almost always exist.

Do trade panels defer to decisions of national scientific authorities?

No, trade panels have not deferred to decisions of national authorities, such as the Environmental Protection Agency, on complex scientific matters. The WTO's Appellate Body, in rejecting the notion of deference to national authorities, pointed to the WTO's dispute settlement procedures, which require trade panels to make an "objective assessment of the facts" presented by the disputing parties. As such, a trade panel has the discretion to decide which evidence it will consider. The panel may assign whatever weight it deems appropriate to that evidence and is free to weigh it differently than the Member whose measure is being challenged. It may even solicit guidance from relevant scientific experts on how to interpret evidence, although it is not required to follow their advice. Nor is the panel under any obligation to gather additional information or to require Members to provide data to the panel.

Panels have expressed a preference for evidence gathered through scientific methods. For panels, this evidence is "characterized by systematic, disciplined and objective enquiry and analysis." The evidence on which a government relies does not have to be the majority view, but any minority view relied upon should come from qualified and respected sources.

In the *Hormones I* dispute, for example, the Appellate Body dismissed the minority view expressed by an expert doctor that ingesting hormone residues in beef injected with hormones for growth purposes carried a small risk of breast cancer. The Appellate Body reasoned that the doctor's view did not purport to be the result of scientific studies focusing specifically on residues of hormones in meat from cattle fattened with such hormones. As such, this sole divergent view was not adequate to overturn the larger body of evidence indicating that hormone-treated beef was safe for human consumption.[39]

What are "arbitrary or unjustifiable distinctions in the levels it considers to be appropriate in different situations"?

The Appellate Body has made clear that Members have the right to determine their own appropriate levels of protection against pests, diseases, and contaminants. However, the SPS Agreement imposes limits on this right. First, the measure may not be more trade restrictive than necessary to achieve that level of protection. Thus, if the risk assessment shows a very low risk of the entry of a pest, a complete ban on the importation of that product may not be warranted.

Second, the SPS Agreement requires Members to "avoid arbitrary or unjustifiable distinctions in the levels it considers to be appropriate in different situations," if such distinctions result in discrimination or a disguised restriction on international trade. The Appellate Body found

that a measure violates this requirement if the following three conditions are met:

- First, the Member has adopted different appropriate levels of sanitary protection in different (i.e., comparable) situations;
- Second, those levels of protection exhibit arbitrary or unjustifiable differences in their treatment of comparable situations; and
- Third, the measure embodying those differences results in discrimination or a disguised restriction on international trade.

Concerning the first element, the Appellate Body has specifically concluded that "different situations" in fact means comparable situations. Situations are comparable if they concern the same pest or disease, the same biological or economic consequences, or the same adverse health effect.[40] For example, the Appellate Body in *Hormones I* concluded that both hormonal and microbial growth promoters were carcinogenic, i.e., they have the same adverse health effects. As such, the levels of protection established for each could be compared to determine whether the measures governing hormones for growth promotion purposes were arbitrary or unjustifiable.[41] In the *Salmon* dispute, the panel found that herring, which is a carrier of four pests or diseases, are comparable to salmon, which may carry up to 24 different pests and diseases, because there was some overlap in the diseases they potentially carry.[42]

Once the panel identifies comparable situations, it compares levels of protection. In *Hormones I*, the Appellate Body found a fundamental distinction between added hormones (natural or synthetic) and naturally occurring hormones in meat and other foods. Thus, different levels of protection were not arbitrary or unjustifiable.[43] Similarly, the Appellate Body concluded that differences in treatment between beef treated with hormones for growth-promotion purposes for human consumption and beef treated with hormones for therapeutic or zoological purposes were not arbitrary or unjustifiable. For hormone-treated beef for general human consumption, entire herds were continuously injected with the hormones throughout their life cycle. For beef treated for therapeutic or zoological purposes, only selected cattle were occasionally administered hormones under the supervision of a veterinarian, and rules required mandatory withdrawal periods, detailed record keeping, and other mandatory safeguards.[44] However, the *Salmon* panel found that Australia's different levels of protection for fresh salmon (imports banned) and fresh herring (imports allowed) were unjustified because the risk of entry of pests and diseases from herring was at least as high as that from salmon. Australia failed to persuade the panel that it was currently performing risk assessments to determine whether herring imports should also be restricted and that it had targeted fresh salmon first because of the number of potential diseases and pests it carried.[45]

The final step in determining whether a measure results in discrimination or is a disguised restriction on international trade is made on a case-by-case basis and could include any number of factors. The *Salmon* panel reviewed a number of "warning signals" that might indicate whether or not the discrimination is arbitrary or unjustifiable or whether the measure constitutes a disguised restriction on trade. For example, the *Salmon* panel explained that failing to meet the requirements of a risk assessment is a "strong indicator" that a measure is arbitrary or unjustifiable.[46] The panel also assessed other factors to conclude that Australia's measure was arbitrary or unjustifiable, such as the "substantial" difference in levels of protection, an unexplained change between its 1995 report recommending restrictions on salmon imports and its 1996 report recommending a ban on salmon imports, and a lack of similar controls on the internal movements of fresh salmon products between regions infested with pests and diseases and regions free of such pests and diseases.[47]

Looking Forward

Despite the highly controversial nature of the SPS Agreement, there has been no movement among WTO Members to change it. Thus, because the SPS Agreement applies to federal, state, and local laws and regulations, all levels of government should be familiar with the basic rules of the SPS Agreement.

A Best Practices Checklist

- ✓ Identify whether an international standard exists when contemplating implementation of a new SPS measure. Use the international standard if it meets your desired level of protection.
- ✓ If you desire a more protective standard than the international standard, prepare (or obtain from elsewhere) a risk assessment to determine whether a more protective standard is justified. Ensure that your risk assessment is tailored to the specific harm concerned and the precise agent that may possibly cause the harm (whether a disease, pest, toxin, or other danger).
- ✓ Ensure a rational relationship exists between the risk identified in the risk assessment and the measure chosen. For example, do not impose a ban if the risk assessment shows a relatively low risk.
- ✓ If a standard higher than the international standard is justified, ensure that the standard does not discriminate against those products that meet the standard. In other words, invoke the restrictions authorized by the SPS measure only against those products that pose the risk.
- ✓ Compare the level of protection in a particular situation with the level of protection in comparable situations with regard to both the level of protection sought and the impacts to be regulated.

Chapter 5

The Role of Subsidies in Shaping Public Choices

Background

Subsidies affect most aspects of our daily lives. Subsidies influence the resources we use, the activities we take part in, and the personal and professional choices we make. Broadly speaking, a subsidy is a benefit the government confers on something, such as an individual entity, an industry, or even the general public. Some common subsidies include the lower cost of in-state college tuition, public transportation, road building, and fire protection. Other subsidies encourage oil and gas drilling and the development of solar energy and wind power. These government benefits take many forms and are easy for us to overlook while we are taking advantage of them.

Many subsidies we take advantage of are available to everyone who qualifies for them; they are not specific to any particular industry or business sector. For example, when the government lowers the cost, gives away, or allows the use of a public good like libraries, education, or health care, it is providing a subsidy to everyone in that jurisdiction. The international trade community is not interested in these types of subsidies, because they typically do not distort international trade in products.

Trade law is concerned with subsidies that are provided to a particular industry or business sector when those subsidies distort international trade, such as those granted to cotton producers and oil and gas companies. Subsidies that distort trade are considered to be an "unfair trade practice," because they artificially lower the cost of production for producers in that business sector. By lowering the cost of production, these subsidies lower the price of a product and may allow the recipient of the subsidy to access new markets and outcompete unsubsidized products from other countries.

Subsidies that distort international trade in this way undermine the goal of trade policy to establish a level playing field for products in trade. It is this basic principal that also underpins the GATT's most favored nation and national treatment obligations, which require a WTO Member to tax and regulate all foreign products alike and treat foreign products no less favorably than like domestic products (see Chapter 2, pages 4–5). If a government has a duty to tax and regulate domestic and imported products equally, eventually a more efficient trading system will result when a product's production takes place in the country that has the best resources and skills to produce that product.

Significantly, trade law is not concerned with the purpose of a subsidy. Even if a government grants a subsidy to create local jobs or develop renewable sources of energy to combat climate change, if that subsidy harms businesses in other countries by, for example, significantly lowering prices in international markets, then trade law provides remedies to those businesses.

The WTO's Agreement on Subsidies and Countervailing Measures (SCM Agreement) regulates and prohibits certain subsidies to prevent the use of subsidies that distort international trade. If a subsidy is found distort trade, trade law allows a country to impose sanctions, typically in the form of higher tariffs on certain subsidized imports, to counteract the trade distortion from the illegal subsidy. These higher tariffs are known as countervailing duties.

Key Questions and Concerns

Does the SCM Agreement apply to state, provincial, or local subsidies?

Yes, there is nothing in the SCM Agreement that exempts state, provincial, and local subsidies. As with other aspects of the WTO regime, however, the state, provincial, or local government will not be the defendant in any WTO dispute. The U.S. federal government will defend the subsidy against any challenge.

Which subsidies are covered by the SCM Agreement?

The SCM Agreement does not establish rules for all subsidies. Instead, it establishes rules for those subsidies that distort trade. To fall within the scope of the SCM Agreement, a subsidy must constitute a financial contribution from the government and confer a benefit on the recipient. In addition, the government must grant the subsidy to a specific enterprise or group of enterprises. By defining subsidy in this way, the SCM Agreement excludes subsidies that apply to everyone, such as fire protection.

Just because a subsidy falls within the scope of the SCM Agreement, however, does not necessarily mean it is illegal. Some subsidies are expressly prohibited, as described below. Others, however, require a complaining party to prove that the subsidy actually distorts trade in some way, such as by increasing market share of the subsidized product.

How does the SCM Agreement define "subsidy"?

The SCM Agreement defines a "subsidy" as a financial contribution that confers a benefit on the recipient. "Financial contribution" is defined broadly to include what is typically considered a subsidy—a direct government transfer of funds such as a grant or loan. A "financial contribution" also exists when a government provides products or services (other than general infrastructure), purchases products, or fails to collect revenue that is other due, among other things. The breadth of "financial contribution can be seen from the *Softwood Lumber* dispute, in which a WTO trade panel concluded that a government program granting timber companies access to trees for logging constituted a "provision of goods"—the trees in the forest (see box on the next page).

In other respects, trade panels have narrowed the meaning of "financial contribution." For example, a government does not forego revenue "otherwise due" by not asking for revenue in the first place. Instead, the phrase "otherwise due" requires a review of the country's tax rules to determine whether the revenue paid by an entity is less than the revenue that entity should have paid under the country's tax laws.[48] In other words, the analysis depends on "the situation that would prevail *but for* the measures in question."[49]

To fall within the scope of the SCM Agreement, a financial contribution must also confer a benefit to a recipient. A financial contribution confers benefit if the recipient of the financial contribution is "better off" than it would have been in the open market (i.e., absent the financial contribution). The marketplace comparison underscores how market distortion is the evil to be prevented. If the recipient does not receive a benefit, then trade will not be distorted and there is no market distortion to worry about. If the recipient does receive a benefit, this benefit might improve the recipient's position over any non-receiving competitor's position or as to the position the recipient otherwise would have been in if transacting in the open market. The benefits from the measure increase the recipient's ability to conduct its business and limit competition, and potentially distort trade.

The Softwood Lumber Dispute

The *Softwood Lumber* dispute illustrates the broad scope of "financial contribution." In that case, Canada argued that a government program allowing access to timber on public lands did not constitute a financial contribution. The WTO's Appellate Body ruled otherwise. It held that the governmental provision of low-cost standing trees to produce timber is a financial contribution. Tangible items, like standing trees, are still "goods" and granting the recipients a right to harvest timber from those trees is a provision of goods. This government program was "providing" standing timber because it was putting particular stands of timber at the disposal of harvesters and allowing them exclusive use of those trees. The Appellate Body emphasized that, when determining whether a government provides goods or not, what is important is the consequence of the transaction. Because this program resulted in the governmental provision of timber to harvesters, it was a government-provided good.

United States — Final Countervailing Duty Determination with respect to Softwood Lumber from Canada, Appellate Body Report, WT/DS257/AB/R, paras. 68–104 (published Jan. 19, 2004) (adopted Feb. 17, 2004)

When is a measure "specific"?

The SCM Agreement only regulates a subsidy if it is "specific"—that is, the subsidy is granted to an identifiable enterprise or group of enterprises. Specific subsidies are more likely to have trade distorting effects than those that are available to everyone. Without this specificity requirement, the SCM Agreement would cover subsidies that have little or no adverse effect on trade, such as subsidies for education or transportation.

A subsidy may be specific if the law expressly limits its availability to certain enterprises, such as oil and gas producers. This is known as *de jure* specificity. This is easily determined by looking at the text of the law.

A subsidy is not specific, however, if the criteria to receive the subsidy are objective, facially neutral, and based on economic factors. A difficulty arises when the law appears facially neutral and generally available but, in fact, is only available to certain enterprises. If a facially neutral subsidy is only really available to a limited set of enterprises, then the subsidy is considered "specific" and the SCM Agreement applies. This is known as *de facto* specificity.

The SCM Agreement provides four factors to consider when making a *de facto* specificity determination. These factors are:

- The actual recipients of the subsidy are limited in number.
- A certain enterprise is the predominant user of the subsidy.
- Certain enterprises receive a disproportionately large part of the subsidy.
- The manner in which the granting authority exercises its discretion to grant the subsidy.
- The extent of diversification of economic activities in the relevant jurisdiction and the length of time the subsidy has been in effect.

The *Softwood Lumber* and *Cotton* disputes, described in the box on the next page, show how specificity findings are made.

Specificity in Context: The *Softwood Lumber* and *Cotton* Disputes

In the *Softwood Lumber* dispute, a WTO trade panel made clear that a subsidy could be specific even if it was theoretically available to anyone. In that dispute, Canada argued that any person could access timber at the low fees charged and that there was no attempt to limit the subsidy to logging companies and others involved in the wood products industry. The panel made clear that the test for specificity focuses on the actual effects; i.e., who is deriving the benefits from the subsidy. In this case, the subsidy may have been generally available but only a certain number of enterprises could take advantage of it as few ordinary citizens have the capacity to log large tracts of forest. In other words, when the inherent characteristics of a good limit the number of recipients who may receive a subsidy that is technically available to anyone, a *de facto* specificity determination is still possible—even likely. The panel noted that "[i]n the case of a *good* that is provided by the government . . . and that has utility only for certain enterprises (because of its inherent characteristics), it is all the more likely that a subsidy conferred via the provision of that good is specifically provided to certain enterprises only." *United States — Final Countervailing Duty Determination with respect to Softwood Lumber from Canada*, Panel Report, WT/DS257/R, para. 7.116 (published Aug. 29, 2003) (adopted as modified by the Appellate Body Feb. 17, 2003) (emphasis in original).

The *Cotton* dispute looks at another aspect of "specificity." In that case, the United States provided various subsidies to a large number of agricultural producers. Some of the subsidies were clearly specific in that they were available only to producers who used or exported upland cotton. However, other measures at issue were not limited to cotton producers only. One measure was available to a group of agricultural producers, including cotton producers, and another measure was available to almost all crop producers but not the entire agricultural sector. The panel made clear that legislation that limits the availability of a measure to a subset of an industry may also be a specific subsidy. The *Cotton* panel found several subsidies, although available to producers of 100 different crops, to be specific, because the cotton producers were among a subset of agricultural producers receiving the subsidy. The panel clarified that, "[t]he fact that some of the subsidies go to farmers who may produce different commodities, or, in theory, may not produce a given commodity does not mean, by some process of reverse reasoning, that the specificity that is apparent from the face of the grant instrument no longer exists." *United States — Subsides on Upland Cotton*, Panel Report, WT/DS267/R, para. 7.1148 (published Feb. 6, 2003) (adopted as modified by the Appellate Body Mar. 21, 2005).

How does the SCM Agreement regulate subsidies?

The SCM Agreement's primary goal is to prevent market distortions resulting from subsidies. It achieves this objective by regulating subsidies, while also recognizing that many subsidies have valid and important governmental purposes. In order to more directly target the market distorting subsidies it wants to regulate, the SCM Agreement distinguishes between subsidies that are always prohibited ("prohibited" subsidies) and subsidies that are prohibited if proven to distort trade ("actionable" subsidies).

What are prohibited subsidies?

Two types of subsidies are always prohibited because they are presumed to distort trade. These are subsidies contingent on 1) export performance (export subsidies) and 2) use of domestic products (import substitution subsidies). Because export subsidies are clearly designed to provide a market advantage to exporters, they are prohibited. Trade panels have concluded that evidence of an export subsidy can be expressly or clearly implied in the legislative text[50] or inferred from the facts that the financial contribution will be given based on certain export performance.[51] Import substitution subsidies are also prohibited because trade law wants businesses to make purchasing decisions based on market conditions, not on the financial contribution they receive for buying domestic products. Doing so leads to unfair competition and market distortion.

Both export and import substitution subsidies mentioned are prohibited because they create additional burdens on unsubsidized competition and are facially discriminatory. As such, a WTO Member may challenge prohibited subsidies without needing to prove that one of its industries producing a like product has been injured. In addition, prohibited subsidies are presumed to be specific.

What are actionable subsidies?

Prohibited subsidies are relatively simple to identify and remedy because no proof of the subsidy's trade distorting effects is needed. "Actionable subsidies," however, are broader in scope because they are identified by their adverse trade effects. These subsidies may be provided to stimulate production of a particular product or even to reduce production, such as U.S. payments to farmers to take wetlands and other marginal lands out of agricultural production. Regardless of their purpose, whether it is to benefit the environment or to incentivize domestic production, these subsidies may adversely affect trade.

The SCM Agreement tries to reconcile the legitimate government interests in offering a subsidy to promote certain activities with a subsidy's potential adverse effects on trade by creating conditions for when a subsidy is actionable. To be actionable, a subsidy must meet the definition of a subsidy and be specific, as described above. In addition, the complaining party must prove that the subsidy causes adverse trade impacts in one of two ways.[52] First, a business entity could prove that the subsidy has caused "material injury" to it. Under these circumstances, the business entity injured by the subsidy may bring a dispute under procedures established by the country in which the subsidized product causes injury. For example, U.S. manufacturers of solar panels brought a case under U.S. law challenging China's subsidies to its solar producers as impeding sales of U.S. solar panels in the United States. If the business entity proves that the subsidy causes or threatens to cause material injury, then the country harmed by the subsidy may impose "countervailing duties." Countervailing duties are increased tariffs imposed on the subsidized

product to offset the damaging effects of the subsidy.

Second, a WTO Member may challenge a subsidy as causing or threatening to cause material injury or "serious prejudice" to its interests. In these circumstances, a WTO Member may use the WTO's dispute settlement procedures to bring a dispute. If the WTO Member proves that the subsidy causes or threatens to cause material injury or serious prejudice, then the country harmed by the subsidy may impose "countermeasures" if the subsidizing country refuses to remove the subsidy. Countermeasures are typically increased tariffs imposed on the subsidized product to offset the damaging effects of the subsidy, but may also include the suspension of other trade benefits, such as the imposition of higher tariffs on non-subsidized products or the refusal to recognize intellectual property rights.

How does a subsidy cause serious prejudice?

Serious prejudice determinations encompass a broad range of impacts. Serious prejudice may occur when one country's subsidies displace or impede imports of a like product of another Member into the market of the subsidizing Member or the market of a third country. Serious prejudice may arise when a subsidy causes significant price undercutting as compared to a like product of another Member or when the subsidy allows the subsidizing Member to increase world market share in the subsidized product.

The purpose of the WTO dispute resolution system is to determine whether serious prejudice exists and, if so, to have the subsidy or adverse effect removed.[53] Because of this purpose, remedies for serious prejudice are meant to create a freely competitive market. In contrast, countervailing duties are meant to mitigate, but not necessarily remove, the effects of subsidies. As a result, while the SCM Agreement requires a causal link between the subsidy and the serious prejudice, it does not require "precise quantitative methodologies pertaining to [the subsidy's] breakdown or allocation."[54] Instead, it calls for a qualitative and, to some extent, quantitative analysis of the existence and nature of the subsidy and the serious prejudice caused.[55]

How does a subsidy cause "material injury"?

A material injury claim is more challenging to prove than a serious prejudice claim due to the level of specificity required to show material injury. To make a material injury claim, a business entity must prove the following characteristics of the injury: (1) the injury is to "like products", (2) the injury is "material," (3) the injury is to a "domestic industry," and (4) there is a causal link between the subsidized product and the injured industry; in other words, the industry must be harmed because of the subsidized product.

Whether products are "like products" is determined on a case-by-case basis. Unlike the GATT, the SCM Agreement defines "like products" to mean products that are physically identical or very closely resemble each other.[56]

The panel in *Indonesia — Autos*, the one panel to review the "like product" question under the SCM Agreement, embraced the GATT's four-part "like product" test of physical characteristics, end uses, consumer preferences, and tariff classification (see Chapter 2 at pages 4–5). In analyzing whether all cars were "like products," the panel said no, relying on differences in size, weight, engine power, technology, and features of various cars. Moreover, the panel noted that substitutability is one measure of a car's physical characteristics. According to the panel, a Rolls Royce and a low budget car such as the Indonesian-made Timor would have very low substitutability and thus are not "like products."[57]

To establish causation—that the subsidy actually

harmed the domestic industry—the challenging party must consider all relevant economic factors relating to the effect of the subsidized imports on prices of the "like product" and the impact on domestic producers of such products. If the facts show that the injury is due to some factor other than the subsidy, such as contraction in demand for the product, then the subsidy will be found not to cause injury. To prove a threat of material injury, the challenging party must show that an injury is clearly foreseeable and imminent; i.e. the injury would definitely occur unless some type of protective action is taken.

The third requirement is that a "domestic industry" must be materially injured. The SCM Agreement defines a "domestic industry" as domestic producers of the like product or producers who collectively produce a large proportion of the like product. Companies are classified as a domestic industry by the product they make, not by the process they use to make the product. For example, the producers of lamb meat are in a different domestic industry from those who produce lambs. Lambs are merely the raw material used to make lamb meat. According to the WTO's Appellate Body, it is irrelevant that "there is no use for the input product other than as an input for the particular end-product, or that there is a substantial coincidence of economic interests between the producers of these products."[58] Under the SCM Agreement, what matters is that the products are "like" or "directly competitive."

How do countervailing duties and countermeasures differ?

Both countervailing duties and countermeasures are remedies to remove the impacts of prohibited and actionable subsidies. Countervailing duties are imposed on the subsidized products under the domestic law of the country whose domestic industry is harmed to offset the benefit of the subsidy. To succeed, the complaining party must prove that the subsidy caused material harm to the complaining party's business and that a causal link exists between the subsidized imports and the injury. The major benefit of a countervailing duties claim over a countermeasures claim for private parties is that they may bring their own countervailing duty claims.

In contrast, countermeasures are only available to WTO Members that initiate a claim under the WTO's dispute settlement procedures. In a claim for countermeasures, a Member must prove that a subsidy of another Member is causing or threatening to cause material injury or "serious prejudice" to its interests or injury to one of its domestic industries. Once proved, the subsidizing country must either remove the subsidy or its adverse effects. If it does not, then the prevailing party may impose countermeasures. The major benefit of a countermeasures claim is that the challenging Member has a range of remedies available to it. Unlike with countervailing duty claims, in which countervailing duties are imposed only on the subsidized products, a successful countermeasures claim allows a Member to impose tariffs on a range of products or even suspend benefits obtained from another WTO agreement, such as non-recognition of intellectual property rights under the WTO's Agreement on Trade-related Intellectual Property Rights.

A countermeasures claim for serious prejudice may remedy a broader range of subsidies than a material injury claim. Like a material injury claim, a serious prejudice claim can offset injuries caused by imported subsidized products in a country's domestic market. However, it can also offset the trade distorting effects of subsidized products that adversely affect a country's exports to the subsidizing country or to a third country.

Moreover, in a countermeasures claim for serious prejudice, the challenging party does not need to precisely quantify the harm. It may rely on general price trends, the relative magnitude of exports on the world market and other factors to meet its burden to demonstrate "serious prejudice."[59]

Looking Forward

Defending a subsidy can be costly and a trade panel may find the subsidy to be inconsistent with the SCM Agreement. However, there are simple steps that may be taken while drafting legislation to ensure that a subsidy will not be subject to a challenge.

For one, a law becomes subject to the SCM Agreement's rules only if it meets the definition of a subsidy. As described above, this requires a financial contribution, a benefit conferred, and specificity. Lawmakers can avoid a financial contribution finding by refraining from requiring the revenue in the first place. For example, a state that wants to incentivize the use of particular pollution control technology could impose a tax on the use of the undesirable pollution control technology while leaving the desired technology untaxed. In this situation, there is no financial contribution because there was no tax on the product in the first place. In addition, the producer is not "better off" because there is no alternative in the marketplace for comparison.

A lawmaker may avoid a specificity finding by drafting the law so that it is generally applicable. To avoid both *de jure* specificity and *de facto* specificity, lawmakers must ensure that use of the subsidy is not limited to certain enterprises, that the predominate use is by certain enterprises, that certain recipients do not receive a disproportionately large amount of the subsidy, and that the granting authority does not appear to favor one type of entity over another. This can be difficult when drafting environmental legislation since generally speaking, incentives to use an alternate method of production or incentives to reduce pollution commonly target specific business sectors that use that particular method or produce a large amount of emissions.

If there is no way to draft the necessary legislation to avoid providing a financial contribution and benefit conferred or making the subsidy specific, then a lawmaker's last option is to ensure that the subsidy is not actionable by causing "material injury" to an industry or "serious prejudice" to the interests of another

Laws that May Violate the SCM Agreement

The Federal Energy Policy Act of 2005 (FEPA) provides tax credits for manufacturers of high-efficiency appliances like clothes washers, refrigerators, and dishwashers. 26 U.S.C. § 45M. The tax credit likely meets the definition of a "subsidy." It likely is a financial contribution as government revenue due but foregone and it confers a benefit to the recipients. The subsidy is also probably "specific." While all appliance manufacturers are eligible for the tax credit, "appliance manufacturers" could be considered a limited set of enterprises, especially when one considers that the same set of manufacturers make a variety of appliances. Whether this tax credit violates the SCM Agreement will depend on whether it causes "material injury" or "serious prejudice" to appliance manufacturers of another country.

The Bureau of Development Services in Portland, Oregon provides an electronic permitting process that makes the permitting process faster while also reducing permitting fees. The law clearly satisfies the requirements of a financial contribution as a provision of services and a conferred benefit. It also is specific. It is only available to solar contractors for solar energy installations while leaving out other contractors that provide different types of energy installations. This would be classified as a subsidy under the SCM Agreement. Whether this subsidy causes injury or serious prejudice would depend on the facts of the case. The value of the subsidy may be low enough that its effect on prices is negligible. Bureau of Development Services, Press Release, Sept. 27, 2008.

Laws that Do Not Violate the SCM Agreement

FEPA also provides rebates to consumers that purchase energy efficient appliances. 42 U.S.C. § 15821. The SCM Agreement does not apply to this law, because it is not specific. While the tax deduction likely constitutes a financial contribution, again as revenue foregone, and confers a benefit to recipients, it is not specific. The deduction is available to everyone.

The Eugene Water & Electric Board created a Solar Electricity Program that credits the accounts of residential and commercial customers who generate electricity from solar photovoltaic systems in excess of what they use; the credit is in excess of market rates for electricity. This subsidy is not covered by the SCM agreement because it is not specific. *See* Eugene Water & Electric Board, Solar Electric Program, http://eweb.org/solar.

country. A lawmaker walks a fine line here, because a subsidy that is small enough not to cause material injury or serious prejudice may also be too small to incentivize the action promoted by the subsidy.

Best Practices Checklist

- ✓ Avoid the provision of a financial contribution by taxing products or behavior that is undesirable, thus leaving the desired behavior untaxed.
- ✓ Avoid benefitting a specific group of enterprises by making the subsidy generally available. This may make the subsidy more expensive, because more individuals or companies may meet the eligibility requirements, but it should insulate the subsidy from a challenge.
- ✓ If it is not possible to avoid the provision of a specific subsidy, then try to gauge the amount of the subsidy to incentivize the desired behavior but to avoid a finding of "material injury" or "serious prejudice."

Chapter 6

The Investment Provisions of NAFTA

Background

As free trade has expanded, so too have rights for foreign investors. Indeed, NAFTA's extension of investor rights to a $7 trillion free trade zone with a vibrant cross-border investment market has sparked renewed interest and opposition to investor rights. Although the NAFTA was the first free trade agreement to include investor rights, they have been a feature of Bilateral Investment Treaties (BITs) for decades. The presence of investor rights in trade agreements, however, has generated intense interest.

Some organizations have called trade rules generally and NAFTA's investment provisions specifically a threat to local efforts to protect the environment and consumer choices. While none of these concerns has proven entirely true, the investment provisions of NAFTA do constrain the regulatory choices of state, provincial, and local governments to protect the environment. In addition, investor rights are becoming a fixture of trade agreements. They have been included in all trade agreements negotiated by the United States since NAFTA, including agreements with Australia, Singapore, and the countries of Central America, among others. Moreover, this is not only a U.S. phenomenon. Investor rights are also included in the Canada–Chile free trade agreement. In addition, although comprehensive investor rights are not currently included in the WTO, the issue remains on the WTO agenda. Because NAFTA's investment provisions have been in effect for more than 15 years now and a substantial body of jurisprudence has developed, this chapter focuses on NAFTA.

A. The Scope of Chapter 11

NAFTA Chapter 11 commits Canada, Mexico, and the United States to liberalize foreign investment opportunities and protect foreign investors and investments from a range of government behavior. The scope of Chapter 11 is broad. First, Chapter 11 applies to a broad range of investments. In addition to "traditional" investments in companies, "investment" is defined to include most profit-seeking investments, including intangible property, loans, and shareholding, among other things. Arbitral tribunals have interpreted "investment" to include access to markets in a host state and market share in a specific business sector.[60]

Second, Chapter 11 applies to all "measures . . . relating to" investments and investors, including local, municipal, state, and federal laws, with few exceptions. NAFTA tribunals have also held "measure" to include judicial conduct and decisions in domestic courts. Although an aggrieved investor must "exhaust" local judicial remedies before claiming a violation of its investor rights,[61] Chapter 11 effectively applies to almost any governmental act. However, as described more fully in this chapter, not all measures are subject to the same Chapter 11 protections.

With definitions of "investment" and "measures" this broad, it is obvious that a wide range of business activity is protected by NAFTA's investment provisions. As described below, both the procedural and substantive rules help investors protect their investments from certain types of governmental interference.

B. Procedure under Chapter 11

Foreign investors may seek compensation from a NAFTA government for breaches of Chapter 11. Unlike most international litigation that requires a nation-State to bring a claim, NAFTA and other free trade agreements allow foreign investors to bring their own claims against Canada, Mexico, or the United States. This is true even if a foreign investor challenges a state, provincial, or local law. Similarly, the federal government pays successful investor claims, even if the investor challenges a state, provincial, or local law.

The lack of "transparency," or access to tribunal hearings and documents, is a common complaint about trade tribunals, and continues to be an issue under Chapter 11. Chapter 11 tribunals initially meet in closed hearings with the disputing parties; other NAFTA governments may submit briefs, but local governments, interest groups, reporters, and the public are denied access to these hearings. Some of this secrecy has begun to erode. Most of the documents, including the claim and defenses, were initially regarded as confidential even though they dealt with public policy matters, such as the transport of hazardous wastes or regulations governing landfills. After numerous complaints, the NAFTA governments now make most documents available to the public. They also established a non-binding procedure for citizens to submit "friends of the court" briefs known as *amicus curiae* briefs. In some cases, and with the consent of the disputing parties in a case, tribunals have allowed closed-circuit telecast of the proceedings to a nearby location where the public can observe.

This lack of transparency has many implications. For example, this Guide advises governments to clearly express the purpose of a law or regulation, partly because they may not have a chance to express the purpose in the hearings.

Arbitral tribunals under Chapter 11 or other investment disputes are separate from domestic courts. Chapter 11 tribunals may review government measures only for breaches of the specific provisions of Chapter 11 itself. Also, investors must exhaust local remedies before they may bring a complaint to an arbitral tribunal. Arbitral decisions, however, are binding on the investor and governments.

An investor initiates a claim by filing a statement under special rules designed for arbitration of investment disputes.[62] The challenged government has an opportunity to respond. If the disputing parties cannot settle their dispute, they select arbitrators to hear the dispute. Typically, each party chooses one arbitrator, and the two arbitrators then choose the third. Except in a few cases, panelists have commercial law backgrounds and experience.

A disputing party may seek review of an arbitral panel's decision by a court in the place where the arbitration occurred.[63] However, laws generally limit review of arbitral decisions to whether the arbitrators exceeded their powers or were biased or corrupt;[64] courts will not review the merits of the case.[65] In one case, the British Columbia Supreme Court overruled portions of the award in the *Metalclad* dispute, ruling that the arbitral tribunal exceeded its jurisdiction by applying the wrong law to the case.[66]

C. Chapter 11's Substantive Obligations

NAFTA Chapter 11 imposes several substantive obligations on Canada, Mexico, and the United States modeled in part on GATT requirements but also creating additional obligations. These rules include the following:

- **Most favored nation**. Each Party must grant to investors of another Party and their investments treatment no less favorable than the treatment it accords, in like circumstances, to investors or investments of any other Party or of a non-Party.

- **National treatment**. Each Party must grant to investors of another Party and their investments treatment no less favorable than the treatment it accords, in like circumstances, to its own investors and their investments.

- **Minimum standard of treatment**. Each Party must apply "treatment in accordance with international law, including fair and equitable treatment and full protection and security." This obligation, known as the minimum standard of treatment, is an obligation that arbitrators have struggled to interpret and apply.

- **Prohibition against expropriation**. Parties may not directly or indirectly expropriate investments without compensation.

- **Prohibition against performance requirements**. Parties may not impose certain performance requirements on foreign investors, such as requirements to use local products.

Chapter 11 applies to all measures adopted before and after NAFTA came into effect, unless specifically included in an Annex of exempted measures or specifically exempted as a non-conforming measure. Chapter 11 specifically exempts state, provincial, and local government measures existing on the date NAFTA entered into force from the national treatment and most favored nation obligations, but not from the expropriation and minimum standard obligations. Because government procurement is exempted from Chapter 11's national treatment and MFN obligations, investors may not challenge discriminatory procurement policies. However, because NAFTA's provisions on government procurement apply national treatment and MFN obligations, a NAFTA government may challenge such policies.

Chapter 11 also exempts measures necessary to protect human, animal or plant life or health or necessary for the conservation of living or non-living exhaustible natural, but it only applies to the prohibition against performance requirements; measures violating MFN, national treatment, and minimum standards requirements are not subject to any environmental exceptions. This appears to be a deliberate decision on the part of the NAFTA Parties as other aspects of Chapter 11 do apply to the environment. For example, Chapter 11 discourages Parties from lowering their environmental standards to attract investment and explicitly allows Parties to put environmental conditions on investments that are "otherwise consistent" with Chapter 11.

1. Most Favored Nation and National Treatment Obligations

Background

Chapter 11 borrows from the GATT by applying the most favored nation (MFN) and national treatment obligations to investments and investors to prevent governments from discriminating against foreign investors and their investments. NAFTA Parties must ensure that foreign investors and their investments receive the same treatment as similarly situated domestic investors and investments as well as investors and investments from non-NAFTA countries.

In the words of Chapter 11, each Party must grant investors of another Party treatment no less favorable than it accords, *in like circumstances*, to its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments. The same rules apply to investments of investors.

This national treatment obligation extends to sub-national governments of a Party. State, and provincial governments must provide investors and investments of another Party "treatment no less favorable than the *most* favorable treatment."[67]

Arbitral tribunals consider various factors in evaluating an alleged violation of MFN or national treatment. The two factors common to all analyses are whether the investors are in like circumstances and whether the government has provided less favorable treatment. Some tribunals have also assessed whether any differential treatment was a result of the foreign investor's nationality and possible justifications for the discrimination. A given tribunal might address other considerations as well.

Key Questions and Concerns

Do these obligations apply to state, provincial, and local governments?

Chapter 11 clearly spells out the applicability of the MFN and national treatment obligations to state, provincial, and local governments. Article 1108 specifically exempts all non-conforming measures of *local governments* from both the MFN and national treatment obligations. It further exempts non-conforming *state and provincial* measures provided they are set out in a Schedule. However, because no state or provincial measures have been placed in a Schedule, all states and provinces must grant to investors and investments of other NAFTA parties treatment no less favorable than the most favorable treatment accorded, in like circumstances, by that state or province to any other investor and investment.

When are investments or investors "in like circumstances"?

Article 1102 requires each NAFTA Party to provide foreign investors and their investments treatment that is no less favorable than it accords to its own investors and investments that are "*in like circumstances*." Although common themes recur in their opinions, tribunals have yet to settle on a single test to determine when investors or investments are in "like circumstances."

Most tribunals appear to begin their analysis by asking whether the foreign and domestic investors are in "the same business sector," although they have interpreted this phrase inconsistently.[68] Some tribunals have begun their analysis by asking whether an identical comparator exists, moving to non-identical comparators if necessary.[69] In *Methanex*, for example, the foreign investor was a methanol producer that argued it suffered less favorable treatment than the treatment accorded to the U.S. ethanol industry.[70] Rejecting this contention, the tribunal identified the proper comparator as domestic methanol producers, which existed and were afforded the same treatment as the foreign methanol producer.[71]

Other tribunals have taken a broader view of "like circumstances." For example, the tribunal in *ADM* began by defining "circumstance" as "a condition, fact, or event accompanying, conditioning, or determining another, or the logical surroundings of an action."[72] Turning to the same business sector test,[73] it concluded that the foreign investor (a producer of high fructose corn syrup (HFCS)) was in like circumstances with the domestic sugar industry because they "compet[ed] face to face in supplying sweeteners to the soft drink and processed food markets."[74] The tribunal justified its decision to choose non-identical comparators by noting that, unlike in *Methanex*, no identical comparators existed (that is, there were no Mexican producers of high fructose corn syrup).[75] In a similar case involving HFCS, the *CPI* tribunal considered HFCS and sugar producers to be in like circumstances because "their products were in direct competition with one another."[76] The *CPI* tribunal drew from the "like products" analysis under the GATT[77] (see Chapter 2, pages 4–5).

In *S.D. Myers*, the tribunal concluded that a U.S-owned company in Canada designed to contract and export polychlorinated biphenyls (PCBs) to its U.S.-based parent company was in like

circumstances to Canadian companies that could both contract for and remediate PCB waste. The tribunal found that the investments were within the same business sector, and therefore in like circumstances, because they both "provid[ed] PCB] waste remediation services" and the foreign investment "was in a position to attract customers" away from the Canadian companies.[78]

From an environmental perspective, the *Pope & Talbot* case is probably the most important. The tribunal began by stating that the same sector test is "a first step" in determining whether foreign and domestic investors are in like circumstances. The tribunal announced a second step: Differences in treatment will presumptively violate Article 1102(2), unless they have a reasonable nexus to rational government policies that 1) do not distinguish, on their face or *de facto*, between foreign-owned and domestic companies and 2) do not otherwise unduly undermine the investment liberalizing objectives of NAFTA.[79]

In other words, discrimination among investors may be justified if there is a reasonable government policy rationale for doing so. In this case, the dispute arose out of the Softwood Lumber Agreement between the United States and Canada to resolve their contentious dispute over prices for accessing timberlands.[80] Under the agreement, Canada divided all softwood lumber producers into different categories. For example, producers in "non-covered provinces" could export softwood lumber to the United States in unlimited quantities and without the payment of any export fees.[81] Producers from other provinces—including the one in which the foreign investment was located—were subject to a variety of restrictions, including export fees.[82] In addition, Canada imposed higher fees for accessing timber in coastal areas of British Columbia than in interior forests.[83] The foreign investor complained that its investments were particularly disadvantaged relative to domestic investors because its investments were in coastal areas of a "covered" province.

The tribunal held, however, that Canada had valid regulatory reasons for making these distinctions and that consequently the foreign investment was not in like circumstances to domestic investments. For example, the distinction between covered and non-covered provinces was designed to avoid a threat of countervailing duties the United States had levied against the covered provinces but not uncovered provinces.[84] The tribunal noted that the foreign investment was arguably in a "disadvantaged class that existed before" Canada undertook action to implement the Softwood Lumber Agreement, thereby rendering the circumstances between the interior producers and coastal producers unlike.[85] The tribunal further found that Canada's decision to settle its dispute with the United States in a manner that burdened certain investments was reasonably related to "a rational choice of remedies aimed at avoiding a threat to the [Softwood Lumber Agreement]."[86] Moreover, the tribunal found that foreign and domestic producers were treated the same in coastal/interior areas and covered/uncovered provinces. As such, the tribunal concluded that the investments in covered provinces were in unlike circumstances to those in uncovered provinces and investments in coastal and interior areas were in unlike circumstances. Other tribunals, including the *Feldman*[87] and *GAMI*[88] tribunals have, referenced this analysis.

These three cases—*Pope & Talbot*, *Feldman*, and *GAMI*—are exceedingly important for environmental purposes. Governments regulate businesses differently for a variety of legitimate policy reasons. The test articulated by these three cases suggests that different treatment related to rational state concerns does not violate Chapter 11's national treatment obligation; different treatment based on legitimate state interests create unlike circumstances. By analogy, a factory in an area subject to strict air quality controls due to its presence in an urban area would not be in "like circumstances" to a factory in a rural area with few air quality concerns. A retail store next to a protected wetland would not be in "like circumstances" to a similar store sited in a previously developed area. Thus, governments may regulate these investments differently without violating NAFTA's national treatment obligation.

A word of caution is warranted here. Despite these decisions, a tribunal in the *CPI* case distanced itself from the rational governmental policy analysis established in *Pope & Talbot*. It reasoned that "[d]iscrimination does not cease to be discrimination, nor to attract the international liability stemming therefrom, because it is undertaken to achieve a laudable goal or because the achievement of that goal can be described as necessary."[89]

When is the treatment less favorable?

Under NAFTA Article 1102, an investor must show that it or its investment was treated less favorably than the relevant domestic investor or investment.[90] Tribunals tend to consider whether the law specifically discriminates against foreign investors (*de jure* discrimination) and whether the law as implemented discriminates against foreign investors (*de facto* discrimination). Further, the discrimination inquiry addresses four sub-issues related to whether 1) the treatment is the *most* favorable; 2) the treatment is a *result of* the foreign investor's nationality; 3) the intent to discriminate suffices to find less favorable treatment; and 4) disparate impacts are required to find less favorable treatment.

Facially Discriminatory Laws

Tribunals have made clear that any law that explicitly favors domestic investors or investments over their foreign counterparts violates Chapter 11's national treatment obligation. The *S.D. Myers* Tribunal articulated the test for this *de jure* discrimination as whether a Party's "measure, on its face, appears to favour its nationals over non-nationals who are protected by the relevant treaty."[91] When the United States instituted and continued a moratorium on Mexican trucks' operating in the United States,[92] the tribunal in *U.S. Trucking* agreed with Mexico that this amounted to facial discrimination in violation of the U.S.'s national treatment obligation.[93]

Facially Neutral Laws

Even when laws do not facially discriminate against foreign investors and investments, governmental agencies may use their discretion in ways that disadvantage foreign investors and violate Chapter 11's national treatment obligation.[94] For example, the *Feldman* tribunal found *de facto* discrimination when Mexico denied a foreign investor tax rebates while granting them to a domestic investor in like circumstances.[95] The foreign investor was also denied registration as an export trading company when similar domestic investors had been granted that registration.[96] Similarly, the tribunal in *ADM* found that applying a tax to products sweetened with non-cane sugar sweetener such as high fructose corn syrup (HFCS) but not to products sweetened with sugar constituted less favorable treatment because the tax was designed to protect the Mexican sugar cane industry, which competes in the same market as producers of HFCS.[97] However, a government's ineffective implementation of a law may not necessarily constitute discrimination in the absence of other information suggesting discriminatory intent.[98]

Discrimination as a Result of Nationality. The question of whether the "less favorable treatment" *resulted from* the investor's foreign nationality has arisen in several cases. The tribunal in *CPI* also considered this factor, albeit not as an explicit requirement.[99] In that case, Mexico asserted that it imposed less favorable tax treatment on HFCS as a lawful countermeasure to breaches of NAFTA by the United States.[100] The tribunal found that the logical consequence of such a claim was that the complaining investors were necessarily "targeted, in part at least, because of the extent of their [nationality]."[101] Other tribunals have rejected this approach.[102] The *Feldman* Tribunal concluded that no such requirement exists in the text of Article 1102 and that requiring such a showing would "tend to excuse discrimination that is not facially directed at foreign owned investments.[103] Giving effect to the plain wording of NAFTA, the *Thunderbird* tribunal held that a foreign investor must prove it was

treated less favorably and why, but not that the discrimination was motivated by nationality.[104]

Intention to Discriminate. Tribunals have inconsistently concluded that the complaining investor must show the defending government *intended* to discriminate against the investor. The *Methanex* tribunal, for example, concluded that the complaining investor must prove that the defending country intended to discriminate against foreign investors in favor of domestic investors,[105] although it did not reach the merits of that issue. The *CPI* tribunal, on the other hand, held that the proof of intent to discriminate was sufficient but not required to establish a national treatment breach.[106] The *ADM* tribunal noted that other tribunals had not relied on intent to find less favorable treatment but nonetheless concluded that Mexico's had intended to protect the domestic Mexican sugar industry from foreign competitors who produce HFCS.[107]

Discriminatory Impacts. Tribunals also diverge on whether a national treatment violation requires evidence of actual impact to the complaining investor.[108] Representing one view, the tribunal in *S.D. Myers* emphatically required a showing of practical impact, because Chapter 11 prohibited "treatment" that is less favorable.[109] The *CPI* tribunal found that adverse effects to a foreign investor relative to a domestic investor was sufficient, but not necessary, to satisfy the element of less favorable treatment.[110] The tribunal in *Cross-Border Trucking Services* (*US Trucking*) took a different view. In that case, the United States prohibited Mexicans from owning, controlling, or acquiring companies that provide transportation services within the United States.[111] The tribunal concluded that such a prohibition violated the national treatment obligation "even if Mexico cannot identify a particular Mexican national or nationals that have been rejected."[112] This tribunal's different view on impacts, however, is likely attributable to the outright ban on such investments.

Do exemptions from the national treatment obligation exist?

Yes. In addition to an exemption for national security, NAFTA exempts government procurement and subsidies from the national treatment obligation.[113] As a result, private investors will not be able to challenge government procurement policies or subsidies as violating Chapter 11's investor rights. Nonetheless, a government may be able to challenge those policies under NAFTA's provisions relating to government procurement or subsidies.

NAFTA also exempts cultural industries from the national treatment obligations of Canada and the United States.[114] Instead, cultural industries are subject to the more specific agreement between the countries.[115] The tribunal in *UPS* held this exemption applied[116] because it, among other things, "has an essential role in the economic, social and cultural life of Canada,"[117] provides for public policy functions including the "universal service obligation,"[118] and "ensur[es] the widest possible distribution of eligible Canadian publications to Canadian readers at affordable and uniform prices."[119]

Examples of the kinds of facially discriminatory laws that may violate NAFTA's national treatment obligations

Laws concerning land ownership and purchase:

- Missouri prohibits the purchase of agricultural land by foreign parties except in certain situations. Mo. Rev. Stat. § 442.571 (2003).

- Oregon limits people who may apply to purchase state lands to U.S. citizens. Or. Rev. Stat. § 273.255 (2003).

Laws concerning natural resource extraction:

- Idaho reserves a large volume of timber sales from state forests for companies that process timber within the state. Idaho Code § 58–1004 (Michie 2003).

- Nevada limits valid mining claims to U.S. citizens. Nev. Rev. Stat. 517.010 (2003).

Examples of facially neutral laws that may disadvantage foreign investors and investments

Laws concerning minimum recycled content or packaging requirements:

- Connecticut requires all publishers within the state to use minimum percentages of recycled fiber in newsprint. Conn. Gen. Stat. § 22a–256n (2003).

- Oregon requires all glass manufacturers conducting business in the state to use minimum percentages of recycled glass in food and drink containers. Or. Rev. Stat. § 459A.550 (2003).

Recycled content requirements may place foreign producers at a competitive disadvantage in the domestic market, because they may not have efficient access to recycled materials.

Laws concerning renewable energy preferences:

- Numerous states require a certain percentage of energy sold or consumed in the state to come from renewable sources. NAFTA problems arise because these states often define "renewable" energy sources in ways that favor in-state producers and resources. For example, Maine defines renewable energy sources to include small hydropower facilities (which are abundant in the state) but not hydro facilities with a production capacity of more than 100 megawatts (which are prevalent in the Canadian provinces that border Maine). Me. Rev. Stat. Ann. tit. 35-A, § 3210 (West 2003). While Maine's law is facially non-discriminatory, it disadvantages Canadian producers of energy.

Best Practices Checklist

- ✓ Avoid drafting laws and regulations that explicitly discriminate based on national origin even if they promote a legitimate public interest. Less discriminatory alternatives likely exist.
- ✓ When drafting facially neutral laws, be careful to include the relevant public policy reasons for enacting the legislation. Chapter 11 claimants will have a more difficult time showing protectionist intent when measures are supported by a legitimate government rationale. Policies grounded in the protection of human health or the environment may provide the best support. Economic reasons are more suspect.

* These recommendations should also reduce the risk of laws or regulations violating the most favored nation obligation of NAFTA Article 1103.

Looking Forward

New trade agreements do little to shed light on the key national treatment questions left unresolved by NAFTA tribunals. Nonetheless, the current ambiguities surrounding national treatment as applied to investment should not create a regulatory chill for policymakers, but they are a factor to consider when drafting legislation. The Best Practices Checklist, if followed, may help reduce the risk of a state or local-level law or regulation violating national treatment obligations.

2. Minimum Standards of Treatment

Background

International law has long recognized a basic obligation of governments to ensure that foreigners, including foreign investors, who have entered a country legally and are engaged in legal activities should at a minimum be secure against abuses of authority by host governments or other grossly unfair or arbitrary treatment. This concept is known as the minimum standard of treatment (MST) and it creates a floor—an absolute "minimum standard"—for a government's treatment of an individual or investor. Unlike the national treatment obligation, the government's treatment of foreigners must satisfy the MST regardless of how that government treats its own citizens.

NAFTA Article 1105 embodies MST by requiring each Party to

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

Article 1105 has been a source of significant tension and interpretive difficulty in part because NAFTA does not explain what constitutes "fair and equitable treatment."

MST's Historic Roots

The MST concept existed long before the NAFTA and it has been incorporated into many bilateral investment treaties (BITs) and free trade agreements.[120] Yet one of the most well-known tests associated with the MST did not arise from an investment dispute. In *U.S. (L.F. Neer) v. United Mexican States*, the U.S.-Mexico General Claims Commission decided a case that stemmed from the shooting death of an American citizen. It was alleged that Mexican authorities had failed to diligently investigate the incident.[121] In deciding that the claim did not rise to the level of an international wrong, the Commission set forth what came to be known as the *Neer* test:

> [T]he treatment of an alien . . . should amount to an outrage, to bad faith, to willful neglect of duty, or to an insufficiency of governmental action so far short of international standards that every reasonable and impartial man would readily recognize its insufficiency.[122]

In short, only the most egregious and shocking government conduct satisfies the *Neer* test. Although its reach has expanded and contracted during the decades since it was announced, the *Neer* test has managed to survive and has been the subject of much debate in disputes arising from NAFTA Article 1105.

MST Disputes Prior to the Free Trade Commission's Interpretive Note

In early NAFTA disputes, tribunals had trouble interpreting NAFTA's MST language in Article 1105. A particularly contentious issue was whether the "fair and equitable treatment" language conferred additional protection on investors above and beyond "treatment in accordance with international law." If it did, then governments might be liable for less egregious conduct than the outrageous or bad faith conduct prohibited under the *Neer* test, because government conduct consistent with the international MST may nevertheless violate Article 1105 if it is unfair and inequitable.

Two early cases took this more expansive approach to NAFTA's Article 1105, with both applying a lower threshold than *Neer* and finding a violation of the MST.

In *S.D. Myers*, the tribunal stated that a breach occurs when "an investor has been treated in such an *unjust or arbitrary* manner that the treatment rises to the level that is unacceptable from the international perspective."[123] Applying the "unjust or arbitrary" standard, the tribunal held that Article 1105 had been violated because another NAFTA provision, Article 1102 on national treatment, had been violated.[124] The *S.D. Myers* tribunal, however, interpreted "fair and equitable treatment" and "full protection and security" as two elements of the relevant "international law" composing MST; they were not additional elements imposed by NAFTA.

In *Pope & Talbot*, the tribunal explicitly adopted the additive approach, stating that "investors under NAFTA are entitled to the international law minimum, *plus* the fairness elements."[125] As a consequence, investors benefit from the "fairness elements under ordinary standards applied in the NAFTA countries, without any threshold limitation" that government conduct reach *Neer's* egregious standard.[126]

The Free Trade Commission Interpretive Note

The NAFTA Parties became increasingly concerned by the tribunals' broad interpretations of Article 1105. As a result, the NAFTA's Free Trade Commission (FTC), composed of the trade ministers from Canada, Mexico, and the United States, issued the following binding interpretive note:[127]

> Article 1105(1) prescribes the customary international law minimum standards of treatment of aliens;
>
> The concepts of "fair and equitable treatment" and "full protection and security" do not require treatment in addition to or beyond customary international law; and
>
> A breach of other provisions of NAFTA or of separate international agreements does not establish that there has been a breach of Article 1105(1).

The FTC interpretation expressly rejects the approach of the *Pope & Talbot* tribunal with the first statement and the *S.D. Myers* tribunal with the second. Thus, lawmakers should look to the FTC interpretive note and the decisions that follow for guidance in drafting rules and regulations that are consistent with Article 1105's MST. Still, it is likely that the FTC has not contained tribunals in the way that it had hoped; subsequent tribunals have read NAFTA's MST requirement more expansively than the *Neer* test. In so doing, these tribunals have noted that MST has evolved since *Neer* was decided in 1926.[128]

Key Questions and Concerns

Virtually every branch of the government can take actions that would violate the MST, including the executive, legislative, and judicial branches, as well as administrative agencies. The type of conduct that is subject to the MST is equally wide-ranging (e.g., laws, regulations, administrative action, and judicial opinions). Article 1105's connection to customary international law ensures that the MST will evolve over time to reflect the changing values and practices of the international community. For that reason, the only consistent factor in the MST analysis is that it is highly fact specific. It is, therefore, impossible to predict how tribunals will analyze a particular rule or regulation in the future, but an understanding of key MST issues may help insulate government conduct from a successful MST claim.

What is customary international law?

As noted above, what constitutes customary international law has been a point of contention in many NAFTA disputes. In general, customary international law "results from a general and consistent practice of [nation] states followed by them from a sense of legal obligation."[129] As a result, customary international law changes as states' customs and practices change.[130] Thus, as nation states alter the meaning of MST in BITs and free trade agreements, customary international law regarding MST will also change.

What is the MST under customary international law?

There is no definitive answer as to what the MST is under customary international law. Traditionally, the minimum standard of treatment referred to the treatment of aliens, not investors. Historically, *Neer* was an important part of the MST analysis, so a violation typically

involved government conduct that was outrageous, shocking, in bad faith, willfully neglectful, egregious, or otherwise extraordinary. Yet the MST under customary international law has evolved to reflect changes in state behavior and practice. One significant change is that BITs and FTAs, including NAFTA, have extended its protections to investors and investments. It also appears that the restrictive *Neer* test has been softened to incorporate less egregious government conduct. Presumably, conduct that violates the restrictive *Neer* test violates the MST under customary international law. What other conduct the customary international law of MST includes, however, remains unclear, but tribunals will identify that law from a variety of sources, including "treaty ratification language, statements of governments, treaty practice (e.g., Model BITs), and sometimes pleadings,"[131] judicial case law, and other "established sources of international law,"[132] among other sources.

Whether custom may derive from interpretations of MST in arbitral awards under NAFTA and other treaties remains disputed. At least one tribunal determined that arbitral awards "do not constitute State practice and thus cannot create or prove customary international law."[133] Other tribunals, however, have reviewed previous awards, FTAs, and BITs as a source of custom concerning MST.[134] At a minimum, previous awards, FTAs, and BITs are informative if they evaluate the MST under customary international law in and of itself. If, however, the analysis incorporates additional protections provided in the underlying BIT that are not found in NAFTA, then that analysis will be less relevant.[135] For example, the FTC interpretive note explicitly rejects the idea that "fair and equitable treatment" confers additional rights on investors beyond the MST under customary international law. Thus, an arbitral body analyzing a BIT in which "fair and equitable treatment" is an additional right will perform a different analysis and reach a different conclusion about the MST than a tribunal that concludes that "fair and equitable treatment" is not an additional right.[136]

What is the MST under NAFTA?

NAFTA tribunals have for the most part, adopted a more lenient MST standard than the *Neer* test, even while recognizing the FTC interpretation. For example, the *Mondev* tribunal stated that conduct could be "unfair and inequitable" today without meeting *Neer's* egregious or outrageous standard, and dismissed the idea that the phrase was confined to the meaning it had in the 1920s.[137] Similarly, the tribunal in *ADF* could find "no logical necessity and no concordant state practice" to support the automatic application of *Neer* in the "contemporary context of treatment of foreign investors and their investments."[138]

Mondev and other tribunals have emphasized that customary international law has evolved during the seventy years since *Neer* was decided. [139] Yet although the standard is more flexible, "the threshold for finding a violation of the minimum standard of treatment still remains high."[140] According to the *Thunderbird* tribunal, Article 1105 is breached if the government's act "amount[s] to a gross denial of justice or manifest arbitrariness falling below acceptable international standards."[141] The *Loewen* tribunal rejected the idea that "bad faith or malicious intention" was required in order to show unfair and inequitable treatment.[142] In the context of two denial of justice claims (explained below), both *Mondev* and *Loewen* stated that a judicial decision is unfair and inequitable if it is "clearly improper and discreditable."[143] Under *Waste Management,* MST is violated by conduct that is:

> [A]rbitrary, grossly unfair, unjust or idiosyncratic, is discriminatory and exposes the claimant to sectional or racial prejudice, or involves a lack of due process leading to an outcome which offends judicial propriety—as might be the case with a manifest failure of natural justice in judicial proceedings or a complete lack of transparency and candour in an administrative process.[144]

What Are Denial of Justice Claims?

Under NAFTA, denial of justice is a type of MST claim arising out of the treatment of investors in a host state's tribunals or courts.[145] A denial of justice occurs when an investor is unable to obtain legal protection or is denied access to legal remedies before a judicial or quasi-judicial body.[146] A denial of justice claim may be brought if a state court refuses to hear a suit at all, if the administration of justice is seriously inadequate, if the claim is subjected to undue delay, or if there is a "clear and malicious misapplication of the law."[147] According to *Mondev*, the question is whether:

> [A] tribunal can conclude in the light of all the available facts that the impugned decision was *clearly improper and discreditable*, with the result that the investment has been subjected to unfair and inequitable treatment.[148]

The tribunal in *Loewen* adopted the test articulated in *Mondev*[149] but stated that by any standard, the trial at issue was a disgrace, the lawyer's tactics were impermissible, and due process had been denied by the judge.[150] Importantly, the tribunal rejected the idea that malicious intent or bad faith is an essential element of a denial of justice claim; rather, "[m]anifest injustice in the sense of a lack of due process leading to an outcome which offends a sense of judicial propriety is enough [to breach NAFTA's MST requirement]."[151] In spite of the finding of manifest injustice, the tribunal held that Article 1105 had not been breached because the claimant had failed to exhaust judicial remedies and, therefore, did not meet the finality requirement.[152] In other words, the Mississippi court's treatment of the claimant had fallen below the MST, but the claimant was "denied justice" because the U.S. Supreme Court had not been given the opportunity to issue a final decision. Nevertheless, the *Loewen* decision provides useful background for analyzing denial of justice claims under NAFTA Article 1105.

The Resurrection of the *Neer* Test?

In 2009, the *Glamis Gold* tribunal resurrected the *Neer* test. The tribunal began its analysis by announcing that the *Neer* standard continued to be the applicable minimum standard of treatment under customary international law. The tribunal did not deny that the customary international law of MST can evolve but rather concluded that the claimant had failed to show that the MST had in fact evolved after *Neer* was decided. In addition, the tribunal asserted that conduct might be considered egregious today that would not have been in 1926, because public sentiments may have changed. In other words, government conduct may shock the conscience of the modern public that would not have been shocking in 1926. What effect the *Glamis Gold* analysis will have on future Article 1105 disputes is unclear. Although it is the latest decision on the MST provision, it conflicts with all of the post-FTC decisions. It is impossible to predict which way the next tribunal facing an Article 1105 dispute will go. *Glamis Gold, Ltd. v*

How does NAFTA's MST relate to Due Process in the United States?

Many NAFTA critics have asked if MST relates to the "due process" requirements of the U.S. Constitution. The Fifth and Fourteenth Amendments to the U.S. Constitution prohibit the federal and state governments from depriving a person "of life, liberty, or property, without due process of law." This due process requirement prevents the government from

infringing a person's fundamental rights unless the infringement is narrowly tailored to serve a compelling state interest.[153] It also "imposes procedural limitations on a State's power to take away protected entitlements," such as property interests and liberty interests.[154] In other words, the government may deprive a person of life, liberty, or property, but only if it provides "due process," which normally implicates judicial and administrative proceedings and requires the government to provide a person notice and an opportunity to be heard.[155]

MST and Due Process are connected by the principles of fairness and equity. Both aim to ensure that protected interests are not infringed unless it is fair and equitable for the government to do so. To that end, each seemingly requires the government to provide some sort of method to dispute the legality of the government's action. Yet both MST and due process also have a threshold that the government's conduct must reach before it rises to the level of an international or constitutional wrong, so both are deferential to the government's action. For example, in order to invalidate a regulation under the Due Process Clause, the plaintiff must show that the regulation is "clearly arbitrary and unreasonable, having no substantial relationship to public health, safety, morals, or general welfare."[156] Similarly, a claimant alleging a violation of Article 1105 must show that the government's conduct was shocking and egregious or simply unfair and inequitable, depending on the standard the tribunal applies. Note, however, that NAFTA tribunals cannot invalidate state action; they can only award monetary compensation. The remedy for a due process violation, however, is to provide due process and invalidate the government's action.

Despite the similarities, the Due Process Clause is only relevant to Article 1105 to the extent that the rights it protects are also protected by customary international law. The FTC interpretive note makes clear that "Article 1105(1) prescribes the customary international law minimum standards of treatment of aliens," nothing more. Accordingly, if the Due Process Clause provides protections that go above and beyond those that are provided under customary international law, then they are irrelevant to an analysis of MST under Article 1105. Likewise, if customary international law provides more protection than the Due Process Clause, then the NAFTA investor will enjoy that added protection.

Looking Forward

The only consistent theme in NAFTA's Article 1105 jurisprudence is that MST claims are highly fact-specific. It is nearly impossible to determine in the abstract whether a tribunal will conclude that an investor has been treated fairly and equitably or if the government's conduct has fallen below the behavioral "floor" recognized by customary international law.[157]

Most likely, a tribunal will consider government conduct that meets the *Neer* test to be a breach of Article 1105. But it is far from clear what government actions will be sufficiently shocking, egregious, or outrageous enough to meet *Neer's* threshold. As the *Glamis Gold* tribunal pointed out, behavior that shocks the conscience of the modern public may be different from what would have shocked the conscience in 1926. A tribunal could frame the issue as whether the public's conscience has evolved or whether customary international law has evolved, but the answer to either question will necessarily depend on the facts of the case.

Best Practices Checklist

Investors are entitled to the customary international law minimum standard of treatment, which includes the right to be treated fairly and equitably. Most NAFTA tribunals have agreed that government conduct does not need to be egregious, outrageous, or shocking in order to violate Article 1105. But the threshold for a violation is still high. While no clear test exists, tribunals have described conduct that would violate Article 1105 in the following ways:

- ✓ Gross denials of justice
- ✓ Manifest arbitrariness that falls below international standards
- ✓ Unfair and inequitable treatment
- ✓ A judicial decision that is clearly improper and discreditable
- ✓ Grossly unfair treatment
- ✓ Unjust or idiosyncratic government conduct

3. Expropriation

Background

The expropriation provisions of NAFTA, other FTAs, and BITs protect foreign investments from government actions that diminish the value of an investment without providing compensation. In U.S. law, expropriations are called "takings" of private property.

NAFTA Article 1110 sets forth a general prohibition against the expropriation of foreign investments, but it also contains an exception for certain government actions:

> 1. No Party may directly or indirectly nationalize or expropriate an investment of an investor of another Party in its territory or take a measure tantamount to nationalization or expropriation of such an investment ("expropriation"), except:
>
> (a) for a public purpose;
> (b) on a non-discriminatory basis;
> (c) in accordance with due process of law and Article 1105(1); and
> (d) on payment of compensation . . .

Although NAFTA does not define the term "expropriation," Article 1110 identifies three different types of expropriation: direct, indirect, and measures tantamount to expropriation.

- "**Direct expropriations**" are the easiest to identify because they involve an overt government action, such as a physical seizure of property or a forced transfer of title from the foreign investor to the government.[158] For example, if a Canadian owns private forestlands in Oregon and the state government condemns the land to build a highway or campground, the Canadian has a claim for direct expropriation.

- "**Indirect expropriations**" usually result from government actions that significantly interfere with the use or value of an investment. They are similar to "regulatory takings" under U.S. law. NAFTA tribunals have not yet settled on a single test for

indirect expropriations, but several factors, discussed below, have repeatedly been considered relevant by the tribunal.

- "**Measures tantamount to expropriation**" are those measures "equivalent to" expropriation.[159] The language of the U.S.–Chile and U.S.–Singapore FTAs confirms this interpretation by specifically using the language "equivalent to."[160] This narrow interpretation appears to define such measures as acts that are equal to direct and indirect expropriations. However, arbitral tribunals have not clearly described how "measures tantamount to expropriation" differ from direct and indirect expropriation.

Public controversy has surrounded Article 1110 since NAFTA's enactment. Of particular concern is whether legitimate environmental regulations that diminish the value of foreign investments would be successfully challenged as expropriations, forcing governments to pay compensation for protecting their environment.

On the one hand, those fears do not appear to have been realized. Since NAFTA came into force in 1994, at least 22 expropriation claims have been filed under NAFTA.[161] Of those 22 claimants, only one party has been compensated for having its investment expropriated.[162]

On the other hand, anxiety persists because many issues related to NAFTA expropriations are unsettled. For instance, "expropriation" has yet to be defined, and there is no clear test for determining when an indirect expropriation has occurred. As a result, it remains unclear when environmental regulations constitute an indirect expropriation.

Key Questions and Concerns

All state, provincial, and local laws are subject to Article 1110; the few exceptions to Chapter 11 do not apply to expropriations. Accordingly, it is vital to understand the scope of Article 1110 and its application to government regulations and actions. Note, however, that NAFTA tribunals are not bound to follow prior tribunal decisions, so it is impossible to definitively predict the outcome of a particular situation. The common bond between the decisions of tribunals is their recognition that the factual circumstances giving rise to an expropriation claim are necessarily unique. As such, expropriation claims must be analyzed with due regard for the complexity of each claim.

What is the test for identifying an indirect expropriation?

The line between a valid government regulation and an indirect expropriation is difficult to draw, and NAFTA tribunals have used different tests to determine whether an indirect expropriation has occurred. Some tribunal decisions have stressed the economic *effect* of the regulation, i.e., whether the financial deprivation was "substantial enough" to be an expropriation.[163] Other tribunals have emphasized the *purpose* of the relevant law, focusing on the government's legitimate public policy reasons.[164] Despite these differences in emphasis, tribunals have repeatedly included certain factors in their analysis. Those factors should be taken into account when drafting laws and regulations.

Degree of interference with property right

Several tribunals have considered the extent to which government action interferes with an investor's property rights.[165] Not all interference rises to the level of an expropriation. The interference must "justify an inference that the owner . . . will not be able to use, enjoy, or dispose of the property."[166] Moreover, the degree of interference must constitute a "substantial deprivation."[167] To determine whether interference is "substantial," tribunals have evaluated the economic impact on the investment, the duration of the interference, and

the investor's remaining property rights.

The property rights that remain with an investor after an alleged expropriation have played a prominent role in a number of decisions. Tribunals have used the terms "property rights" and "economic rights" to describe similar interests, including "ownership, use, enjoyment or management of the business," or "control" over the investment.[168] Generally, if the investor retains significant property rights in the investment after the government action at issue, it is unlikely an expropriation has occurred.[169] Thus, evaluating what property rights remain with the investor, like measuring the economic impact of a measure, is another way of evaluating the degree of interference.[170]

Economic impact

A number of tribunals have incorporated a measure's economic impact into the indirect expropriation analysis, but the weight accorded to that factor has varied. For instance, in *Glamis Gold*, the tribunal stated that a measure must significantly impair the economic value of the investment in order to qualify as an indirect expropriation.[171] In most cases, the impact will not be deemed substantial if the investment retains significant economic value.[172]

Duration of interference

In determining whether an expropriation has occurred, NAFTA tribunals have repeatedly considered the duration of interference to be relevant. A temporary interference with an investor's property rights is unlikely to amount to an expropriation.[173]

Purpose of the measure

Although the purpose of a measure has been discussed in the course of several expropriation decisions, it does not appear to be a relevant factor when determining if an expropriation has occurred.[174] Rather, the purpose plays a role in deciding whether a government must provide compensation to an investor whose investment was expropriated.

Do Post-NAFTA FTAs like CAFTA–DR also include indirect expropriations?

The United States has entered into several post-NAFTA FTAs, all which include expropriation provisions similar to NAFTA's. However, they generally establish a more concrete test for indirect expropriations in two ways. First, they replace the phrase "tantamount to expropriation" with "equivalent to expropriation."[175] They also define the factors to be considered when determining whether an indirect expropriation has occurred. CAFTA–DR, for example, explicitly recognizes that a "case-by-case, fact-based inquiry" must be performed "that considers, among other factors . . . (i) the economic impact of the government action . . . ; (ii) the extent to which the government action interferes with distinct, reasonable investment-backed expectations; and (iii) the character of the government action."[176]

Second, CAFTA–DR and other FTAs provide that, "except in rare circumstances, nondiscriminatory regulatory actions . . . that are designed and applied to protect legitimate public welfare objections [including the environment], do not constitute indirect expropriations."[177] The U.S.–Peru, U.S.–Oman, U.S.–Chile, and U.S.–Singapore FTAs, among others, contain virtually identical language.[178]

Overall, the post-NAFTA FTAs have reacted to the interpretive difficulties NAFTA tribunals have faced when analyzing indirect expropriation claims by incorporating the relevant factors to be considered. The importance of economic impact is expressly stated in the text of those agreements, but it is accompanied by other key ideas, including interference with "reasonable investment-backed expectations," the "character of the government action," and an express exception for regulations that embody legitimate public welfare objectives. While each of those factors has

played a role in NAFTA decisions, they seem to come into play after an expropriation has been found and the tribunal is attempting to determine whether compensation must be paid.[179]

Is this new language on indirect expropriation similar to U.S. takings jurisprudence?

Indirect expropriations under NAFTA are similar to regulatory takings in the United States, so it is perhaps unsurprising that some of the U.S. regulatory takings jurisprudence has been incorporated into several NAFTA expropriation decisions. Many post-NAFTA FTAs, however, have explicitly included the classic U.S. regulatory takings test in the text of the agreement. Under the U.S. Supreme Court's *Penn Central* test, courts consider the economic effect of a regulatory action, the degree of interference with reasonable investment-backed expectations, and the nature of the government action.[180]

It is impossible to predict whether NAFTA tribunals will adopt the *Penn Central* test and, because tribunals are not bound by prior decisions, it is far from clear what effect such an adoption would have on subsequent decisions. Interestingly, the *Penn Central* factors were mentioned in a NAFTA decision, *Glamis Gold*, in which both parties cited the *Penn Central* test and other U.S. takings jurisprudence.[181] In a footnote, the tribunal responded by stating that "[t]he Parties both cite to and rely on U.S. law of takings, not because it is applicable, but because it is argued by both as a well-developed body of law."[182] The tribunal noted, however, that before the *Penn Central* factors are considered, the threshold question of whether a property right was taken (i.e., whether an expropriation has even occurred) must be determined.[183]

How do "measures tantamount to expropriation" differ from indirect expropriations?

NAFTA does not expressly define "measures tantamount to expropriation," but tribunals have consistently interpreted the phrase to mean "equivalent to" expropriation.[184] Both measures tantamount to expropriation and indirect expropriations differ from direct expropriations in that no formal transfer of title occurs.[185] Thus, measures tantamount to expropriation are typically similar to indirect expropriations.[186]

Yet by including the phrase, the drafters of NAFTA appear to have wanted to reach government actions that would not necessarily qualify as indirect expropriations. "Creeping expropriations," which occur when several government measures are "implemented over a period of time," are generally considered measures tantamount to expropriation.[187] Standing alone, an individual measure may not be significant enough to qualify as an expropriation, but the effect of the combined measures may be equivalent to an expropriation. Also, under certain circumstances, a government's failure to act may be a measure tantamount to expropriation, though such a failure will usually be coupled with an overt act.[188]

Similar to indirect expropriation, the analysis of "measures tantamount to expropriation" generally focuses on "the degree of the interference with the property right," including "the severity of the economic impact and the duration of that impact."[189] Because NAFTA tribunals agree that "tantamount to expropriation" means "equivalent to expropriation," it is reasonable to assume that the other factors taken into consideration during the indirect expropriation analysis (set forth above) are also relevant to an analysis of whether a measure is tantamount to expropriation.

The *Metalclad* Dispute

Metalclad v. United Mexican States is the only NAFTA dispute to find an expropriation in violation of NAFTA Article 1110. Metalclad, a U.S. corporation, wanted to build a hazardous waste landfill in Mexico. It entered into an option agreement to purchase a Mexican hazardous waste company, COTERIN. After negotiating with the federal government and receiving assurances that that permits necessary to operate the landfill had been granted, Metalclad exercised its option and constructed the landfill. The state and local governments, however, repeatedly frustrated Metalclad's attempts to open it. Ultimately, the state governor enacted an Ecological Decree and declared the property a "Natural Area," making it permanently unavailable as a landfill.

Mexico's actions were held to be tantamount to expropriation. The tribunal stated that the federal government had the exclusive authority for permitting the landfill and had assured Metalclad that it would be allowed to operate the landfill. Relying on those assurances, Metalclad purchased and constructed the landfill, but the federal government later acquiesced when the state denied the permit. Taken together, Mexico's actions amounted to an indirect expropriation.

Subsequent NAFTA tribunals have distanced themselves from the *Metalclad* reasoning. Although they have not expressly repudiated the reasonable reliance factor—also known as reasonable investment backed expectations—its use has been limited to the facts of the *Metalclad* dispute. *Metalclad Corp. v. The United Mexican States*, Final Award, paras. 104, 107 (Aug. 30, 2000)

If the government acts under a police power, is compensation necessary?

"Police powers" generally refer to public welfare measures, such as those protecting the environment, human health, consumers, and other important government interests. Under U.S. takings jurisprudence and customary international law, a government is generally not required to pay compensation to landowners when it enacts regulations consistent with its police powers—although the U.S. Supreme Court has long recognized that a regulation may go "too far" and constitute a taking. NAFTA Article 1110, however, does not explain how government actions taken pursuant to its police power should be treated,[190] but recent decisions have discussed how much weight to accord police powers when determining if a government act amounts to an expropriation at all.[191] This is a key issue because if a government action is labeled an exercise of its police powers and *not* an expropriation then no compensation must be paid.

Tribunal decisions related to police powers

Early decisions acknowledged that regulatory acts could be expropriations. In *Pope & Talbot*, the tribunal stated that although "the exercise of police powers must be analyzed with special care . . . nondiscriminatory regulations based on police powers" could be expropriations under certain circumstances.[192] The *S.D. Myers* tribunal also declined to rule out that possibility, but stated that regulatory acts are generally not expropriations and are "unlikely to be the subject of legitimate complaint under Article 1110."[193]

Later decisions make it clear that regulations may amount to expropriations, but they also distinguish non-compensable regulations from compensable regulatory expropriations. The *Fireman's Fund* tribunal stated that in order "[t]o distinguish between a compensable expropriation and a non-compensable regulation by a host State, the following factors (usually in combination) may be taken into account: *whether the measure is within the recognized*

police powers of the host State; the (public) purpose and effect of the measure . . . and the bona fide nature of the measure."[194]

In *Glamis Gold*, the tribunal cited customary international law for the proposition that a State is not customarily responsible for losses "resulting from bona fide . . . regulation[s] . . . if [the regulation] is not discriminatory."[195] Further, the Parties cited the *2004 Model Bilateral Investment Treaty* to frame the issue as whether a State's act is "a non-compensable regulation or a compensable expropriation."[196]

These decisions suggest that police powers may be considered during the threshold analysis of whether an expropriation has even occurred. In other words, police powers may impact whether compensation is necessary because the exercise of police powers weighs in favor of a non-compensable regulatory act rather than an expropriation. Yet the precise weight that police powers carry cannot be decisively determined. Still, because it is likely that police powers will be considered at some point in either the initial expropriation analysis or the exception analysis, they are indeed relevant.

Police power trends

In its post-NAFTA free trade agreements, the United States has sought to clarify whether regulatory actions within the police powers may constitute expropriation.[197] The CAFTA–DR, for example, contains the following provision:

> [E]xcept in rare circumstances, nondiscriminatory regulatory actions . . . that are designed and applied to protect legitimate public welfare objections [including the environment], do not constitute indirect expropriations.[198]

Whether the provision achieves its goal is uncertain. By stating that such regulations may constitute an expropriation "in rare circumstances," tribunals still have discretion to decide whether a regulation based on a police power is an expropriation.

What interests does NAFTA Article 1110 protect?

Economic value

Perhaps the most important interest that Article 1110 protects is the economic value of an investment. Indeed, the reason the expropriation provision was included in NAFTA was to promote and protect foreign investments.

Property rights

"Property rights," sometimes referred to as "economic rights," are closely related to the economic value of an investment but they are not necessarily the same thing. They include "ownership, use, enjoyment or management of the business," or "control" over the investment.[199] If the government takes away one of these rights it will almost certainly have a negative impact on the economic value of an investment. Yet if an investor retains significant property rights (e.g., the ability to manage and control the investment) it is less likely that an expropriation has occurred even if the economic value of an investment was diminished by the government's action.[200]

Tangible and intangible property rights

CAFTA–DR and other post-NAFTA FTAs expressly state that "[a]n action or series of actions by a Party cannot constitute an expropriation unless it interferes with a *tangible or intangible property right* or property interest in an investment."[201] In fact, NAFTA defines "investment" in Article 1139 to include "real estate or other property, *tangible or intangible*, acquired in the expectation or used for the purpose of economic benefit or other business purposes."[202] On the one hand, the references to tangible and intangible property are broad enough to encompass many types of property interests. On the other hand, the terms are not specific enough to offer any real guidance as to their boundaries.

Market share

In *Pope & Talbot*, a U.S.-owned timber mill operating in British Columbia argued that it suffered an expropriation because a Canadian regulation limited its exports to the United States. The tribunal concluded that "access to the U.S. market" *was* a property interest subject to protection under Article 1110.[203] Yet because the interference was not substantial, the tribunal did not find an expropriation.

In contrast, the *Methanex* tribunal stated that although market share may help determine the value of an investment for purposes of compensation, it is insufficient, standing alone, to support an Article 1110 claim.[204] The *Fireman's Fund* tribunal cited the market share discussions from both *Pope & Talbot* and *Methanex* to support the broader proposition that an "investment may include intangible as well as tangible property."[205] The tribunal did not, however, whether a loss of market share constituted an expropriation. Overall, it appears that market share is a recognized property interest, but whether it can support an Article 1110 claim by itself is uncertain.

Looking Forward

The post-NAFTA FTAs generally include interpretive annexes to assist tribunals in determining whether an expropriation has occurred. Those annexes include specific factors to consider during an expropriation analysis, guidance that is noticeably absent in NAFTA. But, as more FTAs incorporate interpretive guidance, NAFTA tribunals are increasingly likely to turn to those agreements when deciding NAFTA claims. Consequently, it may be useful to review post-NAFTA expropriation provisions when trying to predict what factors may be adopted by NAFTA tribunals.

Best Practices Checklist

When drafting a law or regulation, policymakers should take into account certain factors to avoid a claim of expropriation. For the most part, if a law or regulation would be considered a regulatory taking under U.S. law, it is perilously close to being an indirect expropriation under NAFTA Article 1110. The following points were considered in recent U.S. free trade agreements and NAFTA tribunal decisions:

- ✓ Are there rational public policy reasons for the regulation (e.g., was the state exercising its police powers when it performed the regulatory act)?
- ✓ Was the degree of interference with the property right substantial (e.g., was the value of the investment radically diminished)? If the investment retains significant value, then it was probably not expropriated.
- ✓ Is the regulation temporary or permanent? A temporary deprivation of property is less likely to be an expropriation.
- ✓ Will the foreign investor still have control over the investment (e.g., a company, a plot of land, day-to-day management decision) and be free to pursue other lines of business? If the investor has lost all control of its investment then an expropriation has probably occurred. An expropriation is less likely to be found if the investor retains control over the investment.

Chapter 7

Government Procurement and Free Trade Agreements

Background

State and local governments frequently establish rules to promote the use of local labor, local products, or sustainable materials through government procurement policies. Because government expenditures are generally large, state and local governments have enormous buying power and with it the possibility to transform production practices or shift demand to more environmentally-friendly products.

Whether they have the right to pursue these policies, however, may depend on the government procurement rules of the WTO, NAFTA, or another free trade agreement. Although the rules of trade agreements such as those of the GATT typically apply to state, provincial, and local governments automatically, the federal governments sometimes include exceptions to trade rules for subfederal governments, as seen earlier with investment provisions. The WTO and NAFTA provisions on government procurement also include an exception for state, provincial, and local government procurement provisions. These provisions apply to state governments only if they consent to be bound,[206] and local governments are exempted and do not have an opportunity to opt in;[207] but local governments should check state government procurement rules to determine whether the state has made the agreements applicable to them.

Several trade agreements, including the WTO's Agreement on Government Procurement (GPA),[208] NAFTA,[209] and the Central America–Dominican Republic-United States Free Trade Agreement (CAFTA–DR),[210] establish rules that apply to governments and their agencies when they purchase products or services. These government procurement rules aim to ensure that participating governments provide fair, non-discriminatory, predictable, and transparent procurement opportunities for suppliers of all participating countries. If an agreement is made applicable to a state, that state's covered agencies must consider trade obligations for any kind of government procurement the agreement specifies, which could range from a large construction project to buying office supplies.

This chapter provides state procurement officials, lawmakers, and others with insight into how the government procurement provisions of trade agreements affect current or proposed legislation regarding government procurement. This Guide focuses primarily on the WTO's GPA because it represents the most basic and broadest government procurement agreement to date and it involves the greatest number of states. Because Mexico and Canada are two of the U.S.'s largest trading partners, this chapter also describes the government procurement provisions of NAFTA, as well as CAFTA–DR. In particular, this chapter explains

- which states are covered by government procurement of free trade agreements;
- which government procurement activities are covered by these agreements;
- how state legislation, including "buy local" or "buy American" requirements, can be affected by these agreements; and
- which mechanisms exist to resolve disputes that may occur.

The guide also provides a quick reference list for state lawmakers and procurement officials to evaluate their government procurement legislation as it relates to these agreements.

Key Questions and Concerns

What exactly is government procurement?

Almost any funds a government expends, apart from wages to employees, could potentially be considered government procurement. The GPA, for example, covers any procurement by any contractual means, including through purchase, lease, or rental.[211] One international tribunal defined governmental procurement as "the obtaining by purchase by a governmental agency or entity of title to or possession of, for instance, goods, supplies, materials and machinery."[212] These expansive definitions would appear to cover nearly every governmental purchase of a good or service. In fact, one tribunal concluded that even the purchase by a contractor of the materials to make the final product, not the final product itself, constituted "government procurement" under NAFTA.[213]

Government procurement also includes procurement of services, such as janitorial services and construction services. As with "government procurement" itself, "services" are defined broadly by a separate WTO document called the Universal List of Services.[214] Although the Universal List is expansive, the GPA specifically excludes transportation services, dredging, services procured for overseas military forces, contracts for the management and operation of facilities that receive federal funding, public utilities, research and development, and, in the case of states, printing services.[215] The GPA also treats "construction services" separately,[216] defining them according to the provisions of a United Nations classification system, which provides detailed definitions for each aspect and stage of construction.[217] Generally, construction services include everything from site investigation and preparation to renting equipment and finishing the interior of a building.[218] While the United Nations classification system expressly excludes architectural, engineering, mapmaking, and surveying services from the construction services classification, they would still be considered "services" and covered by the GPA if the cost surpasses the monetary threshold described below.

Which agencies are covered by the GPA?

The GPA differs from other agreements of the WTO, such as the GATT and TBT Agreement, that automatically apply to all WTO Members. Instead, the GPA is a freestanding agreement that countries must separately ratify. To date, 41 WTO Members have agreed to be bound by the rules of the GPA. These Members are called "Parties" to the GPA.

When WTO Members accede to the GPA, they may specify to which agencies and level of government the GPA applies. For example, when the United States acceded to the GPA, it listed the specific federal agencies and subfederal agencies to which the GPA applies. In the United States, the GPA covers 79 federal agencies.

In addition, 37 states have agreed to bind some of their agencies to the GPA's rules. The GPA also applies to some other entities that are neither "federal" nor "state" agencies, such as the Tennessee Valley Authority, the Port Authority of New York and New Jersey, and the Bonneville Power Administration.[219] It does not apply at all to local governments.

Which GP activities are covered by the GPA?

Even if the GPA applies to a federal or state agency, the GPA may not apply to a specific purchase, because the GPA does not cover all government procurement. First, the GPA only

applies when the procurement rises above a certain specified threshold amount, set in what the GPA calls "Special Drawing Rights" ("SDRs").[220] Although the SDR amount remains fixed, every two years the U.S. Trade Representative calculates the current SDR value in U.S. dollars.[221] For those state governments that have agreed to the GPA's terms, the thresholds currently are

- $554,000 for the procurement of goods and services, and
- $7,804,000 for the procurement of construction services.[222]

The GPA also sets out valuation rules to determine the total cost of a contract, so Parties know whether or not it surpasses the threshold.[223]

Second, although the GPA broadly applies to government purchases of goods, services, and construction,[224] it allows Parties and states to exempt certain government procurement activities from the rules of the GPA. The GPA does not define "goods," but one senior official in the Office of the U.S. Trade Representative argues that the GPA covers *all* goods *unless specifically exempted*.[225] Many states have used the GPA's exemption authority to exempt certain goods from GPA rules. For example, Wyoming, Michigan, and others have exempted coal, steel, and motor vehicles.[226] South Dakota exempts beef while Washington exempts paper products, fuel, and ships.[227]

In addition to these specific exemptions that governments have created for themselves, the United States has declared several general exemptions applicable to all states. These include state programs attempting to help minority-owned businesses (including disabled veterans and women) and distressed areas, as well as "restrictions that promote the general environmental quality in the state," as long as the restrictions are not disguised barriers to international trade.[228] Moreover, the GPA itself establishes a number of general exceptions. For example, the GPA exempts procurement relating to "essential security interests," as well as any procurement

- necessary to protect public morals, order or safety, human, animal or plant life or health or intellectual property; or
- relating to the products or services of handicapped persons, of philanthropic institutions or prison labour.[229]

As described in Chapter 2 of this Guide, trade panels have interpreted the exception for the protection of human, animal, or plant life or health, narrowly, and states should be careful when invoking them.

Given the expansive definitions of government procurement and services, it is clear that the GPA has the potential to affect many government purchases. Nonetheless, a state procuring entity need only concern itself with the GPA if 1) the state has acceded to the GPA, 2) the cost of the proposed activity would exceed the threshold, and 3) one of the specific or general exemptions does not apply.

What are the rules of the GPA?

The GPA attempts to reduce barriers to trade in the area of government contracting for goods and services.[230] Accordingly, the GPA includes the most favored nation and national treatment obligations. These obligations require GPA Parties to treat the goods, services, and suppliers of other Parties no less favorably than they do domestic products, services, and suppliers (national treatment) or those of any other Party (most favored nation).[231]

For example, under the GPA, when the Oregon Department of Administrative Services ("ODAS"),[232] a listed GPA entity, is looking to procure paper, automobiles, or anything else, it must treat Taiwanese and Canadian suppliers no less favorably than an American or Oregon supplier, because both Taiwan (Chinese Taipei)

Is My State Covered?

How do I know if my state must comply with government procurement rules? The United States government has published a complete list at:

edocket.access.gpo.gov/2009/pdf/E9-9073.pdf

For more information on government procurement, you can visit these sites:

GPA: http://www.wto.org/english/tratop_e/gproc_e/gproc_e.htm

CAFTA–DR: http://www.ustr.gov/sites/default/files/uploads/agreements/cafta/asset_upload_file977_3927.pdf

Other free trade agreements: http://www.ustr.gov/trade-topics/government-procurement/ftas-government-procurement-obligations

and Canada are GPA Parties. It must also treat Taiwanese suppliers no less favorably than Canadian suppliers. Similarly, ODAS must treat an Oregon supplier using Canadian-made products no less favorably than a Taiwanese supplier using locally-made products. Although ODAS may want to favor a supplier of locally-produced goods to promote the local economy, it may not do so unless it can show that an exemption applies.

The GPA also prohibits GPA Parties from imposing "rules of origin" on goods or services covered in the agreement different from those applied in the "normal course of trade."[233] In other words, GPA Parties may not specify that a good or service comes from a particular place. Procedurally, the GPA imposes requirements to ensure fair and full competition for contracts, solicitation of bids through negotiation, tendering, and delivery of goods and services.[234] Finally, the GPA gives developing countries greater flexibility with respect to their procurement policies, so the national treatment principle, along with other rules, do not apply to them as strictly.[235]

May states implement "buy local" laws?

When a state has agreed to be bound by the GPA, no, it may not implement "buy local" laws—at least as those laws apply to other GPA Parties. Requirements for governmental agencies to buy American or locally made products or services, such as under the Buy American Act,[236] conflict with the GPA's national treatment obligation. Under the federal Buy American Act, the federal government must buy domestic "articles, materials, and supplies" when they are acquired for public use unless a specific exemption applies. The act applies to all federal procurements, but separate provisions apply to supply contracts and construction contracts. The federal Buy American Act could potentially affect state procurement when a state receives federal funding for a project. Even then, the President has the authority to waive the Buy American Act to maintain compliance with international trade agreements,[237] such as the GPA.

Similarly, a state "buy local" law would also conflict with the state's national treatment obligation and the prohibition against the use of rules of origin—provided that the state has agreed to the GPA's terms.

State Legislation Conflicting with the GPA:
An Isolated Example

In 1996, the state of Massachusetts passed a law prohibiting the procurement of goods and services from businesses or persons that do business with Burma. The European Communities filed a WTO complaint against the United States alleging a violation of the GPA, and Japan joined. However, before a WTO panel could decide the issue, the U.S. Supreme Court overturned the law as unconstitutional, mooting the case before the WTO. Crosby v. National Foreign Trade Council, 530 U.S. 363; 120 S. Ct. 2288; 147 L. Ed. 2d 352 (2000).

In addition, the GPA prohibits what are called "offsets"—those measures "used to encourage local development . . . by means of domestic content, licensing of technology, investment requirement, counter-trade or similar requirements."[238] This prohibition may also include subsidies or tax breaks for local businesses, unless specifically negotiated during accession to the GPA.[239] Thus, when drafting legislation, regulations, or simply advertising that a procurement activity will occur, state governments must be aware of their obligations to foreign parties under international trade agreements.

As such, legislators should carefully consider these rules when drafting "buy local" law. In particular, they should ensure that the provisions exempt goods, services, and suppliers from other GPA Parties. They should also avoid reaching the monetary threshold for application of the GPA.

May states promote "green" procurement?

Recent concerns about climate change, resource exhaustion, and other environmental problems have compelled governments to consider procuring goods and services that are more environmentally friendly. Under the GPA, States might be able to promote procurement of goods and services that minimize these environmental concerns, because, unlike "buy local" laws, the United States has carved out a broad exemption to GPA rules for "restrictions that promote the general environmental quality in that state." The GPA's general exception for measure necessary to protect human, animal, or plant life or health may also apply.

In addition, GPA rules offer other opportunities to promote the purchase of "green" goods and services. Many aspects of "green procurement" fall within a category of regulations known as "technical specifications." Under the GPA, "technical specifications" are those characteristics of a good or service to be procured that specify "quality, performance, safety and dimensions, symbols, terminology, packaging, marking and labelling, or the processes and methods for their production."[240] For example, requiring that all paper the state buys contains at least 50 percent post-consumer recycled content would be a technical specification because it details a "characteristic" of the product. Similarly, a regulation requiring government procurement of sustainably-harvested wood products, dolphin-safe tuna, or organic vegetables would constitute a "technical specification" because it specifies the "processes and methods for [the product's] production."

The GPA allows such "technical specifications" unless they create "unnecessary obstacles to international trade."[241] What constitutes an "unnecessary obstacle to trade" in the context of the GPA has not been decided. However, technical specifications that do not require the purchase of goods and services from a particular

country or region are likely to be permissible. Those that are designed to favor local products over foreign products would likely be considered an "unnecessary obstacle to trade."

Whether technical specifications for recycled content, organic vegetables, and other environmental procurement requirements meet this standard may depend in part on how the specifications were created. For example, The GPA provides that technical specifications should be based on international standards where they exist and if not, then on national technical regulations, recognized national standards, or building codes.[242] Where appropriate, they should be based on performance criteria (e.g., how much energy a light bulb uses), rather than design criteria (e.g., a compact fluorescent light bulb).[243] Moreover, trademarked or similarly recognizable names for items or processes, such as Swiss army knives or Wisconsin cheese, should not appear in procurement legislation, unless there is no other way to describe what the procurement requires.[244] Finally, an entity cannot receive or solicit advice regarding technical specifications from a company that could benefit from the procurement.[245]

Even if a government procurement policy does not fall within an environmental exemption or violates the GPA's rules on technical specifications, "green" procurement policies may not violate the GPA if they are below the specified monetary threshold for application of the GPA. Legislators could insulate their "green" purchasing requirements by ensuring that bids remain below these amounts.

Can states be sued for their procurement policies?

Should state procurement practices raise concerns with another a GPA party, dispute resolution may occur within the WTO dispute settlement body.[246] Only another GPA party may invoke dispute settlement;[247] individual corporations that may feel discriminated against may not, although they could request that their government act on their behalf. However, even if a party were to assert that a state was in violation of the GPA, the federal government has the responsibility to represent the state, because the United States is, strictly speaking, the Party to the agreement. To date, only three disputes have raised claims under the GPA. Of those, one dispute reached a mutually agreeable solution[248] and another was withdrawn.[249] In the one case reaching a decision, the United States complained of Korea's practices regarding the construction of an airport, but the panel determined that the procuring entities were not covered under the GPA.[250]

What do these requirements mean to me?

Suppose a state agency listed under the GPA wishes to procure pipes to use in the construction of a public building. Under the GPA's requirements, a state agency may or may not do the following:

- ✓ A state may specify what the pipes must be able to do (i.e. performance criteria). For example, if the pipes are for the transport of waste from the building, the state may specify the width of the pipes required to perform the job of transporting waste.
- ✓ A state may require the pipes to be manufactured using environmentally friendly techniques if those techniques do not create an obstacle to trade.
- ✓ A state may not specify the manufacturer of the pipe or that the pipes be manufactured in the state or United States.
- ✓ A state may not specify that construction crews come from the state in which the construction will occur.

Do NAFTA and other free trade agreements include government procurement provisions?

Although the GPA is the broadest government procurement agreement, the United States has also adopted GP provisions in NAFTA and CAFTA–DR, as well as FTAs with Australia, Bahrain, Chile, Israel, Morocco, Oman, Peru, and Singapore. Because these agreements would apply in a dispute involving Parties to one of these agreements, states should familiarize themselves with them as well. While this Guide will not go into the details of all those agreements, procuring entities should consult the U.S. Trade Representative's website for more information regarding these FTAs.[251] By and large, the GP provisions of these FTAs apply to states in the same way that the GPA's provisions do.

NAFTA

Although NAFTA may be the most recognizable free trade agreement involving the United States, it has the least direct impact on state's GP activities. NAFTA requires separate consultation and negotiations with state governments before they become bound by the agreement,[252] and to date no state has accepted NAFTA's government procurement provisions. Should a state accept them, states would be bound by provisions slightly different from the GPA's.

Like the GPA, NAFTA requires a governmental entity to treat suppliers of goods and services of another Party no less favorably than domestic suppliers or suppliers from another entity.[253] Also like the GPA, it applies to government purchasing of goods, services, and construction services unless specifically exempted.[254] For example, the United States has exempted research and development; some information processing and telecommunications services; services relating to ship equipment; operation of government-owned facilities; utilities; and transportation, travel and relocation services.[255] The section on construction services does not completely incorporate the same United Nations classifications that the GPA does, but the section is based on them.[256] Importantly, "buy national" requirements for purchase of articles, supplies and other materials acquired for use in construction contracts do not apply to goods from Canada or Mexico.[257] Broadly speaking, NAFTA and the GPA are similar with respect to goods and services covered, as well as requirements for technical specifications.

Lastly, while NAFTA establishes its own dispute settlement mechanism, which allows investors to challenge some decisions of states (*see* Chapter 6), government procurement is exempt from investor disputes. Thus, only the governments of Canada and Mexico will be able to bring an action against the United States to challenge a state's government procurement requirements.

CAFTA–DR

Unlike NAFTA, 22 states and Puerto Rico have agreed to CAFTA–DR's government procurement provisions.[258] As such, it may prove to be more important than NAFTA in terms of state procurement activities. CAFTA–DR's general principles mirror those of the GPA and NAFTA,[259] as do provisions regarding offsets,[260] exceptions,[261] and technical specifications.[262] However, with respect to technical specifications, CAFTA–DR does not prohibit a procuring entity from adopting technical specifications "to promote the conservation of natural resources."[263] As with the GPA, each state has specified to which agencies the GP provisions of CAFTA–DR apply and identified specific exemptions.[264] For all covered entities, though, CAFTA–DR contains environmental and specifically-targeted business exceptions similar to the GPA.[265] Current thresholds for state and local entities are also the same ($554,000 for goods and services, $7,804,000 for construction services).[266] Although certain details of CAFTA–DR may be distinct from the GPA, the broad outlines are the

same, meaning that as long as the procuring entity checks its coverage, compliance with the GPA should constitute compliance with CAFTA–DR.

U.S.–Canada Bilateral GPA Agreement

In February 2010, the U.S. signed the U.S.–Canada Bilateral GPA Agreement, an agreement that modifies each country's government procurement obligations under the GPA.[267] This bilateral agreement is a response, in part, to the American Recovery and Reinvestment Act of 2009 (ARRA),[268] often called "the Stimulus Plan," which requires all the iron, steel, and manufactured goods used in an ARRA-funded project to be produced in the United States. Under this bilateral agreement, the United States exempts Canadian iron, steel, and manufactured goods from ARRA's "buy American" requirements with respect to state procurement involving seven federal programs funded by ARRA.[269] Thus, a state receiving ARRA funds for procuring iron, steel, or manufactured goods may purchase those goods if produced in either the United States or Canada. However, this provision expired on September 30, 2011.[270] Although this may seem like a concession, in exchange Canada has agreed to permanently bind its provinces to the GPA, providing increased opportunities for U.S. businesses in Canada.[271]

How does the American Recovery and Reinvestment Act's "buy American" rule affect these agreements?

Although ARRA contains provisions attempting to require the purchase of only domestically-sourced goods and services, the practical effect of the legislation on states depends on each state's status with respect to the GPA, CAFTA–DR, and other FTAs. While public projects receiving ARRA funding are supposed to only source iron, steel, and manufactured goods domestically, the same section requires compliance with U.S. obligations under international agreements.[272] Thus, for those states that have agreed to the GPA and procurement provisions in other FTAs, the buy American provisions do not apply.[273] In its regulations pursuant to the ARRA, the Office of Management and Budget has created a helpful chart listing the states that are subject to international agreements, so states should be able to assess their particular situation.[274]

May a state withdraw from the GP provisions of an agreement?

Although the majority of states find themselves bound to at least one free trade agreement with GP provisions, states are not uniformly supportive of them after they begin. Some state legislatures have responded to the state executive branch's acceptance of the FTAs by passing legislation requiring legislative approval for any future FTAs.[275] Some state governors and legislatures have also attempted to withdraw their states from CAFTA–DR.[276] With respect to withdrawal from the GPA, the text only discusses withdrawal by a Party.[277] Since sub-central entities (like states) are not "Parties" to the agreement, they cannot officially withdraw from the GPA on their own; rather, the Party must withdraw the smaller entity.[278] CAFTA–DR's withdrawal provisions are similar to those of the GPA in that it is a "Party" that must notify of the withdrawal.[279] Maryland, New Hampshire, and Oregon are still listed as covered states under CAFTA–DR despite requests to withdraw.[280] Since no state has yet agreed to NAFTA, withdrawal is not an issue.

Looking Forward

On March 30, 2012, the WTO's Committee on Government Procurement adopted a revised Government Procurement Agreement. The revised GPA will now go to governments for ratification. The revised GPA does not enter into force until two-thirds of the Parties to the original GPA ratify it.

The GPA Parties have long sought an agreement on government procurement to set the basis for expanded coverage, to further eliminate discriminatory measures, and to increase transparency. The revised GPA accomplishes these goals. It clearly defines terms, such as "commercial goods or services" and "construction service," left undefined by the original GPA.

The effect on states is marginal, however. The revised GPA maintains the same financial thresholds and the same 37 states covered by the original GPA are covered by the revised GPA. The revised GPA incorporates the most-favored nation and national treatment obligations as well as the prohibition against offsets. As in the original GPA, the United States retained exemptions for distressed areas, minority-owned businesses, and restrictions that promote the general environmental quality in that state, as long as such restrictions are not disguised barriers to international trade. The revised GPA also allows the use of technical specifications, provided that they do not have the effect of creating unnecessary obstacles to international trade.

In sum, FTAs can be a way for states to procure goods and services from other countries without trade barriers. However, these agreements may also constrain the ability of states to pass laws favoring the use of local goods and services or specifying the contents and production methods of goods. As such, states should be careful both when engaging in government procurement and when drafting legislation that could affect procurement that they are in compliance with all relevant agreements. The following Best Practices box summarizes key aspects of rules governing government procurement and the following Table indicates the applicability to states of GP provisions in specific FTAs.

Best Practices Checklist

Although states may be bound to agreements they neither sought out nor negotiated, they are not entirely powerless with respect to defining how these agreements will affect their procurement activities. If an agency is covered by the GPA, CAFTA–DR, or another free trade agreement, consideration of the points made below will help ensure that the agency does not run afoul of any rules for government procurement. However, procurement officials should be advised that the GPA is a complex agreement; they should seek more individualized counsel for more nuanced advice.

- ✓ ***National Treatment*:** States should ensure that legislation and any guidelines and rules for procurement treat foreign suppliers no less favorably that local suppliers during every step of the procurement process.

- ✓ ***Monetary Thresholds*:** Because the monetary thresholds are adjusted every two years, states should ensure that legislation is either updated accordingly or references the Federal Register to see if a threshold has been reached.

- ✓ ***Technical Specifications*:** States should be aware that legislating preferences could be viewed as an unnecessary obstacle to trade. When including specifications, states should refer to international standards, if available. In addition, specifying a product or service's performance requirements (e.g., an appliance's energy efficiency) is preferred to specifying a specific type of product (a specific appliance model). No particular country of origin should be specified. If a trademark is necessary, be sure to include "or equivalent" in the language.

- ✓ ***Buy Local Provisions*:** If enacting a "buy local" provision, states should ensure that the procurement activity does not rise to the threshold amounts set in the GPA or other free trade agreement. Legislators should also be careful that any such legislation does not appear to be an attempt to create an "offset" prohibited under these free trade agreements by providing separate provisions benefitting local businesses.

- ✓ ***"Green" Procurement*:** Specifying environmentally-friendly practices, particularly with respect to product performance, should be in accordance with these agreements as long as they do not create a trade barrier by being overly-specific or exclusive. However, if it is apparent that the product can only be sourced locally, such a provision might be seen as hindering trade.

Table 7–1: Trade Agreement Compare and Contrast

Agreement	Applicable to States?	Applicable to Cities?	Cost Thresholds	Buy Local	Green Procurement
WTO GPA[281]	*Maybe*. The GPA applies if states have accepted the GPA for specific agencies. To date, 37 states are bound.	No	Goods & Services: $554,000 Construction Services: $7,804,000	States may not adopt "buy local" or "buy American" provisions as these violate GPA non-discrimination requirements.	• States cannot specify characteristics of production methods that may create an obstacle to trade. • Specifying "green" products may be possible under the environmental exceptions, but if it has a discriminatory effect could be found to be a violation.
NAFTA[282]	*No.* Although NAFTA provides for further negotiations to include states, no states have agreed.	No	N/A	N/A	N/A
CAFTA–DR[283]	*Maybe*. CAFTA–DR applies if states have consented to bind specific agencies. To date, 22 states and Puerto Rico are bound.	No	Goods & Services: $554,000 Construction Services: $7,804,000	States may not adopt "buy local" or "buy American" provisions as these violate CAFTA–DR's non-discrimination requirements.	• States cannot specify characteristics of production methods that may create an obstacle to trade. • Specifying "green" products may be more permissible than under the GPA if it is to conserve natural resources, but technical specifications requirements still apply.

Endnotes

Chapter 1 — An Introduction to the Guide

[1] World Trade Organization, World Trade Report 2009 4 (2009); World Trade Organization, International Trade Statistics 2003 (2003).
[2] UNCTAD, World Investment Report 2009, 1, 4 (2009).

Chapter 2 — An Overview of the GATT and the Global Trading System

[3] *Japan — Measures on Imports of Leather*, GATT Panel Report, L/5623, B.I.S.D., 31st Supp. 94 (1985) (adopted May 15-16, 1984). *See also Japan — Trade in Semi-Conductors*, GATT Panel Report, L/6309, B.I.S.D., 35th Supp. 116, para. 109 (1989) (adopted May 4, 1988) (holding that even measures that are not formally legally binding obligations may be prohibited by Article XI provided that "sufficient incentives or disincentives exist [] for non-mandatory measures to take effect."
[4] Report of the Working Party on Border Tax Adjustments, Nov. 20, 1970, L/3464, B.I.S.D. 18th Supp. 97, para. 18 (1972). Subsequently, GATT panels added tariff classification of the products as an additional criterion for assessing product similarity. *See, e.g.*, *EEC — Measures on Animal Feed Proteins*, GATT Panel Report, L/4599, B.I.S.D. 25th Supp. 49 (1979) (adopted Mar. 14, 1978); *Spain — Tariff Treatment of Unroasted Coffee*, GATT Panel Report, L/5135, B.I.S.D. 28th Supp. 102 (1982) (adopted June 11, 1981).
[5] *Japan — Taxes on Alcoholic Beverages*, Appellate Body Report, WT/DS8/AB/R, WT/DS11/AB/R (published Oct. 4, 1996) (adopted Nov. 1, 1996).
[6] *Spain — Tariff Treatment of Unroasted Coffee*, GATT Panel Report, L/5135, B.I.S.D. 28th Supp. 102 (1982) (adopted June 11, 1981).
[7] *European Communities — Measures Affecting Asbestos and Asbestos Containing Products*, Appellate Body Report, WT/DS135/AB/R, paras. 69–75 (published Mar. 12, 2001) (adopted Apr. 5, 2001) [hereinafter *Asbestos*].
[8] United States — Restrictions on Imports of Tuna, GATT Panel Report, DS21/R (Sept. 3, 1991) (unadopted), reprinted in 30 I.L.M. 1594 (1991) (Tuna/Dolphin I). See also United States — Restrictions on Imports of Tuna, GATT Panel Report, DS29/R (June 16, 1994) (unadopted), reprinted in 33 I.L.M. 839 (1994) (Tuna/Dolphin II).
[9] *Brazil — Measures Affecting Imports of Retreaded Tyres*, Appellate Body Report, WT/DS332/AB/R, paras. 141–56 (published Dec. 3, 2007) (adopted Dec. 17, 2007) [hereinafter *Brazil — Retreaded Tyres*].
[10] *European Communities — Measures Affecting Asbestos and Asbestos Containing Products*, Panel Report, WT/DS135/R, paras. 8.184–8.212 (published Sept. 18, 2000) (adopted Apr. 5, 2001) [hereinafter *Asbestos*].
[11] *Brazil — Retreaded Tyres*, *supra* note 9, at paras. 141–56.
[12] *United States — Standards for Reformulated and Conventional Gasoline*, Appellate Body Report, WT/DS2/AB/R, 19 (published Apr. 29, 1996) (adopted May 20, 1996), *reprinted in* 35 I.L.M. 603 (1996) (*Reformulated Gasoline*).
[13] *Reformulated Gasoline*, Appellate Body Report, *supra* note 12, at 20–21.
[14] *United States-Import Prohibition of Certain Shrimp and Shrimp Products*, Appellate Body Report, WT/DS58/AB/R, paras.127–45 (published Oct. 12, 1998) (adopted Nov. 6, 1998), *reprinted in* 38 I.L.M. 121 (1999) (*Shrimp/Turtle*).
[15] *Reformulated Gasoline*, Appellate Body Report, *supra* note 12, at 14–22.
[16] *Shrimp/Turtle*, Appellate Body Report, *supra* note 14, at paras. 161–84.
[17] *United States — Import Prohibition of Certain Shrimp and Shrimp Products: Recourse to Article 21.5*

of the DSU by Malaysia, Appellate Body Report, WT/DS58/AB/RW, para. 122–50 (published Oct. 22, 2001) (adopted Nov. 21, 2001).

Chapter 3 — Ecolabeling and the Agreement on Technical Barriers to Trade

[18] *Asbestos*, Appellate Body Report, *supra* note 7, at paras. 69–75.
[19] *European Communities — Trade Description of Sardines*, Appellate Body Report, WT/DS231/AB/R, paras. 190–91 (published Sept. 26, 2002) (adopted Oct. 23, 2002) [hereinafter *EC — Sardines*].
[20] *United States — Certain Country of Origin Labelling (COOL) Requirements*, Panel Report, WT/DS384R, WT/DS386R, para. 7.176 (published Nov. 18, 2011) [hereinafter *US — COOL*].
[21] *United States — Measures Concerning the Importation, Marketing and Sale of Tuna and Tuna Products*, Panel Report, WT/DS381/R, para. 7.144 (published Sept. 15, 2011) [hereinafter *Tuna/Dolphin III*].
[22] *EC — Sardines*, Appellate Body Report, *supra* note 19, at para. 286.
[23] See, *e.g.*, *United States — Measures Affecting the Production and Sale of Clove Cigarettes*, WT/DS406/AB/R, para. 175 (published Apr. 4, 2012) [hereinafter *U.S. — Clove Cigarettes*]; *US — COOL*, *supra* note 20, at para. 7.276.
[24] *U.S. — Clove Cigarettes*, Appellate Body Report *supra* note 23, at paras. 193, 215.
[25] *Id.* at para. 225.
[26] *Tuna/Dolphin III*, Panel Report, *supra* note 21, at paras. 7.71–7.79.

Chapter 4 — Food Safety and Agreement on Sanitary and Phytosanitary Measures

[27] *United States — Continued Suspension of Obligations in the EC — Hormones Dispute*, Appellate Body Report, WT/DS321/AB/R, para. 530 (published Oct. 16, 2008, adopted Nov. 14, 2008) [hereinafter *Hormones II*].
[28] *Australia — Measures Affecting Importation of Salmon*, Appellate Body Report, WT/DS18/AB/R, para. 135 (published Sept. 17, 1998) (adopted Nov. 6, 1998) (hereinafter *Australia — Salmon*) (quoting from para. 8.83 of the *Australia — Measures Affecting Importation of Salmon*, Panel Report, WT/DS18/AB/R, para. 135 (published June 12, 1998) (adopted as modified by the Appellate Body Nov. 6, 1998).
[29] *Australia — Salmon*, Appellate Body Report, *supra* note 5, at para. 135.
[30] *Hormones II*, Appellate Body Report, *supra* note 27, at para 530; *European Communities — Measures Concerning Meat and Meat Products (Hormones)*, Appellate Body Report, WT/DS26/AB/R, WT/DS48/AB/R, para. 200 (published Jan. 16, 1998) (adopted Feb. 13, 1998) [hereinafter *Hormones I*].
[31] *Hormones I*, *supra* note 30, at para. 200.
[32] *Japan — Measures Affecting the Importation of Apples*, Appellate Body Report, WT/DS245/AB/R, para. 203. (published Nov. 26, 2003) (adopted Dec. 10, 2003) (hereinafter *Japan — Apples*).
[33] *Id.* at para. 204.
[34] *Japan – Apples*, *supra* note 32, at para. 179.
[35] *Hormones II*, *supra* note 27, at para. 677.
[36] *Japan – Apples*, *supra* note 32, at para. 181–85.
[37] *Hormones II*, *supra* note 27, at para. 705.
[38] *Japan — Apples*, *supra* note 32, at para. 184.
[39] *Hormones I*, *supra* note 30, at para. 198.
[40] *Australia — Salmon*, *supra* note 28, at para. 144; *Hormones I*, *supra* note 30, at para. 216.
[41] *Hormones I*, *supra* note 30, at para. 218.
[42] *Australia — Measures Affecting Importation of Salmon*, Panel Report, WT/DS18/R, paras. 8.113, 8.128 (published June 12, 1998) (adopted as modified by the Appellate Body Nov. 6, 1998).
[43] *Hormones I*, *supra* note 30, at para. 221.

[44] *Id.* at paras. 223–25.
[45] *Australia — Salmon*, Panel Report, *supra* note 42, at para. 8.139, note 390.
[46] *Id.* at para. 8.151.
[47] *Id.* at paras. 8.150, 8.154, 8.156.

Chapter 5 — Constraints Imposed on Subsidies that Affect International Trade

[48] *See United States — Tax Treatment for Foreign Sales Corporations*, Appellate Body Report, WT/DS108/AB/R, para. 90 WT/DS108/AB/R (published Feb. 24, 2000) (adopted Mar. 20, 2000) [hereinafter *US — FSC*].
[49] *Id*. at para. 91. (emphasis added)
[50] *Canada — Certain Measures Affecting the Automotive Industry*, Appellate Body Report, WT/DS139/AB/R, WT/DS142/AB/R, para. 100 (published May 31, 2000) (adopted June 19, 2000) [hereinafter *Canada — Autos*]. *See also United States —Tax Treatment for Foreign Sales Corporations: Recourse to Article 21.5 of the DSU*, Panel Report, WT/DS108/R, para. 8.55 (published Aug. 21, 2001) (adopted Jan. 29, 2002); *Canada — Export Credits and Loan Guarantees for Regional Aircraft*, Panel Report, WT/DS222/R, para. 7.365 (published Jan. 28, 2002) (adopted Feb. 19, 2002) [hereinafter *Canada — Aircraft*].
[51] *Canada — Measures Affecting Exports of Civilian Aircraft*, Appellate Body Report, WT/DS70/AB/R, para. 167 (published Aug. 2, 1999) (adopted Aug. 20, 1999).
[52] A subsidy is also actionable if it nullifies or impairs the benefits of another WTO country. SCM Agreement, art. 5. This could happen, for example, where a subsidy eliminates any tariff concession a WTO member has made with respect to a product. Trade panels have not found such a subsidy in many years. *United States — Continued Dumping and Subsidy Offset Act of 2000 (Byrd Amendment)*, Panel Report, WT/DS217/R, para. 7.127 (Sept. 16, 2002).
[53] *United States — Subsidies on Upland Cotton*, Panel Report, WT/DS267/R, para. 7.1170 (published Feb. 6, 2003) (adopted as modified by the Appellate Body Mar. 21, 2005).
[54] *Id.* at para. 7.1355. *See also United States — Subsidies on Upland Cotton*, Appellate Body Report, WT/DS267/AB/R, paras. 434-435, 461-467 (published Mar. 3, 2005) (adopted Mar. 21, 2005).
[55] *United States — Cotton*, Panel Report, *supra* note 53, at para. 7.1173.
[56] SCM Agreement, footnote 46.
[57] *Indonesia — Certain Measures Affecting the Automobile Industry*, Panel Report, WT/DS54/R, WT/DS54/R, WT/DS59/R, WT/DS64/R, para. 14.175 (published July 2, 1998) (adopted July 23, 1998).
[58] *See United States — Safeguard Measures on Imports of Fresh, Chilled or Frozen Lamb Meat from New Zealand and Australia*, Appellate Body Report, WT/DS177/AB/R, WT/DS178/AB/R, para. 90 (published May 1, 2001) (adopted May 16, 2001)
[59] *United States — Cotton*, Panel Report, *supra* note 53, at paras. 7.1173–7.1180.

Chapter 6 — Limitations on the Establishment of Investment Rules

[60] *See S.D. Myers v. Canada*, Partial Award, para. 232 (Nov. 13, 2000). *See also Pope & Talbot v. Canada*, Award on the Merits of Phase 2, para. 96 (Apr. 10, 2001).
[61] These claims are considered as a "denial of justice" under the minimum standard of treatment obligation, discussed in more detail below. *See, e.g.*, *Loewen Group, Inc. v. United States* (Final Award), ICSID Case No. ARB(AF)/98/3 (June 26, 2003).
[62] ICSID, or the International Centre for the Settlement of Investment disputes, is a World Bank organization providing arbitrations of this sort. UNCITRAL is the United Nations International Commission on Trade Law, providing similar services. Both of these organizations are frequently incorporated into investment and trade agreements, since they have the benefit of established procedures,

rules, and contacts.
[63] Whether the claim is brought under federal law or state or provincial law is a separate question. Canada, Mexico, and the U.S. all have such acts, which determine the allowed scope of review. See, e.g. International Commercial Arbitration Act, RSBC 1996, Chapter 233 § 1 (British Columbia); Commercial Arbitration Act, R.S. 1985, c. 17 (2nd Supp.) (Canada); Federal Arbitration Act, 9 U.S.C. 1-14 (U.S.); Cal. Code of Civil Proc. § 1297.11.
[64] *See, e.g.*, Federal Arbitration Act, 9 U.S.C. § 10(a).
[65] Both Mexico and the U.S. review in their courts, but limit review to jurisdictional issues only. *See United Steelworkers v. Enterprise Wheel & Car. Corp*., 363 U.S. 593, 599 (1960). U.S. courts have also limited themselves to tribunals' findings of fact. *International Brotherhood of Electrical Workers, Local 429 v. Toshiba America, Inc*., 879 F.2d 208 (6th Cir. 1989).
[66] Mexico v. Metalclad Corp., 2001 B.C.S.C. 664 (2001).
[67] North American Free Trade Agreement, Can.-Mex.-U.S., art. 1102(3) (Dec. 17, 1992) (emphasis added) [hereinafter NAFTA].
[68] *See e.g., United Parcel Serv. v. Can., Award on the Merits*, paras. 87–119 (June 11, 2007) (failing to cite a single NAFTA investment opinion in its like circumstances analysis or announce a specific test, despite the complaining investor arguing under the same sector test) [hereinafter *UPS*]; *Archer Daniels Midland Co. & Tate & Lyle Ingredients Americas, Inc. v. Mex.*, Award, paras. 155–158 (Nov. 21, 2007) [hereinafter *ADM*] (lacking a like circumstances test or analysis other than concluding that the evidence does not show a "competitive situation"); *Int'l Thunderbird Gaming Corp. v. Mex.*, Arb. Award, paras. 175–183 (Jan. 26, 2006) (applying like circumstances to the facts at hand without providing a test other than plain wording) [hereinafter *Thunderbird*].
[69] *Methanex Corp. v. U.S.*, Final Award of the Tribunal on Jurisdiction and Merits, Part IV, Chapter B, paras. 17, 19 (Aug. 9, 2005).
[70] *Id.* at para. 13.
[71] *Id.* at para. 17–22.
[72] *ADM, supra* note 68, at para. 197.
[73] *See id.* at paras. 198, 201.
[74] *Id,* at para. 201.
[75] *Id.* at para. 202.
[76] *Corn Prod. Int'l, Inc. v. Mex.*, Decision on Responsibility, at para. 120 (Jan. 15, 2008).
[77] *See id.* at paras. 121–126 (stating that the determination of like products under GATT is highly relevant to like circumstances and distinguishing other NAFTA investment cases); *but see Methanex, supra* note 69, at paras. 29–37 (discussing why the GATT like products analysis is irrelevant to the NAFTA like circumstances analysis).
[78] *See S.D. Myers, supra* note 60, at para. 251.
[79] *Pope & Talbot Inc. v. Can., supra* note 60, at para. 78 (Apr. 10, 2001) (footnote omitted). Although the tribunal announced this as part of the like circumstances test, categorizing it as a justification for differential treatment makes more sense. It is included here, however, because some tribunals have adopted it into the like circumstances test. On a different but related note, the tribunal did not need to announce this as a test to avoid finding that Canada breached its national treatment obligation; the facts of the case illustrate that there were valid distinctions between the factual circumstances of the investments at issue.
[80] *See generally id.* at paras. 18–29 (describing the factual background giving rise to the dispute).
[81] *Id.* at para. 84.
[82] *See generally id.* at paras. 18–29 (describing the factual background giving rise to the dispute).
[83] *Id.* at para. 96.
[84] *Id.* at paras. 86–88.
[85] *Id.* at paras. 99–101.

[86] *Id.* at paras. 102–103.
[87] The tribunal in *Feldman* began with the recognition that "[i]n the investment context, . . . discrimination has been defined to imply *unreasonable* distinctions between foreign and domestic investors in like circumstances." Without explicitly employing the same sector test, the tribunal narrowly construed like circumstances to include "firms that are in the business of reselling/exporting cigarettes." However, in that case, the parties conceded like circumstances, rendering the tribunal's determination on this point superfluous. *Marvin Feldman v. Mex.*, Award, paras. 170–72 (Dec. 16, 2002).
[88] The *GAMI* Tribunal dropped the first step of same sector altogether, looking instead only to the second prong of like circumstances announced in *Pope & Talbot*. In its sparse analysis, the tribunal excused the decision of the Mexican government to expropriate half of the sugar mills because "ensuring that the sugar industry was in the hands of solvent enterprises" was a rational policy. *GAMI Inv., Inc. v. Mex.*, Final Award, 114 (Nov. 15, 2004).
[89] *CPI*, *supra* note 76, at para. 142.
[90] *See e.g.*, *CPI*, *supra* note 76, at para. 117; *UPS*, *supra* note 68, at para. 83; *Feldman*, *supra* note 87, at para. 166.
[91] *S.D. Myers*, *supra* note 60, at para. 252.
[92] *See generally In the Matter of Cross-Border Trucking Serv.* (U.S. v. Mex.), Final Report of the Panel, paras. 35–100 (describing the history and various iterations of the United States prohibition on Mexican trucking services) [hereinafter *U.S. Trucking*].
[93] *Id.* at paras. 291–92.
[94] *Pope & Talbot*, *supra* note 60, at para. 56.
[95] *Feldman*, *supra* note 87, at para. 173.
[96] *Id.* at para. 175.
[97] *ADM*, *supra* note 68, at para. 208.
[98] *GAMI*, *supra* note 88, at para. 114; *see also Thunderbird*, *supra* note 68, at paras. 179–183 (refusing to fault Mexico for failing to uniformly and effectively implement legislation banning gambling facilities); *but see Feldman*, *supra* note 87, at para. 169 (stating that Mexico must enforce its laws in a non-discriminatory manner).
[99] *See CPI*, *supra* note 76, at para. 137 (discussing the relevance that nationality played in the discrimination).
[100] *See id.* at paras. 59–67 (explaining Mexico's defense of lawful countermeasures).
[101] *Id.* at para. 137.
[102] *Thunderbird*, *supra* note 68, at para. 177.
[103] *Feldman*, *supra* note 87, at para. 184 (citing *Pope & Talbot*, Award on the Merits of Phase 2, at paras. 78, 79.
[104] *Thunderbird*, *supra* note 69, at para. 177.
[105] *Methanex*, *supra* note 69, at Part IV, Ch. B, para. 12.
[106] *CPI*, *supra* note 76, at para. 138.
[107] *ADM*, *supra* note 68, at para. 209–210.
[108] *See e.g.*, *S.D. Myers*, *supra* note 60, at para. 254 (impact is required); *U.S. Trucking*, *supra* note X, at para. 292 (impact not required); *CPI*, *supra* note 76, at para. 138 (impact sufficient but not required); *see also ADM*, *supra* note 68, at para. 209–212 (discussing both intent and effects of the treatment at issue, but without resolving whether intent or effect were independently required).
[109] *S.D. Myers*, *supra* note 60, at para. 254; *see also ADF Group Inc. v. US*, Final Award, 18 ICISD Rev.–FILJ 195, para. 157 (Jan. 9, 2003) (stating that "[e]vidence of discrimination . . . is required").
[110] *Cf. CPI*, *supra* note 76, at para. 138 (since the tribunal said a showing of intent alone was sufficient, a showing of effects could not be necessary).
[111] *U.S. Trucking*, *supra* note 92, at para. 291–292.
[112] *Id.* at para. 292.

[113] NAFTA, art. 1108(7).
[114] NAFTA, art. 2106 and annex 2106 (referencing the exemption for cultural industries found in Article 2005 of the Canada – United States Free Trade Agreement).
[115] *Id*. (referencing the Canada – United States Free Trade Agreement).
[116] *UPS*, *supra* note 92, at para. 172.
[117] *Id.* at para. 57.
[118] *Id.* at paras. 140–45.
[119] *Id.* at para. 165.
[120] *See* Aaron Cosbey, et. al, INVESTMENT AND SUSTAINABLE DEVELOPMENT: A GUIDE TO THE USE AND POTENTIAL OF INT'L INVESTMENT AGREEMENTS 11 (2004) (available at http://www.iisd.org/pdf/2004/investment_invest_and_sd.pdf).
[121] 4. R.I.A.A. 60, para. 3-5 (Mexico-U.S. General Claims Commission 1926).
[122] *Id.* at para. 4.
[123] *S.D. Myers*, *supra* note, 60, at para. 263. (emphasis added).
[124] *Id.* at para. 266. Article 1102 is the national treatment provision.
[125] *Pope & Talbot*, *supra* note, 60, at para. 110.
[126] *Id.* at para. 118.
[127] Free Trade Commission, Notes of Interpretation of Certain Chapter 11 Provisions (July 31, 2001).
[128] *Mondev*, Final Award, paras. 116, 123 (Oct. 11, 2001) (claim ultimately unsuccessful).
[129] Claudia T. Salazar, *Applying Int'l Human Rights Norms in the U.S.*, 19 ST. JOHN'S LEG. COM. 111, 130-31 (2004) (citing *Chubb & Son, Inc. v. Asiana Airlines*, 214 F.3d 301, 307-08 (2d Cir. 2000); Restatement (Third) Foreign Relations Law § 1102(2)).
[130] *Thunderbird*, *supra* note 68, at para. 194 (citing Mondev, ADF Group, and Waste Management).
[131] *Glamis Gold, Ltd. v U.S.*, Final Award (June 8, 2009), para. 603.
[132] *Id.* (noting that the intent behind state practice is important); *Pope & Talbot v. Canada*, Damages Award, para. 62 (May 31, 2002); *ADF*, *supra* note 109, at para. 184; Ian Laird, *Betrayal, Shock and Outrage: NAFTA Investment Law and Arbitration*, 74-75 (citing Article 38 of the Statute of the International Court of Justice).
[133] *Glamis Gold*, *supra* note 131, at para. 605.
[134] For example, the *Pope & Talbot* tribunal noted that "state practice" was embodied in over 2000 BITs, which supported the proposition that "the fair and equitable treatment standard had become customary international law. *Pope & Talbot*, *supra* note 60, at para. 62.
[135] *Glamis Gold*, *supra* note 131, at para. 605–06.
[136] *Id.* at paras. 606–08.
[137] *Mondev*, *supra* note 128, at paras. 116, 123.
[138] *ADF*, *supra* note 109, at para. 181.
[139] *Thunderbird*, *supra* note 68, para. 194.
[140] *Id.* at para. 194.
[141] *Id.* at para. 194.
[142] *Loewen*, *supra* note 81, at para. 132.
[143] *Mondev*, *supra* note 128, at para. 128; *Loewen*, *supra* note 61, at para. 137.
[144] *Waste Management v. Mexico*, Award, para. 98 (April 30, 2004) (reasonable reliance on the host state's representations may also be relevant).
[145] *Mondev*, *supra* note 128, at para. 96.
[146] Francesco Francioni, Access to Justice, Denial of Justice and International Investment Law, 20 EUR. J. INT'L L. 729 (2009).
[147] *Mondev*, *supra* note 128, at para 126 (citing *Azinian*, paras 102-03).
[148] *Id.* at para. 127. (emphasis added)
[149] *Loewen*, *supra* note 61, at para. 137.

[150] *Id.* at para. 119
[151] *Id.* at para. 132. It is worth noting that the *Loewen* tribunal also concluded that "[b]y any standard of measurement, the trial involving O'Keefe and Loewen was a disgrace," and was "so flawed that it constituted a miscarriage of justice . . . as that expression is understood in international law." *Loewen* (Award on Jurisdiction), at paras. 119, 54 (Jan. 5, 2001).
[152] *Loewen*, *supra* note 61, at para. 217. The exhaustion requirement that the tribunal relied on to reject the claim has been the subject of much debate. To begin, the only judicial remedy that was not pursued was review by the U.S. Supreme Court, which only accepts a minute fraction of the cases requesting review, making the likelihood of review almost non-existent. Furthermore, some argue that under Article 1121, NAFTA requires parties to *waive* available local remedies as a prerequisite to filing a claim with a NAFTA tribunal. By phrasing the defect in terms of "finality," however, the tribunal suggested that exhausting local remedies—generally a procedural requirement—was a substantive element of the claim itself. The claimant did not petition for a writ of certiorari with the U.S. Supreme Court, and it cannot be said that an entire system of justice has failed until the highest court has reached a *final* decision. Because it was at least *possible* that the Court would have granted cert and reversed the lower court's decision, the tribunal could not conclude that the claimant had been denied justice.
[153] *Reno v. Flores*, 507 U.S. 292, 302 (1993). Fundamental rights include the right to marry, have marital privacy, have children, to use contraception, to maintain bodily integrity, and to have an abortion. *Washington v. Glucksberg*, 521 U.S. 702, 719-20 (1997).
[154] Dist. Attorney's Office for Third Judicial Dist. V. Osborne, 129 S. Ct. 2308, 2319 (2009); Town of Castle Rock, Colo. v. Gonzales, 545 U.S. 748, 756 (2005); Bolling v. Sharpe, 347 U.S. 497, 499-500 (1954); New Motor Vehicle Bd. of California v. Orrin W. Fox Co., 434 U.S. 1345, 1348-49 (1977).
[155] *Phillips Petroleum Co. v. Shutts*, 472 U.S. 797, 811-12 (1985).
[156] Village of Euclid v. Ambler Realty Co., 272 U.S. 365, 395 (1926).
[157] *Mondev*, *supra* note 128, at para. 118.
[158] *Glamis Gold*, *supra* note 131, at para. 355 (citing *Metalclad Corp. v. The United Mexican States*, Final Award (Aug. 30, 2000), para. 103).
[159] *Glamis Gold*, *supra* note 131, at para. 355; Pope *& Talbot Inc. v. The Government of Canada*, Interim Award on the Merits, (June 26, 2000), paras. 96 & 104; *S.D. Myers*, *supra* note 60, at para. 286; *Marvin Feldman*, *supra* note 87, at para. 100.
[160] Interpretive guidelines for expropriations are found in U.S.–Chile annex 10-D and a U.S.–Singapore letter of agreement. They are discussed later in this chapter.
[161] See www.naftalaw.org for published documents from NAFTA Chapter 11 Tribunals. The following arbitral claims each included an Article 1110 expropriation claim:

Against Mexico: *Adams*, *Azinian*, *Calmark*, *Feldman*, *Fireman's Fund*, *Frank*, *GAMI*, *Thunderbird*, *Metalclad*, *Waste Manage*ment;

Against the U.S.: *Baird*, *Canfor*, *Doman*, *Glamis Gold*, *Loewen*, *Methanex*, *Mondev*, *Tembec*;

Against Canada: *Ethyl*, *Crompton*, *Pope & Talbot*, *SD Myers*.

[162] *Metalclad*, Final Award (September 2, 2000).
[163] *Pope & Talbot*, *supra* note 60, at paras. 96 & 102.
[164] *S.D. Myers*, *supra* note 60, at paras. 280-281, 285. *Feldman* also looks for a "rational" public purpose, but notes that the importance of public purpose is limited in determining an expropriation. *Feldman*, *supra* note 87, at paras. 99,135-136.
[165] *Glamis Gold*, *supra* note 131, at para. 356; *GAMI supra* note 88, at para. 126; *Metalclad*, *supra* note 162, at para. 103; *Pope & Talbot*, Final Award, *supra* note 60, at paras. 96 & 102.
[166] *Pope & Talbot*, Interim Merits Award, *supra* note 159, at para. 102.
[167] *Pope & Talbot*, Interim Merits Award, *supra* note 159, at para. 102; *Glamis Gold*, *supra* note 131, at paras. 356 & 357; *Fireman's Fund v. Mexico*, Award (July 17, 2006), para. 176(c); *Metalclad*, *supra* note 162, at para. 103.

[168] *Glamis Gold*, *supra* note 131, at para. 357; *Fireman's Fund*, *supra* note 167, at para. 176(c); *Pope & Talbot*, Final Award, *supra* note 60, at paras. 100 & 102; *Feldman*, *supra* note 87, at para. 142; *Metalclad*, *supra* note 162, at para. 103.
[169] GAMI, *supra* note 88, at paras. 132–33.
[170] *Glamis Gold*, *supra* note 131, at para. 357.
[171] *Glamis Gold*, *supra* note 131, at paras. 357 & 536. *See also Metalclad, supra* note 162, at para. 103 (expropriation includes "covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or in significant part, of the use or reasonably-to-be-expected economic benefit of property.").
[172] *Glamis Gold*, *supra* note 131, at para. 536; *Fireman's Fund*, *supra* note 167, at para. 176(c); *Pope & Talbot*, Final Award, *supra* note 60, at para. 101.
[173] *Glamis Gold*, *supra* note 131, at paras. 356 & 360; *Fireman's Fund*, *supra* note 167, at para. 176(d); *S.D. Myers*, *supra* note 60, at paras 283-84 & 287.
[174] *Firemen's Fund*, *supra* note 167, at para. 176(f); *Feldman*, *supra* note 87, at para. 135; *SD Myers*, *supra* note 60, at para. 281;
[175] *See*, *e.g.*, Dominican Republic-Central American Free Trade Agreement (August 5, 2004), art. 10.7.
[176] CAFTA–DR, Annex 10-C 4(a).
[177] CAFTA–DR, Annex 10-C 4(b).
[178] U.S.–Peru, Annex 10-B (Dec. 14, 2007); U.S.–Oman, Annex 10-B (Jan. 1, 2009); U.S.–Chile, Annex 10-D (Jan. 1, 2004); U.S.–Singapore, Exchange of Letters (May 6, 2003); U.S.–Colombia, Annex 10-B 3(a), (b) (signed Nov. 22, 2006).
[179] Not all NAFTA tribunals agree on when those factors become relevant. Compare *Glamis Gold*, para. 356, to *Fireman's Fund*, *supra* note 167, at para. 176(j) & (k).
[180] Palazzolo v. Rhode Island, 533 U.S. 606, 617 (2001) (citing Penn Central Transportation Co. v. City of New York, 438, U.S. 104, 124 (1978)).
[181] *Glamis Gold*, *supra* note 131, at para. 356 n. 703.
[182] *Id.*
[183] *Id*. at para. 356. The *Fireman's Fund* tribunal, however, suggested that similar factors may be relevant when determining whether an expropriation has occurred. See *Fireman's Fund*, *supra* note 167, at para. 176(j) & (k).
[184] *Glamis Gold*, *supra* note 1319, at para. 355; *Pope & Talbot*, final Award, *supra* note 60, at paras. 96 & 104; *S.D. Myers, supra* note 60, at para. 286; *Feldman, supra* note 87, at para. 100.
[185] *Glamis Gold*, *supra* note 131, at para. 355.
[186] *Id.* para. 355 n 702.
[187] *Id.*; *Fireman's Fund*, *supra* note 167, at para. 176 (i) (the series of measures need not be related to each other); *S.D. Myers*, *supra* note 60, at para. 286.
[188] *See Metalclad*, *supra* note 162, at para. 104 (federal government acquiesced to state's permit denial after the federal government has expressly assured investor that permit would be granted); *Fireman's Fund*, *supra* note 167, at para. 176 (a) n 155.
[189] *Id.* at 356.
[190] Article 1110 states that expropriatory government actions are permissible if taken "*for a public purpose*," in a non-discriminatory manner, according to due process of law, and upon payment of adequate compensation.
[191] *Fireman's Fund*, *supra* note 167, at para. 174.
[192] *Pope & Talbot*, Final Award, *supra* note 60, at para. 99.
[193] *S.D. Myers*, *supra* note 60, at para. 281.
[194] *Fireman's Fund*, *supra* note 167, at para. 176 (j). (italics added).
[195] *Glamis Gold*, *supra* note 131, at para. 354 (citing Restatement Third of Foreign Relations § 712, Comment (g) (1986)).

[196] *Glamis Gold*, *supra* note 131, at para. 356.
[197] *See* Matthew C. Porterfield, *International Expropriation Rules and Federalism*, 23 STAN. ENVTL. L.J. 3 (2004).
[198] CAFTA–DR, Annex 10-C 4(b).
[199] *Glamis Gold*, *supra* note 131, at para. 357; *Fireman's Fund*, *supra* note 167, at para. 176(c); *Pope & Talbot*, final Award, *supra* note 60, at paras. 100 & 102; *Feldman*, *supra* note 87, at para. 142; *Metalclad*, *supra* note 162, at para. 103.
[200] *See Glamis Gold*, *supra* note 131, at para. 357; *Fireman's Fund*, *supra* note 167, at para. 176(c); *Pope & Talbot*, Final Award, *supra* note 60, at paras. 100 & 102; *Feldman*, *supra* note 87, at para. 142; *Metalclad*, *supra* note 162, at para. 103.
[201] CAFTA–DR, Annex 10-C (2); U.S.–Peru, Annex 10-B (Dec. 14, 2007); U.S.–Oman, Annex 10-B(2) (Jan. 1, 2009); U.S.–Chile, Annex 10-D (Jan. 1, 2004); U.S.-Singapore, Exchange of Letters (May 6, 2003); U.S.–Colombia, Annex 10-B(2) (signed Nov. 22, 2006) (awaiting congressional approval).
[202] NAFTA, chapter 11, article 1139(g).
[203] *Pope & Talbot*, Final Award, *supra* note 60, at para. 98.
[204] *Methanex*, *supra* note 69, at part IV, chapter D, para. 17.
[205] *Fireman's Fund*, *supra* note 167, at para. 176 (b) & n156 (also citing *Mondev Int'l Ltd. v. US*, Award (Oct. 11, 2002), para. 98).

Chapter 7 — The Affect of Free Trade Agreements on Government Procurement

[206] World Trade Organization, Agreement on Government Procurement, U.S. App. I, Annex 2, Apr. 15, 1994, *available* at http://www.wto.org/english/tratop_e/gproc_e/gp_gpa_e.htm [hereinafter GPA] (last visited Feb. 16, 2010); North American Free Trade Agreement, U.S.-Can.-Mex., Dec. 17, 1992, ch. 10, art. 1001, 32 I.L.M. 289 (1993), *available at* http://www.nafta-sec-alena.org/en/view.aspx?x=343&mtpiID=140 [hereinafter NAFTA] (last visited Feb. 16, 2010); Central America–Dominican Republic–United States Free Trade Agreement Annex 9.1.2(b)(i), *available at* http://www.ustr.gov/trade-agreements/free-trade-agreements/cafta-dr-dominican-republic-central-america-fta/final-text [hereinafter CAFTA-DR] (last visited Mar. 17, 2010).
[207] However, seven cities have agreed to be bound to a side agreement to the GPA between the European Union and the United States. PUBLIC CITIZEN, FACT VS. SPIN: DEBUNKING USTR'S "STATE GOVERNMENT PROCUREMENT AND TRADE AGREEMENTS: THE FACTS" 3, *available at* http://www.citizen.org/documents/ACF8FE.pdf.
[208] GPA, at Preamble.
[209] NAFTA, at ch. 10.
[210] CAFTA-DR, at ch. 9.
[211] GPA, at art. I(2).
[212] *ADF Group*, *supra* note 109, at para. 161.
[213] *Id.* at para. 162. In this case, the contractor needed to buy steel to manufacture girders for a highway project and the tribunal concluded that the purchase of the steel constituted government procurement. However, because VDOT is not a listed NAFTA entity, it could not be subject to penalties.
[214] *Id.* U.S. App. I, Annex 4. The Universal List of Services is formally titled the "Services Sectoral Classification List," MTN.GNS/W/120 (July 10, 1991), at http://www.wto.org/english/tratop_e/serv_e/mtn_gns_w_120_e.doc.
[215] GPA, at U.S. App. I, Annex 4.
[216] *Id.* U.S. App. I, Annex 5.
[217] United Nations, Department of Economic and Social Affairs, Statistics Division, *Methods and Classifications: Detailed Structure and Explanatory Notes, CPCprov code 51*, http://unstats.un.org/unsd/cr/registry/regcs.asp?Cl=9&Lg=1&Co=51 (last visited Apr. 19, 2010).

[218] *Id.*
[219] *Id.* at U.S. App. I, Annex 1–3.
[220] *Id.* The SDR is "an international reserve asset, created by the [International Monetary Fund] . . . to supplement its member countries' official reserves." International Monetary Fund, Factsheet–Special Drawing Rights (SDRs), http://www.imf.org/external/np/exr/facts/sdr.HTM (last visited Mar. 17, 2010). The IMF defines the SDR as a "basket of currencies, today consisting of the euro, Japanese yen, pound sterling, and U.S. dollar." *Id.* The IMF's website lists an updated U.S. dollar-value of the SDR daily at http://www.imf.org/external/np/fin/data/rms_sdrv.aspx. However, with respect to the GPA, the dollar amount is fixed for two years.
[221] World Trade Org., Comm. on Gov't Procurement, *Decisions on Procedural Matters under the Agreement on Government Procurement (1994)* 4, WT/GPA/1/96-0792 (Mar. 5, 1996), *available at* http://docsonline.wto.org/gen_search.asp?language=1 (enter "96-0792" in "Document Number" field).
[222] Procurement Thresholds for Implementation of the Trade Agreements Act of 1979, 74 Fed. Reg. 68907, 68908 (Dec. 29, 2009). Other countries have their own contract value thresholds which are listed in each country's respective Appendix I.
[223] GPA, at art. II.
[224] GPA, at U.S. App. I. Note, though, that each country may have a distinct definition of each of those terms that can be found in a number of annexes to the GPA, all available on the WTO's website.
[225] Jean Heilman Grier, *Recent Developments in International Trade Agreements Covering Government Procurement*, 35 PUB. CONT. L.J. 385, 390 (2006).
[226] GPA, at U.S. App. I, Annex 2.
[227] *Id.*
[228] *Id.*
[229] GPA, at art. XXIII(1).
[230] *Id.* at Preamble.
[231] *Id.* at art. III:1.
[232] ODAS, through its State Procurement Office, is the "central procurement authority" for the state. State Procurement Office, http://www.oregon.gov/DAS/SSD/SPO/index.shtml (last visited Mar. 31, 2010). ODAS is the only listed entity in the GPA for the state of Oregon. GPA, *supra* note 3, U.S. App. I, Annex 2.
[233] GPA, at art. IV.
[234] *Id.* at arts. VII–XV.
[235] *Id.* at art. V.
[236] Buy American Act, 41 U.S.C. § 10a (2010).
[237] Trade Agreement Act, 19 U.S.C. § 2511 (2010).
[238] GPA, at art. XVI:1, n.7.
[239] *Id.* at art. XVI:2.
[240] *Id.* at art. VI:1.
[241] *Id.* at art. VI:1.
[242] *Id.* at art. VI:2(b).
[243] *Id.* at art. VI:2(a).
[244] *Id.* at art. VI:3.
[245] *Id.* at art. VI:4.
[246] *Id.* at art. XXII.
[247] *Id.*
[248] *Japan — Procurement of a Navigation Satellite*, Notification of Mutually-Agreed Solution, WT/DS73/5 (Mar. 3, 1998).
[249] *United States — Measure Affecting Government Procurement*, Lapse of Authority for Establishment of the Panel — Note by the Secretariat, WT/DS88/6, WT/DS95/6 (Feb. 14, 2000).

[250] *Korea — Measures Affecting Government Procurement*, Panel Report, WT/DS163/R, paras. 7.71–7.73 (published May 1, 2000) (adopted June 19, 2000).
[251] FTAs with Government Procurement Obligations, http://www.ustr.gov/trade-topics/government-procurement/ftas-government-procurement-obligations (last visited Mar. 23, 2010).
[252] NAFTA, at art. 1024.
[253] *Id.* at art. 1003.
[254] *Id.* at art. 1001:1.
[255] *Id.* Annex 1001.1b-2.
[256] *Id.* Annex 1001.1b-3.
[257] *Id.*
[258] CAFTA–DR, at Annex 9.1.2(b)(i), Section B.
[259] *Id.* at ch. 9, art. 9.2.
[260] *Id.* at arts. 9.2, 9.17. *See also supra* note 43 and accompanying text.
[261] *Id.* at art. 9.14. In keeping with its clarification on environmentally-based technical specifications, *see infra* note 67 and accompanying text, Article 9.14 clarifies that the exception relating to human, animal and plant life includes the "environmental measures necessary" to protect them.
[262] CAFTA–DR, at arts. 9.7, 9.17.
[263] *Id.*
[264] *Id.* at Annex 9.1.2(b)(i).
[265] *Id.* The agreement also excludes printing services. *Id.*
[266] Procurement Thresholds for Implementation of the Trade Agreements Act of 1979, 74 Fed. Reg. 68907, 68908 (Dec. 29, 2009).
[267] U.S.–Canada Agreement on Government Procurement, http://www.ustr.gov/trade-topics/government-procurement/us-canada-agreement-government-procurement.
[268] American Recovery and Reinvestment Act of 2009 (ARRA), Pub. L. 111-5, 123 Stat. 115 (Feb. 17, 2009).
[269] U.S.–Canada Agreement on Government Procurement Part A, arts. 5, 7, *available at* http://www.ustr.gov/webfm_send/1638 [hereinafter U.S.–Canada GPA].
[270] *Id.* at Part B, art, 6.
[271] *Id.* at Appendix A.
[272] ARRA, *supra* note 268, at § 1605(d).
[273] Recovery Act and the "Buy American" Provision, http://www.ustr.gov/node/5417 (last visited Mar. 23, 2010).
[274] 2 C.F.R. Pt. 176, Subpt. B, App. (2010) (as revised by 75 Fed. Reg. 14323 (Mar. 25, 2010). The chart is available at edocket.access.gpo.gov/2009/pdf/E9-9073.pdf.
[275] The states are Hawaii, http://www.capitol.hawaii.gov/session2007/Bills/HB30_CD1_.htm, Maine, http://www.citizen.org/documents/PUBLIC385.pdf, Maryland, http://mlis.state.md.us/2005rs/bills/sb/sb0401t.pdf, Minnesota, http://www.citizen.org/documents/StatutoryTradeLanguage.pdf, and Rhode Island, http://www.rilin.state.ri.us/Billtext/BillText06/HouseText06/H6885aa.pdf.
[276] The states are Iowa, Kansas, Maine, Maryland, Minnesota, Missouri, New Hampshire, Oregon, and Pennsylvania. Trade Policy and Government Procurement, http://citizen.org/Page.aspx?pid=1204 (last visited Mar. 23, 2010).
[277] GPA, at art. XXIV(10).
[278] *Id.* at art. XXIV(6)(b).
[279] CAFTA–DR, at art. 9.16(a).
[280] *Id.* at Annex 9.1.2(b)(i).
[281] For more information, see http://www.wto.org/english/tratop_e/gproc_e/appendices_e.htm.
[282] For more information, see http://www.nafta-sec-alena.org.

[283] For more information, see
http://www.ustr.gov/sites/default/files/uploads/agreements/cafta/asset_upload_file977_3927.pdf.