
**PERFORMANCE REQUIREMENT
PROHIBITIONS IN INTERNATIONAL
INVESTMENT LAW: COMPLEX,
CONSTRAINING AND A POTENTIAL THORNE
IN U.S.-INDIA BIT NEGOTIATIONS**

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I. INTRODUCTION

A. India-U.S. BIT Negotiations

Negotiations toward a bilateral investment treaty (“BIT”) between India and the United States (“U.S.”) were launched in August 2009.¹ Four years later, India and the U.S. had completed three rounds of negotiations² after India studied the U.S. Model BIT closely³ and forwarded pre-conditions to further negotiations with the U.S. in July 2013.⁴ Since these pre-conditions, negotiations have been described by some observers as “going nowhere”,⁵ which hints at the difficulties already dividing the potential investment treaty partners.

Finding common ground on performance requirement prohibitions between two countries with opposite views on the matter represents one of the many formidable challenges facing Indian and American negotiators. This article proposes to take a closer look at performance

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1 PTI, India, US Complete 3 Rounds of Negotiations for BIT, ECONOMIC TIMES OF INDIA, Aug. 5, 2013, http://articles.economictimes.indiatimes.com/2013-08-05/news/41093194_1_india-us-trade-policy-forumthree-rounds-treaty.

2 Id.

3 India Still Reviewing U.S. Model BIT; No Formal Negotiations Yet Slated, INSIDE U.S. TRADE, Dec. 19, 2012, <http://insidetrade.com/Inside-Trade-General/Public-Content-World-Trade-Online/india-still-reviewing-usmodel-bit-no-formal-negotiations-yet-slated/menu-id-896.html>.

4 Amrutha Gayathri, India Could Set Preconditions For Investment Treaty With US During Vice President Joe Biden’s Visit, While US Businesses Cry Foul Over India’s Policies, INTERNATIONAL BUSINESS TIMES, Jul. 23 2013, <http://www.ibtimes.com/india-could-set-preconditions-investment-treaty-us-during-vice-president-joebidens-visit-while-us>.

5 Ashish Goel & Harish Goel, India–US Bilateral Investment Treaty Going Nowhere, EAST ASIA FORUM, Aug. 31, 2013, online: <http://www.eastasiaforum.org>.

requirement prohibitions within BITs and free trade agreements (“FTAs”) concluded respectively by India and the U.S. in order to gain some insight into their respective negotiating positions.

B. Performance Requirements: Definition and Public Policy Considerations

States around the world, having labeled foreign direct investment (“FDI”) an indispensable ally in their quest for greater economic development, have resorted to performance requirements (including trade-related investment measures or “TRIMs” and also referred to as host country operational measures (“HCOMs”)) in order to impose obligations upon investors that aim at increasing their contribution to specific public policy objectives.

Certain States – and most prominently the United States – have concluded that performance requirements distort trade and FDI, driving them to include performance requirement prohibitions within numerous bilateral and regional free trade and/or investment agreements (hereinafter international investment agreements or “IIAs”).

Performance requirements, generally left undefined in IIAs, can be defined as “host-state restrictions on the use of inputs and outputs by investments.”⁶ Conceptually speaking, performance requirements could comprise as all State measures that “restrict the inflow of foreign investment” and therefore distort “the pattern of both production and trade”.⁷ Such purely theoretical approaches lead to a definition of performance requirements as encompassing nearly any measure affecting a firm’s profitability, imports and/or exports and just about any investment policy since by definition all investment policies distort the allocation of FDI among countries and therefore distort trade.⁸

6 KENNETH J. VANDEVELDE, *BILATERAL INVESTMENT TREATIES: HISTORY, POLICY, AND INTERPRETATION* 419 (Oxford University Press, 2010).

7 Mohamed Ariff, *TRIMs: a North-South Divide or a Non-issue?*, 12(3) *THE WORLD ECONOMY* 347, 347 (1989).

8 Dallas Deluca, *Trade-Related Investment Measures: U.S. Efforts to Shape a Pro-Business World Legal System*, (The Andrew Wellington Cordier Essay), 48(1) *JOURNAL OF INTERNATIONAL AFFAIRS* 251, 253 (Summer, 1994).

More pragmatically and illustratively, the Uruguay Round negotiations produced an illustrative list of 14 TRIMs that formed the basis of multilateral discussions surrounding TRIMs: investment incentives, local equity requirements, licensing requirements, remittance restrictions, foreign exchange restrictions, manufacturing limitations, transfer-of-technology requirements, domestic sales requirements, manufacturing requirements, product-mandating requirements, trade-balancing requirements, local content requirements, export requirements, and import-substituting requirements.⁹

Performance requirement prohibitions raise issues of policy space and can come into play regarding considerably sensitive matters of national sovereignty. The two investment arbitration awards analyzed in this article provide great examples: in *Lemire v. Ukraine*,¹⁰ the 50% local music broadcast requirement constituted an exercise in State sovereignty involving “deeply felt cultural or linguistic traits of the community”.¹¹ In *Mobil v. Canada*,¹² the research and development (R&D) and employment and training (E&T) expenditure requirements were targeted by reservations adopted by Canada as a precautionary step aimed at ensuring that they were exempt from the prohibition under NAFTA Article 1106. The reservations adopted by Canada led partially dissenting arbitrator Philippe Sands to recognize that these expenditure requirements constituted “matters of considerable national interest” and “matters of considerable significance and sensitivity in the relations between Newfoundland and Labrador and Canada”.¹³ Performance

9 UNITED NATIONS CENTRE ON TRANSNATIONAL CORPORATIONS [hereinafter UNCTC] & UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT [hereinafter UNCTAD], THE IMPACT OF TRADE-RELATED INVESTMENT MEASURES ON TRADE AND DEVELOPMENT, at 2, 11-12, UN Sales No. E.91 II.A.19 (1991).

10 Joseph Charles Lemire v. Ukraine, ICSID Case No. ARB/06/18, Decision on Jurisdiction and Liability, ¶ 499-511 (Jan. 14, 2010), <http://italaw.com/sites/default/files/case-documents/ita0453.pdf> [hereinafter *Lemire v. Ukraine*] regarding the North American Free Trade Agreement, U.S.-Can.-Mex., Dec. 17, 1992, 32 I.L.M. 289 (1993), available at: <https://www.nafta-sec-alena.org/Default.aspx?tabid=97&language=en-US> hereinafter the NAFTA .

11 Id. ¶ 505.

12 Mobil Investments Canada Inc. and Murphy Oil Corporation v. Government of Canada, ICSID Case No. ARB(AF)/07/4, Decision on Liability and Principles of Quantum (May 22, 2012), <http://italaw.com/sites/default/files/case-documents/italaw1145.pdf> [hereinafter *Mobil v. Canada* (Majority)].

13 Mobil Investments Canada Inc. and Murphy Oil Corporation v. Government of Canada, ICSID Case No. ARB(AF)/07/4, Partial Dissenting Opinion, Professor Philippe Sands Q.C., ¶ 5, 7 (May 17, 2012), http://italaw.com/sites/default/files/case-documents/italaw1146_0.pdf [hereinafter *Mobil v. Canada* (Dissent)].

requirement prohibitions therefore provide a new battleground for the “public-private debate”, in addition to debates along the lines of the North-South divide, whereby a necessary and delicate balance must be struck between rights of private investors and obligations of host States.¹⁴

As discussed in greater detail below, performance requirement prohibitions also raise delicate issues pertaining to the predictability of international investment law: the two most recent investor-state arbitrations having applied performance requirement prohibitions (*Lemire v. Ukraine*, 2010 and *Mobil v. Canada*, 2012) have produced diametrically opposite understandings and outcomes with respect to the alleged violations of performance requirement prohibitions. As such, the *Lemire v. Ukraine* (highly deferential to State sovereignty) and *Mobil v. Canada* (highly assertive of investor rights) find themselves at opposite ends of this newly formed spectrum on State sovereignty and investor protection regarding performance requirements. Moreover, the Majority Award in *Mobil v. Canada* has shown the limits and potential inefficiency of reservations adopted to carve-out certain measures from the scope of performance requirement prohibitions.

The uncertainty surrounding the interpretation and application of performance requirement prohibitions, the complexity of the language used in such clauses and the controversy surrounding their underlying economic rationales warrant taking a closer look at performance requirement prohibitions in the context of negotiations between India and the United States, an issue that will likely divide more than it will unite Indian and American negotiators.

14 WENHUA SHAN, *The Protection of Foreign Investment in GENERAL REPORTS OF THE XVIIIITH CONGRESS OF THE INTERNATIONAL ACADEMY OF COMPARATIVE LAW/ RAPPORTS GÉNÉRAUX DU XVIIIÈME CONGRÈS DE L'ACADÉMIE INTERNATIONALE DE DROIT COMPARÉ* 467, 504 (K.B. Brown and D.V. Snyder eds., 2012).

II. PERFORMANCE REQUIREMENTS AND INDIAN AND U.S. IIAS: A SNAPSHOT

A. *Overview of Indian IIAs and Performance Requirement Prohibitions*

1. *Indian BITs*

According to the Indian Ministry of Finance¹⁵ and UNCTAD,¹⁶ India has signed 82 BITs, 73 of which had entered into force as at September 20, 2013. Among the 73 Indian BITs consulted, only one included a provision dealing with performance requirements: the BIT with Kuwait. Signed on November 27, 2001 and entered into force on June 28, 2003, Article 4(4) (Protection of Investments) of the India-Kuwait BIT reads as follows:

4. Once established. investment shall not be subjected in the host Contracting State to additional performance requirements which may hinder or restrict their expansion or maintenance or adversely affect or be considered as detrimental to their viability . unless such requirements are deemed vital for reasons of public order, public health or environmental concerns and are enforced by law of general application.

15 INDIAN MINISTRY OF FINANCE, BILATERAL INVESTMENT PROMOTION & PROTECTION AGREEMENT (BIPAS) at: http://finmin.nic.in/bipa/bipa_index.asp?pageid=1 hereinafter INDIAN BIPAS WEBSITE.

16 UNCTAD, COUNTRY-SPECIFIC LISTS OF BILATERAL INVESTMENT TREATIES, [http://unctad.org/en/Pages/DIAE/International%20Investment%20Agreements%20\(IIA\)/Country-specific-Lists-of-BITs.aspx](http://unctad.org/en/Pages/DIAE/International%20Investment%20Agreements%20(IIA)/Country-specific-Lists-of-BITs.aspx) hereinafter UNCTAD'S BIT LIST . According to the INDIAN BIPAS WEBSITE, supra note 15, India has not concluded a BIT with Montenegro, while UNCTAD'S BIT LIST for India mentions that such a BIT was concluded, but has not yet entered into force. Moreover, the INDIAN BIPAS WEBSITE, supra note 15 indicates that the BIPA with Colombia was signed, but has not yet entered into force, while UNCTAD'S BIT LIST for India indicates that the BIPA with Colombia has entered into force and the text of the BIPA with Colombia is available on the UNCTAD website at: UNCTAD, INTERNATIONAL INVESTMENT AGREEMENTS DATABASE, <http://investmentpolicyhub.unctad.org/Views/Public/IndexIIA.aspx> hereinafter UNCTAD IIA DATABASE .

This performance requirement prohibition exhibits interesting features. First, it applies to investments in the post-establishment phase and therefore does not prohibit the host State from conditioning access to its economy upon compliance with performance requirements. Second, it provides for an exception allowing a host State to impose performance requirements upon established investments when justified by public order, public health or environmental concerns.

Nevertheless, the presence, in only one out of 73 BITs, of a performance requirement prohibition whose scope and coverage is moreover limited and permissive suggests that India will resist a comprehensive performance requirement prohibition in an eventual BIT with the United States. This impression is reinforced by the absence of any reference to performance requirements within the Indian Model Text of Bilateral Investment Promotion and Protection Agreement (BIPA).¹⁷

2. *Indian Comprehensive Economic Agreements*

Hope for successful negotiations on a performance requirement prohibition between India and the U.S. can be gleaned from three recently signed Comprehensive Economic Agreements. First, Article 6.23 of the Comprehensive Economic Cooperation Agreement (“India-Singapore CECA”) between the Republic of India and the Republic of Singapore, signed on June 29, 2005, incorporates the WTO Agreement on Trade-Related Investment Measures¹⁸ within the India-Singapore CECA.¹⁹ The performance requirement prohibition of the India-Singapore CECA would therefore be limited to measures applicable to trade in goods only (as opposed to services) and to the list of TRIMs as prohibited by the WTO TRIMs Agreement. Article 6.16 of the India-

17 INFRASTRUCTURE AND INVESTMENT DIVISION, DEPARTMENT OF ECONOMIC AFFAIRS, GOVERNMENT OF INDIA, INDIAN MODEL TEXT OF BILATERAL INVESTMENT PROMOTION AND PROTECTION AGREEMENT (BIPA), http://finmin.nic.in/the_ministry/dept_eco_affairs/icsection/Indian%20Model%20Text%20BIPA.asp?contrastsheme=Standard&textsize=Largest&pageid=1.

18 Agreement on Trade-Related Investment Measures, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, THE LEGAL TEXTS: THE RESULTS OF THE URUGUAY ROUND OF MULTILATERAL TRADE NEGOTIATIONS 143 (1999), 1868 U.N.T.S. 186 [hereinafter TRIMs Agreement].

19 See Article 6.23 of the India-Singapore CECA at: http://commerce.nic.in/trade/international_ta_framework_ceca.asp.

Singapore CECA provides that the performance requirement prohibition (Article 6.23) does not apply to exceptions specified by the Parties nor to reservations made in respect of the measures specified in Annexes 6A and 6B.

Second, Article 10.5 of the Comprehensive Economic Partnership Agreement between the Republic of India and the Republic of Korea (“India-Korea CEPA”),²⁰ signed on August 7, 2009, lays out a performance requirement prohibition substantively similar to Article 1106 of the North American Free Trade Agreement (“NAFTA”).²¹ However, Article 10.5(3) provides for a strange caveat by stating that nothing in Article 10.2 of the India-Korea CEPA must be construed so as to derogate from the Parties’ rights and obligations under the WTO TRIMs Agreement. The difficulty of reconciling a NAFTA-type performance requirement prohibition with the WTO TRIMs Agreement raises serious issues of clarity and scope that warrant further analysis. The Schedules to Annex I (Explanatory Notes) set out the reservations adopted by India and Korea in respect of Non-Conforming Measures in accordance with Article 10.8 of the India Korea CEPA. Pursuant to Article 10.9(2) of the India Korea CEPA, the Parties committed to consider decreasing their reservations to the performance requirement prohibition.

Third, Article 89 of the Comprehensive Economic Partnership Agreement between the Republic of India and Japan (“India-Japan CEPA”), signed on February 16, 2011,²² consists of a performance requirement prohibition substantively similar to Article 1106 of the NAFTA. By contrast with the India Korea CEPA, Article 89 of the India-Japan CEPA does not refer to the WTO TRIMs Agreement.

The previous Indian Comprehensive Economic Agreements suggest a potential openness on India’s side to include a relatively comprehensive performance requirement prohibition within a BIT with the U.S.

20 See Article 10.5 of the India-Korea CEPA at: http://commerce.nic.in/trade/international_ta.asp?id=2&trade=i.

21 See Article 1106 of the NAFTA at: <https://www.nafta-sec-alena.org/Default.aspx?tabid=97&language=en-US>.

22 See Article 89 of the India-Japan CEPA at: http://commerce.nic.in/trade/IJCEPA_Basic_Agreement.pdf.

B. Overview of U.S. IIAs and Performance Requirement Prohibitions

1. U.S. BITs

Based on data made available by UNCTAD and the U.S. Department of Commerce's Trade Compliance Center, the United States has signed 47 BITs, 41 of which have entered into force.²³ The United States has included performance requirement prohibitions in all 41 of its BITs that have entered into force.²⁴

Moreover, the 2012 U.S. Model BIT includes the most elaborate performance requirement prohibition to date, which suggests that the U.S. might tolerate only minimal dilution of a performance requirement prohibition in order to conclude a BIT with India.²⁵

2. U.S. FTAs

The United States has signed free trade agreements in force with 20 countries. Among these, the FTAs with the following countries provide for performance requirement prohibitions that are virtually identical to that of the 2004 U.S. Model BIT: Australia, Chile, Colombia, Israel, Korea, Morocco, Oman, Peru, Singapore, along with the FTA, known as "CAFTA-DR", concluded with Costa Rica, the Dominican Republic, El Salvador, Guatemala, Honduras and Nicaragua, and the NAFTA concluded with Canada and Mexico. Only the FTAs with Bahrain and Jordan do not include provisions on investment and therefore do not include performance requirement prohibitions.²⁶

23 See UNCTAD'S BIT LIST, *supra* note 16 for the United States. The US-Uruguay BIT was mentioned in the UNCTAD list and is available on UNCTAD's website, but was not mentioned in the list of the website of the U.S. Department of Commerce's Trade Compliance Center at: http://tcc.export.gov/Trade_Agreements/Exporters_Guides/List_All_Guides/exp_002640.asp. Nevertheless, the BIT text is available on the U.S. Department of Commerce website at: http://tcc.export.gov/Trade_Agreements/All_Trade_Agreements/Uruguay_BIT.asp.

24 See BIT texts made available at UNCTAD IIA DATABASE, *supra* note 16; see also BITs made available by U.S. Department of Commerce at: http://tcc.export.gov/Trade_Agreements/Exporters_Guides/List_All_Guides/exp_002640.asp. See also KENNETH J. VANDELDE, U.S. INTERNATIONAL INVESTMENT AGREEMENTS 387-411 (Oxford University Press, 2009) for a review of performance requirement prohibitions within the various U.S. BITs.

25 See Article 8 of the U.S. Model BIT at: <http://www.ustr.gov/sites/default/files/BIT%20text%20for%20ACIEP%20Meeting.pdf>.

26 11 FTAs are made available by the Office of the U.S. Trade Representative at: <http://www.ustr.gov/tradeagreements/free-trade-agreements>.

Given the deep-seated trend demonstrated by previous U.S. BITs and FTAs of including performance requirement prohibitions, the United States will very likely push to include a comprehensive performance requirement prohibition in a BIT with India.

III. PERFORMANCE REQUIREMENT PROHIBITION STACKLE SENSITIVE AREAS AND MAY LEAD TO COMPLEX AND UNPREDICTABLE ARBITRAL AWARDS

Bridging the gap between Indian and U.S. approaches to performance requirement prohibitions will represent an uphill battle for negotiators. However, should India and the U.S. sign a BIT, it is more likely than not that a performance requirement prohibition will have been included, especially considering India's openness to such prohibitions in a few of its recent comprehensive economic agreements.

Given the prevalence of performance requirement prohibitions among U.S. BITs, the United States has been exposed to disputes (without being a disputing party per se in all disputes) related to performance requirement prohibitions to a much greater extent than India. Indeed, all known arbitral awards which applied performance requirement prohibitions were based on treaties to which the United States is a Party.²⁷

27 Pope & Talbot Inc. v. The Government of Canada, UNCITRAL, Interim Award (Jun. 26, 2000), <http://italaw.com/sites/default/files/case-documents/ita0674.pdf>; S.D. Myers Inc. v. Canada, UNCITRAL, First Partial Award (Nov. 13, 2000), <http://italaw.com/sites/default/files/case-documents/ita0747.pdf> hereinafter S.D. Myers v. Canada; ADF Group Inc. v. United States of America, ICSID Case No. ARB (AF)/00/1, Award (January 9, 2003), <http://italaw.com/sites/default/files/case-documents/ita0009.pdf>; Archer Daniels Midland Company and Tate & Lyle Ingredients Americas, Inc. v. The United Mexican States, ICSID Case No. ARB (AF)/04/5, Award (Nov. 21, 2007), http://italaw.com/sites/default/files/case-documents/ita0037_0.pdf; Corn Products International, Inc. v. United Mexican States, ICSID Case No. ARB (AF)/04/1, Decision on Responsibility (Jan. 15, 2008) <http://italaw.com/sites/default/files/case-documents/ita0244.pdf>; Cargill, Incorporated v. United Mexican States, ICSID Case No. ARB(AF)/05/2, Award (Sept. 18, 2009) http://italaw.com/sites/default/files/case-documents/ita0133_0.pdf; Merrill & Ring Forestry L.P. v. The Government of Canada, UNCITRAL, ICSID Administered Case, Award (Mar. 31, 2010), <http://italaw.com/sites/default/files/case-documents/ita0504.pdf> hereinafter Merrill & Ring v. Canada; Lemire v. Ukraine, supra note 10; Mobil v. Canada (Majority), supra note 12.

The two most recent arbitral awards applying performance requirement prohibitions at the time of writing this article can provide insights into the inner-workings of performance requirement prohibitions. These two arbitral awards also illustrate the difficulty in assessing the outcome of disputes centered on performance requirement prohibitions.

A. *The U.S.-Ukraine BIT and Lemire v. Ukraine*

As of June 2013, *Lemire v. Ukraine* was the only known investment arbitration award that interpreted a performance requirement prohibition outside of the NAFTA. Claimant Joseph Charles Lemire, a national of the United States, was the majority shareholder of a licensed radio station in Ukraine. Among other alleged violations, claimant alleged that Article 9.1 of the 2006 Law on Television and Radio Broadcasting (the “LTR”) imposed a local content requirement to the effect that 50% of the broadcasting time of each radio organization had to consist of music produced in Ukraine. “Music produced in Ukraine” included any music where the author, the composer and/or the performer is Ukrainian.²⁸

Claimant argued that this provision amounted to a local content requirement prohibited by Article II.6 of the U.S. – Ukraine BIT, which reads as follows: “Neither party shall impose performance requirements as a condition of establishment, expansion or maintenance of investments, which require or enforce commitments to export goods produced, or which specify that goods and services must be purchased locally, or which impose any other similar requirements”.²⁹

The prohibition of performance requirements found in Article II.6 is not qualified or subject to reservations or exceptions, which suggests a sweeping scope of application and a correlatively significant restriction on the Parties’ ability to enact measures falling within the broad reach of Article II.6.

Three criticisms regarding the Lemire arbitral award can be formulated. First, the Tribunal proceeded with an unwarranted analysis of the performance requirement prohibition under the fair and equitable

28 *Lemire v. Ukraine*, supra note 10, ¶ 501.

29 See *Lemire v. Ukraine*, supra note 10, ¶ 503 for the text of Article II.6 of the U.S. – Ukraine BIT. Also available at UNCTAD IIA DATABASE, supra note 16.

treatment provision. Second, the Tribunal disregarded the ordinary meaning of the terms used in the performance requirement prohibition. Third, the Tribunal assigned a purpose to the measure at issue and to the performance requirement prohibition, without any documentary or witness evidence or citing any authorities to support its interpretation, with a view to providing cover for the effects of the measure at issue.

1. *An Unwarranted Foray Into Fair and Equitable Treatment*

Before proceeding with its analysis under the performance requirement prohibition found in Article II.6 of the U.S. – Ukraine BIT, the Tribunal set the tone with an analysis that the Tribunal itself qualified as “really obiter dicta” under the fair and equitable treatment (“FET”) standard, given that claimant did not allege that Article 9.1 of the LTR (local content radio broadcasting requirement) violated the fair and equitable treatment standard.³⁰

The Tribunal affirmed Ukraine’s inherent right, as a sovereign State, “to regulate its affairs and adopt laws in order to protect the common good of its people”.³¹ The Tribunal displayed a heightened “measure of deference”³² with respect to regulations affecting “deeply felt cultural or linguistic traits of the community”.³³

The tribunal added a second line of justification for Ukraine’s measure within its obiter dicta relating to the fair and equitable treatment standard: protecting national culture is a concern shared and acted upon by many States around the world. Citing a similar statement made by the Tribunal in *Plama v. Bulgaria*,³⁴ the Tribunal stated: “a rule cannot be said to be unfair, inadequate, inequitable or discriminatory, when it has been adopted by many countries around the world.”³⁵ Underlining its non-discriminatory application to all broadcasters, the Tribunal ended its obiter dicta by declaring Article 9.1 of the 2006 LTR compatible

30 Id. ¶ 507.

31 Id. ¶ 505.

32 S.D. Myers v. Canada, supra note 27, ¶ 263.

33 Lemire v. Ukraine, supra note 10, ¶ 505.

34 *Plama Consortium Limited v. Republic of Bulgaria*, ICSID Case No. ARB/03/02, Award, ¶ 269 (Aug. 27, 2008), <http://italaw.com/sites/default/files/case-documents/ita0671.pdf>.

35 Lemire v. Ukraine, supra note 10, ¶ 506.

with the FET standard under the U.S. – Ukraine BIT.³⁶ These remarks thus clearly indicated where the Tribunal stood in its appreciation of the legitimacy of Article 9.1 of the 2006 LTR prior to having undertaken its analysis under the performance requirement prohibition.

2. *Disregarding Ordinary Meaning*

The Tribunal then turned its attention to the following question: does Article II.6 of the U.S. – Ukraine BIT, which prohibits requirements that goods or services must be purchased locally, apply to the requirement that 50% of the broadcasting time of each radio organization consist of music produced in Ukraine as required by Article 9.1 of the 2006 LTR?

The Tribunal considered Article 9.1 of the 2006 LTR from a de jure perspective, noting that it only required that 50% of the music broadcast by radio stations be authored, produced or composed by Ukrainians without specifically imposing that goods or services be purchased locally. As a result, Article 9.1 of the 2006 LTR on its face did not run afoul of Article II.6 of the U.S. – UkraineBIT. However, the Tribunal recognized the limited persuasive effect of a literal reading of the 50% local broadcast requirement, given that de facto the authors, composers and producers of Ukrainian music are located in Ukraine. The Tribunal did not formulate a preliminary conclusion at this stage of its analysis; however, it appeared as though Article 9.1 of the 2006 LTR could not be excluded from the scope of Article II.6 of the U.S. – UkraineBIT based solely on the ordinary meaning of the treaty provision.

3. *Assigning a Drummed-up Purpose to Provide Cover for the Effect of the Measure at Issue*

The Tribunal then shifted its focus onto the object and purpose of Article II.6 of the U.S. – UkraineBIT, which was construed by the Tribunal as “trade-related” and aimed at avoiding the imposition by States of “local content requirements as a protection of local industries against competing imports.”³⁷ The Tribunal grounded the determination of the object and purpose of Article II.6 on the preamble of the U.S.

36 Lemire v. Ukraine, supra note 10, ¶506.

37 Lemire v. Ukraine, supra note 10, ¶ 510.

– UkraineBIT, according to which the BIT aims to “promote greater economic cooperation”. Ultimately, the Tribunal conducted a summary analysis that did not rely on evidence or authorities to substantiate the purpose ascribed to Article II.6.

Having identified the purpose of Article II.6, the Tribunal compared such purpose with that of Article 9.1 of the 2006 LTR. According to the Tribunal, Ukraine intended “to promote Ukraine’s cultural inheritance” and not “to protect local industries and restrict imports”.³⁸ Deeming the purpose of Article 9.1 of the 2006 LTR compatible with the purpose of Article II.6 of the U.S. – UkraineBIT, the Tribunal decided that Article 9.1 of the 2006 LTR did not violate the prohibition of “performance requirements ... which specify that goods or services must be purchased locally”.³⁹

The Tribunal limited its analysis to compatibility of purposes between Article 9.1 of the 2006 LTR and Article II.6 of the U.S. – Ukraine BIT without invoking any evidence or authorities to determine their purposes. The Tribunal did not look at whether the effects of Article 9.1 violated the performance requirement prohibition, even though the Tribunal made the observation that the 50% Ukrainian music requirement amounted de facto to a requirement to purchase musical goods and/or services in Ukraine.

Although the reasoning underlying the decision of the Tribunal may seem hasty, it may simply reflect the intent of granting regulatory flexibility to Ukraine in implementing cultural policies, a considerably sensitive matter of national sovereignty. Circumscribing its analysis to the purpose of Article 9.1 of the 2006 LTR allowed the Tribunal to overcome the unpalatable task of second-guessing Ukrainian cultural policy-making and holding it liable for strengthening its cultural identity. The difficulty lies in that nothing in the U.S. – Ukraine BIT provided an exception to the broad coverage and plain wording of Article II.6, which compelled the Tribunal to disregard its ordinary meaning.

38 *Id.* ¶510.

39 *Id.* ¶511.

B. Mobil v. Canada, Performance Requirement Prohibitions and Reservations (NAFTA Articles 1106, 1108)

The claimants, Mobil Investments Canada Inc. and Murphy Oil Corporation (the “Claimants” or “Mobil and Murphy”), two Delaware corporations, had made investments in the Hibernia and Terra Nova offshore petroleum projects, located off the coast of the Province of Newfoundland and Labrador (“NL”) in Canada (the “Projects”).

The Projects were governed by parallel provincial and federal legislation⁴⁰ which created the Canada-Newfoundland Offshore Petroleum Board⁴¹ (the “Board”). Claimants, like any other prospective offshore oil operator, had to submit a Benefits Plan, which had to include provisions ensuring that research and development (“R&D”) and education and training (“E&T”) expenditures would be made in NL.

The Board had the discretionary power to issue guidelines regarding Benefits Plans.⁴² The Board used that discretion to issue guidelines applicable to Benefits Plans in 1986,⁴³ 1987⁴⁴ and 1988,⁴⁵ which had couched the requirements for expenditures in NL regarding R&D in general terms and asked only for project proponents to submit proposed expenditures.

In 2004 the Board adopted the Guidelines for Research and Development Expenditures (the “2004 Guidelines”), which lied at the heart of the dispute before the Tribunal. The 2004 Guidelines broke ground with previous guidelines in two ways: first, they specifically addressed R&D expenditures during the production phase of oilfield projects (instead of being limited to the exploration and development phases), and second, they imposed compulsory amounts of R&D expenditures.

40 The Canada-Newfoundland Atlantic Accord Implementation Act, R.S.C. 1987, c. 3, available at: <http://lawslois.justice.gc.ca/eng/acts/C-7.5/> hereinafter the Federal Accord Act and the Canada-Newfoundland and Labrador Atlantic Accord Implementation Act, R.S.N.L. 1990, c. C-2 hereinafter the Provincial Accord Act hereinafter jointly referred to as the “Accord Acts”, which are very similar.

41 Provincial Accord Act, supra note 39, § 9.

42 See *Mobil v. Canada* (Majority), supra note 12, ¶37-38 for the texts of § 45 of the Accord Acts, supra note 39 and § 151.1 of the Federal Accord Act, supra note 39.

43 *Mobil v. Canada* (Majority), supra note 12 ¶41.

44 *Id.* ¶42.

45 *Id.* ¶44.

Mobil and Murphy alleged that the 2004 Guidelines violated the performance requirement prohibition in NAFTA Article 1106. Claimants alleged that the 2004 Guidelines compelled Claimants to spend fixed amounts for R&D activities in NL as a condition for operating their investments in the Projects in violation of the performance requirement prohibition under NAFTA Article 1106(1)(c). In addition to its defense under NAFTA Article 1106, Canada argued that, should the Tribunal decide that the 2004 Guidelines violated NAFTA Article 1106, the 2004 Guidelines were exempt from NAFTA Article 1106 by virtue of a reservation adopted in accordance with NAFTA Article 1108. The Majority of the Tribunal ultimately rejected Canada's arguments under NAFTA Articles 1106 and 1108. Prof. Philippe Sands, dissenting, sided with the Majority regarding NAFTA Article 1106, but accepted Canada's argument under NAFTA Article 1108.

The Tribunal identified two main interpretative questions regarding NAFTA Article 1106:

(1) did the term "services" cover R&D and E&T expenditure requirements as formulated within the 2004 Guidelines? And (2) did the 2004 Guidelines exhibit a sufficiently compulsory nature so as to constitute a "requirement"? Four main criticisms can be formulated regarding the Tribunal's answer to these two questions: (1) it narrowly circumscribed the context of NAFTA Article 1106(1)(c); (2) it hastily determined the treaty provision's object and purpose; (3) it disregarded supplementary means of interpretation, and (4) it assigned little or no weight to the purposes of the 2004 Guidelines as opposed to their effects.

In deciding that the 2004 Guidelines, which constituted "matters of considerable national interest", "significance and sensitivity"⁴⁶ could not benefit from a reservation specifically adopted for such measures under NAFTA Article 1108, the Majority in *Mobil v. Canada* rendered a controversial award in two main respects. First, the Majority award of the Tribunal reduced policy space by seriously curtailing a host State's ability to use regulatory flexibility provided by reservations to

46 *Mobil v. Canada* (Dissent), *supra* note 13 ¶ 5, 7.

treaty provisions. Second, the Majority award of the Tribunal reduced consistency and predictability of international investment law by developing a complex analytical approach to assessing the validity of subordinate measures under reservations.

1. *Narrowly Circumscribing the Context of NAFTA Article 1106(1)(c) and the Meaning of “Services”*

The dispute initially turned on the interpretation of NAFTA Article 1106(1)(c), which reads as follows:

1106.(1) No Party may impose or enforce any of the following requirements, or enforce any commitment or undertaking, in connection with the establishment, acquisition, expansion, management, conduct or operation of an investment of an investor of a Party or of a non-Party in its territory: (...) (c) to purchase, use or accord a preference to goods produced or services provided in its territory, or to purchase goods or services from persons in its territory; *Emphasis added.*

The Tribunal decided that although no express reference was made to either R&D or E&T in NAFTA Article 1106(1)(c), the ordinary meaning of the term “services” “is broad enough to encompass R&D and E&T”.⁴⁷ The Tribunal considered that R&D and E&T “may be seen as mainstream forms of service sector activity” and that “there is nothing inherent in term ‘services’ in Article 1106(1) that necessarily excludes R&D and E&T”.⁴⁸

Drawing further support for its interpretation from the context of NAFTA Article 1106(1)(c), the Tribunal limited such context to considering the use of the term “services” within the NAFTA. The Tribunal noted NAFTA Article 1106(4), among other NAFTA provisions using the term “services”, which reads as follows:

1106.(4) Nothing in paragraph 3 shall be construed to prevent a Party from conditioning the receipt or continued receipt of an advantage,

47 Mobil v. Canada (Majority), *supra* note 12, ¶216.

48 *Id.* ¶216.

in connection with an investment in its territory of an investor of a Party or of a non-Party, on compliance with a requirement to locate production, provide a service, train or employ workers, construct or expand particular facilities, or carry out research and development, in its territory. Emphasis added.

The Tribunal inferred from NAFTA Article 1106(4) that the Parties to the NAFTA intended to exclude R&D and E&T from the prohibitions found in NAFTA Article 1106(3), but that having not included a similar exclusion in respect of NAFTA Article 1106(1) meant that they did not intend to exclude R&D and E&T from the NAFTA Article 1106(1)(c) prohibition on services.⁴⁹ However, the Tribunal did not point out that within Article 1106(4) NAFTA Parties distinguished between “providing a service”, “training or employing workers”, and “carrying out research and development”, a distinction that suggests that the term service does not automatically include R&D and E&T and that its meaning may not enjoy the clarity that the Tribunal willingly assigned to it using a contextual approach.

2. A Hasty Determination of NAFTA Article 1106(1)(c)’s Purpose

The Tribunal simply stated that its interpretation, based on the ordinary meaning and the context of NAFTA Article 1106(1)(c), was consistent with the object and purpose of the NAFTA as set forth in Article 102(1)(a) (“eliminating barriers to trade in, and facilitating the cross-border movement of, goods and services between the territories of the Parties”) and

Article 102(1)(c) (“increase substantially investment opportunities in the territories of the Parties”).⁵⁰

The objective mentioned in NAFTA Article 102(1)(a) echoes the purpose ascribed to Article

II.6 of the U.S. – Ukraine BIT (performance requirement prohibition) by the Tribunal in *Lemire v. Ukraine*, which was “trade-related” and aimed

49 Id.¶ 224.

50 Id.¶ 225.

at avoiding the imposition by States of “local content requirements as a protection of local industries against competing imports.”⁵¹ Based on the reasoning of the Tribunal in *Lemire v. Ukraine*, it would have been easy to ascribe a trade liberalization purpose to NAFTA Article 1106(1)(c).

Canada’s argument was in line with the reasoning of the Tribunal in *Lemire v. Ukraine*: according to Canada, NAFTA Article 1106(1)(c) applied only to a “closed set of performance requirements that would otherwise reduce the cross-border flow and importation of goods and services”,⁵² while the R&D and E&T requirements found in the 2004 Guidelines aimed at “increasing the knowledge base of the country”.⁵³

The Tribunal rejected Canada’s approach, stating that excluding R&D and E&T from “services” “because the form of transmission is not always cross-border” advocated for “a special meaning to be given for R&D and E&T”, which we do not see reflected in the NAFTA text”.⁵⁴

The Tribunal did not address the purpose assigned to NAFTA Article 1106 by the Tribunal in the *Merrill & Ring Forestry v. Canada* ⁵⁵ arbitration. According to that Tribunal, all performance requirements enumerated in NAFTA Article 1106 “are related to the export of goods and services and the conditions under which such exports are made” and are “designed to restrict or enhance exports”.⁵⁶

3. *A Peremptory Rejection of Supplementary Means of Interpretation*

Having narrowly circumscribed the relevant context for NAFTA Article 1106(1)(c) and having scurried through the determination of its object and purpose, the Tribunal formulated pointed criticisms with respect to supplementary means of interpretation before dismissing them altogether due to their limited or non-existent relevance and assistance.⁵⁷

51 *Lemire v. Ukraine*, supra note 10, ¶510.

52 *Mobil v. Canada* (Majority), supra note 12, ¶ 222.

53 *Id.* ¶222.

54 *Id.* ¶ 222.

55 *Merrill & Ring v. Canada*, supra note 27.

56 *Id.* ¶ 113, 115.

57 *Mobil v. Canada* (Majority), supra note 12, ¶ 229, 232.

Ultimately, the Tribunal considered that the conditions of Article 32 of the Vienna Convention on the Law of Treaties⁵⁸ for considering supplementary means of interpretation – ambiguous or obscure meaning or manifestly absurd or unreasonable result – were not met. However, the Tribunal did not need to meet either of these criteria to broaden its analysis. It is suggested that a broader interpretative context and approach could have better served the Tribunal, regardless of the outcome.

More particularly, a variety of materials raised by Canada could have shed contextual light onto NAFTA Article 1106(1)(c)⁵⁹: (1) the TRIMS Agreement, concluded around the same time as the NAFTA and which includes in its Illustrative List, at paragraph (1)(a), a prohibition similar to that of NAFTA Article 1106(1)(c); (2) the Canada – U.S. Free Trade Agreement,⁶⁰ which applied between Canada and the United States prior to the NAFTA and included a similar prohibition in Article 1603(1)(c); (3) the 1994 Model U.S. BIT,⁶¹ which in its Article VI(A) includes a performance requirement prohibition drafted shortly after the NAFTA; (4) BITs entered into by other nations that included performance requirement prohibitions; (5) UNCTAD reports on performance requirements; and (6) the OECD draft Multilateral Agreement on Investment.⁶²

The context relevant to NAFTA Article 1106(1)(c) could have been widened to include some or all of these materials on the basis of Article 31(1) of the VCLT, which refers to “the terms of the treaty in their context”.⁶³ Although caution is indeed warranted not to infinitely expand

58 Vienna Convention on the Law of Treaties, May 23, 1969, 1155 U.N.T.S. 331, 8 I.L.M. 679
□ hereinafter the VCLT □.

59 *Id.* ¶ 226.

60 Free Trade Agreement between the Government of Canada and the Government of the United States of America. Ottawa, 22 December 1987 and 2 January 1988, Washington, 23 December 1987 and Palm Springs, 2 January 1988, 27 I.L.M. 281 (1988) [hereinafter the CUSFTA].

61 1994 U.S. Model BIT reproduced in VANDEVELDE, *supra* note 24, at 388-390.

62 OECD, Multilateral Agreement on Investment, Documentation from the Negotiations, May 1997 – April 1998, <http://www1.oecd.org/daf/mai/htm/2.htm>.

63 See J. ROMESHWEEERAMANTRY, *TREATY INTERPRETATION IN INVESTMENT ARBITRATION* ¶ 3.55 (Oxford International Arbitration Series, Oxford University Press, 2012) hereinafter WEERAMANTRY .

such context,⁶⁴ considering similar performance requirement prohibitions, many of which were drafted and/or negotiated around the same time and involved the same State Parties, could have helped better grasp the meaning and purpose of NAFTA Article 1106(1)(c). The approach of the Tribunal in the *S.D. Myers v. Canada* investment arbitration offers a glimpse of the opposite and all-encompassing interpretative approach when it stated that in order to interpret the term “expropriation” the Tribunal had to consider “the whole body of state practice, treaties and judicial interpretations of that term in international law cases”.⁶⁵ The Tribunal in *S.D. Myers v. Canada* also considered that the interpretation of the expression “like circumstances” under NAFTA Article 1102 compelled the Tribunal to consider the “legal context” of the NAFTA, which included legal principles affirmed in related international instruments.⁶⁶

Moreover, the TRIMS Agreement (and possibly the CUSFTA) could have been considered along with the context, on the basis of Article 31(3)(c) of the VCLT, as “relevant rules of international law applicable in the relations between” the NAFTA Parties. Cutting short to their consideration by declaring that these materials offered no interpretative assistance, the Tribunal avoided deciding whether any of these materials formed part of the context relevant to NAFTA Article 1106(1)(c).

In doing so, the Tribunal expressed numerous concerns regarding supplementary means of interpretation and extraneous materials. The Tribunal stated that the materials invoked by Canada “are not the NAFTA”,⁶⁷ that they did not involve “entirely the same parties to the negotiation”,⁶⁸ that they raised inter-temporal discontinuities, that their influence on drafting and negotiating the NAFTA was not substantiated, and that their purposes were “not identical to that of the NAFTA”.⁶⁹

64 See *Id.* ¶ 3.55, quoting ARSANJANI and REISMAN: context as used in Article 31 of the VCLT “(...) does not have the wide-ranging meaning it has for scholars; for diligent scholars, for whom the world is a vast manifold of interrelated events, everything is context” from MAHNOUSH H. ARSANJANI and W. MICHAEL REISMAN, *Interpreting Treaties for the Benefit of Third Parties: The ‘Salvors’ Doctrine’ and the Use of Legislative History in Investment Treaties*, 104 *AJIL* 597 (2010), 599.

65 *S.D. Myers v. Canada*, *supra* note 27, ¶ 280.

66 *Id.* ¶ 247, 250.

67 *Mobil v. Canada* (Majority), *supra* note 12, ¶ 230.

68 *Id.* ¶ 230.

69 *Id.* ¶ 230.

However, these legitimate concerns should not lead to discarding supplementary means of interpretation altogether. Rather, these concerns should be used to grant supplementary means of interpretation an impact proportional to their relevance. Moreover, the Tribunal did call upon supplementary means of interpretation when these confirmed the interpretation it had previously reached without their assistance,⁷⁰ suggesting a piecemeal interpretative approach.

For instance, investment-related treaties often serve similar purposes and use similar language; taking into account general drafting trends among treaties that serve similar purposes can shed some light on the meaning of specific terms and is considered an “accepted and established practice”.⁷¹ Moreover, despite challenges related to the timing of supplementary means of interpretation when compared to the treaty under interpretation, there exists a margin of appreciation within which supplementary means of interpretation prior and subsequent to the drafting of the treaty under interpretation can be taken into consideration, granted that the appropriate interpretative safeguards regarding relevance are applied.⁷²

4. The Effects of the 2004 Guidelines Largely Overweighed Their Purpose

According to the Tribunal, the Board adopted the 2004 Guidelines for two main reasons: first, as a means to create “a lasting economic legacy for the people of the Province of NL”⁷³ through the improvement of the intellectual capital and human resources of the Province of NL, and second in order to combat significant decreases in R&D spending by Claimants in the Projects over the 1997-2001 period.⁷⁴

The Tribunal then disregarded these purposes, stating that the purpose underlying a measure was irrelevant under NAFTA Article 1106(1)(c): so long as a measure required an investor to utilize domestic sources of R&D, it “rather clearly” constituted a prohibited performance requirement.⁷⁵ The Tribunal considered that neither the “furtherance

70 Id.¶ 296.

71 See WEERAMANTRY, *supra* note 63, ¶ 5.32-5.34.

72 See Id.¶ 5.62-5.73.

73 *Mobil v. Canada (Majority)*, *supra* note 12, ¶ 46.

74 Id.¶ 60, 74.

75 Id.¶ 222.

of economic policy objectives”⁷⁶ nor a policy purpose that exceeded “strictly economic”⁷⁷ objectives, using measures that aimed at “promoting economic development and improving the skills and education of Canadians”⁷⁸ would justify excluding such measures from the scope of NAFTA Article 1106(1)(c).

Having determined that a measure had to exhibit “a degree of legal obligation” and a “degree of compulsion”⁷⁹ in order to be caught by NAFTA Article 1106, the Tribunal determined that the “purpose” of the 2004 Guidelines “is to introduce an obligatory expenditure requirement”.⁸⁰

Canada suggested that the requirement for R&D and E&T expenditures “only incidentally resulted in the purchase, use or accord of preference to local services”.⁸¹ Canada had successfully argued a similar position before the Tribunal in the *Merrill & Ring Forestry v. Canada* arbitration. Among other claims of violations under NAFTA Article 1106, *Merrill & Ring Forestry L.P.* (“Merrill”) claimed that the Log Export Control regime imposed the obligation to scale timber rafts metrically in violation of NAFTA Article 1106(1)(c) as Merrill needed to retain the services of qualified Canadian personnel to complete such task.

The Tribunal in the *Merrill & Ring Forestry v. Canada* arbitration had agreed with Canada in that even though the aforementioned requirements had “an incidentally adverse effect on the Investor’s exports to the extent that it might wish to cut, sort and scale its logs as required by its customers in foreign markets”, these requirements were not subject to NAFTA Article 1106 given that they were not “directly and specifically connected to exports” and they “merely had some indirect effect on exports”.⁸²

76 Id.

77 Id.

78 Id.

79 Id.¶ 234.

80 Id.

81 Id.¶ 194.

82 Id.¶ 117.

The Merrill Tribunal had also agreed with Canada that scaling requirements were only remotely and indirectly connected with exports, that Merrill was “free to hire these services from anyone it wished”⁸³, and that Merrill hired in Canada only due to business convenience and to the higher cost of hiring elsewhere.

The Mobil Tribunal distinguished *Merrill & Ring Forestry v. Canada*, in addition to the awards rendered in the *S.D. Myers v. Canada* and *Pope & Talbot v. Canada*⁸⁴ investment arbitrations, based on its assessment that the R&D and E&T spending requirements in the Province of NL constituted a “central feature of the 2004 Guidelines, and not an ancillary objective or consequence”,⁸⁵ that the 2004 Guidelines did not impose only “incidental effects with respect to the purchase, use or accordance of a preference to local goods or services”,⁸⁶ and that in fact the “central purpose of the 2004 Guidelines . . . is to require expenditures in the Province”.⁸⁷

In reaching its decision that the 2004 Guidelines violated NAFTA Article 1106, the Tribunal discarded its own recognition that ways could be envisioned for Claimants to comply with the requirement that R&D and E&T expenditures be undertaken in the Province of NL without directly purchasing domestic goods or services. Construing the 2004 Guidelines in such a way would have made them fall outside the scope of NAFTA Article 1106.⁸⁸

5. *A Failed Attempt at Preserving Policy Space and Predictability Under NAFTA Article 1108*

The Majority in the *Mobil v. Canada* investment arbitration then decided that the R&D requirements embedded in the 2004 Guidelines, could not benefit from a reservation specifically adopted for such measures under NAFTA Article 1108.

83 Id. ¶ 118.

84 Supra note 27.

85 *Mobil v. Canada* (Majority), supra note 12, ¶ 242.

86 Id. ¶ 240.

87 Id. ¶ 239.

88 Id. ¶ 237, 239.

In doing so, the Majority rendered a controversial award in two main respects. First, the Majority award of the Tribunal reduced policy space by seriously curtailing a host State's ability to use regulatory flexibility provided by reservations to treaty provisions. Second, the Majority award of the Tribunal reduced consistency and predictability of international investment law by developing a complex analytical approach to assessing the validity of subordinate measures under reservations. Herein are reproduced the two provisions key to the *Mobil v. Canada* award that will be discussed below.

NAFTA Article 1108(1)(c) reads as follows: "1. Articles 1102, 1103, 1106 and 1107 do not apply to: (...) (c) an amendment to any non-conforming measure referred to in subparagraph

(a) to the extent that the amendment does not decrease the conformity of the measure . . ."

NAFTA Annex I, paragraph (2)(f)(ii) reads as follows: "(f) A measure cited in the Measures element of a reservation . . . (ii) includes any subordinate measure adopted or maintained under the authority of and consistent with the measure . . ."

- a) How did the Majority award of the Tribunal reduce policy space of host States?
- i. By creating a second one-way ratchet provision: new subordinate measures must fall within the scope resulting from the non-conforming measure and prior subordinate measures

In a prescient analysis dating back to 2006, UNCTAD had characterized NAFTA Article 1108(1)(c) as a "ratchet" provision having the effect of increasing a State Party's treaty commitments toward liberalization by automatically reducing its reservations in accordance with regulatory changes that lessen the scope of a reservation. UNCTAD warned that such ratchet provisions "may deprive host countries of flexibility that they may not wish to see locked-in (and open to challenge) under international law".⁸⁹

89 UNCTAD, *Preserving Flexibility in International Investment Agreements: the Use of Reservations*, in UNCTAD SERIES ON INTERNATIONAL INVESTMENT POLICIES FOR DEVELOPMENT, at 19, FN 5 and 35, U.N. Doc. UNCTAD/ITE/IIT/2005/8, U.N. Sales No. E.06.II.D.14 (2006).

One is struck by the eerie similarity between UNCTAD's depiction of one-way ratchet provisions and the application of reservations made by the Tribunal's Majority. However, the Majority of the Tribunal in *Mobil* amplified the liberalizing feedback loop by restricting the scope of new subordinate measures ("NSMs") to that delineated by prior subordinate measures, thus converting NAFTA Annex I, paragraph (2)(f)(ii) into a second one-way ratchet provision. Here is how the Majority accomplished this.

Before going any further, it is interesting to note that despite being invited by the Tribunal to do so, both Mexico and the United States declined to make submissions to the Tribunal as to whether the term "measure", as used at the opening of NAFTA Annex I, paragraph 2(f)(ii), included only the existing non-conforming measure ("NCM") identified in Canada's Schedule to Annex I, or whether it also included prior subordinate measures.⁹⁰

The Majority of the Tribunal ultimately decided that based on its ordinary meaning the term "measure" included subordinate measures, which meant that consistency of a NSM should be evaluated not only against the NCM, but also against any subordinate measures prior to the NSM. This finding significantly reduced the scope of the reservation initially provided in favor of the NCM.⁹¹

- ii. By transforming the consistency test into a non-decreasing conformity test

Under NAFTA Article 1108(1)(c), an amendment to a NCM must not "decrease the conformity" of the NCM in order to benefit from the reservation to NAFTA provisions, while a new subordinate measure ("NSM") must be adopted "under the authority of and consistent with" the NCM. Despite acknowledging the distinctiveness of each criterion,⁹² the Majority of the Tribunal unduly construed the "consistency" test applicable to subordinate measures (mentioned in NAFTA Annex I, paragraph (2)(f)(ii)) in a way nearly identical to the "non-decreasing conformity" test applicable to amendments (mentioned in NAFTA Article 1108(1)(c)). The Majority proceeded in such fashion out of fear

90 *Mobil v. Canada* (Majority), *supra* note 12, ¶ 318-319.

91 *Id.* ¶ 309-310, 315, 317, 324-327.

92 *Id.* ¶ 305-307.

that State Parties might circumvent the seemingly more demanding test for amendments by adopting subordinate measures instead.⁹³

The Majority reformulated the consistency test as “whether the new measures enlarge or unduly expand the non-conforming features of the reservation.”⁹⁴ In doing so, the Majority inordinately distanced the consistency test from the ordinary meaning of “consistent”.

The Majority formulated its consistency test as follows: “whether the changes are imposing such additional burdens that are of an inhospitable, inharmonious, incompatible, contradictory nature, and are otherwise inconsistent with the existing legal framework.”⁹⁵ The Majority thus created a consistency test detached from the NCM and instead evaluated the consistency of the NSM by comparison with the legal framework that applied to the investment projects prior to the NSM.⁹⁶ In other words, the NSM must not “alter the legal framework in a fundamental manner” in order to remain “consistent with” the measure, that is to say the legal framework previously applicable to the relevant investments.⁹⁷ According to Dissenting Arbitrator Philippe Sands, the concept of “legal framework” was “plucked out of the air”⁹⁸ and there exists “a world of difference between “the measure” and “the legal framework”.”⁹⁹ By conflating these two expressions, the Majority discarded the ordinary meaning of the term “the measure” as used in NAFTA Annex I, paragraph (2)(f)(ii).¹⁰⁰

The Majority seems to suggest that only the “character” of burdens imposed by NCMs and NSMs (as opposed to their weight) can vary,¹⁰¹ despite that the three NAFTA Parties (Canada, Mexico and the United States) agreed that a NSM “could impose some additional and/or more onerous commitments than those that were imposed by the earlier measure.”¹⁰²

93 Id.¶ 341.

94 Id.¶ 336, 341, 411.

95 Id.¶ 394.

96 Id.¶ 333, 336, 338, 380, 410.

97 Id.¶ 410.

98 *Mobil v. Canada (Dissent)*, supra note 13, ¶ 28.

99 Id.

100 Id.¶ 31.

101 *Mobil v. Canada (Majority)*, supra note 12, ¶ 339.

102 Id.¶ 374, 400.

The Majority concluded that taken alone neither a mere change in methodology,¹⁰³ nor a requirement for additional spending would breach the consistency test,¹⁰⁴ and that there existed no “no statutory bright line test” for additional spending.¹⁰⁵

However, the Majority decided that the combination of additional spending requirements, new reporting and pre-authorization requirements, and a new funding mechanism amounted to “a substantial adjustment to the regulatory framework” which amounted to a fundamentally different kind of regulatory oversight¹⁰⁶ whose additional burden tripped the requisite consistency threshold.¹⁰⁷ The NSM imposed “quantitatively and qualitatively different, and more burdensome” requirements¹⁰⁸ which substantially expanded the measures that breached NAFTA Article 1106(1).¹⁰⁹ Dissenting, Prof. Philippe Sands considered that a NSM can impose additional burdens in comparison to prior subordinate measures.¹¹⁰

- iii. By overdrawing the NAFTA’s objectives and casting a gloom over the specific objectives of reservations

The Majority failed to assign appropriate weight to the specific purpose of provisions on reservations such as NAFTA Annex I, paragraph (2)(f)(ii) as opposed to the purposes of NAFTA as a whole. Canada argued that NAFTA Annex I, paragraph (2)(f)(ii) served the purpose of preserving “flexibility for the NAFTA Parties in sensitive areas through effective reservations.”¹¹¹ The Tribunal acknowledged this purpose, but seems to have grounded its reasoning almost exclusively on the overarching purposes of the NAFTA as embedded in NAFTA Article 102, including eliminating barriers to trade, facilitating cross-border movement of goods and services and increasing investment opportunities.¹¹²

103 *Id.* ¶ 398.

104 *Id.* ¶ 400.

105 *Id.* ¶ 401.

106 *Id.* ¶ 398, 404.

107 *Id.* ¶ 410.

108 *Id.* ¶ 409.

109 *Id.* ¶ 401.

110 *Mobil v. Canada (Dissent)*, *supra* note 13, ¶ 24.

111 *Mobil v. Canada (Majority)*, *supra* note 12, ¶ 323.

112 *Id.* ¶ 340.

In doing so, the Majority did not appear to heed the Tribunal's approach in *ADF v. The United States*.¹¹³ Dealing with reservations under the NAFTA, the ADF Tribunal cautioned against relying too heavily on NAFTA's general objectives and cited NAFTA Article 102(1) to the effect that the specific rules and principles of the NAFTA elaborate NAFTA's objectives more specifically and act as *lex specialis* compared to NAFTA's overarching objectives, which act as *lex generalis*.

b) *How did the Majority award of the Tribunal reduce consistency and predictability of international investment law?*

The Majority dismissed the notion that the consistency of a NSM should be tested only against the NCM as resulting "in a superficial and partial examination of the legal system."¹¹⁴ In spite of its praiseworthy willingness to tackle complexity head on, the Majority will likely be remembered more for its nonchalant attitude before adopting a methodology fraught with an escalating complexity and unpredictability. The Majority acknowledged "not being troubled by, the implication that consistency, as well as authority, could be evaluated by reference to a different mix of measures".¹¹⁵ The Majority acknowledged that its approach entailed holding State Parties accountable under the NAFTA to an evolving legal and regulatory framework that would include subordinate measures significantly different from the measures initially covered by the reservations.¹¹⁶

One aspect of this increased complexity stems from the lack of obligation for State Parties to provide any information with respect to subordinate measures. There is therefore no way for investors to ascertain which subordinate measures that breach the NAFTA are nevertheless validated thanks to reservations, which reinforces the impression that NAFTA Parties intended for authority and consistency to be evaluated by reference to the NCM and not the NCM plus subordinate measures prior to the NSM.¹¹⁷

113 *ADF Group Inc. v. United States of America*, ICSID Case No. ARB (AF)/00/1, Award, ¶ 147 (Jan. 9, 2003), <http://italaw.com/sites/default/files/case-documents/ita0009.pdf>.

114 *Mobil v. Canada* (Majority), *supra* note 12, ¶ 334.

115 *Id.* ¶ 335.

116 *Id.* ¶ 338.

117 *Mobil v. Canada* (Dissent), *supra* note 13 ¶ 11, 36.

The Majority added an additional layer of complexity by deciding that the consistency of the NSM is to be evaluated against prior subordinate measures, but the authority under which the NSM was adopted is to be evaluated against the NCM itself.¹¹⁸ In his dissent, Prof. Philippe Sands considered that authority and consistency should be measured against the same standard.¹¹⁹

A chilling scenario that stems from the Majority award consists of host States having to establish and consult a register of non-conforming measures and subordinate measures for each reservation and ensuring preliminary compliance of every new subordinate measure with the totality of such measures.

118 *Mobil v. Canada* (Majority), *supra*note 12, ¶ 330, 332.

119 *Id.* ¶ 22, 34-35.