



**BEFORE THE HONORABLE TRIBUNAL ESTABLISHED  
PURSUANT CHAPTER ELEVEN OF THE NORTH AMERICAN  
FREE TRADE AGREEMENT (NAFTA)**

**POPE AND TALBOT, INC.  
CLAIMANTS**

**V.**

**THE GOVERNMENT OF CANADA,  
RESPONDENT**

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**SUBMISSION OF THE UNITED MEXICAN STATES**

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## SUBMISSION OF THE GOVERNMENT OF THE UNITED MEXICAN STATES

1. Pursuant to Article 1128 of the NAFTA, the Government of Mexico submits the following comments on certain interpretative issues arising from the instant claim.
2. Mexico appreciates this opportunity to make submissions on interpretive issues. Mexico does not take a position on any particular issues of fact in this case. However, as the questions of interpretation that Mexico seeks to address arise on certain facts, this submission will refer to the facts that appear to be undisputed or clear on the evidence.
3. In this submission, Mexico will address the interpretation of Articles 1110, 1102, and 1106. It will also comment upon the submission of the Government of Canada on the legal relationship between the NAFTA and the Softwood Lumber Agreement (SLA).
  - A. **The Tribunal's Jurisdiction and the Sources of International Law**
4. Before discussing the specific NAFTA articles at issue in this dispute, Mexico wishes to draw the Tribunal's attention to its jurisdiction and the relevant sources of international law.
5. The NAFTA Parties set out the governing law in Article 1131:

A Tribunal established under this Section shall decide the issues in dispute in accordance with this Agreement and applicable rules of international law.
6. The commonly understood sources of international law are set out in the Statute of the International Court of Justice. Article 38.I of the Statute provides that the Court, whose function is to decide in accordance with international law such disputes as are submitted to it, shall apply:
  - (a) international conventions, whether general or particular, establishing rules expressly recognized by the contesting States;
  - (b) international custom, as evidence of a general practice accepted as law;
  - (c) the general principles of law recognized by civilized nations;
  - (d) subject to the provisions of Article 59, judicial decisions and the teachings of the most highly qualified publicists of the various nations, as subsidiary means for the determination of rules of law.
7. Thus, as a starting point, NAFTA Tribunals would begin by interpreting the text of the Treaty in accordance with the Vienna Convention on the Law of Treaties and apply the applicable rules of international law as set out in the Statute of the International Court of Justice.

8. The Claimant in this proceeding has relied upon decisions of the Iran-U.S. Claims Tribunal<sup>4</sup>. In Mexico's submission, care must be taken when relying upon the decisions of other international arbitral tribunals. It is necessary first to identify with precision what the jurisdiction of the arbitral tribunal in question was.

9. The jurisdiction of that tribunal was broader than that of a NAFTA tribunal.

10. The Joint Settlement Declaration signed by the United States and Iran gave the Claims Tribunal jurisdiction to consider "expropriation or other measures affecting property rights"<sup>2</sup>. Some of that tribunal's awards found that deprivation of property rights constituted "a lesser form of interference" than expropriation. The cases of *Eastman Kodak Company*<sup>3</sup> and *Foremost Tehran*<sup>4</sup>, for example, found a deprivation based on "measures affecting property, although the level of interference established did not rise to the level of a taking"<sup>5</sup>. Although the claims advanced were expropriation claims, two Chambers decided they could consider a claim of deprivation because "a claim for expropriation must be taken to include a claim for a lesser degree of interference with its rights"<sup>6</sup>.

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1. At paragraphs 133, 135, and 148, and footnotes 115, 116, 117, 118, 121, and 126.

2. Article II, paragraph 1 of the Declaration of the Government of the Democratic and Popular Republic of Algeria Concerning the Settlement of Claims by the Government of the United States of America and the Government of the Islamic Republic of Iran (Algiers Accord) states as follows:

1. An International Arbitral Tribunal (the Iran-United States Claims Tribunal) is hereby established for the purpose of deciding claims of nationals of the United States against Iran and claims of nationals of Iran against the United States, and any counterclaim which arises out of the same contract, transaction, or occurrence that constitutes the subject matter of that national's claim, if such claims and counterclaims are outstanding on the date of this agreement, whether or not filed with any court, and arise out of debts, contracts (including transactions which are the subject of letters of credit or bank guarantees), expropriations or other measures affecting property rights, excluding claims described in Paragraph 11 of the Declaration of the Government of Algeria of January 19, 1981, and claims arising out of the actions of the United States in response to the conduct described in such paragraph, and excluding claims arising under a binding contract between the parties specifically providing that any disputes thereunder shall be within the sole jurisdiction of the competent Iranian courts in response to the Majlis position.

3. *Eastman Kodak Company, et al. v. The Government of the Islamic Republic of Iran, et al.*, 17 Iran-U.S. C.T.R. 153 and 27 Iran-U.S. C.T.R. 3.

4. *Foremost Tehran Inc. et al. v. The Government of the Islamic Republic of Iran*, 10 Iran-U.S. C.T.R. 229, 240.

5. In *Foremost*, the Tribunal found that to was open to find that the acts of governmental shareholders against *Foremost's* right to receive dividends constituted interference "attributable to the Iranian Government or other State organs of Iran, while not amounting to an expropriation, gives rise to a right to compensation for the loss of enjoyment of the property in question". [Ibid., at page 251.]

6. Ibid. at 240.

11. In contrast to the Iran-U.S. Claims Tribunal, this Tribunal does not have the jurisdiction under Article 1110 to entertain a claim for "a lesser form of interference". Its jurisdiction is confined to more serious deprivations of defined property interests that amount to a nationalization or expropriation or a measure tantamount to a nationalization or expropriation.

12. The legal issues put before a NAFTA tribunal also differ from other investor-State arbitrations such as under the ICSID Convention. ICSID tribunals do not have the jurisdiction to interpret international treaties such as the NAFTA or (except where the parties agree) to apply purely international law. Rather, according to Article 42 of the ICSID Convention, a Tribunal:

...shall decide a dispute in accordance with such rules of law as may be agreed by the parties. In the absence of such agreement, the Tribunal shall apply the law of the Contracting State party to the dispute (including its rules on the conflict of laws) and such rules of international law as may be applicable.

13. ICSID Tribunal awards applying national law therefore will be of very little assistance to a NAFTA Tribunal. They will be of greater assistance when they apply public international law.

14. In Mexico's submission, what will likely be of most relevance to NAFTA tribunals will be the applicable principles in the awards of other NAFTA tribunals. To date there has only been one Award, *Robert Azinian and others v. The United Mexican States*. It was rendered by a distinguished Tribunal<sup>7</sup>.

15. That Tribunal was presented with a claim that the termination of a concession agreement by a municipality amounted to an expropriation under international law. The relevance of the Tribunal's analysis to the instant proceeding lies in its careful identification of the kind of governmental acts that can be elevated to the plane of international responsibility.

16. As it was the first to consider a dispute on the merits, the Tribunal found it appropriate to consider "first principles"<sup>8</sup>.

82. Arbitral jurisdiction under Section B is limited not only as to the persons who may invoke it (they must be nationals of a State signatory to NAFTA), but also as to subject matter: *claims may not be submitted to investor-state arbitration under Chapter Eleven unless they are founded upon the violation of an obligation established in Section A*<sup>9</sup>. [Emphasis added]

17. The Tribunal continued:

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7. ICSID Additional Facility Case No. ARB(AF)/97/2. Mr. Jan Paulsson (President), Mr. Benjamin R. Civiletti, and Mr. Claus von Wobeser comprised the Tribunal.

8. Ibid. at para. 79.

9. Ibid. at para. 82.

83. To put it another way, a foreign investor entitled in principle to protection under NAFTA may enter into contractual relations with a public authority, and may suffer a breach by that authority, and *still not be in a position to state a claim under NAFTA*. It is a fact of life everywhere that individuals may be disappointed in their dealings with public authorities, and disappointed yet again when national courts reject their complaints. It may safely be assumed that many Mexican parties can be found who had business dealings with governmental entities which were not to their satisfaction; Mexico is unlikely to be different from other countries in this respect. *NAFTA was not intended to provide foreign investors with blanket protections from this kind of disappointment, and nothing in its terms so provides.* [Emphasis in original]

84. It therefore would not be sufficient for the Claimants to convince the present Arbitral Tribunal that the actions or motivations of the Naucalpan Ayuntamiento [the municipal council] are to be disapproved, or that the reasons given by the Mexican courts in their three judgments are unpersuasive. Such considerations are unavailing unless the Claimants can point to a violation of an obligation established in Section A of Chapter Eleven attributable to the government of Mexico.

18. The significance of this award lies in the Tribunal's recognition of the seriousness of making a finding of a breach of international law and its refusal to hold that NAFTA offered "blanket protections" against acts of government that may disappoint investors

19. Mexico also respectfully directs the Tribunal to the decision of a Chamber of the International Court of Justice in the *ELSI Case (Case Concerning Elettronica Sicula S.P.A. (ELSI) (United States v. Italy))* where it was held that a local Mayor's requisitioning of a factory threatened with imminent shut-down by the investor and the factory's subsequent occupation by striking workers did not constitute an expropriation under the relevant provision of the United States-Italy Treaty on Friendship, Commerce and Navigation<sup>10</sup>.

20. The *ELSI Case* is instructive for the Chamber's careful attention to allegations of interference, expropriation, and arbitrariness in light of the settled rules of international law.

21. Finally, it is submitted that there is a particularly important duty upon all NAFTA tribunals, but especially in the first cases, when examining allegations on the merits, to consider what the established international law actually is.

22. This comment applies to such publications as the *Restatement (Third) of the Foreign Relations Law of the United States*. While Mexico recognizes that the *Restatement* is an important work that contributes to the understanding of international law, it must be recognized as the views of the academic and legal community of one State. Moreover, as the *Restatement* itself notes in its foreword: "[I]n a number of particulars the formulations in this *Restatement* are

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10. *Case Concerning Elettronica Sicula S.P.A (ELSI) (United States of America v. Italy)*, 1989 ICJ Reports 15.

at variance with positions that have been taken by the United States Government"<sup>11</sup>. Finally, the propositions of law set out in the *Restatement* do not necessarily reflect the substantial divergence of international opinion as to the substantive content of the law and the unsettled state of the law<sup>12</sup>.

23. In Mexico's submission, in the interpretation of treaties, the work of such bodies as the International Law Commission is to be preferred over that of national commentaries.

24. Assistance can be gained from the writings of qualified publicists, but it is crucial not to confuse what commentators may assert the law should be with what arbitration tribunals and the International Court of Justice have decided.

### B. The Legal Relationship Between the NAFTA and the Softwood Lumber Agreement (SLA)

25. In concluding the SLA, the United States and Canada agreed that Canada should undertake certain measures that could otherwise be in conflict with Canada's obligations under the NAFTA. Canada became obliged to impose duties on certain exports of lumber. The imposition of export duties is prohibited under Article 314. However, by virtue of its status as a subsequent international agreement between the two Parties, the existence of the SLA means that, as between the two Parties, Canada's imposition of duties does not violate the NAFTA.

26. For the record, Mexico wishes to state its position that the SLA does not constitute an amendment of the NAFTA. This can only occur by agreement of all three NAFTA Parties pursuant to Article 2202. It simply represents a settlement of a particular dispute by two NAFTA Parties, without prejudice to any rights of the third.

27. Mexico observes that, for its part, the United States has also taken action to ensure that the SLA is implemented. If a Canadian producer of lumber first manufactured in a Province subject to the quota requirement sought to export lumber without a quota certificate, the United States Customs Service would assess a fee<sup>17</sup>. In the absence of the SLA, such a fee would be contrary to Article 302 of the NAFTA.

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11. *Restatement*, foreword at IX.

12. See Stephen C. McCaffrey, "The Restatement's Treatment of Sources and Evidence of International Law" from *Commentaries on the Restatement (Third) of the Foreign Relations Law of the United States*, Edited by *The International Lawyer*, (1992) ABA Section of International Law and Practice at p.5. "The student of international law is struck by the confidence and simplicity with which a number of the rules in the Restatement (Third) are stated, which sometimes conveys the impression that the rules are rigid and undisputed...A fourth general observation concerns another sense in which the Restatement may present an oversimplified view of international law, namely, that the black letter and commentary often leave the impression that the body of norms making up the field is relatively static rather than dynamic."

13. See Counter-memorial at paragraph 70.

28. In Mexico's submission, applying the law of treaties, any act that Canada is required to take under the SLA cannot be a violation of the NAFTA as far as the United States is concerned. This includes measures that, though not expressly stated in the Agreement, are reasonably necessary to implement it.

29. Mexico agrees with Canada, therefore, that where two NAFTA Parties enter into an agreement that varies their respective rights and obligations under NAFTA, and thereby affects the ability of private parties to conduct trade, neither Party can complain that the rights so varied constitutes a violation of the NAFTA.

30. The obligations of each NAFTA Party are owed to the other NAFTA Parties. If a Party has agreed to a variation of an obligation by another Party, all investors of the former are bound by such variation.

### C. Expropriation

#### 1. Direct and Indirect Expropriation at International Law

31. This Tribunal is presented with measures taken pursuant to an international agreement that affect many enterprises in an industrial sector, in a specific and limited way. Such measures have been imposed pursuant to an international agreement that was expressly designed by the two States concerned to restrict certain enterprises' right to export freely to one of them. It is not contended by the Claimant that the measures have any other effect on its investment.

32. There is no allegation and no record evidence of which Mexico is aware that Canada has taken action that in any way substantially interferes with or deprives the affected Canadian and foreign-owned investors of their ownership or control over their investments.

33. There is no question that, under the commonly accepted standards as to what constitutes a direct or indirect expropriation at international law, the acts complained of do not even remotely resemble the acts that other international arbitral tribunals have found to be expropriations.

34. Upon examination, it can be seen that the decided cases on direct and indirect expropriation involve outright nationalizations or expropriations, or in the *de facto* or indirect expropriation cases, seizure in the form of interference in the management of the claimant's affairs (such as the appointment of a manager or custodian)<sup>14</sup>, armed force by military personnel

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14. For example, see the decisions of the Iran-U.S. Claims Tribunal, including *Starrett Housing Corporation v. Iran*, 4 Iran-U.S. C.T.R. 122, in which the Tribunal held that, by appointing a "temporary manager" of the Iranian firm in which the Claimant owned the majority of shares, the Government of Iran "had interfered with the Claimant's property rights in the Project to an extent that rendered these rights so useless that they must be deemed to have been taken." See also *Thomas Earl Payne v. Iran*, 12 Iran-U.S. C.T.R. 3; *Sedco v. NIOC and Iran*, 9 Iran U.S. C.T.R. 248; *Phelps Dodge International Corp. v. Iran*, 10 Iran-U.S. C.T.R. 157.

or revolutionary guards associated with the respondent state<sup>15</sup>, threats of violence, expulsion of key personnel, and the like<sup>16</sup>.

35. The ownership and control of the Claimant's investment has not been affected or even interfered with at all by the regulatory acts at issue. What has been affected is the covered producers' ability to export subject goods to one particular export market.

## 2. NAFTA Did Not Create a *Lex Specialis* For Expropriation

36. The only possible basis for advancing an expropriation claim in the instant case is if the inclusion of the words "a measure tantamount to nationalization or expropriation" in Article 1110 were given an unduly broad and completely unintended interpretation to reach forms of governmental action that hitherto have never been considered to constitute nationalization or expropriation at international law.

37. This is what the Claimant contends when it asserts that Article 1110 "creates a *lex specialis* that goes beyond those concepts enshrined in the customary international law of expropriation"<sup>17</sup>.

38. The Claimant asserts further that "broad protection" of investment "was intended by the drafters of the NAFTA Investment Chapter". While it is correct that the Parties agreed to a number of important investment protections, each of the articles in Section A of Chapter Eleven has a specific role and meaning at international law. With respect to Article 1110, all three NAFTA Parties have confirmed that they did not intend to have the meaning that the Claimant says they intended.

39. The inclusion of the phrase "tantamount to" in Article 1110 was intended to clarify for greater certainty that a measure that is *equivalent* to nationalization or expropriation is also covered.

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15. See *Amco Asia Corporation v. Indonesia*, 41 ICSID Reports 376, where members of the Indonesian military forces assisted in the takeover of a hotel which was under the management of the Claimant. See also cases of the Iran-U.S. Claims Tribunal, involving a forcible taking of tangible assets and, in some cases, expulsion of personnel from Iran by Revolutionary Guards, including, *Leonard and Mavis Daley v. Iran*, 18 Iran-U.S. C.T.R. 232; *Kenneth P. Yeager v. Iran*, 17 Iran-U.S. C.T.R. 92; *William L. Percira Associates Iran v. Iran*, 5 Iran-U.S. C.T.R. 198.

16. See *Biloune and Marine Drive Complex Ltd v. Ghana Investments Centre and the Government of Ghana*, I.L.R. 184 [1990] where the Claimant was arrested, held in custody for thirteen days without charge, and then deported from Ghana. The Claimant was not permitted to return to Ghana or to carry out any further work on the development of a hotel resort complex, the investment for the purpose of the Claim. See also *Southern Pacific Properties (Middle East) Ltd v. Egypt*, 3 ICSID Reports 45, where legislation entitling the Claimants to develop land surrounding the Pyramids was revoked and the Egyptian joint venture company put under judicial trusteeship.

17. Memorial at paragraph 141.

40. The New Oxford Dictionary of English (1998) defines tantamount as "equivalent in seriousness to; virtually the same as" (p.1895); the Marriam-Webster Collegiate Dictionary (10<sup>th</sup> Edition) defines tantamount as "equivalent in value, significance or effect".

41. Similarly, the Spanish and French texts of NAFTA, which by virtue of Article 2206 are equally authentic to the English version, use the words "equivalente" and "cquivalent".

42. To be equivalent, the measure must share the essential characteristics of a nationalization or expropriation. That is, it must constitute at a minimum, a substantial and long-standing, if not permanent and total, deprivation of the investor's interest in the investment.

43. The view that Article 1110 was intended simply to codify the existing international law on direct and indirect expropriation was expressed by the United States of America in its Article 1128 intervention in the second claim to be heard under the NAFTA, *Metalclad v. The United Mexican States*<sup>18</sup>.

44. The United States commented:

10. The United States Government believes that it was the intent of the Parties that Article 1110(1) reflect customary international law as to the categories of expropriation. The United States Government reflected that position in its Statement of Administrative Action, transmitted to the Senate during the process of concluding the NAFTA. ... Neither of the other Parties has ever expressed a view contrary to this United States public statement of intent. The customary international law of expropriation recognizes only two categories of expropriation: direct expropriation, such as the compelled transfer of title to the property in question; and indirect expropriation, i.e., expropriation that occurs through a measure or series of measures even where there is no formal transfer of title or outright seizure. To conform to these rules of customary international law, Article 1110(1) must be read to provide that expropriation may only be either direct, on one hand, or indirect through "a measure tantamount to nationalization or expropriation of such an investment," on the other.

11. The context in which the phrase "tantamount to expropriation" is found confirms that it was not intended to create a new category of expropriation. If Article 1110 had been meant to create a wholly new, third category of expropriation, thereby departing radically from customary international law, the Parties would surely have included language providing guidance on what circumstances, other than either direct or indirect expropriation, were meant to be covered. Instead, there are no standards for determining when such a new category would be applicable. It is extremely unlikely that the Parties would have exposed themselves to potentially significant liability for an entirely new category of expropriation without such guidance. As they did not provide the necessary standards, the only reasonable conclusion is that the Parties did not intend an expansion

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18. ICSID/AF/ARB/97/01.

of the two categories of expropriation currently recognized under customary international law<sup>19</sup>.

45. Mexico shares the view expressed by the United States in that proceeding, which view has been concurred in by Canada in its Counter-memorial in this proceeding<sup>20</sup>.

46. Thus, all three NAFTA Parties have confirmed that the inclusion of the phrase "tantamount to" was not intended to create a broad *lex specialis* going beyond what was enshrined in customary international law.

### 3. International Law Recognizes the State's Right to Regulate

47. Mexico submits further that the overly expansive interpretation of Article 1110 that has been urged upon the Tribunal would undermine each Party's sovereign right to regulate. International law has always recognized a state's right to regulate.

48. Brownlie states:

"State measures, prima facie a lawful exercise of powers of government, may affect foreign interests considerably without amounting to expropriation. Thus, foreign assets and their use may be subjected to taxation, trade restrictions involving licences and quotas, or measures of devaluation."<sup>21</sup>

49. It is to be observed that Brownlie's comment discusses measures affecting "foreign interests". In the instant case, the challenged measures affect foreign and domestic interests alike which export lumber first manufactured in the subject Provinces.

50. B.H. Weston, "Constructive Takings' under International Law: A Modest Foray into the Problem of 'Creeping Expropriation'"<sup>22</sup> states that it:

"...is serious business to dispute a state's claim to "regulation". International law traditionally has granted states broad competence in the definition and management of their economies."

51. In an article in the British Yearbook of International Law, entitled, "What Constitutes a Taking of Property Under International Law"<sup>23</sup>, G.C. Christie stated:

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19. Submission of the Government of the United States of America in *Metalclad Corporation v. The United Mexican States*, ICSID Case No. ARB(AF)/97/1.

20. Counter-memorial at paragraph 392.

21. Brownlie, *Principles of Public International Law*, 5th ed. (1998) at p. 535.

22. (1975), 16 Va. J. Int'l. L. 103, at page 121.

23. (1988), 33 B.Y.I.L. 307, at page 338.

"A state's declaration that a particular interference with an alien's enjoyment of his property is justified by the so-called "police power" does not preclude an international tribunal from making an independent determination of this issue. But, if the reasons given are valid and bear some plausible relationship to the action taken, no attempt may be made to search deeper to see whether the state was activated by some illicit motive."  
[Emphasis added]

52. Rosalyn Higgins in her article, "The Taking of Property by the State: Recent Developments in International Law"<sup>24</sup>, states that as a general proposition no compensation will be payable for general regulatory measures, even measures that decrease the value of property provided the right to use, enjoy, manage and control property are left substantially intact.

53. Investors expect and assume the risk of regulatory measures on the part of a government, even where their commercial interests are affected negatively. In the instant case, all investors in the lumber industry who export lumber first manufactured in the subject provinces have been affected by the export regulations. However, in Mexico's respectful submission, they have not been the subjects of an expropriation or a measure tantamount to expropriation.

#### 4. The Text of NAFTA Defines What Kind of Interests Are Capable of Being Expropriated

54. Finally, it is important to keep in mind that the protection afforded by Article 1110 is in relation to an "investment".

55. Mexico observes that the Claimant asserts that "the NAFTA establishes a very broad concept of 'property' through its definition of 'investment' in NAFTA Article 1139"<sup>25</sup>. It is true that Article 1139 lists eight legal interests that are to be considered to be an investment for the purposes of the Chapter. The list is exhaustive, not illustrative.

56. A plain reading of Article 1139 shows that it does not include the expectation of an unfettered right to export goods among the possible forms of investment that are subject to Chapter Eleven's disciplines.

57. There is a common sense reason why a right to export goods to another State was not included as a legal right under Article 1139: Canada is not in a position to guarantee market access into the United States; that access is under the control of the United States, not Canada<sup>26</sup>.

58. If no legal interest as defined by the Treaty has been expropriated, that is the end of the matter. Governmental action *affecting* commercial interests cannot be considered to be expropriation under the NAFTA.

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24. Rosalyn Higgins, (1982) 176 *Receuil des Cours* 259 at p. 271.

25. Memorial at paragraph 142.(b).

26. For an example, see Counter-memorial at paragraph 529(c).

59. Thus, a measure that regulates, for public policy reasons (i.e., to settle a long-standing trade dispute), a group of producers' ability to export goods above certain volumes to another State, but which in no way impairs the management and control over such enterprises or their right to carry on business either domestically or in any other foreign market, cannot be said to amount to an expropriation or a measure tantamount to an expropriation.

60. To summarize: a trade measure, imposed by virtue of a bilateral agreement intended to settle a trade dispute, that *affects* many enterprises by regulating their ability to export goods to a single market, neither *relates to* investors *qua* investors, nor amounts to an expropriation at international law.

61. Mexico observes that if the claim of expropriation were accepted, it would follow logically that all investors (domestic and foreign-owned) subject to the export control regime similarly have been expropriated, even though all such investors retained full ownership and control over their investments. To state the proposition is to refute it.

#### D. National Treatment

##### 1. The Central Inquiry in a National Treatment Analysis

62. The Tribunal has been invited to find that because lumber producers in different provinces have been treated differently, Canada has breached Article 1102. In Mexico's respectful submission, this contention is simplistic and incorrect.

63. Mexico observes that the Claimant has described the national treatment obligation in the following way: "Canada is obliged to provide foreign investors and their investments operating in the same industry the best treatment available anywhere in Canada"<sup>27</sup>.

64. With respect, this summary statement is an erroneous description of the standard. The only legal standard that is to be applied under Article 1102 is the comparison of investors of another Party to the Party's own investors, *in like circumstances*. This is done at the federal level under Article 1102.1 and 2 and at the provincial level under paragraph 3.

65. It is of utmost importance to the proper interpretation of the NAFTA that the two tests not be blurred. The treatment accorded by one province is not the standard against which another province is to be judged. Similarly, where federal action vis-a-vis more than one province is being examined, the Tribunal must take care to determine whether producers in the two or more provinces are "in like circumstances".

66. The Tribunal's duty is to examine whether in the implementation of the SLA, Canada accorded less favorable treatment to the Claimant's Canadian subsidiary by virtue of its status as an "investment of an investor of another Party". No issue of a potential breach of Article 1102

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27. Memorial at paragraph 62.

arises unless the measure complained of distinguished between Canadian owned or controlled investments and the Claimant's investment *qua* investment of [an] investor of another Party.

67. The Tribunal could make a finding of breach only if it was satisfied that, when compared to Canadian investors *in like circumstances*, there was actual discrimination against Pope & Talbot, Inc. based on the nationality of its capital.

68. As the Tribunal will see from a review of the Memorial, the Claimant repeatedly complains of the Respondent's treatment of the "British Columbia producers" (at paragraphs 42, 44, 45, 83, 86, 87, and 88). It is Mexico's understanding that B.C. producers are owned or controlled by Canadian, U.S. and other non-NAFTA State investors.

69. There is no indication from the pleadings that the Claimant can point to its investment being discriminated against by virtue of its foreign ownership. Without proof of this element, no claim of denial of national treatment can be made out.

70. It is not enough that the Claimant finds itself restricted in exporting lumber to the United States. It is not enough for the Claimant to argue that some other producer received more quota. The only legally relevant issue is whether the Claimant can prove that it was treated less favorably due to its nationality.

## 2. The Features of the Instant Case That Go to the Issue of "Like Circumstances"

71. In Mexico's submission, in applying the "in like circumstances" standard, it must be shown that the investors (or investments) that are proposed to be used for comparative purposes are truly comparable.

72. In the context of the instant case, the Tribunal may find the following factors to be of assistance:

- a) The fact that under the Canadian Constitution, the Provinces have both proprietary and legislative jurisdiction for natural resources situated therein<sup>28</sup>. Thus, each Province regulates its lumber industry differently. This is reflected in different stumpage regimes and fee structures, reforestation practices, and other features of provincial timber management regimes.
- b) The fact that prior to the negotiation of the SLA, the United States authorities (and the complaining U.S. industry) distinguished between the stumpage and other timber management practices of the various Provinces. It is Mexico's understanding that this distinction continued throughout the CVD investigation and formed the basis for the SLA.

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28. Section 92A, *Constitution Act, 1867*. See also Peter W. Hogg, *Constitutional Law in Canada*, Carswell, (1996), at Chapter 29.

- c) The fact that each Province's producers have organized themselves within provincial industry associations.
- d) The fact that geographic differences and species endowments affect the configuration of markets for each Province's producers. For example, the Coastal producers of British Columbia have traditionally been oriented more to the Asian markets than other Canadian producers.
- e) The fact that by virtue of species endowment, regulatory controls, cost structures such as labor and transportation costs, and simple proximity, producers in a single Province will be in the most similar circumstances<sup>29</sup>.

73. These factors (there may be more) should be considered when the Tribunal seeks to determine the appropriate class of domestic investors against whom the treatment of Pope & Talbot, Inc. is to be adjudged.

### 3. There is No Commonly Accepted Way to Allocate Scarce Quota

74. It warrants noting in this case that the allocation of scarce quota is one of the most difficult undertakings a government can engage in insofar as its trade policy is concerned. For example, freezing allocations based on current market share prevents new entrants from participating in the market. Similarly, allocating quota based on exports to a particular market rather than on total production will favor companies that specialize in that particular export market over companies that may have larger overall production. The selection of a one, two, or three year representative base period will yield different results because producers' export performance will vary year by year. The fact of the matter is that governments must balance many competing demands.

75. When scarce quota is being allocated, questions of fairness inevitably arise. By reason of its scarcity, quota is highly prized and it is common for recipients to complain that they have been given too little. It is for these reasons that Article XIII of the GATT 1994 sets out only general rules to govern the allocation process although in doing so, it recognizes that reliance on volumes of imports or exports during a prior representative period is the object of the allocation exercise<sup>30</sup>.

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29. Even within a Province, the evidence shows that there will be substantial differences between producers. For example, the B.C. industry could be considered to be two industries, with the Coastal producers shipping higher grade species wood to off-shore markets and the Interior producers specializing in dimension lumber destined for the U.S. housing market.

30. Article XIII:5 establishes that the provisions of that article shall apply to any tariff quota instituted or maintained by any contracting party, and, in so far as applicable, the principles of this Article shall also extend to export restrictions. See paragraph 4 for the general approach to be taken by a party when setting quota that is to be allocated to other WTO Members.

#### 4. Applying the Standard

76. Given this legal and factual context, the precise legal issue for this Tribunal is not whether the allocation to the Claimant's investment or to any of its competitors was "fair" but only whether the Claimant's investment was treated less favorably than Canadian-owned or controlled investments *in like circumstances*.

77. If there is no evidence of such discrimination, there can be no breach of Article 1102.

##### a. Applying the Federal Standard: Within British Columbia

78. The Canadian Provinces could be considered to all be in such different circumstances such that it is not appropriate to compare the federal government's treatment of one to another. In Mexico's submission, therefore, applying the factors set out above, the Tribunal's inquiry should be directed to determining whether the federal government has accorded less favorable treatment to the Claimant when compared to other domestically owned or controlled enterprises *in British Columbia*. The balance of the British Columbian producers constitute the group of exporters of lumber first manufactured in British Columbia who are closest to the Claimant's investment (in terms of provincial jurisdiction and regulation, resource endowment, market orientation, cost structure, product mix), and therefore are most likely to be in like circumstances.

79. It should be noted, however, that even within British Columbia, not all producers are in like circumstances because each has a different profile of shipments over the base period. For example, each producer in British Columbia would have a different mix of products and markets at any given time (i.e., domestic shipments, US-destined lumber, and lumber destined for third country markets).

80. Where, as here, producers in British Columbia are all subject to the quota regime regardless of the nationality of their ownership, absent evidence of less favorable treatment being accorded to the Claimant, there is no basis for a finding of a breach of the national treatment standard.

81. There is no allegation of this form of discrimination in the Memorial.

##### b. Applying the Standard to the Issue of Exempted Provinces

82. Mexico observes that the Claimant has also asserted that there was a denial of national treatment because certain Canadian provinces were exempted from the TRQ.

83. In Mexico's submission, this objection can be dismissed summarily. Applying the factors listed above, particularly the fact that the United States authorities distinguished between different provinces for the purposes of the countervailing duty action that ultimately led to the SLA should lead the Tribunal to conclude that the producers of lumber first manufactured in different Canadian provinces were *not* in like circumstances.

c. **Summary on National Treatment**

84. In summary, absent any evidence of discrimination in the allocation of quota based on the nationality of the ownership or control of the investments, there is no basis for a finding of breach of Article 1102. The complaint can succeed only if the Claimant is able to prove that an unfavorable distinction was made by the authorities on the basis of nationality of ownership.

E. **Performance Requirements**

85. In Mexico's respectful submission, the Claimant's argument regarding Article 1106 does not accord with a proper understanding of the intent and purpose of Article 1106. It may be helpful for the Tribunal to have some background into the inclusion of Article 1106 in the NAFTA.

86. The United States, in particular, has long championed the idea of disciplining the use of laws, regulations and policies by host States in order to induce investors to achieve certain governmental trade policy objectives, such as promoting exports, developing infant industries, requiring technology transfer, etc. Indeed, Mexico itself has employed performance requirements, *inter alia*, to develop its domestic automotive industry. Such requirements were exempted from the disciplines of Article 1106 by a reservation taken by Mexico under Annex<sup>31</sup>. Canada similarly filed reservations to Article 1106<sup>32</sup> and even the United States found it necessary to do so in Annex I<sup>33</sup>.

87. The concern over performance requirements that ultimately led to Article 1106 can be traced back at least to a GATT dispute between Canada and the United States<sup>34</sup> in the early 1980s. In that dispute, the United States challenged certain undertakings offered to or sought by Canada's then-extant Foreign Investment Review Agency. The United States succeeded in challenging certain measures (allowing foreign investments if the investors undertook to purchase goods from domestic suppliers or of domestic origin<sup>35</sup>). However, the GATT Panel found that requiring undertakings from investors to export a specified amount or proportion of their production were not inconsistent with the GATT<sup>36</sup>.

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31. See, for example, Mexico's automotive industry performance requirements reserved in Annex 1, at I-M-33.

32. See, for example, I-C-2.

33. See I-U-23.

34. *Canada—Administration of the Foreign Investment Review Act*, GATT BISD/30S/140.

35. *Ibid.*, at paragraph 6.1 of the Panel Report.

36. *Ibid.*, at paragraph 6.2.

88. The issue arose subsequently in the negotiation of NAFTA's regional predecessor, the Canada-U.S. Free Trade Agreement<sup>37</sup>. Article 1603 of the FTA contains a more limited list of prohibited performance requirements than NAFTA but reference to that article shows that the Parties were prepared to agree that export requirements previously excused by the GATT Panel were to be included in the list of prohibited performance requirements<sup>38</sup>.

89. A comparison between FTA Article 1603 and NAFTA Article 1106 shows that the list of prohibited performance requirements was lengthened.

90. The purpose of Article 1106, therefore, was to impose restrictions on a NAFTA Party's ability to require investors to meet certain performance requirements for industrial policy reasons<sup>39</sup>.

91. It can be seen from this brief recapitulation of the treatment of performance requirements that the genre of measures that concerned the Parties was qualitatively different from the measures complained of in this proceeding.

92. It is obvious that the softwood lumber quota available under the SLA possesses value (due to its scarcity premium). There is more demand for quota than supply in Canada. Mexico understands that the purpose of the "use it or lose it" rule in quota allocation, for example, is for Canada to ensure that its lumber industry as a whole is able to fully utilize the restricted access that it has to the U.S. market as a result of the SLA.

93. This is simply not the type of measure covered by Article 1106 when drafting Article 1106 (1) (a), the Parties were considering disciplining such policies as investment promotion schemes which made governmental grants or approvals dependent upon extracting a commitment by a foreign (or in some cases, a domestic investor) to use the investment as an "export platform" to generate foreign exchange, for example. The meaning of Article 1106.1 as a whole is informed by the types of performance requirements that are subject to its disciplines. A perusal of subparagraphs (a) to (g) makes it clear that performance requirements are not to be used for industrial development goals as was once commonly the case.

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37. See Article 1603.

38. See Article 1603 of the FTA. Canada's officially annotated version of the FTA commented: "Article 1603: limits on certain performance requirements. Both countries have agreed to prohibit investment-related performance requirements (such as local content and import substitution requirements) which significantly distort bilateral trade flows. The negotiation of product mandate, research and development, and technology transfer requirements with investors, however, will not be precluded. Moreover, this Article does not preclude the negotiation of performance requirements attached to subsidies or government procurement." Canada-U.S. Free Trade Agreement, Minister of Supply and Services Canada (1988) at page 230. Negotiations on performance requirements also took place in Uruguay Round of Multilateral Trade Negotiations while the NAFTA negotiations were underway.

39. See NAFTA Article 1106(5) which reads:

5. Paragraphs 1 and 3 do not apply to any requirement other than the requirements set out in those paragraphs.

94. As noted above, even if Canada's measures taken to implement the SLA could somehow be covered by Article 1106, as measures reasonably necessary to implement the SLA they would be protected from NAFTA challenge by virtue of the subsequent treaty.

95. Thus, notwithstanding the Claimant's characterization of various aspects of the SLA's implementation as performance requirements, these are simply not the type of measures that the Parties were seeking to discipline in Article 1106.

#### F. Conclusion

96. Mexico has reviewed carefully the pleadings and the Tribunal's Award of January 26, 2000 in relation to the Preliminary Motion on jurisdiction by the Government of Canada. It recognizes that the Tribunal was obliged to base its Award upon the facts as alleged by the Claimant<sup>40</sup>. Nevertheless, Mexico respectfully submits that close examination of this claim confirms the points made by both Canada and Mexico in their earlier submissions. While the Tribunal may well have considered a jurisdictional hearing to be too premature to consider the applicability of the relevant NAFTA provisions to the Claimant's allegations, in Mexico's respectful submission, when examined carefully, the pleadings do not state a claim that can succeed under Chapter Eleven.

97. In Mexico's respectful submission, the interpretations advanced by the Claimant have been strained and are unsupported by the plain language of the text.

98. Chapter Eleven is an important development in North American investment relations, particularly in its conferral of a right of direct access to investors. In so doing, the Parties removed the screening mechanisms used by States when they decide whether to espouse claims on behalf of their nationals. This, of course, frees investors to advance claims and arguments that their State would not have considered to have merit.

99. Mexico intervened in the jurisdictional motion and in the proceeding on the merits because the Claimant's propositions of law are so startling and incorrect that Mexico considered it necessary to express its views.

100. Articles 1116 and 1117 permit an investor to submit a claim based on an alleged breach of any of the obligations in Section A of Chapter Eleven and two other sections of the NAFTA<sup>41</sup>. An investor is not permitted to submit a claim based on any other article of the NAFTA. Where, as here, an investor has characterized what is in reality a complaint about being restricted in its ability to export lumber to the United States as an "expropriation" and a breach of other Chapter Eleven obligations, it is incumbent upon this Tribunal to give effect to the whole of the treaty.

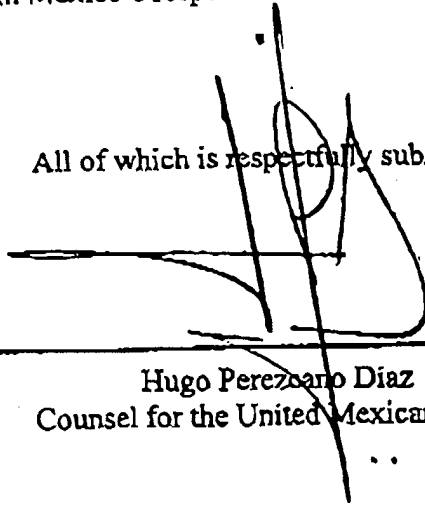
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40. Award at paragraph 25.

41. Articles 1503(2) and 1502(3)(a).

101. All three Parties have fundamental policy interests (not the least of which is the need to husband scarce government resources) in ensuring that tribunals interpret the scope and coverage of Chapter Eleven so as to apply to genuine disputes over "measures adopted or maintained by a Party relating to" investors and investments. In Mexico's respectful submission, this is not such a case.

All of which is respectfully submitted:



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