Hugo Perezcano Díaz
Consultor Jurídico de Negociaciones

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The Honorable Lord Dervaird

4 Monray Place Edinburg EH3 6DS

Fax: 44 131 220 06 44

Mr. Murray J. Belman

Thompson Coburn

700 14th Street, N.W., Sutite 900

Washington, D.C. 20005-2010

Fax: 508 10 10

The Honourable Benjamin Greenberg, Q.C.
Stikeman, Elliot 40e étage, 1155 boul. René Lévesque Ouest, Montreal, PQ H3B 3V2

Fax: (514) 397 32 22

RE: Pope & Talbot v. Government of Canada

SUPPLEMENTAL SUBMISSION OF THE UNITED MEXICAN STATES

This submission is made by the Government of Mexico pursuant to Article 1128 of the NAFTA and the Tribunal's directions at the closing of the hearing of the Initial Phase.

Having heard the testimony, the oral submissions of the disputing parties, and the questions and comments of the members of the Tribunal, Mexico wishes to make further submissions on two matters—the proper interpretation of Articles 1102 (National Treatment) and 1110 (Expropriation and Compensation).

Mexico will not make further submissions on Article 1106 (Performance Requirements) It reiterates paragraphs 85 to 95 of its first submission and acknowledges its general agreement with paragraphs 9 to 13 of the first submission filed by the United States and Section E of Part Three of Canada's Counter-memorial.

A. Article 1102: National Treatment

This section responds to submissions made in Section Four of the claimant's supplementary memorial. Canada did not address such submissions in writing as it apparently was not given a opportunity to file a reply, and neither Mexico nor the United States have commented on those submissions as the supplementary memorial was filed after the filing of their first submissions on

questions of interpretation. Accordingly, Mexico requests the Tribunal to consider carefully the following submissions[1].

The claimant contends that Article 1102 entitles it to receive the best level of treatment available to any lumber producer in Canada or, failing that, to any lumber producer located in the four provinces covered by the SLA. It contends further that Article 1102's objective is to create "equality of competitive opportunity" among investors of the NAFTA parties that are "in like circumstances" which, it submits, consists of all producers in Canada who compete for sales of the same product in the same market—i.e., the sale of softwood lumber to the U.S. market, regardless of where such producers are situated.

This claim is advanced even though Canadian-owned producers in British Columbia subject to the same measures that apply to the claimant—i.e. allocation of EB quota and the application of LFB, UFB and SFB export fees—are treated no more favorably than the claimant. Indeed, nowhere has the claimant advanced or adduced evidence supporting the proposition that the Canadian authorities have treated U.S. investors, or investments of U.S. investors, either individually or as a class, less favorably than Canadian investors, or investments of Canadian investors, either individually or as a class.

Mexico submits that the interpretation urged by the claimant is simply wrong and, if accepted, would have dangerous and completely unintended ramifications because it would unduly broaden the scope of the national treatment rule.

1. The Central Requirement of a Claim of Breach of National Treatment

The flaw in the claimant's argument is that it ignores Article 1102's focus on the essential feature of the obligation, namely, the obligation to refrain from engaging in discriminatory treatment based upon investor nationality which results in more favorable treatment to domestic investors.

It should be noted that mere differential treatment between domestic and foreign investors does not in and of itself breach the national treatment rule: the discrimination must result in less favorable treatment. States are free to differentiate between domestic and foreign goods, investors, and service providers and frequently do so[2]. They do not breach the national treatment rule simply because they do so. An additional element of the differential treatment, which is the

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1. Mexico reiterates paragraphs 62 to 84 of its original submission and acknowledges its general agreement with the submissions of the United States in paragraphs 2 to 8 of its first submission and of the submissions of Canada Section D of Part Three of its Counter-memorial.

2. It goes virtually without saying that they are also free to make distinctions between their own investors.

sine qua non of the breach, must be present: a resulting preferential treatment of domestic investors.

The claimant has attempted to avoid this requirement by interpreting the "in like circumstances" phrase as referring simply to investors who compete in the same market rather than, as the text of Article 1102 requires, a comparison of the treatment of foreign-owned or controlled investors with treatment of domestically-owned or controlled investors. The claimant thus omits any reference to the article's focus upon the discrimination being based upon the claimant's nationality, and any resulting preferential treatment of domestic investors.

Canada, the United States and Mexico have each submitted that the objective of Article 1102 is to prohibit discrimination between investors of the Parties on the basis of their nationality. Their submissions on this point are fully consistent with the language of Article 1102.

As the sovereign States who both drafted and signed the international treaty, their shared view must be considered to be authoritative. The concurrence of the United States, the Party of the investor, shows the settled and uncontroversial nature of the interpretation advanced by each of the NAFTA Parties.

2. The Text of the NAFTA

Article 1102 (1) requires each Party to accord "to investors of another Party" treatment no less favorable than the treatment it accords, in like circumstances "to its own investors" with respect to, *inter alia*, the management, conduct and operation of investments. Article 1102 (2) stipulates the same requirement as between the treatment a Party accords "to the investments of the investors of another Party" and the treatment it accords "to the investments of its own investors".

Article 1139 defines "investor of a Party" as "a Party or state enterprise thereof, or a national or enterprise of such Party, that ... has made an investment". Article 201 provides that "national means a natural person who is a citizen or permanent resident of a Party..." and that "enterprise of a Party means an enterprise constituted or organized under the law of a Party".

Applying the ordinary meaning of the language of Article 1102, and the defined terms it incorporates, a finding of denial of national treatment can be made only where the host country accords better treatment to investors who are its citizens or permanent residents, or enterprises constituted under its laws, than it does to investors who are citizens, permanent residents or enterprises of the other Parties. The finding relies upon proof of discriminatory treatment of investors based upon nationality.

Discrimination may be *de jure*, appearing on the face of the impugned measure, or *de facto*, evident only in the application of the challenged measure. In either case, the measure must have the effect of favoring domestic investors over the investors of another Party[3].

3. The GATT/WTO Jurisprudence

The WTO-GATT jurisprudence applicable to the national treatment rule is to the same effect. In every case where a measure was held to violate GATT Article III, it was found to discriminate between domestic and imported products on the basis of national origin.

With regard to GATT/WTO jurisprudence, the claimant makes much of the "competitive opportunities" doctrine relating to Article III of the GATT. The claimant has asserted that since the underlying purpose of the national treatment rule is to preserve competitive opportunities, any action which affects such opportunities amounts to a breach of the rule.

With the greatest of respect to the claimant it has confused the article's purpose with its legal test. Equality of competitive opportunities is, to quote a GATT Panel, the "underlying principle" of the rule[4]. However, a panel must find less favorable treatment based on the origin of the product in 'trade in goods' cases and the nationality of the capital in 'investment/trade in services' cases before it can find a denial of national treatment. It is that less favorable treatment accorded to imported goods or to foreign investors or service providers that results in the denial of competitive opportunities.

What the claimant has done in the instant case is to assert that producers in the non-covered provinces—regardless of their nationality of ownership—receive better treatment because they are not subject to SLA export controls or, in the alternative, that producers in Quebec—regardless of nationality—may collectively have received a slightly greater share of export quota than producers in British Columbia—regardless of nationality—collectively have received. It has asserted that this resulted in a denial of competitive opportunities. As seen above, this does not meet the proper legal test.

The point was made clearly in one of the GATT panel reports that the claimant relies upon, *United States—Section 337 of the Tariff Act of 1930*[5]. There the Panel stated:

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3. The Claimant misconstrues Canada's position on this point when it says that Canada would insist on an aim and effects tests. See paragraph 53 of the Claimant's Supplementary Memorial. Canada has stated clearly that the measure complained of must have the intent or the effect of discriminating on the basis of nationality. See paragraphs 166, 177 and 194 of Canada's Counter-memorial.

4. See paragraph 25 below.

5. L/6439, adopted on 7 November 1989, 36S/385.

> 5.11 The Panel noted that, as far as the issues before it are concerned, the 'no less favorable' treatment requirement set out in Article III:4, is unqualified. These words are to be found throughout the General Agreement and later agreements negotiated in the GATT framework as an expression of the underlying principle of equality of treatment of imported products as compared to the treatment given either to other foreign products, under the most favored nation standard or to domestic products, under the national treatment standard of Article III. The words 'treatment no less favorable' in paragraph 4 call for effective equality of opportunities for imported products in respect of the application of laws, regulations and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution or use of products. This clearly sets a minimum permissible standard as a basis. On the one hand, contracting parties may apply to imported products different formal legal requirements if doing so would accord imported products more favorable treatment. On the other hand, it also has to be recognized that there may be cases where application of formally identical legal provisions would in practice accord less favorable treatment to imported products and a contracting party might have to apply different legal provisions to imported products to ensure that the treatment accorded to them is in fact no less favorable. *** In such cases, it has to be assessed whether or not such differences in the legal provisions applicable do or do not accord to imported products less favorable treatment. Given that the underlying objective is to guarantee equality of treatment, it is incumbent on the contracting party applying differential treatment to show that, in spite of such differences, the no less favorable treatment standard of Article III is met[6]. [Emphasis added]

To quote the GATT Panel, it "has to be assessed whether or not such differences in the legal provisions applicable do or do not accord to imported products less favorable treatment" when applying the national treatment test in the context of trade in goods. The same approach applies in the case of investment under Chapter Eleven of the NAFTA.

While it is fair to say that the underlying purpose of Article 1102 (like the purpose of Article III of the GATT for goods and Article XVII of the GATS for services), is to create a "a degree of competitive equality between national and foreign investors" as the Claimant contends, GATT/WTO jurisprudence and the proper interpretation of Article 1102 requires a finding of discriminatory less favorable treatment based upon the national origin of the investor in order to find a denial of national treatment. Moreover, as will be explained in further detail below, the concept of "like circumstances" as it applies to investment involves a broader range of considerations than the concept of "like products" as it applies to trade in goods.

4. The United States' Submission

As Mexico filed its first submission prior to that of the United States, Mexico did not have the opportunity to comment upon it. In general, the U.S. submission was fully consistent with Mexico's.

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6. Ibid., at p. 386.

The United States stated that "(t)he NAFTA Parties did not intend Article 1102 to foreclose the use of location-based regulatory measures because such measures have the effect of advantaging some investors and disadvantaging other investors, including those from other NAFTA Parties". The United States observed, by way of example, that it limits business activities in certain environmentally sensitive areas and imposes stricter emission controls in certain urban areas[7].

Mexico concurs in the view that Article 1102 does not prevent the NAFTA Parties from implementing location-based measures to achieve regulatory objectives. In addition to environmental objectives, Mexico submits that location-based measures that address social, economic, health, safety or other policy objectives do not violate Article 1102, unless such measures accord less favorable treatment to investors of another Party (or their investments) when compared to treatment accorded, in like circumstances, to domestic investors.

5. Mr. Belman's Questions

During Canada's oral submissions, Mr. Belman posed the following hypothetical question:

> Supposing you had this situation: British Columbia and Quebec subsidized their wood producers and the United States industry was up in arms and Canada went in and negotiated with the United States, and said, 'Okay, we're going to take care of this. We're going to put a prohibitive tax on exports of British Columbia wood, but we're not going to tax Quebec wood at all.' And the United States said, 'Fine', Canada said, 'Fine', and that was the regime. Would you say that because all British Columbia producers are disadvantaged. that an American producer in British Columbia couldn't claim that they're entitled to the same treatment as the Quebec producers?[8]

In Mexico's respectful view, this was an extreme example apparently intended to test the propositions advanced by counsel and did not reflect the evidence in the proceeding. That notwithstanding, had the question been posed to it, Mexico would have responded that, absent cogent evidence indicating that the difference in treatment between the two provinces was based upon the nationality of ownership of the producers situated therein, the answer would be "yes".

Unless the foreign versus domestic ownership pattern in Quebec and B.C. was not substantially and materially different, there would be no basis for advancing a denial of national treatment claim on the hypothetical posed by Mr. Belman. The reason would be that Canadian-owned and U.S.-owned lumber producers in British Columbia would be treated the same way, just as Canadian-owned and U.S.-owned lumber producers in Quebec would be treated the same way (albeit more favorably when compared to B.C.). A distinction between two provinces is not one based upon the nationality of ownership of the producers located therein.

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7. Ibid., paragraphs 6 and 7.

8. Transcript of the Proceedings, Volume VII (May 4, 2000) at page 81, line 4-18

Only if the evidence showed that there was a substantial and material difference between the two provinces in terms of foreign versus domestic ownership of producers could there be a basis for advancing a claim that the treatment accorded by Canada to investors of another Party was less favorable than it accords, in like circumstances, to its own investors. Even then, the claimant would have to prove that the producers in the two provinces were in like circumstances. This would be consistent with the approach taken in 'trade in goods' and services disputes. As Canada correctly notes in its Counter-memorial, in every case where a violation of GATT Article III has been found, the measure was found to discriminate in law or in fact on the basis of nationality. Either the "favored" like product was found to be wholly or overwhelmingly of domestic origin, or the disfavored like product was found to be wholly or overwhelmingly of foreign origin, and there was no apparent reason other than discrimination by national origin to explain the difference[9].

Embedded in Mr. Belman's question was the assumption that producers in the two provinces were 'in like circumstances'. Even if this assumption were true, absent cogent evidence that any difference in treatment discriminated on the basis of nationality there can be no breach of Article 1102 and, the subsequent question of whether producers are in like circumstances is moot.

Moreover, practically speaking, for the governments of Canada and the United States to differentiate between the two provinces in such a dramatic fashion there would almost certainly be agreement between them that the B.C. and Quebec producers were not in like circumstances. This might be the case if the level of alleged subsidization in B.C. was considered by the U.S. government to be significantly higher than in Quebec such as to justify distinguishing between the two provinces. Or there might be other relevant differences which would lead the two NAFTA Parties to distinguish between the two provinces.

Of course, as noted above, the question was an extreme one and does not reflect the reality of the lumber dispute or international trade disputes generally. Leaving aside the fact that it would be politically impossible for Canada to make one province shoulder the burden of a trade dispute involving another province, if the U.S. considered that both provinces were subsidizing their producers, the Tribunal can rest assured that it, like any other state, would insist on both offending provinces being covered by any agreement. Otherwise, there would be a substitution effect in the U.S. market as restricted B.C. exports were replaced by unrestricted Quebec exports; to this extent, therefore, the example posed is truly hypothetical.

In later exchanges with counsel for Canada, Mr. Belman made the following comments:

> So ... you don't have to go look around for any provision that is intended or has the effect of disadvantaging foreign producers. You don't have to have that, all you have to

9. See paragraph 177 of Canada's Counter-memorial.

> do is have a foreign producer who can claim that he is in like circumstances to other producers in Canada that get better treatment.[10]

and:

> It happens all the time in the national treatment division (sic), because the requirement is just to find somebody in like circumstances and that could be everybody in like circumstances [or] (a)nybody in like circumstances.[11]

Mexico respectfully disagrees with the premise of Mr. Belman's remarks. In Mexico's respectful submission, to the contrary, a finding of denial of national treatment does require the Tribunal to conclude that the impugned measure has the effect of disadvantaging foreign producers and in the absence of such a finding no breach of the obligation can be made out. It is not enough that some other investor receives better treatment than the Claimant.

Moreover, as noted in Mexico's first submission, the "like circumstances" determination requires an assessment of all relevant factors to determine whether investors or their investments are truly comparable. It is not enough to simply focus on the fact that a group of producers serve a particular market. This does not suffice to determine likeness.

The GATT/WTO cases cited by the disputing parties in the instant proceeding show the careful examination of many factors before a determination of likeness is made. Mere participation in a market is only one such factor.

In the first WTO case to consider the matter, *Japan—Taxes on Alcoholic Beverages*, the WTO Appellate Body commented that the GATT's approach to narrowly defining "like products" when applying Article III:1 should be continued under the WTO[12]:

> How narrowly is a matter that should be determined separately for each tax measure in each case. We agree with the practice under the GATT 1947 of determining whether imported and domestic products are "like" on a case-by-case basis. The Report of the Working Party on *Border Tax Adjustments*, adopted by the CONTRACTING PARTIES in 1970, set out the basic approach for interpreting "like or similar products" generally in the various provisions of the GATT 1947:
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> > ... the interpretation of the term should be examined on a case-by-case basis. This would allow a fair assessment in each case of the different elements that constitute a "similar" product. Some criteria were suggested for determining, on a case-by-case basis, whether a product is "similar": the product's end-uses in a given market;

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10. Transcript of the Proceedings, Volume VII (May 4, 2000) at page 84, line 14-21
11. Transcript of the Proceedings, Volume VII (May 4, 2000) at page 201, line 22-26
12. WT/DS8/AB/R, 4 October 1996, at p. 19.

> consumers' tastes and habits, which change from country to country; the product's properties, nature and quality.[13]

To apply the principles underlying the "like product" analysis to determining "like circumstances" in the treatment of domestic and foreign investors, simply focusing on a general description of the goods that the investors produce ("softwood lumber", a description which covers many different types of products) and the fact that many investors export to a particular export market (the United States) does not suffice for determining the appropriate classes of investors in Canada who are to be compared under Article 1102. The concept of "like circumstances" requires a broader and different set of considerations than the concept of "like products". It has to be sufficiently flexible to accommodate all of the forms of "investment" enumerated in Article 1139, including forms of investment that are entirely passive—that do not involve the production of goods or the provision of a service—unlike the investments that are at issue in this case.

The Tribunal is respectfully directed back to paragraph 71 of Mexico's first submission where it set out a list of the potential factors that might be employed to apply the 'like circumstances' test.

B. Article 1110: Expropriation and Compensation

During the course of the hearing, questions by the Tribunal and submissions of counsel touched on whether, in order to establish that a measure is "tantamount" to expropriation, the claimant must show that the effect of the impugned measure on its investment exceeded a "*de minimis* threshold".

In response to this question, Mexico refers paragraphs 36 to 46 of its original submission, and in particular, paragraph 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.

Mexico agrees with the United States[14] and Canada that the NAFTA Parties did not intend, by inclusion of the phrase "or take a measure tantamount to nationalization or expropriation", to create a *lex specialis* that would enable an investor to sue for loss of revenue or diminution in value of its investment resulting from regulatory measures that impede or impair the investment's ability to carry on business as it sees fit, or to have unlimited access to a particular market.

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13. Ibid., at p. 21.

14. See the United States' original submission at paragraph 14 and the referenced attachment.

Rather, for the act complained of to be tantamount to expropriation, it must be equivalent to an expropriation. This means at a minimum a substantial and long-standing, if not complete and permanent, deprivation of the investor's ownership or control over the investment.

As in the case of national treatment, the Tribunal should place great weight on the shared views of the three States party to the agreement.

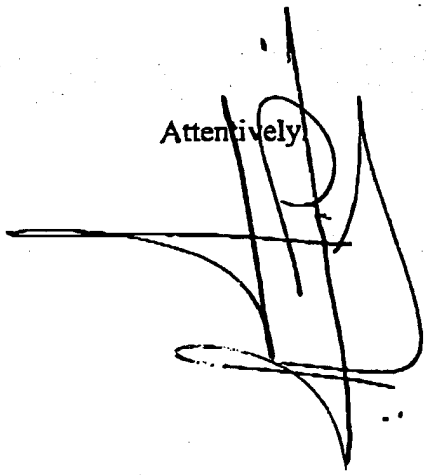
Returning to the *de minimis* threshold approach posited in the hearing, in Mexico's view, the claimant must indeed show that the effect of the impugned measure on its investment exceeded a "threshold". However, the threshold in question is far higher than some *de minimis* level; it requires governmental action that is equivalent to nationalization or expropriation.

The three national governments and some ninety-one sub-national state and provincial governments in the NAFTA region regularly implement measures that have practical and economic consequences–some positive, others negative—on commercial enterprises that carry on business within their respective territories. To construe Article 1110 as obliging the Parties to pay compensation whenever a regulatory measure restricts the manner in which a commercial enterprise owned or controlled by an investor of another Party carries on business, or results in an alleged diminution in value of that enterprise, would have profound implications and would expose all three Parties to unintended claims.

The fact that the NAFTA parties did not intend Article 1110 to allow claims for damages arising from effects of regulatory measures on business operations or diminution in asset value is evidenced by the standard of compensation prescribed by Article 1110 (2). It calls for payment "equivalent to the fair market value of the expropriated investment immediately before the expropriation took place", not for loss of revenue suffered as a direct or indirect result of the impugned measure or diminution in value based on the difference between the fair market value of the investment prior to the implementation of the impugned measure and what it was worth thereafter. This text underscores the point that there must be a transfer or deprivation of the investor's ownership or control over the investment in order to find a breach of Article 1110.

In the instant case, of course, there has been no such transfer or deprivation of ownership or control. Pope & Talbot remains under the full control of its shareholders and officers and has continued to carry on business as a producer of softwood lumber, notwithstanding that its access to the U.S. market was restricted as a result of the SLA.

Finally, as pointed out in Mexico's first submission, if the claimant is right, not only it but all investors in the covered provinces have been expropriated. To state the proposition is to refute it.



Cc. Fulvio Fracassi.- Senior Counsel, Trade Law Division of Canada.-Via Facsimile.
Barton Legum, Chief, NAFTA Arbitration Division.- USA.- Via Facsimile
Barry Appleton, Appleton & Associates International Lawyers.- Via Facsimile