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Paper:

Davies, A. (2015). The GATT Article III:8(a) Procurement Derogation and Canada - Renewable Energy. *Journal of International Economic Law*, 18(3), 543-554.

<http://dx.doi.org/10.1093/jiel/jgv027>

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The GATT Article III:8(a) Procurement Derogation and *Canada – Renewable Energy*

Arwel Davies*

ABSTRACT

This article compares and reviews the panel and Appellate interpretations of the GATT Article III:8(a) procurement derogation in *Canada – Renewable Energy*. When this derogation is available, discriminatory domestic content requirements fall outside of the general GATT Article III:4 national treatment obligation, and are capable of challenge only under the more limited coverage of the plurilateral Agreement on Government Procurement (GPA). It is argued that the panel's understanding should be preferred over that of the Appellate to preserve the operation of the derogation in paradigm situations and to avoid the multilateralization of obligations acceded to, or possibly not yet acceded to, under the GPA.

I. WHEN DOES A MEASURE GOVERN PROCUREMENT UNDER THE DEROGATION?

GATT Article III:8(a) provides as follows:

The provisions of this Article shall not apply to laws, regulations or requirements governing the procurement by governmental agencies of products purchased for governmental purposes and not with a view to commercial resale or with a view to use in the production of goods for commercial sale.

The derogation was interpreted for the first time in *Canada – Renewable Energy*.¹ Japan and the EU complained of domestic content requirements applicable in the construction of solar and wind power generation facilities in the Feed-in tariff programme (FIT Programme) established by the Ontario Power

* Arwel Davies, College of Law, Swansea University.

1 WT/DS412/AB/R *Canada – Certain Measures Affecting the Renewable Energy Generation Sector*; WT/DS426/AB/R *Canada – Measures Relating to the Feed-In Tariff Programme*, adopted 24 May 2013. On the subsidy dimension of this case, see Luca Rubini, '“Ain't Wastin” Time No More: Subsidies For Renewable Energy, The SCM Agreement, Policy Space, And Law Reform' 15 *Journal of International Economic Law* 525 (2012); Aaron Cosbey and Petros C. Mavroidis, 'A Turquoise Mess: Green Subsidies, Blue Industrial Policy and Renewable Energy: The Case for Redrafting the Subsidies Agreement of the WTO' 17 *Journal of International Economic Law* 11 (2014); Rajib Pal, 'Has the Appellate Body's Decision in *Canada – Renewable Energy / Canada – Feed-in Tariff Program* Opened the Door for Production Subsidies?' 17 *Journal of International Economic Law* 125 (2014).

Authority.² Under the FIT Programme, generators of electricity via renewable sources delivered into the Ontarian system were paid a guaranteed price under 20- or 40-year contracts. The meeting of minimum domestic content levels for energy generation equipment were among the conditions for being offered a contract. Both Japan and the EU argued that the domestic content requirements infringed the GATT Article III:4 national treatment obligation³ on the basis that their energy generation equipment was being treated less favourably than like products of Ontarian origin.⁴ Canada countered that the above derogation applied. For Canada, the FIT programme constituted 'laws and requirements that govern the procurement of renewable electricity for the governmental purpose of securing an electricity supply for Ontario from clean sources, and "not with a view to commercial resale or with a view to use in the production of goods for commercial sale"',⁵ No complaint was brought under the GPA. This would not have been possible, partly because the Ontario Power Authority was not a covered entity under the Uruguay Round GPA.⁶

The panel ultimately found that the derogation was not available because the electricity was purchased 'with a view to commercial resale' by reason of the profit made by the Government of Ontario from resale of FIT Programme electricity to consumers, and because the resales were made in competition with licensed electricity retailers.⁷ As the derogation was ultimately not available, the domestic content requirement was confirmed as a GATT Article III:4 violation.⁸ Of greater

2 This body was established under Ontario's Electricity Restructuring Act of 2004 as a government agency responsible for managing Ontario's electricity supply.

3 GATT Article III:4 provides in relevant part: 'The products of the territory of any contracting party imported into the territory of any other contracting party shall be accorded treatment no less favourable than that accorded to like products of national origin in respect of all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use.'

4 Both complainants argued that there was a 'stand-alone' GATT Article III:4 violation (see panel report, paras 3.1–4.3). The complainants also supplemented this claim with an alleged violation of Article 2.1 of the TRIMs Agreement. The Appellate Body confirmed that the GATT Article III:8(a) procurement derogation applies to measures 'that fall within the scope of Article 2.2 of the TRIMs Agreement and the Illustrative List annexed thereto' (Appellate Body report, para 5.33). Therefore, if GATT Article III:4 does not apply to a measure by reason of the Article III:8(a) procurement derogation, then Article 2.1 of the TRIMs Agreement also does not apply to this measure.

5 Ibid, Appellate Body report, para 1.10.

6 Canada's commitments under the Uruguay Round GPA and the Revised GPA at the sub-central (Annex 2) level can be viewed at http://www.wto.org/english/tratop_e/gproc_e/gp_app_agree_e.htm. (visited 4 April 2015).

Notably, a new entity known as the Integrated Electricity System Operator (IESO) has absorbed the old Ontario Power Authority as of January 2015. The IESO falls under the Ontario Ministry of Energy. The Revised GPA covers 'All Ministries of the Province' of Ontario. Therefore, it is reasonably clear that the IESO is now a covered entity. This does not, in itself mean that FIT contracts are now covered by the GPA. This is because goods or services 'procured with a view to commercial sale or resale . . .' are not covered (Revised GPA, Article II:2).

7 However, the panel also noted that 'commercial resale' would not always necessarily involve profit noting that, 'loss-making sales can be, and often are, a part of ordinary commercial activity' (para 7.151). The Appellate Body seemed to broadly agree with this understanding in elaborating its own view of the 'not with a view to commercial resale' language at para 5.71. However, it did not apply this aspect of the derogation to the facts. As explained in the main text, the Appellate Body considered the derogation to be unavailable independently of the 'commercial resale' test.

8 Panel report, above n 4, para 7.167.

significance for this article are the panel's earlier findings which were favourable towards the availability of the derogation, and which were overruled by the Appellate Body. The issue, according to the panel, was whether the challenged measures could be characterized as 'laws regulations or requirements governing procurement'.⁹ In terms of the identity of the challenged measures, the panel focused on the domestic content requirements emphasizing that this measure compelled the purchase and use of equipment sourced in Ontario 'as a necessary prerequisite for the alleged procurement . . . to take place'.¹⁰ As there could not be any procurement of electricity without meeting the domestic content requirement, this requirement governed procurement for the purposes of the derogation.

The crucial insight here is that there need not be any connection between the products discriminated against and the products procured for the derogation to apply. The products need not be in a competitive relationship, and it is also irrelevant that the products might otherwise be in a close relationship in the sense that electricity cannot be generated and then procured without electricity generating equipment. To illustrate this point using an example not used by the panel, requirements to buy buffalo meat sourced in Ontario as a prerequisite for gaining an electricity supply contract would still have governed the procurement of electricity. The panel, therefore, proceeded to dismiss the EU's alternative understanding under which the derogation should be understood as referring only to measures that directly affect a product identical to the product allegedly procured.¹¹ This position is the opposite extreme to that preferred by the panel. While rejecting this understanding, and indeed the need for any degree of similarity between the products at issue, the panel nevertheless noted a 'close relationship' between the products subject to the domestic content requirements (generating equipment), and the product allegedly procured (electricity).¹² In sum, for the panel, the domestic content requirements were laws 'governing' procurement indicating the availability of the Article III:8(a) derogation.

In contrast to the panel, the Appellate Body paid particular attention to the phrase 'products purchased' when deciding whether the domestic content requirements governed the procurement. The core idea here was that the derogation had to be understood in relation to the obligations of Article III. The derogation 'becomes relevant only if there is discriminatory treatment of foreign products that are covered by the obligations in Article III, and this discriminatory treatment results from laws, regulations, or requirements governing procurement by governmental agencies of

9 *Canada – Renewable Energy*, panel report, above n 4, para 7.122.

10 *Ibid*, para 7.124.

11 *Ibid*, para 7.126.

12 *Ibid*, para 7.127. The panel's interpretation has sometimes been understood as being dependent upon the noted 'close relationship'. However, it is reasonably clear that the panel considered that the measure governed procurement independently of this close relationship between electricity and generating equipment. The panel commenced para 7.127 by noting that 'the "Minimum Required Domestic Content Level" is a necessary prerequisite for the alleged procurement by the Government of Ontario to take place, and to this extent, we are of the view that such requirements "govern" the alleged procurement'. The subsequent reference to the 'close relationship' is, therefore, an *obiter dictum*, rather than a condition for the derogation to apply. Hence, it is submitted that the reference to buffalo meat is a correct example of the panel's understanding of the derogation.

products purchased'.¹³ The 'same discriminatory treatment' had to be considered both under Article III and the derogation. It followed that the term 'products purchased' in the derogation was tied to the scope of the 'products' covered by Article III. This resulted in the crucial insight that, for the derogation to apply, 'the product of foreign origin [electricity generating equipment] must be in a competitive relationship with the product purchased [electricity]'.¹⁴ The competitive relationship encompassed products which were either identical, or like, or directly competitive or substitutable.¹⁵ As there was no competitive relationship, the domestic content requirements were not 'laws, regulations or requirements governing the procurement by governmental agencies' of electricity within the meaning of Article III:8(a).¹⁶ As such, the discrimination relating to generating equipment in the FIT contracts was not covered by the derogation.

II. EVALUATION

The arguments presented here relate to the deficiency of the Appellate Body's interpretative method. The cornerstone here has always been Articles 31 and 32 of the Vienna Convention on the Law of Treaties.¹⁷ On these customary rules, the Appellate Body has stated that interpretation 'is ultimately a holistic exercise that should not be mechanically subdivided into rigid components'.¹⁸ Individual provisions can and should be interpreted 'in the light of the object and purpose of the WTO Agreement and the GATT 1994',¹⁹ while '[t]he purpose of treaty interpretation under Articles 31 and 32 ... is to ascertain the "common intention" of the parties ... [to which] "the circumstances of the conclusion of the treaty" may be relevant'.²⁰ Despite these statement, the interpretation of GATT Article III:8 in *Canada – Renewable Energy* was confined to a particular understanding of the ordinary meaning understood in the narrow context of Article III. The ordinary meaning was not informed by consideration of a number of pertinent questions of relevance

13 *Canada – Renewable Energy*, Appellate Body report, above n 4, para 5.63.

14 *Ibid*, para 5.74.

15 *Ibid*, para 5.63.

16 *Ibid*, para 5.79.

17 Article 31(1) A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.

Article 32 Recourse may be had to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion, to confirm the meaning resulting from the application of Article 31, or to determine the meaning when the interpretation according to Article 31: (i) leaves the meaning ambiguous or obscure; or (ii) leads to a result which is manifestly absurd or unreasonable.

Works include, M. Fitzmaurice *et al.* (eds.), *Issues of Treaty Interpretation and the Vienna Convention on the Law of Treaties: 30 Years On* (Martinus Nijhoff, 2010); R. Gardiner, *Treaty Interpretation* (Leiden: Oxford: Oxford University Press, 2008); U. Linderfalk, *On the Interpretation of Treaties: The Modern International Law as Expressed in the 1969 Vienna Convention on the Law of Treaties* (Dordrecht: Springer, 2007).

18 WT/DS269, 286/AB/R, *European Communities - Customs Classification of Frozen Boneless Chicken Cuts*, adopted September 27, 2005, para 176.

19 *Ibid*, para 240.

20 WT/DS363/AB/R, *China – Measure Affecting Trading Rights and Distribution Services for Certain Publications and Audiovisual Entertainment Products*, adopted 19 January 2010, para 405

to the object and purpose of the provision in the context of the WTO Agreement which includes the plurilateral GPA.

In interpreting the provision it is necessary to take an informed view of how broad or narrow its scope of application should be. Relevant here is the sensitivity of subjecting procurement to the national treatment standard. It is also pertinent to ask how the Appellate Body's preferred interpretation operates in situations other than those at issue, or at least in a paradigm situation. An interpretation resulting in an outcome which could not possibly have been intended by the parties cannot be correct. The following analysis covers these two areas.

A. Sensitivity of subjecting procurement to the national treatment standard

The question of whether to regulate government procurement was subject to a sharp U turn at an early point in the post-war negotiations. The Suggested Charter for an International Trade Organization drafted by the USA, and published in September 1946, originally proposed that government procurement should be subject to the general national treatment obligation.²¹ However, it quickly became apparent that this would not be possible because of the prevalence of, and desire to retain, discriminatory laws and practices involving preferences for domestic suppliers. The Charter's initial inclusion of procurement was substituted²² with the derogation eventually expressed in GATT Article III:8(a).²³

The rejection of a multilateral national treatment obligation in the procurement context might have led to the abandonment of attempts at regulation. However, some states eventually wanted to move forward with procurement market liberalization to extend commercial opportunities for private suppliers to this economically significant sector. The Tokyo Round GPA, which entered into force on 1 January 1981, was therefore plurilateral/optional in character. This instrument included a general national treatment principle along with rules governing the advertisement and award of contracts. Its coverage was limited to central government goods contracts above specified financial thresholds. Contract coverage was significantly expanded by the Uruguay Round GPA which entered into force on 1 January 1996. This instrument extended coverage, in principle, to the sub-central level of government and to 'other entities'—in practice those providing utility functions such as the generation and supply of energy and public transport services. Coverage was also

21 Article 9(1) covered 'laws and regulations governing the procurement by governmental agencies of supplies for public use other than by or for the military establishment', <http://www.worldtradelaw.net/document.php?id=misc/Suggested%20Charter.pdf>.

22 The derogation first appeared in Article 2(5) of the Tentative and Non-Committal Draft Suggested by the Delegation of the USA of 7 February 1947, E/PC/T/C.6/W.53, <http://www.worldtradelaw.net/document.php?id=misc/Draft%202.pdf>.

23 I appreciate that I have arguably resorted here to the 'preparatory work of the treaty and the circumstances of its conclusion' as referred to in Article 32 of the Vienna Convention, without first having applied Article 31. However, the Appellate Body has itself sensibly referred to the negotiating history of GATT without specifically establishing that the conditions for recourse to supplementary means of interpretation are present. We are informed in *US – Shrimp* that most of the chapeau of GATT Article XX was absent Article 32 of the Suggested Charter for an International Trade Organization and an account is provided of the concerns which led to its inclusion (*United States – Import Prohibition of Certain Shrimp and Shrimp Products*, WT/DS58/AB/R (adopted 6 November 1998) note 154).

extended beyond goods to services and construction services. Contract coverage under the GPA does not operate on a most favoured nation, or most favoured party, basis. It is not the position that when a supplier of a particular GPA party is entitled to participate in a contract award of another GPA party, the suppliers of all GPA parties are entitled to participate. Rather, beyond central government goods contract, the entitlement to participate depends on the content of the coverage Annexes maintained by each GPA party. The content of these Annexes depends on the outcome of negotiations conducted with reciprocity considerations in mind.

In April 2014, the Revised GPA entered into force. The text of the agreement has been improved in a number of respects including the recognition of electronic forms of communication and procurement and enhanced recognition of the position of developing countries with a view to expanding membership.²⁴ While procurement market liberalization remains firmly rooted in the plurilateral model, there have been significant gains. Market access under the Revised GPA is estimated to have increased by between \$80 billion and \$100 billion annually. This has resulted from coverage of 400–500 additional procuring entities, coverage by three major parties of Build Operate Transfer Arrangements, generally expanded coverage of services procurement (especially telecommunications) and coverage by all parties of the full range of construction services.²⁵

Membership of the GPA, while expanded, remains limited. It covers 43 of the WTO's 160 Members, a figure which includes the 28 EU Member States and which will shortly increase to 45 with the accession of Montenegro and New Zealand. The membership is also imbalanced towards developed countries, albeit that there is at least the possibility for this position to gradually change. Article V of the Revised GPA contains strengthened transitional arrangements for developing and least developed WTO Members. Furthermore, some WTO Members which have started the process of accession to the GPA are, according to World Bank criteria,²⁶ lower middle income countries (Moldova, Kyrgyz Republic, Ukraine). Mongolia and Tajikistan, which have provisions on GPA accession in their protocols of accession to the WTO are, respectively, lower middle income and low income countries. Future accessions, in particular by China which submitted its first coverage offer in 2007, could prompt other states towards membership. Suppliers from other major developing/transition economies may petition their governments for the same access

24 See, A. Reich, 'The New Text of the Agreement on Government Procurement: An Analysis and Assessment', 12 *Journal of International Economic Law* 989 (2009).

25 R.D. Anderson, 'The Coming into Force of the Revised WTO Agreement on Government Procurement, and Related Developments', 5 *Public Procurement Law Review* NA160 (2014). It is difficult to comment on the extent of the achievement with regard to the market access dimension. This rather depends on whether the aspirations and expectations of negotiators were met. The gain in market access opportunities seems to be of the order of 5–10%. It, therefore, seems clear that substantial future gains will come more from accessions than from further commitments from existing GPA parties. It has been estimated e.g. that the accession of China alone will yield market access gains in the range of \$US 113–289 billion. P. Pelletier *et al.*, 'Assessing the Value of Future Accessions to the WTO Agreement on Government Procurement (GPA): Some New Data Sources, Provisional Estimates, and an Evaluative Framework for Individual WTO Members Seeking Accession', Staff Working Paper ERSD-2011-15, 6 October 2011, at 13, http://www.wto.org/english/res_e/reser_e/ersd201115_e.pdf.

26 <http://data.worldbank.org/country>.

to overseas procurement markets as that enjoyed by China's suppliers by reason of GPA membership. It is, therefore, possible that we are on the brink of a period of intense activity towards an expansion in the level and diversity of membership.

This account tells us that WTO members think long and hard before acceding to the GPA. The conditions of accession in terms of contract coverage are also hard fought. The interpretation of the derogation is, therefore, a sensitive matter. If it is interpreted, restrictively, such that GATT Article III:4 applies to domestic content requirements applied in the context of government procurement, the consequence may be that obligations which only some WTO members have acceded to under the GPA, or even obligations which no GPA party has acceded to, are multilateralized. This is surely a consideration which the Appellate Body ought to have had in mind. In terms of the object and purpose of the derogation and the WTO Agreement, the origin and development of procurement market liberalization at the WTO indicates that the locus is the plurilateral GPA rather than GATT Article III. In turn, this indicates that the derogation should be interpreted reasonably broadly, or at least sufficiently broadly to cover a paradigm situation. As discussed below, the Appellate Body's narrow interpretation may mean that the derogation is not available in such a situation. GATT Article III:4 may now apply to areas conventionally thought to be covered by the derogation.

B. Applying the panel and Appellate Body interpretations in a paradigm situation

How do these different interpretations apply in the type of situation which, it can reasonably be supposed, the procurement derogation was incorporated to cover? Buy national policies involving discriminatory preferences and set-asides in favour of domestic goods have been under the spotlight in recent years following the economic downturn of 2008–09 and the increased emphasis on public infrastructure spending. The American Recovery and Reinvestment Act of 2009²⁷ was among the most prominent instruments. The Act was passed with a provision stipulating that the new Buy American requirements 'shall be applied in a manner consistent with United States obligations under international agreements'.²⁸ Commentators have assessed whether the Recovery Act and its implementing federal regulations breach the WTO commitments of the USA.²⁹ Understandably, the primary focus has been on whether the Recovery Act breaches the GPA. It is generally thought that a breach is unlikely. When the contracts are not covered by the GPA, the Buy American requirements can be applied while covered contracts are exempt from Buy American treatment. With regard to GATT Article III, commentators tend to cite the paragraph 8 derogation as exempting government procurement from national treatment. However, as a result of *Canada – Renewable Energy*, it must also be asked whether buy national requirements are covered by GATT Article III:4.

27 Public Law No. 111-5, 123 Stat, 115 (17 February 2009). (Recovery Act).

28 Recovery Act Section 1605(d).

29 J. Linarelli, 'Global Procurement Law in Times of Crisis: New Buy American Policies and Options in the WTO Legal System', in Arrowsmith and Anderson (eds), *The WTO Regime on Government Procurement* (Cheltenham: Edward Elgar) 773.

Take the example of a buy national requirement under which steel used in the construction of a highway must be of US origin. Such a requirement clearly falls under Article III:4 to the extent that it applies since imported steel is treated less favourably than like domestic steel. Arguably, Article III:4 does not apply because the Article III:8(a) derogation may not be available. Based on the Appellate Body's interpretation, the subject matter of the contract is a highway which is not in a competitive relationship with the steel being discriminated against under Article III:4. In contrast, the panel's approach has the potential of extending the derogation to this situation. As the highway construction contract requires the use of domestic steel, this requirement governs the procurement. There is also a reasonably strong connection between the steel discriminated against under Article III and the highway construction project which cannot be completed without steel. Continuing with the other main element of the derogation, the purchase of the highway would not be 'with a view to commercial resale' so that, under the panel's analysis, the buy national requirement in relation to the steel would fall under the derogation. Article III:4 would be inapplicable.

Of course, it would be extraordinary if Article III:4 were to apply in the situation above. The original Buy American Act was passed in 1933 and it is reasonable to suppose that GATT Article III:8(a) was incorporated to shelter this instrument, and comparable instruments maintained by other states, from review under Article III. The question is, therefore, how the Appellate Body's approach would be applied or refined in the situation above.

A possible refinement is that the Appellate Body's interpretation will only potentially result in the non-availability of the derogation when the goods subject to discrimination (electricity generating equipment), are not a physical input of the product being procured (electricity). In this situation, there is a workable distinction between the two products, and the availability of the derogation depends in part on whether the separate products are in a competitive relationship. If they are not, the derogation will not be available to shelter the discrimination from a GATT Article III:4 claim. In contrast, the steel is a physical input and consumed in the construction of a highway. As such, it is arguable that the product subject to discrimination (steel) and the product being procured (steel) are one and the same, and therefore self-evidently in a competitive relationship. However, this argument is not wholly convincing. It requires a formalistic view of what is being procured which is removed from commercial reality. While the steel is a consumed physical input, and the electricity generating equipment is not, the price of the electricity will, over time, involve recouping the cost of the generating equipment, just as the price of the highway involves recouping the cost of the steel. It is also arguably artificial to concede that steel is being procured in the context of highway construction. One of Canada's statements in a NAFTA Chapter 11 claim, *Mesa Power v Canada*,³⁰ is particularly striking. It notes that, in *ADF v United States*,³¹ 'the state of Virginia was not procuring steel, and it certainly was not procuring the process by which steel was

30 The submissions, <http://www.international.gc.ca/trade-agreements-accords-commerciaux/topics-do-maines/disp-diff/mesa.aspx?lang=eng>

31 ICSID ARB(AF)/00/1, Award 9 January 2003.

manufactured; it was procuring the construction of a highway interchange'.³² If this is accepted, the GATT Article III:8(a) derogation would not shelter a buy national requirement in relation to steel from review under Article GATT Article III:4. There is no competitive relationship between a highway and steel.

It is possible that the Appellate Body was aware that its test could produce odd results in a situation different from that before it:

What constitutes a competitive relationship between products may require consideration of inputs and processes of production used to produce the product. In its rebuttal of Canada's claim under Article III:8(a), the European Union acknowledges that the cover of Article III:8(a) may also extend to discrimination relating to inputs and processes of production used in respect of products purchased by way of procurement. Whether the derogation in Article III:8(a) can extend also to discrimination of the kind referred to by the European Union is a matter we do not decide in this case.³³

This passage commences as an elaboration of the nature of the required 'competitive relationship between products'. It is clear, of course, that the test for 'like' products under Article III can involve considering inputs. The Appellate Body noted in *Japan – Alcoholic Beverages* that 'the product's properties, nature and quality' are among the criteria for determining likeness under GATT Article III:2 first sentence.³⁴ Partly on this basis, vodka and shochu were found to be like products. However, it is difficult to see how this understanding applies in the present context. Steel as a material and a highway which contains steel as an input share a physical characteristic but this does not place them in a competitive relationship. In the passage, the Appellate Body proceeds to note the EU's acknowledgement. It is perhaps notable that the reference to 'competitive relationship' is not repeated here. Perhaps the Appellate Body is signalling that the derogation might apply to discrimination in relation to steel used in a highway procurement notwithstanding the absence of any competitive relationship. Some support for this position can be found in a subsequent statement in which the meaning of 'governmental purposes' within the derogation was discussed:

An obvious example is where a governmental agency purchases a good, uses it to discharge its governmental functions, and the good is totally consumed in the process. None of the participants disputes that this would constitute an example of a good purchased for governmental purposes.³⁵

The meaning of 'governmental purposes' is, however, a separate matter from the earlier issue of whether the measure governs the procurement—the matter for which the Appellate Body requires a competitive relationship. Therefore, this passage does

32 Ibid, 77.

33 *Canada – Renewable Energy*, Appellate Body report, above n 4, para 5.63 (notes omitted). A very similar statement was provided in note 523 to para 5.74.

34 WT/DS8,10,11/AB/R page 20, *Japan – Taxes on Alcoholic Beverages* adopted 1 November 1996.

35 *Canada – Renewable Energy*, Appellate Body report, above n 4, para 5.68.

not establish that this relationship is established, or that it is waived, when the good is consumed.

The analysis above can now be summarized:

- i. Under the Appellate Body's test, a condition for the availability of the derogation is the existence of a competitive relationship between the product discriminated against (generating equipment) and the product procured (electricity).
- ii. In a different situation, involving discrimination against steel in the context of a highway procurement, it is arguable that the competitive relationship test can still be satisfied. This could be achieved through the argument that the steel is a physical input and consumed in the highway construction. As such, steel is being both procured and subject to discrimination thereby clearly establishing the required competitive relationship. The competitive relationship test is, therefore, preserved via the refinement of the physical input test.
- iii. The problem with preserving the competitive relationship test via the refinement of physical inputs is that it does not correspond with commercial reality. It is arguably illusory to claim that generating equipment is not being procured, whereas steel is being procured because the cost of electricity depends on the cost of the generating equipment, just as the cost of highways depends of the cost of the steel.
- iv. If it is acknowledged that the highway procurement is not directly a procurement of steel, the competitive relationship test is not satisfied. The derogation can then only apply if the need for a competitive relationship is jettisoned when the product discriminated against is a physical input of the product procured. This casts doubt on the requirement for a competitive relationship when the product discriminated against is not a physical input of the product procured.

In sum, when the Appellate Body's approach is applied in a different and paradigm situation, it can only produce what must surely be the correct result (derogation available) either by using reasoning at odds with commercial reality, or, if we are to acknowledge commercial reality, by jettisoning the need for any competitive relationship. If the need for a competitive relationship does not make much sense in a paradigm situation, it cannot be sensibly defended in a non-paradigm situation. All this uncertainty and complexity is avoided by preferring the panel's approach under which domestic content requirements govern the procurement in the sense that the award of a highway contract depends on using domestic steel.

III. THE NAFTA CHAPTER 11 DIMENSION

As indicated, procurement derogations have been interpreted in NAFTA Chapter 11 investor state dispute settlement cases. This dimension is briefly considered here by reason of the growing interest in relationship between the trade law and investment law regimes and the possibility of interpretations adopted in one regime influencing interpretations of similar provisions in the other.

The tribunal in *ADF v United States* confirmed that a highway construction project in which Buy American requirements were applied in relation to steel was covered by a derogation.³⁶ However, the reasoning and outcome here cannot be automatically applied in the GATT/WTO context because both the substantive obligations and the derogation are drafted in different terms. NAFTA Article 1108(7) and (8) provides that several substantive obligations such as National Treatment, Most-Favoured-Nation Treatment, and Performance Requirements 'do not apply to procurement by a Party or a state enterprise'. The very brevity of this derogation means that there are fewer express elements which must be satisfied compared to GATT Article III:8. It does not e.g. expressly provide that the products purchased must be for the benefit or use of government, albeit that it is arguable that this concept is inherent to the ordinary meaning of 'procurement'. It may, therefore, be that the NAFTA derogation can shelter a measure from review under Chapter 11, when the same measure would not be sheltered from review in WTO proceedings under GATT Article III.

It is possible that the scope of the NAFTA procurement derogation will be considered in *Mesa Power v Canada* in which an American investor is challenging the measures at issue in *Canada – Renewable Energy*. The claimant in *Mesa* contends that the Appellate Body's reasoning should be carried over to the NAFTA Chapter 11 procurement derogation. It, therefore, considers that the NAFTA derogation can only apply when the goods being procured are identical to the goods subject to domestic content provisions.³⁷ Of course, this was not the test established by the Appellate Body since it is well established that non-identical products can be in a competitive relationship. Canada's position is that the plain language of the NAFTA derogation does not envisage so tight a nexus between the product discriminated against and the product purchased.³⁸ Indeed, Canada goes so far as to argue that the derogation could not possibly be interpreted as not applying to domestic content requirements. Given that 'the majority of the world's nations discriminate in their government procurement', had the NAFTA parties intended for the Chapter 11 investment obligations to cover domestic content requirements in government procurement, they would have expressly so provided.³⁹

It will be interesting to see what the *Mesa* tribunal makes of these arguments. One point is reasonably certain. If the tribunal follows the methodology of many previous NAFTA Chapter 11 tribunals, it will at least engage with the WTO law position. The Award ought, therefore, to further elucidate on the relationship between the trade law and investment law regimes.

IV. CONCLUSION

The Appellate Body's interpretation of GATT Article III:8(a) in *Canada – Renewable Energy*, has the potential to bring swathes of discriminatory domestic content requirements, many of which may be excluded from the GPA's coverage,

36 ICSID ARB(AF)/00/1, Award 9 January 2003, paras 159–74.

37 *Mesa Power*, Claimant's Reply Memorial, para 205.

38 *Mesa Power*, Canada – Rejoinder, para 78.

39 *Ibid.*

within the scope of GATT Article III. As this was surely not the Appellate Body's intention, the challenge is to suggest how the competitive relationship test should be applied in paradigm situations to ensure that the derogation is available. The test can only survive if an unconvincing distinction is drawn between situations when goods discriminated against are incorporated into other goods, and situations in which there is no incorporation. It is, therefore, difficult to accept that the Appellate Body's view of when a measure governs procurement is correct. In contrast, the panel's test is generally applicable, easier to understand, and corresponds with commercial reality. It also does not seem to be at odds with the treaty language to find that a measure governs procurement when the contract cannot be awarded unless certain conditions are fulfilled, or when contract performance requires that conditions are fulfilled. This establishes a close connection between the measure and the procurement even if there is no competitive relationship between the products discriminated against under the measure and the procured products. While the panel's interpretation expands the scope of the derogation, its availability does not depend solely on whether the measure governs procurement. Furthermore, when the derogation applies, the discrimination does not fall into a legal vacuum. While GATT Article III will not apply, the GPA may apply depending on contract coverage; a matter which is the subject of hard fought concessions.