Chapter 5
NAFTA's Approach to Protecting Public Services: Fragmentary, Asymmetrical, Rigid and Limited

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Abstract The chapter surveys NAFTA's approach to protecting public services with a view to drawing some conclusions regarding its costs and benefits. The chapter first discusses the scope of NAFTA's application to public services, focussing on the obligations relating to trade in services and investment and the relevant reservations taken by each NAFTA party state. This is followed by an examination of how the specific NAFTA obligations relating to financial services, telecommunications services, energy, government procurement, and competition as well as the treaty's exceptions provisions address public services. Finally a synthesis is provided of NAFTA's approach to public services with a view to identifying its costs and benefits in relation to the approach in GATS and EU trade agreements.

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5.1 Introduction

Public services are treated differently under the North American Free Trade Agreement (NAFTA) compared to the WTO General Agreement on Trade in Services (GATS) and European Union (EU) trade treaties.[1] The approach in NAFTA, which is followed in many bilateral and regional agreements worldwide,[2] has three main distinctive characteristics.

First, NAFTA is a negative list agreement—meaning that all of the obligations in the treaty, including those related to services and investment, apply to all state actions except to the extent specifically carved out through reservations or exceptions. By contrast, GATS and EU trade treaties are positive list agreements under which some services obligations only apply to a sector or activity if and to the extent that a state lists it in an national schedule of commitments to the treaty.[3] A positive list approach makes it easier in practice for state parties to limit the scope of their obligations to areas they choose and avoid unanticipated consequences of their obligations, including in relation to public services.

Second, NAFTA contains no general exception from all treaty obligations for any category of public service. There is no exception for services delivered in the exercise of governmental authority as is found in the GATS and many EU trade treaties, nor is there any unifying concept of public services in the treaty. Instead, there are a variety of limited exceptions and country-specific reservations that exclude the application of certain treaty obligations to some categories of public services and to specific kinds of measures that may be related to public services, like subsidies. Reservations vary by country.

Third, NAFTA contains comprehensive obligations relating to investment, which are not found in the GATS or EU trade treaties. These obligations are similar to those found in the bilateral investment treaties of EU member states.[4] NAFTA provides specific protections to the investments of foreign investors, including those in public services where such investment is permitted. Only some of these obligations are subject to exceptions and reservations. As in most bilateral investment treaties, if a country fails to comply with a NAFTA investment obligation, an investor that suffers a loss as a result may seek compensation in binding arbitration.

[1]Krajewski 2011a. See e.g. European Community–CARIFORUM Economic Partnership Agreement (2008).

[2]Houde et al. 2007.

[3]Although the final text of the Comprehensive Economic and Trade Agreement between Canada and the EU has not been agreed to, it is reported that it will be the first EU negative list agreement: Council of the European Union, EU Canada Comprehensive Economic and Trade Agreement—landing zones, Note by the Commission, DS 1744/12, 6 November 2012. Apparently, the Parliament has said that this should not be considered a precedent for future agreements, see Krajewski 2011a, p. 9.

[4]Of course, this may change for treaties concluded after the Treaty on the Functioning of the European Union [TFEU] came into force on December 2009. The Comprehensive Trade and Investment Agreement between Canada and the EU may be the first EU treaty with comprehensive investment obligations.

Canada and the United States have essentially followed the NAFTA approach in most subsequent trade treaties.[5] In part, this may be because there has been little political or academic discussion in either country regarding the application of NAFTA to public services generally.[6] There have been significant concerns vocally and consistently expressed by labour organizations and progressive NGOs regarding the risk to particular public services, especially health care, which NAFTA (and other trade obligations) represent.[7] But the Canadian government's consistent response to these concerns has been to flatly deny that the delivery of health, education, social services and other public services is threatened by Canada's existing commitments under the NAFTA.[8] Perhaps as a result of the government's position, there has been limited policy discussion in government or academia about alternative ways to address public services in trade agreements. Even less attention has been paid to these issues in the United States.

Undoubtedly, one other reason for the lack of discussion of trade and public services as a distinct subject of enquiry has been the absence in Canada and the United States of a domestic policy-making framework that uses a concept of public services as starting point for developing general principles that qualify the application of market-based legal disciplines to public services. There is no equivalent to the provisions of the Treaty on the Functioning of the European Union[9] or the European Charter[10] dealing with services of general interest in Canada or the United States.[11] There are no North American institutions comparable to the EU Commission, the Parliament or the Social Protection Committee[12] that deal with these issues. The Biennial Reports on social services of general interest[13] and the

[5]Canada and, to a lesser extent, the US has followed the same approach in its investment treaties.

[6]There has been some academic writing on NAFTA and health care. E.g. Epps and Flood 2002; VanDuzer 2004.

[7]E.g. Grieshaber-Otto and Sanger 2002, pp. 46–84. More recently similar concerns have been expressed regarding possible obligations under a Comprehensive Economic and Trade Agreement between Canada and the EU: see Sinclair 2010.

[8]This commitment was expressed repeatedly by former trade Minister Pierre Pettigrew (e.g. Canada 2000).

[9]TFEU, Articles 14, 106, and Protocol No. 26 on Services of General Interest.

[10]Charter of Fundamental Rights of the European Union, Article 36.

[11]Arguments have been made regarding entitlements to certain public services under Canada's Charter of Rights, e.g. Jackman and Porter 2008. Some public service issues have been addressed in Canadian intergovernmental agreements: Agreement on Internal Trade—Consolidated Version, available at http://www.ait-aci.ca/en/ait/ait_en.pdf, accessed 14 January 2014, and the New West Partnership Agreement entered into by the provinces of British Columbia, Alberta and Saskatchewan, see Compendium of the New West Partnership Agreements available at http://www.gov.sk.ca/nwp, accessed 14 Jan 2014. Under these agreements, most obligations do not apply to government regulation taken for a legitimate purpose. Each agreement goes on to list what legitimate purposes are.

[12]The Social Protection Committee was created in accordance with Article 160 of the TFEU, through Decisions of the European Council in 2000 and 2004. The Committee facilitates cooperation between Member States and the European Commission on social inclusion, health care and long-term care, including pensions.

[13]E.g. European Commission, Commission Staff Working Document, 3rd Biennial Report on Social Services of General Interest, SWD(2013) 40 final, 20 February 2013, p. 40.

forums on such services sponsored by the Presidency of the Council of the European Union have no North American equivalents.

Another reason for the limited attention to public services in North America may be that, despite the concerns noted above, there has been no state-to-state dispute between NAFTA countries in which one party claimed that some public service measure was inconsistent with the agreement. Claims have been made by private investors under NAFTA's investor-state arbitration procedures related to various public services, including waste disposal, water distribution, postal services, and health services. But few of these cases have been successful. As well, the issues in these cases have typically related to the manner in which the state has acted in dealing with the investor, such as whether it met acceptable standards for administrative process or acted in an arbitrary or discriminatory way, rather than the public service character of the measure.[14] While the public nature of the services at issue has played a role in the analysis by the tribunal in at least one case, a distinct approach to public services has not developed.[15]

In this chapter, I will survey NAFTA's approach to protecting public services with a view to drawing some conclusions regarding its costs and benefits. Section 5.2 discusses the scope of NAFTA's application to public services, focussing on the obligations relating to trade in services and investment and the relevant reservations taken by each NAFTA party state. This is followed by an examination of how the specific NAFTA obligations relating to financial services, telecommunications services, energy, government procurement, and competition as well as the treaty's exceptions provisions address public services. Section 5.3 provides a synthesis of NAFTA's approach to public services with a view to identifying its costs and benefits in relation to the approach in GATS and EU trade agreements.

5.2 Survey of NAFTA

5.2.1 Introduction

As noted above, NAFTA does not have a general exclusion for any category of public service. There is no equivalent to GATS exception for services "supplied in the exercise of governmental authority" meaning services "supplied neither on a commercial basis, nor in competition with one or more service suppliers."[16]

[14]Concerns about how investor-state tribunals were interpreting the balance between investor-protection and state's right to regulate caused Canada and the US to adopt an interpretation of indirect expropriation that better protected the right to regulate in subsequent US and Canadian trade and investment agreements. Krajewski notes that many investor-state cases have dealt with public services, especially public water services, but the issues have been characterized as human rights issues rather than public services issues, see Krajewski 2012.

[15]*United Parcel Service of America Inc. v. Government of Canada,* UNCITRAL Arbitration, Award on the Merits, 24 May 2007, discussed below.

[16]GATS, Articles I.3(b) and (c).

Instead, various provisions of the treaty limit its application to different aspects of public services. As a negative list agreement, the starting point is that treaty obligations apply to all services, including public services, except to the extent specifically excluded. NAFTA's approach to protecting public services from the application of the market-based disciplines in the treaty has three features: (i) exceptions and country-specific reservations that exempt identified services activities and measures from certain services and investment obligations, (ii) specific chapters on financial services, telecommunications, energy and government procurement that address, among other things, the distinctive public service characteristics of these services and (iii) limited disciplines on state monopolies and state enterprises that recognize their public service responsibilities. In short, the NAFTA approach is not based on an over-arching conception of what defines a public service. For the most part, it provides limited protection to whole areas of public services policy-making, like public health services, and to specific public services measures, but no protection at all for other areas typically considered to be public services like water distribution.

This somewhat fragmentary approach is not surprising given that the overall goal of NAFTA is to promote trade and investment within North America. Public services are not a signficant focus of the treaty. The preamble to the agreement expresses the parties' resolution to "…preserve their flexibility to safeguard the public welfare,…" but only as one of fifteen matters addressed. This aspect of the preamble has not been referred to in cases decided under NAFTA's dispute settlement mechanisms. The preamble makes clear that the principal purpose of the agreement is to "create an expanded and secure market for the goods and services produced in [the party states'] territories." The priority accorded to trade and investment in the preamble is confirmed in a separate objectives provision, which states that the objectives of the agreement are to "eliminate barriers to trade in, and facilitate the cross-border movement of, goods and services" and to "increase substantially investment opportunities".[17] Nowhere in the objectives provision is public welfare mentioned.

The features of NAFTA that address or are likely to affect public services are described in turn below, beginning with the rules most likely to be relevant to public services: NAFTA obligations relating to trade in services and investment.

5.2.2 Services and Investment Rules

5.2.2.1 Introduction

Both NAFTA's Chapter 11 on investment and Chapter 12 on services contain an interpretive direction regarding the application of its provisions to some public services. As well they include exceptions and reservations that exclude certain public services and particular existing public services measures from some investment obligations and most services obligations.

[17]NAFTA, Article 102. This approach to interpretation was adopted in *In the Matter of Cross-Border Trucking Services*, USA-Mex-98-2008-01, Final Report of the Panel, 6 February 2001.

5.2.2.2 Scope of Application

Services

Chapter 12 applies to measures relating to cross-border trade in services, including public services. Cross-border trade in services is defined to mean the provision of a service

- from the territory of a NAFTA party state (a *Party*) into the territory of another Party (such as medical advice given over the telephone by an American doctor in the United States to a Canadian patient in Canada);
- in the territory of a Party by a person of that Party to a person of another Party (such as an American doctor providing medical treatment to a Canadian who has travelled to the United States); and
- by a national of a Party in the territory of another Party (such as a Mexican doctor providing medical treatment while temporarily in Canada).[18]

These three modes of services supply correspond to GATS mode 1 (cross-border supply), mode 2 (consumption abroad) and mode 4 (presence of natural persons). Unlike the GATS, Chapter 12 does not cover measures related to GATS mode 3, the provision of a service in the territory of a Party through a commercial presence, such as a US business operating a private school in Canada. As discussed under 'Investment' below, Chapter 11 creates extensive and distinctive rules relating to the protection of NAFTA investors and their investments in other NAFTA states that apply to services supplied through a commercial presence, as well as a wide range of other forms of investment.

As well, the services chapter does not apply to government procurement or financial services, each of which is the subject of a separate chapter in NAFTA,[19] or to "subsidies or grants provided by a Party or state enterprise, including government-supported loans, guarantees and insurance."[20] This broad exclusion for state financial support, which is similar to provisions found in EU trade agreements,[21] provides substantial flexibility for the NAFTA countries to provide financial support for public services. As discussed below, the investment chapter provides a more limited exception for procurement, subsidies and grants.

[18]NAFTA, Articles 1201(1) and 1213(2). NAFTA also has a separate chapter setting out commitments regarding the temporary entry of business persons (Chapter 16).

[19]NAFTA Chapters 10 and 14 respectively.

[20]NAFTA, Article 1201(2).

[21]Krajewski 2011b, p. 14. There are no obligations in GATS that are tailored to subsidies. Subsidies disciplines were left for future negotiations (GATS, Article XV). Nevertheless, general GATS obligations apply, including national treatment for services listed in national schedules of commitments. For this reason, many countries have included provisions in their schedules preserving their ability to subsidize in a discriminatory way. E.g. European Communities and their Member States, Schedule of Specific Commitments (the European Communities are not bound in relation to subsidies in the public sector), and Canada, Schedule of Specific Commitments (Canada is not bound to grant national treatment in relation to "[t]he supply of a service, or its subsidization, within the public sector" or "[s]ubsidies related to research and development").

Investment

Chapter 11 obligations apply in relation to an "investor," which is defined to mean:

- a NAFTA Party state;
- a state enterprise of a NAFTA Party state;
- a natural person who is a national of a NAFTA Party state; and
- an enterprise constituted or organized under the laws of a NAFTA Party state and a branch located in the territory of a NAFTA Party state and carrying out business activities there.[22]

In order to be eligible for protection under the treaty, an investor, as defined, must "seek…to make, be making or [have] made an investment." By including investors who "seek" to make or are in the process of "making" an investment, the definition of investor extends the protections of the agreement to investors even before any investment has actually been made. As discussed below, this intention to provide pre-establishment rights is expressly confirmed by the language in the non-discrimination obligations in Chapter 11, national treatment and MFN, the obligations most likely to be relevant to investors before their investment is in place. In this way, the investment provisions address market access for investors, as well the treatment of investors after they have entered the market. This is a distinctive feature of NAFTA as well as other Canadian and US investment treaties, compared to investment treaties of EU Member states.

The definition of investment in NAFTA is extremely broad. It includes virtually any kind of economic interest, such as ownership interests in enterprises, debt and equity securities issued by an enterprise, all forms of real and personal property including intellectual property, interests that entitle the owner to share in income or profits or that arise out of commitments of capital or other resources and certain contracts and loans. Concessions by states to private parties, such as those that might be given for the distribution of water or gas, are expressly included.[23] The definition goes far beyond investments representing control of an enterprise to include much less significant interests, such as portfolio investment. As well, an "enterprise" is defined to include government-owned entities and not-for-profit entities.[24]

[22]NAFTA, Article 1139. "[E]nterprise" is defined broadly to mean "any entity constituted or organized under applicable law, whether or not for profit, and whether privately-owned or governmentally-owned, including any corporation, trust, partnership, sole proprietorship, joint venture or association" (NAFTA, Article 201).

[23]NAFTA, Article 1139.

[24]The investment chapter provides that if the investor is an enterprise constituted or organized under the laws of a NAFTA Party state but is owned or controlled by persons who are investors of a state or states not party to NAFTA and the enterprise has no substantial business activities in the territory of the NAFTA Party state under whose law it is constituted or organized, the NAFTA Party state complained against may deny that investor the benefits of the agreement, including access to investor-state dispute settlement (NAFTA, Article 1113). In order to deny benefits to such an investor, notification to the NAFTA Party state under whose laws the enterprise is constituted or organized is required in accordance with Article 1803. The NAFTA Party state notified may request consultations under Article 2006. A NAFTA Party state may also deny access in certain other circumstances. The services chapter has a provision (NAFTA, Article 1211(2)) that is identical to Article 1113.

Consequently interests in not-for-profit and public or publicly-controlled entities engaged in public service delivery are investments for the purposes of NAFTA.

Eligible investors of a NAFTA Party may seek compensation through binding arbitration in relation to measures of another NAFTA Party that do not conform to the obligations of that state under Chapter 11.[25] An investor-state case dealing with public services is discussed below. With respect to claims that a NAFTA Party has not fulfilled its obligations under other provisions of NAFTA, including those relating to services, there is no such private right to relief. Such claims may only be addressed through state-to-state dispute settlement under NAFTA Chapter 20. While investor-state arbitration is common in the investment treaties of member states, it is unknown in WTO agreements and EU trade treaties.

5.2.2.3 Interpretive Direction

Pursuant to NAFTA Articles 1101(4) and 1201(3), nothing in the investment or services chapters respectively shall be construed to

> prevent a Party from providing a service or performing a function such as law enforcement, correctional services, income security or insurance, social security or insurance, social welfare, public education, public training, health, and child care in a manner *not inconsistent with this Chapter*. [emphasis added]

These provisions have never been interpreted in NAFTA dispute settlement proceedings. Nevertheless, since they relate only to a Party state performing services in a manner "not inconsistent with this Chapter," they are not exceptions from the substantive services and investment obligations discussed below. Indeed, if this direction were interpreted as an exception it would make some of the exceptions and reservations related to public services in NAFTA redundant.[26] For example, the list of services used in these provisions is identical to that in Annex II reservations taken by all three NAFTA countries. Consequently, there is no basis to interpret these provisions as exceptions.[27] Nevertheless, these provisions are part of the context for interpreting the substantive obligations in each chapter. Any interpreter of an obligation should seek an interpretation that would permit a Party to provide services of the kinds indicated. This list of services benefiting from this interpretation is expressed not to be exhaustive, but there is no general language indicating what other kinds of services should be included. Accordingly, the character of what fits within this provision is likely to be determined by reference to the items on the list.

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[25]The investor-state dispute settlement process is described in VanDuzer 2002, pp. 51–71. This right to seek compensation is also available in relation to certain provisions of Chapters 14 and 15.

[26]Such an interpretation would be contrary to the effectiveness principle of treaty interpretation. Lennard 2002, p. 17; Maki 2000.

[27]A similarly worded provision describing states right to act to protect the environment (Article 1114(1)) has been interpreted as an interpretive direction only (Kinnear et al. 2008).

5.2.2.4 Services and Investment Obligations Subject to Canadian Reservations

Some of the obligations in Chapters 11 and 12 are subject to reservations. In this section, these obligations are described. Other obligations that cannot be reserved against are discussed later in the chapter.

With respect to cross-border trade in services, Chapter 12 obliges each NAFTA Party to provide the better of national treatment and most favoured nation (*MFN*) treatment to services providers from another NAFTA Party.[28] So, for example, Canada is obliged to treat US water services suppliers no less favourably than it treats, in like circumstances, Canadian water services providers *and* no less favourably than water service providers from any other country.[29] Chapter 12 also provides that no NAFTA Party can impose requirements for a local presence in its national market as a condition of allowing NAFTA services suppliers to operate in the market.[30]

With respect to services delivered through an investment, Chapter 11 imposes similar rules. Canada, the US and Mexico must each provide the better of national treatment and MFN treatment in relation to investors of the other NAFTA Parties and their investments.[31] In the investment chapter, the obligations are expressed to apply with respect to the "establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments."[32] Because the scope of the national treatment and MFN obligations extends to the "establishment, acquisition, [and] expansion" of an investment, they benefit investors' investments prior to the moment that their investments enter the national market of a NAFTA Party. As noted, such pre-establishment rights are not commonly found in investment treaties entered into by European countries but are characteristic of those entered into by the US and Canada.[33] Because of these pre-establishment rights, the carve-outs from these obligations in the Annex I and Annex II

[28]NAFTA, Article 1204.

[29]NAFTA, Articles 1202 and 1203.

[30]NAFTA, Article 1205.

[31]NAFTA, Articles 1102, 1103, and 1104. Chapter 11 clarifies that the national treatment obligation means that requirements of a NAFTA Party that its nationals hold a minimum level of equity in a NAFTA investor are prohibited and NAFTA investors cannot be required to sell their investments simply because of their nationality (NAFTA, Article 1102(4)).

[32]In the case of measures of a state or province, the national treatment obligation is modified. States and provinces are only obliged to grant treatment no less favourable than the most favourable treatment accorded, in like circumstances, to investors and investments of the Party of which it forms a part (NAFTA, Article 1102(3)).

[33]See US Model Bilateral Investment Treaty, Articles 3 and 4 and Canadian Model Foreign Investment Promotion and Protection Agreement, Articles 3 and 4. Also investors eligible for protection are defined to include persons seeking to make an investment (Canadian Model Foreign Investment Promotion and Protection Agreement, Article 1; US Model Bilateral Investment Treaty, Article 1). Pre-establishment rights are also found in some Japanese and Australian investment treaties.

reservations for each country described below are essential for public services schemes that permit only local private suppliers, including not-for-profit organizations, such as local not-for-profit private hospitals to provide services.

Chapter 11 prohibits a NAFTA Party state from imposing specified requirements (referred to as *performance requirements*) in connection with the "establishment, acquisition, expansion, management, conduct or operation" of an investment of a NAFTA investor, such as requirements

- to source inputs locally or meet domestic content requirements,
- to meet export performance targets or restrict imports, or
- to transfer technology to a person in its territory.[34]

Again, because the scope of this performance requirement obligation extends to the "establishment, acquisition, [and] expansion" of an investment, these obligations apply to new investments prior to the moment that they enter the national market of a NAFTA party.[35] For example, none of the listed performance requirements could be imposed by the United States as a condition allowing a Mexican investor into the country. The performance requirement obligation does not prohibit the kinds of requirements typically imposed on public service providers, such as those related to public access, quality or affordability. They do prohibit requirements for an investor to be an exclusive supplier of goods or services to a specific region.[36] Such a requirement might be imposed in relation to a public service like a requirement to provide passenger rail transportation services in a part of the country. NAFTA Party states may not condition the receipt by an investor of an advantage, such as a subsidy, on a subset of these performance requirements. These prohibited performance requirements include domestic sourcing or content requirements but not exclusive regional supply.[37]

As well, under Article 1107, NAFTA prohibits the imposition by a Party of nationality requirements for senior managers of enterprises formed under its laws that are investments of investors from other NAFTA countries. This obligation does not apply to nationality requirements regarding a majority of members of the board of directors of an enterprise, so long as these requirements do not affect control of the enterprise.

All these investment obligations in Chapter 11 are subject to some exceptions. The national treatment, MFN and prohibition on nationality requirement obligations do not apply to government procurement or to "subsidies or grants provided by a Party or state enterprise, including government-supported loans, guarantees and insurance."[38] In this way, NAFTA permits financial support for public services

[34]These obligations go beyond the requirements of the WTO Agreement on Trade-related Investment Measures, (1994).

[35]Again, this obligation may be subject to reservations as discussed below.

[36]NAFTA, Article 1106(1)(g).

[37]NAFTA, Article 1106.

[38]NAFTA, Article 1108(7).

that discriminates in favour of local suppliers of such services.[39] The performance requirement prohibition is subject to some more narrowly targeted exceptions.[40] The application of country-specific reservations to the services and investment obligations described in this section that apply to public services are discussed in the next section.

5.2.3 NAFTA's Annex I and Annex II Reservations

5.2.3.1 Introduction

NAFTA permits Parties to take reservations against NAFTA services and investment disciplines relating to national treatment and MFN as well as—in the case of cross-border services—the prohibition on local presence requirements and—in the case of investments—the prohibitions on certain performance requirements and nationality requirements for senior managers. Annex I reservations apply only to existing non-conforming measures of the NAFTA Parties, while Annex II reservations apply to existing and future measures in discrete areas of policy-making identified in each reservation, including certain public services. The annexes are the most important limit on the application of the disciplines in NAFTA to public services.

5.2.3.2 Annex I Reservations

Annex I to NAFTA contains a national schedule for each NAFTA Party in which it lists specific non-conforming measures that are to be excluded from the obligations in the treaty identified in the reservation. No Party may add new non-conforming measures to this list and an amendment to a measure is only protected against the application of the treaty "to the extent that the amendment does not decrease the conformity of the measure, as it existed immediately before the amendment."[41] Also, once a measure subject to the reservation is liberalized, in the sense that some non-conforming aspect of it is removed, the obligations apply to the measure as amended. As a result, if a Party state changes a listed measure to, for example, remove a preference in favour of domestic businesses, then the reservation continues to apply to the amended measure. However, the Party state cannot subsequently reinstate the preference or change the measure in any other

[39] An example would be discrimination against foreign education services suppliers.

[40] NAFTA, Article 1108(8). These exceptions provide that certain of the prohibitions do not apply to government procurement, requirements to qualify for export promotion programs, foreign aid programs or preferential tariffs or quotas.

[41] NAFTA, Articles 1206(1)(c) and 1108(1)(c). For financial services, reservations are permitted under Articles 1409(1) and (4).

way that makes it less consistent with the Party's obligations under the treaty. This so-called "ratchet" effect means that when a state liberalizes a measure listed in its Schedule to Annex I, it becomes bound to the new level of openness provided by the liberalized measure.[42]

All three NAFTA states have listed certain federal-level measures in their schedule to Annex I, few of which implicate public services. One example related to public services is a reservation in relation to the privatization of state assets taken by Canada from the national treatment obligation, the prohibition on certain performance requirements and nationality requirements for senior managers.[43] Under this reservation, if Canada sold off assets employed in the delivery of a public service, like publicly-owned hospitals that provide medical care to military veterans, it could favour a Canadian purchaser over a purchaser from the US or Mexico.

At the time NAFTA was signed, the Parties intended that each of their states and provinces would prepare a list of measures to be included in their schedule to Annex I. In a subsequent exchange of letters, the three NAFTA Parties agreed that all non-conforming provincial and state measures in existence prior to the date NAFTA came into force, 1 January 1994, would benefit from this reservation.[44] All existing non-conforming local government measures were also excluded in the treaty.[45]

In summary, Annex I reservations provide protection for any listed federal measure as well as public services regimes in the NAFTA Parties that are within provincial, state nor local jurisdiction and were in place on 1 January 1994. This would include, for example, most health, education and social services in Canada and the United States. In practice, however, the effective scope of these reservations will likely diminish over time as federal, provincial and state programs evolve.[46] As noted by Krajewski and others, public services are inherently dynamic.[47] In many North American jurisdictions, this dynamism is reflected in new government measures reducing the scope of public funding and direct state provision of services in favour of private provision or public/private partnerships.[48] The result of such liberalizing measures is the diminution of protection from NAFTA obligations under Annex I reservations.

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[42]Krajewski 2011a; and VanDuzer et al. 2013, p. 241.

[43]It is not clear why this is not an Annex II reservation, since it applies to an area of activity rather than a specific measure.

[44]Exchange of Letters between Canada, the U.S. and Mexico (29 March 1996), cited in de Mestral 1998.

[45]NAFTA, Articles 1206(1)(a)(iii) and 1108(a)(iii).

[46]Johnson 2002.

[47]Krajewski 2011b, p. 41. This is also noted by the European Commission in European Commission, A Quality Framework for Services of General Economic Interest in Europe, COM(2011) 900 final, 20 December 2011.

[48]Though they take many forms, most public/private partnerships provide a service through a partnership with one or more private parties and a government entity. Typically, the private party undertakes some financial or operational risk related to the provision of the service.

Whether an Annex I reservation applies or not, NAFTA Parties cannot introduce new measures in relation to public services that discriminate against services providers from other Parties or are otherwise inconsistent with applicable NAFTA obligations. To do that an Annex II reservation must be available, as discussed below.

5.2.3.3 Annex II Reservation for Social Services

Annex II reservations apply to federal, state, provincial and local government[49] measures in areas identified by each NAFTA country in its schedule to Annex II of NAFTA. Within the areas identified in their reservations, governments may introduce new measures that are more restrictive than the regime that existed at the time NAFTA entered into force notwithstanding that such measures do not conform to the obligations reserved against. All three NAFTA parties took identical Annex II reservations relating to certain public services (the *Social Services Reservation*). Each country

> …reserves the right to adopt or maintain any measure with respect to the provision of public law enforcement and correctional services, and the following services to the extent that they are social services established or maintained for a public purpose: income security or insurance, social security or insurance, social welfare, public education, public training, health, and child care.[50]

Canada's schedule provides that its Annex II reservation for these social services only applies to the national treatment and MFN obligations, the prohibition on requirements for a local presence to be able to provide a service and nationality requirements for senior management in Chapters 11 and 12.[51] Canada's reservation does not extend to the performance requirements prohibition in Chapter 11. One result of Canada's reservation is that the market access guaranteed by the national treatment and MFN obligations need not be provided in the areas identified in the Social Services Reservation. The Annex II reservations of Mexico and the United States also apply to national treatment but not to the MFN obligation or the performance requirements prohibition. Mexico's reservation extends to the prohibition on nationality requirements for senior managers.

This Social Services Reservation has not been addressed in state-to-state or investor-state dispute settlement but Canadian and American officials have suggested divergent interpretations. Canadian government representatives have said

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[49]Though NAFTA Annex II is not clear as to whether it applies to measures by governments below the national level, it appears to be understood as applicable to such measures: Johnson 1994, p. 309.

[50]NAFTA, Canada's Schedule to Annex II, Sector: Social Services.

[51]Canada's Annex I and II reservations regarding national treatment and most favoured nation treatment are deemed to apply to the financial services obligations in Articles 1405 and 1406 (NAFTA, Article 1409(4)). Additional reservations are permitted under Article 1409.

that the broad wording of the Social Services Reservation was adopted intentionally to permit the provision to be interpreted flexibly and, significantly, that it is largely up to each Party to decide whether it views a particular service as falling within the reservation or not.[52] By contrast, in a 1995 communication to states, the US Trade Representative (USTR) suggested the following interpretation of the reservation.

> The reservation…is intended to cover services which are similar to those provided by a government, such as childcare or drug treatment programs. If those services are supplied by a private firm, on a profit or a not-for-profit basis, Chapter Eleven [investment] and Twelve [services] apply.

Elsewhere in the same document the USTR expressed the view that Chapters 11 and 12 apply once "[a] state allows private providers to offer similar services on a commercial basis."[53] Such after-the-fact unilateral statements regarding the meaning of a treaty are not likely to affect its interpretation should the matter come before a dispute settlement panel.[54] Statements regarding the subjective interpretation of a Party will not be relied on to replace a textual analysis.[55] Nevertheless, both cannot be right and the existence of such a large disparity in understanding suggests a real prospect for disputes arising between Canada and the United States regarding the scope of the Social Services Reservation. None have arisen so far, however.

Some support may be offered for both interpretations. The NAFTA preamble and objectives might be relied on to argue for a narrow interpretation of the Social Services Reservation. Consistent with the approach adopted in Cross-Border Trucking, one of only three (3) state-to-state panel decisions under NAFTA, the reservation may be viewed as being in the nature of an exception to the overall

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[52]Letter from John Weekes dated 31 January 1995 to the provinces and Letter from Douglas Waddell dated 22 September 1995 to the provinces, quoted in Schwartz 1997. Professor Schwartz also cites some criticism of this interpretation from the government of Ontario.

[53]USTR 1995. In effect, the USTR's interpretation appears to be close to the governmental services exception defined in GATS, Article 1.3.

[54]This is consistent with the approach in *In the Matter of Cross-Border Trucking Services*, USA-Mex-98-2008-01, Final Report of the Panel, 6 February 2001, where the Panel refused to consider the subjective intent of the United States in relation to its moratorium on Mexican trucking operations in the US (at para 214). In limited circumstances, statements by WTO Members regarding the meaning of certain provisions have been held by dispute settlement panels to be relevant for interpreting a Member's obligations. In *United States—Sects. 301-310 of the Trade Act of 1974*, Report of the Panel, WT/DS152/R, statements made in a panel proceeding by persons with authority to bind the state and intending to bind the state were held to be relevant.

[55]There is no NAFTA case on this precise issue. In *European Communities—Customs Classification of Certain Computer Equipment,* Report of the Appellate Body, WT/DS62/AB/R, WT/DS67/AB/R, WT/DS68/AB/R, the WTO Appellate Body refused to adopt an interpretation of "automatic data processing equipment" that the UK had relied on in its negotiations with the US, even in the face of US argument that the meaning adopted in negotiations had informed its expectations. The Appellate Body ruled that the interests of all Members in being able to rely on the text of an agreement meant that interpretation had to be grounded in the text alone. See Maki 2000, pp. 354–356, Lennard 2002, pp. 72–73.

trade and investment liberalization objectives of the agreement,[56] and so should be interpreted narrowly. Such an approach would be consistent with the American position. However, giving effect to the very narrow US position that any private provision takes a service outside the Annex II reservation would virtually exclude the application of the Annex II exemption to many public services. For example, most doctors' and hospital services in Canada are delivered by private parties that are fully funded by the state. Under the US approach, these would be fully subject to the obligations of NAFTA. The US approach would limit services excluded by the Social Services Reservation to those delivered by the state, in a manner similar to the GATS exclusion for services in the exercise of governmental authority, but the Social Services Reservation would be narrower in scope because it only applies to services in the discrete areas identified in the reservation.

On the other hand, it is possible to argue for a broader interpretation. The phrase "social service established or maintained for a public purpose" has a broad ordinary meaning.[57] Neither social service nor public purpose is defined in the agreement. "Social service" is defined broadly in the *Oxford English Dictionary* as "a service supplied for the benefit of the community, esp., one provided by the state, as education, health care, housing, etc."[58] This definition suggests that social services typically are services provided directly by the state but may include private supply. For privately delivered services, such as private schools, it would seem necessary to demonstrate that a particular measure was related to services with respect to which a state had undertaken some responsibility to ensure that they were being delivered for the benefit of the community. This might include a consideration of the nature and extent of state involvement in the delivery of the service, including the degree of public funding and the role played by the state in ensuring that the services were provided by private parties in a manner that achieves a public benefit. The interpretive direction in Chapters 11 and 12 discussed above provides no support for a broad interpretation of the reservation that

[56]This view is consistent with how the WTO Members have agreed to interpret the exclusion for services in the exercise of governmental authority (see Krajewski 2011a, p. 29, citing WTO Council for Trade in Services, Report of the Meeting Held on 14 October 1998, Note by the Secretariat, S/C/M/30, 12 November 1998, para 22(b)). Such an approach, however, is not consistent with WTO case law holding that there is no distinctive approach to interpreting exception provisions like GATT Article XX. In *European Communities—Measures Concerning Meat and Meat Products* (*Hormones*), Report of the Appellate Body, WT/DS26/AB/R, WT/DS48/AB/R, para 104, the Appellate Body said that "merely, characterizing a treaty provision as an 'exception' does not by itself justify a 'stricter' or 'narrower' interpretation of that provision that would not be warranted…by applying the normal rule of treaty interpretation." See generally, Newcombe 2011, p. 361.

[57]This is also the conclusion of Schwartz 1997.

[58]*Oxford English Dictionary* 2009: "A public purpose has for its objective the promotion of the public health, safety, morals, general welfare, security, prosperity, and contentment of all the inhabitants or residents within a given political division, as, for example, a state, the sovereign powers of which are exercised to promote such public purpose or public business." http://www.oed.com. Accessed 14 January 2014.

would allow private supply of public services, since it is restricted to services provided directly by the state.

A broader approach does not, however, require adopting the Canadian position that, in effect, the content of the social service reservation may be defined by each Party. In the absence of clear language to this effect, what falls within the Social Services Reservation cannot be whatever a state asserts is a measure related to "social services established or maintained for a public purpose." The attributes of the funding, delivery and regulation of the service, among other things, would have to be examined. Regardless of the meaning of the public purpose limitation, it will not always be obvious what falls into some of the categories of services identified in Annex II. For example, what are considered health services provided for a public purpose will vary over time with a state and from one state to the next.

In short, while a narrow interpretation can be supported to some extent, there is also support for a broader view. Given the untested nature of the Social Services Reservation, there is residual uncertainty regarding how it will be applied. Reliable conclusions about the extent to which NAFTA commitments apply to the listed public services are difficult. Some such uncertainty is the inevitable consequence of applying a short, broadly worded treaty provision to services subject to a range of complex regulation like public services. What is clear is that the Social Service Reservation represents a different approach to dealing with public services than is found in the GATS or EU trade treaties, as discussed below. It provides an exhaustive list of specific areas that are protected, to a limited extent, from the obligations in the treaty. Many services considered public services in most countries, such as water services, are not listed. By contrast, as discussed below, GATS and EU trade treaties exclude public services based on their functional and operational characteristics and provide scope for states to decide for themselves what constitutes a public service in some cases.

5.2.3.4 Other Annex II Reservations Related to Public Services

Several other Annex II reservations in NAFTA relate to particular public services or aspects of public services.[59] Canada, the United States and Mexico have each taken a reservation against the national treatment obligation and the prohibition on local presence requirements in relation to "any measure according rights or preferences to socially or economically disadvantaged minorities,…". Canada has also taken a reservation against these obligations as well as MFN and the performance requirements prohibition permitting it to deny to foreign investors and service providers any right or preference that it gives to aboriginal peoples. These would include a wide range of social assistance and other sorts of preferences for the benefit of the identified groups.

[59]The Appendix to this chapter summarizes the Parties' reservations under Annex II.

All three countries have listed telecommunications networks and telecommunications services in their schedules to Annex II, though the forms of these reservations vary.[60] The United States reservation applies only to national treatment, MFN treatment and the prohibition on local presence requirements. Canadian and Mexican reservations extend to the prohibition on nationality requirements for senior managers as well as these obligations. Other reservations common to the three countries relate to air and marine transport and cabotage.

In addition, Mexico has taken a reservation against the national treatment and MFN obligations and the prohibition on local presence requirements in relation to any measure that it adopts or maintains related to postal services as well as "telegraph services, radiotelegraphy services, satellite communications services…, and railroad services." Mexico has also taken reservations for measures related to broadcasting and energy services.[61]

5.2.4 Services and Investment Rules not Subject to National Reservations

5.2.4.1 Introduction

A variety of NAFTA services and investment obligations are not subject to Annex I or Annex II reservations or the exception for subsidies and government procurement described above. These include rules regarding the licensing and certification of services suppliers in Chapter 12, as well as, more significantly, the prohibition on the expropriation of investments of NAFTA investors without compensation and the requirement to provide fair and equitable treatment to investments of such investors in Chapter 11. Any measure of a Party that is contrary to these latter obligations is a breach of the treaty and may be the subject of a claim by an investor of another Party that suffers loss as a result. An investor-state arbitration tribunal may award financial compensation to such an investor. These kinds of provisions do not appear in any EU agreement, though they are typical of the more than 1200 bilateral investment treaties negotiated by individual member states.[62] While it is generally recognized that the application of these standards must take into account the need for the state to be able to regulate and otherwise act in the public interest, there is substantial disagreement regarding what government actions are insulated from investors' claims.[63]

[60]This reservation does not apply to providers of enhanced or value-added services whose underlying telecommunications transmission facilities are leased from providers of public telecommunications transport networks.

[61]Mexico reserves to itself the provision of services and investment in electricity "supplied as a public service" (NAFTA, Annex 602.3(1)(c)).

[62]VanDuzer et al. 2013, p. 408.

[63]VanDuzer et al. 2013, pp. 410–415.

5.2.4.2 Licencing and Certification Requirements

Chapter 12 seeks to ensure that measures related to licensing and certification of services suppliers do not operate as unnecessary barriers to trade and obliges each Party to "endeavor" to ensure that each such measure

- is based on objective and transparent criteria, such as competence and the ability to provide a service;
- is not more burdensome than necessary to ensure the quality of the service; and
- does not constitute a disguised restriction on the cross-border provision of a service.[64]

These rather general requirements follow language used in the GATS, though specific WTO disciplines based on these requirements are still being negotiated.[65] As has been noted by others, these standards are hard to apply in the context of public services like health and education services where a variety of goals other than quality of the service, narrowly conceived, are fundamental determinants of public policy. It is not clear, for example, to what extent a measure that imposes a universal service obligation on a supplier of hospital services as a condition of permitting the supplier to offer such services would be considered to relate to the quality of the service. Even if the measure was found to relate to quality, it is not clear to what extent a new universal service obligation would be considered no more burdensome than necessary to ensure the quality of the service. Alternative ways of ensuring the availability of hospital services to the population, such as some form of program providing financial incentives to suppliers, are certainly conceivable.[66]

As formulated in NAFTA, these obligations relating to licencing and certification are best endeavours undertakings only. Rather than a guarantee that the Parties' domestic regulation will meet these standards, these provisions require states simply to make a good faith effort to comply. As well, these kinds of provisions only become relevant when foreign supply of the service is allowed by a Party. As discussed in the next section, NAFTA Parties are not obliged generally to allow foreign supply.

5.2.4.3 Market Access

NAFTA Parties have no obligation in NAFTA's services chapter to provide market access to services suppliers from other NAFTA Party states. Existing quantitative limitations on market access for cross-border trade in services, such as non-discriminatory limits on the number of service suppliers, may be maintained, subject to some specific

[64]NAFTA, Article 1210(1).

[65]GATS, Article VI. There is also an annex to the services chapter that obliges that NAFTA parties to encourage professional bodies in each country to develop mutually acceptable licensing standards for professionals (Annex 1210.5).

[66]Luff 2003, pp. 204–6; Krajewski 2011b; Adlung 2003, p. 455.

liberalization commitments undertaken, and while the Parties must negotiate with a view to removing existing restrictions, NAFTA allows Parties to adopt new market access restrictions.[67] By contrast, under GATS, market access obligations apply to sectors listed in a member's schedule of commitments subject to any limitation written into the schedule.[68] Consequently, NAFTA gives Canada, the US and Mexico significant flexibility to exclude foreign services suppliers through non-discriminatory market access limitations like quotas.

5.2.4.4 Investment Obligations

In terms of their impact on the delivery and regulation of public services, the investment obligations in Chapter 11 that are not subject to reservations are likely to be more significant than the services commitments in Chapter 12. The next section discusses the most significant of the Chapter 11 obligations: the obligation to provide fair and equitable treatment to foreign investments and the obligation not to expropriate foreign investments without certain requirements being met including the payment of compensation.

Fair and Equitable Treatment (FET)

Article 1105(1) provides that investments of NAFTA investors must be given at least "treatment in accordance with international law, including fair and equitable treatment and full protection and security"[69] Arbitral tribunals have adopted inconsistent and, in some awards, quite broad interpretations of this standard. While it is far beyond the scope of this paper to try to define this inherently open-ended standard, a number of commentators have expressed concerns that the FET standard as it has been applied creates a significant risk that it will be used to constrain a state's sovereignty and its ability to regulate in the public interest.[70] A particular concern is that this obligation has been interpreted to protect an investor's legitimate expectations, based on the legal regime of the host country at the time the investment was made. Strong protection of investor's expectations in this regard would make it difficult for states to change their regimes. In particular, returning to public provision of a privatized service or the imposition of substantially more intrusive regulation of a service to ensure that it meets public goals could be prohibited in some circumstances on the basis that such a change was considered

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[67]NAFTA, Articles 1207, 1208. Federal level restrictions must be listed by each party in its Schedule to Annex V of NAFTA. Local government restrictions do not have to be notified (Article 1207(3)). Market access for investors is guaranteed through the pre-establishment operation of the national treatment and MFN obligations, subject to the exceptions and reservations in NAFTA, including the Annex I and Annex II reservations described above.

[68]GATS, Article XVI.

[69]NAFTA, Article 1105.

[70]Kläger 2011, p. 241; Mayeda 2007, p. 273. For a synthesis of the standard see UNCTAD 2012b, pp. 62–63.

contrary to the investor's legitimate expectations when it made the investment.[71] A country that experiments with private supply or increased private supply of a public service might be constrained if it decided to return to public provision. In 2001, the NAFTA Parties adopted a binding interpretation of this obligation with a view to narrowing its application. They stated that the obligation imposes only the customary international law standard for the treatment of aliens. Despite this statement, significant uncertainty remains regarding what the standard requires.[72]

Prohibition on Expropriation without Compensation

As well, a NAFTA Party must not, directly or indirectly, nationalize or expropriate investments of investors of other Parties, or take a measure tantamount to nationalization or expropriation, except upon complying with certain requirements. The state action must be

- for a public purpose,
- on a non-discriminatory basis,
- in accordance with due process of law and Article 1105(1)(the FET obligation), and
- on payment of compensation equivalent to the fair market value of the investment immediately before the expropriation took place.

Compensation must be paid without delay in a form that is fully realizable.[73]

Like most investment treaties, NAFTA applies to both direct and indirect expropriation. Direct expropriation refers to a situation in which a state takes title to the property of a foreign investor or otherwise transfers the benefit of the foreign investor's investment to itself, typically through an outright seizure. What constitutes indirect expropriation is much more difficult to define and, potentially, much more problematic for public services provision. Indirect expropriation refers to state action that deprives the foreign investor of the ability to make use of its property in some substantial way, but ownership remains with the investor. An indirect expropriation can occur even if the host state does not benefit from the limitation

[71]This approach has been more common in investor-state arbitration awards interpreting similar obligations in other investment treaties. E.g. *Tecnicas Medioambientales Tecmed S.A. v. United Mexican States*, ICSID Case No. ARB(AF)/00/2, Award, 29 May 2003, para 154; *CME Czech Republic B.V. v. Czech Republic*, UNCITRAL Arbitration, Final Award, 14 March 2003, para 601; *Occidental Exploration and Production Company v. Republic of Ecuador*, LCIA Case No. UN 3467, Final Award, 1 July 2004, para 190.

[72]Free Trade Commission 2001. Where the Free Trade Commission established under NAFTA has interpreted a provision of NAFTA, the interpretation is binding on arbitral tribunals (NAFTA, Article 1131). There has been some controversy about the legitimacy of this interpretation: see VanDuzer 2002.

[73]NAFTA, Articles 1110(1), (2) and (3). Certain other obligations are also imposed in Chapter 11, which are not subject to reservations. NAFTA Article 1109 requires each NAFTA Party to permit all financial transfers, like profits, fees, dividends and loan repayments relating to an investment freely and without delay. Exceptions permit Parties to prevent transfers where they are applying their laws in areas like bankruptcy, such as to prevent preferences to be given to investors to the prejudice of other creditors.

on the foreign investor's ability to use its property. It can also occur through a series of acts, sometimes referred to as "creeping expropriation". Defining an indirect expropriation requires specifying the degree of diminished control necessary to qualify as an expropriation. It is impossible, however, to cite a single rule applicable in all circumstances that precisely identifies the degree of control that must be lost for an expropriation to have occurred.

Some NAFTA investor-state tribunals have considered that diminished control or deprivation of the benefits of property alone is sufficient to constitute an indirect expropriation applying what is called the "sole effects doctrine". For these tribunals, the host state's motivation for the measure is irrelevant.[74] Other tribunals have rejected this approach. Instead, deprivation is treated as a necessary but not sufficient condition for a finding of indirect expropriation. The character of the measure, including, in particular, whether it is a regulatory act for a public purpose needs to be considered.[75] Under this approach, non-discriminatory regulation for a public purpose undertaken in good faith would not be considered an indirect expropriation. Traditionally, this has been referred to as the "police power" of states. Thus, while most regulatory measures will not result in a deprivation substantial enough to be considered an expropriation in any case, even if a measure did reach this threshold, it would not be an expropriation if it is within the police powers. Such an approach could insulate most state measures related to public services from successful compensation claims by investors in investor-state arbitration.

To address uncertainty regarding the application of this provision, Canada and the US have adopted a more specific expression of the nature of these obligations in treaties subsequent to NAFTA. In particular, because of the existence of a broad police powers carve-out from expropriation is not universally acknowledged,[76] Canada and the US have adopted a detailed statement as to what constitutes an indirect expropriation requiring compensation to describe what should be considered regulatory measures that do not constitute an expropriation.[77] In the US model bilateral investment treaty, for example, whether or not an indirect expropriation has occurred is to be determined using several criteria:

- An indirect expropriation must have an effect equivalent to a direct expropriation, even though there is no formal transfer of title or an outright seizure;
- The determination of whether an indirect expropriation has occurred requires a case-by-case analysis, including a consideration of the character and economic impact of the government action and the extent to which the action "interferes with distinct, reasonable investment-backed expectations";

[74] E.g. *Fireman's Fund Insurance Company v. United Mexican States*, ICSID Case No. ARB(AF)/02/1, Award, 17 July 2006, para 176(f).

[75] E.g. *Chemtura Corporation v. Government of Canada*, UNCITRAL Arbitration, Award, 2 August 2010.

[76] E.g. Hoffman 2008, p. 165.

[77] UNCTAD identifies the adoption of such an approach as a "clear trend" (UNCTAD 2012a, p. 86).

- The fact that a measure or series of measures of a party state has an adverse effect on the economic value of an investment does not by itself establish that an indirect expropriation has occurred; and
- "Except in rare circumstances, non-discriminatory regulatory measures that are designed and applied to protect legitimate public welfare objectives, such as public health, safety, and the environment, do not constitute indirect expropriations".[78]

This kind of specification provides a relatively clear direction to interpreters of the treaty regarding whether a public service measure should be found to be an indirect expropriation. To the extent that this standard is applied there would appear to be substantial scope for states to take action in relation to public services. There is residual uncertainty, however regarding some elements of this specification. For example, what are the "rare circumstances" in which public welfare regulation will trigger a compensation obligation and what are public welfare objectives beyond those specifically enumerated?[79] Would measures revoking an investor's licence to provide water services on the basis that the service was poor or unpopular fall into this category? Nevertheless, even though this attempted clarification leaves significant residual uncertainty, it does represent an improvement over NAFTA's terse and vague formulation of the expropriation standard.[80]

5.2.5 Investor-State Cases Related to Public Services

The application of NAFTA Chapter 11's broad and uncertain standards of investor protection to public services has encouraged investors to make a number of investor-state claims in relation to public services measures of the NAFTA Parties, including waste disposal,[81] water distribution,[82] postal services,[83] and health

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[78]US Model Bilateral Investment Treaty (2012), Annex B.

[79]For an example of the chilling effect that investment protections can have in this regard, see Sinclair 2014, fn 32.

[80]There is also a debate over whether the formulations adopted are different from what customary international law would require in any case (VanDuzer et al. 2013, pp. 253–255).

[81]*Robert Azinian, Kenneth Davitian, & Ellen Baca v. United Mexican States*, ICSID Case No. ARB(AF)/97/2, Award, 1 November 1999 (waste collection and disposal); *Metalclad v. United Mexican States*, ICSID Case No. ARB(AF)/97/1, Award, 30 August 2000 (toxic waste disposal facility); *Waste Management, Inc. v. United Mexican States*, ICSID Case No. ARB (AF)/00/3, Award, 30 April 2004 (waste collection and disposal); *S. D. Myers Inc. v. Government of Canada*, UNCITRAL Arbitration, Partial Award, 13 November 2000 (toxic waste remediation).

[82]*Bayview Irrigation District* et al. *v. The United Mexican States*, ICSID Case No. ARB(AF)/05/1, Award, 19 June 2007 (water distribution).

[83]*United Parcel Service of America Inc. v. Government of Canada,* UNCITRAL Arbitration, Award on the Merits, 24 May 2007 (postal services).

services[84] as well as government procurement.[85] Few, however, have been successful. Most of these cases have addressed a claim that an investor with concessions to perform some public service, like water distribution, was treated unfairly or arbitrarily or denied justice by the state in the way it terminated the concession. Only one has directly addressed the distinctive nature of public services in applying NAFTA's substantive standards of protection.

That case involved an American courier company, UPS, that competed for courier business with Canada Post, the entity of the Canadian federal government that provides basic mail delivery. Canada provided certain benefits to Canada Post, including a subsidy for Canada Post's delivery of Canadian magazines and periodicals. Canada did not provide these benefits to UPS or any other private courier. UPS claimed, among other things, that Canada's denial of these benefits to UPS was inconsistent with NAFTA's national treatment obligation.[86] The arbitration tribunal decided that there was no breach, however, because UPS and Canada Post were not "in like circumstances" as required under NAFTA Article 1102 and so Canada was entitled to treat Canada Post more favourably. In particular, for the purposes of the subsidies, UPS and Canada Post were not in like circumstances because (i) Canada Post has a universal service obligation under its governing legislation and (ii) under its statutory mandate Canada Post must fulfill a variety of "significant public policy functions,…, which are not governed solely by commercial considerations".[87] The tribunal found, for example, that through the subsidies and benefits Canada sought to ensure the widest possible distribution of Canadian magazines and other periodicals to individual Canadian consumers at affordable and uniform prices with the goal of promoting Canadian culture. Only Canada Post, with its universal service obligation and vast distribution network, was able to ensure that Canada achieved this goal.[88] Also, the volume carried by Canada

[84]E.g. *Melvin J. Howard, Centurion Health Corporation & Howard Family Trust v. Government of Canada*, PCA Case No. 2009-21, Order for the Termination of the Proceedings and Award on Costs, 2 August 2010 (health services).

[85]E.g. *ADF Group Inc. v. United States of America*, ICSID Case No. ARB(AF)/00/1, Final Award, 9 January 2003 (government procurement), *Mondev International Ltd v. United States of America*, ICSID Case No. ARB(AF)/99/2, Award, 11 October 2002 (government procurement).

[86]*United Parcel Service of America Inc. v. Government of Canada*, UNCITRAL Arbitration, Award on the Merits, 24 May 2007. The main benefit was to subsidize the distribution of Canadian magazines and other periodicals by Canada Post (paras 137–181). Other alleged benefits consisted of preferential treatment by Canada's national customs agency, including the provisions of certain services for free. The alleged benefits are listed in para 80. The tribunal found that any preference related to mail service as opposed to courier service was not relevant. The tribunal also found that fee-based services provided by one branch of government to another constituted government procurement and so was exempt from the NAFTA investment obligations.

[87]*United Parcel Service of America Inc. v. Government of Canada,* UNCITRAL Arbitration, Award on the Merits, 24 May 2007, para 142. The tribunal discussed the mandate of Canada Post under the Canada Post Corporation Act, Revised Statutes of Canada 1985, c C-10.

[88]*United Parcel Service of America Inc. v. Government of Canada,* UNCITRAL Arbitration, Award on the Merits, 24 May 2007, para 175.

Post resulted in substantial efficiencies in the delivery of Canadian magazines and periodicals. Canadian and US private courier companies, including UPS, might compete for some of the business of distributing Canadian magazines and periodicals but they do not and could not serve all addresses in Canada. US private courier companies, including UPS, were in like circumstances with Canadian courier companies, but they were treated identically so the national treatment obligation was complied with. Only Canada Post received the subsidy and other benefits.

This case provides the only example of a NAFTA investment tribunal recognizing the unique characteristics of a public service provider as a consideration relevant to its decision. It remains to be seen whether this approach will be followed in subsequent cases.

5.2.6 NAFTA Chapters Dealing with Particular Aspects of Public Services Provision

5.2.6.1 Introduction

In addition to general framework rules for services and investment, NAFTA has chapters dealing with particular services that address aspects of public service provision: financial services, telecommunications, and energy. As well, NAFTA has separate chapters on government procurement and government monopolies that may have an effect on public services. Finally, NAFTA contains general exceptions that help define the scope for states to act in relation to public services. All these are discussed in the next sections.

5.2.6.2 Financial Services

Chapter 14 and not Chapters 11 or 12 apply to investment in and the cross-border supply of financial services.[89] The pattern of basic obligations in the investment and services chapters is followed in Chapter 14, but with certain modifications that tailor the provisions to the specific characteristics of financial services and address some of the public service dimensions of such services, including the protection of depositors.[90] The need to ensure cost-effective access to basic financial services, which has been characterized as a public service issue in Europe, is not addressed.[91]

[89] NAFTA, Articles 1101(3) and 1201(2)(a). "[F]inancial service" is defined as a "service of a financial nature, including insurance." NAFTA, Article 1416.

[90] GATS Annex on Financial Services; and European Communities–CARIFORUM Economic Partnership Agreement (2008), Title 2, Chapter 5, Section 5.

[91] European Commission, A Quality Framework for Services of General Economic Interest in Europe, COM(2011) 900 final, 20 December 2011.

In terms of its scope of application, Chapter 14 applies to measures of a Party relating to financial institutions[92] of another Party,[93] investors of another Party in financial institutions in the territory of the Party, and their investments in such institutions as well as cross-border trade in financial services,[94] which is defined to mean provision of a financial service through GATS modes 1, 2 or 4.[95] Most significantly for public services, the scope of Chapter 14 is limited by Article 1401(3), which provides as follows:

> Nothing in this chapter shall be construed to prevent a Party, including its public entities, from *exclusively* conducting or providing in its territory:
>
> (a) activities or services forming part of a public retirement plan or statutory system of social security; or
> (b) activities or services for the account or with the guarantee or using the financial resources of the Party, including its public entities.[96] [emphasis added]

This limitation carves out direct and exclusive state provision of services relating to retirement and social security programs, as well as other financial services to which the chapter would otherwise apply that are delivered exclusively on behalf of the state through public and private entities that the state fully funds or with respect to which it guarantees the payment of some identified return. An example of private supply might be below market rate government loans to students for their post-secondary education where the loans are administered by private banks but repayment is guaranteed by the state. The reference to "exclusively" in the NAFTA provision means that Chapter 14 does apply to services of these kinds where private parties are permitted to supply them alongside the state.

For the purposes of GATS, the Annex on Financial Services defines the kinds of services described in Article 1401(3) as "services in the exercise of governmental authority" so that they are excluded from the agreement. The absence of competition by private parties as a condition of the availability of the exception is more explicitly addressed in GATS Annex on Financial Services.

Most of the obligations in Chapter 14 are commitments by each Party in relation to financial services providers and investors in financial institutions from other NAFTA Parties regarding their access to the market of the Party and the security of their position in that market. While these provisions go beyond that commitments of WTO Members expressed in the Understanding on Commitments in Financial Services, they have limited implications for public services.

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[92]Financial institution is defined in terms of the scheme of financial services regulation in each Party, rather than a discrete list of activities. It means "a financial intermediary or other enterprise that is authorized to do business and regulated or supervised as a financial institution under the law of the Party in whose territory it is located." NAFTA, Article 1416.

[93]A financial institution of another Party is one that is controlled by persons of the other Party and is located in the territory of that other Party (NAFTA, Article 1416).

[94]NAFTA, Article 1401(1).

[95]NAFTA, Article 1416.

[96]*See also* NAFTA, Article 1410(3).

Each Party must give national treatment to investors in financial institutions and their investments with certain caveats.[97] Like the national treatment obligation in Chapter 11, the Chapter 14 obligation extends expressly to the "establishment, acquisition, [or] expansion" of such investments in financial institutions meaning that the obligations extend to the pre-establishment period and provide a guarantee of market access. National treatment must also be provided to cross-border financial service providers of another Party.[98] However, national treatment need only be provided in relation to any particular service provided across the border, if the Party permits the service to be provided in that way. A Party is free to refuse to allow services to be provided cross-border. A Party might choose to do so due to the difficulty in regulating foreign service providers that have no presence in the territory to ensure that they comply with public service obligations imposed by the state, or because the state provides the service directly.

Chapter 14 imposes an MFN obligation in relation to investors in financial institutions and their investments, with certain caveats, and to cross-border services suppliers.[99] The MFN obligation is attenuated in that a Party may recognize prudential measures[100] of a particular Party (or a non-Party) without triggering an MFN obligation to recognize the prudential measures of the other Party or Parties. The recognizing Party must, however, "provide adequate opportunity to another Party to demonstrate that circumstances exist in which there are or would be equivalent regulation, oversight, implementation of regulation, and, if appropriate, procedures concerning the sharing of information between the Parties."[101]

Article 1408 prohibits nationality requirements for senior managers of financial services providers, reproducing the general prohibition on such requirements in Chapter 11.[102] As well, the Parties committed to allowing financial institutions of another Party to transfer data into and out of their territory for the purposes of data processing in the ordinary course of business.[103]

Chapter 14 incorporates by reference certain provisions from Chapter 11, including the obligation not to expropriate investments of other NAFTA Parties except in accordance with certain requirements, including compensation.[104]

[97]NAFTA, Articles 1405(1), (2) and (4).

[98]NAFTA, Article 1405(3).

[99]NAFTA, Article 1406(1).

[100]As discussed in more detail below, prudential measures include those designed to protect depositors and others dealing with financial institutions.

[101]NAFTA, Articles 1406(2), and (3).

[102]NAFTA, Article 1407(1). The Parties agreed that they would permit financial institutions of another Party to provide any new financial services that develop on the same basis as domestic institutions.

[103]NAFTA, Article 1407(1).

[104]NAFTA, Article 1401(2) incorporates by reference Articles 1109 (transfer of funds), 1110 (expropriation), 1111 (special formalities and information requirements), 1113 (denial of benefits), and 1114 (environmental measures). The denial of benefits provision is also carried over from Chapter 12 (Article 1211).

The investor-state arbitration scheme under Chapter 11 is incorporated to protect investments in financial services but only from violations of the obligations that are incorporated by reference from Chapter 11.[105]

Significantly, the same Annex I and Annex II reservations as were discussed above in relation to Chapters 11 and 12, including the Social Services Reservation, apply to the national treatment and MFN obligations in Chapter 14.[106] Without these reservations, provincial health care funding plans in Canada that operate as a kind of insurance might be caught by Chapter 14.[107]

Most important for public services, NAFTA includes a fairly broad prudential exception that is very similar to the carve-out for such measures in the GATS Annex on Financial Services. It ensures that NAFTA obligations do not apply to limit the ability of Parties to protect public interests implicated by financial services provision, including the interests of investors in financial institutions, bank depositors, and insurance policy holders as well as the public interest in the overall health of individual financial institutions and the financial system generally. The activities of central banking authorities in pursuit of monetary and related credit policies or exchange rate policies are also excluded from obligations in the chapter.[108]

The prudential exception applies not only to the obligations in Chapter 14 but also those in Chapters 11, 12 and 13 (telecommunications), Chapter 15 (competition) and Chapter 16 (the temporary entry of business persons). Where an investor makes a claim against a Party, and the Party invokes this exception, the issue is referred to a Committee established under Chapter 14 which makes a binding decision on whether the exception applies.[109]

Article 1411 imposes certain obligations regarding the transparency of measures relating to financial services and applications to be permitted to provide financial services. There is no obligation, however, on a Party to furnish confidential information or information regarding the financial affairs of individual customers.[110]

To summarize, Chapter 14 has a number of features relevant to public services. NAFTA contains a version of the governmental authority exclusion for public retirement and social security plans as well as other financial services supplied exclusively by public or private entities on behalf of the state with the

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[105]NAFTA, Articles 1414 and 1415. Article 1401(2) incorporates by reference the dispute settlement provisions (Articles 1115–1138) of Chapter 11 into Chapter 14.

[106]NAFTA, Article 1409(4). Reservations in Schedules to Annexes III and IV are also incorporated.

[107]See VanDuzer 2004. Categories of non-conforming measures that are listed by each Party in their schedule to Annex VII are also excluded, though none of these relate to public services. Existing local government measures are also excluded.

[108]See Malloy 2004, p. 231.

[109]NAFTA, Article 1412 (Financial Services Committee), Article 1415 (procedure for dealing with claim that prudential exception applies).

[110]NAFTA, Article 1411(5).

financial resources or guarantee of the state. It also exempts prudential measures and central bank activities. NAFTA Annex I and Annex II reservations discussed above in relation to Chapters 11 and 12, including the Social Services Reservation, apply to the national treatment and MFN obligations in Chapter 14. Finally, Chapter 14 recognizes that Parties cannot be obliged to disclose confidential information or information regarding the financial affairs of individual customers.

5.2.6.3 Telecommunications

NAFTA Chapter 13 deals with telecommunications. The main purpose of Chapter 13 is to establish some additional specific obligations that relate to the distinctive characteristics of this sector, including its public service dimension. One commentator has called the chapter a "code of regulatory conduct".[111] It does not commit the NAFTA countries to allowing foreign businesses to deliver basic telecommunications services, but, like the GATS Annex on Telecommunications Services, obliges them to guarantee access to these services and the telecommunications networks that deliver them on a reasonable and non-discriminatory basis. The chapter also establishes some requirements for licencing regimes for enhanced or value-added telecommunications services[112] and the operation of state monopolies. In dealing with inter-connection and anti-competitive practices, NAFTA Chapter 13 follows the GATS Annex on Telecommunications and the Reference Paper on Telecommunications,[113] though Chapter 13 is more detailed and specific.

Telecommunications services are fully subject to the obligations in Chapters 11 and 12, except to the extent that any obligation in Chapter 13 is inconsistent with these chapters, in which case, the Chapter 13 obligation prevails.[114] As noted, the impact of Chapters 11 and 12 is circumscribed by the Annex II reservations filed by each NAFTA Party relating to telecommunications networks and services.

In terms of scope, Chapter 13 provides rules governing

- access to and use of public telecommunications networks or public telecommunications services (meaning services, like telephone services, that involve only the transmission of information supplied by a customer between points that is not changed in form or content end-to-end);

[111]Johnson 2002, p. 328.

[112]NAFTA, Article 1310.

[113]Telecommunications Services 1996. GATS Annex on Telecommunications only commits members to providing access to public telecommunications networks and services.

[114]NAFTA, Article 1307. One implication of this is that the reservations in Chapters 11 and 12 do not prevail over any obligation in Chapter 13 (Johnson 2002, p. 327).

- licensing the provision of enhanced or value-added telecommunications services (meaning telecommunications services other than public telecommunications services as described, such as services that act on the form, content or other aspects of the customer's information,[115] like email or remote alarm services); and
- standards for attaching equipment to public telecommunications networks.[116]

Chapter 13 does not, however, grant any right to investors or services suppliers to establish, acquire or build a telecommunications network or provide public telecommunications services.[117]

Article 1302(1) establishes the basic rule that each Party must ensure that persons from other NAFTA countries have access to any public telecommunications network or service operated within its territory or across its borders on reasonable and non-discriminatory terms. Pricing of public telecommunications services has to reflect the costs directly related to providing the service.[118] NAFTA countries are expressly permitted to take steps to ensure the privacy of subscribers or the confidentiality of messages and impose conditions that are "necessary … to safeguard the public service responsibilities" of telecommunications networks or services providers, including their ability to make their networks or services available to the public.[119] No other conditions on access to or use of networks or services may be imposed. The explicit requirement for cost-based pricing would seem to prohibit charging higher prices to subsidize universal service or other public service obligations of providers of networks or services, except to the extent that they are based on the costs of meeting such obligations.[120] Mexico was found to have failed to ensure that cost-justified rates were charged by its public telecommunications network contrary to GATS in *Mexico-Measures Affecting Telecommunications Services*. The same result would likely have followed in a challenge under NAFTA. Cross-subsidization, however, is expressly permitted. For example, a telephone company may subsidize the cost of local service from revenues from long distance services.

NAFTA 1303 deals with the conditions upon which enhanced or value-added telecommunications services may be provided. Some of these commitments are of limited relevance to public services regulation. For example, registration and other procedures must be transparent and non-discriminatory, and any information required to be filed must be limited to that required to demonstrate the applicant's

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[115]NAFTA, Article 1310.

[116]NAFTA, Article 1301(1). Chapter 13 does not deal with the distribution of television or radio programs except to require that persons operating broadcast stations and cable systems be given access to public telecommunications networks (NAFTA, Article 1301(2)).

[117]NAFTA, Article 1301(3)(b).

[118]NAFTA, Article 1302(3). Cross-subsidization between public services is permitted.

[119]NAFTA, Articles 1302(5) and (6).

[120]*Mexico—Measures Affecting Telecommunications Services,* Report of the Panel, WT/DS204/R.

solvency or compliance with technical standards. Of greater significance, NAFTA countries cannot impose on providers of enhanced or value-added services the kinds of requirements that are often imposed on public services providers, such as obligations to

(a) provide [services] generally to the public;
(b) cost-justify its rates;
(c) file a tariff; [[121]]
(d) interconnect its networks with any particular customer or network;
(e) conform with any particular standard or technical regulation for interconnection other than for interconnection to a public telecommunications transport network.

Certain requirements are also imposed in relation to standards imposed by the operators of such telecommunications networks for the attachment of equipment to networks.[122] One of the permitted categories of standards-related measures is to ensure users' safety and access to the network.

Where a NAFTA country maintains or designates a monopoly to provide certain telecommunications services and the monopoly competes with private firms in providing enhanced or value-added telecommunications, it must ensure that the monopoly does not engage in anti-competitive conduct when doing so.[123]

Finally, Chapter 13 does not permit reservations to be taken. By virtue of the reservations taken by each country in the investment and services chapters, however, the national treatment and MFN obligations as well as some other obligations in those chapters do not apply to telecommunications networks or the provision of public telecommunications services.[124] Consequently, discriminatory restrictions on investment in and cross-border supply of telecommunications services that would otherwise be contrary to Chapters 11 and 12 may be maintained. Chapter 13 prevails over Chapters 11 and 12, so the Annex II reservations cannot derogate from the obligations in Chapter 13. Since Chapter 13 does not address discrimination, except for the obligation of public monoplies described above, the likelihood of such derogation would appear to be small.

In summary, Chapter 13 provides certain guarantees of access to public telecommunications networks and services but allows conditions to be imposed on suppliers of public telecommunications networks and services to ensure that public service objectives are achieved. Parties can also impose other standards to achieve other public interest goals, such as the protection of public safety. With respect to the important area of enhanced or value-added services, however, public services obligations, like universal service obligations and rate specification are prohibited.

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[121]A tariff, meaning rates to be charged, may be required if the provider is a monopoly or the tariff is needed to remedy an anticompetitive action (NAFTA, Article 1303(3)).

[122]NAFTA, Article 1304.

[123]NAFTA, Article 1305.

[124]Johnson 1994, p. 330. The wording of these reservations is not identical.

5.2.6.4 Energy

Special rules regarding the supply of energy are not commonly found in trade or investment treaties. NAFTA has no rules that specifically address the provision of energy in the territory of a Party. Chapter 6, however, creates some special rules dealing with "energy and basic petrochemical goods".[125] NAFTA's provisions are mainly concerned with protecting energy security within North America by limiting the ability of NAFTA Parties to constrain exports to each other. Critics have expressed concerns that these obligations could be invoked to prevent a country from limiting exports to respond to a domestic shortage with the goal of ensuring adequate access to energy for its domestic population.[126] There is no evidence that this has occurred in practice, however.

For the most part, Chapter 6 incorporates the basic limitations on the ability of Parties to restrict imports and exports of energy and petrochemical goods to which each of the Parties is subject under the GATT.[127] The chapter expresses the Parties' understanding that GATT prohibits minimum and maximum export prices in most circumstances.[128] The Parties also agree that they shall not impose discriminatory export taxes. These are taxes that apply to exports to a Party but not to goods sold for domestic consumption or that do not apply to exports to other countries.[129]

Chapter 6 also imposes three further limitations on the ability of NAFTA Parties to restrict exports of energy and petrochemical goods. In general, export restrictions are prohibited, except where there are domestic shortages or a Party imposes similar restrictions related to domestic energy supply. These limitations apply even in circumstances where export restrictions would be permitted under the GATT.[130]

[125]These goods are defined with reference to specific classes of goods in the Harmonized System (NAFTA, Article 602). Consistent with the Mexican Constitution, Mexico reserves to itself the right to carry on most activities in the energy sector, including exploring for, exploiting, refining, processing and trade in petrochemical products and the supply of electricity as a public service. Private investment is not permitted and the services obligations in Chapter 12 only apply to the extent that the government grants a private party a right to perform services related to energy (NAFTA, Annex 602.3).

[126]E.g. Laxer and Dillon 2008. The critics' views are discussed Johnson 1994, pp. 206–210.

[127]NAFTA, Article 602. This provision excludes the application of the Parties' protocols of provisional application. One implication of this is that, for NAFTA purposes, the provision in Mexico's protocol that permitted Mexico to rely on the exception in GATT Article XX(g) based on "social and development needs" does not apply (see Johnson 1994, p. 204).

[128]NAFTA, Article 603(2). There is some uncertainty regarding whether the GATT requires this (Johnson 1994, pp. 204–205).

[129]NAFTA, Article 604.

[130]I.e. the exceptions in GATT Articles XI:2(a), XX(g), (i), or (j). NAFTA, Article 607 also imposes limitations on the Parties' ability to rely on the national security exception in GATT XXI. These limitations do not apply to Mexico or to Canada and the United States in relation to Mexico.

A Party cannot impose a restriction in relation to the export of an energy or petrochemical product to another Party unless the following conditions are met.

(a) The restriction does not reduce the proportion of the total export shipments… to that other Party relative to the total supply of that good of the Party maintaining the restriction as compared to the proportion prevailing for the most recent 36 month period…
(b) The Party does not impose a higher price for exports of an energy or basic petrochemical good to that other Party than the price charged for such good when consumed domestically, by means of any measure such as licenses, fees, taxation and minimum price requirements.
(c) The restriction does not require the disruption of normal channels of supply to that other Party or normal proportions among specific energy or basic petrochemical goods supplied to that other Party, such as, for example, between crude oil and refined products and among different categories of crude oil and of refined products.

These limitations only apply as between Canada and the US. Mexico is not subject to them and neither Canada nor the United States has to comply with these rules in relation to Mexico.[131] Apart from the basic GATT rules dealing with import and export restrictions, the Mexican energy sector is exempt from the obligations in the treaty. The obligations in the treaty of Canada and the United States dealing with goods, services and investment, as well as those in the energy chapter, all apply to the energy sector.

The rules in Chapter 6 are only likely to be relevant in the circumstances where there has been a decline in production or for some other reason supply within a NAFTA country has been reduced. In these circumstances, the main obligation on Canada and the US is not to restrict or otherwise limit exports to the other country except in proportion to reductions in domestic distribution. As noted, in Canada, this proportionality restriction has been a significant concern though there is no evidence that problems have arisen in practice to date. In light of new sources of resources coming into production in all three NAFTA countries, problems of this kind seem unlikely.

5.2.6.5 Government Procurement

NAFTA Chapter 10 provides a set of rules to govern procurement by NAFTA country governments of goods and services. Like the World Trade Organization's Agreement on Government Procurement,[132] Chapter 10 imposes an obligation on specified government bodies of a Party not to discriminate against suppliers from the other Parties in making some procurement decisions, sets standards for

[131] Energy production and distribution in Mexico is reserved to the Mexican state. This is expressly provided for in Article 27 of the Mexican Constitution, see also Articles 25 and 28.

[132] WTO Agreement on Government Procurement (1994).

procurement bidding procedures and requires each Party to put in place a process to challenge procurement decisions. Similar kinds of commitments are found in EU trade agreements.[133]

In terms of scope, Chapter 10 applies to purchases of goods and services as well as leases and rentals by national governments and some national government enterprises that exceed specified financial thresholds. Provincial and state procurement is not caught by Chapter 10.[134] Of relevance to public services, procurement does not include:

> (a) non-contractual agreements or any form of government assistance, including cooperative agreements, grants, loans, equity infusions, guarantees, fiscal incentives, and government provision of goods and services to persons or state, provincial and regional governments;…

The basic financial threshold for the application of the Chapter 10 rules to procurements of goods or services by governments is US$50 000 but for procurement of construction services is US$6.6 million. For government enterprises, the threshold for procurement of goods or services is US$250 000 and US$8 million for construction services. Chapter 10 obligations do not apply to purchases of arms or other national security procurements.[135]

With respect to procurement measures covered by Chapter 10, the NAFTA countries commit not to treat goods of another Party, suppliers of such goods or service suppliers of another Party less favourably than the most favourable treatment they provide to their own goods and suppliers or the goods and suppliers of another Party. The provision goes on to specify that this means that local suppliers cannot be discriminated against because (i) they are affiliated with foreign firms of another Party or foreigners of another Party hold ownership interests in them or (ii) the goods or services they offer are goods or services of another Party. This would preclude discrimination in favour of local private suppliers of public services.

Significantly, all three countries have taken a variety of reservations for procurement of services related to research and development, transport services, public utilities services (including telecommunications, water and energy services). Canada also excluded health and social services.[136] Consequently, there is substantial flexibility for NAFTA governments to use procurement in these sectors to achieve economic development and social objectives, such as the promotion of

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[133]E.g. European Communities–CARIFORUM Economic Partnership Agreement (2008), Title IV, Chapter 3.

[134]These obligations have been expanded in accordance with the Canada-US Agreement on Government Procurement of 2010, which resulted in some reciprocal provincial and state commitments under the WTO Agreement on Government Procurement.

[135]NAFTA, Article 1001(1)(c). As between Canada and the US, the lower threshold agreed to in the Canada-United States Free Trade Agreement (1989) applies to procurements of goods by some entities: US$25,000 (Annex 1001.2c). These categories were expressed with reference to a classification system established in NAFTA.

[136]NAFTA, Chapter 10, Schedule B.

local employment and research and development activity, notwithstanding the procurement rules. Discrimination in favour of local suppliers in these areas is permitted for any reason. In some cases, governments might want to discriminate in connection with public services to ensure that services are appropriate for local conditions.

The general exceptions in NAFTA do not apply to Chapter 10.[137] Chapter 10, however, has its own exceptions similar to those in GATT Article XX. Nothing in Chapter 10 prevents any Party from adopting measures:

(a) necessary to protect public morals, order or safety;
(b) necessary to protect human, animal or plant life or health;
(c) necessary to protect intellectual property; or
(d) relating to goods or services of handicapped persons, of philanthropic institutions or of prison labor.

Like the general exceptions in GATT Article XX, the exceptions are only available in relation to measures that "are not applied in a manner that would constitute a means of arbitrary or unjustifiable discrimination between Parties where the same conditions prevail or a disguised restriction on trade between the Parties".[138] Some public services measures might benefit from this exception, though it is hard to imagine that discriminatory procurement practices could ever be necessary to achieve the identified objectives. Alternatives are likely to be available in most circumstances.

The procurement rules of NAFTA limit the ability of NAFTA countries to discriminate against suppliers from other NAFTA countries but are subject to some significant limitations as applied to public services. Government assistance is generally not considered procurement. As well, procurement in relation to a list of public services, including telecommunications, energy and water services, are not subject to the procurement rules. Discrimination in favour of local suppliers is permitted in these areas. As well, actions otherwise inconsistent with the procurement rules that can be justified as necessary to protect health and the other interests identified in the general exceptions in Chapter 10 are permitted.

5.2.6.6 Competition Rules

The provisions of NAFTA Chapter 15 dealing with monopolies and state enterprises have some relevance to public services, since these kinds of entities are often the mechanism for the delivery of such services. NAFTA Chapter 15 obliges the Parties to have in place competition law rules addressing anti-competitive conduct and to cooperate on enforcement.[139] Nevertheless, existing monopolies,

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[137] The exceptions are discussed below. GATS contains identical exceptions (Article XXIII).

[138] NAFTA, Article 1018(2). A national security exception is also provided (NAFTA, Article 1018(1)).

[139] NAFTA, Article 1501.

including those delivering public services, may be maintained and new ones designated,[140] though certain requirements are imposed to minimize the consequences of monopoly conduct on the businesses of other Parties. These obligations are broadly similar to those regarding monopolies in GATS.[141] States must ensure that their monopolies operate in accordance with commercial considerations except where monopolies are acting to comply with their mandate. Regardless of their mandate, however, a monopoly must not be permitted to act in a discriminatory way in the market in which it has a monopoly or in a way that is anticompetitive to the extent that it also operates in a non-monopolized market.

Monopoly is defined in NAFTA as

> An entity, including, a consortium or government agency, that in any relevant market in the territory of a Party, is designated as the sole provider of or purchaser of a good or a service…

Article 1502(1) provides that a NAFTA Party may designate a monopoly, so long as the Party gives prior notice to the other Parties and the Party must "endeavour" to impose conditions on the operation of the monopoly that will minimize or eliminate the nullification or impairment of certain NAFTA provisions.[142] This is not an obligation to guarantee that nullification or impairment does not occur.

NAFTA Article 1502(1) applies only to newly designated monopolies. As a result, it has no application to monopolies in public services that pre-date NAFTA, such as existing Canadian provincial health care plans that are the sole funders of basic medical services. It would be relevant, however, with respect to any expansion of existing monopolies. For example, if the categories of health services funded exclusively by the state were expanded beyond those that were delivered on this basis on 1 January 1994 when NAFTA came into force, such a policy shift might be characterized as designating a monopoly in these services to the extent

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[140]Designation includes the expansion of existing monopolies, such as a public monopoly health care provider being authorized to provide new categories of health services exclusively (NAFTA, Article 1505).

[141]GATS, Article VIII provides that each WTO member will ensure that any monopoly service supplier acts consistently with the MFN obligation in GATS and the member's specific commitments. Where a monopoly competes outside the monopoly in a sector in which the member has made specific commitments, the member shall ensure that the monopoly does not abuse its monopoly position in a manner inconsistent with its commitments. Notification is required for any new monopoly. Where a member authorizes a small group of exclusive service suppliers and substantially prevents competition among them, the same obligations apply. If a member makes a market access and national treatment commitment by listing a sector, subsequent designation of a monopoly supplier would require a member to withdraw the concession and negotiate compensation under GATS.

[142]NAFTA, Article 1502(2). Article 1502(2) refers to the benefits listed in Annex 2004. The Annex does not list the obligations under Chapters 11 (investment) or 14 (financial services). Any impact on rights protected under these chapters does not have to be taken into account under this provision. The effect on rights protected under Chapter 12 (trade in services) would have to be considered. The investment and financial services obligations would still apply however.

that it precluded private insurance companies from selling insurance to cover those services.[143]

NAFTA Article 1502(3) imposes certain other requirements to be observed by monopolies designated by a Party that are operated either by private firms or the federal government. Each Party must ensure that such a monopoly

(a) acts in a manner not inconsistent with the Party's obligations where it exercises any regulatory, administrative or other government power delegated to it…;
(b) *except to comply with any terms of its designation that are not inconsistent with subparagraph (c) or (d), acts solely in accordance with commercial considerations* in its purchase or sale of the monopoly good or service in the relevant market, including with regard to price, quality, availability, marketability, transportation and other terms and conditions of purchase or sale;
(c) provides non-discriminatory treatment[[144]] to investments of investors, to goods and to service providers of another Party in its purchase or sale of the monopoly good or service in the relevant market; and
(d) does not use its monopoly position to engage, either directly or indirectly, including through its dealings with its parent, its subsidiary or other enterprise with common ownership, in anticompetitive practices in a non-monopolized market in its territory that adversely affect an investment of an investor of another Party, including through the discriminatory provision of the monopoly good or service, cross-subsidization or predatory conduct.[145] [emphasis added]

Chapter 15 also deals with state enterprises. Unlike the monopolies subject to Article 1503(2), state enterprises include those set up by the sub-national governments of states and provinces.[146] In contrast to the obligation in Article 1502(3)

[143]Even if such a characterization were accepted, however, Canada would not have to worry about this obligation in relation to US or Mexican insurance companies based on the obligations in Chapter 14 (financial services) because the benefits of Chapter 14 are not among those protected against nullification and impairment under Article 1502(1) as a result of not being listed in Annex 2004. Nevertheless, the obligations in Chapter 14, including the prohibition on expropriation without compensation incorporated by reference from Chapter 11, would still apply.

[144]Non-discriminatory means the better or national or MFN treatment (NAFTA, Article 1515).

[145]This last obligation is broadly similar to GATS, Article VIII. Where a Member authorises a monopoly service supplier to operate, such as a single provider of telecommunications services, and the services supplier competes in the supply of a service that is outside the scope of its monopoly rights and in a sector listed in the Member's schedule, the member must ensure that the monopoly supplier does not abuse its monopoly position (GATS, Article VIII). Abuse would include, for example, subsidising its activities in the competitive market with its monopoly profits. Members are also obliged to ensure that monopoly service suppliers do not undermine access commitments undertaken in national schedules of commitments (GATS, Article VIII.1).

[146]State specific definitions of state enterprises are set out in NAFTA Annex 1505. The obligation on monopolies in Article 1502(3)(a) and state enterprises in Article 1503 can be the subject of an investor-state claim if they are breached in a way that breaches an investor-protection obligations in Chapter 11. NAFTA, Articles 1116(1)(b), 1117(1)(b). This basis for an investor-state claim is excluded for Mexico in Annex 1120.1.

for monopolies to comply with all of a Party's NAFTA obligations, state enterprises exercising delegated regulatory, administrative or other governmental authority are only required not to act in a manner inconsistent with Chapter 11 (investment) and Chapter 14 (financial services). Parties must also ensure that state enterprises give the better of national or MFN treatment when selling goods or services to investments of investors of another NAFTA country in the Party's territory.[147]

In summary, while monopolies and state enterprises, including providers of public services, can continue to operate and new ones can be designated by NAFTA states, some restrictions apply. Parties must try to avoid nullification and impairment of certain obligations when they designate a new federal level or private monopoly. This obligation does not extend to the obligations in Chapter 11 (investment) or Chapter 14 (financial services). That does not mean, however, that these obligations do not apply to all state measures related to monopolies. Nothing in Chapter 15 excludes the obligations in Chapters 11 or 14. The obligation not to expropriate without compensation, for example, in these chapters continues to apply and may discourage the establishment of new monopolies in public services or the expansion of existing monopolies.[148] As well, where a federal or private monopoly has been designated, Chapter 15 expressly provides that Parties are obliged to ensure that it complies with all obligations in NAFTA, including Chapters 11 and 14. State enterprises, which includes sub-federal level enterprises, must be required to comply with Chapters 11 and 14 only. Of the other obligations relating to monopolies, the requirement to ensure that federal and private monopolies act "solely in accordance with commercial considerations" could interfere with public service obligations of these monopolies. This obligation does not apply, however, to any public service obligation provided for in the terms of the designation of a monopoly. This protection is restricted in two ways. Actions of a monopoly in its monopoly market that are discriminatory and actions outside its monopoly market that are anti-competitive are not protected even if the actions would promote the monopoly's mandate. These provisions would not apply, however, to common, non-discriminatory public service obligations, such as universal service obligations.

5.2.6.7 General Exceptions

Chapter 21 of NAFTA provides some general exceptions that apply to the Parties' obligations. One general exception permits measures that a Party considers necessary for the protection of its national security interests.[149] There is also a general

[147]NAFTA, Article 1503.

[148]Johnson 1994, p. 409.

[149]NAFTA, Article 2102.

exception for measures taken in response to a balance of payments emergency.[150] Taxation measures are generally excluded with some limitations.[151] A taxation measure may be found to be an expropriation contrary to Chapter 11, unless the appropriate authorities in the host state and the investor's state agree that it is not an expropriation.[152] Chapter 21 also incorporates the GATT Article XX exceptions relating to, among other things, measures necessary for the protection of public morals, human, animal or plant health and the conservation of exhaustible natural resources, but only for measures related to trade in goods.[153]

NAFTA does not contain the general exceptions from the services obligations that are found in GATS and many EU trade agreements.[154] There is one exception of some relevance to public services. The services rules in Chapter 12 and the rules on telecommunications in Chapter 13 are subject to the following exception for measures related to compliance with laws, including those relating to health, safety and consumer protection:

> Provided that such measures are not applied in a manner that would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail or a disguised restriction on trade between the Parties, nothing in: …
>
> (c) Chapter Twelve (Cross-Border Trade in Services), and
> (d) Chapter Thirteen (Telecommunications),
>
> shall be construed to prevent the adoption or enforcement by any Party of measures necessary to secure compliance with laws or regulations that are not inconsistent with the provisions of this Agreement, including those relating to health and safety and consumer protection.

The structure of this exception means that its application is subject to several significant limitations. First, a measure must be necessary, not for the protection of any public interest directly, but to secure compliance with laws that are not themselves inconsistent with the agreement. In cases interpreting similar WTO obligations, necessary has been interpreted as meaning that there must not be an alternative measure reasonably available to the state to achieve the defined objective that is less restrictive of trade.[155] Second, the measure must "not [be] applied in a manner that

[150]NAFTA, Article 1501.

[151]NAFTA, Article 2103(4). National treatment and MFN in Chapter 11 relating to investments apply to certain taxation measures and the national treatment obligations in Chapters 12 and 14 apply to income and capital gains tax as well as some other taxes.

[152]NAFTA, Article 2103(6).

[153]NAFTA, Article 2101.

[154]Under GATS, measures are excluded if they are necessary "to protect public morals or to maintain public order" or "to protect human, animal or plant life or health." As well, GATS provides an exception for the enforcement of laws relating to privacy. As an example of an EU agreement, see the European Communities–CARIFORUM Economic Partnership Agreement (2008), Articles 184 and 221.

[155]E.g. *European Communities—Measures Affecting Asbestos and Products Containing Asbestos*, Report of the Appellate Body, WT/DS135/AB/R.

would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail or a disguised restriction on trade between the Parties." This architecture follows GATT Article XX and GATS Article XIV. Finally and most importantly, this exception does not apply to obligations under Chapter 11 (investment) or 14 (financial services). In short, where necessary for the enforcement of regulatory standards that are consistent with NAFTA, a Party could treat foreign services suppliers (apart from financial services suppliers and investors) differently. This exception simply recognizes that it may be more difficult to take enforcement action against foreign suppliers that are outside the territory of the enforcing party. It provides little protection for public service measures.

5.3 Analysis of NAFTA Rules Applicable to Public Services

5.3.1 Introduction

The survey of NAFTA provisions in this chapter discloses some distinctive features of the approach taken in the NAFTA to protecting public services from treaty disciplines as compared to the approach in the GATS and EU trade agreements. In this section, these differences in approach are discussed in detail and some of the relative costs and benefits identified.

5.3.2 Approaches to the Protection of Public Services in GATS and EU Trade Agreements

The conceptual starting point for NAFTA, as a negative list agreement, is that all provisions of the agreement apply to all activities of a party state, including subnational governments.[156] In contrast, key provisions of GATS and EU trade agreements only apply to sectors and activities that are positively listed by each party.

GATS and EU trade agreements also limit their scope of application to public services by an exclusion for services in the exercise of governmental authority.[157]

[156]NAFTA, Article 105. Each Party commits to "take all necessary measures" to give effect to the provisions of the agreement, "including their observance, except as otherwise provided, by state and provincial governments." The international law rules of state responsibility regarding treaty obligations that relate to matters within the jurisdiction of subordinate state actors are clear: a state is internationally responsible for their actions that are not in compliance with the state's international obligations. A state cannot invoke any internal constitutional rules that allocate jurisdiction to subordinate levels of government as an excuse for non-compliance: Vienna Convention on the Law of Treaties (1980), Article 27; International Law Commission 2001, Article 3.

[157]E.g. European Communities–CARIFORUM Economic Partnership Agreement (2008), Article 129.

NAFTA contains no such exclusion, relying largely on sector specific reservations and exceptions. The governmental authority exclusion is defined typically to encompass only services that are delivered not on a commercial basis and not in competition with one or more services suppliers. There has been much debate about the scope and utility of the governmental authority exclusion[158] but, as yet, no authoritative interpretation.[159] One leading commentator concludes that there is an emerging consensus that the protection provided by the governmental authority exclusion is narrow, including only core services delivered directly by the state.[160] Services that typically are considered public services, like health and education, but that are delivered on a fee-paid basis or by private institutions may be outside the protection of the exclusion.

In GATS and EU trade agreements, in addition to the exclusion for services supplied in the exercise of governmental authority, the EU typically includes in its schedule of commitments an exclusion for a broader category of public services: public utilities. In practice, this exclusion is limited in three ways: it applies (i) only to the market access and national treatment obligations, (ii) only in relation to one mode of service delivery, commercial presence, and (iii) only to one kind of public service delivery: public monopolies and exclusive rights granted to private operators. For example, the EU's national schedule of commitments to the GATS contains the following horizontal limitation (i.e. one applying to all listed sectors) in relation to the supply of a service through a commercial presence.

> In all EC Member States services considered as public utilities at a national or local level may be subject to public monopolies or to exclusive rights granted to private operators.*[161]

This limitation is accompanied by the following note.

> *1) Explanatory Note: Public utilities exist in sectors such as related scientific and technical consulting services, R&D services on social sciences and humanities, technical testing and analysis services, environmental services, health services, transport services and services auxiliary to all modes of transport. Exclusive rights on such services are often granted to private operators, for instance operators with concessions from public authorities, subject to specific service obligations. Given that public utilities often also exist at the sub-central level, detailed and exhaustive sector-specific scheduling is not practical.[162]

This limitation provides examples of what might be considered a public utility but not an exclusive list. In effect, it is up to the relevant authority in each member state to determine what is a public utility. The ability of local authorities to make these determinations on an ongoing basis provides significant flexibility with

[158] E.g. Leroux 2006, p. 345; Krajewski 2003, p. 341; Luff 2003; Adlung 2003; VanDuzer 2005, p. 303.

[159] The similarly worded exemption in Article 51 Treaty on the Functioning of the European Union has been interpreted by the European Court of Justice.

[160] Krajewski 2011a, p. 23.

[161] European Communities and their Member States, Schedule of Specific Commitments (1994).

[162] European Communities and their Member States, Schedule of Specific Commitments (1994).

respect to the areas which benefit from the limitation. The scope of permitted policy-making in relation to public utilities, however, is constrained. Public monopolies may be set up and exclusive private service suppliers designated with specific public service obligations, but no other form of public service delivery is carved out. As well, in relation to such monopolies or exclusive services suppliers the obligations in the GATS, other than market access and national treatment, would continue to apply. As well, GATS obligations for listed sectors, including national treatment and market access, would apply to any particular listed public service that is not provided through a commercial presence. These obligations, however, are subject to any other limitations written into the EU schedule. In its other positive list agreements, the EU typically also includes limitations that cut back the commitments it undertakes in specific sectors.[163]

5.3.3 Possible Costs and Benefits of NAFTA's Approach to the Protection of Public Services

In contrast to the functional approach adopted in the governmental services exception and the targeted flexibility offered by the horizontal limitation for public utilities in GATS and EU trade treaties, the general approach in NAFTA is to carve out specific public services areas and measures. For example, the Social Services Reservation in the NAFTA Parties' Schedules to Annex II specifically excludes all present and future measures related to a finite list of identified areas: "public law enforcement and correctional services, and … to the extent that they are social services established or maintained for a public purpose: income security or insurance, social security or insurance, social welfare, public education, public training, health, and child care."

As discussed above, the meaning of "public purpose" in the abstract is somewhat uncertain. The use of a specific list of policy areas does provide a higher degree of certainty and predictability regarding the areas of public services that fall within it, compared to functional definitions like services in the exercise of governmental authority, the content of which is inherently contestable, or public utilities the content of which is largely up to member states. The same observation may be made regarding the other Annex II reservations that relate to specific policy areas implicating public service considerations.[164] The Annex I reservations for existing measures have precisely defined content and, as a result, are even more certain, though certainty is somewhat compromised with respect to existing

[163] Krajewski 2011a, p. 30.

[164] As noted, the main categories of Annex II reservations that implicate public services are set out in the Appendix to this chapter.

state and provincial measures which are protected by Annex I but, contrary to the Parties' original intention, were never listed.[165]

The procurement, financial services and telecommunications chapters also provide important area-specific rules relevant to public services. Annexes to Chapter 10 on procurement list areas of policy-making and regulation identified by each NAFTA country to which the procurement obligations do not apply. Chapter 14 on financial services exempts identified categories of prudential measures and the telecommunications chapter preserves the right of states to impose public service responsibilities on suppliers of public telecommunications networks and services.

Despite being relatively certain and specific, the NAFTA approach has inherent limits. Because it relies on discrete lists of areas and measures, it is fragmentary. Some generally recognized public services, such as water services, are not on any list in NAFTA, other than the list of exceptions from the government procurement obligations. Lists are not the same for all three countries and vary depending on the obligation. The government procurement lists of sectors reserved by each Party, for example, are more extensive than the Annex II lists.

NAFTA's approach is also rigid. What constitutes a public service is both dynamic and context specific. Policies on what services should be delivered as public services are inherently subject to experimentation and change over time.[166] Fixed lists, like the list in the Social Services Reservation, are poorly adapted to accommodate inevitable changes in the categories and nature of public services. NAFTA Annex II reservations and other NAFTA provisions with implications for public services can only be changed by an amendment to the treaty, which has never occurred and is unlikely in the future. As well, the dynamic nature of public services means that the standstill protection for particular measures under Annex I based on the form they took on 1 January 1994 is likely to diminish over time. In particular, the operation of the ratchet will mean that experiments involving liberalization will be locked in as part of the liberalizing Party's obligations. By contrast, the functional approach in the governmental services exclusion means that states can bring public services within the exclusion by adopting a policy of providing the service directly.[167] The horizontal limitation for public utilities is even more flexible since its application is up to EU member states.

Exclusions for subsidies and procurement from the services and investment obligations and the exclusion of government assistance from the procurement rules mitigate the rigidity of NAFTA's list-based approach. Carving out

[165] Annex I and Annex II reservations are not symmetrical.

[166] Krajewski 2011a, p. 28.

[167] If a state were to begin supplying a service directly that was the subject of specific commitment in its national schedule of commitments certain other GATS obligations might apply. If the state became the exclusive supplier, for example, GATS Article VIII.4 would require the state to give notice to the Council for Trade in Services. In such a case, at the request of any Member, the state would be required to enter into negotiations to agree on a compensating adjustment of its trade concessions. Any such adjustment would have to be extended on a most favoured nation basis to all WTO Members (GATS, Article XXI).

particular policy instruments that are not tied to any particular sector or activity gives flexibility to states to use these instruments to support public services in all areas, even those not protected specifically by exceptions or reservations. As discussed above, EU trade agreements also carve out these kinds of policy measures.

A final concern regarding the NAFTA approach is that it carves out public services activities largely without regard to the way in which services are delivered or the nature of the challenge that particular obligations represent for public services. For example, activities listed in the Social Services Reservation are excluded in their entirety from some NAFTA obligations even if all of the suppliers are private businesses that compete with each other, subject to the uncertain requirement that they are social services for a public purpose. The areas carved-out from the government procurement obligations, as well as other Annex II reservations and the Annex I reservations, do not contain this qualification. Areas of services supply identified in these provisions are fully excluded. By contrast, in EU trade agreements, the governmental services exclusion and the public utilities limitation do not fully exclude whole areas of services supply. As noted above, the governmental authority exclusion is likely limited to public services offered directly and exclusively by the state. The EU's horizontal limitation for public utilities is even more limited. It only permits the continuation and designation of monopolies and exclusive rights holders for one mode of supply (commercial presence) and only protects them from the market access and national treatment obligations. While EU member states can decide if public utilities are to be state or private monopolies or exclusive rights holders, if private competition is allowed, this provision would not apply to permit member states to discriminate against foreign suppliers in favour of local suppliers contrary to the national treatment obligation or to restrict market access.[168] The absence of these functional limitations in NAFTA means that the protection from the treaty obligations in areas listed in reservations is broader that under GATS and EU trade treaties. Most public services areas that are not listed, however, enjoy no protection at all.

The survey of NAFTA provisions does disclose a slightly more nuanced and functional approach to public services in some areas. In the financial services chapter, direct public provision of services relating to public funding and operation of retirement and social security programs, or other services that are delivered by the state through public or private entities that the government fully funds or with respect to which it guarantees the payment of some identified return are not subject to the obligations in the financial services chapter. But the exclusion is only available if the public or private entities are the exclusive providers of the service. If competition is permitted, then the exclusion does not apply and private parties

[168] European Commission, Commission Proposal for the Modernization of the Treatment of Public Services in EU Trade Agreements, TRADE.B.1/SC/am D(2011) 1146318, 26 October 2011.

benefit from the protections against discrimination in the treaty. This is similar in approach to GATs and European trade treaties.[169]

The NAFTA provisions on competition also reflect a more nuanced approach that limits the scope of obligations to the extent that they interfere with the mandate of state maintained monopolies. Monopolies and state enterprises can continue to operate and NAFTA countries can designate new ones but the measures relating to them are subject to the obligations in the investment chapter, including investor-state dispute settlement. A federal or private monopoly must operate solely in accordance with commercial considerations in relation to its purchases or sales of its monopoly good or service, "except to comply with any terms of its designation", meaning the terms on which it was set up. Thus a public service mandate for a monopoly would be a basis to deviate from commercial considerations. Even if doing so would assist a monopoly to comply with its "terms of its designation," however, a monopoly cannot behave in a discriminatory way in its monopoly market or engage in anti-competitive conduct outside its monopoly market. While the recognition of the essential role to be played by the public service mandate of a state monopoly does protect the ability of state monopolies to fulfill their mandates, these limitations restrict the scope of that protection.

Competition disciplines in some EU trade agreements also protect public service mandates of state monopolies but more comprehensively. The ability of states to designate monopolies and other enterprises with special or exclusive rights is commonly preserved in EU trade treaties. Competition disciplines still apply to these monopolies and enterprises but not to the extent that they would "obstruct the performance, in law or in fact, of the particular tasks assigned to them."[170] This would seem to go beyond NAFTA in permitting anti-competitive conduct by a monopoly if such conduct would promote the achievement of a monopoly's mandate.

Finally, public services are fully subject to the obligations protecting investors that may not be reserved against in NAFTA Chapter 11. These include the obligation to provide fair and equitable treatment and not to expropriate unless

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[169]The comparable provision in the EC-CARIFORUM EPA expressly denies the exclusion when a party's domestic law permits those activities to be carried out by financial service suppliers in competition with public entities or private institutions. See also European Union-Korea Free Trade Agreement (2011), Article 7.44; European Communities–CARIFORUM Economic Partnership Agreement (2008), Article 108. Decision No. 2/2001 of the EU-Mexico Joint Council of 27 February 2001 implementing Articles 6, 9, 12(2)(b) and 50 of the Economic Partnership, Political Coordination and Cooperation Agreement, *OJ* 2001 L 70/7, Article 26. The same approach is taken in the Canada-Europe Comprehensive Economic and Trade Agreement (CETA), consolidated text of 26 September 2014, available at http://trade.ec.europa.eu/doclib/docs/2014/september/tradoc_152806.pdf.

[170]E.g. European Communities–CARIFORUM Economic Partnership Agreement (2008), Article 129, European Union-Korea Free Trade Agreement (2011), Article 11.4, cited in Krajewski 2011a, p. 21. Special rights mean that the state has limited competition to the enterprises with special rights or confers advantages on the enterprises with special rights that affect the ability of other enterprises to compete.

certain conditions are met, including the payment of compensation. While the UPS case provides an example of an investment tribunal recognizing the unique characteristics of a public service provider, concerns remain regarding the broad scope of NAFTA's investment obligations and their ability to constrain the public service policy choices of NAFTA countries. NAFTA has not be updated to adopt some of the limitations on its investment obligations that that Canada and the US now routinely incorporate in their trade and investment treaties, such as a specification of when an indirect expropriation occurs. These kinds of provisions are not found in GATS or EU trade treaties, though they are likely appear in some form in future EU treaties now that competence for investment has been shifted to the EU level.[171]

5.4 Summary and Conclusions

NAFTA's main approach to protecting public services is to exclude specific identified areas of public service provision and certain public service measures from the application of most NAFTA treaty obligations. With a couple of exceptions, NAFTA does not treat public services in a functional way that focuses on their distinct characteristics, including whether they are delivered by or on behalf of the state, nor does the treaty seek to circumscribe exclusions to what is necessary to ensure that the public interest mandate of public services may be discharged. Instead, exclusions in NAFTA are defined by reference to discrete lists of policy areas and existing measures that are protected from particular NAFTA obligations as well as a few sector specific provisions that preserve some flexibility for states to provide or regulate public services in ways that might otherwise be contrary to the disciplines of the agreement in relation to these sectors. In general, the scope of these provisions is more certain than the broadly worded functional exclusions in GATS and some European trade agreements, though the NAFTA provisions have never been challenged or interpreted and remain subject to some residual uncertainty. The result is protection that is somewhat more predictable, but possibly over-inclusive for public service areas listed in reservations. Most areas of public service provision not listed in reservations, however, are not protected at all. Some public service activities, like waste removal services, are subject to all of the obligations in the treaty. Other public services, like postal services, have been protected by reservations by one country only. The result is that protection for public services is both fragmentary and asymmetrical.

Reliance on discrete lists of services also means that NAFTA's approach is rigid compared to the GATS and EU trade agreement provisions. The NAFTA approach

[171]Krajewski 2011b.

cannot easily accommodate changes in national policies regarding what are considered public services. This rigidity is mitigated through exclusions from the application of some NAFTA provisions of a few policy tools, like subsidies, that can be used to support the delivery of public services outside of listed sectors.

Protection of public services under NAFTA is also limited, though the impact of the limits remains hazy. Some obligations, notably the Parties' obligations not to expropriate investments of investors of other Parties without compensation and to provide fair and equitable treatment, continue to apply to all public services. The extent to which these provisions actually limit the policy choices of NAFTA Parties in relation to public services is uncertain and contested

The survey of NAFTA provisions does disclose a slightly more nuanced approach to public services in the financial services chapter where protection is limited to delivery of services on behalf of the state by public or private entities exclusively entitled to do so with the financial support of the state. As well, the provisions on competition recognize and provide some protection for the public services mandate of state maintained monopolies from the disciplines in the competition chapter. Generally, however, the NAFTA approach to public services is fragmented, asymmetrical, rigid and limited.

In contrast to NAFTA, the approach adopted in the GATS and EU trade agreements typically involves adopting an open-ended and functional characterization of public services that permits the content to vary over time and in different contexts and that focuses more precisely on protecting the aspects of public services that make them different and in need of special treatment. This sort of approach would address some of the problems with the NAFTA approach, though at the cost of diminished predictability and likely does not provide protection for public services that is as broad as NAFTA for the public services listed in NAFTA reservations. While it is far beyond the scope of this paper to conclude that the current EU approach or the new approach to public services proposed recently by the Commission[172] should be followed in Canada and the US, the foregoing analysis suggests that more serious attention needs to be paid to the application of trade and investment rules to public services in North America. In this context, EU practice provides one example of an attempt to do so.

[172]European Commission, Commission Proposal for the Modernization of the Treatment of Public Services in EU Trade Agreements, TRADE.B.1/SC/am D(2011) 1146318, 26 October 2011. The Commission proposed that in its future trade agreements, the EU would reserve "the right to adopt or maintain any measure that is not inconsistent with its obligations under Article XVI of the General Agreement on Trade in Services with respect to limiting the number of suppliers through the designation of a monopoly or by conferring exclusive rights to private operators, for services of general economic interest which are subject to specific public service obligations imposed by public authorities on the provider of the service in order to meet certain public interest objectives".

Appendix: NAFTA Annex II Reservations Relevant to Public Services

Country	Sector	Obligations reserved against
Canada	Aboriginal peoples	National Treatment (Articles 1102, 1202)
		Most-Favored-Nation Treatment (Articles 1103, 1203)
		Local Presence (Article 1205)
		Performance Requirements (Article 1106)
		Senior Management and Boards of Directors (Article 1107)
	Air Transport	National Treatment (Article 1102)
		Most-Favored-Nation Treatment (Article 1103)
		Senior Management and Boards of Directors (Article 1107)
Mexico	Postal services	Most-Favored-Nation Treatment (Article 1203)
		Local Presence (Article 1205)
	Energy services	Most-Favored-Nation Treatment (Article 1203)
		Local Presence (Article 1205)
	Rail transport	Most-Favored-Nation Treatment (Article 1203)
		Local Presence (Article 1205)
	Air traffic, navigation and related telecommunications	National Treatment (Articles 1102, 1202)
		Most-Favored-Nation Treatment (Articles 1103, 1203)
		Local Presence (Article 1205)

Country	Sector	Obligations reserved against
All three countries (note the specific terms of these reservations vary by country)	Public law enforcement and correctional services, and the following services to the extent they are social services established or maintained for a public purpose: income security or insurance, social security or insurance, social welfare, public education, public training, health, and child care.	National Treatment (Articles 1102, 1202)
		Local Presence (Article 1205)
		Senior Management and Boards of Directors (Article 1107)
		(Canada and US only)
		Most-Favored-Nation Treatment (Article 1203) (Canada only)
	Marine transport	National Treatment (Articles 1102, 1202)
		Most-Favored-Nation Treatment (Articles 1103, 1203)
		Local Presence (Article 1205)
		Performance Requirements (Article 1106) Canada only
		Senior Management and Boards of Directors (Article 1107) (Canada and US only)
	Socially or economically disadvantaged minorities	National Treatment (Articles 1102, 1202)
		Local Presence (Article 1205)
		Performance Requirements (Article 1106) Canada only
		Senior Management and Boards of Directors (Article 1107) (Canada and US only)
	Telecommunications networks and services	National Treatment (Articles 1102, 1202)
		Most-Favored-Nation Treatment (Articles 1103, 1203)
		Local presence requirements (Article 1205)
		Senior Management and Boards of Directors (Article 1107) (Canada and Mexico only)

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