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# The Use and Abuse of WTO Law in Investor–State Arbitration: Competition and its Discontents

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## Abstract

*This article offers a contribution to the broader project of isolating the causes of inconsistency in investor–state arbitral jurisprudence. It examines the norm of national treatment and explores the methodological tendency of arbitrators to draw on complex WTO jurisprudence as a means of guiding the application of a similar but not identical legal norm in the investment treaty setting. It argues that, when one unpacks the complicated arbitral jurisprudence on national treatment, misuse of WTO law is the controlling factor for critical inconsistency in the jurisprudence. The article examines a central question surrounding national treatment under investment treaties being the role for competition between foreign and domestic actors in determining whether they stand ‘in like circumstances’. It also focuses on two key cases – Occidental v. Ecuador and Methanex v. USA – both of which are under-analysed in the secondary literature. The article concludes by identifying implications of the problematic interpretative methods at play and canvasses suggestions on reform models to incentivize probity and consistency in interpretation in this field of international law.*

## 1 Introduction

Investor–state arbitration provisions have formed part of modern investment treaties for more than 40 years. Until recently, there has been a marked reluctance to invoke this unique system of dispute settlement. The first reported arbitral award was issued

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just under 20 years ago<sup>1</sup> and, even then, the early to mid 1990s were characterized by sporadic use at best.<sup>2</sup> We now face a very different world; investor–state arbitration has grown exponentially over the last decade.<sup>3</sup> This feverish invocation has begun to generate a host of systemic and normative challenges. Most visibly, significant parts of the emerging jurisprudence have been marked by inconsistencies and, at times, even incoherence. These have, on occasion, triggered the intervention by state parties such as the ‘authoritative interpretation’ of the NAFTA legal text by the NAFTA Free Trade Commission.<sup>4</sup> There are also the beginnings of a project of paring back the classic model of investment treaty protection, even by the traditional *demandeurs* of that model.<sup>5</sup> The contradictory jurisprudence driving these changes is now attracting the attention of legal scholars. For many, such inconsistency is anathema to the very precepts of a vision of the rule of law in this setting. The end-point in these analyses is then not wholly unexpected. It usually takes the form of a call for systemic reform so as to incentivize consistency in interpretation of legal norms. The strongest reform proposal is the construction of an appellate organ in the system,<sup>6</sup> which even finds reflection as a ‘promise to negotiate’ in recent treaty practice.<sup>7</sup> The World Trade Organization (WTO) – with its formalized and seemingly successful structure of first instance and then appellate review – remains for many a lodestar in charting the desired evolution of the system of investor–state arbitration.

Those sympathetic to this vision may be putting the cart before the horse, so to speak. I am not here concerned with the myriad of complex, technical barriers to marrying appellate review to a heterogeneous set of legal regimes. Those barriers are formidable but, like most technical challenges, manageable. My broader concern is the failure systematically and comprehensively to analyse the causes which underlie the ‘problem’ of inconsistent interpretation and outcome in investor–state arbitration. After all, in constructing a sophisticated ‘response’ one must first be able to identify, disentangle, and weight the underlying factors that are driving the ‘problem’.

<sup>1</sup> *Asian Agricultural Products Ltd v. Sri Lanka*, Award (ICSID, 27 June 1990).

<sup>2</sup> UNCTAD, *Investor–State Dispute Settlement and Impact on Investment Rule-Making* (2007), at 7.

<sup>3</sup> The total cumulative number of known investment treaty-based cases reached 290 at the end of 2007. For statistics and analysis on exponential growth in invocation through the late 1990s onwards see UNCTAD, ‘Latest Developments in Investor–State Dispute Settlement’, *International Investment Agreements Monitor* No.1 (UNCTAD/WEB/TTE-IIA/2008/3, 2008), at 1–2.

<sup>4</sup> Cf. *Pope & Talbot Inc v. Canada*, Award on the Merits of Phase 2 (UNCITRAL, 10 Apr. 2001), at paras 110–111; *SD Myers Inc. v. Canada*, Partial Award (UNCITRAL, 13 Nov. 2000), at paras 259–269 (both ruling that the fair and equitable standard in NAFTA Art. 1105 adopts an additive component beyond the scope of protection at customary international law) with NAFTA Free Trade Commission, *Notes of Interpretation of Certain Chapter 11 Provisions* (31 July 2001), at Parts B(1)–(2) (confining NAFTA Art. 1105 to the ‘customary international law minimum standard of treatment of aliens’).

<sup>5</sup> In 2001, for instance, the US revised its Model Bilateral Investment Treaty (BIT) to include a new Annex on expropriation, offering elaborations on the precise conditions by which general regulation would be sanctioned as an indirect expropriation. Other states – Norway and Japan included – have broken from traditional BIT practice and now include substantive and binding exceptions for host state regulation.

<sup>6</sup> E.g., K.P. Sauvant (ed.), *Appeals Mechanisms in International Investment Disputes* (2008).

<sup>7</sup> E.g., Chile–United States Free Trade Agreement, signed 6 June 2003, Chapter 10 Investment, at Annex 10-H (Possibility of a Bilateral Appellate Body/Mechanism).

The stakes are also very high when it comes to proposals to add another legal layer to the existing system. For one thing, the added costs may have significant adverse impacts when it comes to the ability of both states and certain investors to access the system. The usual narrative here tends to emphasize the cost barriers faced by poorer states – a dynamic borne out in the WTO legal system – as respondents to investor–state arbitration. Yet it is a barrier which will also impact significantly on smaller foreign investors who may be those at the highest risk of discrimination and rent seeking and, as such, have the greatest need to access the system.<sup>8</sup>

The usual account of the underlying causes of conflicting jurisprudence in this field falls into one of two broad categories. The first focuses on the general (and rather obvious) features of the system, not least its uncoordinated, *ad hoc* nature.<sup>9</sup> The second category tends to micro-analyse the phenomenon through the fact pattern of particular cases, the usual suspects being the *Lauder* and *CME* awards.<sup>10</sup> These are important lines of inquiry, but there are many others. For one thing, the root origins of this system as one of arbitration and the tendency of arbitrators to self-identify as an epistemic community could be part of the puzzle. After all, arbitration by definition is a dispute settlement system which prioritizes party autonomy, speed, and finality over the process of legal reasoning and justification. Viewed in these terms, the curious absence in legal analysis (and failure to situate a ruling in support of or departure from other cases) is not simply a product of a failure to coordinate, but an ethos hard-wired to particular actors within the system.

My intention in this article is to offer a modest contribution to the project of isolating the causes of inconsistency in arbitral jurisprudence. I focus on the norm of national treatment and explore the methodological tendency of the arbitrators to engage in a particular form of comparative analysis. This I define as an attempt to draw on the complex WTO jurisprudence on national treatment as a means of guiding the application of a similar but not identical legal norm in the investment treaty setting. My thesis is simple and easily stated; when one unpacks the complicated arbitral jurisprudence on national treatment, the misuse of WTO law is *the* controlling factor for critical inconsistency in the legal tests applied to effect that norm. I focus on a central question surrounding national treatment in the investment treaty setting being the role for competition between a foreign and a domestic actor in determining whether they stand ‘in like circumstances’. As any person schooled in this legal norm (whether

<sup>8</sup> My point here engages the political economy of investment policy, which turns on the size (and crucially employment capacity) of foreign investment in a host state. See Grossman and Helpman, ‘Foreign Investment with Endogenous Protection’, in R.C. Feenstra *et al.* (eds), *The Political Economy of Trade Policy: Papers in Honor of Jagdish Bhagwati* (1996), at 199, 216; Facchini and Willmann, ‘The Political Economy of International Factor Mobility’, 67 *J Int’l Economics* (2005) 201, at 215–216.

<sup>9</sup> E.g., Franck, ‘The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law Through Inconsistent Decisions’, 73 *Fordham L Rev* (2005) 1521, at 1545–1546.

<sup>10</sup> In *Lauder*, the arbitral tribunal constituted under the US–Czech BIT found that the claimant did not suffer an expropriation. Ten days later, the tribunal constituted in *CME* found that the same governmental conduct – now implicating the corporate entity rather than individual shareholder – was an expropriation by the Czech government. Cf. *Lauder v. Czech Republic*, Final Award (UNCITRAL, 3 Sept. 2001), at paras 202–204 with *CME Czech Republic v. Czech Republic*, Partial Award (UNCITRAL, 13 Sept. 2001), at paras 575–585.

in a federal or international legal regime) appreciates, the manner in which one defines the relational concept of likeness is central to mapping the ambit of its operation. I also focus my analysis on two key cases, *Occidental v. Ecuador*<sup>11</sup> and *Methanex v. USA*,<sup>12</sup> which I regard as under-analysed (as is indeed national treatment jurisprudence generally<sup>13</sup>) in the secondary literature.

Both of these cases reject or oppose competition as a condition of likeness, but their preferred tests diverge significantly. For *Occidental*, foreign and domestic producers are alike simply if they are both exporters of goods, even if not in competition with each other.<sup>14</sup> This broad reading is diametrically at odds with the narrow search for a domestic actor which is 'identical' to the foreign investor, the test adopted by the later *Methanex* Tribunal.<sup>15</sup> Here, though, is the critical nexus; both tribunals reject competition before constructing their own preferred tests solely because of the misperception of its limitation or breadth as applied in the WTO context. An entire part of their analytical sequence rests on a misreading of an external legal norm. This serious methodological flaw alone should inform our evaluation of the substance of their reading and raises, in turn, questions of how reform proposals may address this specific cause of jurisprudential uncertainty.

To fully explore this thesis, I need as a starting point to introduce and briefly assess the manner in which national treatment is articulated in the two legal regimes. I do so in section 2 with a particular focus on the different historical imperatives at play in the development of the two regimes. I then examine how comparative analysis across these legal settings might be employed to offer sensible and constructive insights. Section 4 then tests this ideal form of comparativism against the actual method employed in the *Occidental* and *Methanex* awards. To contextualize my analysis, I also offer a prologue in section 3 where comparison with WTO law has been used in a better, although not ideal, manner by earlier tribunals (especially *SD Myers* and *Pope & Talbot*). I conclude with an analysis of the implications of the questionable interpretative method identified and canvass suggestions on possible reform models to build consistency in interpretation in this area of international law.

## 2 Comparing National Treatment Across the WTO and International Investment Law

### A *The Law of the WTO: GATT Article III*

National treatment provisions exist in various parts of the WTO including the General Agreement on Tariffs and Trade (GATT) and the General Agreement on

<sup>11</sup> *Occidental Exploration and Production Company v. Ecuador*, Final Award (UNCITRAL, 1 Jul. 2004).

<sup>12</sup> *Methanex Corporation v. USA*, Final Award (UNCITRAL, 3 Aug. 2008).

<sup>13</sup> E.g., C. McLachlan, L. Shore, and M. Weiniger, *International Investment Arbitration: Substantive Principles* (2007), at 251–253 (offering a bare three pages on national treatment in an otherwise comprehensive analysis of investment treaty law).

<sup>14</sup> *Occidental*, *supra* note 11, at para. 176.

<sup>15</sup> *Methanex*, *supra* note 12, at Pt IV, Chp. B, para. 17.

Trade in Services (GATS). GATT Article III for instance obliges WTO members to provide national treatment to imports of foreign goods. That obligation applies to both internal taxation (in GATT Article III(2)) and regulation (GATT Article III(4)). Article III(4) for example states:

The products of the territory of any contracting party imported into the territory of any other contracting party shall be accorded treatment no less favourable than that accorded to like products of national origin in respect of all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use.<sup>16</sup>

Unlike the typical construction in the investment treaty context, the drafters of the GATT provided specific direction as to the purpose of national treatment when applied to trade in goods. GATT Article III(1) states:

The contracting parties recognize that internal taxes and other internal charges, and laws, regulations and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution or use of products, and internal quantitative regulations requiring the mixture, processing or use of products in specified amounts or proportions, should not be applied to imported or domestic products *so as to afford protection to domestic production*<sup>17</sup> [emphasis added].

Article III(1) then tells us very clearly that the purpose of Article III is to prevent protectionism in the use of domestic taxes and regulations. It acts as a fail-safe for the primary project of liberalization of border barriers to trade in goods.<sup>18</sup> In particular, it prevents a state from circumventing its tariff reduction commitments by substituting domestic (tax or regulatory) restrictions which discriminate against foreign goods. The national treatment article then preserves the value of tariff concessions negotiated among the state parties to the GATT. Even where there are no concessions, GATT Article III channels protectionism into tariff mode so that it can be more easily negotiated down.<sup>19</sup> The obligation ultimately ensures that conditions of competition within the state are not modified by government intervention so as to advantage a domestic product over its foreign competitors.

So much is clear. What has proven to be more difficult is isolating the appropriate test for determining whether or not a domestic tax or regulation is in fact protectionist under WTO law. The dense jurisprudence on GATT Article III has traversed, with different emphases, questions of effect and purpose and, on the latter, the appropriate indicia to isolate impermissible (protectionist) purpose.<sup>20</sup> At this early stage, I offer only one comment on the jurisprudence, although I examine key cases later in this article. It is clear that *part* of the reason for the complexity of the jurisprudence

<sup>16</sup> General Agreement on Tariffs and Trade, 30 Oct. 1947, 55 UNTS 194.

<sup>17</sup> *Ibid.*

<sup>18</sup> *Ibid.*, at Arts. I (Most-Favoured-Nation Treatment), II (Scheduling of Tariff Concessions), and XI (Prohibition on Quantitative Restrictions).

<sup>19</sup> Regan, 'Regulatory Purpose and "Like Products" in Article III:4 of the GATT (With Additional Remarks on Article III:2)', 6 *J World Trade* (2002) 443, at 452.

<sup>20</sup> For a useful survey of 5 distinct periods in WTO adjudication on GATT Art. III, see Di Mascio and Pauwelyn, 'Nondiscrimination in Trade and Investment Treaties: Worlds Apart or Two Sides of the Coin?', 102 *AJIL* (2008) 48, at 61–66. See also Horn and Mavroidis, 'Still Hazy After All These Years: The Interpretation of National Treatment in the GATT/WTO Case-Law on Tax Discrimination', 15 *EJIL* (2004) 39.

is the different textual inter-relationship between the articulation of the goal of the norm (in Article III(1)) and the separate obligations to accord national treatment on internal tax measures (through the first and second sentences of Article III(2)<sup>21</sup>) and regulation (in Article III(4)).<sup>22</sup> This complicated textual set-up is reminiscent of Robert Hudec's memorable description of the GATT as 'an old, and often badly drafted, instrument'.<sup>23</sup> Indeed, this structure has proven central in setting the tenor of Article III jurisprudence,<sup>24</sup> given the well-known and strategic emphasis accorded to text in the hermeneutics of WTO (and especially Appellate Body) adjudication.<sup>25</sup>

Balanced against this rather unsatisfactory state of affairs, GATT Article III itself is situated within a structure which reflects a bold, normative vision. John Ruggie has described the normative principle infusing the GATT as one of a sophisticated compromise of 'embedded liberalism'.<sup>26</sup> The liberal component of this bargain comprised the reduction of trade barriers and, by extension, the fail-safe of national treatment. This though was never an endorsement of a pure or *laissez-faire* model of economic liberalism. The drafters of the GATT countenanced a series of targeted departures from these operative commitments. Some of these are designed directly to safeguard domestic stability,<sup>27</sup> while others – most notably GATT Article XX – elevate particular values (including environmental protection) over and above the project of trade liberalization.

## B National Treatment in International Investment Law

When compared to the elaborate structure of GATT Article III, national treatment in most investment treaties has a rather minimalist appearance. Consider its formulation in NAFTA Article 1102(1):

1. Each Party shall accord to investors of another Party treatment no less favorable than that it accords, in like circumstances, to its own investors with respect to the establishment,

<sup>21</sup> GATT, *supra* note 16, Art. III(2) on taxation provides:

'The products of the territory of any contracting party imported into the territory of any other contracting party shall not be subject, directly or indirectly, to internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products. Moreover, no contracting party shall otherwise apply internal taxes or other internal charges to imported or domestic products in a manner contrary to the principles set forth in paragraph 1' (emphasis added, footnote omitted).

<sup>22</sup> There is no direct textual link between the principle articulated in GATT Art. III(1) and GATT Art. III(4).

<sup>23</sup> Hudec, 'GATT/WTO Constraints on National Regulation: Requiem for an "Aims and Effects" Test', 32 *Int'l Lawyer* (1998) 619, at 633.

<sup>24</sup> E.g., *Japan – Taxes on Alcoholic Beverages*, Report of the Appellate Body, WT/DS11/AB/R, 4 Oct. 1996, at 18–30; *European Communities – Measures Affecting Asbestos and Asbestos-Containing Products*, Report of the Appellate Body, WT/DS135/AB/R, 12 Mar. 2001, at paras 96–98.

<sup>25</sup> On the emphasis accorded to text in Appellate Body adjudication as part of a project of building 'adjudicative legitimacy' see Howse, 'Adjudicative Legitimacy and Treaty Interpretation in International Trade Law: The Early Years of WTO Jurisprudence', in J.H.H. Weiler (ed.), *The EU, the WTO and the NAFTA: Towards a Common Law of International Trade* (2000), at 35, 51–56.

<sup>26</sup> Ruggie, 'Embedded Liberalism and Postwar Economic Regimes', in J. Ruggie (ed.), *Multilateralism Matters: The Theory and Praxis of an Institutional Form* (1993), at 62, 72–76.

<sup>27</sup> E.g., GATT, *supra* note 16, at Art. XIX (allowing for safeguard measures).



acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.<sup>28</sup>

The obligation then proscribes ‘less favourable’ treatment of a foreign investor which stands ‘in like circumstances’ with a domestic actor. While there is some superficial similarity with GATT Article III(4), this simple, pared-down structure omits any guide as to the ultimate purpose of a norm of non-discrimination in this treaty setting. This is by no means accidental, but reflects the inception and evolution of the system of investment treaty protection.

The absence of an interpretative guide – along the lines of GATT Article III(1) – tracks the dominant ethos at play in the inception of the system in the immediate post-Second World War era and its replication with minimal iterations in later periods. This was the strategic desire of capital-exporting states to protect their investors against hostile expropriatory behaviour and to counter changes in customary law being advanced by newly independent states emerging from processes of decolonization.<sup>29</sup> The role of relative standards of treatment (like national treatment) was a marginal one in this strategy, given the emphasis on fixing strong, absolute protections, especially on guarantees of full compensation in the event of expropriation.<sup>30</sup> With this in mind, broader notions of balancing treaty commitments with systems of regulatory heterogeneity – as revealed in the story of the GATT – were sacrificed to the immediate and dominant goal of investment protection. This is starkly illustrated not only by the minimalist structure of national treatment guarantees but also by the very absence of exceptions which might operate to allow states to exempt themselves from the strictures of investment treaty protections.<sup>31</sup>

### ***C The Merits and Limits of Comparative Analysis***

With this general background in mind, I offer four observations on an interpretative methodology that seeks guidance from the approach taken in one legal setting when adjudicating in another.

First, any such comparative analysis must be closely attentive to textual differences between national treatment as formulated and applied across these legal systems. This

<sup>28</sup> North American Free Trade Agreement, signed 17 Dec. 1992, Can.–Mex.–US, 32 ILM (1993) 289 and 605.

<sup>29</sup> The narrative of newly independent states advancing claims to changes in customary rules on expropriation through the 1960s (including the critical GA Res 1803) and 1970s is well known. It is important also to recognize that by the mid-1970s, lump sum settlement tribunals had begun to identify some of these resolutions (particularly 1803) as reflecting ‘the state of customary law in the field’. See, e.g., *TOPCO v. Libya*, 17 ILM (1974) 3, at 27–31.

<sup>30</sup> R. Dolzer and C. Schreuer, *Principles of International Investment Law* (2008), at 89–115.

<sup>31</sup> There are few exceptions directed towards general regulatory measures in the typical post-war bilateral investment treaty. At most, these treaties would include an exception for measures taken to advance national security objectives. This position is replicated in the NAFTA. The general exception provisions (*à la* GATT Art. XX) in NAFTA Chapter 21 do not apply to the investment chapter 11 of the NAFTA: NAFTA, *supra* note 27, at Art. 2101(1)(a).

is not confined, as is often suggested, to the simple visible difference between the formulation of ‘like product’ in GATT Article III and variants of ‘like circumstances’ in the investment treaty system. One cannot convincingly claim that the phrase ‘like product’ in GATT Article III has an ordinary, context-independent meaning which necessarily includes the notion of a competitive relationship.<sup>32</sup> This is, however, a persistent assumption among investor–state arbitral panels and usually offered as a simple first-order justification for rejecting competition in the application of the search for ‘like circumstances’ among domestic and foreign investors.<sup>33</sup> In the GATT setting, the requirement of a competitive relationship between foreign and domestic products turns on the context provided for that term by the rest of Article III and the GATT. GATT Article III(1) is especially critical, as it defines the purpose of national treatment as a discipline on protectionism. There is simply no question of protecting a domestic product against a foreign product unless the two are in competition. There is no such direction present in most investment treaties, and this throws up a host of open complex interpretive questions. The most fundamental is how we are to understand the very *telos* of national treatment in the investment treaty setting.<sup>34</sup>

Secondly, any such comparison should be attentive to key contextual differences across the two systems. A critical contextual difference here is the absence of a GATT Article XX in the investment treaty regime. GATT Article XX exempts certain forms of regulatory measures passed for, *inter alia*, environmental or health purposes from the strictures of the GATT, including national treatment. The absence of such an exemption in older investment treaties is not accidental, but instead reflects the unique history and evolution of this field. The very presence of GATT Article XX has influenced the jurisprudence on national treatment in the GATT<sup>35</sup> as well as normative claims of how GATT Article III *should* be read.<sup>36</sup> We do not have the luxury of such an exemption and potential fail-safe to correct for legal error in constructing a reading of national

<sup>32</sup> Regan, ‘Further Thoughts on the Role of Regulatory Purpose Under Article III of the General Agreement on Tariffs and Trade: A Tribute to Bob Hudec’, 37 *J World Trade* (2003) 737, at 750.

<sup>33</sup> E.g., *Methanex*, *supra* note 12, at para. 29 (noting that NAFTA Art. 1102(1)–(3) ‘do[es] not use the term of art in international trade law, “like products”, which appears in and plays a critical role in the application of GATT Article III’); *Occidental*, *supra* note 11, at para. 176.

<sup>34</sup> Kurtz, ‘National Treatment, Foreign Investment and Regulatory Autonomy: The Search for Protectionism or Something More?’, in P. Kahn and T. Wälde (eds), *New Aspects of International Investment Law* (2007), at 311, 349–351.

<sup>35</sup> Cf. *European Communities – Measures Affecting Asbestos and Asbestos-Containing Products*, Report of the Panel, WT/DS135/R, 18 Sept. 2000, at para 8.130 (rejecting the relevance of health risks in examining the physical properties of a product in a GATT Art. III(4) inquiry, as to do so ‘would largely nullify the effect of Article XX(b)’) with *European Communities – Measures Affecting Asbestos and Asbestos-Containing Products*, Report of the Appellate Body, *supra* note 14, at para. 115 (overturning the Panel’s ruling on this point but noting that evidence relating to health risks is relevant in assessing competition between products under GATT Art. III(4) while the same evidence ‘serves a different purpose under Article XX(b)’).

<sup>36</sup> E.g., Trebilcock, ‘International Trade and International Labour Standards: Choosing Objectives, Instruments, and Institutions’, in S. Griller (ed.), *International Economic Governance and Non-Economic Concerns: New Challenges for the International Legal Order* (2003), at 289, 305 (arguing for an ‘economic definition of like products as the Appellate Body did in *Asbestos*’ and remitting justifications to Art. XX).



treatment in the investment treaty setting. The stakes, as it were, are higher in this discipline of international economic law.

My third set of observations falls at the level of systemic difference across the two regimes. Dispute settlement within the WTO, as with much of public international law, is reserved for states. On the other hand, investment treaties confer standing on foreign investors (of a signatory state) against a host (signatory) state. This systemic difference has acute implications for tracking the likely invocation of the legal system but also raises questions of informational asymmetry (which in turn may inform our thinking on issues of burden and standard of proof).

There are various factors which will control the choice of a WTO member to bring a compliance action against another member state. These include the extent of the economic impact of the measure in question and the lobbying efforts of a well-organized export industry. On the other hand, the costs of initiating action may limit access for some (usually poorer) member states, as will more nuanced considerations.<sup>37</sup> The latter engage the very precepts of a state-to-state system of dispute resolution, including an unwillingness to disrupt the broader political relationship between the parties<sup>38</sup> and, crucially, the potential for reciprocity of action by the targeted state. These political and legal dimensions will, albeit imperfectly,<sup>39</sup> act as a filter against improper or incautious invocation of legal rights. There are no such filters within the system of investor–state arbitration. A foreign investor rationally considers only the commercial imperatives in bringing the action and there is no possibility for the state party to retaliate through cross-claim or other invocation of the system.<sup>40</sup> The absence of these control factors is one contributor to the dramatic, explosive growth in invocation of investor–state arbitration in the last decade.

The presence of these extensive legal protections in investor–state arbitration should, however, be balanced against the significant practical hurdles faced by a particular class of litigants. Here again a comparison with WTO dispute settlement is instructive. In a system populated by sovereign states, there is some rough equality in the capacity of a significant component of the membership to participate in dispute resolution, at least as measured by the simple metric of the ability to draw on public funds to finance compliance litigation.<sup>41</sup> That capacity also extends to less visible,

<sup>37</sup> See generally Shaffer, 'The Challenges of WTO Law: Strategies for Developing Country Adaptation', 5 *World Trade Rev* (2006) 177.

<sup>38</sup> This is rarely explicitly raised in the course of inter-state legal proceedings. But see *Case Concerning Elettronica Sicula S.p.A (ELSI)* [1989] ICJ Rep 15, at paras 117 and 122.

<sup>39</sup> Cf. Guzman and Simmons, 'Power Plays and Capacity Constraints: The Selection of Defendants in World Trade Organization Disputes', 35 *J Legal Studies* (2005) 557, at 591 (arguing that capacity limitations are more important than 'the fear of political or economic retribution' on the initiation of WTO dispute settlement).

<sup>40</sup> A small qualification; my analysis here goes to the absence of formal filters on invocation of rights under investment treaties. There are naturally multiple, extra-legal factors which form part of the calculus of an investor in choosing to elevate a dispute into the international sphere.

<sup>41</sup> I do not deny the serious and documented difficulties faced by the smaller member states in accessing the dispute settlement processes of the WTO. My point is merely that, assuming the presence of a functioning tax collection system, a sovereign state can elect to draw on public funds to finance compliance litigation.

technical advantages enjoyed by a grouping of sovereign states – through judicious use of expertise within government bureaucracy – in their ability to access, collate, and process the complex factual information required as a condition of initiating litigation. Certain WTO treaties even require member states to transfer information on particular measures to potential complainants.<sup>42</sup> This is not to say that these factors mean that WTO members stand in the position of complete informational equality.<sup>43</sup> On the other hand, it is reasonable to suggest that there is a far higher likelihood of informational asymmetry in investor–state arbitration.

Not all foreign investors fall into the category of large, multi-national economic actors. Some foreign actors will be relatively small (whose foreign investment is the first and sole excursion outside the home state)<sup>44</sup> and other investors may simply be individuals operating abroad.<sup>45</sup> These smaller foreign actors will, due to the particular political economy surrounding foreign investment restrictions,<sup>46</sup> be those at the highest risk of discriminatory conduct or other forms of rent seeking. Yet, it is precisely this class of investor which faces the greatest disadvantage in its ability to fund proceedings and collate the factual evidence necessary to bring a claim. On the latter point, parts of the factual record – say on alternatives that a state may have considered to a chosen measure – may even be subject to forms of privilege and cabinet confidence, and thus exist *solely* within the province of a respondent state.<sup>47</sup> These various and often deep forms of informational asymmetry should inform our thinking on how properly and fairly to allocate both the burden of proof (the responsibility to adduce evidence before an adjudicator) and the requisite standard of proof (the type and quantum of evidence necessary to persuade an adjudicator) on particular substantive questions, including national treatment.<sup>48</sup>

A final, critical systemic difference goes to the issue of remedies. Remedies in the WTO legal system are prospective. A losing state must, as a first step, withdraw or modify an offending measure within a ‘reasonable period of time’.<sup>49</sup> It is only after a state fails to do so that unilateral countermeasures are available under this system.<sup>50</sup> On the one hand, this sequenced approach can allow for free riding by offenders, given the time it takes for a dispute to wind its way through the system. On the other hand, it

<sup>42</sup> Agreement on Technical Barriers to Trade, Legal Texts of the WTO (1994), at Arts. 2.5 and 10; *European Communities – Trade Description of Sardines*, Report of the Appellate Body, WT/DS231/AB/R, 26 Sept. 2002, at paras 277–279.

<sup>43</sup> E.g., Horn and Weiler, ‘European Communities – Trade Description of Sardines: Textualism and its Discontent’, in H. Horn and P. Mavroidis, *The WTO Case Law of 2002* (2005), at 248, 264–265 (analysing the efficacy of the information exchange mechanisms in the TBT Agreement).

<sup>44</sup> E.g., *SD Myers Inc.*, *supra* note 4.

<sup>45</sup> E.g., *Marvin Feldman v. Mexico*, Award (ICSID, 16 Dec. 2002).

<sup>46</sup> See sources cited *supra* in note 8.

<sup>47</sup> E.g., *United Postal Service of America v. Canada*, Decision of Tribunal Relating to Canada’s Claim of Cabinet Privilege (ICSID, 8 Oct. 2004).

<sup>48</sup> On the distinction between burden and standard of proof see *Case Concerning Oil Platforms (Iran v. USA)* [2003] ICJ Rep. 68, at paras 30–39 (Separate Opinion of Judge Higgins).

<sup>49</sup> Understanding on Rules and Procedures Governing the Settlement of Disputes, Legal Texts of the WTO (1994), Arts. 19–1.

<sup>50</sup> *Ibid.*, Art. 22.

enables risk-averse governments to experiment with options which push the boundaries of WTO law as they know that, if there is violation, their sole responsibility is to remove the measure. In contrast, remedies in investor–state arbitration take the form of damages and are retrospective. This can significantly curtail experimental regulatory space (especially for developing states) and, as such, may even have a chilling effect on regulation.<sup>51</sup>

### 3 Prologue: Early Jurisprudence

The 2000 arbitral award in *SD Myers v. Canada* is the first substantive analysis by an investor–state arbitral tribunal of the national treatment obligation. This was followed roughly by a case per year so that we now have a formidable total of 10 dedicated cases: *Pope & Talbot v. Canada* (2001), *Feldman v. Mexico* (2002); *ADF v. USA* (2003); *Occidental v. Ecuador* (2004); *GAMI v. Mexico* (2004); *Methanex v. U.S* (2005); *UPS v. Canada* (2007); *Archer Daniels v. Mexico* (2007); *Corn Products International, Inc. v. Mexico* (2008).

My principal interest lies in the opposition to a competition-based reading of national treatment articulated in both *Occidental* and *Methanex*. At first blush, the idea that competition could have no role to play in a likeness analysis seems rather implausible, given that this is a treaty device to facilitate capital flows. After all, foreign investors normally establish operations in a host state in order to supply goods or services to a market in the host state or as a means of acquiring lower cost inputs into production processes.<sup>52</sup> In doing so, they are usually operating in some form of competition with domestic actors (where they exist) or, indeed, other foreign interests. One might imagine then a sensible role for national treatment as a check on discrimination driven by domestic producers lobbying for protection against competing foreign actors in the host state.<sup>53</sup>

My overarching concern though is not strictly on the substantive correctness of the reasoning adopted by these tribunals, however illogical it may appear.<sup>54</sup> For the purposes of this article, I am largely agnostic on the various contours of the complicated jurisprudence which attaches to national treatment. My focus is on the interpretive method which both the *Occidental* and *Methanex* Tribunals employ to justify their opposition to competition in a national treatment inquiry. To fully contextualize

<sup>51</sup> Sykes, 'Public versus Private Enforcement of International Economic Law: Standing and Remedy', 34 *J Legal Studies* (2005) 631, at 660.

<sup>52</sup> For a recent analysis of the factors that drive foreign investment see Lothian and Pistor, 'Local Institutions, Foreign Investment and Alternative Strategies of Development', 42 *Columbia J Transnat'l L* (2003) 101, at 106.

<sup>53</sup> For a recent endorsement of national treatment along these lines see *Corn Products International, Inc. v. Mexico*, Decision on Responsibility (ICSID, 15 Jan. 2008), at para. 135.

<sup>54</sup> Cf. *United Postal Service of America Inc v. Canada*, Award on the Merits (ICSID, 24 May 2007) – Separate Statement of Arbitrator Cass, at para. 17 ('The most natural reading of NAFTA Article 1102... gives substantial weight to a showing of competition between a complaining investor and an investor of the respondent Party').

my analysis and to draw out the dramatic *volte-face* implicated in these cases as well as their questionable interpretative methods, something must first be said of earlier doctrinal developments.

### A *SD Myers v. Canada*

Let us take as our starting point the arbitral award in *SD Myers v. Canada*. This case has a curious set of facts, an unfortunate feature of many of the early NAFTA Chapter 11 awards. It concerned Canada's imposition of a temporary export ban on a particular type of hazardous waste. A US company had established minimal operations in Canada in order to market its services and to formalize contracts for waste remediation services. The substantive processing of waste would occur only once the waste was shipped across the border to its remediation facilities in the US.<sup>55</sup> The US investor claimed that the Canadian export ban constituted a form of discrimination, contrary to the obligation to accord national treatment in NAFTA Article 1102.

While a detailed exegesis of the various elements of the Tribunal's ruling is beyond the intended scope of this article, it is worth mentioning the thrust of the award in passing. It is, in some respects, a remarkable judgment, given the willingness of the adjudicators in this inaugural moment to position national treatment as a discipline on purposeful protectionism. In the WTO context, the move to affirm protectionist purpose as a condition of breach (even with the guidance of GATT Article III(1)) has proceeded in slow and distinct stages and, on occasion, with setbacks.<sup>56</sup> For the *Myers* Tribunal, 'likeness' is first and foremost an inquiry into the competitive relationship between domestic and foreign investors.<sup>57</sup> Differential treatment alone though would not suffice to justify breach; some form of protectionist intent would also be required.<sup>58</sup>

What is especially critical for our analysis is the interpretive methodology employed in this ruling. The *Myers* Tribunal dips briefly into GATT Article III jurisprudence<sup>59</sup> but then examines, as we suggested earlier, a notable contextual difference between the two regimes, being the absence of a GATT Article XX in the NAFTA Chapter 11.<sup>60</sup> Indeed, this seems to be *the* controlling factor shaping its choice to ground a reading of national treatment as a discipline on purposeful protectionism.<sup>61</sup> The Tribunal turns to a targeted external guide – the OECD National Treatment Instrument – only to buttress its affirmation of both competition and purpose as elements of the obligation.<sup>62</sup> We have then a sophisticated juridical approach – which marries adverse competitive

<sup>55</sup> *SD Myers*, *supra* note 4, at para. 93.

<sup>56</sup> Di Mascio and Pauwelyn, *supra* note 20, at 61–66.

<sup>57</sup> *SD Myers*, *supra* note 4, at paras 250–251.

<sup>58</sup> *Ibid.*, at paras 252–254.

<sup>59</sup> *Ibid.*, at para. 244.

<sup>60</sup> *Ibid.*, at para. 246.

<sup>61</sup> *Ibid.*, at para. 250 (ruling that 'the assessment of "like circumstances" must also take into account circumstances that would justify governmental regulations that treat [domestic and foreign investors] differently in order to protect the public interest').

<sup>62</sup> *Ibid.*, at para. 248.

impact with an assessment of impermissible regulatory purpose – explicitly adopted in light of the absence in NAFTA Chapter 11 of a fail-safe exception for regulatory autonomy. Then again, it may be that we should temper enthusiasm for this early ruling. *Myers* might stand – at least on the sensitive question of operationalizing an inquiry into governmental purpose – as the classic easy case. There was abundant evidence on the record of protectionist statements by the incumbent government (which, in turn, would be highly probative of a finding of intentional discrimination). Notably, these were not of a simple individual legislator but of the very Minister administering the legal scheme in question.<sup>63</sup>

## **B *Pope & Talbot v. Canada***

The next NAFTA arbitral award to consider national treatment – *Pope & Talbot v. Canada* in 2001 – engages in a roughly similar interpretive methodology. This case concerned the allocation of quotas for softwood lumber exports from ‘covered’ provinces in Canada to the US, as part of a negotiated agreement to settle a trade dispute between those countries. A US investor in British Columbia (a ‘covered’ province) engaged in softwood lumber production challenged the manner in which Canada had implemented its quotas. It claimed breach of national treatment on a variety of bases including: (i) that domestic producers in the non-covered provinces were treated more favourably than the foreign investor because those producers faced no quota whatsoever, and (ii) even domestic producers in covered provinces were treated more favourably than the foreign investor as they received a greater quota share.<sup>64</sup>

Canada’s defence is especially interesting, given its attempt to draw on WTO jurisprudence. It argued that, while the foreign investor may have been awarded less of a quota share than some domestic competitors, there was no overall discrimination because the measure did not disproportionately disadvantage foreign actors as a group.<sup>65</sup> Canada’s argument here goes to the trigger requirement of finding ‘less favourable treatment’ in a national treatment test. On a strict (sometimes termed diagonal<sup>66</sup>) approach, all that may be necessary is to show that there is at least one domestic actor which is receiving more favourable treatment than the foreign claimant. Canada’s approach would instead require a comparison of the impact of the measure between two broad groups – foreign investors and their domestic competitors – to assess whether the adverse impact falls disproportionately on foreign economic actors as a whole.

As in *SD Myers*, the *Pope & Talbot* Tribunal strongly endorses competition as a necessary condition of likeness in a national treatment inquiry.<sup>67</sup> It also appears ultimately

<sup>63</sup> *Ibid.*, at para. 116.

<sup>64</sup> *Pope & Talbot*, *supra* note 4, at paras 83–104.

<sup>65</sup> *Ibid.*, at paras 43–44.

<sup>66</sup> E.g., Ehring, ‘De Facto Discrimination in WTO Law: National Treatment and Most-Favoured-Nation Treatment – or Equal Treatment?’, 36 *J World Trade* (2002) 921.

<sup>67</sup> *Pope & Talbot*, *supra* note 4, at para. 78.

to require some evidence of protectionist purpose as a condition of breach.<sup>68</sup> The bulk of the award though is devoted to Canada's claim to a disproportionate disadvantage reading of the test for 'less favourable treatment'. It is on this question that the Tribunal engages in an extensive walk-through of WTO jurisprudence. Recall that Canada had justified its reading of 'less favourable treatment' as grounded in WTO law.<sup>69</sup> The Tribunal elected to conduct its own review of particular WTO cases as a means of rebutting Canada's claim that the disproportionate disadvantage test found authority and reflection in WTO law.<sup>70</sup> On the whole, the Tribunal here is correct in its assessment of the state of WTO jurisprudence, *at least as pleaded at the time of adjudication*. The latest in the line of WTO cases pleaded by Canada and assessed by the Tribunal is that of the WTO Panel in *EC – Asbestos*.<sup>71</sup> It is only by the time of the Appellate Body's ruling in *EC – Asbestos* – handed down a bare month before the award in *Pope & Talbot* – that we can discern a clear statement in WTO law of the sort of 'disproportionate disadvantage' test advocated by Canada.<sup>72</sup> Even here though, it is important to note that the Tribunal does not simply reject Canada's claim because of its absence in WTO law at that time. It also evaluates and discards that claim based on a careful assessment of the specific features of the litigants and the system of investment treaty arbitration. It identifies, as we touched upon earlier, the practical burdens that would be faced by a private litigant (here the investor) in amassing the type of evidence necessary to support a claim of disproportionate disadvantage.<sup>73</sup> My interest here is not strictly on evaluating the Tribunal's ruling on this point, although I tend to have some sympathy for it. I would only point out that the Tribunal's ultimate reading is based not only on an assessment of the

<sup>68</sup> *Ibid.*, at para. 79 (ruling that difference in treatment must 'be justified by showing it bears a reasonable relationship to rational policies not motivated by preference of domestic over foreign owned investments').

<sup>69</sup> *Ibid.*, at para. 45.

<sup>70</sup> *Ibid.*, at paras 46–63.

<sup>71</sup> *Ibid.*, at paras 58–60.

<sup>72</sup> In *Asbestos*, the Appellate Body offered the following interpretation of the requirement of 'less favourable treatment':

'The term "less favourable treatment" expresses the general principle in Article III(1), that internal regulations "should not be applied...so as to afford protection to domestic production". If there is "less favourable treatment" of the group of "like" imported products, there is, conversely, "protection" of the group of "like" domestic products. However, a Member may draw distinctions between products which have been found to be "like", without, for this reason alone, according to the group of "like" imported products "less favourable treatment" than that accorded to the group of "like" imported products.'

*European Communities – Measures Affecting Asbestos and Asbestos-Containing Products*, Report of the Appellate Body, *supra* note 24, at para. 100.

<sup>73</sup> The Tribunal ruled:

'Canada's disproportionate disadvantage test would require the Investor to ascertain whether there are any other American owned lumber producing companies among the more than 500 softwood lumber quota holders operating in Canada. If so, the treatment accorded those companies as a whole would have to be measured and then weighted against the predominant treatment, whatever that might mean, accorded to Canadian companies operating in like circumstances ... Simply to state this approach is to show how unwieldy it would be and how it would hamstring foreign owned investments seeking to vindicate their Article 1102 rights. Only in the simplest and most obvious cases of denial of national treatment could the complainant hope to make a case for recovery.'

*Pope & Talbot*, *supra* note 4, at paras 71–72.



merits or otherwise of WTO law, but also on its own separate and careful consideration of the unique institutional features of investor–state dispute settlement.

To sum up, national treatment is firmly situated within the early arbitral jurisprudence as a limitation on some form of competitive disruption. Where the early tribunals engage in comparison with WTO law, this is done reasonably well with an understanding of the limits of comparative analysis and the need to ensure attention to the specific features of the treaty regime in question. The next two cases on national treatment – *Feldman v. Mexico* in 2002 and *ADF v. USA* in 2003 – follow this early direction and also broadly affirm competition as a condition of likeness. We have then a sequence of cases grounded in a careful and prudent interpretive method. Let us now compare this method with the approach adopted in the next two cases in the system which oppose competition, and do so by relying on questionable comparisons with WTO law.

#### 4 Opposing Competition as a Condition of Likeness: Ruling in the Shadow of WTO Law

*Occidental v. Ecuador* is the first arbitral case clearly to reject a role for competitive interaction in a national treatment inquiry. Occidental, a US company, entered into a contract with Petroecuador to explore and produce oil in Ecuador.<sup>74</sup> Until 2001, Occidental had received refunds for value-added tax (VAT) paid on purchases required to perform its services under the contract.<sup>75</sup> Under Ecuadorian tax law, exporters were entitled to VAT refunds on the purchase of goods as part of their export activities.<sup>76</sup> In 2001, the Ecuadorian tax authority denied Occidental further VAT refunds as its new contract with Petroecuador provided for a remuneration formula expressed as a percentage of oil production.<sup>77</sup> The Ecuadorian tax authority ruled that VAT refunds had already been accounted for as part of the new remuneration formula.<sup>78</sup> Petroecuador – the primary exporter of oil under the contract – was also denied VAT refunds.<sup>79</sup> The Tribunal made no direct reference to the presence or tax treatment of other operators in the oil sector.

Occidental brought an action for breach of national treatment under the US–Ecuador BIT. It claimed that it was afforded less favourable treatment as VAT refunds were paid to domestic companies involved in the export of non-oil-related goods such as flowers and seafood products.<sup>80</sup> Occidental’s claim was thus an invitation to the arbitral tribunal to treat the national treatment obligation as a discipline on discrimination divorced from competition interactions between foreign and domestic actors. In contrast, Ecuador sought a delineation of the national treatment obligation in line with the jurisprudential sequence which we have explored. It argued that the ‘in

<sup>74</sup> *Occidental*, *supra* note 11, at para. 1.

<sup>75</sup> *Ibid.*, at paras 1–3.

<sup>76</sup> *Ibid.*, at para. 133.

<sup>77</sup> *Ibid.*, at paras 26–30.

<sup>78</sup> *Ibid.*, at para. 3.

<sup>79</sup> *Ibid.*, at para. 172.

<sup>80</sup> *Ibid.*, at para. 168.

like situations' qualifier in the treaty obligation limits the operation of the clause to companies competing in the same economic sector.<sup>81</sup> Ecuador in turn denied breach, given that Petroecuador – as Occidental's competitor in the export of oil – had also been denied VAT refunds.<sup>82</sup>

The Tribunal sided with Occidental and refused to limit the operation of the national treatment clause to protectionist regulation.<sup>83</sup> A strange analysis of the teleology of this clause formed the initial foundation for this expansive interpretation:

In fact, 'in like situations' cannot be interpreted in the narrow sense advanced by Ecuador as the *purpose of national treatment is to protect investors* as compared to local producers, and this cannot be done by addressing exclusively the sector in which the particular activity is undertaken [emphasis added].<sup>84</sup>

There is no doubt that, like all other investment treaty norms, national treatment operates in some broad sense to 'protect' foreign investors. But this claim tells us little about what particular risks of operation faced by foreign actors are to be countered by individual treaty standards. In order to ensure coherence and effective operation, the different treaty standards should be matched to particular risks faced by foreign investors.<sup>85</sup> A general claim of 'protection' offers no real guidance on why competition is or is not a relevant factor in a national treatment inquiry.

Perhaps recognizing this weak normative foundation, the *Occidental* Tribunal next turns to WTO law to buttress its claim. Here we are faced with a selective and misleading account of national treatment jurisprudence in the GATT-WTO. The Tribunal begins by claiming that the term 'like products' in the law of the WTO 'has to be interpreted narrowly and that like products are related to the concept of directly competitive or substitutable products'.<sup>86</sup> The suggestion appears to be that, as a particular formulation of likeness in the GATT-WTO has been interpreted narrowly to include a limited sub-set of factors, this makes its application problematic in the investment treaty setting.<sup>87</sup>

The *Occidental* Tribunal may have had in mind the decision of the WTO Appellate Body in *Japan – Alcohol* which did rule that the term 'like product' is to be construed narrowly where it appears in GATT Article III(2) (first sentence).<sup>88</sup> However, the Appellate Body's finding there is driven by the complex relationship between GATT

<sup>81</sup> *Ibid.*, at para. 171.

<sup>82</sup> *Ibid.*, at para. 172.

<sup>83</sup> *Ibid.*, at para. 173.

<sup>84</sup> *Ibid.*

<sup>85</sup> My claim here is not dissimilar to that put forward by Petros Mavroidis concerning WTO jurisprudence: 'In the majority of [WTO] cases ... the adjudicating bodies have refused to consider that the meaning of treaty terms may differ with the context. Indeed, it is the context that defines the meaning of the terms used, and WTO adjudicating bodies should first ask the question "Why has a particular instrument become a WTO commitment?" before asking what the particular details of that commitment are.' Mavroidis, 'No Outsourcing of Law? WTO Law as Practiced by WTO Courts', 102 *AJIL* (2008) 421, at 470.

<sup>86</sup> *Occidental*, *supra* note 11, at para. 174.

<sup>87</sup> See also *ibid.*, at paras 175–176.

<sup>88</sup> *Japan – Taxes on Alcoholic Beverages*, Report of the Appellate Body, WT/DS11/AB/R, 4 Oct. 1996, at 19–20.

Article III(2)'s first and second sentences. The presence of a comparator in Article III(2)'s second sentence ('directly competitive or substitutable products') required, as a means of ensuring the efficacy of both parts of Article III(2), that the comparator in Article III(2)'s first sentence ('like product') be interpreted narrowly.<sup>89</sup> Yet, as we saw earlier, there is no such complex textual make-up in national treatment as is commonly found in most investment treaties and, by extension, no obligation to be controlled by this jurisprudential approach. The *Occidental* Tribunal is thus offering inutile and misleading comparison with selective parts of WTO law.

There are striking similarities in the problematic method adopted by the *Occidental* Tribunal and in the later award of *Methanex v. US*. Like *Occidental*, the *Methanex* Tribunal also opposes a role for competition in a likeness inquiry, and does so based on a misreading of national treatment in the GATT-WTO. There is, though, a critical difference between these close cousins. The strategic concern of the *Methanex* Tribunal is the reverse of that in *Occidental*; competition (and its reflection in WTO law) is now regarded as unduly broadening the scope of operation of the national treatment obligation.

*Methanex* involved a phased Californian ban on the use of methyl tertiary butyl ether (MTBE), an octane enhancer in unleaded gasoline. The use of oxygenates in refined petroleum was designed to reduce gasoline-related air pollution.<sup>90</sup> *Methanex*, a Canadian-based corporation, was a major producer of methanol, a key component of MTBE.<sup>91</sup> California had banned the use of MTBE on the basis that the additive was contaminating drinking water supplies due to leaking underground storage tanks, and therefore posed a significant risk to human health. While MTBE was to be banned, other oxygenates – particularly ethanol – could continue to be used in the Californian market.

*Methanex* claimed that the Californian ban was discriminatory, in breach of the NAFTA national treatment guarantee. Relying on pre-*Occidental* jurisprudence, *Methanex* argued that a competitive relationship between foreign and domestic investors (and their investments) is a necessary condition of their standing 'in like circumstances'.<sup>92</sup> According to the claimant, methanol (the disfavoured product produced by the foreign investor) competed directly with ethanol (a favoured product under the new regulatory regime) as oxygenates in the production of reformulated gasoline. As a result, *Methanex* and other methanol producers would stand 'in like circumstances' with US ethanol producers as they both competed for customers in the oxygenate market. In defence, the US argued that the function of national treatment is to address simple, nationality-based discrimination based purely on the nationality of ownership of investment. Instead of applying a competition-based test, the US suggested that comparison should be made with a domestic actor 'that is like [the foreign investment] in all respects, but for nationality of ownership'.<sup>93</sup>

<sup>89</sup> *Ibid.*

<sup>90</sup> *Methanex*, *supra* note 12, at Pt II, Chp. D, paras 14–19.

<sup>91</sup> *Ibid.*, at para. 3.

<sup>92</sup> *Ibid.*, at Pt IV, Chp. B, paras 4–6.

<sup>93</sup> *Ibid.*, at para. 14.

The Tribunal applied a test closer to the US's preferred approach and, like *Occidental*, moved away from the jurisprudential beginnings in *Myers* and *Pope & Talbot*. It ruled that it would be 'perverse' to ignore 'identical comparators' where they exist,<sup>94</sup> given the task of disciplining nationality-based discrimination. The Tribunal then accepted the domestic methanol industry as the identical comparator to the claimant. As the Californian ban had the same effect on these domestic actors as the foreign methanol producer (Methanex), the Tribunal ruled that there was no breach of the national treatment obligation.<sup>95</sup>

The *Methanex* approach is an exceedingly narrow reading which, contrary to the Tribunal's expectation, will fail fully to capture typical embodiments of nationality-based discrimination. Consider a schematized and hypothetical version of the facts of *Methanex*. Let us assume that almost all methanol produced in a state is made in foreign-owned plants. There may be some domestic production but it is a comparatively small segment. On the other hand, there is extensive domestic ethanol production which competes with methanol as measured by the purchasing preferences of a range of consumers. Finally, both products raise the same environmental and health concerns, but the state has chosen to regulate only methanol while leaving ethanol unregulated.<sup>96</sup> On the *Methanex* test, there will be no breach of national treatment merely because 'identical' comparators (domestic and foreign methanol producers) have been treated in precisely the same fashion. Yet, this may be an archetypal case of protectionism. The failure to regulate the sizable domestic industry involved in ethanol production could reflect the political influence of domestic industry (and, by extension, the marginal influence of foreign actors in the host state), especially given that both products raise the same public policy concerns. In contrast, a test which saw a fuller conception of competition and adverse competitive effects as a necessary but not sufficient condition of breach could, as a starting point, be used to ferret out these hidden forms of discrimination. Properly formulated, such an approach would force the regulating state to present a convincing explanation of its choice to treat competing domestic and foreign actors differently.

The Tribunal justifies its narrow ruling with two comparisons of national treatment as applied in the law of the WTO. First, it relies on a series of simple textual differentiations. For example, it notes that the provisions of NAFTA Article 1102 'do not use the term of art in international trade law, "like products", which appears in and plays a critical role in the application of GATT Article III'.<sup>97</sup> The absence of this sort of language in NAFTA Chapter 11 is in turn taken as evidence that the NAFTA framers intended to create 'distinct regimes for trade and investment'<sup>98</sup> (with competition presumably cabined in the former). This initial justification can be easily discounted.

<sup>94</sup> *Ibid.*, at para. 17.

<sup>95</sup> *Ibid.*, at paras 18–19.

<sup>96</sup> The reader familiar with this case will of course appreciate that this is the critical difference between our hypothetical and the actual fact-set in *Methanex*.

<sup>97</sup> *Methanex*, *supra* note 12, at para. 29.

<sup>98</sup> *Ibid.*, at para. 35.

That foreign and domestic products must stand in a competitive relationship in the GATT context does not, as the Tribunal assumes, automatically flow from the use of the term ‘like products’. It is, as we have seen, justified by the overall context of the use of that term, including the rest of Article III and especially Article III(1).

There is though a more substantive justification offered in the *Methanex* ruling. As with *Occidental*, this Tribunal appears concerned with the manner in which competition has been interpreted in WTO jurisprudence on GATT Article III. The concern is now reversed; that approach was said to embody ‘rather precise criteria [allowing] the importing or receiving state *relatively little discretionary scope* with respect to the goods entitled to national treatment’.<sup>99</sup> The perception here may be that competition and adverse effects are sufficient conditions for breach of GATT Article III, which would indeed significantly curtail regulatory discretion. On occasion, particular scholars have presented this strict reading as a normative claim on how GATT Article III should be read (yet notably relying on the fail-safe of the exceptions in Article XX).<sup>100</sup> It is not, however, a reading reflected in recent WTO jurisprudence which has increasingly affirmed the role of protectionist purpose as a critical requirement of breach. The WTO Appellate Body has consistently examined both the effect and purpose of a tax or regulatory measure because, according to Article III(1), breach exists only if the measure is applied ‘so as to afford protection to domestic production’. For instance, in *Chile – Alcohol*, the Appellate Body ruled on GATT Article III(2) (second sentence) that ‘a measure’s purposes objectively manifested in the design, architecture and structure of the measure, *are* intensely pertinent to the task of evaluating whether or not that measure is applied to so as to afford protection to domestic production’.<sup>101</sup> This is not to say that WTO jurisprudence has proceeded uniformly in this direction. It is, for example, difficult simply to account for the Appellate Body’s ruling on GATT Article III(4) in *EC – Asbestos* on these terms.<sup>102</sup> Then again, WTO adjudication here is hampered by the complex inter-relationship between the various sub-paragraphs of GATT and a strategic desire to achieve consistency in jurisprudence across these legal norms.<sup>103</sup>

The *Methanex* Tribunal seems to have recognized the weak normative foundation (based on simple and inutle comparison with WTO jurisprudence) for its asserted ‘identical comparator’ test. This may account for its attempt to buttress its ultimate conclusion by concluding that methanol and ethanol do not, in any event, compete

<sup>99</sup> *Ibid.*, at para. 30 (emphasis added).

<sup>100</sup> E.g., Trebilcock, *supra* note 36.

<sup>101</sup> *Chile – Taxes on Alcoholic Beverages*, Report of the Appellate Body, WT/DS110/AB/R, 13 Dec. 1999, at para. 71 (emphasis added).

<sup>102</sup> E.g., Horn and Weiler, ‘EC-Asbestos: European Communities – Measures Affecting Asbestos and Asbestos Containing Products’, in H. Horn and P. Mavroidis (eds), *The WTO Case Law of 2001* (2003), at 14, 34–37 (examining 3 possible methodologies employed by the Appellate Body in *Asbestos*, including methodology II (the ‘Effect and Purpose’ approach)).

<sup>103</sup> Howse and Tuerk, ‘The WTO Impact on Internal Regulations – A Case Study of the Canada-EC Asbestos Dispute’, in G. De Burca and J. Scott (eds), *The EU and the WTO: Legal and Constitutional Issues* (2001), at 283, 304–305 (presenting the Appellate Body’s ruling on ‘like products’ in Art. III(4) as navigating between two constituencies and offering continuity with jurisprudence on Art. III(2)).

for market share. In other words, the Tribunal tries to show that – even on the investor’s preferred competition-based approach – the claim would fail. Yet, the Tribunal uses a very narrow test of competition, being an examination of whether the products produced by the foreign and domestic actors have the same function.<sup>104</sup> On this narrow test (misleadingly characterized as one which solely represents a ‘trade law criterion’), there is little objective evidence that methanol and ethanol compete in terms of their initial function; ethanol can be used directly as an oxygenate by gasoline blenders while methanol acts only as a feedstock into the ultimate oxygenate, MTBE.<sup>105</sup> The notion of initial function alone though is a poor and artificial indicator of the presence of a competitive relationship between foreign and domestic producers. For one thing, if the vast majority of methanol is *only* used as an input into MTBE, then the end-uses of methanol and ethanol are arguably the same.

A broader but more accurate indicator of competition is the extent to which consumers treat products as substitutable, as well as the extent to which they are functionally interchangeable as end products. We have already seen that a significant proportion of consumers – gasoline blenders who blend oxygenates with raw materials – did not regard the two products as substitutable. These were, however, not the only consumers of the two products. Integrated oil refiners like Chevron would purchase methanol and use by-products of their gasoline production process to convert methanol to MTBE which would then be blended with their own gasoline and sold on to consumers in branded gasoline pumps.<sup>106</sup> In the aftermath of the Californian ban, these refiners began to use ethanol as a means of producing reformulated gasoline. There was thus an arguable case as to competitive interactions between methanol and ethanol in the purchasing decisions of one particular class of consumer, integrated oil refiners.

This need not conclude an adjudicator’s inquiry even on a test which requires competition as a necessary condition of likeness. There is still the question of the requisite *degree* of competition between the relevant producers. It is not the case that *any* degree of competition need suffice as a means of finding that domestic and foreign producers are, at least initially, alike.<sup>107</sup> A test based on competition could sensibly require the foreign investor to present evidence that its output is in an appreciable (i.e., not a *de minimis*) competitive relationship with the output of a domestic producer. In other words, the Tribunal could have come to the same conclusion – denying the investor’s

<sup>104</sup> *Methanex*, *supra* note 12, Pt IV, Chp. B, at para. 28.

<sup>105</sup> *Ibid.*

<sup>106</sup> *Ibid.*, at para. 6 ([‘Methanex’s] central case is that integrated oil refineries buy either methanol or ethanol, i.e., prior to the California ban of MTBE, Methanex sold methanol to integrated oil refiners in California for the purposes of manufacturing MTBE, whereas since the ban those refineries have shifted to using ethanol’). See also Transcript of Merits of Hearing Day One, *Methanex v. USA*, 7 June 2004, at 21–22 (on file with author).

<sup>107</sup> Somewhat ironically, the *Methanex* Tribunal could have drawn upon pertinent guidance in WTO jurisprudence on this point; e.g., *Asbestos*, *supra* note 72, at para. 99 (where the Appellate Body rules that ‘[T] here is a spectrum of degrees of “competitiveness” or “substitutability” of products in the marketplace, and that it is difficult, if not impossible, in the abstract, to indicate precisely where on this spectrum the word “like” in Article III:4 of the GATT 1994 falls. We are not saying that *all* products which are in *some* competitive relationship are “like products” under Article III:4.’).



claim – even at the starting point of a competition-based test, and would have done so in a far more convincing fashion. That aside, the Tribunal’s concern about the breadth of a competition-based approach has perhaps more to do with a textual absence in the NAFTA (of a binding health and environmental exception as in the form of GATT Article XX(b) or (g)) than its simple reflection in GATT Article III jurisprudence.

This is a legitimate, overarching concern which goes to the delineation between treaty disciplines and regulatory freedom, but the question is how best to respond to it. We saw that the strategic approach in the earlier stages of investment treaty jurisprudence was to require a state to adduce a legitimate, non-protectionist reason for its differentiation between foreign and domestic competitors. In contrast, the *Methanex* Tribunal has elected to constrain the scope of the obligation on the first-order question of likeness without ever really offering the opportunity for the state in question to present its compelling and objective reasons – here justified by extensive scientific inquiry and an open, participatory regulatory process<sup>108</sup> – for electing to ban the use of MTBE. The difference between these two approaches is critical for future cases. The artificial and formalist *Methanex* test of searching for domestic and foreign actors that are ‘identical’ runs the very real risk of excluding swathes of discriminatory conduct from the scope of national treatment protection.

## 5 Conclusion

The steadily growing caseload of investor–state arbitration has begun to raise questions of the sufficiency and rigour of the interpretive methods adopted by these tribunals. We have examined two broad categories in the nascent national treatment jurisprudence. The first – *SD Myers, Pope & Talbot* and others – endorses competition as a condition of likeness but in an overall inquiry devoted to isolating purposeful protectionism. The second – *Occidental* and *Methanex* – strongly opposes competitive interactions before constructing individual juridical tests. These categories are distinguished by more than a simple difference in outcome; they engage vastly differing interpretive methodologies. On the whole, the early case law pays careful attention to the dictates of treaty interpretation and, when delving into comparison with WTO law, does this with some accuracy and a keen eye to the inherent limits of a comparative methodology. In stark contrast, both *Occidental* and *Methanex* bluntly justify their entire readings on national treatment based on simple and, at times, mistaken comparison with WTO law.

Some may question whether these differences in reasoning really matter, at least in the long term. After all, there is no formal rule of *stare decisis* in investor–state arbitration. Arbitral tribunals are free to choose from a range of competing juridical approaches, and may naturally discount those that are less compelling. *Occidental* and *Methanex* then may simply represent early growing pains, soon to be forgotten as the system evolves and develops over time. This optimistic prediction ignores the

<sup>108</sup> *Methanex*, *supra* note 12, at Pt III, Chp. A.

*de facto* influence of even poorly reasoned awards in controlling future jurisprudence. A cursory review of later cases shows that we are now in a state of serious jurisprudential uncertainty about the application of the national treatment norm. *Occidental* and *Methanex* are no longer outliers, and later tribunals seem not to have understood or appreciated the methodological flaws implicated in those awards.<sup>109</sup> If anything, *Occidental* and *Methanex* have thrown open the gates to equally problematic and impressionistic methods of interpreting the national treatment obligation. In the later award of *United Postal Service of America Inc v. Canada*, the Tribunal – in a thoroughly mystifying move – looks to conventions dealing with letter postage as the sole basis for finding that Canada Post (a state-owned entity providing both postal and courier mail services) did not stand ‘in like circumstances’ to UPS (a foreign-owned entity in Canada providing only courier services).<sup>110</sup> *United Postal Service* is another case which deserves significant and close attention in the secondary literature, which it has not to date received. For our purposes, the strongest and most convincing criticism of the Tribunal’s interpretation of national treatment can be found in the eloquent and reasoned Separate Opinion of Arbitrator Cass in that award. He gently reminds the Tribunal that reliance on these external conventions is not only ‘misplaced’ but, taken to its logical conclusion, would point in the opposite direction to Canada’s claim (and the Tribunal’s eventual ruling in that case).<sup>111</sup>

The question then is how our analysis might inform the broader project of building consistency and coherence in legal interpretation by investor–state arbitral tribunals. It is difficult to escape the sense that the interpretive failures exhibited in *Occidental* and *Methanex* come down to an absence of knowledge on the part of the adjudicators of the specific features of the treaty text and jurisprudence of the WTO. This may reflect the distinct and somewhat separate historical trajectories of these two systems. This functional and institutional separation is no longer feasible or desirable. It is not feasible, as the same regulatory measure can fall within the jurisdictional reach of both systems and may even be adjudicated simultaneously. One need only recall the Mexican tax on high-fructose corn syrup that triggered national treatment claims both by the US as a state party in the WTO<sup>112</sup> and by a range of US investors under the investment chapter 11 of the NAFTA.<sup>113</sup> As to desirability, much can be learned within both systems by the different approaches to the adjudication of a range of ‘shared’ norms, including national treatment. With this in mind, there may be merit in devoting greater attention to the types of actors appointed to investor–state arbitral

<sup>109</sup> E.g., *Archer Daniels Midland Company and Tate & Lyle Ingredients Americas, Inc. v. Mexico*, Award (ICSID, 21 Nov. 2007), at paras 197–203 (applying, in part, the *Methanex* test of searching for an identical comparator).

<sup>110</sup> *United Postal Service of America Inc. v. Canada*, Award on the Merits (ICSID, 24 May 2007), at paras 80–118.

<sup>111</sup> *Ibid.*, Separate Statement of Arbitrator Cass, at paras 33–47.

<sup>112</sup> *Mexico – Tax Measures on Soft Drinks and Other Beverages*, Report of the Panel (WT/DS308/R, 7 Oct. 2005); *Mexico – Tax Measures on Soft Drinks and Other Beverages*, Report of the Appellate Body (WT/DS308/AB/R, 6 Mar. 2006).

<sup>113</sup> *Archer Daniels*, *supra* note 109; *Corn Products*, *supra* note 53.

tribunals. This could involve formalizing more sophisticated rules which distill desirable skills and qualifications of individuals suitable for appointment in this increasingly contentious area of adjudication.<sup>114</sup> We might even look to requiring one or even two members of an investor–state arbitral tribunal to be recognized authorities in the increasingly specialized international economic law components of the broader field of public international law. Such a proposal would require reform of various appointing institutions, such as the ICSID Convention. It would face an even greater barrier in the embedded and stubborn insistence on party autonomy in arbitral adjudication.

Those opposed to these modest reform proposals might be inclined to leave it to the market, as it were. Indeed, there are cases where party appointments have proceeded in the broad direction I have endorsed. The recent *Continental v. Argentina* Tribunal was presided over by a member of the WTO Appellate Body, and that award is characterized by careful and sophisticated use of WTO exceptions jurisprudence.<sup>115</sup> On the other hand, *Continental* was preceded by four separate awards involving the same legal issue which rule in the opposite direction and, most crucially, do so because of a mistaken reading of the relationship between customary and treaty exceptions for state conduct.<sup>116</sup> The market for appointments then will not, in any predictable fashion, control for quality in reasoning and outcome. There are serious, real-world implications which flow from this unsatisfactory state of affairs. Argentina is now liable for hundreds of millions of dollars in damages despite objective evidence of legal error on the part of tribunals ruling on the question of liability.<sup>117</sup> These inconsistencies may even lead to selective exit on the part of state parties, as revealed by Ecuador’s election to confine ICSID jurisdiction in the aftermath of the *Occidental* award.<sup>118</sup> Viewed against this broader terrain, revision of the rules on arbitral appointment may be a modest way forward in the project of ensuring greater consistency in adjudication, thereby potentially forestalling even deeper forms of backlash in investment treaty arbitration.

<sup>114</sup> The ICSID Convention currently requires that persons designated by contracting states to serve on arbitral panels simply ‘be persons of high moral character and recognized competence in the fields of law, commerce, industry or finance who may be relied upon to exercise independent judgment’: Convention on the Settlement of Investment Disputes Between States and Nationals of Other States, opened for signature 18 Mar. 1965, 55 UNTS 159, at Art. 14(1). In contrast, the rules on qualification of appointment to both WTO panels and the Appellate Body are far more finely tuned to the specifics of that treaty system. In particular, the Appellate Body must comprise ‘persons of recognized authority, with demonstrated expertise in law, international trade and the subject matter of the covered agreements generally’: Dispute Settlement Understanding, *supra* note 49, at Art. 17(3).

<sup>115</sup> *Continental Casualty Company v. Argentine Republic*, Award (ICSID, 5 Sept. 2008), at paras 193–199. For an analysis of this award and its interpretive methodology see Kurtz, ‘Adjudging the Exceptional at International Law: Security, Public Order and Financial Crisis’, Jean Monnet Working Paper No. 06/08 (2008), available at: [www.jeanmonnetprogram.org](http://www.jeanmonnetprogram.org), at 39–54.

<sup>116</sup> On these earlier awards see Kurtz, *supra* note 115, at 22–38.

<sup>117</sup> *CMS Gas Transmission Company v. Argentine Republic*, Decision of Ad Hoc Committee on the Application for Annulment (ICSID, 25 Sept. 2007), at paras 130–135. See also Kurtz, *supra* note 115, at 25–29.

<sup>118</sup> ‘Ecuador’s Notification under Article 25(4) of the ICSID Convention’, ICSID News Release, 5 Dec. 2007 (detailing Ecuador’s withdrawal of its consent to ICSID jurisdiction over disputes concerning investment in the petroleum, gas, and mineral sectors).