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THE CETA BRIEFINGS

Who Else Benefits from CETA? Some Implications of "Most-Favoured Nation" Treatment

by
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- While the recently negotiated trade agreement between Canada and the European Union (EU) will provide greater market access for exports of goods, services and investments from each party to the other, an intriguing question is whether the trade pact will have beneficial side effects for Canada's other trading partners, by virtue of the "Most-Favoured Nation" rule of international trade law.
- This E-Brief finds that under the terms of Canada's WTO membership and Foreign Investment Protection Agreements (FIPAs), the answer is no. However, with respect to investors and investments from the United States, Mexico, Peru, Chile and others with which Canada has preferential trade agreements (PTAs), the answer is yes.

The conclusion of the negotiations in the ground-breaking Canada-EU Comprehensive Trade and Economic Agreement (CETA) in October 2013 generated intense business interest and wide media coverage. For good reason. Even as we await the final text, it is clear that this will be a singular document, more extensive than the North American Free Trade Agreement (NAFTA) in depth and scope of coverage.

The central pillar of the CETA will be the general obligation of each side (that is, Canada and the European Union, including respective political subunits) to not discriminate against the goods,

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services and investments of the other and to accord equal treatment to respective imports; that is, equal to that given to local goods, services and capital within domestic markets, as well as the treatment given to imports from third parties.

All of this is standard and in conformity with the key elements of international trade law as embodied in the World Trade Organization (WTO) Agreement. The overall objective of trade law is to improve market access reciprocally. But in the case of the CETA and all other regional trade agreements there is a distinction. Their purpose is to open those markets on a *preferential* basis. For that reason, agreements such as the CETA, the North American Free Trade Agreement (NAFTA) and the myriad of other such treaties are referred to commonly as preferential trade agreements, or "PTAs."

This E-Brief examines one of the important elements of the non-discrimination obligation in the CETA – the Most-Favoured-Nation ("MFN") rule – and discusses beneficial side effects of the CETA, with regard to investment flows in particular, for Canada's other PTA partners. I conclude CETA operates to improve market access for capital inflows including investments from third states such as the United States, Mexico and others.

CETA and Most-Favoured Nation Treatment

The CETA will be NAFTA-plus, a 21st century agreement addressing provincial procurement, agrifood trade, geographic indications, patent protection and other matters far beyond what's in the NAFTA. These provisions will ultimately be enforceable through a binding state-to-state dispute settlement mechanism.

As well as state-level arbitration, the CETA will give binding arbitration rights to private investors to litigate against governments in cases where it is alleged that the treaty's foreign investment obligations are being infringed. EU investors will be able to invoke these rights against Canada, including where the provinces and municipalities fail to live up to CETA's terms. Canadian investors, of course, will have the same rights vis-à-vis European governments.

One of the main features of the CETA, like all trade agreements, will be incorporation of the MFN treatment rule. Reference to MFN has been bandied about a good deal but probably not many observers are entirely sure of its meaning or potential impact on the overall agreement.

The MFN concept has a venerable ancestry, hinged on the notion of fair and non-discriminatory treatment in international commerce, and is one of the fundamental pillars of the global trading system. Its historic roots go back to early commerce and navigation treaties, where the idea was that states that signed these agreements would guarantee that imports from the other would get the best level treatment given to traders from other states. This meant, for example, that countries would guarantee tariff or tax treatment on imports that was on the same level and no less beneficial than treatment granted to imports from any other country.[1]

1 As described in *Most Favoured-Nation Treatment in International Investment Law* (OECD 2004), MFN can be traced back to the 12th century, although the phrase seems to have first appeared in the seventeenth century. MFN treaty clauses spread with the growth of commerce in the 15th and 16th centuries. The United States included an MFN clause in its first treaty, a 1778 treaty with France. In the 1800s and 1900s the MFN clause was included frequently in various treaties, particularly in the Friendship, Commerce, and Navigation treaties. MFN treatment was made one of the core obligations of commercial policy under the Havana Charter where Members were to undertake the obligation "to give due regard to the desirability of avoiding discrimination as between foreign investors." The inclusion of MFN clauses became a general practice in the numerous bilateral, regional and multilateral investment-related agreements which were concluded after the Charter failed to come into force in 1950.

The MFN rule was codified as a multilateral obligation in the *General Agreement on Tariffs and Trade* (GATT) in 1947, written into the very first article of the GATT:

> *With respect to customs duties and charges of any kind imposed on or in connection with importation or exportation or imposed on the international transfer of payments for imports or exports, and with respect to the method of levying such duties and charges, and with respect to all rules and formalities in connection with importation and exportation . . . . any advantage, favour, privilege or immunity granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties.*

The GATT rule was ultimately incorporated into the WTO Agreement in 1994 so that MFN treatment applies as an unrestricted and fundamental obligation on the part of all WTO members. No member can apply any law or regulation or any advantage, favour, privilege or immunity to imported products that does not apply to the same or "like" products from all WTO members on the same basis.

It means that Canada is bound to apply the same duties, taxes and regulatory requirements on imported goods from all WTO members, regardless of source, and accord equal treatment in other areas of internal regulation to like goods from all WTO member countries on a fully non-discriminatory basis.

A long history of GATT and WTO panel decisions have said that the objective of the MFN obligation is that every WTO member has to assure fair competition to imports from all member states, the proverbial level-playing-field and one of the cardinal rules in international trade law.[2]

When MFN Does Not Apply

There is an important qualification to the MFN rule, however. The WTO Agreement, like the GATT before it, endorses the rights of member states to enter into discrete trade agreements (PTAs) whereby preferential treatment is permitted among the treaty parties, notwithstanding the otherwise multilateral application of the MFN rule. GATT Article XXIV, paragraph 5, which is incorporated into the WTO Agreement, affirms this right, stating that, ". . . the provisions of this Agreement shall not prevent, as between the territories of contracting parties, the formation of a customs union or of a free-trade area . . . ."[3] A similar exception to MFN exists for preferential agreements liberalizing trade in services under Article V of the General Agreement on Trade in Services.

The point of these PTAs is to give *better* treatment to goods and services from the treaty partners than multilateral MFN treatment required under the WTO Agreement. This kind of preference is best shown in the

2 There are many panel and WTO Appellate Body decisions dealing with the intended scope of the MFN principle. Among these is the AB decision in *Canada-Certain Measures Affecting the Automotive Industry* (AB-2000-2, WT/DS139/AB/R; WT/DS142/AB/R, 31 May 2000) where the AB referred to the words "any advantage" and "any product" in GATT Article I:1 as demonstrating the "pervasive character" of the MFN principle of non-discrimination (para. 82).

3 Paragraph 4 of Article XXIV sets out the general principle in this respect: "The contracting parties recognize the desirability of increasing freedom of trade by the development, through voluntary agreements, of closer integration between the economies of the countries parties to such agreements. They also recognize that the purpose of a customs union or of a free-trade area should be to facilitate trade between the constituent territories and not to raise barriers to the trade of other contracting parties with such territories."

Canadian Customs Tariff. There is a column that shows the MFN tariff rate that applies generally to goods from all WTO members. There are separate columns that show the preferential rate (often down to zero) for goods from countries with whom Canada has a preferential trade agreement (like the US, Mexico, Chile, Peru, etc.).

Because such preferential treatment is legal under GATT and WTO, it means – importantly – that no other WTO member can then claim that the MFN obligation extends these bilateral preferences, such as duty-free treatment, beyond the particular PTA to the goods and services of all other WTO members.

With respect to the CETA, it follows that the US, for example, can't claim that Canada must now give imported American products treatment – equal competitive opportunities – in the Canadian market on the same footing as imports from the EU. For example, it means US cheese exporters cannot claim the same duty-free quotas that Canada has agreed to give EU exporters. This applies as well to other countries with which Canada has free trade agreements, such as Chile, Peru and Colombia.

This critical distinction between MFN and preferential treatment is important to keep in mind in the discussion that follows.

MFN in Investment Protection Agreements

Together with trade agreements, Canada has had an active agenda of concluding foreign investment protection agreements (FIPAs).[4] FIPAs are not trade agreements. They are not within the GATT or WTO rules. They don't cover the movement of goods or services but apply to capital flows; that is, to investors and investments.

The objective of these FIPAs is to ensure that Canadian investors are treated fairly and on a non-discriminatory basis in foreign markets. They extend the same right to foreign investors in Canada.

Because FIPAs are outside the scope of the WTO Agreement, the obligation in GATT Article 1 for "immediate" and "unconditional" MFN treatment does not apply. Each FIPA has to specifically apply the MFN rule to investors and investments to the extent and subject to any variation both sides agree to.

Canada's model FIPA, which has been employed many times, provides:

> *Each Contracting Party shall grant to investments or returns of investors of the other Contracting Party in its own territory treatment no less favourable than that which it grants, in like circumstances, to investments or returns of investors of any third state.*

However, there is an important qualifier in Canada's model FIPA, which provides:

> *The National Treatment and Most-Favoured-Nation Treatment provisions of this Agreement shall not apply to advantages accorded by a Contracting Party pursuant to its obligations as a member of a customs, economic or monetary union, a common market or a free trade area.*

This model wording reflects the basic principle in Canadian trade and investment policy that the MFN obligation in any particular treaty will not automatically extend to advantages accorded by Canada under other existing or future bilateral trade agreements with other countries. That makes eminent sense.

4 See the Canadian FIPA program explained in detail on the Department of Foreign Affairs and International Trade web-site: http://www.international.gc.ca/trade-agreements-accords-commerciaux/agr-acc/fipa-apie/fipa-purpose.aspx?lang=en.

An example of this principle in treaty language is found in the 2012 Canada-China FIPA, which is not yet in force. The agreement states that the MFN provision does not extend to,

> *". . . treatment by a Contracting Party pursuant to any existing or future bilateral or multilateral agreement establishing, strengthening or expanding a free trade area or customs union."*

This qualification is critical. It means that in the case of trade agreements like the NAFTA and the CETA, which create "free trade areas," Canada retains the flexibility to give better treatment to investors from those countries than the treatment accorded to other foreign investors under existing FIPAs. It means Canada can give special advantages to US and Mexican, or to European investors without running afoul of its FIPA obligations vis-a-vis third states.[5]

MFN Provisions in Trade Agreements

There is an important twist to this, however. This is found under the NAFTA and in Canada's other bilateral trade agreements – and likely under the CETA, although we haven't seen the text yet.

Article 1103 in Chapter 11 of the NAFTA illustrates the point. It repeats the standard MFN obligation towards NAFTA investors. However, unlike the qualifying language in Canada's FIPAs that MFN rights do not apply to any advantages to foreign investors under any other PTAs concluded by Canada, the NAFTA contains no such exclusionary wording.[6]

This is of major significance. It means that preferential treatment for investors or investments granted by Canada under any existing or future bilateral free trade agreement therefore extends equally to NAFTA investors and investments. It means American and Mexican investors must be treated on an equal footing with and given the same preferences as EU investors or investments under the CETA.[7]

This has important implications. While we await the final text of the CETA, some of the special benefits for EU investors have been explained. For example, we know that EU investors will get additional market access benefits for investments in the uranium sector.[8] As well, there will be a freezing of the regulatory status quo in respect of foreign investments in particular sectors.[9]

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5 See *Most-Favoured-Nation Treatment* (UNCTAD, 2011) for a detailed discussion of the scope and application of these kinds of exception clauses in international investment treaties.

6 It is to be noted, however, that while there is no general wording in the NAFTA that excludes the application of the MFN obligation toward NAFTA investors in existing or future Canadian treaties – meaning US and Mexican investors benefit from any increased levels of investment rights – there are reservations in the NAFTA Annexes covering some specific sectors. For example, NAFTA Annex IV excludes MFN treatment for the US and Mexico in future Canadian agreements covering aviation, fisheries, maritime matters, telecommunications and transportation services.

7 See the discussion of the extension of the MFN rule under new trade and investment agreements in Stoler, A., "Investment & Services – Implications of the MFN Rule at the Regional/Bilateral Level," Institute for International Trade (2007).

8 Canada-European Union Comprehensive Economic and Trade Agreement, Technical Summary of Final Negotiated Outcomes, Government of Canada; www.actionplan.gc.ca/ceta.

9 The extent of this obligation respecting the provinces is not particularly clear in the federal government's explanatory material.

Among some of the benefits for EU investors will be the raising of the threshold for investment review under the *Investment Canada Act* from the current enterprise value level of $344 million to $1.5 billion.[10]

Because NAFTA Chapter 11 doesn't contain any qualifying language, the MFN provisions apply and investors from the US and Mexico will thus be entitled to the same preferential benefits as EU investors get under the CETA. That means that the increased review threshold of $1.5 billion will apply equally to them as it does to investors from the European Union.

The point just illustrated refers to the position of US and Mexican investors under the NAFTA. Other Canadian trade agreements – such as the PTAs with Chile, Peru and Colombia – also contain no qualification to the application of MFN in respect of foreign investors and their investments. It means these investors will benefit from any new or additional advantages given to EU investors under the CETA.

This point is actually noted in Ottawa's Technical Summary of the CETA, where the fine print says that in respect of the $1.5 billion investment review threshold, "other FTA partners will benefit as a result of the MFN commitment in those FTAs."[11] This sentence hasn't been widely commented on but it is of extraordinary importance.

There is an important point to be made about uranium-sector investments, which, as noted in the Technical Summary (at p. 12), are being loosened up for EU investors. Under NAFTA Annex I, Canada filed a reservation on extending MFN obligations in the uranium sector to US and Mexican investors. That reservation applies only to non-conforming measures in existence when the NAFTA entered into force, however, and does not apply to new investment rights in the Canadian uranium business accorded to EU investors under the CETA.

The result is that, because of the MFN rule, US and Mexican investors will obtain the same level of investment rights as EU investors in that sector. This is an important aspect of the CETA that will entail potential changes of significance in the Canadian uranium extraction and processing industry.[12]

The Impact of the MFN Rule on Dispute Settlement

An intriguing question remains as to whether and to what extent the MFN rule in the NAFTA and in the other Canadian PTAs mentioned above will extend to not only substantive improvements but also to enhanced procedures for settling disputes in the CETA investment chapter.

The Technical Summary (p.14) states that the investor-state dispute settlement (ISDS) provisions in the CETA investment chapter will be a step forward from Canada's FIPA model and the investor-state dispute system found in Chapter 11 of the NAFTA, notably by allowing *amicus curiae* interventions, by including provisions to weed out frivolous claims, and by clarify the meaning of indirect expropriation. As noted above, that process gives private investors from either side rights to invoke binding arbitration against Canada or the EU where it is alleged that the non-discrimination provisions of the investment chapter have not been lived up to.

The unanswered question is whether any new or improved procedures for dealing with investor-state disputes – such as more efficient time-frames or clarification of some of the legal concepts and terms in the chapter – will

10 The $344 million threshold is being phased in over four years to $1.0 billion once the relevant amendments announced in the last federal budget come into force.

11 Technical Summary of Final Negotiated Outcomes, *supra*, p. 13.

12 Note, however, that the reservations Canada filed under the NAFTA in respect of other sectors such as communications and transportations will continue to govern.

extend to parties outside the CETA because of the MFN rule. If it does, the next question is whether these changes will impact on any of the current NAFTA investment disputes underway against Canada.[13]

Whether there are these and other benefits granted to EU investors in the CETA that will also extend automatically to investors from other countries will have to be analyzed when we have the complete text of the document.

Conclusions

As reviewed above, the special investment benefits for Europeans in the Canada-EU deal – notably the increased review threshold under the *Investment Canada Act* – extend to investors from other countries with which Canada has trade agreements with investment protection provisions; that is, not only the US and Mexico under the NAFTA, but also Colombia, Peru, Chile and Panama. There is a potential opening up of investment flows as a result.

Trade agreements are two-way streets. While this note discusses the MFN rule on inbound investment, Canadian investors in the EU will also profit under the MFN rule from EU investment treaties with third parties.

But the broader conclusion is that this issue extends beyond the Canadian-EU circumstance. While each investment treaty has to be looked at individually, the MFN rule, standard in hundreds of foreign investment protection agreements around the world, could be the tide that raises all boats. In other words, improved investment protection in any particular bilateral treaty potentially applies on an MFN basis to a wide array to investors and investments from countless non-treaty parties. The net effect would be to open markets on a non-discriminatory basis to foreign direct investment on an even wider basis. Canada will thus be the beneficiary of any investment liberalization under an eventual Trans-Atlantic Trade and Investment Partnership between the EU and the US.

Without wishing to overstate things, this illustrates the “pervasive character” of the MFN rule,[14] as well as its implications for who benefits from the CETA and from future comprehensive agreements involving Canada’s partners.

13 At present, there are seven active investment arbitrations against Canada filed by US investors. http://www.international.gc.ca/trade-agreements-accords-commerciaux/topics-domaines/disp-diff/gov.aspx?lang=eng. The question is whether any of these cases, which have not yet been heard, will be impacted by substantive or procedural changes in the CETA by virtue of the MFN obligation.

14 This phrase is borrowed from the Appellate Body’s decision in the WTO dispute between the EU plus Japan against Canada in the so-called Autos Case *supra* footnote 2.

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