

**IN THE MATTER OF AN ARBITRATION UNDER CHAPTER ELEVEN OF
THE NORTH AMERICAN FREE TRADE AGREEMENT
AND THE UNCITRAL ARBITRATION RULES**

BETWEEN:

MERRILL & RING FORESTRY L.P.

Claimant/Investor

AND:

GOVERNMENT OF CANADA

Respondent/Party

GOVERNMENT OF CANADA

COUNTER-MEMORIAL

May 13, 2008

Departments of Justice and of
Foreign Affairs
and International Trade
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I. OVERVIEW OF THE CASE

1. Merrill & Ring (“the Investor”) introduces the present arbitration as “a case about governance gone wrong.”¹ It portrays the federal log export regime under which it has operated for the last 10 years as “arbitrary, non-transparent and fundamentally unfair.”² The Investor even goes so far as to indict the log export regime as “inconsistent” with Canada’s “duties to the international community.”³

2. The truth of the matter is that this arbitration deals with a minuscule portion of the Investor’s overall log export business. Ultimately, it is about ■ parcels of logs in the last 10 years. This is the number of parcels advertised by Merrill & Ring on the Federal Bi-Weekly list that were declared non-surplus to British Columbia (“B.C.”) domestic market needs and, therefore, were unavailable for export. The remainder of Merrill & Ring’s ■ log parcels were promptly declared surplus and made available for export under Notice 102⁴ in the last 10 years. The ■ parcels of logs complained about represent a mere ■ of the total number of logs advertised for export by the Investor under the measure at issue - Notice 102.⁵

3. The charges of “basic unfairness”⁶ and the dramatic language used by the Investor in its Memorial are difficult to reconcile with the facts that not only has it operated under Notice 102 for the last 10 years, but it also operated under an almost identical regime from 1986 to 1998 pursuant to Notice 23. It is not credible that the Investor waited until the end of 2006 to file the present arbitration under NAFTA had it truly been suffering the hardship it claims.

¹ Investor’s Memorial, ¶ 1.

² Investor’s Memorial, ¶ 7.

³ Investor’s Memorial, ¶ 4.

⁴ Notice to Exporters, Exports and Permits Act (Serial No. 102), 1 April 1998 (“Notice 102”) (Tab 101).

⁵ In the last 10 years, the Investor has advertised ■ parcels of logs on the Federal Bi-Weekly List: *Korecky Affidavit*, Exhibit 32.

⁶ Investor’s Memorial, ¶ 1.

4. This long waiting period is not only inexplicable but, most importantly, it is fatal to Merrill & Ring's present claim.

5. Article 1116(2) of NAFTA bars claims submitted more than three years after an investor *first* acquired knowledge of breach and loss. Canada received the Investor's Notice of Arbitration on December 27, 2006. As a result, Merrill & Ring's claim is time-barred because it acquired actual or constructive knowledge of the alleged breaches and loss before December 27, 2003.

6. There is overwhelming evidence that Merrill & Ring had actual knowledge of the alleged breaches and loss arising from Notice 102 throughout the decade before it commenced this arbitration. For instance, on April 18, 1998 (*i.e.* a mere two weeks after Notice 102 entered into force), Merrill & Ring's solicitor wrote to the Department of Foreign Affairs and International Trade ("DFAIT") to raise concerns about the new policy. In fact, the issues raised then are the same as those now challenged some 8 years later in the present arbitration. The record demonstrates that Merrill & Ring even knew in 2000 that it could file an arbitration claim under NAFTA Chapter Eleven concerning the same breaches and loss it seeks to adjudicate today.⁷ The Investor took no such action for the next 6 years.

7. The Investor does not contest the unquestionable fact that it had actual knowledge of the alleged breaches and loss well before 2003. Instead, it seeks to avoid the time bar hurdle by asserting that the breach is "continuous." Merrill & Ring's position is not only illogical, it is also impossible to reconcile with the plain words of Article 1116(2). Under the Investor's creative interpretation, the requisite knowledge of breach and loss would begin afresh every day. This means that an investor would not have "first" knowledge of an event *only* the "first" time it occurs, but (strangely enough) *every time* it subsequently recurs. Under this interpretation, an investor would be allowed to commence an

⁷ This is clear from a June 2000 report submitted to DFAIT by the Private Forest Landowners Association ("PFLA"), an association representing B.C. private forest landowners, including Merrill & Ring. The report outlines the PFLA's opposition to Notice 102 and states that Notice 102 is "open to challenge through ... NAFTA Chapter 11." See, "Log Export Restrictions on Private Lands", June 16, 2000, in: *Korecky Affidavit*, ¶ 49, Exhibits 17, 18.

arbitration claim three years after it *last* acquired the requisite knowledge, effectively applying the time bar at the opposite time stated by the NAFTA Parties in Article 1116(2).

8. The present arbitration claim is undeniably time-barred and must, consequently, be dismissed by this Tribunal. Any other conclusion would render Article 1116(2) completely meaningless.

9. On the merits, the Investor attempts to transform this arbitration into a debate on whether the log export control regime is the least trade restrictive option available or whether it is an optimal policy tool. Such discussions are properly left to political fora. The unique expertise of this Tribunal is to determine whether the federal log export control regime complies with Canada's obligations under Chapter Eleven of the NAFTA. Canada will demonstrate that all four NAFTA Chapter Eleven breaches alleged by the Investor are groundless and that Canada fully complied with its NAFTA obligations.

10. First, Merrill & Ring alleges that Notice 102 violates the national treatment standard of Article 1102. To establish a breach of Article 1102, an investor must compare its treatment by the State Party with that accorded by the Party to investors "in like circumstances." In this case, *identical* domestic comparators are available: all owners of federal land that seek to export timber harvested from their land operating under Notice 102. They are subject to the log export regime control in exactly the same way as Merrill & Ring. Because comparison with such companies in identical circumstances would defeat, rather than prove, its claim, Merrill & Ring ignores domestic investors in identical circumstances. Instead, Merrill & Ring invents a "special meaning" for Article 1102 that is contrary to its ordinary meaning and permits comparison with investors who are not in identical circumstances. This is unsustainable on the text of Article 1102, NAFTA case law and common sense.

11. Second, Merrill & Ring raises a claim under Article 1105, the "minimum standard of treatment" clause. Under Article 1105, a violation occurs only if the Investor demonstrates that Canada has breached a rule of customary international law that is recognized as part of the international minimum standard for the treatment of aliens.

Merrill & Ring fails to prove that any of the “obligations” referred to in its Memorial are actually customary legal obligations. In any event, none of the measures complained of by the Investor has reached the high threshold for breach of the customary international law minimum standard of treatment of aliens under Article 1105. The recommendation-making process is transparent, not arbitrary and does not constitute an abuse of rights. The log export regime also does not create an insecure legal and business environment and does not frustrate Merrill & Ring’s legitimate expectations.

12. Third, Merrill & Ring complains that Canada has imposed “performance requirements” in violation of Article 1106. The log export regime does not impose any requirement to achieve a given level of export, to accord a preference to goods produced in Canada, to purchase services from persons in Canada and, finally, does not impose any restriction on the Investor’s sale of goods in Canada.

13. Fourth, Canada will show that Notice 102 has not expropriated Merrill & Ring’s investment. The Investor has not been substantially deprived of its investment. On the contrary, Merrill & Ring has maintained control of its investment at all relevant times while earning substantial profit and exporting almost 100% of the logs it sought to export under the auspices of Notice 102.

14. Finally, the damage claim advanced by Merrill & Ring is based on erroneous and illogical assumptions and is not supported by empirical or other objective evidence. A correct analysis of the Investor’s damage claims results in nominal, or no, losses.

15. For all these reasons, Canada respectfully submits that Merrill & Ring’s claim should be dismissed with costs.

II. FACTS

A. Materials Submitted by Canada

16. Canada's Counter-Memorial is accompanied by a compilation of relevant legal authorities. In addition, Canada submits 8 affidavits in support of its Counter-Memorial:

- **KORECKY AFFIDAVIT:** Judy Korecky is the Deputy Director of the Export Controls Division ("ECD") of DFAIT. Her affidavit outlines the operation of Notice 102 and responds to various points raised by Messrs Stutesman, Schaaf and Kurucz in the Investor's Memorial and in their respective affidavits.
- **COOK AFFIDAVIT:** John Cook is the Export Policy Forester for the British Columbia Ministry of Forests and Range ("BCMoF") as well as the Secretary of the Timber Export Advisory Committee ("TEAC") and the Federal Timber Export Advisory Committee ("FTEAC"). He addresses issues arising out of the B.C. local use and manufacture requirement and its intersection with Notice 102. These include the operation of TEAC/FTEAC, sorting and scaling requirements and minimum and maximum volume requirements.
- **FALKINER AFFIDAVIT:** Michael Falkiner is the Director of Operations for the B.C. Timber Services ("BCTS"). He describes the functions of BCTS which are raised in connection with the national treatment claim.
- **REISMAN AFFIDAVIT:** Professor W. Michael Reisman, the Myres S. McDougal Professor of International Law at Yale University, addresses the time bar in Article 1116(2) of NAFTA.
- **CASHORE AFFIDAVIT:** Professor Benjamin Cashore is a Professor of Political Science, Forestry and Environmental Science at Yale University who reviews policy considerations relevant to log export controls. Professor Cashore also responds to some of the points made on behalf of the Investor by Professor Pearse.
- **REISHUS AFFIDAVIT:** David Reishus, a Ph.D economist specialising in natural resource and international trade regulation, explains the economics of the forestry sector in B.C. and Canada as they relate to Merrill & Ring's claims. He describes the market economics relevant to logs in Coastal B.C. (where Merrill & Ring is located) and compares federal and provincial log export policies. He also provides an economic analysis of the Investor's claims for damages.

- JENDRO AFFIDAVIT: David Jendro, of Jendro and Hart LLC, prepared a commentary on the Mason, Bruce & Girard Report submitted by the Investor. Mr. Jendro is an expert on log and timberland valuation. In particular, Mr. Jendro challenges various of the assumptions in the Mason, Bruce and Girard Report, which are the foundation of the PricewaterhouseCoopers (“PwC”) damage assessment relied on by the Investor.
- BOWIE REPORT: Michael D. Bowie of KPMG LLP reviewed the PwC calculation of the economic losses claimed by Merrill & Ring in this arbitration. He reviews the quantum of damages claimed by the Investor.

B. The Investor – Merrill & Ring Forestry L.P.

17. The claimant in this case is Merrill & Ring Forestry L.P. The Investor is a limited partnership constituted under the laws of the State of Washington. It is headquartered in Port Angeles, on Washington’s Olympic Peninsula.⁸

18. The Investor is a forestry and land management company whose partners hold 75,000 acres of timberland in B.C., western Washington and New Zealand.⁹ Merrill & Ring has owned forestry land in B.C. for more than one hundred years.¹⁰ It owns approximately 7,627 acres of timberland in the Campbell River, Squamish and the Sunshine Coast forest districts in British Columbia.¹¹ Most of this land is regulated by the Canadian federal government with the exception of 584 acres that are regulated by the B.C. provincial government.¹²

19. The Investor harvests second-growth alder, balsam, douglas-fir, hemlock, red cedar and spruce.¹³ Its total B.C. timber inventory for January 2008 was [REDACTED].¹⁴

⁸ Certificate of Limited Partnership of Merrill & Ring Forestry L.P., (Investor’s Schedule of Documents, Tab 1).

⁹ Investor’s Memorial, ¶ 16; See also Merrill & Ring, “Welcome to Merrill & Ring”, online at: <http://www.merrillring.com> (“MR Website – Welcome”) (Tab 89).

¹⁰ Investor’s Memorial, ¶ 17.

¹¹ Investor’s Land and Timber Ownership as of December 31, 2007 (Investor’s Schedule of Documents, Tab 6).

¹² Investor’s Memorial, ¶ 18.

¹³ Investor’s Memorial, ¶ 19.

The primary export markets for the Investor's logs are in the State of Washington, Japan and South Korea. Of its total B.C. harvest, approximately [REDACTED] is sold domestically in Canada, [REDACTED] is exported to the United States, [REDACTED] to Japan and the remaining [REDACTED] to South Korea.¹⁵

C. Canada's Forestry Industry

1. The Fundamentals of Forestry

20. The forestry industry can usefully be organized into three stages: forests; timber harvesting and log production; and processing into primary products.¹⁶

21. Not all forests are commercially viable due to factors such as location, tree size, species distribution, coverage density, costs of harvesting or other environmental restrictions. Forests that have never been logged or were logged so long ago that they have taken on the characteristics of a forest that has never been logged are called "old growth" forests.¹⁷ Previously logged forests that have been replanted or have regenerated are called "second growth" forests.¹⁸ Forests planted with a single or limited variety of species are called "plantation" forests.¹⁹ It can take between 25 and 40 years, or sometimes longer, for trees to grow to a commercially harvestable size.²⁰

22. "Standing" timber refers to uncut trees. Forest owners harvest (cut) the timber themselves, contract out logging and log-handling to third parties, or sell the right to

¹⁴ M & R Canadian Lands Timber Inventory, (Investor's Schedule of Documents, Tab 8).

¹⁵ Investor's Memorial, ¶ 21.

¹⁶ *Reishus Affidavit*, ¶ 20.

¹⁷ *Reishus Affidavit*, ¶ 21.

¹⁸ *Reishus Affidavit*, ¶ 21.

¹⁹ *Reishus Affidavit*, ¶ 21.

²⁰ *Reishus Affidavit*, ¶ 21.

harvest outright.²¹ If the right to harvest is sold, the owner charges a stumpage fee; in return the buyer harvests and takes title to the logs.²²

23. Once harvested, the timber is known as a log. Logs are scaled (*i.e.*, they are measured and possibly graded). Log scaling involves the measurement of each log based on multiple characteristics that assist in making comparisons between logs.²³ Thus, factors such as size, shape and quality are taken into account. Often a sampling is conducted and an average weight is used to scale low-value logs.²⁴ However, higher value logs are piece-scaled (on a log-by-log basis).²⁵

24. Different regions throughout North America employ different scaling systems. Metric and Scribner scaling are relevant in this dispute. All timber harvested in B.C. must be scaled with the B.C. metric scaling policy. This obligation is found in sections 94 and 96 of the B.C. *Forest Act*. The metric system uses top and butt diameters with lengths, allowing for the measurement of the conical shape of logs in cubic meters.²⁶ The Scribner scale measures each log based on the top diameter and set lengths. This assumes the log is a cylinder rather than a cone, and hence is less accurate than the metric system.²⁷ The Scribner scale is used in the Pacific Northwest U.S. and measures logs in “board feet.”²⁸

25. There is no simple way to convert between metric and Scribner measurements because they measure logs in a fundamentally different manner.²⁹

²¹ *Reishus Affidavit*, ¶ 23.

²² *Reishus Affidavit*, ¶ 23.

²³ *Reishus Affidavit*, ¶ 24; *Cook Affidavit*, ¶¶ 65-68.

²⁴ *Reishus Affidavit*, ¶ 24.

²⁵ *Reishus Affidavit*, ¶¶ 26, 44; *Cook Affidavit*, ¶ 68.

²⁶ *Cook Affidavit*, ¶ 67.

²⁷ *Cook Affidavit*, ¶ 70.

²⁸ *Reishus Affidavit*, ¶ 25; *Cook Affidavit*, ¶¶ 70-71, Exhibits 25 & 26.

²⁹ *Reishus Affidavit*, ¶ 25.

26. Logs are also sorted by species, size, quality and other characteristics relevant to the local marketplace. Sorts optimise the value of harvested logs by putting together logs of similar economic characteristics. Apart from the lowest valued sorts, log sorts are not fungible.³⁰

27. Grading differentiates between logs of different economic value. However, even within a particular grade, logs can differ substantially in their economic value. The value of a log ultimately is determined by its various end-uses.³¹ Sorting by species, size, quality and other characteristics groups logs of similar economic value, thus permitting potential buyers to understand the end-uses of a particular log sort. Buyers generally base pricing decisions on inspection of individual log sorts so that they can assess log quality.³²

28. Costs to transport logs vary significantly due to geography and distance from the harvest area to processing facilities. Water transportation is much cheaper than land transportation.³³ Water transportation of logs involves “booming” (*i.e.*, floating logs inside a fence of logs chained together, which can then be towed). Booming is typically used on the B.C. Coast, where sheltered waters are relatively close to the forest lands being harvested.³⁴ Using these waters, logs can economically be transported great distances for sale and processing. Where transport by towboat is not possible, barges are often used.³⁵ Ultimately, logs can also be loaded onto ships for ocean transportation.

29. Land transportation of logs, usually by truck, is expensive relative to the value of the logs. As a result, the cost of land transportation limits the market opportunity for logs.³⁶ For this reason, a number of processing facilities are found scattered throughout

³⁰ *Reishus Affidavit*, ¶ 26.

³¹ *Reishus Affidavit*, ¶ 26.

³² *Reishus Affidavit*, ¶ 26.

³³ *Reishus Affidavit*, ¶ 27.

³⁴ *Reishus Affidavit*, ¶¶ 27, 34.

³⁵ *Reishus Affidavit*, ¶ 27.

³⁶ *Reishus Affidavit*, ¶ 27.

the B.C. Interior, close to the harvested forest areas.³⁷ Logs in the B.C. Interior typically are not transported very far to be sold or processed at a sawmill.

30. Sawmills tend to specialize according to the type of logs they process and therefore the lumber products they produce. Given the relatively high cost of transportation compared to the value of logs, sawmills tend to locate close to harvested forests and the type of logs produced in a given region will dictate the type of sawmill located in that region.³⁸ Again, this is particularly the case in regions such as the B.C. Interior, where transportation costs are relatively high.

31. The three economically most significant products derived from logs are lumber, panel products (plywood and other similar flat wood materials) and pulp and paper.³⁹ Generally speaking, the highest quality softwood logs are used for lumber or veneer production.⁴⁰ Limited amounts of specialty logs of very high value are used in specialty applications. Lower quality logs are chipped into wood chips and ultimately used for pulp and paper.⁴¹

2. The Importance of Forestry to Canada and British Columbia

32. The forestry industry is very important to the Canadian economy. In 2006, this industry contributed CDN \$36.3 billion to Canada's GDP.⁴² In terms of direct employment, the industry accounted for some 294,100 jobs in 2007.⁴³

33. The Canadian forest industry as a whole exported nearly CDN \$33.5 billion worth of goods in 2007.⁴⁴ The vast majority of this, over CDN \$24 billion (or 73.7%), was

³⁷ *Reishus Affidavit*, ¶ 45.

³⁸ *Reishus Affidavit*, ¶ 29.

³⁹ *Reishus Affidavit*, ¶ 28.

⁴⁰ *Reishus Affidavit*, ¶ 28.

⁴¹ *Reishus Affidavit*, ¶ 28.

⁴² Natural Resources Canada, *The State of Canada's Forests*, Annual Report 2007 (Ottawa: Queen's Printer, 2007), at 25 (Tab 102).

⁴³ Natural Resources Canada, "Canada's Forests Statistical Data" online at: <<http://canadaforests.nrcan.gc.ca/statsprofile>> ("*NR Canada – Statistics*"), at 29 (Tab 103).

exported to the United States.⁴⁵ By comparison, only CDN \$2.1 billion was exported to the European Union, CDN \$1.7 billion to China and CDN \$1.5 billion to Japan.⁴⁶

34. Of these exports, pulp and paper products accounted for CDN \$20.1 billion, wood-fabricated materials accounted for CDN \$12.5 billion, while primary wood products were CDN \$0.8 billion.⁴⁷ Of the primary wood products, logs and bolts account for CDN \$406.8 million worth of exports.⁴⁸

35. By contrast, Canada only imported CDN \$10.2 billion of forestry products.⁴⁹ Pulp and paper products account for CDN \$6.7 billion, wood-fabricated materials for CDN \$3.0 billion, while primary wood products account for only CDN \$0.6 billion.⁵⁰

36. The forestry industry is especially significant to the economy of British Columbia.⁵¹

37. In 2006, exports of forest products from B.C. totalled CDN \$13.6 billion.⁵² This represents 41% of the total value of all goods exported from the province.⁵³ The forestry industry contributed CDN \$10 billion or 7.4% to the province's GDP in 2006.⁵⁴ Amongst goods producing industries in B.C., the forestry industry contributed 29% of GDP.⁵⁵

⁴⁴ *NR Canada – Statistics*, at 2 (Tab 103).

⁴⁵ *NR Canada – Statistics*, at 1, 6 (Tab 103).

⁴⁶ *NR Canada – Statistics*, at 6 (Tab 103).

⁴⁷ *NR Canada – Statistics*, at 2, 3 (Tab 103).

⁴⁸ *NR Canada – Statistics*, at 2 (Tab 103).

⁴⁹ *NR Canada – Statistics*, at 4 (Tab 103).

⁵⁰ *NR Canada – Statistics*, at 4 (Tab 103).

⁵¹ British Columbia Ministry of Forests, Economics & Trade Branch, *The State of the British Columbia Forest Industry* (October 2007), at 1 (“*BCMoF – Forests*”) (Tab 13).

⁵² *BCMoF – Forests*, at 1 (Tab 13).

⁵³ *BCMoF – Forests*, at 1 (Tab 13).

⁵⁴ *BCMoF – Forests*, at 1 (Tab 13).

⁵⁵ *BCMoF – Forests*, at 1 (Tab 13).

Estimates by the provincial government have found that forestry accounts for as much as 15% of total economic activity in B.C. when indirect impact is included.⁵⁶

38. Direct employment by the forestry industry in 2006 was 81,600 jobs or 3.7% of total provincial employment.⁵⁷ When indirect and “spin-off” economic activity is accounted for, the forestry industry accounts for as much as 7.1% of total provincial employment.⁵⁸

3. British Columbia: Coast and Interior

39. While roughly 2/3 of B.C.’s 95 million hectare land mass is forested, more than half of its forested territory is either protected or could not sustain a commercial forestry.⁵⁹ This leaves a substantial area of some 25 million hectares of harvestable forests in the province.⁶⁰

40. These forests are divided by the Cascade summit line into two economically and geographically distinct regions. They are the Coast and the Interior regions.⁶¹ The differences between the Coast and the Interior, apart from geography, are due to differences in forest ecosystems (reflected in different species, sizes, end-use, and diversity), harvesting methods, costs of production and transportation. Thus, the processing industries, product mixes, end-markets and economics of these regions also differ.

41. The B.C. Coast is part of the temperate rainforest that stretches along the Pacific coast from California to Alaska.⁶² Forests on the B.C. Coast are old-growth, predominantly hemlock, with some old and second growth douglas fir forests, in

⁵⁶ *BCMoF – Forests*, at 1 (Tab 13).

⁵⁷ *BCMoF – Forests*, at 1 (Tab 13).

⁵⁸ *BCMoF – Forests*, at 1 (Tab 13).

⁵⁹ *Reishus Affidavit*, ¶ 32.

⁶⁰ *Reishus Affidavit*, ¶ 32.

⁶¹ *Reishus Affidavit*, ¶ 33; *Cook Affidavit*, ¶¶ 96-97.

⁶² *Reishus Affidavit*, ¶ 38.

particular in the south.⁶³ Timber harvests consist mainly of hemlock (28%), douglas fir (27%) and western red cedar (20%), which represent $\frac{3}{4}$ of the Coastal harvest.⁶⁴

42. The variability in size, quality and value of logs from the B.C. Coast is much greater than for logs from the Interior. Thus, while some Coastal logs are amongst the highest quality and value in the world, other Coastal logs are suitable only for pulp. This variability is reflected in the categorization, sorting and pricing of logs from the Coast.⁶⁵

43. Due to disparities in quality, value and suitability for particular processes, logs harvested from the B.C. Coast must be sorted into specific sorts for particular processes and markets. With over 40 officially recognized domestic sorts for Coastal wood and further degrees of specialization or re-sorting by buyers and brokers, the process of sorting is integral to sales.⁶⁶

44. The B.C. Coast has also developed its own “over-the-counter” market for logs on the southern Coast, close to processor activity. The Vancouver Log Market (“VLM”) allows loggers to sell their logs and mills to purchase additional logs. Vertically integrated companies also use the VLM to sell logs unsuitable for their own processing facilities. The VLM has significant activity due to the inexpensive water transportation and the concentration of processors in this region.⁶⁷ Arm’s length invoice price information is reported to the B.C. Ministry of Forests (BCMof) which uses this information to identify marketplace values of Coastal logs.⁶⁸

45. The *Coast End Use Sort Descriptions* are used on Coastal trades to assess the full value of logs marketed on the Coast.⁶⁹

⁶³ *Reishus Affidavit*, ¶ 38.

⁶⁴ *Reishus Affidavit*, ¶ 38.

⁶⁵ *Reishus Affidavit*, ¶ 39.

⁶⁶ *Reishus Affidavit*, ¶ 40.

⁶⁷ *Reishus Affidavit*, ¶ 41.

⁶⁸ *Reishus Affidavit*, ¶ 41; *Cook Affidavit* ¶¶ 62-63.

⁶⁹ *Cook Affidavit*, ¶ 55.

46. The forests of Interior B.C. are quite different from the Coast. The Interior forests are drier, and have different species, quality and volumes of trees than the Coast.⁷⁰ The Interior forests are dominated by lodgepole pine (61%) and spruce (18%).⁷¹ These species make up only 2% of Coastal harvests, but represent 79% of Interior harvests.⁷²

47. The Interior also has a more homogenous and lower average quality and size harvest than the Coast.⁷³ This is reflected in how logs are scaled. While logs on the Coast are typically scaled log-by-log, in the Interior logs are typically scaled by weight based on a sample.⁷⁴

48. There is no centralized log market equivalent to the VLM in the Interior due to greater uniformity in log quality and high transportation costs. Instead, logs are commonly hauled from the point of harvest directly to one of the numerous processing facilities located throughout the Interior.⁷⁵

49. Given the differences in the forests in the Interior and on the Coast, it is not surprising that the processing sectors and end-users for both regions also differ.

50. As noted above, logs harvested in the B.C. Interior are transported by truck to nearby mills that are scattered throughout the region's small towns.⁷⁶ These milling centres cater to the types of logs produced locally. The presence of these many processing centres in the B.C. Interior makes transportation by truck economically viable despite the relatively low value and the homogeneity of logs harvested in that region.⁷⁷ Thus, ensuring that processing is nearby is essential to the economic viability of forestry in the B.C. Interior region.

⁷⁰ *Reishus Affidavit*, ¶ 43.

⁷¹ *Reishus Affidavit*, ¶ 43.

⁷² *Reishus Affidavit*, ¶ 43, Figure 4.

⁷³ *Reishus Affidavit*, ¶ 44.

⁷⁴ *Reishus Affidavit*, ¶ 44.

⁷⁵ *Reishus Affidavit*, ¶ 45.

⁷⁶ *Reishus Affidavit*, ¶ 36.

⁷⁷ *Reishus Affidavit*, ¶¶ 36, 45.

51. This is not the case on the B.C. Coast. Logs harvested on the B.C. Coast are transported primarily by water because harvesting occurs close to navigable waterways and due to the limited road systems.⁷⁸ Logs are boomed together into rafts and hauled by tugboat from the harvest areas of the lower two-thirds of Vancouver Island to sort yards, mills or export facilities. Barges are used in areas with less sheltered waters. Due to the lower transportation costs on the Coast, processing facilities tend to be concentrated in the more populous southern areas of the B.C. Coast, in and around Vancouver.

52. In the Interior, sawmills are modern, highly efficient, high volume facilities. Such mills produce studs and dimension lumber that is typically used in North American home construction.⁷⁹ The size of the total harvest in the Interior is three times the size of the total harvest on the Coast.⁸⁰ The Interior ships over 90% of its lumber to the U.S. and another 7% to Japan.⁸¹

53. Processing on the Coast, however, is more diverse. The Coast produces North American structural lumber, large volumes of cedar lumber, specialty cedar products, and lumber designed for other markets, in particular the Japanese-style post-and-beam home construction.⁸² The Coast ships over half of its lumber by volume to the U.S., but less than half by value.⁸³ Japan accounts for about one-third of export shipments from the Coast by value.⁸⁴

54. The wood products available from B.C. are highly sought after internationally. B.C. Coastal logs, in particular, are among the highest quality and most valuable logs in the world.

⁷⁸ *Reishus Affidavit*, ¶ 37.

⁷⁹ *Reishus Affidavit*, ¶ 47.

⁸⁰ *Reishus Affidavit*, ¶ 43.

⁸¹ *Reishus Affidavit*, ¶ 48.

⁸² *Reishus Affidavit*, ¶ 47.

⁸³ *Reishus Affidavit*, ¶ 48.

⁸⁴ *Reishus Affidavit*, ¶ 48.

D. Trade in Logs

55. Canada's log exports are predominately from British Columbia. In terms of value, on average British Columbia exported 78% of Canadian logs between 2000 and 2007.⁸⁵

56. The vast majority of B.C.'s log exports are from the Coast. For the fiscal year ending March 31, 2006, 91.5% of log exports originated from B.C.'s Coast, while only 2.6% of log exports originated from the Southern Interior Forest Region, and 5.9% from the Northern Interior Forest Region. In fact, B.C.'s Coastal region has accounted for a minimum of 87% of that province's log exports since the 1880s.⁸⁶

57. Export volumes tend to be cyclical. Several major factors have contributed to the most recent downturn in the B.C. Coastal log export market. The collapse of the Japanese green hemlock markets for Coastal forest products, the barriers to accessing the U.S. market since 1996, domestic timber harvesting and milling costs that are among the highest in the world, the uneven transition from old-growth to second-growth harvesting and the rapid appreciation of the Canadian dollar since 2003 have all had an effect.⁸⁷

E. The British Columbia Log Export Regime

1. Historical Overview

58. Log export restrictions are common-place around the world where forestry contributes to the achievement of economic, social and environmental goals. Such restraints currently exist in the following countries: the Russian Federation, Bolivia,

⁸⁵ Dumont, Bill & Don Wright, *Generating More Wealth from British Columbia's Log Export Policies, A Review of British Columbia's Log Export Policies*, Report for the British Columbia Minister of Forests and Range, December 2006 ("Dumont"), at 95-97 (Tab 38); *Korecky Affidavit*, ¶ 28, Exhibit 4.

⁸⁶ Ironically, Canada as a whole is a net importer of logs as measured by volume. This is attributable to the large net import of logs by eastern Canada from the U.S. northeast. From 1996 to 2005, Canada's total exports in logs were 29,409,070 m³. In the same period, however, Canada imported more than double the amount of those logs, some 62,755,735 m³. *Dumont*, at 14 (Tab 38).

⁸⁷ *Dumont*, at 32 (Tab 38).

Cameroon, Costa Rica, Ghana, Indonesia, Papua New Guinea, Malaysia, Viet Nam, Cambodia, Thailand, the Philippines and New Zealand.⁸⁸

59. Log export bans and restrictions have also been used since the 1800's in the United States. They are currently maintained in various states across the Pacific Northwestern United States.⁸⁹

60. The Constitution of Canada divides certain legislative responsibilities between the federal and provincial governments. Provinces have exclusive legislative jurisdiction for the management and sale of public lands and the timber and wood thereon (*Constitution Act*, s. 92(5)). However, the federal government has exclusive legislative jurisdiction over international trade and commerce (*Constitution Act*, s. 91(2)).

61. Historically, forest lands in Canada were owned either by the federal or provincial governments. Lands originally owned by the federal government continue to be subject to federal jurisdiction, regardless of whether they were subsequently transferred to private interests. Similarly, lands owned by or transferred to private interests by provincial governments remain subject to provincial jurisdiction.

62. As a colony, B.C. depended heavily on its forest resources for employment of settlers.⁹⁰ British Columbia first restricted the export of logs from provincial Crown lands to within-province use in 1891.⁹¹ Since 1891, logs on provincial Crown land have been subject to a local use or manufacture requirement.

⁸⁸ *Reishus Affidavit*, ¶ 66.

⁸⁹ *Reishus Affidavit*, ¶ 66.

⁹⁰ *Dumont*, at 21 (Tab 38).

⁹¹ *Land Act Amendment Act*, S.B.C. 1891, c.15 (Tab 66).

63. In 1918 the B.C. government formed a Log Export Advisory Committee (“LEAC”) to advise on log export exemptions.⁹² The record shows that Merrill & Ring applied to the LEAC for export exemptions in the 1930s.⁹³

64. The first federal government measure restraining log exports was the *War Measures Act* (“WMA”), which prohibited the export of unmanufactured douglas fir to meet domestic wartime requirements. This prohibition was extended to all species by 1942. These restraints continued after the Second World War, particularly because most exports of logs from B.C. originated from federal land.

65. In 1947, the provisions for log export controls were incorporated into the *Export and Import Permits Act* (“EIPA”).⁹⁴

66. The EIPA gave the then Minister of Industry, Trade and Commerce authority to issue export permits for items of actual and potential strategic importance, including logs. Despite this legislation, logs from land not restricted by the Province continued to provide most of the export volume. Federal export permits were not subject to restrictive review other than total quota volumes. Quotas were increased following the Second World War.

67. In 1969, the federal Minister of Industry, Trade and Commerce drafted a policy to harmonize log export restraints with those in British Columbia. This was requested by the B.C. government. A committee similar to the province’s LEAC was commissioned to give expert advice to the federal Minister and effectively harmonize the federal and provincial processes.⁹⁵ The BCMoF agreed to assist the federal government with the process. Notice 23 formalized this harmonization between the federal government and the Province of British Columbia.

⁹² Shinn, C., *British Columbia Log Export Policy: Historical Review and Analysis*, U.S. Department of Agriculture (1993), at 5 (Tab 127).

⁹³ *Cook Affidavit*, ¶ 10.

⁹⁴ *Dumont*, at 23-24 (Tab 38).

⁹⁵ *Dumont*, at 24-25 (Tab 38); *Korecky Affidavit*, ¶ 31.

2. The Current Regulation of Log Exports from British Columbia

68. Currently the export of logs from B.C. is regulated by both provincial and federal legislation. At the provincial level, log exports are regulated by the B.C. *Forest Act*.⁹⁶ At the federal level, log exports are regulated by Notice 102. Both regulatory regimes include a surplus test prior to authorizing log exports. In addition, all logs exported from Canada require an export permit issued by the federal government pursuant to the EIPA.

a) The Four Categories of Land

69. Land in B.C. was classified into different categories for forestry purposes in the late 19th and early 20th centuries. These categories are still accurate today. The four categories are:

- (1) Federal Land: This refers to private land acquired through Crown grant prior to March 12, 1906. Logs from these lands are subject only to federal regulation, including Notice 102. Although less than 5% of B.C. productive forest land is “federal land,” logs originating from this land account for over 70% of B.C. log exports. This land is generally referred to in the industry as “federal land.”
- (2) Aboriginal Land: Aboriginal affairs, including the control of logs from aboriginal lands, generally fall within the exclusive authority of the federal Department of Indian and Northern Affairs (“INAC”). Like federal land, log exports from these lands are subject to Notice 102.
- (3) Crown Land: (B.C. Government owned). The provincial Crown (government) retains title to this land. Harvesting occurs under a tenure agreement, which is a contract that imposes various obligations on the tenure holder in return for the right to harvest logs on the land and sell the logs. Certain Crown lands and tenure agreements are managed by B.C. Timber Sales (“BCTS”), an organization within the British Columbia Ministry of Forests and Range.

Since 1891, British Columbia has imposed a local use and manufacture requirement on logs cut from provincial Crown lands. These logs must be used or manufactured locally within British Columbia. Over 90% of B.C. productive forest lands belong to the provincial Crown. This land is generally referred to in the industry as “provincial land.”

⁹⁶ British Columbia *Forest Act*, R.S.B.C. 1996, c.157 (“*B.C. Forest Act 1996*”) (Tab 12).

- (4) Private land acquired through Crown tenure granted after March 12, 1906. In 1906, B.C. passed the *Timber Manufacture Act* (the “TMA”),⁹⁷ which extended the policy of local use and manufacture to private land transferred by Crown grant after March 12, 1906. Following the passage of the TMA, Crown grants disposed of the land, but maintained certain rights in the timber – including the right to tax the timber and impose domestic use or manufacture requirements. This land is also generally referred to in the industry as “provincial land.”⁹⁸

70. Canada (the federal government) has exclusive jurisdiction over private land acquired through Crown grant prior to March 12, 1906 known as “federal land.” Logs from timber grown on “federal land,” like most of the Investor’s logs, are subject *only* to federal regulation (Notice 102).

71. British Columbia has jurisdiction over logs harvested from the categories of land referred to above as “provincial land.” Log exports from Canada of timber on “provincial land” are subject to federal export regulation *and* to a provincial local use and manufacture policy regime.

b) Regulation on Provincial Land: B.C. *Forest Act*

72. Section 127 of the B.C. *Forest Act*, requires all “timber” from “provincial land” to be used or manufactured in British Columbia. This is known as the B.C. “local use and manufacture requirement.”⁹⁹

73. Section 128 of the *Forest Act* sets out three exemptions from the provincial local use and manufacture requirement. These exemptions are for:

- i) Timber that is surplus to local manufacturing requirements (the “surplus” exemption);

⁹⁷ *Timber Manufacture Act*, Statutes of British Columbia, 1906, c. 42 in *Cook Affidavit*, Exhibit 1.

⁹⁸ *Korecky Affidavit*, ¶ 11.

⁹⁹ “Timber” is defined in section 1 of the British Columbia *Forest Act 1996* as “trees, whether standing, fallen, living, dead, limbed, bucked, or peeled.” In short, “timber” refers to a standing tree, while a “log” is a tree that has been harvested, s 1, Definitions and interpretation (Tab 12).

- ii) Timber that cannot be processed and/or transported economically by or for a mill in B.C. (the “economic” exemption); and
- iii) Cases where an exemption would prevent the waste of, or improve the utilization of, timber cut on provincial Crown land (the “utilization” exemption).¹⁰⁰

74. The “economic” and “utilization” exemptions are known in the forestry industry as “standing exemptions” or “standing green exemptions.”¹⁰¹

75. The surplus exemption from the local use or manufacture requirement is for logs that are found to be surplus to local manufacturing requirements. The surplus exemption is administered by the BCMoF with the recommendations of the Timber Export Advisory Committee (“TEAC”) through a surplus test procedure. Under the surplus test, logs must be advertised on a “provincial Bi-Weekly List” for 14 days during which log processors can make offers to purchase the advertised logs. The TEAC is a provincial committee of industry experts which provides advice and recommendations to the B.C. provincial government.¹⁰² The TEAC reviews all offers made to determine whether they correspond to the domestic fair market value of the logs. If TEAC finds that the offer reflects fair market value, it will recommend that the BCMoF reject the exemption application. However, if TEAC finds that the offer does not reflect the fair market value, it will recommend that a surplus exemption be granted. Ultimately, the final decision to grant a surplus exemption is taken by the B.C. Minister of Forests and Range. When no offer is made on advertised logs, they are deemed to be surplus and the Minister grants an exemption.¹⁰³

¹⁰⁰ *B.C. Forest Act 1996*, Part 10, ss. 127-128 (Tab 12); see also, *Cook Affidavit*, ¶ 12; *Reishus Affidavit*, ¶ 108.

¹⁰¹ *Cook Affidavit*, ¶ 18; *Dumont*, at 16 (Tab 38).

¹⁰² *Korecky Affidavit*, ¶ 38.

¹⁰³ *Cook Affidavit*, ¶¶ 13-16.

76. When provincial logs are found to be surplus, a fee-in-lieu of manufacture must be paid when applying for a permit from B.C. and before the logs can be removed from the province. The fee-in-lieu for coastal logs is in the amount of 5% to 15% of the domestic value of the log and varies depending on the species and grade of the log. For interior logs, the fee-in-lieu is a flat rate of CDN \$1.00 m³.¹⁰⁴

77. The economic exemption from the local use or manufacture requirement applies when logs cannot be processed economically in the vicinity of the land from which they are produced, and cannot be transported economically to another processing facility in British Columbia. TEAC processes applications for the economic exemption and provides the B.C. government with its recommendations as to whether the logs in question can be harvested economically at current domestic prices, or whether they can only be harvested if international are prices obtained. The exemption is granted by an Order-in-Council (“OIC”) of the B.C. government.¹⁰⁵

78. The economic exemption covers a specific geographic area. This exemption is not based on individual harvests, but is available to anyone operating on provincially regulated lands within the geographic area of the exemption. There are currently seven active economic exemptions in British Columbia. None of the exemptions is for timber located on B.C.’s South Coast, where Merrill & Ring harvests timber. Logs subject to the economic exemption are assessed a fee-in-lieu of local manufacture when a permit to remove the logs from B.C. is applied for.¹⁰⁶

79. The utilization exemption from B.C.’s local use and manufacture requirements applies to prevent waste or improve utilization of timber in B.C. (“utilization exemption”). This exemption is initiated by BCMoF or industry and is used as a forest management tool.¹⁰⁷

¹⁰⁴ *Cook Affidavit*, ¶ 16; *Reishus Affidavit*, ¶ 115.

¹⁰⁵ *Cook Affidavit*, ¶¶ 17-18.

¹⁰⁶ *Cook Affidavit*, ¶¶ 18, 21.

¹⁰⁷ *Cook Affidavit*, ¶ 19.

c) Regulation on Federal land: Notice 102

80. There are approximately 2.1 million hectares of private forestland in B.C. held by more than 20,000 land owners. Most of the private forestland on the Coast is owned by three companies, TimberWest (a Canadian company), Island Timberlands and Merrill & Ring (an American company). These three companies cumulatively exported 96% of Coastal logs originating from B.C. federal land in 2007. All of their exports were subject to the federal surplus test in Notice 102.¹⁰⁸

81. Log wholesalers also purchase logs on the domestic market and export logs under Notice 102.

82. In 2005 to 2006, Coastal log exporters from federal lands that were subject to the federal surplus test in Notice 102 accounted for nearly 60% of the total log exports from British Columbia. The total value of their exports in that year amounted to CDN \$3,051,273.¹⁰⁹

83. The government of Canada first implemented a surplus testing procedure for logs from federally regulated lands proposed for export from B.C. on January 1, 1986 with *Notice to Exporters Serial No. 23* (Notice 23).¹¹⁰ This surplus testing procedure was maintained in the current Notice 102, which has been in force since April 1, 1998.¹¹¹

84. Notice 23 and Notice 102 provide guidance to exporters by setting out the policy and administrative practices used by the Minister of Foreign Affairs (“MFA”) when exercising discretion regarding the export of logs harvested from federal lands in British Columbia.¹¹² The log export control regimes implemented by Notice 23 and Notice 102 are almost identical.¹¹³ The power to provide advice and make recommendations to the

¹⁰⁸ *Korecky Affidavit*, ¶ 68.

¹⁰⁹ *Dumont*, at 99 (Tab 38).

¹¹⁰ *Korecky Affidavit*, ¶ 34.

¹¹¹ *Korecky Affidavit*, ¶ 43, 75.

¹¹² *Korecky Affidavit*, ¶¶ 35, 53.

¹¹³ *Korecky Affidavit*, ¶ 53.

MFA under Notice 102 was continued in a reconstituted Federal Timber Export Advisory Committee (“FTEAC”).¹¹⁴ FTEAC is composed of one representative of the federal government plus 8 to 10 industry members who also sit on TEAC.¹¹⁵ FTEAC members must have “suitable background knowledge of the costs, practicalities and economics of conducting logging operations, and knowledge of the domestic and export log markets.”¹¹⁶ A short list of qualified candidates is created through an informal poll of TEAC membership and Ministry industry contacts. Short-listed candidates are asked whether they are interested in a position, and, if so, their names are forwarded to the BCMoF and DFAIT for final consideration and appointment.¹¹⁷

85. All logs originating from federally regulated lands that are proposed for export must undergo the federal surplus test, which gives domestic purchasers an opportunity to make offers on the logs.¹¹⁸ Logs originating from the B.C. Coast must be harvested before they may be advertised on the Bi-Weekly List,¹¹⁹ but logs originating from the Interior may be advertised either while still standing or after harvest.¹²⁰ The ability to advertise standing timber for logs from the Interior reflects the commercial reality of limited storage space for cut logs in the Interior, the more rapid deterioration of logs stored on dry land, and the shortened harvesting and transport period in the Interior.¹²¹

¹¹⁴ *Korecky Affidavit*, ¶¶ 42, 51. As explained by Ms. Korecky at ¶¶ 38-42 of her affidavit, the reconstitution of FTEAC under Notice 102 addressed the results of the *Evans* case, a domestic administration law ruling..

¹¹⁵ *Cook Affidavit*, ¶ 24.

¹¹⁶ *Cook Affidavit*, ¶ 26, citing TEAC Terms of Reference (Exhibit 17).

¹¹⁷ *Cook Affidavit*, ¶ 27.

¹¹⁸ *Notice 102*, (Tab 101).

¹¹⁹ *Korecky Affidavit*, ¶ 78.

¹²⁰ *Korecky Affidavit*, ¶ 80.

¹²¹ *Korecky Affidavit*, ¶ 82.

86. Those wishing to export logs harvested from federal lands must make an online application to the Export Controls Division (ECD) of the Department of Foreign Affairs and International Trade.¹²²

87. After the application has been reviewed, DFAIT will ask that BCMoF list the logs on the B.C. Federal Bi-Weekly List, which is available on the BCMoF website.¹²³ Advertisement on the Bi-Weekly List gives domestic purchasers the opportunity to place offers on the logs within 14 days of the notification date.¹²⁴

88. Logs advertised on the Bi-Weekly List must meet the volume, sorting and scaling requirements of Notice 102.¹²⁵ Notice 102 requires that logs located in remote areas¹²⁶ be advertised for a minimum volume of 2,800 m³. This requirement does not have to be met if the logs are transported to non-remote established log marketing areas before being advertised.¹²⁷ In addition, applications from any location for log volumes above 15,000 m³ normally will not be considered.¹²⁸

89. Notice 102 requires that logs be sorted to conform to normal log market practices, so that at least 90% of the logs, measured by volume, must be from a single species and recognized domestic end use sort description.¹²⁹ This sorting requirement ensures that parcels of logs are assessed to their maximum potential value.¹³⁰ Notice 102 also requires

¹²² Notice 102, s. 2.1 (Tab 101).

¹²³ *Korecky Affidavit*, ¶ 76.

¹²⁴ Notice 102, s. 2.2 (Tab 101); see also, *Korecky Affidavit*, ¶ 76.

¹²⁵ *Korecky Affidavit*, ¶ 84.

¹²⁶ *Cook Affidavit*, ¶ 76 states that the term “remote areas” is roughly defined as any location that requires an inordinate amount of time or cost to access from the lower mainland. This is generally understood as locations where logs need to be barged, rather than towed, to their destination. See also, *Korecky Affidavit*, ¶ 85.

¹²⁷ Notice 102, s. 1.4 (Tab 101).

¹²⁸ Notice 102, s. 1.4 (Tab 101).

¹²⁹ Notice 102, s. 1.5 (Tab 101).

¹³⁰ *Cook Affidavit*, ¶ 62.

that logs be scaled using the B.C. metric scale; other scaling methods, such as the Scribner Scale, will not be accepted.¹³¹

90. If no offer is made on an advertised parcel, the MFA grants surplus status.¹³²

91. All offers to purchase logs must be made in writing on company letterhead and must be sent to the advertiser, with copies sent to DFAIT.¹³³ Once offers to purchase are made, they cannot be withdrawn unless notice is provided to DFAIT.¹³⁴

92. Some private landowners refer to the term “blockmailing” to denote any offer made on their logs that are being advertised for export. These landowners sometimes object that the offer is not made in good faith.¹³⁵ DFAIT disciplines companies that violate the requirements of Notice 102 and the MFA may grant export permits to advertising companies believed to have been unfairly targeted.¹³⁶

93. Offers made, with the relevant details, are forwarded by DFAIT to FTEAC,¹³⁷ which will only consider valid, complete offers from persons who own or operate log processing facilities.¹³⁸ An offer will be considered invalid if it is made by a company that exported logs within 90 days prior to that offer, if the offer was not received by the deadline specified in the Bi-Weekly List or if the offer’s expiry date precedes the end of the period specified in the Bi-Weekly List.¹³⁹

94. Before reviewing the actual offers to determine whether they are fair, FTEAC reviews the domestic market values of each specific log species and sort to determine its

¹³¹ Notice 102, s. 1.6. (Tab 101); *Cook Affidavit*, ¶¶ 65, 70, 71.

¹³² *Korecky Affidavit*, ¶ 98.

¹³³ Notice 102, s. 2.4 (Tab 101).

¹³⁴ Notice 102, s. 2.4(c)(i) (Tab 101).

¹³⁵ *Korecky Affidavit*, ¶ 96.

¹³⁶ *Korecky Affidavit*, ¶ 97.

¹³⁷ Notice 102, s. 2.4(d) (Tab 101).

¹³⁸ Notice 102, s. 4.3(c) (Tab 101).

¹³⁹ *Korecky Affidavit*, ¶ 118.

current fair market value.¹⁴⁰ FTEAC members use up-to-date market summaries and actual sales data to determine the fair market value of each log species and sort for the B.C. Coast and both the northern and southern B.C. Interior.¹⁴¹

95. FTEAC considers whether each offer is fair based on the domestic market price of logs of similar type and quality, as determined during the market review. When assessing an offer, FTEAC also accounts for other factors such as the location of the logs, transportation costs and weather conditions.¹⁴² Usually, an offer is considered fair if it falls within 5% of the current domestic market price.¹⁴³

96. While this benchmark of 5% is not set out in Notice 102, it has always been shared with industry when explaining FTEAC's consideration of an offer.¹⁴⁴ Ms. Korecky of DFAIT discussed this benchmark with Mr. Stutesman, Vice-President of the Investor.¹⁴⁵ Mr. Kurucz, the Investor's log broker, states that he was advised of this benchmark by John Cook, the Secretary of FTEAC.¹⁴⁶

97. If an offer is considered fair, FTEAC will recommend to DFAIT that the logs be considered not surplus to domestic needs.¹⁴⁷ If an offer is invalid or below fair market value, FTEAC will recommend that the MFA consider it surplus to domestic requirements.

98. Once a surplus letter has been issued, the exporter may apply for an export permit. The export permit is valid for the 120 days from the date of issuance of the surplus letter.¹⁴⁸ An exporter may request an extension to an existing export permit.¹⁴⁹ In 2005,

¹⁴⁰ *Korecky Affidavit*, ¶ 111.

¹⁴¹ *Korecky Affidavit*, ¶ 112.

¹⁴² *Korecky Affidavit*, ¶ 113.

¹⁴³ *Korecky Affidavit*, ¶ 116.

¹⁴⁴ *Korecky Affidavit*, ¶ 117.

¹⁴⁵ *Korecky Affidavit*, ¶ 129.

¹⁴⁶ *Kurucz Affidavit*, ¶ 51.

¹⁴⁷ *Korecky Affidavit*, ¶ 122.

¹⁴⁸ *Korecky Affidavit*, ¶ 159.

the maximum extension period was reduced from 120 days to 30 days from the date of the approval of the extension; repeated extensions were also disallowed, absent extenuating circumstances.¹⁵⁰

99. While the MFA normally agrees with FTEAC's recommendations, the MFA also considers factors other than the FTEAC surplus recommendation when determining whether logs are surplus. These factors include the price of offers, log supply, the interests of log processors in Canada and evidence that a company has been targeted with offers when similar sorts and species are advertised by others.¹⁵¹

100. Exporters can make submissions regarding the fairness of an offer at any time from the date of receipt of the offer until the date that the MFA decides whether the logs are surplus to domestic needs.¹⁵² Any submission made to FTEAC is considered during the fair market value assessment and is also considered by DFAIT with respect to the broader context and other factors.¹⁵³

101. After the MFA has made a decision, the exporter is always entitled to apply for judicial review of that decision by the Federal Court of Canada.¹⁵⁴ The decision of the Federal Court can, in turn, be appealed to the Federal Court of Appeal and, ultimately, to the Supreme Court of Canada with leave of that Court.

102. The Investor has made numerous such submissions to FTEAC and the MFA, although it has not judicially reviewed a decision of the MFA under Notice 102.¹⁵⁵

103. Companies may also initiate legal challenges to the constitutionality of federal measures such as Notice 102. In fact, TimberWest Corporation challenged Notice 102 in

¹⁴⁹ *Notice 102*, s. 4.5 (Tab 101).

¹⁵⁰ *Korecky Affidavit*, ¶ 166.

¹⁵¹ *Korecky Affidavit*, ¶ 152.

¹⁵² *Korecky Affidavit*, ¶ 130.

¹⁵³ *Korecky Affidavit*, ¶ 132.

¹⁵⁴ *Korecky Affidavit*, ¶ 156.

¹⁵⁵ *Korecky Affidavit*, ¶¶ 132-149.

the Federal Court of Canada, claiming that it is *ultra vires* the legislative authority of the federal government. It also claimed that the EIPA does not authorize the establishment of a legislative and administrative scheme applicable to the export of logs from privately owned land in British Columbia.¹⁵⁶ This claim was ultimately unsuccessful.¹⁵⁷

d) Comparison Between Federal and B.C. Regimes

104. Several differences between the federal and provincial regimes should be highlighted for the purpose of this arbitration. First, the B.C. legislation is aimed at ensuring local use and manufacture in the province. On the other hand, Notice 102 ensures that there is an adequate supply and distribution of logs in Canada.

105. Second, the B.C. legislation contains three exemptions from the local use and manufacture requirement. These are the “surplus”, “economic” and “utilization” exemptions.¹⁵⁸ No economic or utilization exemption has been granted for logs on the south Coast of B.C. (where the Investor harvests) since at least 1990. Logs produced on the south Coast of B.C. do not meet the criteria for the economic and utilization exemptions.¹⁵⁹

106. Log exports under the provincial economic and utilization exemptions account for a mere 1.8% of total exports by volume.¹⁶⁰ Even if these logs are exempt from the local use and manufacture requirement, a fee-in-lieu of manufacture must be paid before removing the logs from the province.¹⁶¹ The economic exemption is generally given for lower-quality logs that have expensive transportation costs.¹⁶² Economic exemptions for

¹⁵⁶ *Korecky Affidavit*, ¶ 188.

¹⁵⁷ *Korecky Affidavit*, ¶ 188.

¹⁵⁸ *Cook Affidavit*, ¶ 12.

¹⁵⁹ *Cook Affidavit*, ¶ 22.

¹⁶⁰ *Dumont*, at 17 (Tab 38).

¹⁶¹ *Cook Affidavit*, ¶¶ 16, 18, 21.

¹⁶² *Cook Affidavit*, ¶¶ 12, 18.

a specific geographic area only allow the landowner to export 35% of the logs harvested without further surplus testing.¹⁶³

107. No exemptions are given under Notice 102.

108. Third, B.C. regulations prohibit the removal of yellow and western red cedar logs and high grades of logs (above H grade) of all other species from the province. The federal policy has no species prohibition.¹⁶⁴

109. Fourth, B.C. regulations require payment of a fee-in-lieu of manufacture for all provincial logs removed from the province. This fee varies depending on the type of exemption and whether the log is a coastal or interior log.¹⁶⁵ The federal policy has no such fee.

F. This Arbitration Deals With A Miniscule Percentage of Merrill & Ring's Log Exports

110. Under Notice 102, the percentage of offers received on booms advertised on the Bi-Weekly List is very low compared to the total number of booms advertised. Since DFAIT grants surplus status when no offers have been received, the vast majority of logs advertised are surplus and can be exported from Canada. This is demonstrated by the table below.

111. From April 1, 1998 to March 31, 2008, 38,876 parcels of logs were advertised on the federal Bi-Weekly List.¹⁶⁶ Of these, only 933 domestic offers were received and subsequently considered by FTEAC. This represents only 2.4% of all federal booms advertised during the last 10 years. In other words, as shown in the following table, since the inception of Notice 102 at least 98% of the booms of logs advertised on the Federal

¹⁶³ *Cook Affidavit*, ¶ 18.

¹⁶⁴ *Dumont*, at 4 (Tab 38).

¹⁶⁵ *Cook Affidavit*, ¶¶ 16-18.

¹⁶⁶ *Korecky Affidavit*, ¶ 98, Exhibit 38.

Bi-Weekly lists have been granted surplus status by DFAIT because no offers were received.¹⁶⁷

Number of offers considered by FTEAC compared to the total number of parcels advertised on the Bi-Weekly List (April 1, 1998 to March 31, 2008)¹⁶⁸

Year	Number of parcels advertised from federal lands	Number of federal parcels on which offers were considered by FTEAC
2008 (to March 31)	883	2
2007	4,958	115
2006	5,010	116
2005	5,098	39
2004	4,390	55
2003	4,265	76
2002	3,569	147
2001	3,348	79
2000	3,142	113
1999	2,708	97
1998 (from April 1)	1,505	94
TOTAL	38,876	933

112. The Investor's own experience is not significantly different from that of all other log exporters from federal land in British Columbia. The Investor advertised [REDACTED] parcels of logs on the Bi-Weekly List, between April 1, 1998 and March 31, 2008. [REDACTED] of these parcels received no offers and were immediately deemed surplus and eligible for export. As shown below, during this period, FTEAC considered domestic

¹⁶⁷ *Korecky Affidavit*, ¶ 98.

¹⁶⁸ *Korecky Affidavit*, ¶ 98, Exhibit 38.

offers for only [REDACTED] of those parcels.¹⁶⁹ This represents only [REDACTED] of all logs advertised by the Investor since Notice 102's inception.

Number of offers considered by FTEAC compared to the number of parcels advertised by Merrill & Ring on the Bi-Weekly List (April 1, 1998 to March 31, 2008)¹⁷⁰

Year	Number of Merrill & Ring's parcels advertised	Number of Merrill & Ring's parcels on which offers were considered by FTEAC
2008 (to March 31)	[REDACTED]	[REDACTED]
2007	[REDACTED]	[REDACTED]
2006	[REDACTED]	[REDACTED]
2005	[REDACTED]	[REDACTED]
2004	[REDACTED]	[REDACTED]
2003	[REDACTED]	[REDACTED]
2002	[REDACTED]	[REDACTED]
2001	[REDACTED]	[REDACTED]
2000	[REDACTED]	[REDACTED]
1999	[REDACTED]	[REDACTED]
1998 (from April 1)	[REDACTED]	[REDACTED]
TOTAL	[REDACTED]	[REDACTED]

113. Of the [REDACTED] offers considered by FTEAC in the last ten years, [REDACTED] were declared non-surplus. The remaining [REDACTED] of these offers were declared surplus and therefore eligible for export. This is shown in the following table:

¹⁶⁹ *Korecky Affidavit*, ¶ 146.

¹⁷⁰ *Korecky Affidavit*, ¶ 146, Exhibit 32.

**Number of Merrill & Ring’s parcels for which FTEAC considered offers
then declared non-surplus and surplus
(April 1, 1998 to March 31, 2008)¹⁷¹**

Year	Number of parcels on which offers were considered by FTEAC	Number of parcels declared <u>non-surplus</u>	Number of parcels declared <u>surplus</u>
2008 (to March 31)	█	█	█
2007	█	█	█
2006	█	█	█
2005	█	█	█
2004	█	█	█
2003	█	█	█
2002	█	█	█
2001	█	█	█
2000	█	█	█
1999	█	█	█
1998 (from April 1)	█	█	█
TOTAL	█	█	█

114. This Table demonstrates that █ of the █ offers on the Investor’s parcels considered by FTEAC were declared non-surplus, while █ of offers were in fact declared surplus and therefore available for export.

115. In sum, of the total of █ federal parcels advertised by the Investor over the last 10 years, █ or █ were deemed surplus and therefore available for export. Although the Investor was granted surplus status for █ parcels, the Investor only

¹⁷¹ Korecky Affidavit, Exhibit 32.

applied for export permits for [REDACTED] parcels. In other words, it chose not to export more than [REDACTED] parcels it had permission to export.

116. The only possible conclusion from these statistics is that this Tribunal has been convened to adjudicate a complaint concerning a miniscule percentage of the Investor's log exports.

III. PRINCIPLES OF NAFTA INTERPRETATION

A. NAFTA Investors Have Limited Access to Arbitration

117. The NAFTA is an international treaty between Canada, the United States and Mexico. Each of the States to this treaty assumes obligations toward the others with respect to a range of international trade matters. Chapter Eleven of the NAFTA imposes obligations on the Parties concerning foreign investment. Other chapters address matters including trade in goods, cross-border trade in services, competition policy, the temporary entry of business personnel, and procedures for the review of anti-dumping and countervailing duty orders.

118. As a general matter, only a Party to the NAFTA has the right to enforce the obligations contained therein and to ensure that each other Party complies. Private parties, even if they are nationals of a NAFTA country, do not have such rights.¹⁷² However, certain chapters of the NAFTA create mechanisms through which private parties are granted limited access to international jurisdiction. Chapter Eleven of the NAFTA creates one such mechanism.¹⁷³

119. Chapter Eleven is divided into three Sections: Section A (Investment), Section B (Settlement of Disputes) and Section C (Definitions). Section A sets out the substantive obligations that each Party owes to the other Parties with respect to measures relating to investors and their investments. These obligations apply only with respect to investments made in host NAFTA countries by investors of other NAFTA countries. They do not relate to domestic investments or to cross-border trade.¹⁷⁴

¹⁷² See NAFTA, Arts. 2004, 2018 (allowing only a State-to-State arbitral panel constituted pursuant to Chapter 20 to require compliance with a NAFTA obligation); NAFTA, Art. 2021 (prohibiting the creation of a domestic right of action to enforce NAFTA obligations); see also, Sornarajah, M., *THE INTERNATIONAL LAW ON FOREIGN INVESTMENT*, (Cambridge University Press), 2004 (2d ed.), at 267 (“[investment] treaty provisions operate indirectly in that the obligation relating to the arbitration of the dispute is immediately owed to the foreign investor but its breach creates responsibility to the home state of the foreign investor and not to the foreign investor.”) (“*Sornarajah*”) (Tab 131).

¹⁷³ NAFTA, Art. 1115.

¹⁷⁴ *Canadian Cattlemen for Fair Trade v. United States* (UNCITRAL) Award on Jurisdiction (28 January 2008) ¶ 111 (“[A] careful review of the key provisions of Chapter Eleven in their full context, as

120. Section B provides investors with derivative procedural rights to seek arbitration against a NAFTA Party in limited circumstances. As the Tribunal in *Canadian Cattlemen* recently explained, Section B provides private parties with direct access to international jurisdiction but only for a circumscribed set of breaches.¹⁷⁵

B. Investors Must Meet All Requirements to Bring a Chapter Eleven Arbitration

121. Several provisions of Chapter Eleven itself describe the circumscribed set of breaches for which Section B gives investors access to international jurisdiction. This Tribunal has been constituted pursuant to Section B. As a creature of the NAFTA, it has only the authority granted by the NAFTA. Accordingly, it must operate within the stated limits of its jurisdiction, power and mandate.

122. This Tribunal's subject matter jurisdiction is limited by Article 1101 to "measures adopted or maintained by a Party relating to: (a) investors of another Party; (b) investments of investors of another Party in the territory of the Party; and (c) with respect to Articles 1106 and 1114, all investments in the territory of the Party."

123. Further, pursuant to Articles 1116 and 1117, this Tribunal may only hear claims if the investor alleges that it or its investment has suffered loss or damage as a result of measures in breach of an obligation under Section A, Article 1503(2), or in certain circumstances, Article 1502(3)(a). An investor cannot bring claims through the Chapter Eleven mechanism for violations of another NAFTA chapter, violations of other rules of international law, or violations of private agreements between the investor and a NAFTA Party.¹⁷⁶ As the Tribunal in *Waste Management* explained, "it is always necessary for a

the VCLT requires, demonstrates that the only investors who may avail themselves of the protections of Chapter Eleven ... are actual or prospective foreign investors in another NAFTA party." ("Canadian Cattlemen – Jurisdiction Award") (Tab 18); *Bayview Irrigation District v. Mexico* (ICSID No. ARB(AF)/05/1) Award, 11 June 2007 ¶ 96 ("The ordinary meaning of the text of the relevant provisions of Chapter Eleven is that they are concerned with *foreign* investment, not domestic investments.") (Tab 10).

¹⁷⁵ *Canadian Cattlemen – Jurisdiction Award*, ¶ 42 (Tab 18).

¹⁷⁶ *Waste Management Inc. v. Mexico* (ICSID No. ARB(AF)00/3) Award, 30 April 2004, ¶ 73 ("Waste Management II – Award") (Tab 157).

claimant to assert as its cause of action a claim founded in one of the substantive provisions of NAFTA referred to in Articles 1116 and 1117.”¹⁷⁷

124. Articles 1116(2) and 1117(2) are temporal limits on jurisdiction, requiring that an investor make a claim within three years from the date on which the investor *first* acquired knowledge of the alleged breach and loss therefrom. As explained later in these submissions, Canada maintains that this case is entirely time barred pursuant to Article 1116(2). Additionally, an investor seeking to access international jurisdiction pursuant to Section B must meet all of the procedural conditions precedent to submitting a dispute to arbitration. Articles 1119 to 1121 of the NAFTA describe these conditions.

125. If, and only if, *all* of these requirements have been met can this Tribunal treat Section B of Chapter Eleven of the NAFTA as constituting Canada’s consent to arbitration with the Investor. International law does not give an investor the benefit of the doubt with respect to the existence of a state’s consent to arbitration.¹⁷⁸ Rather, the investor bears the burden of proving that “the requirements of Article 1101 are fulfilled, that a claim has been brought by a claimant investor in accordance with Article 1116 or 1117, and that all preconditions and formalities under Articles 1118-1121 are fulfilled.”¹⁷⁹ Unless the investor can prove that all of the requirements have been satisfied, this Tribunal lacks the authority to hear its claims.

126. The Investor must also prove the merit of its claims. Article 24(1) of the UNCITRAL Arbitration Rules incorporates this as a general rule. It provides that, “[E]ach party shall have the burden of proving the facts relied on to support his claim or defence.” To meet this burden the Investor must present persuasive evidence and legal

¹⁷⁷ *Waste Management II – Award*, ¶ 73 (Tab 157).

¹⁷⁸ *Fireman’s Fund Insurance Company v. Mexico* (ICSID No. ARB(AF)/02/1) Decision on the Preliminary Question, 17 July 2003, ¶ 64 (Tab 52).

¹⁷⁹ *Canfor Corporation v. United States; Tembec et al. v. United States and Terminal Forest Products Ltd. v. United States* (Consolidated UNCITRAL) Decision on Preliminary Question, 6 June 2006, ¶ 176 (“*Canfor – Preliminary Question*”) (Tab 20); *United Parcel Service v. Canada*, (UNCITRAL), Award on Merits and Dissenting Opinion, 24 May 2007, ¶ 120 (Tab 144); *ADF Group Inc. v. United States* (ICSID No. ARB (AF)/00/1) Final Award, 6 January 2003, ¶ 185 (“*ADF – Award*”) (Tab 2).

argument to demonstrate that its claims are within the jurisdiction of this Tribunal, timely and that Canada's actions were inconsistent with NAFTA Articles 1102, 1105, 1106 and 1110. The Investor must also prove that the damages claimed flow from the breaches alleged and are reasonable and accurate. As the Tribunal in *Thunderbird* explained, it is "the party alleging a violation of international law giving rise to international responsibility [that] has the burden of proving its assertion."¹⁸⁰

C. The Tribunal Decides on the Basis of Applicable Law

127. In considering whether the Investor has met its burdens, this Tribunal must "decide the issues in dispute in accordance with this Agreement and applicable rules of international law... [and any] interpretation by the [Free Trade Commission]."¹⁸¹ It has no power to decide issues based on any other law. In particular, it has no authority to decide matters *ex aequo et bono*.

128. In addition to applying the text of the NAFTA, Article 1131 requires this Tribunal to apply "the applicable rules of international law." These rules consist in part of the rules of treaty interpretation described below. However, other general rules of international law, including the rules concerning state responsibility, are also potentially applicable. These rules cannot replace or modify the specific rules in the NAFTA. Indeed, the NAFTA is *lex specialis* between the parties and, as such, the generally applicable rules of international law cannot override or displace its provisions. Such rules can only apply as a residual and supplementary matter.¹⁸²

129. Article 1131 of the NAFTA also requires this Tribunal to apply any interpretation of the NAFTA issued by the Free Trade Commission (the "FTC"). Article 1131(2) provides that "[a]n interpretation by the [Free Trade Commission] of a provision of [the

¹⁸⁰ *International Thunderbird Gaming Corporation v. Mexico* (UNCITRAL) Arbitral Award, 26 January 2006, ¶ 95 ("*Thunderbird – Award*") (Tab 136); see also, *United States – Measure Affecting Imports of Woven Wool Shirts and Blouses from India*, Report of the Appellate Body, WT/DS33/AB/R and Corr.1, adopted 23 May 1997, at 14, 16 (Tab 85).

¹⁸¹ NAFTA, Art. 1131(1) and (2).

¹⁸² *UPS – Award*, ¶¶ 55, 59 (Tab 144).

NAFTA] shall be binding on a Tribunal established under this [Section B of Chapter Eleven.]” The FTC issued such binding *Notes of Interpretation of Certain Chapter Eleven Provisions* on July 31, 2001.¹⁸³ These *Notes* addressed the procedures for obtaining access to documents, and provided a binding interpretation of Article 1105 of the NAFTA. NAFTA tribunals have consistently found the *FTC Notes* to be binding.¹⁸⁴

D. NAFTA Is Interpreted Pursuant to the Vienna Convention on the Law of Treaties

130. To apply the NAFTA to a dispute, this Tribunal must first interpret the Agreement. Article 102 of the NAFTA provides that the NAFTA’s provisions are to be interpreted and applied “in accordance with applicable rules of international law.” Article 38(1) of the *Statute of the International Court of Justice* (“*ICJ Statute*”) identifies the sources for applicable rules of international law.¹⁸⁵ The primary sources are applicable treaties, customary international law, and “the general principles of law recognized by civilized nations.”¹⁸⁶ A subsidiary source is “judicial decisions and the teachings of the most highly qualified publicists.”¹⁸⁷

131. The rules of international law applicable to NAFTA disputes include the rules of interpretation codified in Articles 31 and 32 of the *Vienna Convention on the Law of Treaties* (“*Vienna Convention*”).¹⁸⁸ Articles 31 and 32 of the *Vienna Convention* provide as follows:

¹⁸³ NAFTA Free Trade Commission, *Notes of Interpretation of Certain Chapter Eleven Provisions*, 31 July 2001, online at <http://www.international.gc.ca/trade-agreements-accords-commerciaux/disp-diff/nafta-interpr.aspx?lang=en> (Tab 92).

¹⁸⁴ See e.g., *Thunderbird – Award*, ¶ 192 (Tab 136); *Mondev International Ltd. v. United States* (ICSID No. ARB(AF)/99/2) Award, 11 October 2002 (“*Mondev – Award*”) ¶¶ 121-125 (Tab 87); *ADF – Award*, ¶¶ 176-178 (Tab 2); *Methanex Corp. v. United States*, (UNCITRAL) Final Award of the Tribunal on Jurisdiction and the Merits, 3 August 2005, Part IV, Ch. C, ¶ 20 (“*Methanex – Award*”) (Tab 85).

¹⁸⁵ *Methanex – Award* Part II, Ch. B, ¶ 3 (Tab 85); *Thunderbird – Award*, ¶¶ 89-90 (Tab 136).

¹⁸⁶ *Statute of the International Court of Justice*, Art. 38(1)(a)-(c). (“*ICJ Statute*”) (Tab 59).

¹⁸⁷ *ICJ Statute*, at Art. 38(1)(d) (Tab 59).

¹⁸⁸ *Vienna Convention on the Law of Treaties*, 23 May 1969, Can. T.S. 1980 No. 37 (also published at 1155 U.N.T.S. 331, (1969) 8 ILM 679), Arts. 31-32 (“*Vienna Convention*”) (Tab 155); see

Article 31
General rule of interpretation

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

2. The context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes:

(a) any agreement relating to the treaty which was made between all the parties in connection with the conclusion of the treaty;

(b) any instrument which was made by one or more parties in connection with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty.

3. There shall be taken into account, together with the context:

(a) any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions;

(b) any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation;

(c) any relevant rules of international law applicable in the relations between the parties.

4. A special meaning shall be given to a term if it is established that the parties so intended.

Article 32
Supplementary means of interpretation

Recourse may be had to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of article 31, or to determine the meaning when the interpretation according to article 31:

(a) leaves the meaning ambiguous or obscure; or

also *Thunderbird – Award*, ¶ 91 (Tab 136); *Ethyl Corporation v. Canada* (UNCITRAL) Decision on Jurisdiction, 24 June 1988, ¶ 55 (Tab 45); *Methanex – Award*, Part II, Ch. B, ¶ 15. (Tab 85).

(b) leads to a result which is manifestly absurd or unreasonable.

132. NAFTA tribunals uniformly accept that the interpretive rules in Articles 31 and 32 are part of customary international law, and apply to disputes under the NAFTA.¹⁸⁹

1. Article 31 Describes the Primary Means of Interpreting the NAFTA

133. Article 31(1) of the *Vienna Convention* requires this Tribunal to interpret the NAFTA “in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.”¹⁹⁰

134. The starting point for interpreting any provision of the NAFTA is therefore the ordinary meaning of the text itself. As the NAFTA Tribunal in *ADF* recently explained, “the rules of interpretation found in customary international law enjoin us to focus first on the actual language of the provision being construed.”¹⁹¹ This approach is generally accepted by all bodies applying international law. For example, the ICJ has stated that “interpretation must be based above all on the text of the treaty.”¹⁹² Similarly, the Appellate Body of the WTO has explained that, pursuant to the *Vienna Convention*, “the task of interpreting a treaty provision must begin with the specific words of that provision.”¹⁹³

¹⁸⁹ *Methanex – Award*, Part IV, Ch. B, ¶ 29 (Tab 85); *Fireman's Fund Insurance Company v. Mexico* (ICSID No. ARB(AF)/02/1) Award, 14 July 2006, ¶ 136 (“*Fireman's Fund – Award*”) (Tab 51); *Canfor – Preliminary Question*, ¶ 177 (Tab 20); *S.D. Myers Inc. v. Canada*, (UNCITRAL), First Partial Award, 13 November 2000 ¶¶ 200-202 (“*S.D. Myers First Partial Award*”) (Tab 120); *Pope & Talbot, Inc v. Canada* (UNCITRAL) Interim Award, 26 June 2000, ¶¶ 64-69 (“*Pope & Talbot – Interim Award*”) (Tab 112).

¹⁹⁰ *Vienna Convention*, Arts. 31-32 (Tab 155).

¹⁹¹ *ADF – Award*, ¶ 147 (Tab 2).

¹⁹² *Territorial Dispute (Libyan Arab Jamahiriya/Chad)* (1994 I.C.J. Reports 6) Judgment, 3 February 1994, at 37 (Tab 135).

¹⁹³ *United States – Continued Dumping and Subsidy Offset Act of 2000*, Report of the Appellate Body, WT/DS217/AB/R, WT/DS234/AB/R, adopted 27 January 2003, at Section VIII.B, ¶ 1 (Tab 151); see also, *Japan – Taxes on Alcoholic Beverages*, Report of the Appellate Body, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, adopted 1 November 1996, at 12 (Tab 62).

135. The text of any provision of the NAFTA must also be interpreted in the appropriate context. While the text of each provision in the NAFTA is the primary source for identifying the ordinary meaning of the words therein,¹⁹⁴ the context of any provision is usually broader. Indeed, each provision must be interpreted in the context of the entire NAFTA. Thus, in interpreting the NAFTA, this Tribunal must:

read all applicable provisions . . . in a way that gives meaning to all of them, harmoniously. An important corollary of this principle is that [the NAFTA] should be interpreted as a whole, and, in particular, its sections and parts should be read as a whole.¹⁹⁵

136. Accordingly, the context of any particular provision of the NAFTA includes all of the other provisions of the NAFTA as well as the preamble and annexes to the agreement.¹⁹⁶ The context of each provision also includes the structure of the provision, the Chapter in which it is contained and the NAFTA as a whole.¹⁹⁷

137. The text of the NAFTA must also be interpreted in light of the object and purpose of the Agreement.¹⁹⁸ In a Chapter Eleven dispute, the Preamble of the NAFTA and Article 102 provide this Tribunal with an appropriate starting point for understanding the object and purpose of the NAFTA.¹⁹⁹

138. To illustrate, as the Preamble makes clear, the NAFTA represents a balance struck by the Parties between promoting trade and economic development while protecting the

¹⁹⁴ *ADF – Award*, ¶ 147 (Tab 2).

¹⁹⁵ *Korea – Definitive Safeguard Measure on Imports of Certain Dairy Products*, Report of the Appellate Body, WT/DS98/AB/R, adopted 12 January 2000 ¶ 29 (Tab 65); *ADF – Award*, ¶ 147 (“[A NAFTA] provision under examination must of course be scrutinized in context; but that context is constituted chiefly by the other relevant provisions of NAFTA”) (Tab 2); *Canfor – Preliminary Question*, ¶ 183 (interpreting the NAFTA as a series of “special agreements . . . would fail to capture a significant part of the NAFTA”) (Tab 20); *Methanex – Award*, Part IV, Ch. B. ¶¶ 30-37 (interpreting Article 1102’s term “like circumstances” by contrasting it with the use of “like goods” in other NAFTA Chapters) (Tab 85).

¹⁹⁶ *Vienna Convention*, Art. 31(2) (Tab 155).

¹⁹⁷ *Canfor – Preliminary Question*, ¶ 122 (“Article 1901(3) can be properly understood only within the context of the structure of Chapter Nineteen as a whole.”) (Tab 20).

¹⁹⁸ *Vienna Convention*, Article 31 (Tab 155); see also NAFTA, Article 102.

¹⁹⁹ *S.D. Myers – First Partial Award*, ¶ 196 (Tab 120).

public interest and welfare.²⁰⁰ For example, while the Parties intended to “ensure a predictable commercial framework for business planning and investment,” they also desired to “preserve their flexibility to safeguard the public welfare; promote sustainable development; strengthen the development and enforcement of environmental laws and regulations; and protect, enhance and enforce basic workers’ rights.”²⁰¹ Importantly, the NAFTA was not intended by the Parties to be a one-sided agreement favouring only commercial interests.

139. NAFTA tribunals have adopted this understanding of the object and purpose of the NAFTA, and applied it in their interpretation of the Treaty’s provisions. In *Waste Management II*, the Tribunal noted that NAFTA does not provide an insurance policy against business risk, nor does it protect investors from the ordinary disappointments of business operations.²⁰² Simply put, the NAFTA does not mandate that every regulatory action of the government inure to the benefit of the investor or that the investor will never be disappointed in its dealings with public authorities.²⁰³ The NAFTA Tribunal in *GAMI* summarized this by noting that the NAFTA does not “constitute[s] a guarantee of economic success.”²⁰⁴

140. NAFTA tribunals have also cautioned against using statements as to the object and purpose of the treaty as anything more than an interpretive tool. In *ADF*, the Tribunal explained that the general provisions stating the object and purpose of the NAFTA “may frequently cast light on a specific interpretive issue; but [are] not to be

²⁰⁰ See e.g., *S.D. Myers – First Partial Award*, ¶¶ 196, 220 (Tab 120); see also, *United States – Import Prohibition of Certain Shrimp and Shrimp Products*, Report of the Appellate Body, WT/DS58/AB/R, adopted 6 November 1998, ¶ 14 (Tab 152).

²⁰¹ NAFTA, Preamble.

²⁰² *Waste Management II – Award*, ¶ 160 (“It is not the function of Article 1110 to compensate for failed business ventures...”) (Tab 157); see also, *Fireman’s Fund – Award*, ¶¶ 179-84 (Tab 51).

²⁰³ *Azinian, Davitian, & Baca v. Mexico* (ICSID No. ARB (AF)/97/2) Award, 18 October 1999 ¶ 83 (“It is a fact of life everywhere that individuals may be disappointed in their dealings with public authorities...NAFTA was not intended to provide foreign investors with blanket protection from this kind of disappointment, and nothing in its terms so provides.”) (“*Azinian – Award*”) (Tab 7).

²⁰⁴ *GAMI Investments, Inc. v. Mexico* (UNCITRAL) Final Award, 15 November 2004, ¶ 85 (“No one has suggested that NAFTA entitles an investor to act on the basis that a regulatory scheme constitutes a guarantee of economic success.”) (“*GAMI – Award*”) (Tab 54).

regarded as overriding and superseding the [text].”²⁰⁵ This rule is also made clear by the text of Article 102, which provides that the objectives of the NAFTA are “elaborated more specifically through its principles and rules.”

141. As a result, in interpreting the NAFTA, this Tribunal must be careful to avoid adding terms to or deleting terms from the NAFTA. “[T]he principles of treaty interpretation set out in Article 31 of the *Vienna Convention*... neither require nor condone the imputation into a treaty of words that are not there or the importation into a treaty of concepts that were not intended.”²⁰⁶

2. Article 32 Describes Supplementary Means of Interpretation

142. Pursuant to Article 32 of the *Vienna Convention*, if interpreting a NAFTA provision in accordance with Article 31 leads to a result which is ambiguous or obscure, or leads to a manifestly absurd or unreasonable conclusion, then, and only then, may a tribunal turn to supplementary interpretive material. Article 32 of the *Vienna Convention* provides that supplementary material is limited to “the preparatory work of the treaty and the circumstances of its conclusion.”²⁰⁷

143. In light of Article 32, NAFTA tribunals have turned to such supplementary material only in limited circumstances. As the Tribunal in *Methanex* cautioned, “the text of the treaty is deemed to be the authentic expression of the intentions of the parties; and its elucidation, rather than wide-ranging searches for the supposed intentions of the parties, is the proper object of interpretation.”²⁰⁸ Similarly, NAFTA tribunals have

²⁰⁵ *ADF – Award*, ¶ 147 (Tab 2).

²⁰⁶ *India – Patent Protection for Pharmaceutical and Agricultural Chemical Products*, Report of the Appellate Body, WT/DS50/AB/R, adopted 16 January 1998, ¶ 45 (Tab 61); see also, *Methanex – Award*, Part IV, Ch. B, ¶ 37 (“Article 1102 is to be read on its own terms and not as if the words “any like, directly competitive or substitutable goods” appeared in it.”) (Tab 85); *European Communities – Anti-Dumping Duties on Imports of Cotton-Type Bed Linen from India – Recourse to Article 21.5 of the DSU by India*, Report of the Appellate Body, WT/DS141/AB/RW, adopted 24 April 2003, at 57 (refusing to use Article 9.4 of the *Anti-Dumping Agreement* to interpret Article 3 because it would require reading words into the Article that were not there) (Tab 41).

²⁰⁷ *Vienna Convention*, Art. 32 (Tab 155).

²⁰⁸ *Methanex – Award*, Part II, Ch. B, ¶ 22 (Tab 85).

concluded that the relevance of supplementary means of interpretation declines where there has been a series of decisions on a given provision by international tribunals or where the treaty parties have agreed upon the appropriate interpretation of a provision.²⁰⁹ All these rules of interpretation apply to this Tribunal's consideration of its jurisdiction and the merits of Merrill & Ring's claims.

²⁰⁹ *Methanex – Award*, Part II, Ch. H, ¶ 24 (Tab 85).

IV. JURISDICTION

A. The Investor's Claim Is Time Barred by Article 1116(2)

1. Summary of Canada's Position

144. Article 1116(2) of NAFTA bars claims made more than three years after the investor *first* acquired knowledge of breach and loss. There is overwhelming evidence that Merrill & Ring had such knowledge for almost a decade, and certainly well more than three years, before it commenced this arbitration.

145. Merrill & Ring tries to evade the time bar by arguing that an investor cannot acquire the requisite knowledge for as long as the log export regime is operative (“continuing” breach). In addition, the Investor argues that each routine application of the regime in the most recent three years is a distinct measure in breach of NAFTA (“non-continuing” breach). These theories contradict the ordinary meaning of Article 1116(2), and cannot override the “*lex specialis*” time bar drafted by the NAFTA Parties.

146. This claim is clearly and entirely time barred. The Tribunal should dismiss it without further consideration of the substantive obligations pleaded.

2. Interpretation of Article 1116(2)

147. Article 1116(2) limits the time within which investors may commence a claim under Chapter Eleven. It states,

An investor may not make a claim if more than three years have elapsed from the date on which the investor first acquired, or should have first acquired, knowledge of the alleged breach and knowledge that the investor has incurred loss or damage.

148. Article 1117(2) is the same as Article 1116(2), but with respect to claims by investors of a Party on behalf of an enterprise.

a) The Ordinary Meaning Is Clear

149. The wording of Article 1116(2) is abundantly clear. As Professor Reisman notes in his expert report filed in these proceedings,

It takes great effort to misunderstand Article 1116(2). It establishes that the challenge of the compatibility of the measure must be made within three years of *first* acquiring (i) knowledge of the measure and (ii) that the measure carries economic cost for those subject to it. If the challenge is not made within those three years, it is time-barred.²¹⁰

150. While perhaps obvious, “first” means “earliest in occurrence, existence.”²¹¹ It identifies the start of a period or event, and not the middle or end of a continuing situation. Professor Reisman summarises this well when he notes, “an investor does not and logically cannot “*first* acquire” knowledge of the allegedly incompatible measure that constitutes the challenged “breach” *repeatedly*.”²¹²

151. The inclusion of “first” to modify the phrase “acquired knowledge” in Article 1116(2) was a deliberate drafting choice intended to mark the beginning of the time when knowledge of breach and loss existed. The provision must be applied as ordinarily understood and plainly drafted.

b) The Context Confirms the Ordinary Meaning

152. The context for Article 1116(2) confirms that it is an absolute time bar, calculated from the moment the investor first acquires knowledge of breach and loss. Four aspects of context should be highlighted.

(1) Article 1116(2) Defines the Scope of the Right to Claim

153. Article 1116 creates an extraordinary right: the right of an investor to sue a State for breach of a treaty obligation causing loss to that investor. Absent this express

²¹⁰ *Reisman Affidavit*, ¶ 28; see generally *Reisman Affidavit* ¶¶ 27-31.

²¹¹ *Shorter Oxford English Dictionary*, 5th ed. (Oxford University Press, 2002), at 965 (“*Shorter Oxford*”) (Tab 128).

²¹² *Reisman Affidavit*, ¶ 29.

language, investors would not have recourse to the treaty and would have to persuade their governments to espouse their claim in State-to-State proceedings.²¹³

154. Article 1116(1) carefully defines the circumstances under which the extraordinary right to arbitrate breach of a NAFTA obligation accrues to an individual investor.

155. It is no accident that Article 1116(2) directly follows conferral of the right to commence investor-State arbitration in Article 1116(1). Article 1116(2) is part of the definition of that right, prescribing its scope by virtue of when it may be exercised. The language of Article 1116(2), and in particular the inclusion of “first” in this context, clearly and intentionally limits the scope of the right to arbitrate and defines the time within which that right must be exercised.²¹⁴

**(2) Compliance With the Time Bar in Article
1116(2) as a Condition Precedent to Canada’s
Consent to Arbitrate**

156. Article 1116(2) is also one of several jurisdictional pre-conditions to a Chapter Eleven claim. Article 1121 is titled “Conditions Precedent to Submission of a Claim to Arbitration,” and allows a disputing investor to submit a claim under Article 1116 “only if” the investor consents to arbitration “in accordance with the procedures in this Agreement.”²¹⁵ Article 1122 of NAFTA conditions the advance consent to arbitrate given by the State-Parties on compliance with these conditions.²¹⁶ Investors must fulfill Articles 1101 and 1116 to 1121 to take advantage of the State-Party’s advance consent.

157. As explained by the *Methanex* Tribunal,

²¹³ Dolzer, Rudolf & Christoph H. Schreuer, *PRINCIPLES OF INTERNATIONAL INVESTMENT LAW* (Oxford University Press, 2007) at 211-216: “In the absence of an agreement to the contrary, an investment dispute would normally have to be settled by the host state’s courts.” (at 214) (Tab 37).

²¹⁴ *Reisman Affidavit*, ¶ 27 (“Article 1116(2) sets forth a clear period of repose...directed at the investor...is a limitation on the *right of the investor* to bring a claim under Chapter 11...”).

²¹⁵ Article 1121(1)(a) of NAFTA.

²¹⁶ Article 1122(1) provides, “[E]ach Party consents to the submission of a claim to arbitration in accordance with the procedures set out in this Agreement.”

In order to establish the necessary consent to arbitration, it is sufficient to show (i) that Chapter 11 applies in the first place, i.e. that the requirements of Article 1101 are met, and (ii) that a claim has been brought by a claimant investor in accordance with Articles 1116 or 1117 (and that all pre-conditions and formalities required under Articles 1118-1121 are satisfied). Where these requirements are met by a claimant, Article 1122 is satisfied; and the NAFTA Party's consent to arbitration is established.²¹⁷

158. Compliance with the time bar in Article 1116(2) is one of the pre-conditions to Canada's consent to arbitrate, and must be applied in accordance with its ordinary meaning to establish Chapter Eleven jurisdiction.

(3) The NAFTA Parties Used Deliberate Language for Time Frames in Dispute Settlement

159. A comparison of Article 1116(2) with other timing provisions in NAFTA further demonstrates its very specific meaning. Various provisions in Chapter Eleven establish times within which investor-State dispute settlement must be commenced or a step in dispute settlement must be taken. Generally, the NAFTA Parties inserted temporal conditions in an article by using phrases such as "within," "at least" or "no later than."²¹⁸ No other article in NAFTA adopts the formula in Articles 1116(2) and 1117(2) of counting time from a date on which an investor "first" acquired knowledge.²¹⁹ Nor does

²¹⁷ *Methanex – Award* (7 August 2002), ¶ 120 (Tab 85).

²¹⁸ See for example, Article 1119(1) requiring delivery of a notice of intent "at least 90 days" before submitting a claim; Article 1120 allowing submission of a claim "provided six months have elapsed"; Article 1124 allowing Secretary-General appointments of tribunal members if a tribunal has not been constituted "within 90 days" of submission of a claim; Article 1126(5) and (11) requiring steps to be taken "within" 15 or 60 days of a prior step in consolidation; Article 1127(1) requiring notice of a claim to be given "no later than 30 days after" submission of a claim; Article 1132 requiring Free Trade Commission interpretations "within 60 days" of a request; and Article 1136(3)(a)(i) and 1136(3)(b)(i) requiring that 120 days and three months respectively "have elapsed" from the date an award was rendered. In addition, Article 1137 states that a claim is submitted to ICSID arbitration when it has been received by the Secretary-General of ICSID and is submitted to UNCITRAL arbitration when it is received by the disputing Party.

²¹⁹ Only Article 1118 uses "first" in connection with a temporal condition, by requiring disputing parties to "first" attempt to settle a claim through consultation before commencing dispute settlement. This use of the word "first" is consistent with its ordinary meaning, discussed above, in that a disputing party is expected to attempt resolution of a grievance when it initially becomes aware of it, rather than after commencing arbitration.

any provision on dispute settlement in other chapters of NAFTA impose a time limit in the same manner as Articles 1116(2) and 1117(2).

160. The formula in Article 1116(2) was a precise one intended to pinpoint the moment of first acquiring knowledge and to bar claims made more than three years after that time.

(4) The NAFTA Parties Anticipated Claims for Continuing Conduct and Designed the Time Bar Accordingly

161. The NAFTA Parties obviously contemplated that investors would challenge on-going or continuing measures. Article 1101 authorises investors to make Chapter Eleven claims based on continuing measures when it defines the scope and coverage of the chapter by reference to “measures adopted or maintained.”²²⁰

162. Similarly, various substantive obligations envisage claims concerning on-going measures. For example, Article 1105(2) provides for non-discriminatory treatment by measures a Party “adopts or maintains” relating to losses owing to armed conflict or civil strife. Article 1108(1), (2) and (3) addresses non-conforming measures “maintained” by a Party. Article 1113 allows a Party to deny benefits as a result of measures it “adopts or maintains,” while Article 1114 states that nothing in Chapter Eleven prevents a Party

²²⁰ Article 1101 is entitled “Scope and Coverage” and provides:

1. This Chapter applies to measures adopted or maintained by a Party relating to:
 - (a) investors of another Party;
 - (b) investments of investors of another Party in the territory of the Party; and
 - (c) with respect to Articles 1106 and 1114, all investments in the territory of the Party.
2. A Party has the right to perform exclusively the economic activities set out in Annex III and to refuse to permit the establishment of investment in such activities.
3. This Chapter does not apply to measures adopted or maintained by a Party to the extent that they are covered by Chapter Fourteen (Financial Services).
4. Nothing in this Chapter 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 that is not inconsistent with this Chapter.

from “adopting, maintaining or enforcing” a measure to ensure investment activity is sensitive to environmental concerns.

163. Article 1116 itself demonstrates that the NAFTA Parties anticipated claims for conduct that was continuing at the commencement of an arbitration. Article 1116(1) uses the past tense, allowing claims that the Party “has breached” an obligation and the investor “has incurred” loss due to the breach. Article 1116(2) prohibits an investor from claiming if more than three years “have elapsed.” No provision of the NAFTA even suggests that a measure must be finalised or spent to be the subject of an investor claim.

164. Knowing that continuing conduct would be challenged by investors, the NAFTA Parties must be assumed to have addressed the precise moment at which the time bar for such claims would apply. That time was counted from the “first” acquisition of relevant knowledge, not subsequent, repeated or ultimate acquisition of such knowledge.

165. Had the NAFTA Parties been willing to delay the time bar for continuing measures in the fashion suggested by the Investor, they would not have used the phrase “first acquire.” It is only logical to conclude that the NAFTA Parties designed Chapter Eleven to permit claims for continuing measures while ensuring that such claims be asserted within a reasonable time. That reasonable time is clearly stated as three years after “first” acquisition of the relevant knowledge.

c) The Ordinary Meaning Enhances Effective Dispute Settlement

166. The object and purpose of Article 1116(2) is consistent with one of the listed objectives of NAFTA: to create effective procedures for the resolution of disputes.²²¹ This article enhances the effective resolution of disputes by ensuring that claims are raised as soon as the investor has the information needed to do so. It ensures that relevant

²²¹ NAFTA Article 102, entitled “Objectives” provides, “The objectives of this Agreement, as elaborated more specifically through its principles and rule...are to: ... (e) create effective procedures for the implementation and application of this Agreement, for its joint administration and for the resolution of disputes; ...”.

evidence will be available and that allegations of non-compliance with NAFTA will be addressed rather than allowed to linger.

167. Article 1116(2) serves the usual purposes of a limitation period.²²² First, it provides peace and repose by ensuring that an alleged breach of NAFTA Chapter Eleven is raised and arbitrated at the earliest reasonable opportunity. This allows the NAFTA Parties to address an allegedly non-compliant measure, or to adjudicate the matter and have its compliance with NAFTA determined by a Tribunal. If non-compliant, the NAFTA Party can take steps to cure, amend or repeal the measure. In turn, this creates certainty and stability for NAFTA Parties and investors.

168. Evidentiary concerns are also addressed by Article 1116(2). Requiring investors to raise claims when first known to them allows the disputing parties to collect relevant evidence. This may include testimony of witnesses or production of documents that might otherwise be lost with the passage of time. In turn, this contributes to a fair investor-State dispute settlement process.

169. Economic and public interest considerations are likewise fulfilled by Article 1116(2). Investment will be encouraged by providing investors with certainty about the legality of existing regulatory regimes. Allowing long-standing regimes to be challenged for decades after they have been in operation, in particular by entities that have operated for lengthy periods under these very regimes, can only contribute to uncertainty.²²³

170. The Investor's interpretation of Article 1116(2) defeats the object and purpose of the time bar. It would allow potential claims to languish for decades; deprive State Parties of the opportunity to establish compliance with NAFTA or remedy a violation of NAFTA; deprive investors of confidence that a long-standing regime is not perpetually subject to challenge; and prejudice fair adjudication of a claim. The Investor's approach

²²² Mew, Graeme, *THE LAW OF LIMITATIONS*, 2d. ed. (LexisNexis, 2004) at 12-13 (Tab 86). Mew, cited in part by the Investor, states that time bars generally serve four broad purposes: (1) peace and repose; (2) evidentiary concerns; (3) economic and public interest considerations, and (4) judgmental reasons. The Investor only comments on two of the four purposes of time bars explained by Mew.

²²³ *Reisman Affidavit*, ¶¶ 32-37.

renders Article 1116(2) ineffective by allowing an investor to sit on its hands notwithstanding that it has all the knowledge needed to pursue a claim.

171. Professor Reisman also comments on the implications of the Investor's theory. In his view:

...[it] would lead to a torrent of investor-state arbitral claims. It would also make a mockery of good faith interpretation of NAFTA Article 1116(2)...[if] the 1998 policy regime established by *Notice 102* constitutes a "continuing violation" that may be challenged under Chapter 11, then it is difficult to see what laws and regulations that predated NAFTA would *not* be subject to challenge.²²⁴

172. The Investor's approach to Article 1116(2) is antithetical to the object and purpose of that provision and must be rejected.

d) Supplementary Sources Confirm Canada's Position

173. A Tribunal need not refer to supplementary sources if the meaning of a provision is clear from interpretation according to Article 31 of the *Vienna Convention*. However, Article 32 of the *Vienna Convention*²²⁵ permits resort to supplementary sources if necessary to confirm the interpretation under Article 31.²²⁶ Canada submits that in this case there is no need to refer to secondary sources. In any event, the supplementary sources on point confirm the interpretation of Article 1116(2) urged by Canada.

²²⁴ *Reisman Affidavit*, ¶¶ 36-37.

²²⁵ The conditions justifying resort to supplementary sources are set out in Article 32 of the *Vienna Convention* (Tab 155), entitled "Supplementary means of interpretation" and which provides,

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

²²⁶ See also, *Grand River Enterprises Six Nations, Ltd. v. United States* (UNCITRAL) Decision on Objections to Jurisdiction, 20 July 2006 ("*Grand River – Jurisdiction Decision*") ¶ 35 (Tab 57), reciting supplementary sources confirming the interpretation of NAFTA Article 1116(2) but not apparently placing substantial reliance on these.

174. The first relevant supplementary source is the NAFTA negotiating texts. The first NAFTA draft containing a limitation period was proposed by Canada on June 4, 1992. It read,

[A]n investor is not entitled to initiate arbitration ...if...(b) more than two years have elapsed since the date on which the investor first acquired, or should have first acquired, knowledge of the alleged breach that is at issue in the dispute.²²⁷

175. The provision was revised on August 4, 1992 to read,

An investor shall not be entitled to submit an investment dispute to arbitration if more than three years have elapsed since the date on which the investor first acquired, or should have first acquired, knowledge of the alleged breach and knowledge that it incurred loss or damage.²²⁸

176. At 1:30 a.m. on September 4, 1992, the text was altered minimally so that “shall” became “may” and “investment dispute” became “claim.”²²⁹ At 1:30 (likely p.m.) on the same day, the provision was replaced by the language used in the earlier August 4, 1992 text.²³⁰ A final revision at 6 p.m. on September 4, 1992 changed the text to its current form.²³¹

²²⁷ Article XX07.4(4)(b), NAFTA Negotiating Text, “Virginia Composite Investment” 4 June 1992, found at <http://www.international.gc.ca/assets/trade-agreements-accords-commerciaux/pdfs/11-June041992.pdf> (Tab 93).

²²⁸ Article 2124, NAFTA Negotiating Text, “Watergate Daily Update Investment” 4 August 1992, found at <http://www.international.gc.ca/assets/trade-agreements-accords-commerciaux/pdfs/16-August041992.pdf> (Tab 94).

²²⁹ Article 1116(2) NAFTA Negotiating Text, “Investment Chapter Section B Settlement of Disputes Between a Party and An Investor of Another Party” 4 September 1992, 1:30 a.m., found at <http://www.international.gc.ca/assets/trade-agreements-accords-commerciaux/pdfs/28-September041992.pdf>. found at <http://www.international.gc.ca/assets/trade-agreements-accords-commerciaux/pdfs/27-September041992.pdf> (Tab 95).

²³⁰ Article 1119, NAFTA Negotiating Text, “Lawyers Revision Investment” 4 September 1992 (6:00), found at <http://www.international.gc.ca/assets/trade-agreements-accords-commerciaux/pdfs/26-September041992.pdf> (Tab 96).

²³¹ Article 1116(2), NAFTA Negotiating Text, “Lawyers Revision Investment” 4 September 1992 (1:30), found at <http://www.international.gc.ca/assets/trade-agreements-accords-commerciaux/pdfs/27-September041992.pdf> (Tab 97).

177. These drafts establish that the Parties consistently retained the words “first acquired knowledge,” showing that they intended a provision that did not allow an investor to delay commencing its claim once it had the requisite knowledge to do so. The Investor’s approach here is inconsistent with this intention.

178. The other potentially relevant supplementary sources are the Canadian and American implementation statements. In commenting on Articles 1116 and 1117, the American Statement of Administrative Action simply states, “[A]ll claims must be brought within three years.”²³² This evidences the American view that the continuing nature of a measure does not affect the time for commencing an arbitration. The Canadian Statement of Implementation repeats Article 1116(2), with the exception of noting that knowledge of “a” loss is required.²³³

3. The Evidence Overwhelmingly Shows that Merrill & Ring Knew of the Breach and Loss Well Before December 2003

179. Article 1116(2) means that Merrill & Ring could not commence this arbitration more than three years after the date on which it first acquired, or should have first acquired, knowledge of the alleged breach and knowledge that it had incurred loss or damage.

180. Canada received the Notice of Arbitration in this case on December 27, 2006. As a result, Merrill & Ring’s claim must be time barred if it acquired actual or constructive knowledge of the alleged breach and loss before December 27, 2003.²³⁴ The evidence overwhelmingly establishes that it had actual (and constructive) knowledge of the breach and loss well before December 27, 2003.

²³² *NAFTA Implementation Act*, Statement of Administrative Action, (Public Law 103-182, 107 Stat. 2057), Article 1102, at 146 (“U.S. – Statement of Administrative Action”) (Tab 150).

²³³ Canada, Department of Foreign Affairs, *Statement on Implementation: North American Free Trade Agreement*, vol. 128, no. 1, (Ottawa: Canada Gazette, 1994), at 153 (“Canadian Statement”) (Tab 19).

²³⁴ This proposition and these dates are not disputed by the Investor: Investor’s Memorial, ¶ 452.

a) Actual Knowledge Is a Question of Fact

181. The existence of actual knowledge of breach and loss is a question of fact.²³⁵ There can be no doubt in this case that the Investor had actual knowledge of the breaches alleged and the loss arising therefrom well before December 27, 2003.

(1) The Record Proves Actual Knowledge of Breach

182. There is a lengthy and clear paper trail demonstrating that Merrill & Ring had ample knowledge of the alleged breach and loss at issue in this arbitration at all times from before the inception of Notice 102 in 1998 to the present day.

183. In fact, DFAIT specifically consulted Merrill & Ring before Notice 102 came into effect. In January 1997, DFAIT sent Merrill & Ring a copy of proposed Notice 102 as part of its regulatory consultation process. The letter advised that procedures under Notice 23 were being amended and attached a draft of what became Notice 102 in April 1998.²³⁶

184. On January 24, 1997, the solicitor for Merrill & Ring acknowledged receipt of the draft revised notice and reiterated its view that the regulatory regime was fundamentally flawed. This letter complains specifically about abusive bid practices and blockmailing (breaches alleged in this arbitration) and their impact on Merrill & Ring's profit and loss (damage alleged in this arbitration).²³⁷ That same month, DFAIT officials visited Merrill & Ring in Vancouver to explain the procedures under Notice 102.²³⁸

185. On January 30, 1997, Mr. Schaaf, the Vice-President of Merrill & Ring and an affiant in these proceedings, wrote DFAIT reiterating his demand that DFAIT "drop this trade restrictive policy immediately." In that letter, Mr. Schaaf makes specific demands that are the subject of this arbitration, including: a demand to be given the factors and

²³⁵ *Grand River – Jurisdiction Decision*, ¶ 54 (Tab 57).

²³⁶ *Korecky Affidavit*, ¶ 45, Exhibit 10.

²³⁷ *Korecky Affidavit*, ¶ 45, Exhibit 11.

²³⁸ *Korecky Affidavit*, ¶ 46.

criteria considered by DFAIT in making a decision; proof of evidence and anecdotal information considered by FTEAC and TEAC; an opportunity to comment and provide further information to FTEAC and DFAIT; and an opportunity for appeal of the FTEAC process. Mr. Schaaf asserts that the policy “amounts to a subsidy by land owners to British Columbia sawmills,” and “is discriminatory in that it applies to British Columbia and not the other provinces,” accusations that are at the heart of the alleged violation of Articles 1102 and 1105 in this arbitration. Mr. Schaaf comments on losses caused by the policy, noting that blockmailing requires Merrill & Ring to make “below market trade-offs” and that Merrill & Ring cannot gain the best price for its products.²³⁹

186. Notice 102 was issued on April 1, 1998 and has applied continuously to the Investor since that date.²⁴⁰ Canada sent the Investor a copy of Notice 102 in April 1998 and the then Deputy Director for export controls at DFAIT spent the afternoon of April 1, 1998 with officers of Merrill & Ring discussing the effect of Notice 102 on its operations.²⁴¹

187. On April 7, 1998, Mr. Stutesman, a Vice-President of Merrill & Ring and an affiant for the Investor in these proceedings, sent a letter to DFAIT acknowledging his company’s discussion of Notice 102 with DFAIT officials. This letter reiterates industry concerns about the policy, and asks for the names of TEAC members, their positions in industry and the results of advertisements in 1998.²⁴²

188. On April 13, 1998, Mr. Schaaf wrote to DFAIT to raise Merrill & Ring’s concerns about the operation of Notice 102 and its predecessor, Notice 23.²⁴³ In that letter, Mr. Schaaf argues that TEAC members have a conflict of interest and offers his

²³⁹ *Korecky Affidavit*, ¶ 46, Exhibit 12.

²⁴⁰ *Korecky Affidavit*, ¶ 43; Investor’s Memorial ¶ 95. The charts at ¶¶ 110-115 of this Counter-Memorial demonstrate the application of Notice 102 to Merrill & Ring since April 1998.

²⁴¹ *Korecky Affidavit*, ¶ 47.

²⁴² *Korecky Affidavit*, ¶ 47, Exhibit 14.

²⁴³ *Korecky Affidavit*, Exhibit 15.

proposal for approval of “standing green” exemptions on federal land. These issues are also central to the allegations of breach of Article 1102 and 1105 in this arbitration.

189. On April 18, 1998, the solicitor for Merrill & Ring sent a follow up letter to DFAIT again acknowledging receipt of Notice 102. Among the concerns raised in this letter are “blockmailing”; price-fixing by purchasers; a discriminatory process; conflict of interest of TEAC members; the inability of exporters to attend TEAC meetings or make direct submissions to it; the lack of a standing timber exemption; and the effect of Notice 102 on planning and economic decisions – the very issues challenged eight years later in the Notice of Arbitration in this case. This letter concludes with the following warning to DFAIT on behalf of Merrill & Ring,

If the abuses continue, then clearly the new system will be shown to be new in name only. Our clients and other exporters will be closely monitoring and documenting the process in order to make a fair determination in that regard.²⁴⁴

190. In practice, Merrill & Ring has operated under Notice 102 since April 1998. DFAIT first applied Notice 102 to Merrill & Ring in mid-April 1998, when it determined that three log booms were not surplus to domestic needs and hence not eligible for export permits.²⁴⁵ DFAIT sent Merrill & Ring a letter recording its decision under Notice 102. Similar correspondence was sent each time thereafter when logs were not deemed surplus to domestic needs.²⁴⁶ Every time logs were deemed surplus to domestic needs, DFAIT sent a “surplus letter” to this effect.²⁴⁷

²⁴⁴ *Korecky Affidavit*, ¶ 48, Exhibit 16.

²⁴⁵ *Statement of Defence*, ¶ 49.

²⁴⁶ *Korecky Affidavit*, ¶ 154.

²⁴⁷ *Korecky Affidavit*, ¶ 154.

191. The Korecky Affidavit documents the Investor's operations under Notice 102 since April 1998, showing repeated applications by Merrill & Ring under Notice 102 every year.²⁴⁸

192. Since April 1998, senior officers of Merrill & Ring have sent numerous letters to DFAIT complaining about specific aspects of Notice 102 and its effect on Merrill & Ring's operations in Canada.²⁴⁹ For example, in 1999 the Investor wrote DFAIT complaining about cancellation of the Bi-Weekly Advertisement List.²⁵⁰ It also discussed the availability of standing timber exemptions with DFAIT.²⁵¹

193. Merrill & Ring contacted DFAIT regularly regarding concerns about specific applications governed by Notice 102. Merrill & Ring contacts DFAIT and the MFA concerning Notice 102 more than any other company advertising on the federal Bi-Weekly List.²⁵² There is a lengthy history of communication between Merrill and DFAIT between April 1998 and the present, examples of which are attached to the Korecky Affidavit.²⁵³

194. Merrill & Ring also had actual knowledge of Notice 102 through its membership in the Private Forest Landowners Association ("PFLA"). The PFLA is an association representing private forest landowners in British Columbia. Merrill & Ring and its expert witness in this arbitration, Professor Pearse, are private forest landowners in British Columbia and members of the PFLA.²⁵⁴

²⁴⁸ *Korecky Affidavit*, ¶ 124 lists the dates of Merrill & Ring's permit applications and the results of each at Exhibit 32 of her affidavit. Notably such applications span the full period of April 1998 to the present.

²⁴⁹ *Korecky Affidavit*, ¶¶ 47-49, 127.

²⁵⁰ *Stutesman Affidavit*, ¶ 16.

²⁵¹ *Stutesman Affidavit*, ¶ 18.

²⁵² *Korecky Affidavit*, ¶ 132.

²⁵³ *Korecky Affidavit*, Exhibits 14-16, 43-45, 49, 51-53, 55-57.

²⁵⁴ *Korecky Affidavit*, ¶¶ 49-50; *Cook Affidavit*, ¶¶ 99-100.

195. On June 16, 2000, the PFLA submitted a report to DFAIT entitled “Log Export Restrictions on Private Lands.” The report outlines the PFLA’s opposition to Notice 102 and states that Notice 102 is “open to challenge through...NAFTA Chapter 11.”²⁵⁵ On the next page, the report reiterates PFLA’s position, concluding that “B.C.’s private landowners are prepared to seek the same treatment as other Canadians from the federal government through such measures as ...Chapter 11 challenge under NAFTA.”²⁵⁶ It is therefore clear that not only did Merrill & Ring first have actual knowledge about the breach and loss alleged well before 2000, it even had actual knowledge of its ability to arbitrate its complaints under NAFTA Chapter Eleven by mid-June 2000.

196. Finally, proof that Merrill & Ring had knowledge of the breach and loss alleged are found throughout its materials filed in this arbitration. Generally, Merrill & Ring acknowledges that the Canadian federal government regulates most of its land and that it has been subject to Notice 102 since April 1998.²⁵⁷ In its memorial and affidavits, Merrill & Ring details how Notice 102 has affected its operations, its impact on corporate strategy and harvest plans, and corporate efforts to maximise profits given the regulatory regime imposed by Notice 102 since 1998.²⁵⁸

197. It is undeniable that Merrill & Ring had actual knowledge of the alleged breaches of NAFTA and alleged loss flowing from those breaches before December 2003. By 2000, Merrill & Ring even had knowledge of its ability to bring these complaints before a NAFTA Chapter Eleven tribunal. Nonetheless, it waited six more years before commencing this arbitration.

²⁵⁵ *Korecky Affidavit*, Exhibit 17, Section 2.0.

²⁵⁶ *Korecky Affidavit*, Exhibit 17, Section 3.0.

²⁵⁷ *Stutesman Affidavit*, ¶ 5.

²⁵⁸ *Schaaf Affidavit*, ¶¶ 24-41.

(2) The Investor Admits Actual Knowledge of Loss

198. Under NAFTA, it is sufficient to prove that the investor had knowledge of loss generally arising from the breach; an exact calculation of loss is not required.²⁵⁹

199. In his affidavit Merrill & Ring's Vice-President, Mr. Schaaf, clearly admits that the Investor always knew exactly what losses it was incurring when selling in British Columbia. He states,

We sell logs from non-Canadian sources into the U.S. and Asian markets on a regular basis. These logs are the same species and grades as our Canadian logs. Based on our experience selling in other markets, *we know exactly what the international market value of our BC logs is, and we know exactly how much loss we incur by being forced to sell our logs at suppressed BC prices.*²⁶⁰

200. In any event, it is also clear that the Investor had actual knowledge of the price it obtained for each domestic and export sale, and therefore knew the difference between these for each transaction. Likewise, the Investor knows how much it pays for staff and contracted services, and therefore had actual knowledge of loss arising from the alleged breach.

b) Constructive Knowledge May Be Imputed

201. Even if the Investor did not have actual knowledge of the breach and loss, it is sufficient that it have constructive knowledge of the breach and loss. Constructive knowledge is imputed to an investor "if by exercise of reasonable care or diligence, the person would have known of that fact."²⁶¹

202. Companies investing significant sums in a foreign jurisdiction ought to have made reasonable inquiries about relevant operating requirements such as Notice 102 and its

²⁵⁹ *Grand River – Jurisdiction Decision*, ¶ 73 (Tab 57); *Mondev – Award*, ¶ 87 (Tab 87); *Reisman Affidavit*, ¶ 60.

²⁶⁰ *Schaaf Affidavit*, ¶ 32 [Emphasis added].

²⁶¹ *Grand River – Jurisdiction Decision*, ¶ 59 and generally ¶¶ 58-71 (Tab 57).

impact on log exports from British Columbia.²⁶² In these circumstances, knowledge of breach and loss can be imputed to them.

(1) Knowledge of Breach Can Be Imputed to Merrill & Ring

203. Merrill & Ring is a sophisticated participant in the B.C. logging industry with substantial operations in Canada and abroad. It is the “longest standing investor(s) in the ownership of private forest lands in B.C.” and one of the top three exporters under Notice 102.²⁶³ It maintains detailed annual plans for species and harvesting locations and more general and strategic long-term plans.²⁶⁴ It offers clients from “all over the world” a variety of speciality and standardized products. There is no doubt that awareness of Notice 102 would be vital to a reasonable investor in the position of Merrill & Ring.

204. Merrill & Ring acknowledges that “Notice 102 has been continuously in effect since April 1, 1998.”²⁶⁵ It has been publicly available since 1998. It has also been the subject of public controversy and debate.²⁶⁶ Knowledge of Notice 102 and its practical application at all relevant times must therefore be imputed to Merrill & Ring.

(2) Knowledge of Loss Can Also Be Imputed to Merrill & Ring

205. As a sophisticated, long-term player in the B.C. log export market, Merrill & Ring must be assumed to know the cost of the regulatory requirements governing it. Specifically, it must be assumed that Merrill & Ring knows the price it receives for domestic and export sales of logs and the cost of services it hires to process those logs.

²⁶² As noted in *Grand River – Jurisdiction Decision*, ¶ 66 (Tab 57), “...parties intending to participate in a field of economic activity in a foreign jurisdiction, and to invest substantial funds and efforts to do so, ought to have made reasonable inquiries about legal requirements potentially impacting on their activities... This is particularly the case in a field that the prospective investors know from years of past personal experience to be highly regulated...”

²⁶³ *Schaaf Affidavit*, ¶ 7 and generally ¶¶ 7-9, 17-22.

²⁶⁴ *Schaaf Affidavit*, ¶ 18, and generally ¶¶ 6-23.

²⁶⁵ Investor’s Memorial, ¶ 95.

²⁶⁶ *Pearse Affidavit*, ¶¶ 1, 20.

As a participant in this industry, Merrill & Ring must also be assumed to know and follow publicly available pricing information. As a result, it is reasonable to impute to Merrill & Ring knowledge of the loss caused by the alleged breaches of NAFTA each time that Notice 102 was applied to it between April 1998 and the present day.

206. The evidence overwhelmingly demonstrates that Merrill & Ring had both actual and constructive knowledge about the measure that it now seeks to arbitrate and about the extent of losses stemming from that measure. The evidence is equally overwhelming that Merrill & Ring had such knowledge since well before December 2003. Article 1116(2) applies in these circumstances and bars Merrill & Ring from pursuing this claim. It should be dismissed without further consideration of the substantive allegations.

4. The Investor's Interpretation of Time Bar Is Wrong in Law

207. The Investor never denies that it had actual knowledge of the breach alleged and loss well before 2003. Instead, it seeks to avoid the clearly applicable time bar by asserting that the breach is continuous and so the requisite knowledge of breach and loss begin afresh every day, either restarting the time clock each day or not even triggering the three-year clock until the end of the continuing measure.²⁶⁷

208. In addition, the Investor labels each routine and usual application of the continuing measure within three years of commencing its claim as a “non-continuing,” or new, measure and hence also not time barred.

209. The facts demonstrate that this assertion is pure fiction. From a legal perspective, Merrill & Ring's approach is ill-founded and cannot override the clear *lex specialis* in Article 1116(2).

²⁶⁷ Investor's Memorial, ¶¶ 434-482 and in particular ¶¶ 452-456, 471-482.

a) The “Continuing Measure” Theory Cannot Save This Claim

210. The Investor lists four categories of continuing measure in this case. These four categories list every aspect of the measure challenged in the claim and hence, in reality, the Investor classifies its entire claim as a continuing measure.²⁶⁸

211. The Investor’s argument that a continuing measure cannot be time barred until it is concluded gives no meaning to the word “first” and is impossible to reconcile with the plain words of Article 1116(2). The Investor twists the ordinary meaning of “first” into something that happens continuously and is “first” every time it recurs. This is illogical: an event can be first only once, and not every time it repeats.

212. The wording of Article 1116(2) makes continuation of the challenged measure immaterial to application of the time bar. Whether a measure continues or ends is irrelevant to the operation of the NAFTA time bar because calculation of the three-year period has already been triggered by first knowledge of breach and loss.

213. The practical application of the Investor’s interpretation of Article 1116(2) is perverse: it allows an investor to commence a claim when it *last* acquired the requisite knowledge, effectively applying the time bar at the opposite time stated by the drafters. Applied to this case, the Investor’s theory means that Merrill & Ring would not be required to commence its Chapter Eleven case until three years after the repeal of Notice 102, no matter how long it has had the information needed to commence an arbitration.

214. The Investor’s approach to Article 1116(2) converts what is a clear treaty prohibition on commencement of an arbitration into a mere three year cap on damages if breach is found.²⁶⁹ This also defies the ordinary meaning of the article.

²⁶⁸ Investor’s Memorial, ¶ 435. Ironically, every measure is classified as both continuing and non-continuing: compare ¶¶ 435 & 436, and see chart below at ¶ 256.

²⁶⁹ Damages are addressed in Article 1135 and 1110(2) (for expropriation), and of course, there is no three year cap on damage.

215. Nor does the Investor's approach make sense from a policy perspective. The Investor's use of continuing measures to postpone the Article 1116(2) time bar is fundamentally inequitable: it allows an investor to "sit on their hands," potentially for decades, notwithstanding that it has all the information needed to initiate an arbitration. The NAFTA Parties did not draft a provision that allows for this kind of gamesmanship, which undermines the certainty and stability that is fundamental to promoting investment.²⁷⁰

b) Article 1116(2) Is *Lex Specialis* and Applies On Its Own Terms

216. The Investor relies on customary international law, and in particular human rights cases, to support its theory of continuing breach. Resort to customary international law ignores the *lex specialis* provided by Article 1116(2). In any event, the Investor misunderstands the concept of continuing breach at customary international law and inappropriately borrows the theory of continuing breach from international human rights law.

(1) Article 1116(2) Is *Lex Specialis*

217. Limitation provisions are well known in the domestic law of the Investor²⁷¹ and Respondent.²⁷² The situation is slightly different at international law where there may be no prescribed time limit. In this circumstance the international law doctrine of extinctive

²⁷⁰ *Reisman Affidavit*, ¶¶ 36-37.

²⁷¹ See, for example: *Yakus v. U.S.*, 321 U.S. 414, 444 (1944) (Tab 163) ("[N]o procedural principle is more familiar than even a constitutional right may be forfeited in criminal as well as civil cases by failure to make timely assertion of the right. . . .", citing *O'Neil v. State of Vermont*, 144 U.S. 323, 331 (1892), (Tab 104); *Barbour v. State of Georgia*, 249 U.S. 454, 460 (1919) (Tab 9); *Whitney v. People of State of California*, 274 U.S. 357, 360, 362, 380 (1926)) (Tab 162). See also, *Grand River – Jurisdiction Decision*, ¶ 33 (Tab 57).

²⁷² See for example, *Corpex (1977) Inc. v. Canada*, [1982] 2 S.C.R. 643, varied [1982] 2 S.C.R. 674 (Tab 32) (A Court may apply an absolute prescription period even if a party fails to plead it); *M.(K.) v. M.(H.)*, [1992] 3 S.C.R. 6 (Tab 77) (holding that a tort claim accrues when a plaintiff is reasonably capable of discovering the wrongful nature of defendant's actions and its nexus with plaintiff's injuries); *Soper v. Southcott*, [1998] O.J. No. 2799, ¶ 21 (Tab 130) ("Limitation periods are not enacted to be ignored. The plaintiff is required to act with due diligence in acquiring facts in order to be fully apprised of the material facts upon which a negligence or malpractice claim can be based.").

prescription gives an adjudicator discretion to bar a claim due to lapse of time in presentation of that claim.²⁷³

218. However, an express limitation provision in an international treaty is inconsistent with, and displaces, the doctrine of extinctive prescription. As Professor Reisman notes, “Article 1116(2) is a *lex specialis* which displaces customary international law which might otherwise apply.”²⁷⁴ Such a limitation applies on its own terms, in accordance with the rules of interpretation of the *Vienna Convention*. It is *lex specialis* and the intent of the Parties drafting the limitation must govern.

219. Professor Pauwelyn, cited by the Investor²⁷⁵, also affirms that a *lex specialis* governs limitation periods for continuing violations. Professor Pauwelyn states that,

...time-limits, can be activated in two instances: firstly, where time limits are explicitly inserted in the legal instrument or provision conferring jurisdiction on the tribunal...A second category of time limits emerges in the operation of the rules of general international law related to the doctrine of extinctive prescription.²⁷⁶

220. There can be no debate that Article 1116(2) of NAFTA is a *lex specialis* that governs limitation periods for investor-State dispute settlement under NAFTA.

(2) The Investor Misapplies “Continuing Violation” at International Law

221. Even if international law were to apply to an assessment of the timeliness of this claim, the doctrine of continuing violation would not be applicable. As Professor Reisman explains,

²⁷³ Brownlie, Ian, *PRINCIPLES OF PUBLIC INTERNATIONAL LAW*, 6th ed. (Oxford University Press, 2003), at 481-482 (“*Brownlie*”) (Tab 17); Crawford, James, *THE INTERNATIONAL LAW COMMISSION’S ARTICLES ON STATE RESPONSIBILITY* (Cambridge University Press, 2001), at 266-269, and FN. 738 (“*Crawford ILC*”) (Tab 33).

²⁷⁴ *Reisman Affidavit*, ¶ 38.

²⁷⁵ Investor’s Memorial, ¶ 455.

²⁷⁶ Pauwelyn, Joost, *The Concept of a “Continuing Violation” of an International Obligation: Selected Problems*, 66 *BRITISH YB OF INT’L L.* 415 at 430 (1996) (Tab 109). Professor Pauwelyn goes on at 431 to state that “...the principles to be applied in case of a continuing violation are generally the same.” See also, *Reisman Affidavit*, ¶ 42 and FN. 37.

...Merrill & Ring’s argument in my judgment, misunderstands the concept and function of a “continuing violation” in international law. That concept is not applied mechanically or acontextually...[but] will depend both on the primary obligation and the circumstances of the given case...NAFTA, which supplies the relevant primary obligation here, did not invest Chapter 11 tribunals with jurisdiction retrospectively to appraise measures, such as laws and regulations that predated its entry into force.²⁷⁷

(3) Human Rights Precedents are Irrelevant

222. The Investor relies substantially on international human rights cases to suggest that a time bar cannot be triggered until the continuing measure has ceased to exist.²⁷⁸ The human rights law cited by the Investor is inapposite for interpretation of the *lex specialis* found in NAFTA.

223. It is unlikely that international human rights instruments could create norms for NAFTA Chapter Eleven. Such instruments relate to a Tribunal’s competence to enforce fundamental human rights norms rather than mere commercial interests of an investor.²⁷⁹ International human rights cases enforce *jus cogens* norms that are, by definition, insusceptible to derogation. As explained by Professor Reisman, “NAFTA does not contravene *jus cogens*, so a *lex specialis* such as Article 1116(2) ... would not be barred by the considerations operative in the human rights cases”²⁸⁰

²⁷⁷ *Reisman Affidavit*, ¶ 39, and generally ¶¶ 39-44.

²⁷⁸ Investor’s Memorial, ¶¶ 455-464.

²⁷⁹ *Reisman Affidavit*, ¶ 45.

²⁸⁰ *Reisman Affidavit*, ¶ 48, and generally ¶¶ 45-52; see also, Higgins, Rosalyn, *Time and the Law: International Perspectives on an Old Problem*, INTERNATIONAL AND COMPARATIVE LAW QUARTERLY, Vol. 46, Part 3 (July 1997) at 516 (Tab 58) (“There are good reasons for thinking that treaties that guarantee human rights—whether expressly or as an incident of their subject matter—fall into a special category so far as inter-temporal law is concerned.”).

**c) The Investor’s Approach Is Not Supported By NAFTA
Case Law**

(1) Grand River Correctly Interprets Article 1116(2)

224. The most detailed consideration of Article 1116(2) by a NAFTA Tribunal is in *Grand River v. United States*.²⁸¹ The investor in Grand River commenced a NAFTA Chapter Eleven claim on March 12, 2004. It alleged that the Master Settlement Agreement (MSA) for tobacco litigation entered into in 1998 and “subsequent state actions taken pursuant to the MSA, including adoption and enforcement of the escrow statutes, more recent amendments to those statutes, and other enactments and actions aimed at cigarette manufacturers outside the MSA regime”²⁸² breached Chapter Eleven. The United States challenged the Tribunal’s jurisdiction to entertain the claim based on Article 1116(2).

225. In a carefully and fully reasoned decision (45 pages), the Tribunal addressed the meaning of Article 1116(2) and dismissed Grand River’s claim based on the MSA and subsequent measures taken pursuant to the MSA as time-barred. The only claim it reserved for consideration on the merits was a claim based on distinct legislation adopted by individual states after March 12, 2001, within the applicable three-year limitation period.²⁸³

226. The Tribunal held that, “Articles 1116(2) and 1117(2) introduce a clear and rigid limitation defence – not subject to any suspension, prolongation or other qualification.”²⁸⁴ It explained the operation of Article 1116(2),

NAFTA Articles 1116(2) and 1117(2) establish several conditions
that must be met in order to trigger operation of the three-year

²⁸¹ *Grand River – Jurisdiction Decision* (Tab 57).

²⁸² *Grand River – Jurisdiction Decision*, ¶¶ 4, 24 (Tab 57). See also ¶¶ 6-24 for a comprehensive description of the measures at issue in *Grand River*. Canada notes that Merrill & Ring’s claim is even more stale-dated than the *Grand River* claim: both were based on 1998 measures but Merrill & Ring only commenced arbitration in December 2006.

²⁸³ *Grand River – Jurisdiction Decision*, ¶¶ 84-94 (Tab 57).

²⁸⁴ *Grand River – Jurisdiction Decision*, ¶ 29 (Tab 57).

limitation periods created by those provisions. Claims are barred as untimely only if the investor or enterprise:

- First acquired certain specific knowledge, or
- Should have first acquired such knowledge, and
- Did so within three years of the alleged breach.

The requisite knowledge has two elements:

- Knowledge of the alleged breach, and
- Knowledge that the investor has incurred loss or damage.²⁸⁵

227. “[A]ctual knowledge” of the breach and of loss or damage was “foremost a question of fact,”²⁸⁶ whereas constructive knowledge could be imputed to an investor if it would have known that fact had it exercised reasonable care or diligence. Constructive knowledge could be imputed to an investor based on the surrounding circumstances, including the claimants experience in the relevant industry and the notoriety of the challenged measures in that industry.

228. The *Grand River* Tribunal also found that knowledge of loss or damage exists for the purposes of Article 1116(2) even if the amount or extent of that loss or damage may not become known until some future time.²⁸⁷ It need not be precisely quantified.

229. Merrill & Ring’s effort to avoid the clear time bar in Article 1116(2) through the fiction of “continuing” and “non-continuing” measures is fully answered and rejected in *Grand River*.

230. As explained above, Merrill & Ring had actual knowledge both of the breaches and loss alleged in this arbitration more than three years before actually commencing this arbitration. Merrill & Ring must also be found to have had constructive knowledge of the breach and loss alleged from April 1998 onward, when Notice 102 was applied to Merrill

²⁸⁵ *Grand River – Jurisdiction Decision*, ¶ 38 (Tab 57).

²⁸⁶ *Grand River – Jurisdiction Decision*, ¶ 54 and generally ¶¶ 53-72 (Tab 57).

²⁸⁷ *Grand River – Jurisdiction Decision*, ¶¶ 73-83 (Tab 57).

& Ring’s log exports from British Columbia. Its claim is therefore time barred based on the reasoning in *Grand River*.

231. The measures found to be time barred in *Grand River* were clearly “continuing” measures: the MSA was entered into in 1998 and subsequent state actions taken pursuant to the MSA, including implementing measures and amendments thereto, occurred after 1998.²⁸⁸ In fact, the measure at issue in this arbitration are of an even less “continuing” nature than in *Grand River*: Notice 102 has remained the same since April 1998 other than a minor amendment concerning permit extensions. It has been applied in the same fashion to successive log exports of Merrill & Ring since April 1998. The fact that a measure is continuing does not preclude application of Article 1116(2).

232. The investors in *Grand River* also sought to justify their failure to claim in a timely fashion on the same type of “non-continuing measure” theory as does the Investor in this case. As noted by the Tribunal, “...the Claimants advanced a further argument, to the effect that the limitations periods under Articles 1116(2) and 1117(2) applied separately to *each* state implementing the MSA. Hence, they maintained, there is not one limitations period, but many.”²⁸⁹ The *Grand River* Tribunal rejected the non-continuing measures theory completely, noting its contradiction of the wording and object and purpose of Article 1116(2). It stated,

...this analysis seems to render the limitations provisions ineffective in any situation involving a series of similar and related actions by a respondent state, since a claimant would be free to base its claim on the most recent transgression, even if it had knowledge of earlier breaches and injuries.²⁹⁰

233. These reasons apply with equal force to this arbitration. Merrill & Ring’s non-continuing measure approach would render Article 1116(2) ineffective with respect to the

²⁸⁸ *Grand River – Jurisdiction Decision*, ¶ 24 (Tab 57).

²⁸⁹ *Grand River – Jurisdiction Decision*, ¶ 81 (Tab 57).

²⁹⁰ *Grand River – Jurisdiction Decision*, ¶ 81 (Tab 57).

continuing and routine application of Notice 102 and should not be allowed to resuscitate its time barred claim.

**(2) The *Feldman*, *Mondev* and *Glamis* Cases
Complement the Approach in *Grand River***

234. The *Feldman*, *Mondev* and *Glamis* cases each consider temporal limitations in some respect, although none of them is directly applicable to the issue in this case. Nonetheless, they support Canada's approach to interpretation of Article 1116(2) and contradict the logic of the Investor's continuing and non-continuing breach theories.

235. The final award in *Feldman v. Mexico* is completely consistent with Canada's position in this case and with *Grand River*. In finding that Mexico had not made representations that might estop it from relying on a time bar, the Tribunal commented that,

...NAFTA Articles 1117(2) and 1116(2) introduce a clear and rigid limitation defence which, as such, is not subject to any suspension (see *supra* para. 58), prolongation or other qualification. Thus the NAFTA legal system limits the availability of arbitration within the clear-cut period of three years, and does so in full knowledge of the fact that a State, i.e., one of the three Member Countries, will be the Respondent, interested in presenting a limitation defence.²⁹¹

236. The *Feldman* Tribunal's refusal to apply Article 1116(2) to *Feldman*'s claim in that case was not because it agreed that the conduct in question was a continuing measure. To the contrary, the *Feldman* Tribunal applied the three-year time bar, finding a limitation period of April 30, 1996, three years after the Notice of Arbitration was filed on April 30, 1999.²⁹² If the theory of continuing breach advanced by Merrill & Ring were supported by the *Feldman* case, *Feldman* would not have been time barred at all.

²⁹¹ *Feldman v. Mexico* (ICSID No. ARB(AF)/99/1) Award, 16 December 2002, ¶ 63 ("*Feldman – Award*") (Tab 49).

²⁹² *Feldman – Award*, ¶ 49 (Tab 49). The Tribunal also refused *Feldman*'s request for damages for the period between January 1994 and May 1996 because it was before the cut-off for the limitation period and was not proved sufficiently in any event: ¶ 199.

237. The Preliminary Award on Jurisdiction in *Feldman* contains *obiter* language which the Investor has seized upon to support its continuing measures approach. In addressing whether it had jurisdiction over claims commencing before NAFTA came into force, the *Feldman* Tribunal held that it lacked jurisdiction over acts or omissions occurring before January 1, 1994 (the NAFTA “in force” date) and continued that,

...if there had been a permanent course of action by Respondent which started before January 1, 1994 and went on after that date and which, therefore, “became breaches” of NAFTA Chapter Eleven...that post-January 1, 1994 part of Respondent’s alleged activity *is* subject to the Tribunal’s jurisdiction...²⁹³

238. It did not even attempt to address whether and when Feldman first acquired knowledge of the breach and loss under Article 1116(2) or 1117(2), and can hardly be construed as helpful on that issue. It is also difficult to reconcile this passage with the more reasoned determination, and the results, of the *Feldman* final award.²⁹⁴

239. In *Mondev*, the investor filed a Notice of Arbitration on September 1, 1999. The Tribunal found that the only claim within its jurisdiction (a claim related to U.S. court decisions) occurred within three years of commencement of the claim, and hence “no question arises as to the time bar.” That said, the Tribunal continued its analysis as follows,

If it had mattered, however, the Tribunal would not have accepted *Mondev*’s argument that it could not have had “knowledge of...loss or damage” arising from the actions of the City and BRA prior to the United States court decisions. A claimant may know that it has suffered loss or damage even if the extent or quantification of the loss or damage is still unclear. It must have been known to *Mondev*, at the latest by 1 January 1994, that not all its losses would be met by the [court] proceedings.... Thus, if *Mondev*’s claims concerning the conduct of the City and BRA had

²⁹³ *Feldman v. Mexico* (ICSID No. ARB(AF)/99/1) Interim Decision, 6 December 2000, ¶ 62 (“*Feldman – Interim Decision*”) (Tab 50).

²⁹⁴ See also, *Reisman Affidavit*, ¶¶ 55-58.

been continuing NAFTA claims as at 1 January 1994, they would now be time-barred.²⁹⁵

240. It is therefore clear that the *Mondev* Tribunal would also have rejected the Investor's theory of continuing breach had the situation before it been ripe for such consideration. In this respect, the *Mondev* case also supports Canada's position in this arbitration.

241. In *Glamis*, the Tribunal refused to bifurcate proceedings because it found that at least one of the four bases for claim was timely. As a result, bifurcation would not exclude the claim in its entirety, even if the other three claims were time barred. The *Glamis* Tribunal did not discuss time bar in any further detail.²⁹⁶

(3) The *UPS* Case is Wrong

242. The only case that supports the Investor's position is *UPS v. Canada*. The *UPS* Tribunal addressed the time bar in Articles 1116(2) and 1117(2) of NAFTA in its award on the merits. Its reasons are a mere 11 paragraphs²⁹⁷ in a 78 page judgment, and it does not even cite the *Grand River* case, notwithstanding that *Grand River* was issued almost a year before *UPS*.

243. *UPS* challenged various aspects of Canada's enforcement of customs laws, access to the Canadian postal infrastructure, application of the *Postal Assistance Program* and an allegedly unfair contract.²⁹⁸ The measures at issue were first implemented by Canada well before 1997, although *UPS* asserted that they were "either maintained or first occurred April 17, 1997, three years before the claim was made."²⁹⁹ *UPS* argued its claim was not time barred either because it did not have knowledge of particular aspects of Canada's conduct or because on-going conduct constituted a new violation of NAFTA

²⁹⁵ *Mondev – Award*, ¶ 87 (Tab 87).

²⁹⁶ *Glamis Gold Ltd v. United States*, (UNCITRAL) Procedural Order No. 2, 31 May 2005, ¶¶ 17-20 (Tab 56). See also, *Reisman Affidavit*, ¶ 63.

²⁹⁷ *UPS – Award*, ¶¶ 20-31 (Tab 144).

²⁹⁸ *UPS – Award*, ¶¶ 11-13 (Tab 144).

²⁹⁹ *UPS – Award*, ¶¶ 21-22 (Tab 144).

each day with the three-year period beginning anew each day.³⁰⁰ This latter aspect of the *UPS* argument is similar to the argument made by Merrill & Ring in this case.³⁰¹

244. The *UPS* Tribunal summarised its decision as follows,

The generally applicable ground for our decision is that, as *UPS* urges, continuing courses of conduct constitute continuing breaches of legal obligations and renew the limitation period accordingly. This is true generally in the law, and Canada has provided no special reason to adopt a different rule here. The use of the term “first acquired” is not to the contrary, as that logically would mean that knowledge of the allegedly offending conduct plus knowledge of loss triggers the time limitation period, even if the investor later acquires further information concerning the conduct or allowing more precise computation of loss. The *Feldman* tribunal’s conclusion on this score buttresses our own.³⁰²

245. Finally, the *UPS* Tribunal found that the limitation period would limit any damages recovered to losses arising within three years of the date the claim was filed. It stated,

Although we find that there is no time bar to the claims, the limitation period does have a particular application to a continuing course of conduct. If a violation of NAFTA is established with respect to any particular claim, any obligation associated with losses arising with respect to that claim can be based only on losses incurred within three years of the date when the claim was filed. A continuing course of conduct might generate losses of a different dimension at different times. It is incumbent on claimants to establish the damages associated with asserted breaches, and for continuing conduct that must include a showing of damages not from the inception of the course of conduct but only from the conduct occurring within the period allowed by article 1116(2).³⁰³

246. Canada respectfully submits that the interpretation of the *UPS* Tribunal is flawed for the reasons noted above and should not be followed by this Tribunal.

³⁰⁰ *UPS – Award*, ¶¶ 22-24 (Tab 144).

³⁰¹ Counsel for the Investor was also counsel for *UPS*.

³⁰² *UPS – Award*, ¶ 28 (Tab 144).

³⁰³ *UPS – Award*, ¶ 29 (Tab 144).

247. Several fundamental errors should be noted. In particular, the *UPS* Tribunal ignores the fact that Article 1116(2) is a clear *lex specialis* which supersedes general international law that might otherwise be applicable. Its interpretation gives the word “first” no meaning and ignores the expressed intent of the NAFTA Parties.

248. In addition, the *UPS* Tribunal incorrectly applies the doctrine of continuing violation to Chapter Eleven. The obligations in NAFTA Chapter Eleven do not implicate *jus cogens* norms as would certain human rights violations, and continuing violation in the human rights context is inapposite for a NAFTA Chapter Eleven case.

249. The reliance placed by the *UPS* Tribunal on whether an investor might acquire further information or might be able to do a more precise calculation of loss is also misplaced. The time bar in Article 1116(2) commences when the investor first has the requisite knowledge of breach and loss. Knowledge of how long the measure will continue, when (if ever) the measure will be repealed, or a precise computation of damages are not needed to commence a claim and cannot be read into the plain language of Article 1116(2).

250. Finally, the *UPS* Tribunal converts Article 1116(2) into a mere three-year cap on damages rather than an absolute prohibition on arbitrating a stale claim. This is not supportable based on the plain language of the provision read in context and mindful of its object and purpose.³⁰⁴

251. As Professor Reisman concludes,

I believe that *UPS* erred in its application of the “continuing violation” doctrine to Article 1116(2). It is not inapposite that it deviates from all the other decisions treating Article 1116(2). Prior decisions are certainly entitled to respectful consideration but NAFTA does not establish a system of precedent, and the Tribunal seized of the Merrill & Ring case therefore may – and, in my

³⁰⁴ Nor is it supported by Article 1135 on damage awards.

judgment, should – revisit, with fresh eyes, an issue in *UPS* that is both scantily reasoned and substantively doubtful.³⁰⁵

252. Canada agrees with this conclusion and respectfully urges this Tribunal to revisit and reject the Investor's theory of continuing violation in this case. Article 1116(2) is a clear *lex specialis* which must prevail in the circumstances and results in complete dismissal of the Investor's claim.

d) The “Non-Continuing” Measures Are Simply Recent Examples of Continuing Measure

253. In addition to its claim for continuing measures, the Investor asserts claims for allegedly “non-continuing measures” occurring since December 27, 2003.³⁰⁶ It argues that the non-continuing measures are breaches in and of themselves, and are not time barred by Article 1116(2).

254. The measures labelled as “non-continuing” by the Investor are in fact just recent and routine examples of the conduct challenged as a continuing measure. The Investor attempts to avoid Article 1116(2) by pleading that “each time” Canada applied the continuing measure in the usual and routine manner after December 2003, it committed a fresh breach under Chapter Eleven. This ignores the plain meaning of the provision. As Professor Reisman observes,

It would require no small violence to the ordinary meaning of Article 201 to describe, for example, “[e]ach time since December 27, 2003 that Canada” has implemented or administered Notice 102 as a “law, regulation, procedure, requirement or practice.” The implication of such a forced construction would be that while *Notice 102* is undoubtedly a “measure,” each routine application of that “measure” is a separate and distinct “measure.”...it makes little sense to speak of discrete events implementing *Notice 102* as

³⁰⁵ *Reisman Affidavit*, ¶ 69 and generally ¶¶ 64-69.

³⁰⁶ *Investor's Memorial*, ¶ 478.

independent measures that have been “adopted or maintained” by Canada.³⁰⁷

255. The Investor’s contrived approach is strikingly clear when one compares the actual allegations of continuing and non-continuing breach in the Investor’s Memorial. The identical conduct is alleged, in one case as a continuing measure and in the other as non-continuing measures. The non-continuing measures alleged are not independent or distinct charges of breach of NAFTA. Nor has the Investor presented evidence to demonstrate that any of the non-continuing measures in and of themselves contravene a NAFTA obligation.

256. The chart below demonstrates the extent to which the Investor’s non-continuing measures simply reiterate recent and routine application of the continuing measures pleaded.³⁰⁸

³⁰⁷ *Reisman Affidavit*, ¶ 19. At ¶ 20 Professor Reisman concludes, “The ordinary meaning of the provision and the most reasonable construction are, rather, to identify measures in accordance with the examples in Article 201.”

³⁰⁸ See also, *Reisman Affidavit*, ¶ 25 (“...the actions which Merrill & Ring calls “measures” and proffers as examples of “[n]on-continuing measures since December 27, 2003” in fact describe discrete occasions on which Canada *implemented or administered* a single, prior measure, namely, *Notice 102*. Merrill & Ring’s objection to these actions is not based on the supposed incompatibility of each discrete application with NAFTA but with the incompatibility of the long-standing policy regime which they are implementing.”) and ¶ 26 (“It is, to say the least, difficult to see by what logic this “continuing measure” does not, in Merrill & Ring’s view, *include* the various ‘non-continuing’ measures ... the two terms – continuing and non-continuing – are tautological. Stated otherwise, the “non-continuing measures ... perforce depend on the *legal* conclusion that Article 1116(2) does *not* time-bar the alleged “continuing measures.”).

CONTINUING MEASURES – INVESTOR’S MEMORIAL, ¶ 435	NON-CONTINUING MEASURES – INVESTOR’S MEMORIAL, ¶ 436
<p>a) Canada’s Preferential treatment of log exports for logs produced from lands managed by British Columbia Timber Sales in comparison to requests made by investments with federal timbermark lands such as those owned by Merrill & Ring;</p> <p>b) Canada’s use of its discretion to offer standing timber export exemptions to landowners subject to provincial regulation but failure to provide such exemptions to private landowners subject to federal regulation;</p> <p>c) Canada’s unfair administration of the Surplus Testing Procedure, through:</p> <p style="padding-left: 40px;">i) arbitrary time and sort requirements;</p> <p style="padding-left: 40px;">ii) encouraging ‘blockmailing’ by bidders to obtain concessions;</p> <p style="padding-left: 40px;">iii) encouraging non <i>bona fide</i> purchasers to block logs from export;</p> <p style="padding-left: 40px;">iv) FTEAC’s members’ conflicts of interest;</p>	<p>a) Each time Canada provided export permission for logs produced from British Columbia Timber Sales lands in a manner more favourable than logs seeking export permission produced from private pre-March 12, 1906 forest lands, such as those owned by Merrill & Ring;</p> <p>b) each time since December 27, 2003 that Canada used its discretion to grant standing timber exemptions to land owners subject to provincial regulation but failed to grant such exemptions to land owners subject to federal regulation;</p> <p>c) each time since December 27, 2003 that Canada administered the Surplus Testing Procedure unfairly, including the following examples:</p> <p style="padding-left: 40px;">i) requiring Merrill & Ring to undergo arbitrary requirements on each occasion after December 27, 2003 that Merrill & Ring applied for an export permit under Notice 102;</p> <p style="padding-left: 40px;">ii) allowing ‘blockmailing’ since December 27, 2003;</p> <p style="padding-left: 40px;">iii) allowing non <i>bona fide</i> purchasers to block logs from export since December 27, 2003, including failing to reject a competitor’s bid in 2005, even though that competitor was using Canadian logs in its US mills, and failing to reject another competitor’s bids since December 27, 2003, even though that competitor is a subsidiary of a company, which regularly purchases logs for export to Japan;</p> <p style="padding-left: 40px;">iv) appointing people with apparent conflicts of interest to sit on the FTEAC since December 27, 2003, including the appointment of [REDACTED] on [REDACTED] and [REDACTED]</p>

CONTINUING MEASURES – INVESTOR’S MEMORIAL, ¶ 435	NON-CONTINUING MEASURES – INVESTOR’S MEMORIAL, ¶ 436
<p>v) decisions are not transparent;</p> <p>vi) decisions are based on unknown criteria;</p> <p>vii) there is no appeal or review of decisions.</p> <p>d) The continuing application of Notice 102.</p>	<p>██████████ on ██████████;</p> <p>v) decisions to block Merrill & Ring’s exports of, at least, the following rafts without explaining the criteria on which those decisions were based: MRE-4-97-476; MRM-4-97-731; MRT-4-97-203; MRS-5-97-222; MRT-5-97-334; MRT-5-97-319</p> <p>vi) Canada’s failure to provide an appeal or review of the same decisions;</p> <p>d) The specific requirements that Merrill & Ring was required to follow each time after December 23, 2003 in order to apply for an export permit under Notice 102.</p>

257. The device of isolating “each time” that Canada applied the time barred continuing measure in the three years before commencing this claim is simply another way to characterise what has been in effect since 1998, and has already been pleaded as a continuing measure. If this device were effective, Article 1116(2) could never prescribe conduct based on continuing measures.

258. The Investor’s actual claim for damages in this case provides further evidence that it has simply repackaged the continuing measures as non-continuing measures to try to avoid Article 1116(2). If the claim for non-continuing measures was truly a claim for recent and distinct measures that violated Chapter Eleven, the Investor’s damage claim would have to assess loss and causation independently for each distinct allegation of breach. It does not do so. Rather, the Investor makes an omnibus claim for damages

based on the entire loss it alleges flowed from Canada's log export regime since December 2003.

259. For the reasons noted above, this non-continuing measures approach is inconsistent with the plain language, context and object and purpose of Article 1116(2) and subsidiary sources interpreting the Article. The non-continuing breach theory is also not supported by NAFTA case law other than the *UPS* case, which is incorrect on the issue of time bar.

260. A Chapter Eleven claim must be made within three years of the investor first acquiring actual or constructive knowledge of the breach and losses caused by the breach. The Investor cannot convert the routine and repeated application of Notice 102 since December 2003 into a fresh breach when that policy has applied to it in the same fashion since 1998. The label of "non-continuing measure" is simply a mask for more recent applications of the continuing measure alleged to breach the NAFTA in this case.

5. Conclusion on Time Bar

261. The Investor seeks to avoid the clear and specific wording of Article 1116(2) and to resuscitate its time barred claim by importing the devices of "continuing measure" and "non-continuing measure." Both of these approaches are inapplicable to Article 1116(2) which is a clear *lex specialis*.

262. Merrill & Ring had knowledge of the alleged breaches, the alleged loss and its ability to bring a NAFTA Chapter Eleven claim to arbitrate these breaches well before 2003. It failed to do so. It would be fundamentally unfair to allow the Investor to pursue this claim now, years after the limitation for doing so has expired. If a claim as obviously time barred as this one can proceed, Article 1116(2) will be rendered meaningless.

B. The “Right to Sell Export Logs into Foreign Markets” and the “Right to Sell for Fair Market Value” Are not Investments Under NAFTA

1. Article 1139 Defines “Investment”

263. NAFTA Chapter Eleven defines “investment” in Article 1139.³⁰⁹ In this case, the Investor claims breaches of NAFTA Chapter Eleven based on four categories of investment: (1) timberland it owns in British Columbia;³¹⁰ (2) timber and logs it harvests in British Columbia;³¹¹ (3) the right to sell its export logs into foreign markets;³¹² and (4) the right to sell for fair market value.³¹³ Canada concedes that the land, timber and logs at

³⁰⁹ The definition of “investment” in Article 1139 is:

investment means:

- (a) an enterprise;
- (b) an equity security of an enterprise;
- (c) a debt security of an enterprise
 - (i) where the enterprise is an affiliate of the investor, or
 - (ii) where the original maturity of the debt security is at least three years, but does not include a debt security, regardless of original maturity, of a state enterprise;
- (d) a loan to an enterprise
 - (i) where the enterprise is an affiliate of the investor, or
 - (ii) where the original maturity of the loan is at least three years, but does not include a loan, regardless of original maturity, to a state enterprise;
- (e) an interest in an enterprise that entitles the owner to share in income or profits of the enterprise;
- (f) an interest in an enterprise that entitles the owner to share in the assets of that enterprise on dissolution, other than a debt security or a loan excluded from subparagraph (c) or (d).;
- (g) real estate or other property, tangible or intangible, acquired in the expectation or used for the purpose of economic benefit or other business purposes; and
- (h) interests arising from the commitment of capital or other resources in the territory of a Party to economic activity in such territory, such as under
 - (i) contracts involving the presence of an investor’s property in the territory of the Party, including turnkey or construction contracts, or concessions, or
 - (ii) contracts where remuneration depends substantially on the production revenues or profits of an enterprise;

but investment does not mean,

- (i) claims to money that arise solely from
 - (i) commercial contracts for the sale of goods or services by a national or enterprise in the territory of a Party to an enterprise in the territory of another Party, or
 - (ii) the extension of credit in connection with a commercial transaction, such as trade financing, other than a loan covered by a subparagraph (d); or
- (j) any other claims to money,

that do not involve the kinds of interests set out in subparagraphs (a) through (h);

³¹⁰ Investor’s Memorial, ¶ 27.

³¹¹ Investor’s Memorial, ¶ 28.

³¹² Investor’s Memorial, ¶ 30.

³¹³ Investor’s Memorial, ¶ 30.

issue are investments for the purposes of this case. However, the “right to sell logs into foreign markets” and the “right to sell for fair market value” are not “investments” as defined by Article 1139. As a result, the Investor cannot claim for breaches of Articles 1102, 1105, 1106 or 1110 based on these so-called rights.

264. The definition of investment in Article 1139 is exhaustive (“investment means...”), and not illustrative.³¹⁴ As part of its evidentiary burden, the Investor must establish that the interest alleged to be an investment fits squarely within the definition of investment in Article 1139. The Investor ignores accepted principles of treaty interpretation at international law and recent NAFTA Chapter Eleven case law in arguing that these alleged rights fall within the meaning of “investment” under NAFTA Chapter Eleven.

265. The “right to sell its export logs into foreign markets” and “the right to sell for fair market value” are not investments defined by NAFTA Article 1139(g) and (h).³¹⁵ NAFTA Article 1139(g) and (h) define investment as,

(g) real estate or other property, tangible or intangible, acquired in the expectation or used for the purpose of economic benefit or other business purposes; and

(h) interests arising from the commitment of capital or other resources in the territory of a Party to economic activity in such territory, such as under

(i) contracts involving the presence of an investor’s property in the territory of the Party, including turnkey or construction contracts, or concessions, or

³¹⁴ Parra, Antonio R., *Provisions on the Settlement of Disputes in Modern Investment Laws, Bilateral Investment Treaties and Multilateral Instruments on Investment*, 12 ICSID Rev. 287 (1997) at 355-356 (“...in contrast to the all-inclusive definitions of covered investments found in most of the other treaties, the NAFTA’s definition provides an exhaustive (though admittedly very broad) enumeration, rather than an open-ended, illustrative list, of covered assets or investments...” (Tab 108).

³¹⁵ Investor’s Memorial, ¶ 30. Canada addresses Article 1139(g) and (h) below because these are the subparagraphs relied on by the investor to classify the rights claimed as NAFTA investments. It is even more obvious that these alleged rights are not investments under any of the other headings in Article 1139.

(ii) contracts where remuneration depends substantially on the production, revenues or profits of an enterprise.

266. NAFTA Article 1139(g) lists real estate and tangible or intangible property as covered investments. The ordinary meaning of “property” is a thing or possession that a person or entity owns. For example, the *Shorter Oxford Dictionary* defines “property” as “[T]hat which one owns; a thing or things belonging to a person or persons” and “[T]he condition or fact of owning or being owned; the (exclusive) right to the possession, use or disposal of a thing, ownership.”³¹⁶ Generally, property can be acquired, owned, and alienated by its owner.

267. There is no doubt that a “right to sell export logs into foreign markets” and a “right to sell [logs] for fair market value” are not within the ordinary meaning of tangible or intangible property. No one, including the Investor, can own, acquire, possess, use, rent, mortgage, dispose of or otherwise alienate a right to sell its export logs into foreign markets or a right to sell its logs for fair market value. Nor does the Investor manage or control these so-called rights. At most, these so-called “rights” are aspirations of the Investor. They are not interests that constitute an investment and they do not attract protection under an international investment treaty.

268. Similarly, the ordinary meaning of the terms used in Article 1139(h) would not include the rights alleged by the Investor. The *Shorter Oxford Dictionary* defines “interest” as a “right or a title, esp. to a share in property.”³¹⁷ The aspirations described as investments by the Investor are clearly not legal concerns, titles or rights. In the same vein, “commitment” denotes an obligation that restricts freedom of action, while the verb “commit” refers to conduct in the nature of a pledge, undertaking or guarantee.³¹⁸ Again, the alleged investments are aspirations, and are not of the same nature as an obligation, pledge, undertaking or guarantee.

³¹⁶ *Shorter Oxford*, at 2369 (Tab 128).

³¹⁷ *Shorter Oxford*, at 1400 (Tab 128).

³¹⁸ *Shorter Oxford*, at 460-461 (Tab 128).

269. Article 1139(h)(i) and (ii) provide relevant context for the interpretation of “interests arising from the commitment of capital.” Article 1139(h)(i) and (ii) narrow the potential scope of “interests arising from the commitment of capital” by limiting them to interests “such as” contracts and concessions. The *ejusdem generis* rule of interpretation would restrict the scope of the word “interests” to things like “contracts” and “concessions.”³¹⁹ Neither of the Investor’s alleged rights are remotely like interests that arise from contracts or concessions.

270. More generally, the terms included in Article 1139’s definition of investment provide clear indicia of what this Tribunal may consider as an “investment”; these include an enterprise, an equity security, a debt security, a loan, or an interest entitling its owner to share in income, profits, or assets upon dissolution. These items share attributes in that they are concrete, definite interests liable to be bought, sold, traded or borrowed against. The NAFTA Parties have assigned a core meaning to what comprises an investment under Article 1139, which is not captured by aspirations “to sell logs into foreign markets” or “to sell for fair market value.”

271. Nothing in the object and purpose of NAFTA justifies expanding the definition of investment to include the rights alleged by the Investor. In particular, NAFTA’s objective to “increase substantially investment opportunities in the territories of the Parties”³²⁰ is not a licence to transform vague, uncertain aspirations into an investment for the purposes of investor promotion and protection.

2. NAFTA Case Law

272. The Investor’s expansive definition of investment has been considered and rejected in international jurisprudence, including NAFTA Chapter Eleven arbitrations, other cases interpreting bilateral investment treaties (BIT) and doctrine.

³¹⁹ The *ejusdem generis* rule means that general words following special words are limited to the *genus* indicated by the special words. See generally, Lord McNair, *THE LAW OF TREATIES*, Oxford University Press (1961) at 393-410 (Tab 81).

³²⁰ NAFTA Article 102(1)(c).

273. *Pope & Talbot v. Canada* is the only case relied upon by the Investor to support its argument that the “right to export logs into foreign markets” and the “right to sell for fair market value” are “investments.”³²¹ The *Pope & Talbot* Tribunal stated that, “the Investment’s access to the U.S. market is a property interest subject to protection under Article 1110.”³²² However, this assertion is inconsistent both with the result in that case and with the Tribunal’s subsequent reasoning. In deciding there was no expropriation, the *Pope & Talbot* Tribunal looked at interference with the investor’s business as a whole, and only considered the impact of limiting access to the U.S. market on the investment as a whole. It held,

While Canada suggests that the ability to sell softwood lumber from British Columbia to the U.S. is an abstraction, it is, in fact, a very important part of the “business” of the Investment. Interference with that business would necessarily have an adverse effect on the property that the Investor has acquired in Canada, which, of course, constitutes the Investment. While Canada’s focus on the “access to the U.S. market” may reflect only the Investor’s own terminology, that terminology should not mask the fact that the true interests at stake are the Investment’s asset base, the value of which is largely dependent on its export business.³²³

274. While the *Pope & Talbot* Tribunal initially asserted that market access was a property interest, it subsequently labelled such access as only “a part” of the business of the investor, and identified the investment as the property the investor acquired in Canada or its asset base. Equally importantly, the Tribunal’s application of the law to the facts of the case did not treat market access, by itself, as an investment capable of being expropriated.³²⁴

275. Subsequent NAFTA Chapter Eleven tribunals have not even suggested that a vague aspiration can be considered as a stand-alone investment. In *Methanex*, the investor claimed for lost customer base, goodwill and market share. The United States

³²¹ Investor’s Memorial, ¶ 370.

³²² *Pope & Talbot – Interim Award*, ¶ 96 (Tab 112).

³²³ *Pope & Talbot – Interim Award*, ¶ 98 (Tab 112).

³²⁴ *Pope & Talbot – Interim Award*, ¶ 96 (Tab 112).

countered that none of these items qualified as investments under Article 1139 of NAFTA. The Tribunal stated:

The USA is correct that Article 1139 does not mention the items claimed by Methanex. But in *Pope & Talbot Inc. v. Canada*, the tribunal held that “the Investor’s access to the U.S. market is a property interest subject to protection under Article 1110.” Certainly, the restrictive notion of property as a material “thing” is obsolete and has ceded its place to a contemporary conception which includes managerial control over components of a process that is wealth producing. In the view of the Tribunal, items such as goodwill and market share may, as Professor White wrote, “constitute [] an element of the value of an enterprise and as such may have been covered by some of the compensation payments”. Hence in a comprehensive taking, these items may figure in valuation. But it is difficult to see how they might stand alone, in a case like the one before the Tribunal.³²⁵

276. In reaching its conclusion, the *Methanex* Tribunal relied in part on the writings of Professor Gillian White, who addressed the type of rights that were protected against expropriation. She wrote,

A property right, in order to qualify for the protection of the international law rules must be an actual legal right, as distinct from a mere economic or other benefit, such as a situation created by the law of a State in favour of some person or persons who are therefore interested in its continuance. ...[T]he notion of goodwill is too vague to be regarded as a separate property right apart from the enterprise to which it is attached. This assumption gains support from the complete absence of any reference to goodwill or business reputation in any of the post-war decrees or compensation agreements examined by the writer. The most that can be said is that goodwill constitutes an element of the value of an enterprise and as such may have been covered by some of the compensation payments.³²⁶

277. The Tribunal in *Feldman* also addressed an allegation of expropriation of a right to export. Feldman was a U.S. investor carrying on a cigarette exporting business in

³²⁵ *Methanex – Award*, Part IV – Chapter D, at 7-8, ¶ 17 [footnotes omitted] (Tab 85).

³²⁶ White, Gillian, NATIONALISATION OF FOREIGN PROPERTY (*Stevens & Sons Limited*, 1961) at 49 (Tab 160).

Mexico whose profitability hinged on collecting Mexican tax rebates on exported cigarettes. When the government ceased paying the rebates, Feldman argued that his investment had been expropriated. The Tribunal held that the investor's business was an "enterprise" as defined by NAFTA Article 1139 and that the enterprise was within the scope of the definition of "investment." At the same time, the Tribunal doubted whether the claimant possessed a right to export that was a right liable to expropriation. In particular, the Tribunal said,

Given that the Claimant here has lost the effective ability to export cigarettes, and any profits derived therefrom, application of the *Pope & Talbot* standard [referring to the degree of interference required] might suggest the possibility of an expropriation. However, [...] it may be questioned as to whether the Claimant ever possessed a "right" to export that has been "taken" by the Mexican government.³²⁷

278. The implication, for present purposes, is that the alleged "right to export" does not constitute a stand alone investment under NAFTA Chapter Eleven.

279. Non-NAFTA tribunals have also rejected claims based on the insufficiency of the rights alleged to exist. For example, in *Occidental Exploration v. Ecuador*, the investor argued that Ecuador breached the U.S.-Ecuador bilateral investment treaty when it stopped reimbursing value-added-tax paid by the investor. The *Occidental* Tribunal denied a claim of expropriation, finding that "[H]owever broad the definition of investment might be under the Treaty it would be quite extraordinary for a company to invest in a refund claim."³²⁸

280. In the *Oscar Chinn* case, the government of the Belgian Congo substantially reduced transport tariffs in an effort to combat a widespread economic downturn. Chinn owned a river transport business that was severely affected by the tariff reduction, and

³²⁷ *Feldman – Award*, ¶ 152 (Tab 49).

³²⁸ *Occidental Exploration and Production Company v. Ecuador* (LCIA No. UN 3467, IIC 202) Award, 1 July 2004, ¶ 86 ("*Occidental – Award*") (Tab 105).

ultimately he went out of business. Nonetheless, the Permanent Court of International Justice refused to order reparations for Chinn's loss, concluding that it was,

...unable to see in [Mr. Chinn's] original position -- which was characterized by the possession of customers and the possibility of making a profit – anything in the nature of a genuine vested right. Favourable business conditions and goodwill are transient circumstances, subject to inevitable changes.³²⁹

281. In summary, to the extent that the *Pope & Talbot* Tribunal is interpreted as having held that “market access” constitutes an investment within the meaning of NAFTA Article 1139, it is incorrect. This view has been rejected in *Methanex* and undermined by the Tribunal in *Feldman*. Doctrinal authorities as well as other international decisions support the *Methanex* perspective on the definition of investment.

282. The “right to export logs into foreign markets” and the “right to sell for fair market value” are not stand alone investments for the purposes of NAFTA Article 1139. Merrill & Ring never acquired, sold or owned such rights. Nor has Merrill & Ring ever had managerial control over the right to export or the right to obtain a given price. Instead, these are aspirations which, if achieved, add value to the enterprise but do not constitute investments in and of themselves. As a result, the Tribunal should dismiss the claims for breach of Chapter Eleven based on these alleged rights without further consideration of their merits.

³²⁹ *The Oscar Chinn Case, (UK v. Belgium)*, P.C.I.J. Series A/B, No. 63, 12 December 1934 at 88 (Tab 23).

V. BREACHES ALLEGED

A. National Treatment – Article 1102

1. Summary of Canada's Position

283. The Investor has not established the essential elements of Article 1102 with respect to any allegation it has made. Nor could it: the Investor has always been accorded exactly the same treatment as domestic investors under Notice 102. The Investor has not been discriminated against in any fashion, much less has it suffered nationality-based discrimination.

284. To try to avoid the deficiencies in its position, the Investor invents a “special meaning” for Article 1102 that would transform national treatment into a guarantee of equality of competitive opportunities for foreign investors in the same business or economic sector as a domestic investor. This “special meaning” is insupportable. It ignores the ordinary meaning of Article 1102, its context, the object and purpose of NAFTA and all relevant jurisprudence, and must be rejected.

2. The Three Essential Elements of National Treatment

285. Article 1102 states in relevant part:

(1) Each Party shall accord to investors of another Party treatment no less favourable than that it accords, in like circumstances, to its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.

(2) Each Party shall accord to investments of investors of another Party treatment no less favourable than that it accords, in like circumstances, to investments of its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.

286. The text of Article 1102 contains three essential elements. An investor must prove each of these elements to prevail on its national treatment claim. In this case, the three elements the Investor must establish, are:

- First, that Canada accorded treatment to Merrill & Ring and to domestic investors;
- Second, that Canada accorded such treatment to Merrill & Ring and to domestic investors “in like circumstances”; and
- Third, that the treatment accorded to Merrill & Ring was “less favourable” than that accorded to the domestic investors.

287. As noted in the *UPS* case,

Failure by the investor to establish one of those three elements will be fatal to its case. This is a legal burden that rests squarely with the Claimant. That burden never shifts to the Party, here Canada. For example, it is not for Canada to prove an absence of like circumstances between UPS Canada and Canada Post regarding article 1102.³³⁰

288. Merrill & Ring has not established the three required elements for any of the six allegations of breach of national treatment made in its Memorial. The Investor’s Article 1102 claims should therefore be dismissed.

a) **The Investor Must Establish that Canada Accorded Treatment to Merrill & Ring and to Domestic Investors**

289. The first element of the national treatment test requires proof that a Party accorded treatment to the Investor and to domestic investors. Article 1102 requires a comparison of the treatment accorded to foreign investors with the treatment accorded to domestic investors. Accordingly, the Investor must identify the specific treatment at issue for the purposes of this comparison.

290. The ordinary meaning of “treatment” is “the act or manner or an instance of treating someone or something,” or “the techniques or actions customarily applied in a

³³⁰ *UPS – Award*, ¶ 83-4 (Tab 144). To the same effect see *Methanex – Award*, Part IV-Chapter B-Page 6 ¶ 12 (Tab 85) (“Methanex must demonstrate cumulatively, that California intended to favour domestic investors by discriminating against foreign investors and that Methanex and the domestic investor supposedly being favored by California are in like circumstances.”); *Thunderbird – Award*, ¶ 176 (Tab 136): “[T]he burden of proof lies with Thunderbird, pursuant to Article 24(1) of the UNCITRAL Rules. In this respect, Thunderbird must show that its investment received treatment less favourable than Mexico has accorded, in like circumstances, to investments of Mexican Nationals.”

specific situation.”³³¹ In *S.D. Myers v. Canada*, the Tribunal noted that “the word ‘treatment’ suggests that practical impact is required to produce a breach of Article 1102, not merely a motive or intent that is in violation of Chapter 11.”³³²

291. The context of Article 1102 further defines the scope of the treatment to be compared in a national treatment analysis. First, Article 1102 requires the treatment at issue to be “with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.” While broad, this list nonetheless limits the types of treatment to which Article 1102 applies.

292. Second, the treatment at issue pursuant to Article 1102 must be “treatment with respect to investments.” Article 1139 defines “investment” for the purposes of NAFTA Chapter Eleven.

293. Third, Article 1102 contemplates a comparison of treatments accorded by the same government to different investors (foreign and domestic). Articles 1102(1) and 1102(2) both state that, “[e]ach Party shall accord to (foreign investors)...treatment no less favourable than that *it* accords ...to its own investors.”³³³ Hence, the comparison to be made is between the treatment accorded by the government to foreign investor(s) on the one hand with the treatment that same government (“it”) accords to domestic investor(s) on the other hand. The comparison is between the treatment accorded to different investors by the same government.

294. Similarly, where the treatment in question is treatment accorded by a sub-national government, Article 1102(3) stipulates that the relevant comparison is between treatments accorded by the same sub-national government. It provides:

The treatment accorded by a Party under paragraphs 1 and 2 means, with respect to a state or province, treatment no less favourable than the most favourable treatment accorded, in like

³³¹ *Shorter Oxford*, at 3338 (Tab 128).

³³² *S.D. Myers – First Partial Award*, ¶ 254 (Tab 120).

³³³ NAFTA Article 1102 (1), (2).

circumstances, by that state or province to investors, and to investments of investors of the Party of which it forms part.

295. It is, therefore, incorrect to compare a treatment accorded by a national government with a different treatment accorded by a sub-national government. Applied to this case, the Investor cannot establish a breach of Article 1102 by comparing Canada's treatment of Merrill & Ring with a province's treatment of a domestic investor. It must compare Canada's treatment of Merrill & Ring with Canada's treatment of domestic investors in like circumstances.

b) The Investor Must Establish that Canada Accorded the Treatment "In Like Circumstances"

(1) The Ordinary Meaning of "In Like Circumstances"

296. The second element of Article 1102 mandates a comparison of the treatment that is accorded "in like circumstances" to foreign and domestic investors. According to the *Shorter Oxford Dictionary*, "like" means "having the characteristics of; similar to", "typical of", or "comparable."³³⁴ "Circumstance" includes "that which stands around or surrounds; surroundings" or "the material, logical or other environmental conditions of an act or event."³³⁵

297. The NAFTA Parties deliberately used the words "in like circumstances" in Article 1102 to indicate the breadth of the comparison envisaged. As noted in Canada's Statement on Implementation of NAFTA,

National treatment means that Canada will treat US and Mexican investors and their investments as favourably as it treats Canadian investors and their investments, in like circumstances. This last phrase establishes the basis for comparison between domestic and NAFTA investors and investments.³³⁶

³³⁴ *Shorter Oxford*, at 1595 (Tab 128).

³³⁵ *Shorter Oxford*, at 413 (Tab 128).

³³⁶ *Canadian Statement*, at 148 (Tab 19).

298. In practice, identification of investors accorded treatment “in like circumstances” calls for a consideration of those circumstances most relevant to the treatment at issue. The goal is to identify the domestic investors in the “most” like circumstances with the claimant. This search is relatively easy where there is a domestic investor in exactly the same situation as the claimant and therefore there is an identical domestic comparator.

299. Where an identical domestic investor exists, that domestic investor should be compared to the foreign investor to determine if the treatment is accorded in like circumstances. This was the situation in *Methanex v. United States*, where the Tribunal refused to compare the treatment accorded to methanol producers with the treatment of ethanol producers because other methanol producers were available for comparison purposes. It explained,

Given the object of Article 1102 and the flexibility which the provision provides in its adoption of “like circumstances”, it would be as perverse to ignore identical comparators if they were available and to use comparators that were less “like”, as it would be perverse to refuse to find and to apply less “like” comparators when no identical comparators existed.... the tribunal selected the entities that were in the most “like circumstances” and not comparators that were in less “like circumstances”. It would be a forced application of Article 1102 if a tribunal were to ignore the identical comparator and to try to lever in an, at best, approximate (and arguably inappropriate) comparator. The fact stands—Methanex did not receive less favourable treatment than the identical domestic comparators, producing methanol.”³³⁷

300. Consequently, a Tribunal’s identification of treatment “in like circumstances” requires that identical comparators be referred to where they exist. In this case, identical domestic comparators are available. All owners of federal land in B.C. that seek to export logs harvested from their land operate under Notice 102 and are subject to the log export regime in exactly the same way as the Investor. For example, in 2007 there were 62 exporters of logs from federal land in British Columbia. Most of these entities were

³³⁷ *Methanex – Award*, Part IV-Chapter B, 8-9, ¶¶ 17, 19 (Tab 85).

Canadian companies.³³⁸ Collectively TimberWest (a Canadian company), Island Timberlands and Merrill & Ring (both American companies) exported 96% of federal logs under Notice 102 in 2007.³³⁹ The Canadian companies operating under Notice 102 are in the most like circumstances to Merrill & Ring for the purposes of Article 1102. These companies are identical investors in this case, and they are therefore the appropriate comparator for the national treatment analysis.

301. Surprisingly, the Investor completely ignores domestic investors operating under Notice 102 in its “in like circumstances” analysis. Instead, it selects comparators that are in materially “unlike” circumstances.³⁴⁰ In the words of the *Methanex* Tribunal, this is a “perverse” application of “in like circumstances,” and should be rejected. A comparison of Merrill & Ring with domestic investors subject to Notice 102 demonstrates that the Investor has been treated in exactly the same fashion as all other investors under Notice 102 and that there has been no breach of Article 1102.

302. Where identical comparators are not available, a Tribunal must determine the “most” like circumstances by considering the totality of the circumstances in which the treatment is accorded. The Tribunal’s assessment of the factors that are material to the “like circumstances” analysis necessarily relates to the breach alleged and the nature of the treatment at issue.³⁴¹ NAFTA Chapter Eleven tribunals have considered diverse factors in assessing whether foreign and domestic investors or their investments are “in like circumstances.” Their determination of the appropriate comparator always depends on the breach alleged and the particular facts of the case.

303. For example, in *S.D. Myers v. Canada*, the investor challenged Canada’s closing of the border to exports of polychlorinated biphenyl (“PCB”) waste. In determining the

³³⁸ *Korecky Affidavit*, ¶¶ 68-74, Exhibit 34.

³³⁹ *Korecky Affidavit*, ¶ 68.

³⁴⁰ See ¶¶ 311-335, below, for discussion of the Investor’s approach to “in like circumstances” and ¶¶ 353-439, below, for discussion of the appropriate comparators in the specific allegations of breach of national treatment made by the Investor.

³⁴¹ *Pope & Talbot v. Canada*, (UNCITRAL), Award on the Merits of Phase II, 10 April 2001, ¶ 75 (“*Pope & Talbot – Merits Award*”) (“circumstances are context-dependent”) (Tab 113).

appropriate comparator “in like circumstances” to the claimant S.D. Myers, the Tribunal ruled that “the phrase ‘in like circumstances’ in Article 1102 must take into account the general principles that emerge from the legal context of the NAFTA, including both its concern with the environment and the need to avoid trade distortions that are not justified by environmental concerns.”³⁴²

304. In *UPS v. Canada*, the Tribunal considered the differences in the services and functions of the compared investments. In its comparison of goods arriving by international mail and goods arriving by courier, the Tribunal noted that mailed goods were handled by bulk and volume and that no individual record was kept about the good in question. It also noted that courier services provide for expedited customs clearance, simplified reporting, consolidated accounting and deferred duty payment. Based on these differences, the Tribunal concluded that the importation of goods by mail was not in like circumstances with courier imports “because of their different characteristics.”³⁴³ As UPS could not prove that its courier service was in like circumstances with the regular international mail, its claim failed.

305. It is well established that policy objectives are a relevant factor when determining appropriate comparators for the “in like circumstances” element. The OECD states:

As regards the expression ‘in like situations’, the comparison between foreign-controlled enterprises established in a Member country and domestic enterprises in that Member country is valid only if it is made between firms operating in the same sector.

*More general considerations, such as the policy objectives of Member countries, could be taken into account to define the circumstances in which comparison between foreign-controlled and domestic enterprises is permissible inasmuch as those objectives are not contrary to the principle of national treatment.*³⁴⁴

³⁴² *S.D. Myers – First Partial Award*, ¶ 250 (Tab 120).

³⁴³ *UPS – Award*, ¶ 99 (Tab 144).

³⁴⁴ OECD Declaration, *National Treatment for Foreign-Controlled Enterprises*, OECD: 1993, at 22. (“*OECD Declaration – National Treatment*”) [Emphasis added] (Tab 106).

306. UNCTAD has also endorsed consideration of a broad range of circumstances in a national treatment analysis, including the impact of policy objectives of the host country.³⁴⁵

307. Numerous NAFTA tribunals have factored policy considerations into their assessment of like circumstances. The *Myers* Tribunal affirmed the OECD Declaration, stating that "...an evaluation of 'like situations' in the investment context should take into account policy objectives in determining whether enterprises are in like circumstances."³⁴⁶ It continued, noting that the assessment of like circumstances must "take into account circumstances that would justify governmental regulations" that treat investors differently.³⁴⁷

308. The *Pope & Talbot v. Canada* Tribunal accounted for public policy considerations in determining whether treatment was accorded "in like circumstances." It considered the "entire background of [Canada's] disputes with the United States concerning softwood lumber trade between the two countries" to be relevant to determining like circumstances.³⁴⁸ On the facts, the *Pope* Tribunal explicitly found an absence of "likeness" based on public policy considerations.³⁴⁹ It determined:

A formulation focusing on the like circumstances question,(...) will require addressing any difference in treatment, demanding that it be justified by showing that it bears a reasonable relationship to rational policies not motivated by preference of domestic over foreign owned investments.³⁵⁰

309. The Tribunal in *GAMI v. Mexico* considered the policy objectives of the Mexican Government when determining that insolvent investments expropriated for public

³⁴⁵ UNCTAD, "National Treatment," UNCTAD/ITE/IIT/11 (Vol. IV), United Nations, 1999, at 33, Referencing OECD, 1993 at 22 ("*UNCTAD National – Treatment*") (Tab 143).

³⁴⁶ *S.D. Myers – First Partial Award*, ¶ 248 (Tab 120).

³⁴⁷ *S.D. Myers – First Partial Award*, ¶ 250 (Tab 120).

³⁴⁸ *Pope & Talbot – Merits Award*, ¶ 77 (Tab 113).

³⁴⁹ *Pope & Talbot – Merits Award*, ¶¶ 87-88 (Tab 113).

³⁵⁰ *Pope & Talbot – Merits Award*, ¶ 79 (Tab 113).

purposes were not in like circumstances with solvent investments operating in the same economic sector. It commented that, “[the Tribunal] has not been persuaded that GAM’s circumstances were demonstrably so “like” those of non-expropriated mill owners that it was wrong to treat GAM differently.”³⁵¹

310. The Investor’s approach “to like circumstances” confines itself to identifying the economic sector in which the Investor competes.³⁵² This approach excludes consideration of the policy objectives behind the treatment at issue and therefore completely misses relevant considerations. As demonstrated below, legitimate policy considerations are relevant to the determination of like circumstances for some of the allegations of breach of national treatment advanced by Merrill & Ring. Consideration of these policy differences shows that there has been no discrimination and that any difference in treatment has a rational explanation.

(2) The Investor’s “Special Meaning” Is Wrong in Law

311. The Investor argues that “in like circumstances” has a “special meaning” that is limited to whether comparator investments are competitors in the same economic sector as Merrill & Ring.³⁵³

312. Canada’s position is that “in like circumstances” means what it says, and that the Investor’s interpretation of “in like circumstances” departs from its ordinary meaning. The Investor’s “special meaning” considers only one factor (out of many) - the economic sector - that has been considered by past NAFTA tribunals when determining whether entities are “in like circumstances.” It has tried to limit the entire “in like circumstances” test to an examination of that one factor.

313. Canada does not deny that whether foreign and domestic entities “compete in the same economic sector” may be relevant to whether those entities are “in like

³⁵¹ *GAMI – Award*, ¶ 114 (Tab 54).

³⁵² Investor’s Memorial ¶¶ 258, 259, 266.

³⁵³ Investor’s Memorial, ¶¶ 258, 259, 266.

circumstances.” However, to limit the Tribunal’s examination of circumstances to this one factor is erroneous in law.³⁵⁴

314. Article 31(4) of the *Vienna Convention* provides that “[a] special meaning shall be given to a term if it is established that the parties so intended.” The Investor has produced no evidence to show that the NAFTA Parties ever intended to adopt the Investor’s “special meaning.” The ordinary words “in like circumstances” in Article 1102 neither support the proposed special meaning, nor do they indicate that anything other than the ordinary meaning was intended by the NAFTA Parties.

315. No NAFTA tribunal has limited its consideration of like circumstances to a determination that the foreign and domestic investors being compared operated or competed in the same economic or business sector. The *S.D. Myers* Tribunal, cited by the Investor as support for its approach,³⁵⁵ actually went well beyond a consideration of the economic sector in which the claimant operated. Instead, the *S.D. Myers* Tribunal affirmed that policy considerations, general principles emerging from the legal context of NAFTA such as concern for the environment and the need to avoid trade distortions and “general principles that would justify governmental regulations that treat them [investors] differently in order to protect the public interest” were all relevant in determining like circumstances.³⁵⁶

316. The *Pope & Talbot* Tribunal acknowledged that being in a common business or economic sector was pertinent, but expressly cautioned that it was only the “first step.” That Tribunal continued to factor in policy justifications for apparently differential treatment as part of its like circumstances analysis.³⁵⁷

³⁵⁴ In section 3, below, Canada identifies other elements that are relevant in the circumstances of each allegation and shows that the Investor is not in like circumstances with the domestic investors to which it compares itself.

³⁵⁵ Investor’s Memorial, ¶ 260.

³⁵⁶ *S.D. Myers – First Partial Award*, ¶¶ 248-250 (Tab 120).

³⁵⁷ *Pope & Talbot – Merits Award*, ¶ 78 (Tab 113).

317. Likewise, non-NAFTA cases interpreting similar BIT clauses have refused to limit “in like circumstances” to a showing that the companies operate in the same business sector.³⁵⁸ For example, in *Occidental v. Ecuador*, the Respondent argued that “in like situations” means that companies in the same sector should be treated alike. The Tribunal considered arguments based on WTO text and concluded,

In fact, “in like situations” cannot be interpreted in the narrow sense advanced by Ecuador as the purpose of national treatment is to protect investors as compared to local producers, and this cannot be done by addressing exclusively the sector in which that particular activity is undertaken.³⁵⁹

318. There also is no support for the Investor’s approach in secondary sources. For example, the OECD Declaration states that the national treatment obligation requires a comparison of *all* the relevant factors surrounding a State’s treatment of the investment.³⁶⁰

319. The Investor also tries to find support for its proposed special meaning by pointing to various uses of “like” in different chapters of the NAFTA.³⁶¹ The opposite conclusion seems more logical. The NAFTA Parties obviously were aware of these different uses of “like” and nonetheless rejected them in favour of “in like circumstances” in Chapter Eleven.³⁶² This confirms that “in like circumstances” was deliberately used in Article 1102 because it best conveyed the intent of the Parties. The Tribunal in *Methanex v. United States* also rejected the argument that descriptions of likeness from other parts of NAFTA could be imported into Article 1102. The Tribunal concluded that,

³⁵⁸ See, e.g., *Champion Trading Co. et al. v. Egypt*, (ICSID Case No. ARB/02/09), Award, (27 October 2006) ¶ 154 (Tab 21), where the Tribunal determined that the investor operating in the cotton industry was not ‘in like situation’ with the domestic comparator because it chose to buy cotton on the free market, rather than through the Collection Centres at fixed prices.

³⁵⁹ *Occidental – Award*, ¶ 173 (Tab 105).

³⁶⁰ All 30 OECD member countries have subscribed to the Declaration, including Canada, Mexico and the United States. The OECD Declaration contains a national treatment provision similar to Article 1102, providing that adhering governments should, “(...) accord to enterprises operating in their territories and owned or controlled directly or indirectly by nationals of another adhering government (...) treatment under their laws, regulations and administrative practices, consistent with international law and no less favourable than that accorded in like situations to domestic enterprises.

³⁶¹ Investor’s Memorial, ¶¶ 267-286.

³⁶² For example, NAFTA Articles 301(1), 301(2), 712, 904(3), 908(6), 1202, 1405.

It is thus apparent from the text that the drafters of NAFTA were careful and precise about the inclusion and the location of the respective terms, “like goods,” “any like, directly competitive or substitutable goods, as the case may be”, and “like circumstances.” “Like goods” is never used with respect to the investment regime of Chapter 11 and “like circumstances”, which is all that is used in Article 1102 for investment, is used with respect to standards-related measures that might constitute technical barriers to trade only in relation to services; nowhere in NAFTA is it used in relation to goods.³⁶³

320. Nor can the likeness language in GATS (“like services and service suppliers”) be relied on by the Investor to import a “special meaning” to “in like circumstances” in Article 1102 (especially one that contradicts the clear words of the treaty text). These are distinct phrases in different treaties and cannot be interpreted as if they were the same. The mere fact that treaties were negotiated during the same period in no way proves that their meanings are similar. Rather, one must look to the structure, purpose and negotiating history of each treaty to determine whether one borrowed from the other.

321. To similar effect, the Investor argues that “in like circumstances” means “like” because “[i]t is readily apparent that the structure of Article III: 4 of the GATT was used as a model for NAFTA Article 1102.”³⁶⁴ The suggested association between the GATT Article III and NAFTA Article 1102 ignores the plain meaning of the terms “like products” and “in like circumstances.” There is no basis for importing the content of “like products” in one article of the GATT into a provision of NAFTA addressing investment obligations and intentionally using terms that little resemble those in the GATT.

322. NAFTA cases have uniformly rejected the Investor’s premise that a GATT “like goods” analysis is relevant to the interpretation of “in like circumstances” in Article 1102. As the Tribunal in *Methanex* determined,

³⁶³ *Methanex – Award*, Part IV-Chapter B-Page 17, ¶ 33 (Tab 85).

³⁶⁴ Investor’s Memorial, ¶ 281.

...[t]he Tribunal begins with an inquiry into the plain and natural meaning of the text of Article 1102. Paragraphs 1, 2, and 3 of Article 1102 enjoin each Party to accord to investors or investments of another Party “treatment on less favourable than that it accords, in like circumstances, to its investors [or investments]...” These provisions do not use the term of art in international trade law, “like products”, which appears in and plays a critical role in the application of GATT Article III. Indeed, the term “like products” appears nowhere in NAFTA Chapter 11.

The drafting parties of NAFTA were fluent in GATT law and incorporated, in very precise ways, the term “like goods” and the GATT provisions relating to it when they wished to do so.³⁶⁵

The issue here is not the relevance of general international law (...), or the theoretical possibility of constructing a provision of NAFTA by reference to another treaty of the parties, for example the GATT. International law directs this Tribunal, first, to the text; here the text and the drafters intentions, which the text manifests, shows that trade provisions were not to be transported to investment provisions. Accordingly the Tribunal holds that Article 1102 is to be read on its own term and not as if the words “any like directly competitive or substitutable goods” appeared in it.”³⁶⁶

323. A similar view has been expressed by other tribunals interpreting bilateral investment treaties. For example, the *Occidental* Tribunal rejected the argument that “like products” in the GATT assisted in interpreting “in like situations” in the national treatment obligation of the U.S. - Ecuador bilateral investment treaty. The Tribunal found that “in like situations” used in the Treaty was different from “like products” in the GATT. In particular, the “like situation” could relate to all exporters that share a

³⁶⁵ *Methanex – Award*, Part IV-Chapter B-Page 14, ¶¶ 29-30 (Tab 85).

³⁶⁶ *Methanex – Award*, Part IV-Chapter B-Page 14, ¶ 37 (Tab 85); the *Methanex* Tribunal notes at ¶ 34:

“It may also be assumed that if the drafters of NAFTA had wanted to incorporate trade criteria in its investment chapter by engrafting a GATT-type formula, they could have produced a version of Article 1102 stating “Each Party shall accord to investors [or investments] of another Party treatment no less favourable than it accords its own investors, in like circumstances with respect to any like, directly competitive or substitutable goods”. It is clear from this constructive exercise how incongruous, indeed odd, would be the juxtaposition in a single provision dealing with investment of “like circumstances” and “any like, directly competitive or substitutable goods.”

disadvantageous condition, while the “like product” necessarily relates to competitive and substitutable products.³⁶⁷

324. UNCTAD has also rejected efforts to apply the meaning of the GATT “like goods” test to the “in like circumstances” element of national treatment in an investment treaty. In its view,

... [t]he scope of national treatment in the investment field goes well beyond its use in trade agreements. In particular, the reference to “products” in article III of the GATT is inadequate for investment agreements in that it restricts national treatment to trade in goods. The activities of foreign investors in their host countries encompass a wide array of operations, including international trade in products, trade in components, know-how and technology, local production and distribution, the raising of finance capital and the provision of services, not to mention the range of transactions involved in the creation and administration of a business enterprise.³⁶⁸

325. In short, none of the provisions of NAFTA and the WTO Agreements relied on by the Investor supports its special meaning for “in like circumstances” in Article 1102. The Investor’s approach to determining comparators for the “in like circumstances” analysis is wrong and has no support in relevant cases or any other sources. Article 1102 was deliberately drafted for the investment context of Chapter Eleven and must be applied as drafted by the NAFTA Parties.

**(3) The Facts Also Do Not Support the Investor’s
“Special Meaning”**

326. The Investor’s claim that it is in “like circumstances” with other timber growers and log harvesters from B.C. and the rest of Canada solely because it competes in the same business or economic sector as these entities is also highly debatable from a factual perspective.

³⁶⁷ *Occidental – Award*, ¶¶ 173-176 (Tab 105).

³⁶⁸ *UNCTAD – National Treatment*, at 9 (Tab 143).

327. It is a gross oversimplification to state that Merrill & Ring is operating in the same sector as, and competes with, timberland owners in the Interior of British Columbia. The Coastal and Interior regions of B.C. are two economically distinct regions due to differences in geography, climate and forest ecosystems, resulting in different species, grades and quality of wood; timber harvesting methods, costs and transportation alternatives. In turn, the processing industries, mix of products and economic forces that shape the forestry sector in these regions also differ. They transport product differently, market in different ways, sell to different end-markets and export to different regions.³⁶⁹

328. Contrary to the Investor's assertion at paragraph 360(b) of its Memorial, the species harvested on the Coast and in the Interior differ significantly. Timber harvested on the Coast is predominantly hemlock (28%), douglas fir (27%) and western red cedar (20%), which together account for three-quarters of the Coastal harvest. On the other hand, the Interior has a different distribution of tree types and quality, dominated by pine species. Lodge pole pine (61%) and spruce (18%) make up 79% of the Interior harvest, whereas they are only 2% of the Coastal harvest.³⁷⁰

329. Contrary to the allegations in paragraph 360(c) of the Investor's Memorial, log processing on the B.C. Coast and in the Interior also differ. Interior saw milling is characterised by modern, high-volume mills that produce lumber typically used in North American home construction. Over 90% of the lumber produced in the B.C. Interior was exported to the U.S. in 2003, while 7% was shipped to Japan. By contrast, Coastal processing is more diverse, including large volumes of specialty cedar and lumber designed for use in other markets, notably Japanese style home construction. The Coast ships over half of its volume to the United States, although less than half its lumber by value is shipped to the United States. Japan accounts for a third of Coastal exports by value.³⁷¹

³⁶⁹ These differences are comprehensively explained in the *Reishus Affidavit*, ¶¶ 31-53, 62, 128.

³⁷⁰ *Reishus Affidavit*, ¶¶ 38-46, Figures 4 & 5. This contradicts the Investor's assertion at ¶ 360(b) of its Memorial that Merrill & Ring produces the same species as Interior B.C. competitors.

³⁷¹ *Reishus Affidavit*, ¶¶ 47-49.

330. Contrary to the allegations at paragraph 360(d) of the Investor's Memorial and the Mason, Bruce & Girard affidavit, the data shows that B.C. Coastal logs rarely compete with Interior logs and that logs from the two regions are rarely interchangeable or substitutable. This is due mainly to the high cost of transportation from the Interior and the different species processed by mills, which are adapted to the type of timber most readily available to them.³⁷²

331. Similarly, it is a gross oversimplification to state that Merrill & Ring competes with other entities in the log sector in provinces outside of British Columbia. There is very significant variation between the forestry sectors in each province. Logs from B.C. generally do not compete with logs from other provinces. Each province has its own types of forests, forestry economics and forestry regulation that differ from those in British Columbia.³⁷³

332. The case of Alberta, B.C.'s neighbour, is instructive. Alberta has mainly provincially owned forests and imposes local processing requirements on logs from provincially owned forests. There are no significant industrial forestlands in Alberta and over 85% of the private harvest in Alberta consists of hardwood. The volume of log exports from Alberta is small and declining. In particular, the cost of trucking timber from Alberta to the United States, different species and mill types in Alberta and the generally lower-valued timber in Alberta (as compared to the B.C. Coast) effectively prevent it from competing with B.C. Coastal timber. The volumes exported from Alberta are insignificant.³⁷⁴ The small export volume of Alberta's logs justifies the conclusion that Alberta does not really compete at all in the export log market, much less with Coastal B.C. logs of different species and sizes.³⁷⁵

³⁷² *Jendro Affidavit*, ¶¶ 4.1 – 4.7.2; *Reishus Affidavit*, ¶¶ 47-49, 132-135.

³⁷³ *Reishus Affidavit*, ¶¶ 54-60, 128-135.

³⁷⁴ Since 2005, annual log exports from Alberta never exceed 5,000 m³, well under ¼% of the private harvest: *Reishus Affidavit*, ¶¶ 55-58, 131.

³⁷⁵ *Reishus Affidavit*, ¶¶ 55-58, 128-135, Figure 20 (at 77); *Jendro Affidavit*, ¶¶ 4.1-4.7.2.

333. Provinces in eastern Canada are also different from the B.C. Coast in forestry terms. Overall, eastern Canada is a net importer of logs. Eastern Canada grows more hardwood, has smaller average tree size, and uses more wood for pulp rather than for high value solid wood products than does British Columbia. Of the four major species on the B.C. Coast, douglas fir and red cedar do not occur in eastern Canada and white balsam and hemlock are just 3% of Ontario's harvest. Eastern Canada tends to export to Europe and eastern markets rather than to the Pacific Rim markets that are the main destination for B.C. Coastal wood.³⁷⁶

334. In short, from a factual perspective, Merrill & Ring shares only the most basic characteristics with timberland owners outside Coastal B.C. – they all grow and harvest trees and sell the harvested logs. However, if one considers the facts at any greater level of detail, it is clear that Merrill & Ring does not compete with and is not in the same economic sector as timberland owners in the Interior of B.C. and in other provinces.

335. The Investor's proposed "special meaning" for the "in like circumstances" element is not justified from a legal or factual perspective. The plain words of Article 1102 govern. These words require a Tribunal to look at the totality of the circumstances in which the treatment is accorded to determine whether those circumstances are like. While competing in a common business sector may be a first step in determining like circumstances, it is not the exclusive test under Article 1102. The Investor grows, harvests and sells logs like other timberland owners in Canada, but it does not compete in the same economic sector with Interior B.C. or the rest of Canada in any other sense.

c) The Investor Must Establish that the Treatment Accorded to it was "Less Favourable" than the Treatment Accorded to the Domestic Comparators

336. The third element of Article 1102 requires a Party to accord treatment to foreign investments that is no less favourable than the treatment it accords in like circumstances to investments of its own investors. The ordinary meaning of according treatment "no

³⁷⁶ *Reishus Affidavit*, ¶¶ 59-60.

less favourable” is that foreign investors must be treated as favourably as domestic investors in like circumstances. As noted in Canada’s Statement on Implementation of the NAFTA, “[n]ational treatment means that Canada will treat U.S. and Mexican investors and their investments *as favourably as* it treats Canadian investors and their investments, in like circumstances.”³⁷⁷ UNCTAD affirms that as long as the treatment accorded to the foreign investor and its investments is as favourable as that received by national investors of a host country, then the host country has met its national treatment obligation.³⁷⁸

337. To establish that it was accorded less favourable treatment, the Investor must prove that some disadvantage flows to it from the treatment in question as compared to the treatment accorded to the domestic investor or investment. The precise nature of that disadvantage will depend on the circumstances of the case.

338. If the foreign investment receives the same treatment as the appropriate domestic comparator, there can be no violation of national treatment. Similarly, if the foreign investment is accorded treatment that is equivalent to (no better or worse than) the appropriate domestic comparator, there can be no violation of national treatment under NAFTA Chapter Eleven.

339. The Investor cites the GATT *Section 337* case interpreting GATT Article III:4 to argue that the “no less favourable” element in Article 1102 is “an obligation to provide equality of competitive opportunities.”³⁷⁹

340. Again, this ignores the plain language, context and object of Article 1102. Article 1102 does not impose an obligation to provide equality of competitive opportunity. As noted above, there is no basis to read Article 1102 as if it meant the same thing as GATT Article III:4. The provisions are differently worded articles in different treaties.

³⁷⁷ *Canadian Statement*, at 148 (Tab 19). The *U.S. Statement of Administrative Action* simply paraphrases Article 1102 (Tab 150).

³⁷⁸ *UNCTAD – National Treatment*, at 37 (Tab 143).

³⁷⁹ *Investor’s Memorial*, ¶ 292.

341. The Investor also suggests a different test based on *Pope & Talbot v. Canada*: that a NAFTA Party must treat the foreign investor as well as the best treated domestic investor and investment.³⁸⁰ In *Pope*, the Tribunal found that “national governments cannot comply with NAFTA by according foreign investments less than the most favourable treatment they accord their own investments.”³⁸¹

342. The debate concerning “best treatment” does not even arise in this case. On the facts, Canada treated foreign and domestic investors in like circumstances that were subject to Notice 102 in exactly the same fashion. There is no more or less favourable treatment. Rather, the treatment accorded by Canada is uniform.³⁸² The more favourable treatment that the Investor compares itself to in each of its specific allegations is either not treatment accorded in like circumstances, not less favourable treatment or not treatment accorded by Canada.

d) The Overriding Purpose of Article 1102 Is to Prevent Nationality-based Discrimination

343. Finally, the Investor’s construction of Article 1102 ignores the overriding purpose of a national treatment obligation: to prohibit discrimination based on nationality. It is not a broad non-discrimination obligation, but rather a prohibition on nationality-based discrimination.

344. This is clear from the title of Article 1102: “National Treatment.” “National” means “of or relating to a nation,” or “comprising or characteristic of a nationality.”³⁸³ Article 1102 mandates a comparison between the treatment that a NAFTA Party accords to its nationals and that which it accords to non-nationals in like circumstances.

³⁸⁰ Investor’s Memorial, ¶ 293.

³⁸¹ *Pope & Talbot – Merits Award*, ¶ 41 (Tab 113).

³⁸² See *Methanex – Award*, Part IV-Ch. B-Pages 9-10, ¶¶ 20-22 (Tab 85), where there was a similar holding but based on Article 1102(3) as the treatment at issue was accorded by California.

³⁸³ *Shorter Oxford*, at 1888-9 (Tab 128).

345. The fundamental object and purpose of a national treatment clause is to prevent discrimination based on the nationality of the investor or its investment. In the context of NAFTA, Article 1102 ensures that Canadian, Mexican and American investors are not discriminated against by another NAFTA Party based on their nationality.³⁸⁴

346. Canada's Statement on Implementation confirms that Article 1102 was intended to protect foreign investors from nationality-based discrimination,

The article explains that national treatment prohibits the imposition of requirements that a minimum level of equity be held by nationals as well as forced divestiture on the basis of nationality. In effect, the national treatment obligation provides investors the right to establish an investment on as favourable terms as domestic investors and as favourable treatment as domestic investors after establishment.(...)

One of Canada's principal goals in negotiating the NAFTA was to ensure that Canada remains an attractive place to invest. It ensures that investors in Canada, whether foreign or domestic, have secure access to North American markets on the same basis as investors in the United States and Mexico.³⁸⁵

347. Similarly, the U.S. Statement of Administrative Action affirms that Article 1102 protects against nationality-based discrimination. It states that Article 1102 sets out the

³⁸⁴ All three NAFTA Parties have affirmed this principle in past NAFTA Chapter Eleven arbitrations: On behalf of the United States, see *Loewen v. United States*, Counter-Memorial of the United States of America, 30 March 2001, at 128 (Tab 74) "They have no evidence of any "nationalistic" bias on the part of the Mississippi judiciary."; On behalf of Mexico see *GAMI Investments, Inc. v. Mexico* (UNCITRAL) Statement of Defense, 24 November 2003, ¶ 273 (Tab 53) "A violation of national treatment requires discrimination on the basis of nationality." see also Mexico's Article 1128 Submission in *Methanex Corporation v. United States*, 30 January 2004 ¶ 16 (Tab 84): "When applying the national treatment rule, the only relevant issue of status is the investor's nationality. Where a breach of Article 1102 is alleged, it is less favourable treatment based on the Claimant's Canadian nationality only that can give rise to a finding of breach of Article 1102 (...);" and on behalf of Canada, *Pope & Talbot v. Canada*, Counter-Memorial, 29 March 2000, ¶ 166 (Tab 110): "Article 1102(2) does not prevent a Party from implementing a measure that affects investments differently as long as the measure neither directly nor indirectly discriminates on the basis of nationality as between foreign and domestic investments"; see also *UPS v. Canada*, Counter-Memorial ¶ 585 (Tab 145): "The terms of Article 1102... reveal the Article's general purpose of preventing nationality based discrimination."; and finally *Methanex v. United States*, Fourth Submission of the Government of Canada Pursuant to NAFTA Article 1128, 30 January 2004 (Tab 84), "[Article 1102] prohibits treatment which discriminates on the basis of the foreign investment's nationality."

³⁸⁵ *Canadian Statement*, at 148-149, 159 (Tab 19).

basic non-discrimination rule of national treatment and makes clear that “the ‘national treatment’ rule prohibits governments from imposing local equity requirements or requiring an investor from another NAFTA country, by reason of its nationality, to sell an investment.”³⁸⁶

348. NAFTA Chapter Eleven jurisprudence affirms that the central object of Article 1102 is to prevent nationality-based discrimination. The tribunal in *Myers* stated that treatment would be contrary to a national treatment norm where either the practical effect of the measure was to create a disproportionate benefit for nationals over non-nationals or the measure on its face favoured nationals over non-nationals.³⁸⁷ The Tribunal in *Feldman v. Mexico* determined that the breach of Article 1102 rested on differential treatment of the investors, based on their nationality. It added “...the interpretive hurdles for Article 1102...include ...the extent to which differential treatment must be demonstrated to be a result of the foreign investor’s nationality.”³⁸⁸ In *Loewen v. United States* the tribunal clearly held that Article 1102 deals with discrimination based on nationality. It stated, “... Article 1102 is direct only to nationality-based discrimination and that it proscribes only demonstrable and significant indications of bias and prejudice on the basis of nationality...”³⁸⁹

349. Evidence of nationality has also been decisive in the outcome of various NAFTA Chapter Eleven cases. The *GAMI* award held that Mexico’s expropriation of insolvent Mexican sugar mills did not violate national treatment since it could be explained by reasons other than the existence of a foreign minority shareholder.³⁹⁰ The Tribunal in *ADF*

³⁸⁶ *U.S. – Statement of Administrative Action*, at 140 (Tab 150).

³⁸⁷ *S.D. Myers – First Partial Award*, ¶ 252 (Tab 120).

³⁸⁸ *Feldman – Award*, ¶ 166 (Tab 49).

³⁸⁹ *Loewen Group, Inc. and Raymond L. Loewen v. United States* (ICSID No. ARB/98/3) Award on Merits, 25 June 2003 ¶ 139 (Tab 73).

³⁹⁰ *GAMI – Award*, ¶¶ 111-115 (Tab 54).

v. *United States* also refused to find a breach of Article 1102 in the absence of evidence of discrimination based on nationality.³⁹¹

350. The OECD Declaration is consistent with this case law. It states,

In any case, the key to determining whether a discriminatory measure applied to foreign-controlled enterprises constitutes an exception to National Treatment is to ascertain whether the discrimination is motivated, at least in part, by the fact that the enterprises concerned are under foreign control.³⁹²

351. Likewise, UNCTAD has stated that a key issue in national treatment cases is to “ascertain whether the discrimination is motivated, at least in part, by the fact that the enterprises concerned are under foreign control.”³⁹³

352. In this case it is abundantly clear that there was no nationality-based discrimination. Not only is the measure complained of facially neutral; in addition, the measure complained did not have the effect of creating a disproportionate benefit for nationals over non-nationals.³⁹⁴ The alleged disadvantages identified by the Investor were felt equally by Canadians in the same circumstances as the Investor and had nothing to do with discrimination.

3. Canada Has Not Breached National Treatment

353. In the paragraphs that follow, Canada applies the three elements of the national treatment analysis to each allegation of breach by the Investor.

a) The Surplus Test Treats Investors in Like Circumstances the Same and Does Not Violate National Treatment

354. The Investor claims:

³⁹¹ *ADF – Award*, ¶ 157 (Tab 2).

³⁹² *OECD Declaration – National Treatment*, at 22 (Tab 106).

³⁹³ *UNCTAD – National Treatment*, at 33 (Tab 143).

³⁹⁴ *S.D. Myers – First Partial Award*, ¶ 252 (Tab 120).

Merrill & Ring's federal timberlands are subject to the log export restrictions of Notice 102, while private timberland owners in all other Canadian provinces are automatically eligible to receive export permits and are not subjected to Notice 102 and the rest of the Log Export Control Regime. They are the best treated investments in Canada.³⁹⁵

355. This allegation compares the treatment which the Investor receives under Notice 102 with the treatment of all other log producers in Canada that are not subject to Notice 102. While log producers outside B.C. are subject to provincial forestry regulation by their province of origin, Canada does not dispute that producers outside of B.C. are not subject to Notice 102 before applying for an export permit.

356. The Investor proffers private timberland owners in other provinces as the proper comparators for its “in like circumstances” analysis. This applies the Investor’s legally and factually incorrect test considering only whether the foreign and domestic investors compete in the same economic or business sector. It ignores a more accurate comparator, those investors in the “most like” circumstances to the Investor.

357. As explained above, a Tribunal should select the “most like” comparator for an “in like circumstances” analysis. Numerous domestic entities in B.C. are subject to Notice 102, and are in identical circumstances to Merrill & Ring.³⁹⁶ These B.C. entities should be used as the domestic comparators for purposes of assessing “in like circumstances.” To paraphrase the *Methanex* Tribunal, in selecting the best comparator, it would be perverse to ignore domestic investors operating under Notice 102 on federal land in B.C. that are identical to Merrill & Ring in favour of the “less like” investors in provinces outside of British Columbia. Applying the identical comparator in the circumstances of this case demonstrates that Canada has given exactly the same treatment to foreign and domestic investors in like circumstances and that there has been no breach of national treatment. Notice 102 applies in the same fashion to timberland owners in B.C. as it does to Merrill & Ring.

³⁹⁵ Investor’s Memorial, ¶ 361(a).

³⁹⁶ *Korecky Affidavit*, ¶¶ 68-74.

358. It is clear that B.C. is in entirely unlike circumstances from all other provinces with respect to the need for, and application of, Notice 102. Simply put, Notice 102 was implemented in B.C. for exactly the reason it states: “to ensure that there is an adequate supply and distribution of (logs) in Canada for defence or other needs.”³⁹⁷ This is complemented by section 3(b) of the EIPA which, “ensures that any action taken to promote the further processing in Canada of a natural resource that is produced in Canada is not rendered ineffective by reason of the unrestricted exportation of that natural resource.”³⁹⁸

359. The fundamental differences between the forestry sector in B.C. and in other provinces (which have been discussed above) result in a circumstance where potential shortages in supply would have a more severe adverse effect on the B.C. economy as a whole than on the economies of other provinces. This is because of the signal importance of forestry to British Columbia.

360. Recall that B.C. exports vastly more logs from Canada than any other province. In fact, in 2007 B.C. was the only net exporter of logs in Canada. Every other province was a net importer of logs in 2007. Figure 20 in the Reishus Affidavit dramatically illustrates this. In 2007 B.C. exported a volume of 3,227,000 m³ logs. By contrast, in the same year every other province was a net importer: Alberta net imported 1,000 m³, Ontario net imported 108,000 m³, Quebec net imported 3, 783,000 m³ and the rest of Canada net imported 797,000 m³.³⁹⁹ This statistic alone makes it clear how ridiculous it would be to apply Notice 102 to any province other than British Columbia.

361. In addition, B.C. has unique access to the Pacific Rim market, in particular due to the vast and valuable forests in Coastal British Columbia and their proximity to convenient and cost-effective water transport for logs. The Pacific Rim is an extremely active log market in which B.C. participates, whereas practically speaking, other

³⁹⁷ Notice 102, ¶ 1 (Tab 101); *Korecky Affidavit*, ¶ 21, Exhibit 1 (EIPA, s. 3(e)).

³⁹⁸ *Korecky Affidavit*, ¶ 21, Exhibit 1 (EIPA, s. 3(b)).

³⁹⁹ *Reishus Affidavit*, ¶ 129, Figure 20; see also ¶¶ 130 – 131.

provinces cannot take advantage of this trade to any meaningful degree due to their geographic location.⁴⁰⁰

362. These statistics, paired with the importance of logging to the overall economic well-being of B.C., demonstrate the very different circumstances of B.C. compared to other provinces and why Notice 102 makes sense in the B.C. context.⁴⁰¹

363. In any event, timberland owners in other provinces are not “in like circumstances” with the Investor. They grow different species of wood, face different transportation challenges, service different end-markets, and export to different regions. They are also governed by provincial regulations to which the Investor is not subject.⁴⁰²

364. The Investor is treated identically to domestic investors subject to Notice 102. No domestic investor receives more favourable treatment than Merrill & Ring. The measures at issue do not breach Article 1102 because the Investor has not established the second (in like circumstances) and third (no less favourable) elements of the test for national treatment.

365. Further, the Investor has not proved that the different treatment it receives as compared to the treatment of private timberland owners in other provinces is nationality-based. The Investor has introduced no evidence with respect to this point. The facts on record demonstrate that both Canadian and American investors are subject to Notice 102 and that they are treated identically in the application of Notice 102. It would therefore be illogical to suggest that the surplus policy is applied to Merrill & Ring for nationality-based reasons. No nationality-based discrimination has been alleged or proved in this instance and none exists. As a result, no breach of Article 1102 has been established.

⁴⁰⁰ *Reishus Affidavit*, ¶¶ 74-75; see generally *Reishus Affidavit* ¶¶ 63 – 67.

⁴⁰¹ See Facts section of Canada’s Counter-Memorial.

⁴⁰² *Reishus Affidavit*, ¶¶ 46, 55.

b) Notice 102's Remote Advertising Requirement Does Not Even Apply to Merrill & Ring

366. The Investor complains as follows about remote area advertising requirements:

Notice 102 forces Merrill & Ring to advertise logs in "remote" areas in minimum volumes of 2,800 m³. Logs advertised in "non-remote" areas are not subjected to this minimum volume requirement.⁴⁰³

367. In this allegation, the treatment stems from paragraph 1.4 of Notice 102, which states: "In remote areas of the Coast, applications may be made for a minimum export of 2800 m³ of logs. Volumes below this level will not be accepted and must be transported to the established log marketing areas before making applications."⁴⁰⁴

368. This charge fails for the simple reason that the Investor does not operate in a remote area, and hence the minimum volume requirement does not apply to it.⁴⁰⁵ There can be no breach of Article 1102 when the treatment complained of does not even apply to the Investor. Nor could any damage be caused by a requirement that does not apply to the Investor. As a result, this allegation should be summarily dismissed without even considering the other elements of national treatment.

369. The Investor apparently compares investors advertising logs in remote and non-remote areas for the purposes of establishing like circumstances in this instance. In fact, investors advertising logs harvested in remote areas of the B.C. Coast are not in like circumstances with those advertising logs harvested in non-remote areas of the province. As explained in the Cook Affidavit, potential buyers of logs in remote areas must travel long distances to inspect log booms. Generally, they will not travel these distances for small booms. Historically, this resulted in some loggers in remote areas advertising small volume booms to avoid offers on their logs and hence to circumvent the surplus test. Minimum volume requirements for advertising logs in remote areas were established to

⁴⁰³ Investor's Memorial, ¶ 361(b).

⁴⁰⁴ Cook Affidavit, ¶¶ 76-78. It should be noted that this requirement relates to advertising only and is not an export volume restriction.

⁴⁰⁵ Cook Affidavit, ¶ 81.

prevent such circumvention. The minimum volume requirement establishes a volume threshold above which it is economical for potential buyers to inspect booms in remote areas.

370. The minimum volume requirement for advertising logs in remote areas avoids potential abuse of the surplus test and is a reasonable policy in the circumstances. As the potential for this type of abuse does not exist in non-remote areas, there is no reason to apply the minimum volume requirement to advertisement of logs in non-remote areas. Loggers advertising logs from non-remote areas are therefore not in like circumstances with loggers advertising logs from remote areas and hence this element of the national treatment test has not been proved.⁴⁰⁶

371. The Investor suffers no disadvantage from the minimum volume requirement for advertising, as that requirement does not apply to it. It therefore cannot claim that it has been given less favourable treatment than domestic investors.

372. Even if Merrill & Ring were subject to the minimum volume requirement, it would not constitute less favourable treatment because it does not disadvantage the foreign investor. The minimum volume requirement does not limit a log owner's ability to export: once the booms are declared surplus the Investor can export any amount it wishes. Further, an investor wishing to advertise logs in a volume less than 2800m³ can easily do so by towing those logs from remote areas to non-remote areas. As the logs ultimately have to be towed to a mill or sales point, this would not be an additional burden on the Investor.⁴⁰⁷

373. Finally, the treatment complained of is not imposed for nationality-based reasons. It applies for legitimate policy reasons and is implemented without regard for nationality and hence does not violate national treatment. The Investor has not established any of the

⁴⁰⁶ *Cook Affidavit*, ¶¶ 79-81.

⁴⁰⁷ *Cook Affidavit*, ¶¶ 82, 84. See also *Kurucz Affidavit*, ¶ 56, stating Merrill & Ring often tows its logs for an inspection; *Schaaf Affidavit*, ¶ 27; *Reishus Affidavit*, ¶ 156; *Korecky Affidavit*, ¶ 85.

three required elements to prove a breach of national treatment and its allegation concerning the minimum volume requirement for advertising must be dismissed.

c) Sort and Scale Requirements Under Notice 102 Also Respect national Treatment

374. The Investor complains as follows about sort and scale requirements,

Merrill & Ring's coastal logs have to be prepared in a particular way, in accordance with the *Coast Domestic End Use Sort Descriptions*, while log producers in the BC interior as well as anywhere else in Canada, do not. Sorting and scaling requirements in the BC interior are less stringent than they are on the BC coast.⁴⁰⁸

375. The sorting and scaling treatments at issue both stem from Notice 102 and apply to the Investor.

(1) Sorting

376. Paragraph 1.5 of Notice 102 sets out the sort requirement: “[L]ogs must be sorted, boomed or decked to conform to normal log market practices of not less than 90% of a single species and recognized domestic end use sort by volume.” The *Coast Domestic End Use Sort Descriptions* specify normal log market sorting practices for domestic and export sorting of Coastal lumber. They are jointly drafted by log traders, mills, exporters and government. They are industry-driven and not a government initiative.⁴⁰⁹

377. To bring its claim against such requirements, the Investor relies on its special meaning for in like circumstances, and compares itself with certain competitors in the same economic or business sector. However, the Investor ignores the identical comparators: all other companies subject to Notice 102 that must comply with the same sort requirements as Merrill & Ring.

⁴⁰⁸ Investor's Memorial, ¶ 361(c).

⁴⁰⁹ *Cook Affidavit* ¶¶ 54-56. See ¶¶ 57-61 for definition of the sort descriptions.

378. The sort requirements for entities operating pursuant to Notice 102 distinguish between B.C. Coastal and Interior producers because normal market sorting practices in these areas differ. As a result, in this respect entities operating on the B.C. Coast are not in like circumstances with entities operating in the B.C. Interior or in other Canadian provinces.

379. The entire timber industry on the B.C. Coast uses the *Coast Domestic Market End Use Sort Descriptions* for both domestic and export sales. These have been in place since at least 1999 and are normal market practice on the B.C. Coast.⁴¹⁰ These sort descriptions reflect the particular characteristics of B.C. Coastal logs, which have greater variability in size, quality, and value than logs in the B.C. Interior or elsewhere in Canada.⁴¹¹

380. Sorting practices on the Coast account for this high variability in the species and log-by-log value of Coastal trees.⁴¹² The detailed sort descriptions tailored to B.C. Coastal forests maximise the value of log production and more accurately serve the needs of log processors. Mills require preferred log dimensions, pay premium prices for optimum sorts and pay lower prices for sorts that do not meet their criteria.⁴¹³ Specific Coastal sorting practices also facilitate the unique over-the-counter market on the Coast, the VLM.⁴¹⁴

381. The sorting practices in the B.C. Interior differ from Coastal sorting practices because they reflect the particular characteristics of the Interior forests. In particular, the B.C. Interior has different species, more homogenous harvests and harvests that on average are smaller and are sold for lower prices than logs from the Coast.⁴¹⁵ There is less variance in the log-by-log value of the timber produced in the Interior and Interior

⁴¹⁰ *Cook Affidavit*, ¶¶ 56-57. Recent and insubstantial changes to the Coast Descriptions were made in January 2008 to reflect the evolving nature of coastal forests and mill requirements.

⁴¹¹ *Cook Affidavit*, ¶¶ 57-63; *Reishus Affidavit*, ¶ 39.

⁴¹² *Reishus Affidavit*, ¶ 40.

⁴¹³ *Cook Affidavit*, ¶¶ 62-63; *Reishus Affidavit*, ¶ 40.

⁴¹⁴ *Cook Affidavit*, ¶ 63; *Reishus Affidavit*, ¶ 41.

⁴¹⁵ *Reishus Affidavit*, ¶¶ 43-46.

sorting practices reflect that homogeneity.⁴¹⁶ In addition, the Interior has no centralized log market equivalent to the VLM on the Coast, and, instead, Interior logs are commonly hauled to local processing facilities distributed throughout the Interior.⁴¹⁷

382. In short, the different sorting practices for the B.C. Coast and the B.C. Interior reflect the very different forests and markets served by these distinct areas. As a result, the Investor, with its Coastal production, is not in like circumstances with producers in the Interior or other provinces for the purposes of sorting logs and has no basis to complain about the differences in sort requirements applicable to its Coastal wood.⁴¹⁸

383. The sorting practices of the B.C. Coast are not less favourable treatment than the sorting practices of the B.C. Interior or elsewhere. In fact, market specific sorting practices ensure that logs are assessed to their maximum potential value and are advantageous to the Investor and other log producers.⁴¹⁹ Market specific sorting practices accord the most favourable treatment available to processors in each market and maximise the value of both Interior and Coastal logs.

(2) Scaling

384. The note to paragraph 1.6 of Notice 102 establishes the scaling requirement: “[A]ll parcels of logs scaled for export purposes whether original scale for export or stock scale for export must be scaled by timber mark using the B.C. metric scale....No other scale format will be acceptable.” The Investor must follow this scaling practice for all logs harvested in British Columbia.⁴²⁰

⁴¹⁶ *Reishus Affidavit*, ¶ 44.

⁴¹⁷ *Reishus Affidavit*, ¶ 45.

⁴¹⁸ *Reishus Affidavit*, ¶¶ 128-131.

⁴¹⁹ *Cook Affidavit*, ¶¶ 62-64; *Reishus Affidavit*, ¶ 26. See also *Reishus Affidavit*, ¶¶ 85-90 on the economic advantages of sorting.

⁴²⁰ *Cook Affidavit*, ¶¶ 65-66.

385. The Investor is in like circumstances with, and treated the same as, all other B.C. loggers with respect to scaling and cannot complain of differential treatment.⁴²¹ Scaling is a measurement requirement for logs that expresses the size of the log. The *Forest Act* of B.C. requires all logs harvested in B.C. to be scaled in cubic metres, whether they come from the Coast or the Interior.⁴²²

386. Other provinces have various measuring schemes. As the Investor is not operating in other provinces, it is not in like circumstances with the out of province log producers for log-scaling purposes.

387. The same scaling practices apply to B.C. Coastal and Interior logs. As a result, the Investor receives the same treatment as loggers scaling logs in the Interior of B.C. and Merrill & Ring is not treated less favourably.⁴²³

388. No evidence suggests that scaling requirements outside of B.C. are more advantageous than scaling requirements within B.C. and hence there is also no evidentiary basis to conclude that the Investor receives less favourable treatment than loggers in other provinces.

389. Nor could it be said that metric scaling is any more or less favourable than Scribner scaling. They are simply different measurements of log size. While the Investor might prefer Scribner scaling because of its particular export clientele, this does not make metric scaling a less favourable treatment.

390. Finally, both the sort and scale requirements are operational tools for log harvesters and are not even remotely based on considerations of nationality. Again, the Investor has failed to prove a single required element to establish a breach of national treatment and this allegation should also be rejected.

⁴²¹ *Cook Affidavit*, ¶¶ 50-53; *B.C. Forest Act 1996*, ss. 94 and 96 (Tab 12).

⁴²² *Reishus Affidavit*, ¶¶ 24-25, 158; *Cook Affidavit*, ¶¶ 65-71.

⁴²³ *Cook Affidavit*, ¶¶ 65-69.

**d) Standing Advertising Applications in the Interior
Reflect Storage Capacity and Market Practice, Not
Discrimination**

391. The Investor complains that it is not eligible for a standing timber exception:

Merrill & Ring's timber is not eligible to receive standing green exemptions. Standing timber exemptions allow Merrill & Ring's competitors to apply for an export permits (sic) without having to first harvest their timber, thereby allowing them to forego the costs and risks created by the Log Export Control Regime. Standing timber exemptions are formally available to provincial timber, but not for provincial timber located on the BC south-coast. Canada routinely grants export permits to logs produced under such exemptions. In addition, standing timber exemptions are supposedly not available to federal timber that is not in a tree farm license area. Nonetheless, Canada has granted standing timber exemptions for private federal lands that are not in a tree farm license area and that produces logs that are very similar to Merrill & Ring's logs. (...).⁴²⁴

392. The treatment at issue appears to be the lack of standing timber exemptions for federal land. The Investor claims that Canada grants a "standing timber exemption" to timber growers and log producers located in the Interior.⁴²⁵ Its affiant, Mr. Stutesman, makes a different allegation, asserting that "BCMOF has granted (and continues to grant) standing timber exemptions to federal timber mark lands in the BC interior."⁴²⁶ The entire complaint concerning standing exemptions is based on a misapprehension of the relevant facts and a failure to distinguish the relevant policies.

393. First, Canada has no constitutional authority to grant standing exemptions on provincial land and has not done so.⁴²⁷ The provincial government has never granted a

⁴²⁴ Investor's Memorial, ¶ 361(d).

⁴²⁵ Investor's Memorial, ¶ 361(d). The litany of reasons the Investor gives as to why it receives less favorable treatment than investors that operate under "standing exemptions" seems to be based on exemption from the provincial surplus test: "...they do not have to pass the surplus test...they can sell their logs on international markets...as a result of standing timber exemptions, only one half to one third of BC logs exported from provincially regulated lands are actually subject to the surplus test under the BC Forest Act." This is inaccurate: see *Korecky Affidavit*, ¶¶ 82-83; *Cook Affidavit*, ¶¶ 11-22, 109.

⁴²⁶ *Stutesman Affidavit*, ¶ 19.

⁴²⁷ *Korecky Affidavit*, ¶ 87.

standing exemption on federal land; nor does it have constitutional authority to do so.⁴²⁸ As a result, it is impossible to say that Canada has accorded anything that can even be considered treatment to the Investor, let alone an unfavourable treatment. It is more accurate to state that Canada has not accorded a treatment that the Investor wishes Canada would accord. This cannot be the basis of a claim for breach of national treatment.

394. Second, the Investor appears to have confused treatments and terminology. In particular, the Investor confuses “standing exemptions” and “standing applications” to advertise.

395. Provincial land is eligible for three exemptions from the local use and manufacture requirement: (1) the surplus exemption for logs that are surplus to local manufacturing requirements; (2) the economic exemption for timber that cannot be processed by or transported economically to a facility in B.C.; and (3) the utilization exemption for forest management. All three exemptions are established by section 128 of the B.C. *Forest Act*. All three exemptions can be granted by the province to provincial timber.

396. Economic and utilization exemptions are sometimes referred to in the forestry industry as standing exemptions or standing green exemptions. They are rarely granted and are not available on the south Coast of B.C. where Merrill & Ring harvests.⁴²⁹ As a result, even if Merrill & Ring were on provincial lands and subject to provincial jurisdiction, it would still not be eligible for a standing exemption in practice because it is a Coastal harvester. In any event, the Investor advised Canada and this Tribunal that it is not challenging the B.C. *Forest Act*, hence provincial standing exemptions cannot be at issue in this Claim.

397. Provincial exemptions from the provincial local use and manufacture requirements are distinct from the policy governing the ability to advertise standing

⁴²⁸ *Cook Affidavit*, ¶¶ 6-7. See below, ¶¶ 409-411 concerning Pluto Darkwoods.

⁴²⁹ *Cook Affidavit*, ¶¶ 11-22; *Korecky Affidavit*, ¶¶ 14-18.

timber on the provincial Bi-Weekly List. Timber from provincial land in the B.C. Interior can be advertised in either standing or harvested form on the provincial Bi-Weekly List but must be harvested before a provincial permit is issued allowing removal from British Columbia.

398. Logs from provincial land on the B.C. Coast can be advertised only in harvested form on the provincial Bi-Weekly List.⁴³⁰

399. The federal policy for advertising is exactly the same as the provincial policy for advertising: timber from the Interior may be advertised on the federal Bi-Weekly List in either standing or harvested form. Timber from the Coast must be harvested before advertisement on the federal Bi-Weekly List.⁴³¹

400. All logs originating on federal land are subject to the federal surplus test under Notice 102 if they are to be exported. There is no legal authority to grant an exemption from the federal surplus test on any basis. Contrary to the Investor's allegations, Canada has never given standing exemptions from the surplus test for Coastal B.C. logs.⁴³²

401. As a result, Canada understands that the Investor is complaining about its practice of allowing timber in the B.C. Interior on federal land to remain standing while being advertised on the Bi-Weekly List, as that is the only treatment Canada accords that has any connection to whether timber is standing. Canada will therefore apply the correct legal test to this treatment.

402. Allowing timber on federal land in the Interior of B.C. to remain standing while being advertised on the Bi-Weekly List is based on differences in storage capacity and market practice between Interior and Coastal B.C. producers. As a result, the treatment accorded to Merrill & Ring, which is a Coastal producer, is not in like circumstances with

⁴³⁰ *Cook Affidavit*, ¶ 109.

⁴³¹ *Reishus Affidavit*, ¶¶ 106-118; *Korecky Affidavit*, ¶ 78; *Cook Affidavit*, ¶¶ 9-20.

⁴³² *Korecky Affidavit*, ¶ 87.

the treatment accorded to logs harvested on federal land in the Interior of British Columbia.

403. Drier species of logs are grown in the Interior and logs deteriorate far more quickly when stored on land than in water. Sales of logs harvested in the Interior often take place on standing timber, as there is limited storage space for cut logs. In addition, there is a shortened harvesting and transportation period in the Interior due to harsh seasonal conditions in B.C., in particular in the spring thaw. All of these conditions result in the current market practice of B.C. Interior mills, which generally purchase standing timber and transport it to the mill immediately upon harvest.⁴³³

404. Coastal log producers like Merrill & Ring are in a very different situation. Coastal producers store and move logs in water and do not have substantial storage limitations. Logs deteriorate less quickly in water than on land and the Coastal species are not as dry as Interior species. The climate on the Coast is less harsh so that there are no seasonal impediments to harvest and transport of logs. As a result, sales on the Coast usually take place on harvested logs, not standing timber. The advertising process for the Bi-Weekly List simply reflects this reality.⁴³⁴

405. In light of these factually different situations, Interior producers cannot be considered in like circumstances with Coastal producers such as Merrill & Ring for the purpose of allowing timber to stand during the Bi-Weekly advertising period.

406. The treatment of the Investor is no less favourable than the treatment of Coastal log producers on federal or provincial land. This is because, in practice, the ability to advertise in standing form has not been given to Coastal loggers.

407. The Investor would be in the same situation with respect to advertising were it operating on B.C. provincial, rather than federal, land. In fact, the Investor would be in a less favourable position were it on provincial land because it would also have to pay a

⁴³³ *Korecky Affidavit*, ¶ 82.

⁴³⁴ *Korecky Affidavit*, ¶ 83; *Reishus Affidavit*, ¶¶ 34-37.

fee-in-lieu of manufacture for exported logs and would be subject to provincial species and grade restrictions that do not apply to federal lands.⁴³⁵ Further, BCMoF has not granted standing surplus applications on the B.C. Coast for at least 15 years.⁴³⁶ Mr. Reishus assesses the financial consequence of Merrill & Ring being on provincial, rather than federal, land as reducing revenues by CDN \$1 million for September 2004 to December 2007.⁴³⁷

408. Finally, the requirements at issue do not discriminate based on nationality. The Investor has not established that Canada accorded a treatment to it, has not showed that different treatment was given to investors in like circumstances and has not established that the treatment it received was less favourable. As a result, there is no breach of national treatment.

**(1) The Investor Misunderstands the Pluto
Darkwoods Situation**

409. The Investor cites the case of an Ontario company named Pluto Darkwoods (“Pluto”) and suggests that it receives provincial standing exemptions notwithstanding that it is on federal lands in the B.C. Interior.⁴³⁸ On this basis, the Investor argues that Canada has given standing timber exemptions to a domestic investor on federal land and has refused to give Merrill & Ring treatment as favourable as received by Pluto. This is based on a misapprehension of the facts.

410. Until 2005, Pluto operated on provincial lands and was eligible to apply for a standing exemption (economic or utilization) from the province in accordance with section 128 of the B.C. *Forest Act* and to advertise logs in standing or harvested form on the provincial Bi-Weekly List. As the Investor is aware, Pluto applied to the B.C. courts to have its land reclassified as federal land. In June 2005, Pluto’s land was reclassified as federal land, and thereafter Pluto became subject to federal jurisdiction.

⁴³⁵ *Reishus Affidavit*, ¶¶ 124-127.

⁴³⁶ *Cook Affidavit*, ¶ 109.

⁴³⁷ *Reishus Affidavit*, ¶ 127.

⁴³⁸ *Stutesman Affidavit*, ¶ 19; Investor’s Memorial, ¶¶ 174-181.

411. Transition measures were put in place for logs that were in process when Pluto was reclassified. Under the transition measures, Pluto's logs that had already been approved for removal from B.C. pursuant to provincial measures continued under the provincial process. However, logs belonging to Pluto that were under application at the time of the 2005 reclassification were designated as federal applications and continued under the federal process. Thereafter Pluto has been treated under the federal system. Since becoming subject to the federal process, Pluto has been treated in exactly the same manner as other companies with federal land in Interior British Columbia.⁴³⁹

412. In particular, Pluto can advertise in standing or harvested form like other companies on federal land in the B.C. Interior.⁴⁴⁰ Canada has never given Pluto a standing exemption, consistent with the fact that Canada does not grant exemptions. No issue of less favourable treatment being accorded in like circumstances arises in this situation.⁴⁴¹ Accordingly, Merrill & Ring has not been accorded treatment by Canada that is less favourable than the treatment accorded by Canada to Pluto and this allegation must also be rejected.

e) BCTS Initiatives Are Provincial Treatment that does Not Violate National Treatment

413. The Investor complains that it does not benefit from BCTS silviculture, reforestation, and infrastructure initiatives:

Unlike timber harvesters on BCTS lands, Merrill & Ring does not receive the support of BCTS for its silviculture and reforestation operations, construction and maintenance of roads on its lands, and other possible benefits for which access to BCTS documents is necessary to elaborate upon.⁴⁴²

414. The Investor cannot demonstrate even the first element of the national treatment test in respect of this allegation: it does not allege a treatment accorded by Canada.

⁴³⁹ *Cook Affidavit*, ¶¶ 101-108.

⁴⁴⁰ *Korecky Affidavit*, ¶ 94; *Cook Affidavit*, ¶108.

⁴⁴¹ *Cook Affidavit*, ¶¶ 105-108; *Korecky Affidavit*, ¶¶ 93-94.

⁴⁴² *Investor's Memorial*, ¶ 361(e).

Instead, it appears to complain that it is not treated by Canada in the same way as BCTS treats harvesters that harvest timber on BCTS land pursuant to timber licence agreements.

415. The treatment accorded by BCTS is not part of the “treatment” identified by the Investor as having violated Article 1102 in its pleadings. The treatment accorded by BCTS is also unrelated to Canada’s log export control regime. The BCTS initiatives are a provincial land management tool, not a part of the federal log export process.

416. Nor are the BCTS reforestation and infrastructure initiatives treatment with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of the investor’s investments.⁴⁴³ The BCTS reforestation and maintenance initiatives do not accord any treatment to the Investor or to other companies that are subject to the federal surplus test under Notice 102.

417. In this instance, the Investor seeks to compare provincial treatment (BCTS “benefits”) with federal treatment (no BCTS “benefits”). BCTS is a provincial agency charged with implementing the B.C. 2003 Forestry Revitalization Plan, including the provincial government’s commitment to environmental sustainability and setting a fair price for the public forestry resource.

418. In essence, Merrill & Ring is complaining about the fact that BCTS performs silviculture and forestry activities only on BCTS land and not on the Investor’s land. It is odd that the Investor would claim to be entitled to such treatment. As Mr. Reishus comments, “While undoubtedly Merrill & Ring would be happy if others took care of its property for it, it is a strange notion of a market economy in which investing in and managing one’s own property, without investing in and managing others’ property, represents impermissible ‘unfavourable’ treatment.”⁴⁴⁴

⁴⁴³ *Falkiner Affidavit*, ¶¶ 33-35.

⁴⁴⁴ *Reishus Affidavit*, ¶ 139 and generally ¶¶ 138-139.

419. The main functions of BCTS are granting auction rights to bid for provincial Crown timber and reforestation initiatives.⁴⁴⁵ BCTS is not a private sector forest company. It does not export logs, harvest timber, sell logs or act as a log broker.⁴⁴⁶

420. NAFTA Article 1102 does not allow an investor to compare *provincial* treatment given to *domestic* investors on the one hand, with *federal* treatment given to the *foreign* investor on the other hand. To the contrary, the plain words of Article 1102 require that “each Party (Canada) accord treatment to investors of another Party (Merrill) no less favourable than the treatment it (Canada) accords to its own investors.” The Investor seeks to compare treatment by the provincial BCTS to provincial licencees with treatment by Canada of Merrill & Ring. This does not fit under the plain terms of Article 1102.

421. The Investor’s allegation also fails the “in like circumstances” element. The Investor could not be in more “unlike” circumstances with loggers harvesting on BCTS land. Timber sales licensees operate on BCTS land. They are not timber growers or log producers. They simply have the right to go onto B.C. Crown land and remove trees from a designated area, having successfully bid at auction for this right and having paid a fee to BCTS.

422. These licensees bid in a market-driven auction process. Factored into the price of their licences are costs for reforestation, silviculture, safety, stewardship, and wilderness and environmental protection. In other words, they purchase a specific package of benefits with certain obligations. The Investor does not do anything of the kind.⁴⁴⁷

423. Timber sales licensees are not the owners of the land on which they operate, nor do they participate in reforestation of the land. They operate under a completely different business model than timberland owners. By contrast, timberland owners like Merrill & Ring do not operate on BCTS land and have no right to remove trees from BCTS land. Merrill & Ring operates on its own land and harvests its own logs. As a result, Merrill &

⁴⁴⁵ *Falkiner Affidavit*, ¶¶ 4-8.

⁴⁴⁶ *Falkiner Affidavit*, ¶¶ 29-32.

⁴⁴⁷ *Falkiner Affidavit*, ¶¶ 11-12, 18-23.

Ring must reforest and act as steward of its lands to preserve the value and future viability of its log enterprise. In short, the Investor is not in like circumstances with BCTS timber sales licensees.

424. In any event, the treatment accorded to the Investor is no less favourable than the treatment accorded by BCTS to its tenure agreement licensees. The BCTS reforestation and infrastructure initiatives do not accord free benefits to the timber sales licensees. Rather, timber sales licences are sold at auction at market-driven prices. These prices take into account the various statutory and contractual obligations imposed on the harvester, including, for example, preserving certain trees and undertaking road construction, reforestation and road development.⁴⁴⁸ The BCTS reforestation and infrastructure initiatives do not accrue to the tenure agreement licensees and do not provide more favourable treatment.

425. In fact, the Investor is eligible to bid on BCTS timber sales licences and receive whatever alleged benefits (and burdens) go with a successful bid if it wishes to do so.⁴⁴⁹

426. Further, to the extent that harvesters on BCTS land seek to export the timber harvested, they are treated less favourably than Merrill & Ring. Merrill & Ring does not pay a fee-in-lieu of local manufacture when it exports its federal logs from Canada. This is to be compared with producers exporting logs from provincial land that pay an additional fee-in-lieu of local manufacture upon removing the logs from British Columbia. In addition, timber growers under provincial jurisdiction are sometimes subject to specific species and grade export restrictions. Private landowners under federal jurisdiction, such as the Investor, are not subject to species and grade restrictions.⁴⁵⁰ Consequently, the Investor receives no less favourable treatment, and likely obtains more favourable treatment, than obtained by BCTS timber licensees exporting from provincial land.

⁴⁴⁸ *Falkiner Affidavit*, ¶¶ 33-38.

⁴⁴⁹ *Falkiner Affidavit*, ¶¶ 13-15.

⁴⁵⁰ *Reishus Affidavit*, ¶¶ 117, 121-127.

427. Finally, there is no nationality-based discrimination at play in this instance either. The Investor has attempted to “cherry pick” the benefits of a completely different situation and apply it to Merrill & Ring without being in like circumstances to BCTS log harvesters. This is a misconceived effort to invoke Article 1102 and should be dismissed.

f) Domestic Sales of Non-surplus Logs do Not Violate National Treatment

428. The Investor complains that every time it sells its logs domestically, it must unfairly price its logs to compete with logs from Provincial Crown land,

Canada has extended less favourable treatment to Merrill & Ring and its investments every time Merrill & Ring has been denied an export permit. When Merrill & Ring is denied an export permit, it must price its logs to compete with logs harvested from provincial Crown Land in the domestic market. Provincial Crown Land is licensed by and enjoys advantages granted and financed by BCTS that are unavailable to private timberland owners. Merrill & Ring’s competitors with standing timber exemptions do not have to sell their logs under such circumstances.⁴⁵¹

429. In most respects, this allegation restates the same complaints as the fourth and fifth allegations and does not raise a new basis of challenge. Canada will not repeat the points made earlier and refers the Tribunal to the relevant discussion above.

430. The treatment at issue is the domestic sale of the Investor’s logs that are not declared surplus under Notice 102. This is not a treatment accorded by Canada. Rather, the price the Investor can achieve on a domestic sale is a function of a variety of market forces and its own marketing ability.

431. The Investor’s selection of a domestic comparator for the “in like circumstances” element of national treatment ignores the “most like” comparator: domestic investors under Notice 102 that have also been denied surplus status from time to time and that also must sell non-surplus logs domestically. These are the proper comparators for this allegation of breach of national treatment. It is evident that these domestic investors have

⁴⁵¹ Investor’s Memorial, ¶ 361(f).

been treated in the same way as the Investor in all respects and that no treatment less favourable has been accorded. As a result, Merrill & Ring has been accorded treatment no less favourable than accorded to domestic investors in like circumstances.

432. As standing exemptions have not been given by B.C. to provincial lands on the Coast, the Investor is in exactly the same position as domestic investors on provincial lands.

433. Further, as noted above, logs on provincial land are subject to a fee-in-lieu and species restrictions when they are removed from British Columbia. If Merrill & Ring sold logs in other provinces, it would effectively be treated more favourably than log owners on provincial lands.

434. Again, there is no discrimination in the circumstances alleged, much less nationality-based discrimination.

4. Conclusion on Article 1102

435. The national treatment allegations made by the Investor are ill-founded; not one of them meets the three essential criteria required to establish a breach of Article 1102.

436. In certain cases there is not even treatment of the Investor, for example in the case of remote area advertising which does not apply to Merrill & Ring. In other cases the treatment complained of is treatment by a provincial agency such as BCTS, and not treatment by Canada under the log export regime.

437. The assertions that the Investor is in like circumstances with the comparators selectively chosen by the Investor are all contingent on the Tribunal defining “in like circumstances” in the same “special”, and incorrect, way as does the Investor. The assertions based on like circumstances also require the Tribunal to ignore domestic investors receiving the exact same treatment as Merrill & Ring that are identical domestic comparators. Instead, the Investor proposes that the Tribunal base its comparison on less like domestic comparators. The Investor’s like circumstances analysis also ignores all circumstances, including policy justifications, that explain the legitimate policy basis for

the treatment it complains of, preferring simply to assert that it gets treated less favourably for no reason. This is not the case.

438. Several of the Investor's claims of receiving less favourable treatment are factually incorrect. For example, it receives the same treatment with respect to scaling as domestic entities and would receive the same treatment as BCTS licencees if it harvested on BCTS land.

439. Finally, none of the conduct complained of accords differential treatment for nationality-based reasons. There is not even a suggestion that the practical effect of any of the measures complained of is to create a disproportionate benefit for nationals over non-nationals or that the measures on their face favour nationals over non-nationals. Canada's log export regime does not breach Article 1102 and the Investor's claim under this obligation should be dismissed.

B. Minimum Standard of Treatment – Article 1105

1. Summary of Canada’s Position

440. A violation of Article 1105 occurs only if the Investor demonstrates that Canada has breached a rule of customary international law that is recognized as part of the international minimum standard for the treatment of aliens. Decisions rendered by other tribunals in the context of non-NAFTA arbitrations are not relevant to this Tribunal in determining the content of Article 1105. The Investor has not proved the existence of any customary legal obligation applicable to the treatment of aliens as required by Article 1105.

441. Nor do any of the measures complained of by the Investor reach the high threshold for breach of the customary international law minimum standard of treatment of aliens required under Article 1105. The TEAC/FTEAC recommendation-making process is transparent, not arbitrary and does not constitute an abuse of rights. The log export control regime does not create an insecure legal and business environment and does not frustrate the Investor’s legitimate expectations. The Investor’s Article 1105 claim should therefore be dismissed.

2. The Law

a) The Proper Meaning of Article 1105

442. The Investor advances an interpretation of Article 1105 that is contrary to the plain text of the provision as confirmed by the Free Trade Commission’s Note of Interpretation.

(1) Article 1105 Is a “Minimum Standard of Treatment” Clause

443. NAFTA Article 1105(1) reads as follows:

Each Party shall accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security.

444. As explained in Canada's *Statement on Implementation* for NAFTA issued in 1994, Article 1105 was "intended to assure a minimum standard of treatment of investments of NAFTA investors" and "provides for a minimum absolute standard of treatment, based on long-standing principles of customary international law."⁴⁵²

445. The proper interpretation of Article 1105 was confirmed by the NAFTA Free Trade Commission in its binding Note of Interpretation of July 31, 2001. The Note of Interpretation reads as follows:

1. Article 1105(1) prescribes the customary international law minimum standard of treatment of aliens as the minimum standard of treatment to be afforded to investments of investors of another Party.

2. The concepts of "fair and equitable treatment" and "full protection and security" do not require treatment in addition to or beyond that which is required by the customary international law minimum standard of treatment of aliens.

3. A determination that there has been a breach of another provision of the NAFTA, or of a separate international agreement, does not establish that there has been a breach of Article 1105(1).⁴⁵³

446. The Note of Interpretation directs tribunals as to how they must interpret and apply Article 1105(1). The Note of Interpretation represents the definitive meaning to be given to Article 1105(1) and it is binding on tribunals constituted under NAFTA Chapter Eleven.⁴⁵⁴

447. As stated in its title and confirmed by the Note of Interpretation, Article 1105 is an international standard ensuring that treatment by a State does not fall below an established minimum level.

448. Article 1105 is therefore an "objective" standard of treatment for investors. The *S.D. Myers* Tribunal explained the *raison d'être* of such a provision as follows:

⁴⁵² *Canadian Statement*, at 149 (Tab 19).

⁴⁵³ *NAFTA FTC Notes*, 31 July 2001, at B [Emphasis added] (Tab 92).

⁴⁵⁴ NAFTA Article 1131(2).

[This clause] is necessary to avoid what might otherwise be a gap. A government might treat an investor in a harsh, injurious and unjust manner, but do so in a way that is no different than the treatment inflicted on its own nationals. The “minimum standard” is a floor below which treatment of foreign investors must not fall, even if a government were not acting in a discriminatory manner.”⁴⁵⁵

(2) The Customary International Law Minimum Standard of Treatment of Aliens Applies

449. The Note of Interpretation establishes that “international law” in Article 1105 means the “customary international law minimum standard of treatment of aliens.” In other words, a violation of Article 1105 occurs only if the Investor demonstrates breach of a rule of customary international law that is recognized as part of the international minimum standard for the treatment of aliens. As explained by the *Mondev* Tribunal:

[T]he standard of treatment, including fair and equitable treatment and full protection and security, is to be found by reference to international law, i.e., by reference to the normal sources of international law determining the minimum standard of treatment of foreign investors.⁴⁵⁶

450. A clear hierarchy is thus established by the text of Article 1105(1). The phrase “treatment in accordance with international law” is the generic concept. The word “including” introduces the subsidiary clause containing two examples of the generic category (“fair and equitable treatment” and “full protection and security”).

451. This hierarchy has been adopted consistently by all NAFTA tribunals that have rendered decisions subsequent to the Note of Interpretation.⁴⁵⁷ Thus, the *UPS* Tribunal held that “the obligation to accord fair and equitable treatment is not in addition to or

⁴⁵⁵ *S.D. Myers – First Partial Award*, ¶ 259 (Tab 120).

⁴⁵⁶ *Mondev – Award*, ¶ 120 (Tab 87).

⁴⁵⁷ As explained by Schreuer, Christoph H., *Fair and Equitable Treatment In Arbitral Practice* 6 JOURNAL OF WORLD INVESTMENT AND TRADE (June 2005), at 363 (Tab 125): “Subsequent NAFTA tribunals have accepted the FTC Interpretation without further resistance. Therefore, it may now be regarded as established that, in the context of Article 1105(1) NAFTA, the concept of fair and equitable treatment is equivalent to the minimum standard of treatment under customary international law.”

beyond the minimum standard.”⁴⁵⁸ Similarly, the *Loewen* Tribunal held that fair and equitable treatment and full protection and security were “not free-standing obligations” and that “[t]hey constitute obligations only to the extent that they are recognized by customary international law.”⁴⁵⁹

452. Surprisingly, some 7 years after the Free Trade Commission confirmed the proper meaning of Article 1105(1), the Investor nevertheless proposes its own re-interpretation of the meaning of “international law” in this provision. For the Investor, “international law” is not a straightforward reference to “customary international law,” as clearly stated in the Note of Interpretation. Rather, the Investor adds a supplemental and alternative source for the meaning of “international law,”

The content and scope of the international law standard falls to be determined by reference to customary international law practices and the many decisions of international tribunals dealing with aspects of the overarching international law obligation to act in good faith. The international law standard is a composite standard; that is, it subsumes within it numerous duties, *including* – a duty to provide fair and equitable treatment and a duty to provide full protection and security.⁴⁶⁰

453. This surprising addition is contrary to the plain language of the Note of Interpretation where no reference is found either to “decisions of international tribunals” or to a “good-faith” obligation. The Note of Interpretation only refers to “customary international law.”

454. Canada submits that the decisions of international tribunals dealing with good faith referred to by the Investor in its Memorial⁴⁶¹ are therefore completely irrelevant to the Tribunal’s task of determining customary international law applicable to foreign investors.

⁴⁵⁸ *United Parcel Service v. Canada*, (UNCITRAL) Award on Jurisdiction, 22 November 2002, ¶ 97 (Tab 146).

⁴⁵⁹ *Loewen – Award on Merits*, ¶ 128 (Tab 73).

⁴⁶⁰ Investor’s Memorial, ¶ 191.

⁴⁶¹ Investor’s Memorial, ¶¶ 190-242.

(3) The Investor Grossly Misconceives Customary International Law

455. The Investor’s interpretation of customary international law is so fundamentally flawed that Canada is compelled to restate here some of the most basic canons of the Law of Nations.

456. Article 38 of the Statute of the International Court of Justice (ICJ) provides that in making decisions in accordance with international law, the Court should consider, *inter alia*, “international custom, as evidence of a general practice accepted as law.” This is a reference to customary international law.

457. The *UPS* Tribunal stated that “to establish a rule of customary international law two requirements must be met: consistent state practice and an understanding that that practice is required by law.”⁴⁶² The two-fold requirement of customary international law is one of the most well-established principles of international law. It has been recognized as such by several decisions of the International Court of Justice.⁴⁶³

458. Despite the settled state of the law on this matter, the Investor nevertheless advances its own astonishing interpretation of customary international law. For the Investor, the “content of customary international law can be sourced through international tribunal decisions and ... the elements of practice and *opinio juris* need not be specifically proven.”⁴⁶⁴ These two statements are both wrong.

⁴⁶² *UPS – Jurisdiction Award*, ¶ 84 (Tab 146).

⁴⁶³ *The Case of the S.S. “Lotus” (France v. Turkey)*, 1927 P.C.I.J. (Series A) No. 10, at 18, 28 (Tab 76); *North Sea Continental Shelf Cases (Federal Republic of Germany v. Denmark / Federal Republic of Germany v. Netherlands) Judgement* [1969], I.C.J. Rep. 3, at 44 (Tab 100).

⁴⁶⁴ Investor’s Memorial, ¶ 246. Elsewhere in its Memorial (¶ 252), the Investor also states that the *ADF* tribunal “found [that] customary international law can be evidenced by international tribunal decisions and that it is not necessary to specifically prove the elements of practice and *opinio juris*”. [Emphasis added]

(a) **Customary International Law Must Be Proved**

459. The Investor's proposition that the content of customary international law no longer needs to be "specifically proven" is contrary to all authority.

460. International tribunals have consistently held that the burden of proving the existence of a rule of customary international law rests on the party that alleges it.⁴⁶⁵ This fundamental principle is unanimously recognized by scholars.⁴⁶⁶ It has also been adopted by NAFTA tribunals.⁴⁶⁷ For instance, the *UPS* Tribunal stated in no uncertain terms that,

[T]he obligations imposed by customary international law may and do evolve. The law of state responsibility of the 1920s may well have been superceded by subsequent developments. It would be remarkable were that not so. But relevant practice and the related understandings must still be assembled in support of a claimed rule of customary international law.⁴⁶⁸

461. In fact, the Investor's claim under Article 1105 in *UPS* failed on the ground that it had "not attempted to establish that that state practice reflects an understanding of the existence of a generally owed international legal obligation."⁴⁶⁹ The Tribunal therefore

⁴⁶⁵ *Case Concerning Rights of Nationals of the United States of America in Morocco (Fr. V. U. S.)*, [1952] I.C.J. Rep. 176 (Tab 119) (quoting *Asylum (Colom. v. Peru)*, 1950 I.C.J. 266) ("The Party which relies on a custom of this kind must prove that this custom is established in such a manner that it has become binding on the other Party.").

⁴⁶⁶ Nguyen, Quoc Dinh, & Patrick Dallier & Alain Pellet, *DROIT INTERNATIONAL PUBLIC*, 6th ed. (L.G.D.J., 1999) (Tab 35) (burden on party "who relies on a custom to establish its existence and exact content") ("c'est à [la partie] qui s'appuie sur une coutume d'en établir l'existence et la portée exacte") (translation by counsel); *Brownlie*, at 12 (Tab 17) ("In practice the proponent of a custom has a burden of proof the nature of which will vary according to the subject-matter and the form of the pleadings.").

⁴⁶⁷ For instance, the *ADF* Tribunal stated: "The Investor, of course, in the end has the burden of sustaining its charge of inconsistency with Article 1105(1). That burden has not been discharged here and hence, as a strict technical matter, the Respondent does not have to prove that current customary international law concerning standards of treatment consists only of discrete, specific rules applicable to limited contexts." (*ADF – Award*, ¶ 185 (Tab 2)).

⁴⁶⁸ *UPS – Jurisdiction Award*, ¶ 84 (Tab 146).

⁴⁶⁹ *UPS – Jurisdiction Award*, ¶ 86 (Tab 146).

concluded that there was “no rule of customary international law prohibiting or regulating anticompetitive behaviour.”⁴⁷⁰

462. In short, the content of any rule of customary international law must be proved by reference to State practice and *opinio juris*. The burden rests on the Investor to,

- (1) Show the existence of a customary international rule and that it forms part of the international minimum standard of treatment of aliens; and
- (2) Demonstrate that Canada breached the customary international rule.

**(b) Arbitral Awards Are Not Customary
International Law**

463. The Investor suggests that the present Tribunal should simply look at decisions of other tribunals to determine the content of customary international law.⁴⁷¹ This seriously misstates the most basic elements of the concept of customary international law.

464. Customary international law requires a continuous and consistent practice of States in their international relations and manifestation of the belief by States that such practice is required by law (“*opinio juris*”). In other words, customary international law can be established only by actual State practice, and not by the practice of international tribunals. Similarly, the relevant *opinio juris* is that of States, and not that of judges or arbitrators. Thus, for the International Court of Justice, “[i]t is of course axiomatic that the material of customary international law is to be looked for primarily in the actual practice and *opinio juris* of States (...).”⁴⁷²

465. Arbitral awards do not constitute a formal source of State practice. As explained by Lauterpacht, “[d]ecisions of international courts are not a source of international law

⁴⁷⁰ *UPS – Jurisdiction Award*, ¶ 92 (Tab 146).

⁴⁷¹ Investor’s Memorial, ¶ 246. The Investor argues that the content of customary international law “can be sourced through international tribunal decisions.” [Emphasis added]

⁴⁷² *Case Concerning the Continental Shelf, (Libyan Arab Jamahiriya v. Malta)* [1985] I.C.J. Rep. at 13 (¶ 20) (Tab 30).

... [t]hey are not direct evidence of the practice of States or of what States conceive to be the law.”⁴⁷³ Such decisions are relevant for the present Tribunal only to the extent that they contain valuable analysis of actual State practice. The Tribunal may thus find guidance in what other tribunals have said in the past about whether a given rule should be considered as part of customary international law. These decisions are just a useful tool for the Tribunal in the context of its own mission to determine the content of customary international law.

466. The Investor’s objective is to convince this Tribunal to apply the decisions of international tribunals dealing with good faith referred to in its Memorial. This is an attempt by the Investor to avoid actual practice of States which is not at all supportive of its position.

**(c) The Investor’s Position Is Not Supported
By NAFTA Case Law**

467. In support of its misconceived interpretation of customary international law, the Investor refers to the *ADF* Tribunal, which allegedly “found [that] customary international law can be evidenced by international tribunal decisions and that it is not necessary to specifically prove the elements of practice and *opinio juris*.”⁴⁷⁴

468. What the *ADF* Tribunal actually stated is quite different:

We understand *Mondev* to be saying—and we would respectfully agree with it—that any general requirement to accord “fair and equitable treatment” and “full protection and security” must be disciplined by being based upon State practice and judicial or arbitral caselaw or other sources of customary or general international law.⁴⁷⁵

469. The *ADF* Tribunal’s statement does not support the drastic proposition that it is no longer necessary to prove the elements of State practice and *opinio juris*.

⁴⁷³ Lauterpacht, Sir Hersch, *THE DEVELOPMENT OF INTERNATIONAL LAW BY THE INTERNATIONAL COURT*, F.A. Praeger, 1958, at 20-21 (Tab 69).

⁴⁷⁴ Investor’s Memorial, ¶ 252.

⁴⁷⁵ *ADF – Award*, ¶ 184 (Tab 2).

470. The *ADF* Tribunal only suggests (wrongly, in Canada’s view) that “judicial or arbitral caselaw” is a source of customary international law along with State practice. Canada submits that the *ADF* Tribunal’s assessment is contrary to Article 38 of the I.C.J. Statute, which states that “judicial decisions” (along with doctrine) are only a subsidiary source of law, and not an element of customary international law *per se*.

(4) Other BITs Are Irrelevant In This Arbitration

471. The Investor states that “[t]ribunals, NAFTA and non-NAFTA alike, have also recognized that the customary international law standard has been constituted by the many bilateral investment treaties obliging states to provide fair and equitable treatment and full protection and security.”⁴⁷⁶

472. Article 38 of the ICJ Statute distinguishes “treaties” from customary international law. These are two distinct sources of international law.

473. The Investor quotes the *Mondev* Tribunal in support of its allegation.⁴⁷⁷ In fact, the *Mondev* Tribunal came to exactly the opposite conclusion as the one suggested by the Investor. It explicitly held that the standard set in other investment treaties is completely irrelevant to determining the content of customary international law under NAFTA Article 1105:

[T]he FTC (...) makes it clear that Article 1105(1) refers to a standard existing under customary international law, and not to standards established by other treaties of the three NAFTA Parties. (...) If there had been an intention to incorporate by reference extraneous treaty standards in Article 1105 and to make Chapter 11 arbitration applicable to them, some clear indication of this would have been expected.⁴⁷⁸

474. As a result of the specific language in Article 1105 as well as the subsequent Note of Interpretation, this provision must be interpreted on its own. Decisions rendered in the

⁴⁷⁶ Investor’s Memorial, ¶ 247.

⁴⁷⁷ Investor’s Memorial, ¶¶ 245-248, 252.

⁴⁷⁸ *Mondev – Award*, ¶ 121 (Tab 87).

context of non-NAFTA investor-State arbitration are not relevant for this Tribunal in determining the content of Article 1105.

475. Modern BITs typically contain a provision obliging the host State to provide foreign investors with “fair and equitable treatment according to the principles of international law” (some clauses do not even refer to “international law”).⁴⁷⁹ The wording of Article 1105 is very different from that of a typical “fair and equitable treatment” clause contained in a BIT. Article 1105 is entitled “Minimum Standard of Treatment” and refers to “international law, including fair and equitable treatment.” Although the “minimum standard of treatment” and the “fair and equitable treatment” standard share some common elements, the two standards are not synonymous.

476. As the *UPS* Tribunal noted, many BITs “state an obligation of fair and equitable treatment to be accorded to investors independently of the treatment required by international law.”⁴⁸⁰ In other words, such BITs refer to fair and equitable treatment without linking the obligation to the applicable customary international law minimum standard of treatment of aliens; NAFTA Article 1105 does not. This important distinction has significant practical implications.

477. Non-NAFTA tribunals have concluded that the “fair and equitable treatment” clause contained in BITs is broader in scope and that it requires treatment beyond that due under the customary international law standard.⁴⁸¹ This is the conclusion reached by the *Enron* Tribunal interpreting the U.S. – Argentina BIT:

⁴⁷⁹ UNCTAD, *Bilateral Investment Treaties 1995–2006: Trends in Investment Rulemaking* UNCTAD/ITE/IIT/2006/5 (United Nations, 2007), at 28 *et seq.* (“UNCTAD – BIT Trends”) (Tab 141) notes the different variations of fair and equitable treatment clauses.

⁴⁸⁰ *UPS – Jurisdiction Award*, ¶ 86 (Tab 146).

⁴⁸¹ The same conclusion was reached in a recent OECD study: OECD, *Fair and Equitable Treatment Standard in International Investment Law*, Working Paper on International Investment Number 2004/3 [September 2004], at 40 (Tab 107): “Because of the differences in its formulation, the proper interpretation of the “fair and equitable treatment” standard depends on the specific wording of the particular treaty, its context, the object and purpose of the treaty, as well as on negotiating history or other indications of the parties’ intent. For example, some treaties include explicit language linking or, in some cases limiting, fair and equitable treatment to the minimum standard of international customary law. Other treaties which either link the standard to international law without specifying custom, or lack any reference

It might well be that in some circumstances where the international minimum standard is sufficiently elaborate and clear, fair and equitable treatment might be equated with it. But, in other more vague circumstances, the fair and equitable standard may be more precise than its customary international law forefathers. This is why the Tribunal concludes that the fair and equitable standard, at least in the context of the Treaty applicable to this case [the U.S.-Argentina BIT], can also require a treatment additional to, or beyond that of, customary international law. The very fact that the recent FTC interpretations or investment treaties have purported to change the meaning or extent of the standard only confirms that those specific instruments aside, the standard is or might be a broader one.⁴⁸²

478. In the context of Article 1105, the relevance of the standard of treatment under other BITs is only demonstrated if it had crystallized into an established rule of customary international law. The Investor failed to demonstrate this. In any event, as the *UPS* Tribunal explained, “in terms of *opinio juris* there is no indication that [the BITs] reflect a general sense of obligation” and that “the failure of efforts to establish a multilateral agreement on investment provides further evidence of that lack of a sense of obligation.”⁴⁸³

479. In deciding the present claim, the Tribunal must respect the NAFTA Parties’ clear objective in drafting Article 1105 to avoid the “risk” increasingly associated with unqualified fair and equitable treatment clauses like those typically found in BITs.⁴⁸⁴

to international law, could, depending on the context of the parties’ intent, for example, be read as giving the standard a scope of application that is broader than the minimum standard as defined by international customary law.” The same conclusion was also reached in *UNCTAD – BIT Trends*, at 29 (Tab 141), which stated that the “practical implications” of adopting one of the two distinct approaches under NAFTA Article 1105 and under BITs are “significant”. See also, Schreuer, Christoph H., *Fair and Equitable Treatment (FET): Interactions with other Standards* (2007) 4 TRANSNATIONAL DISPUTE MANAGEMENT, at 17 (“*Schreuer – FET Interactions*”) (Tab 124), for whom “[o]verall, [fair and equitable treatment] describes a higher standard that is additional to the customary law minimum standard.”

⁴⁸² *Enron Corporation and Ponderosa Assets, L.P. v. Argentine Republic* (ICSID No. ARB/01/3) Award, 15 May 2007, ¶ 258 (“*Enron – Award*”) (Tab 44). See also: *Sempra Energy International v. Argentine Republic* (ICSID No. ARB/02/16) Award, 18 September 2007, ¶ 302 (Tab 126).

⁴⁸³ *UPS – Jurisdiction Award*, ¶ 97 (Tab 146).

⁴⁸⁴ *UNCTAD – BIT Trends*, at 32 (Tab 141): The UNCTAD report identifies the “risk” as follows: “The debate regarding the fair and equitable treatment clause in the context of Chapter 11 of NAFTA has shown the risks of including language in BITs providing for unqualified fair and equitable treatment of

480. In applying Article 1105, this Tribunal should therefore not be influenced by standards of treatment that may exist under other investment treaties and the related cases interpreting these different standards.

b) The Investor Has Identified No Customary Legal Standards With Respect To Treatment of Aliens

481. Canada has demonstrated in the previous section that the Investor's expansive interpretation of the scope of Article 1105 must be rejected. In fact, the burden rests with the Investor to prove the existence of a customary rule and to demonstrate that it forms part of the international minimum standard of treatment applicable to aliens. The Investor failed to prove the existence of any customary obligation and, consequently, its Article 1105 claim must be dismissed.

(1) Only Existing Rules of Customary International Law Apply

482. The Investor relies on broad and general principles, such as "good faith" and legitimate expectations, but fails to demonstrate that these amount to independent rules of customary international law.⁴⁸⁵ The Investor's objective is to stretch the meaning of

foreign investment. The wording of this clause might be broad enough to be invoked in respect of virtually any adverse treatment of an investment, thus making the fair and equitable treatment provision among those most likely to be relied upon by an investor in order to bring a claim under the investor-State dispute settlement proceedings. It is therefore not surprising that some countries have begun to consider redrafting their BIT models to clarify the scope and content of the fair and equitable treatment standard." A similar assessment is made in: UNCTAD, *Investor-State Dispute Settlement and Impact on Investment Rulemaking*, UNCTAD Series on Issues in International Investment Agreements, New York and Geneva: United Nations, 2007, at 75 (Tab 142): "The inclusion of language clarifying the content and scope of the minimum standard of treatment in new [international investment agreements] may be particularly relevant to counterbalance two recent trends in [investor-State dispute settlement] practice. First, the clarification concerning the meaning of customary international law included in, for example, Annex A of the Australia-United States FTA is important for providing guidance as to how to interpret the fair and equitable treatment standard properly. Some recent arbitration panels have granted themselves a certain degree of freedom in this respect. Given the evolutionary nature of customary international law, the content of the fair and equitable treatment standard no longer requires bad faith or "outrageous" behaviour on behalf of the host country. By eliminating these requirements, some arbitral decisions had the effect of equating the minimum standard under customary international law with the plain meaning approach to the text. However, it is not self-evident that customary international law has evolved to such a degree."

⁴⁸⁵ Investor's Memorial, ¶¶ 190-198, 220-227.

Article 1105 to accommodate its claims of “inequitable” treatment even though such treatment does not violate any specific legal rule.

483. However, this Tribunal must apply an objective and ascertainable rule to the facts before it. As stated by the *Mondev* Tribunal, it is not for the Tribunal to “apply its own idiosyncratic standard in lieu of the standard laid down in Article 1105(1).”⁴⁸⁶

484. The first step in the Tribunal’s analysis must be to determine whether the Investor’s claim is related to an existing customary rule of international law that forms part of the minimum standard of treatment of aliens. There is a finite number of instances where international law contains customary rules dealing with the protection of aliens. These rules, and only these rules, are incorporated by Article 1105 into NAFTA.

485. Admittedly the scope of the minimum standard, and the content of the rules that it incorporates, may evolve over time. It is, however, for the Investor to prove the existence of any such change in the law. As explained by the *Mondev* Tribunal:

The FTC interpretation makes it clear that in Article 1105(1) the terms “fair and equitable treatment” and “full protection and security” are, in the view of the NAFTA Parties, references to existing elements of the customary international law standard and are not intended to add novel elements to that standard.⁴⁸⁷

486. Canada submits that the “obligations” referred to by the Investor in its Memorial are not part of customary international law. The Tribunal must reject the Investor’s attempt to introduce the following new obligations into the NAFTA:

- the obligation of fairness and good faith;
- the obligation to provide treatment free from arbitrary and discriminatory conduct;
- the obligations to fulfill an investor’s legitimate expectations;

⁴⁸⁶ *Mondev – Award*, ¶ 120 (Tab 87).

⁴⁸⁷ *Mondev – Award*, ¶ 122 (Tab 87).

- the obligation of transparency;
- the obligation to provide a secure legal environment; and
- the obligation to prevent abuse of rights.⁴⁸⁸

487. This is fundamental because the present Tribunal is the ultimate guardian of a fine balance between potentially conflicting interests. On the one hand, an overly expansive interpretation of Article 1105 will usurp the legislative role of the NAFTA Parties. On the other hand, a too restrictive interpretation of the same provision may discourage foreign investment. The *Saluka* Tribunal described this tension aptly:

The protection of foreign investments is not the sole aim of the Treaty, but rather a necessary element alongside the overall aim of encouraging foreign investment and extending and intensifying the parties' economic relations. That in turn calls for a balanced approach to the interpretation of the Treaty's substantive provisions for the protection of investments, since an interpretation which exaggerates the protection to be accorded to foreign investments may serve to dissuade host States from admitting foreign investments and so undermine the overall aim of extending and intensifying the parties' mutual economic relations.⁴⁸⁹

(2) Good Faith Is Not An Independent Source of Obligation

488. According to the Investor, the “overarching duty of good faith is the touchstone for much of the content of the international law standard, including its fair and equitable treatment.”⁴⁹⁰ Elsewhere, the Investor states that, “[t]he NAFTA Parties’ obligation to treat investors fairly and equitably is grounded in their obligation to act in good faith – perhaps the most fundamental preemptory norm of international law.”⁴⁹¹

⁴⁸⁸ Investor’s Memorial, ¶ 198.

⁴⁸⁹ *Saluka Investments BV v. The Czech Republic*, Partial Award, 17 March 2006 (“*Saluka – Partial Award*”) (Tab 123).

⁴⁹⁰ Investor’s Memorial, ¶ 192.

⁴⁹¹ Investor’s Memorial, ¶ 193.

489. For the Investor, the so-called “duty to act in good faith” is basically the same thing as the fair and equitable treatment obligation.⁴⁹²

490. The Investor then argues that these “specific” good faith obligations are part of the customary international law minimum standard of treatment of aliens and, therefore, within the scope of Article 1105.⁴⁹³ This is an improper attempt to broaden the scope and content of this provision.

491. No doubt “good faith” is a fundamental principle of international law. The *pacta sunt servanda* principle, as reflected in Article 26 of the *Vienna Convention*, states that “[e]very treaty in force is binding upon the parties to it and must be performed in good faith.”⁴⁹⁴ It is nonetheless just an auxiliary principle that bears upon the application of other substantive rules. The duty to act in “good faith” becomes relevant only when invoked in connection with a subject matter that already forms part of the customary international law minimum standard of treatment of aliens. This was explicitly stated by the ICJ in the *Case Concerning Border and Transborder Armed Actions (Nicaragua v. Honduras)*:

The principle of good faith is, as the Court has observed, “one of the basic principles governing the creation and performance of legal obligations” (Nuclear Tests, I.C.J. Reports 1974, p. 268, para. 46; p. 473, para. 49); it is not in itself a source of obligation where none would otherwise exist.⁴⁹⁵

⁴⁹² This is clear from Investor’s Memorial, ¶ 198 where the Investor entails six specific obligations.

⁴⁹³ Investor’s Memorial, ¶ 253. This is clear from this quote: “NAFTA and non-NAFTA tribunal decisions alike demonstrate that the words or [sic] Article 1105 import an obligation to provide customary international law minimum standard of treatment which requires a state: a) not to act arbitrarily; b) to act transparently; c) to provide a secure legal environment; and d) not to abuse its rights”. See also at ¶ 200: “A state’s obligation to act in good faith is also manifested in a number of specific ways, including the state’s obligation: a) to protect the investor’s legitimate expectations; b) to not act in an arbitrary or discriminatory way; c) to fulfill its commitments; and d) not to abuse its rights. These are all independent obligations and their expression as part of the international law standard by numerous international tribunals demonstrates that, in agreeing to Article 1105, Canada has agreed to be bound by them.”

⁴⁹⁴ *Vienna Convention*, Article 26 (Tab 155).

⁴⁹⁵ *Case Concerning Border and Transborder Armed Actions (Nicaragua v. Honduras)*, *Jurisdiction and Admissibility, Judgment*, [1988] I.C.J. Rep. 69, at 105-106, ¶ 94 (Tab 98).

**(3) There Is No General Prohibition Against
Arbitrary Conduct Under Article 1105**

492. According to the Investor, “[a] state breaches customary international law obligations when it acts arbitrarily.”⁴⁹⁶ In this section, Canada will demonstrate that the so-called prohibition against arbitrary conduct is in fact not an independent source of legal obligation under NAFTA and that the case-law referred to by the Investor does not support such claim.

**(a) The Prohibition of Arbitrariness Is Not a
Stand-alone Obligation**

493. The so-called prohibition against arbitrary conduct and the obligation for host States to provide foreign investors with fair and equitable treatment are not the same thing. The need to differentiate between arbitrariness and fair and equitable treatment is well explained by Schreuer:

Despite this tendency of some tribunals to amalgamate the prohibition of arbitrary or discriminatory measures with [fair and equitable treatment], there are weighty arguments in favour of treating the two standards as conceptually different. (...) The tendency to fuse the prohibition of arbitrariness with [fair and equitable treatment] is probably more a consequence of the insecurity of tribunals confronted with two relatively novel and unspecific standards. As the case law evolves, it may be expected that tribunals develop a clearer perception of the precise implications of each of these principles. In fact, in a number of cases tribunals have already given a more concrete meaning to these standards.⁴⁹⁷

494. Like the duty to act in good faith, the prohibition against arbitrary conduct is not a rule in itself and not an independent source of legal obligation. No stand-alone obligation preventing arbitrariness exists at international law.

⁴⁹⁶ Investor’s Memorial, ¶ 201. More specifically, the Investor alleges that there is “comprehensive support among NAFTA tribunals for interpreting Article 1105 as inclusive of an independent obligation not to act arbitrarily or discriminate against investors from other parties.” (¶ 210).

⁴⁹⁷ Schreuer – *FET Interactions*, at 7-8 (Tab 124).

**(b) The Investor's Position Is Not Supported
By Case Law**

495. None of the NAFTA cases cited by the Investor held that arbitrary conduct breaches Article 1105.

496. The Investor relies on *Metalclad v. Mexico* to argue that Canada is prohibited from “acting on the basis of irrelevant considerations.”⁴⁹⁸ The *Metalclad* Tribunal did not apply any such “principle.”⁴⁹⁹ It concluded that the denial of a construction permit by the municipality was “improper”⁵⁰⁰ in the circumstances of the case and that the Claimant had not been “treated fairly or equitably under the NAFTA,” in breach of Article 1105.⁵⁰¹ The Tribunal did not even mention the concept of arbitrary conduct, hence this decision can hardly support a claim that Article 1105 prohibits arbitrary treatment.⁵⁰²

497. The Investor also refers to the *Waste Management II* case,⁵⁰³ in concluding that the Tribunal there “recognized an independent obligation under Article 1105 to not act in an

⁴⁹⁸ Investor's Memorial, ¶¶ 204, 209. According to the Investor in this case “Mexico breached Article 1105 by refusing on irrelevant grounds to issue a permit to construct a landfill” and the tribunal “applied the principle that arbitrary conduct breaches Article 1105” (¶ 203).

⁴⁹⁹ The Investor cites the *Metalclad* Tribunal without acknowledging that the B.C. Supreme Court subsequently reversed this decision.

⁵⁰⁰ *Metalclad v. Mexico* (ICSID No. ARB(AF)/97/1) Award, 25 August 2000, ¶ 86 (“*Metalclad – Award*”) (Tab 82). The full quote reads as follows: “[T]he denial of the permit by the Municipality by reference to environmental impact considerations in the case of what was basically a hazardous waste disposal landfill, was improper, as was the municipality's denial of the permit for any reason other than those related to the physical construction or defects in the site.”

⁵⁰¹ *Metalclad – Award*, ¶ 101 (Tab 82).

⁵⁰² The relevant two quotes of the *Metalclad – Award* reads as follows: “The Town Council denied the permit for reasons which included, but may not have been limited to, the opposition of the local population, the fact that construction had already begun when the application was submitted, the denial of the permit to COTERIN in December 1991 and January 1992, and the ecological concerns regarding the environmental effect and impact on the site and surrounding communities. None of the reasons included a reference to any problems associated with the physical construction of the landfill or to any physical defects therein. The Tribunal therefore finds that the construction permit was denied without any consideration of, or specific reference to, construction aspects or flaws of the physical facility.” (¶¶ 92-93) (Tab 82).

⁵⁰³ *Waste Management II – Award*, at ¶ 98 (Tab 157). The Tribunal stated that NAFTA case law “suggests that the minimum standard of treatment of fair and equitable treatment is infringed by conduct attributable to the State (...) if the conduct is arbitrary.”

arbitrary or discriminatory manner.”⁵⁰⁴ In fact, the Tribunal’s reference to “arbitrary” conduct is only one of a long list of other conduct also deemed contrary to Article 1105.⁵⁰⁵ “Arbitrary” conduct is just one element that is used as an indicia of a breach of the “fair and equitable treatment” standard. It is not an “independent” obligation under NAFTA.

498. The Investor refers to non-NAFTA cases to support its claim that arbitrary treatment is an independent obligation under Article 1105. These cases do not support its position. The few cases which held that arbitrariness is contrary to fair and equitable treatment were decided in the totally distinct context of BIT clauses specifically prohibiting arbitrary measures. Article 1105 does not include the prohibition of arbitrary or discriminatory conduct found in numerous BITs. This was a deliberate omission by the NAFTA Parties.

499. The Investor refers to *Lauder v. Czech Republic* to support its contention that tribunals have “concluded that a State acts arbitrarily ... when it acts on the basis of prejudice or preference and not on reason or fact.”⁵⁰⁶ The U.S.-Czech BIT at issue contained an explicit obligation prohibiting “arbitrary measures.”⁵⁰⁷ NAFTA Chapter

⁵⁰⁴ Investor’s Memorial, ¶ 207. The *GAMI – Award* (Tab 54) mentioned by the Investor simply repeats *Waste Management II – Award*: Investor’s Memorial, ¶¶ 203, 207.

⁵⁰⁵ *Waste Management II – Award*, ¶ 98 (Tab 157). The different types of conducts referred to by the Tribunal include conduct that is “grossly unfair, unjust or idiosyncratic”, conduct that is “discriminatory and exposes the claimant to sectional or racial prejudice”, and conduct that “involves a lack of due process leading to an outcome which offends judicial propriety.”

⁵⁰⁶ Investor’s Memorial, ¶ 205 citing *Lauder v. Czech Republic*, (UNCITRAL) Final Award, 3 September 2001, ¶¶ 221, 232 (“*Lauder – Final Award*”) (Tab 68).

⁵⁰⁷ Article II of the Treaty with the Czech and Slovak Federal Republic Concerning the Reciprocal Encouragement and Protection of Investment, Signed October 22, 1991; Entered into Force December 1992 (“*U.S. – Czech BIT*”): provides as follows:

“1. Each Party shall permit and treat investment, and activities associated therewith, on a basis no less favorable than that accorded in like situations to investment or associated activities of its own nationals or companies, or of nationals or companies of any third country, whichever is the most favorable [...]

2.(a) Investment shall at all times be accorded fair and equitable treatment, shall enjoy full protection and security and shall in no case be accorded treatment less than that required by international law.

(b) Neither Party shall in any way impair by arbitrary or discriminatory measures the management, operation, maintenance, use, enjoyment, acquisition, expansion, or disposal of investments. For purposes of dispute resolution under Article 3 VI and VII, a measure may be arbitrary or discriminatory

Eleven does not contain any such provision. In fact, the prohibition on “arbitrary measures” has nothing to do with the obligation to accord fair and equitable treatment in the U.S.-Czech BIT. They are separate obligations and are dealt with in different portions of the treaty.⁵⁰⁸ More significantly, the Investor omits the Tribunal’s conclusion that the alleged arbitrary treatment did not breach the minimum standard of treatment.⁵⁰⁹

500. The Investor ultimately fails to demonstrate the existence of a general prohibition on “arbitrary” conduct at international law and this portion of the claim should, consequently, be dismissed.

notwithstanding the fact that a Party has had or has exercised the opportunity to review such measure in the courts or administrative tribunals of a Party.

(c) Each Party shall observe any obligation it may have entered into with regard to investments.”

⁵⁰⁸ Thus, Article II(2)(a) of the *U.S. – Czech BIT* deals with the obligation to accord fair and equitable treatment, while Article II(2)(b) is concerned with the prohibition of arbitrary measures.

⁵⁰⁹ *Lauder – Final Award*, ¶ 293 (Tab 68). The Tribunal concluded that “none of the actions and inactions [...] which have already been examined with respect to the prohibition against arbitrary and discriminatory measures [...] constitutes a violation of the duty to provide fair and equitable treatment”. The Investor quotes the statement by the *CMS* Tribunal that “[a]ny measure that might involve arbitrariness (...) is in itself contrary to fair and equitable treatment.” *CMS Gas Transmission Company v. The Argentine Republic* (ICSID No. ARB/01/8) Final Award, 25 April 2005, ¶ 290 (“*CMS – Final Award*”) (Tab 28). This statement was made in the distinct context of the U.S.-Argentina BIT, which contains a specific provision expressly prohibiting “arbitrary” treatment. Again, the obligation to accord fair and equitable treatment and the prohibition of arbitrary measures are considered as separate issues and are dealt with in different portions of the provision. Thus, Article II(2)(a) of the U.S.-Argentina BIT deals with the obligation to accord fair and equitable treatment, while Article II(2)(b) is concerned with the prohibition of arbitrary measures. (*Treaty Between United States of America and the Argentine Republic Concerning the Reciprocal Encouragement and Protection of Investment*, Signed November 14, 1991; Entered into Force October 20, 1994 (Tab 147)).

The Investor also quotes the *Eureko* Tribunal’s finding that Poland had “acted not for cause but for purely arbitrary reasons” in breach of the fair and equitable treatment obligation under the Netherlands-Poland BIT. This decision is also not relevant here because it was decided under a BIT clause specifically prohibiting “unreasonable or discriminatory measures.” *Eureko B.V. v. Republic of Poland*, Partial Award, 19 August 2005, ¶ 233 (Tab 46). Article 3(1) of the Netherlands-Poland BIT reads as follows: “Each Contracting Party shall ensure fair and equitable treatment to the investments of investors of the other Contracting Party and shall not impair, by unreasonable or discriminatory measures, the operation, management, maintenance, use, enjoyment or disposal thereof by those investors.” For the same reason, the *Occidental* case also referred to by the Investor is of no help to this Tribunal. *Occidental – Award*, ¶ 163 (Tab 105). See Article II(3) of the *Treaty Between the United States of America and the Republic of Ecuador Concerning the Encouragement and Reciprocal Protection of Investment*, Signed 27 August 1993, Entered into Force 11 May 1997 (Tab 149).

**(4) There Is No General Prohibition Against
Discrimination Under Article 1105**

501. According to the Investor, “a state’s obligation to act in good faith is also manifested in a number of specific ways” including not to act in a “discriminatory way.” More specifically, the Investor alleges that the log export control regime is “inherently discriminatory.”⁵¹⁰

502. Canada submits that no stand-alone or independent obligation prohibiting “discrimination” exists under Article 1105(1). NAFTA Chapter Eleven includes a comprehensive and specific legal regime governing nationality-based discrimination. Discrimination is covered by Articles 1102 to 1104, not Article 1105(1).

503. This is confirmed by the Note of Interpretation, which affirms the distinct context of each obligation under Chapter Eleven.⁵¹¹ This is also supported by the fact that the obligation prohibiting nationality-based discrimination in Article 1102 is subject to a long list of reservations contained in Annexes to the NAFTA. Such reservations do not apply to the minimum standard of treatment in respect of which no reservations were allowed because it is an absolute standard, “a floor below which treatment of foreign investors must not fall.”⁵¹² To apply the concept of discrimination in the context of 1105(1) would contradict the intent of the NAFTA Parties.

504. In the *Methanex* case, the claimant contended that California discriminated against it in a manner contrary to Article 1105. The Tribunal expressly stated that Article 1105(1) does not include any prohibition concerning discrimination:

[T]he plain and natural meaning of the text of Article 1105 does not support the contention that the “minimum standard of treatment” precludes governmental differentiations as between nationals and aliens. Article 1105(1) does not mention discrimination; and Article 1105(2), which does mention it, makes

⁵¹⁰ Investor’s Memorial, ¶¶ 141, 200.

⁵¹¹ *NAFTA FTC Notes*, at 3 (Tab 92). It provides that “a determination that there has been a breach of another provision of the NAFTA ... does not establish that there has been a breach of Article 1105(1).”

⁵¹² *S.D. Myers - First Partial Award*, ¶ 259 (Tab 120).

clear that discrimination is not included in the previous paragraph.⁵¹³

This is not an instance of textual ambiguity or lacuna which invites a tribunal even to contemplate making law. When the NAFTA Parties did not incorporate a non-discrimination requirement in a provision in which they might have done so, it would be wrong for a tribunal to pretend that they had.⁵¹⁴

505. In any event, there exists no rule of customary international law that prohibits a State from differentiating between nationals and aliens. The absence of a general prohibition against discrimination at international law was explicitly recognized by the *Methanex* Tribunal:

As to the question of whether a rule of customary international law prohibits a State, in the absence of a treaty obligation, from differentiating in its treatment of nationals and aliens, international law is clear. In the absence of a contrary rule of international law binding on the States parties, whether of conventional or customary origin, a State may differentiate in its treatment of nationals and aliens. As the previous discussion shows, no conventional rule binding on the NAFTA Parties is to the contrary with respect to the issues raised in this case. Indeed, the text of NAFTA indicates that the States parties explicitly excluded a rule of non-discrimination from Article 1105.⁵¹⁵

506. The Investor failed to demonstrate the existence of a general prohibition against discrimination at international law and this portion of the claim should, consequently, be dismissed.

(5) There Is No General Obligation To Protect the Investor's Legitimate Expectations Under Article 1105

507. According to the Investor, “[t]he fair and equitable treatment obligation includes the obligation to protect legitimate expectations.”⁵¹⁶ This section will demonstrate that the

⁵¹³ *Methanex – Award*, Part IV, Ch. C, ¶ 14 (Tab 85).

⁵¹⁴ *Methanex – Award*, Part IV, Ch. C, ¶ 16 (Tab 85).

⁵¹⁵ *Methanex – Award*, (UNCITRAL) Part IV, Ch. C, ¶ 25 (Tab 85).

⁵¹⁶ Investor’s Memorial, ¶ 220.

so-called obligation to protect the Investor's legitimate expectations is not part of customary international law. Moreover, the conditions necessary to support a legitimate expectations claim are not fulfilled in the present case.

(a) This Obligation Is Not Part of Customary International Law

508. The "obligation" to protect the legitimate expectations of an investor is not part of the customary international law minimum standard of treatment of aliens. There is no such "obligation" under Article 1105.

509. In its Memorial, the Investor states that tribunals have been "applying the customary international law obligation to protect legitimate expectations."⁵¹⁷ Other than *Metalclad*,⁵¹⁸ the Investor refers to cases decided in the different context of BITs. As explained above, these cases are not relevant to interpretation of NAFTA Article 1105. Further, the case law cited by the Investor is selective and misleading. It omits the Annulment Committee's conclusion in *CMS v. Argentina* that "[a]lthough legitimate expectations might arise by reason of a course of dealing between the investor and the host State, these are not, as such, legal obligations (...)."⁵¹⁹ In any event, the Investor fails to demonstrate the existence of a general obligation to protect legitimate expectations at international law. Nor have the specific conditions required to support any legitimate expectations been fulfilled in the present case.

(b) The Conditions For a Legitimate Expectations Claim Are Not Met

510. The concept of legitimate expectation must be based on objective rather than subjective expectations. Thus, for an investor's expectations to be protected they must be based on a treaty or specific representations by the host State and not on whatever

⁵¹⁷ Investor's Memorial, ¶ 222.

⁵¹⁸ This case, which does not support the Investor's position, will be examined in more detail below.

⁵¹⁹ *CMS Gas Transmission Co. v. Argentina* (ICSID No. ARB/01/8) (Annulment Proceeding), 21 August 2007, ¶ 89 (Tab 28).

subjective expectations the investor might have had when it made the investment.⁵²⁰ This was explained by the *MTD* Annulment Committee as follows:

For example the *TECMED* Tribunal's apparent reliance on the foreign investor's expectations as the source of the host State's obligations (such as the obligation to compensate for expropriation) is questionable. The obligations of the host State towards foreign investors derive from the terms of the applicable investment treaty and not from any set of expectations investors may have or claim to have. A tribunal which sought to generate from such expectations a set of rights different from those contained in or enforceable under the BIT might well exceed its powers, and if the difference were material might do so manifestly.⁵²¹

511. Several specific conditions must also be met before an investor can claim that the host State frustrated its legitimate expectations. The *Enron* Tribunal correctly identified the following three conditions:

What seems to be essential, however, is that these expectations derived from the conditions that were offered by the State to the investor at the time of the investment and that such conditions were relied upon by the investor when deciding to invest.⁵²²

512. These essential conditions have not been met in the present case.

**(i) Legitimate Expectations Must Be
Based On Pre-Investment
Conditions**

513. Whether an investor's expectations are "legitimate" can be assessed based only on the conditions prevailing in the host State at the time the investment was made.

⁵²⁰ The *M.C.I.* Tribunal stated that "the alleged legitimate expectations of an investor with respect to the behaviour required of a host State cannot include merely subjective assessments..." (¶ 349). The Tribunal also indicated that "[t]he legitimacy of the expectations for proper treatment entertained by a foreign investor protected by the BIT does not depend solely on the intent of the parties, but on certainty about the contents of the enforceable obligations." *M.C.I. Power Group L.C. and New Turbine, Inc. v. Ecuador* (ICSID No. ARB/03/6) Award, 26 July 2007 (Tab 78).

⁵²¹ *MTD Equity Sdn. Bhd. & MTD Chile S.A. v. Chile* (ICSID No. ARB/01/7) Decision on Annulment, 16 February 2007, ¶ 67 (Tab 91).

⁵²² *Enron – Award*, ¶ 262 (Tab 44). [Emphasis added].

514. This is a basic requirement that has been recognized by all tribunals that have examined the concept of legitimate expectation. Thus, the *Enron* Tribunal stated that it was “essential” that “these expectations derived from the conditions that were offered by the State to the investor at the time of the investment.”⁵²³ Similarly, the *LG&E* Tribunal stated that “the investor’s fair expectations” have several “characteristics,” the first being that “they are based on the conditions offered by the host State at the time of the investment.”⁵²⁴ The *Tecmed* Tribunal also explained that the Spain-Mexico BIT required Mexico to “provide to international investments treatment that does not affect the basic expectations that were taken into account by the foreign investor to make the investment.”⁵²⁵ The same assessment is made by the *Saluka* Tribunal: “An investor’s decision to make an investment is based on an assessment of the state of the law and the totality of the business environment at the time of the investment as well as on the investor’s expectation that the conduct of the host State subsequent to the investment will be fair and equitable.”⁵²⁶

515. Hence, the legal regime existing at the time an investment is made defines what the investor’s legitimate expectations should be. As explained by Dolzer, “[t]he pre-investment legal order forms the framework for the positive reach of the expectation which will be protected and also the scope of considerations upon which the host state is entitled to rely when it defends against subsequent claims of the foreign investor.”⁵²⁷ In other words, an investor takes the law of the host State as it finds it and cannot subsequently complain about the application of that law to its investment.

516. In the present case, the Investor argues that the log export control regime, which was continued by Notice 102 in 1998, is “inconsistent with Canada’s obligation not to

⁵²³ *Enron – Award*, ¶ 262 (Tab 44).

⁵²⁴ *LG & E v. Argentina* (ICSID No. ARB/02/1) Decision on Liability, 26 September 2006, ¶ 130 (Tab 70).

⁵²⁵ *Tecnicas Medioambientales TECMED S.A. v. Mexico*, (ICSID No. ARB(AF)00/2), Award, 29 May 2003, ¶ 154 (Tab 134).

⁵²⁶ *Saluka – Partial Award*, ¶ 301 (Tab 123).

⁵²⁷ Dolzer, Rudolf, *Fair and Equitable Treatment: A Key Standard in Investment Treaties* (2005) 39 INT’L LAWYER 87, at 103 (“Dolzer”) (Tab 36).

frustrate [its] legitimate expectations.”⁵²⁸ As explained by Dolzer, “the legitimacy of [the investor’s] expectations will largely depend upon the objective state of the law as it stands at the time when the investor acquires the investment.”⁵²⁹

517. The Investor presented no evidence whatsoever as to the conditions prevailing when it initially made its investment. It is therefore impossible for the Tribunal to determine whether the Investor’s expectations might have been frustrated by the log export control regime.

**(ii) Legitimate Expectations Must Be
Based on Representations By the
State**

518. The expectations that an Investor may have had at the time it made its investment are relevant only to the extent that representations were given by a government to the investor.⁵³⁰

519. The only NAFTA Tribunal (*Metalclad v. Mexico*) to apply the concept of legitimate expectation did so solely based on the ground that clear, specific, repetitive and credible government assurances had been given directly to the investor who had relied upon those representations to make its investment.

520. In that case, the Government of Mexico had issued federal construction and operating permits for a landfill prior to Metalclad’s purchase of another Mexican company. The issue was whether a municipal permit was also required. The Tribunal noted that “federal officials assured [Metalclad] that it had all that was needed to undertake the landfill project”⁵³¹ and it “was led to believe, and did believe, that the

⁵²⁸ Investor’s Memorial, ¶ 356.

⁵²⁹ Dolzer, at 103 (Tab 36).

⁵³⁰ *The Waste Management II – Award* Tribunal states (at ¶ 98) (Tab 157) that “in applying [minimum standard of treatment] it is relevant that the treatment is in breach of representations made by the host State which were reasonably relied on by the claimant.”

⁵³¹ *Metalclad – Award*, ¶ 80 (Tab 82).

federal and state permits allowed for the construction and operation of the landfill.”⁵³² It is therefore based on “the representations of the federal government” that Metalclad started constructing the landfill.⁵³³ For the Tribunal, “Metalclad was entitled to rely on the representations of federal officials and to believe that it was entitled to continue its construction of the landfill.”⁵³⁴ The Tribunal adds that when Metalclad finally filed for a municipal permit application it “was merely acting prudently and in the full expectation that the permit would be granted.”⁵³⁵ This finding was subsequently reversed by the B.C. Supreme Court.

521. In its Memorial, the Investor does not mention any representations made by the government with respect to Merrill & Ring’s investment. This is because no such representations were made by the government.

522. In fact, the Investor’s federal lands have been subject to some kind of export controls in B.C. since 1942. The surplus test applied to the Investor since 1986 (Notice 23). From the exporter’s perspective, little has changed with respect to the process for the surplus list.⁵³⁶ The only legitimate expectation the Investor could have held was that it would be regulated in the same way as other logging companies in B.C. and that Notice 102 would apply equally to it. This is exactly how the Investor was treated in the present case.

⁵³² *Metalclad – Award*, ¶ 85 (Tab 82).

⁵³³ *Metalclad – Award*, ¶ 87 (Tab 82). The Tribunal also indicates (¶ 88) that “In addition, Metalclad asserted that federal officials told it that if it submitted an application for a municipal construction permit, the Municipality would have no legal basis for denying the permit and that it would be issued as a matter of course.”

⁵³⁴ *Metalclad – Award*, ¶ 89 (Tab 82).

⁵³⁵ *Metalclad – Award*, ¶ 89 (Tab 82). The Municipality finally denied Metalclad’s application for a construction permit after the landfill had already been constructed. The Tribunal concluded that Mexico had “failed to ensure a transparent and predictable framework for Metalclad’s business planning and investment” contrary to Article 1105.

⁵³⁶ *Korecky Affidavit*, ¶ 53.

523. As explained by Ms. Korecky in her affidavit, there was an extensive consultation process with stakeholders when Notice 102 came into force in 1998.⁵³⁷ The record shows that the then Deputy Director of the Export Controls Division and the federal representative on FTEAC, Mr. Thomas Jones, met with Merrill & Ring officials on April 1, 1998 to discuss the changes resulting from Notice 102.⁵³⁸ At the time, the Investor expressed concern about the revised policy.⁵³⁹ It is clear from the correspondence, however, that Canada continuously and clearly advised Merrill & Ring that it would be subject to Notice 102.

524. The Tribunal must dismiss the Investor's legitimate expectations claim because no representations were made by Canada that it would not be subject to log export controls or Notice 102. Hence, the second fundamental condition is not fulfilled.

**(iii) The Investor Must Rely on the
Representations When Investing**

525. A third condition that must be fulfilled to prove frustration of legitimate expectations is actual reliance by the Investor on the governmental representations when making the decision to invest.

526. This requirement was recognized by the *Waste Management II* Tribunal: "it is relevant that the treatment is in breach of representations made by the host State which were reasonably relied on by the claimant."⁵⁴⁰ The same conclusion was reached by the *Thunderbird* Tribunal.⁵⁴¹

⁵³⁷ *Korecky Affidavit*, ¶ 45.

⁵³⁸ *Korecky Affidavit*, Exhibit 13 (Jones Memo to Minister, 14 April 1998).

⁵³⁹ *Korecky Affidavit*, Exhibit 16 (letter of 18 April 1998 from the Investor's solicitors to Mr. Jones).

⁵⁴⁰ *Waste Management II – Award*, ¶ 98 (Tab 157).

⁵⁴¹ *Thunderbird – Award*, ¶ 147 (Tab 136): "Having considered recent investment case law and the good faith principle of international customary law, the concept of "legitimate expectations" relates, within the context of the NAFTA framework, to a situation where a Contracting Party's conduct creates reasonable and justifiable expectations on the part of an investor (or investment) to act in reliance on said conduct, such that a failure by the NAFTA Party to honour those expectations could cause the investor (or investment) to suffer damages."

527. In the present case, as no representations were made by governments, it follows that the Investor could not reasonably have relied upon them when it decided to invest. The Tribunal must therefore dismiss the Investor's legitimate expectations claim because none of the essential conditions required in support of such claim were fulfilled.

(6) There Is No General Obligation of Transparency Under Article 1105

528. According to the Investor, "[t]he customary international law standard is breached where a party acts without transparency."⁵⁴²

(a) Transparency Is Not a Stand-alone Obligation

529. Canada submits that Article 1105 does not include any general obligation of "transparency" and it is not part of the customary international law minimum standard of treatment of aliens.⁵⁴³ This is also the conclusion reached in a recent study done by the OECD, which described the transparency requirement as a "relatively new concept not generally considered a customary international law standard."⁵⁴⁴

(b) The Investor's Position Is Not Supported By Case Law

530. The Investor cites the *Metalclad* case to argue that Article 1105 includes an obligation to provide transparency. Its description of the case is incorrect and misleading.

531. One such misleading statement by the Investor is that the *Metalclad* Tribunal "drew the obligation of transparency from Articles 102 and 1802 of the NAFTA and not from an interpretation of Article 1105 or customary international law."⁵⁴⁵ In fact, the

⁵⁴² Investor's Memorial, ¶ 228.

⁵⁴³ In its Memorial, the Investor admits that the "transparency" obligation overlaps with the "obligation to avoid acting arbitrarily" (¶ 229) as well as with the obligation to provide fair and equitable treatment (¶ 230).

⁵⁴⁴ OECD, *Fair & Equitable Treatment*, at 37 (Tab 107).

⁵⁴⁵ Investor's Memorial, ¶ 232.

reverse is true. The Tribunal drew the obligation of transparency precisely from Article 1105.⁵⁴⁶

532. While the *Metalclad* Tribunal’s finding suggests that transparency is included in Article 1105, this aspect of the Award was subsequently set aside by Justice Tysoe of the B.C. Supreme Court on the ground that it exceeded the scope of Chapter 11. The Investor is completely wrong when it alleges that “Justice Tysoe did not comment on whether Article 1105 or customary international law themselves establish an obligation of transparency.”⁵⁴⁷ In fact, Justice Tysoe specifically held that the so-called transparency obligation was not part of customary international law and was not covered by Article 1105:

On my reading of the Award, the Tribunal did not simply interpret Article 1105 to include a minimum standard of transparency. No authority was cited or evidence introduced to establish that transparency has become part of customary international law. (...).⁵⁴⁸

In the present case, however, the Tribunal did not simply interpret the wording of Article 1105. Rather, it misstated the applicable law to include transparency obligations and it then made its decision on the basis of the concept of transparency.⁵⁴⁹

Justice Tysoe also expressly stated that no transparency obligation exists under NAFTA Chapter Eleven (but only under another chapter, Chapter 18).⁵⁵⁰

533. The Investor is also wrong in arguing that the set-aside decision of the B.C. Supreme Court “does not affect the weight given to a NAFTA tribunal’s decision under

⁵⁴⁶ Thus, the Tribunal’s finding (¶ 99) that “Mexico failed to ensure a transparent and predictable framework for Metalclad’s business planning and investment” is in the Award’s section dealing with Article 1105. Tribunal concluded that Metalclad “was not treated fairly or equitably” in breach of Article 1105 (*Metalclad – Award*, ¶ 101) (Tab 82).

⁵⁴⁷ Investor’s Memorial, ¶ 233.

⁵⁴⁸ *Mexico v. Metalclad*, 2001 BCSC 664, 2 May 2001 (B.C. Sup. Ct.) (“*Metalclad, Judicial Review*”), ¶ 68 (Tab 82). [Emphasis added]

⁵⁴⁹ *Metalclad – Judicial Review*, ¶ 70 (Tab 83).

⁵⁵⁰ *Metalclad – Judicial Review*, ¶¶ 71-72 (Tab 83).

international law” because it is a “domestic court decision.”⁵⁵¹ This interpretation ignores the fact that the set-aside decision is made pursuant to NAFTA Article 1136(3), which authorizes review of final awards under applicable (domestic) legislation rendered in cases applying the UNCITRAL or ICSID Additional Facility Rules.

534. The Investor also cites the *Waste Management II* Tribunal, which held that the fair and equitable treatment obligation is infringed if conduct “involves a lack of due process leading to an outcome which offends judicial propriety – as might be the case with a manifest failure of natural justice in judicial proceedings or a complete lack of transparency and candor in an administrative process.”⁵⁵² This is a reference to the well-known principles of denial of justice and due process, not to the abstract concept of “transparency.” This sentence cannot support the investor’s position that “transparency” is part of customary international law and is covered by Article 1105. At any rate, the Tribunal found no breach of Article 1105.

535. The Investor has not demonstrated the existence of a general obligation of transparency at international law and this portion of the claim should, consequently, be dismissed.

(7) There Is No General Obligation to Provide a Secure Legal Environment Under Article 1105

536. The Investor alleges that the obligation to act in good faith entails a specific “obligation to provide a secure legal environment,”⁵⁵³ which is included in Article 1105.⁵⁵⁴

(a) This Is Not a Stand-alone Obligation

537. In support of its position, the Investor refers to the *Metalclad* ruling that Mexico “failed to ensure a transparent and predictable framework for Metalclad’s business

⁵⁵¹ Investor’s Memorial, ¶ 234.

⁵⁵² *Waste Management II – Award*, ¶ 98 (Tab 157).

⁵⁵³ Investor’s Memorial, ¶ 198.

⁵⁵⁴ Investor’s Memorial, ¶ 235.

planning and investment.”⁵⁵⁵ As previously mentioned, this aspect of the Award was set aside by Justice Tysoe of the B.C. Supreme Court. He concluded that no such “obligation” was part of customary international law.

538. The Investor’s position is not reinforced by NAFTA’s preamble, which states that the NAFTA Parties “resolved to ... ensure a predictable commercial framework for business planning and investment.” This vague statement does impose an obligation to provide a secure legal environment that can be sanctioned by an arbitral tribunal. It is also a highly selective choice of preambular elements that does not reflect the overall balance of interests stated in the preamble.

539. The Investor also refers to non-NAFTA cases to support its claim. The *CMS* and *Occidental* Tribunals found that the fair and equitable treatment clauses in the U.S.-Argentina BIT and the U.S.-Ecuador BIT, respectively, found that “a stable legal and business environment is an essential element of fair and equitable treatment.”⁵⁵⁶ These findings are of no help to the present Tribunal because the Investor here must prove that the so-called obligation to provide foreign investors with a “secure legal environment” is part of customary international law.

540. Article 1105 does not include any general obligation to “provide a secure legal environment” which is not part of customary international law. The Investor fails to demonstrate the existence of a general obligation, and this portion of the claim should, consequently, be dismissed.

⁵⁵⁵ *Metalclad – Award*, ¶ 99 (Tab 82).

⁵⁵⁶ *CMS – Final Award*, ¶ 274 (Tab 28). See also the similar quote in *Occidental – Award*, ¶¶ 183, 190 (Tab 105).

(b) The Obligation to Provide Full Protection and Security Does Not Include “Legal” Security

541. The Investor argues that tribunals have interpreted the obligation to provide “full protection and security” in Article 1105 “to extend to legal security.”⁵⁵⁷

542. The non-NAFTA case-law interpreting very different obligations is not relevant in the context of the present dispute. At any rate, the case-law cited is selective. Thus, the Investor omits the latest decision addressing the issue, *PSEG v. Turkey*, where the Tribunal stated that the obligation to provide “full protection and security” is generally limited to physical security, and that only in exceptional circumstances can it apply in other situations:

The Claimants have also alleged a breach of the obligation to provide full protection and security as a separate heading of liability. This obligation is indeed embodied in Article II (3) of the Treaty. (...) The Tribunal is mindful of the fact that this particular standard has developed in the context of the physical safety of persons and installations, and only exceptionally will it be related to the broader ambit noted in *CME*. To the extent that there is such an exceptional situation, the connection with fair and equitable treatment becomes a very close one. The Tribunal does not find that in the present case there has been any question of physical safety and security, nor has any been alleged. Neither does the Tribunal find that there is an exceptional situation that could qualify under this standard as a separate heading of liability. The anomalies that have been found are all included under the standard of fair and equitable treatment discussed above. This heading of liability is accordingly dismissed.⁵⁵⁸

543. The *PSEG* Tribunal rightly limited the scope of the obligation to provide full protection and security in light of the particular context in which this concept was originally developed by investor-State tribunals. In the specific context of physical destruction or seizure of property, tribunals have held that the host State is required to

⁵⁵⁷ Investor’s Memorial, ¶¶ 238-239 [Emphasis in original]. See also Investor’s Memorial, ¶¶ 240-242.

⁵⁵⁸ *PSEG Global Inc. and Konya Elektrik Uretim ve Ticaret Limited Sirketi v. Republic of Turkey* (ICSID No. ARB/02/5), Award, 17 January 2007 ¶¶ 257, 258, 259 (Tab 114).

exercise due diligence and to be vigilant in taking precautions to protect foreign investors.

544. The case of *AAPL v. Sri Lanka* involved a shrimp farm that was destroyed by the Sri Lankan army as part of an operation against the Tamil Tiger rebels reported to be using the installation.⁵⁵⁹ In *AMT v. Zaire*, the Tribunal held that Zaire had “manifestly failed to respect the minimum standard required of it by international law”⁵⁶⁰ as a result of loss to the claimant’s investment caused by widespread looting in the country.⁵⁶¹ Similarly, *Wena v. Egypt* involved agents of a State-owned entity forcibly and illegally seizing hotels.⁵⁶² Finally, in *Eastern Sugar v. Czech Republic*, the Tribunal determined that the obligation to provide full protection and security in a BIT concerns the obligation of the host State to protect investors from third parties engaged in “physical violence against the investors in violation of the state monopoly of physical force.”⁵⁶³

545. Investor-State case law on the obligation to provide “full protection and security” was summarized as follows in a recent comprehensive UNCTAD Study:

The standard of *full protection and security* has traditionally applied to foreign investors in periods of insurrection, civil unrest

⁵⁵⁹ *Asian Agricultural Products Ltd. (AAPL) v. Republic of Sri Lanka* (ICSID No. ARB/87/3) Award, 15 June 1990, at 634 (Tab 1). In his dissenting opinion, Judge Asante made the following relevant observations with respect to the obligation to provide full protection and security: “Article 2(2) [of the Sri Lanka/UK BIT] prescribes the general standard for the protection of foreign investment. The requirements as to fair and equitable treatment, full protection and security and non-discriminatory treatment all underscore the general obligation of the host state to exercise due diligence in protecting foreign investment in its territories, an obligation that derives from customary international law.” [Emphasis added]

⁵⁶⁰ *American Manufacturing & Trading, Inc. v. Republic of Zaire* (ICSID No. ARB/93/1) Award, 10 February 1997, ¶ 6.10., at 30 (“*AMT – Award*”) (Tab 4), in 36 ILM 1997, at 1531.

⁵⁶¹ *AMT – Award* at 1548 (Tab 4), the Tribunal explained: “The obligation [to accord fair and equitable treatment and protection and security under the US-Zaire BIT] incumbent upon Zaire is an obligation of vigilance, in the sense that Zaire...shall take all measures necessary to ensure the full enjoyment of protection and security of its [the US] investment and should not be permitted to invoke its own legislation to detract from any such obligation. Zaire must show that it has taken all measure of precaution to protect the investments of AMT in its territory”. [Emphasis added]

⁵⁶² *Wena Hotels Ltd. (U.K.) v. Arab Republic of Egypt*, ICSID Case No ARB/98/4, Award 8 December 2000 (Tab 159). The Tribunal held that “the obligation incumbent on the [host state] is an obligation of vigilance”.

⁵⁶³ *Eastern Sugar B.V. v. Czech Republic*, SCC Case No. 088/2004 Partial Award, 27 March 2007 ¶ 203 (Tab 39).

and other public disturbances, although it is not explicitly limited to those circumstances. ISDS jurisprudence has traditionally held that the full protection and security standard encompasses damage or losses sustained by an investor as a result of such violent episodes, whether directly due to government acts or to a lack of adequate protection of the investment by government officials or police.⁵⁶⁴

546. The report notes that some tribunals have recently applied the concept of full protection and security in situations not involving violence. For the author of the report, “[t]he application of the full protection and security standard in non-violent contexts risks merging this specific standard with the more general standard of fair and equitable treatment” which would be “odd.”⁵⁶⁵

547. The specific circumstances of the cases mentioned above defining the obligation to provide full protection and security clearly have no common features with the legal environment in which Merrill & Ring has been operating in B.C. for more than 100 years. The concept was developed in a totally different context that has nothing to do with the kind of treatment Merrill & Ring complains about in the present arbitration.

(8) There Is No General Prohibition of Abuse of Rights Under Article 1105

548. According to the Investor, “Canada has an obligation under the international law standard not to abuse the rights of foreign investors.”⁵⁶⁶ For the Investor, the prohibition against abuse of rights is a “stand alone obligation under customary international law.”⁵⁶⁷

549. Canada submits that this so-called prohibition is not a stand-alone obligation under the customary international law minimum standard of treatment of aliens. The concept of “abuse of right” is part of the more general principle of denial of justice. The

⁵⁶⁴ UNCTAD, *Investor-State Rulemaking*, at 46 (Tab 142).

⁵⁶⁵ UNCTAD, *Investor-State Rulemaking*, at 47 (Tab 142).

⁵⁶⁶ Investor’s Memorial, ¶ 216.

⁵⁶⁷ Investor’s Memorial, ¶ 216.

Investor refers to the *Azinian* case in support of its position.⁵⁶⁸ However, the *Azinian* Tribunal clearly viewed the concept of “abuse of right” as one specific aspect of the denial of justice.⁵⁶⁹

550. The Investor failed to prove that the so-called prohibition on abuse of rights is a stand-alone obligation. In fact, there is support for the contrary position that the concept of “abuse of right” has limited use at international law. As explained by Brownlie “as a general principle, it does not exist in positive law.”⁵⁷⁰ Others believe that the concept of “abuse of right” is only a “specific application of the doctrine of good faith.”⁵⁷¹

551. At any rate, as further explained below, the allegations referred to by the Investor do not even approach what is generally considered as an abuse of rights.

c) A High Threshold Applies for Finding a Breach Under Article 1105

552. A NAFTA Chapter Eleven tribunal is not mandated to adjudicate the legitimacy of the log export control regime or whether it is soundly administered. Nor is it charged with deciding whether the alleged measures violate domestic law. Its sole task is to assess whether there has been a breach of NAFTA Chapter Eleven.

553. As explained by the *S.D. Myers* Tribunal, NAFTA Chapter Eleven arbitration is not the proper medicine to cure an imperfect regulatory regime,

When interpreting and applying the “minimum standard”, a Chapter 11 tribunal does not have an open-ended mandate to second-guess government decision-making. Governments have to make many potentially controversial choices. In doing so, they

⁵⁶⁸ Investor’s Memorial, ¶ 219.

⁵⁶⁹ *Azinian – Award*, ¶ 103 (Tab 7): “There is a fourth type of denial of justice, namely the clear and malicious misapplication of the law”.

⁵⁷⁰ *Brownlie*, at 429-430 (Tab 17).

⁵⁷¹ Bishop, R. Doak, James Crawford & W. Michael Reisman, *FOREIGN INVESTMENT DISPUTES, CASES, MATERIALS AND COMMENTARY* (The Hague: Kluwer Law International, 2005), at 15-16: “Another claim that is part of customary international law is for abuse of rights. An abuse of rights is another specific application of the doctrine of good faith.” (Tab 15)

may appear to have made mistakes, to have misjudged the facts, proceeded on the basis of a misguided economic or sociological theory, placed too much emphasis on some social values over others and adopted solutions that are ultimately ineffective or counterproductive. The ordinary remedy, if there were one, for errors in modern governments is through internal political and legal processes, including elections.⁵⁷²

554. Article 1131 requires this Tribunal to decide the present dispute under the NAFTA and international law.⁵⁷³ The Tribunal cannot determine whether the log export control regime violates Canadian law. NAFTA arbitration is not the proper forum to decide claims dealing with ordinary breach of domestic law.⁵⁷⁴ As explained in *ADF*, a NAFTA Tribunal does not sit as an appellate court.⁵⁷⁵ This feature of the investor-State dispute settlement mechanism under NAFTA was highlighted by the first NAFTA Tribunal in the *Azinian* case:

To put it another way, a foreign investor entitled in principle to protection under NAFTA may enter into contractual relations with a public authority, and may suffer a breach by that authority, and *still not be in a position to state a claim under NAFTA*. It is a fact of life everywhere that individuals may be disappointed in their dealings with public authorities, and disappointed yet again when national courts reject their complaints.⁵⁷⁶

⁵⁷² *S.D. Myers – First Partial Award*, ¶ 261 (Tab 120). The *Azinian* Tribunal also stated that “NAFTA does not, however, allow investors to seek international arbitration for mere contractual breaches. Indeed, NAFTA cannot possibly be read to create such a regime, which would have elevated a multitude of ordinary transactions with public authorities into potential international disputes.” (*Azinian – Award*, ¶ 87) (Tab 7).

⁵⁷³ This is clearly stated by the *ADF* Tribunal, *ADF – Award*, ¶ 190 (Tab 2): “Our jurisdiction is confined by NAFTA Article 1131(1) to assaying the consistency of the U.S. measures with relevant provisions of NAFTA Chapter 11 and applicable rules of international law.”

⁵⁷⁴ This is also the conclusion reached by *Schreuer – FET Interactions*, at 21 (Tab 124): “Does the investor have a right under international law that the host State acts at all times in accordance with its own law? Compliance with domestic law would be the primary responsibility of domestic enforcement mechanisms and not a matter for international adjudication.”

⁵⁷⁵ *ADF – Award*, ¶ 190 (Tab 2): “The Tribunal has no authority to review the legal validity and standing of the U.S. measures here in question under U.S. internal administrative law. We do not sit as a court with appellate jurisdiction with respect to US measures.”

⁵⁷⁶ *Azinian – Award*, ¶ 83 (Tab 7).

555. Allegations of breach under domestic law are irrelevant for the present Tribunal because, as the *GAMI* Tribunal stated, “[a] failure to satisfy requirements of national law does not necessarily violate international law”.⁵⁷⁷ Thus, a finding by this Tribunal that the log export control regime violates Canadian domestic law would not render it illegal under international law. This essential point is explained by the *ADF* Tribunal as follows:

The Tribunal would emphasize, too, that even if the U.S. measures were somehow shown or admitted to be *ultra vires* under the internal law of the United States, that by itself does not necessarily render the measures grossly unfair or inequitable under the customary international law standard of treatment embodied in Article 1105(1). An unauthorized or *ultra vires* act of a governmental entity of course remains, in international law, the act of the State of which the acting entity is part, if that entity acted in its official capacity. But something more than simple illegality or lack of authority under the domestic law of a State is necessary to render an act or measure inconsistent with the customary international law requirements of Article 1105(1).⁵⁷⁸

556. As observed by the *ADF* Tribunal, for measures to breach Article 1105, “something more” than just illegality is required. That “something more” is the requirement that the acts or omissions exceed the high threshold set by international law for breach of the minimum standard of treatment.⁵⁷⁹

557. The *ELSI* case decided by the Chamber of the I.C.J. was rendered in the different context of a treaty provision containing an express guarantee prohibiting “arbitrary” measures.⁵⁸⁰ This case is nonetheless useful as it defines the concept of “arbitrariness” and establishes a high threshold for breach:

⁵⁷⁷ *GAMI – Award*, ¶ 97 (Tab 54). The same conclusion was reached by the Chamber of the ICJ in the *ELSI* case, ¶ 124 (Tab 42): “The fact that an act of a public authority may have been unlawful in municipal law does not necessarily mean that that act was unlawful in international law.”

⁵⁷⁸ *ADF – Award*, ¶ 190 (Tab 2).

⁵⁷⁹ *Schreuer – FET Interactions*, at 21 (Tab 124): “a violation by the host State of its own law will not automatically amount to a breach of the FET standard. This would be the case only if the violations were systemic and were to affect the stability and transparency of the investment’s legal environment.”

⁵⁸⁰ *Elettronica Sicula S.p.A. (United States of America v. Italy)* 1989 I.C.J. Rep. 15 (Tab 42). Article 1 of the Agreement Supplementing the Treaty of Friendship, Commerce and Navigation between

The fact that an act of a public authority may have been unlawful in municipal law does not necessarily mean that that act was unlawful in international law. . . . To identify arbitrariness with mere unlawfulness would be to deprive it of any useful meaning in its own right. Nor does it follow . . . that an act was unjustified, or unreasonable, or arbitrary, that that act is necessarily to be classed as arbitrary in international law. . . .⁵⁸¹

Arbitrariness is not so much something opposed to a rule of law, as something opposed to the rule of law. . . . It is wilful disregard of due process of law, an act which shocks, or at least surprises, a sense of judicial propriety.⁵⁸²

558. The high threshold adopted in the *ELSI* case has been endorsed by other investor-State tribunals, including the *Noble*⁵⁸³ and *Azurix* Tribunals, which held that “the definition in *ELSI* is close to the ordinary meaning of arbitrary since it emphasizes the element of willful disregard of the law.”⁵⁸⁴ Similarly, the *Genin* Tribunal held that irregularities must “amount to bad faith, a wilful disregard of due process of law or an extreme insufficiency of action,” to violate a BIT prohibition on arbitrary treatment.⁵⁸⁵

559. The concept of arbitrariness has been discussed in several NAFTA cases which affirmed a high threshold for breach. For instance, the *Mondev* Tribunal expressly endorsed the high threshold mentioned in the *ELSI* case.⁵⁸⁶ For the *S.D. Myers* Tribunal, the threshold for breach of Article 1105 is reached only when State action is deemed unacceptable compared to what other States do:

the United States of America and the Italian Republic, Sept. 26, 1951, U.S.–Italy, 12 U.S.T. 131, reads as follows: “The nationals, corporations, and associations of either High Contracting Party shall not be subjected to arbitrary or discriminatory measures within the territory of the other High Contracting Party”.

⁵⁸¹ *ELSI*, ¶ 124 (Tab 42).

⁵⁸² *ELSI*, ¶ 128 (Tab 42).

⁵⁸³ *Noble Ventures v. Romania* (ICSID No. ARB/01/11) Award, 5 October 2005 (Tab 99) ¶ 176 : “The BIT gives no definition of either the notion “arbitrary” or “discriminatory.” Regarding arbitrariness, reference can again be made to the decision of the ICJ in the *ELSI* case.”

⁵⁸⁴ *Azurix v. Argentine Republic* (ICSID No. ARB/01/12) Award, 23 June 2006, ¶ 392 (Tab 8).

⁵⁸⁵ *Genin v. Estonia*, ICSID No. ARB/99/2, Award, 25 June 2001 (Tab 55) ¶ 371 (“*Genin – Award*”) (Tab 55). The Tribunal concluded that it did “not regard the license withdrawal as an arbitrary act that violates the tribunal’s “sense of judicial propriety”.

⁵⁸⁶ *Mondev – Award*, ¶ 127 (Tab 87).

The Tribunal considers that a breach of Article 1105 occurs only when it is shown that an investor has been treated in such an unjust or arbitrary manner that the treatment rises to the level that is unacceptable from the international perspective. That determination must be made in the light of the high measure of deference that international law generally extends to the right of domestic authorities to regulate matters within their own borders...⁵⁸⁷

560. The *Thunderbird* Tribunal rightly observed that under NAFTA “the threshold for finding a violation of the minimum standard of treatment still remains high.”⁵⁸⁸ The Tribunal held that conduct must be manifestly arbitrary or unfair in order to breach the minimum standard of treatment under Article 1105:

The Tribunal cannot find sufficient evidence on the record establishing that the SEGOB proceedings were arbitrary or unfair, let alone so manifestly arbitrary or unfair as to violate the minimum standard of treatment.⁵⁸⁹

561. In that case, the Tribunal acknowledged that the administrative proceedings “may have been affected by certain procedural irregularities.”⁵⁹⁰ However, the Tribunal held that it could not find “any administrative irregularities that were grave enough to shock a sense of judicial propriety and thus give rise to a breach of the minimum standard of treatment.”⁵⁹¹

562. None of the measures complained of by the Investor in this case reaches the necessary threshold for breach of the customary international law minimum standard of treatment of aliens under Article 1105.

⁵⁸⁷ *SD Myers – First Partial Award*, ¶ 263 (Tab 120).

⁵⁸⁸ *Thunderbird – Award*, ¶ 194 (Tab 136).

⁵⁸⁹ *Thunderbird – Award*, ¶ 197 (Tab 136).

⁵⁹⁰ *Thunderbird – Award*, ¶ 200 (Tab 136).

⁵⁹¹ *Thunderbird – Award*, ¶ 200 (Tab 136). Similarly, the *Waste Management II – Award* (Tab 157) Tribunal also sets a high threshold. The Tribunal first indicated that it was “clear that the City [of Acapulco] failed in a number of respects to fulfil its contractual obligations to Claimant under the Concession Agreement.” (¶ 109) The Tribunal nevertheless found no breach Article 1105 insofar as the City had not acted in a “wholly arbitrary way or in a way that was grossly unfair” at ¶ 115 [Emphasis added]. The Tribunal went so far as to say that non-payment of debts breaches Article 1105 only if it amounts to an “outright and unjustified repudiation of the transaction” at ¶115 [Emphasis added].

3. The Law Applied to the Facts

563. Canada has demonstrated in previous sections that the Investor has completely distorted the proper meaning of Article 1105. The Investor has not identified a single customary international legal standard with respect to treatment of aliens as required by Article 1105.

564. The Investor alleges that Canada breached its obligations under NAFTA Article 1105(1) because the federal log export regime:

- a) contains arbitrary rules that are administered in an arbitrary manner;
- b) is administered in a non-transparent manner;
- c) creates an uncertain legal and business environment;
- d) violates Merrill & Ring's legitimate expectations; and
- e) constitutes an abuse of Canada's rights.⁵⁹²

565. These allegations are unsubstantiated. In any event, none of the measures complained of by the Investor breaches the customary international law minimum standard of treatment of aliens.

a) Overview of the Investor's Claim

566. Despite the serious accusations of breach of the minimum standard of treatment, ultimately Merrill & Ring's claim concerns a miniscule portion of its log business in British Columbia.

567. Overall, under Notice 102 the number of offers received on booms advertised is typically very low compared to the total number of booms advertised. For instance, of the 38,876 parcels of logs which have been advertised on the Bi-Weekly List since 1998,

⁵⁹² Investor's Memorial, ¶ 352.

only 933 offers were considered by FTEAC.⁵⁹³ At a minimum, 97.6% of all logs advertised were deemed surplus and allowed to be exported from Canada.

568. Merrill & Ring's situation is not significantly different. It typically advertised on average [REDACTED] federal booms annually and offers generally were received on only [REDACTED] of them.⁵⁹⁴ In the last 10 years, FTEAC has therefore considered offers on only [REDACTED] of all logs advertised by Merrill & Ring.⁵⁹⁵ In fact, over the last 10 years, only [REDACTED] parcels of logs were declared non-surplus.⁵⁹⁶ In other words, over [REDACTED] of the Investor's parcels were ultimately declared surplus and available for export. As a result, the "big picture" to keep in mind when deciding this claim is that a very small percentage of Merrill & Ring's overall business is "affected" by the alleged shortcomings of the log export regime.

569. The Investor's serious allegation that Canada is "complicit"⁵⁹⁷ in the practices of "blockmailing" and "special targeting" concern only a handful of offers each year.⁵⁹⁸ In fact, in its Memorial, the Investor refers to only one event of (alleged) "blockmailing."⁵⁹⁹ At any rate, Canada has no role in blockmailing and disciplines such conduct when it comes to its attention.⁶⁰⁰

570. A practice that affects less than [REDACTED] of Merrill & Ring's business can hardly be considered to create an "insecure" legal and business environment.⁶⁰¹ Had the Investor

⁵⁹³ *Korecky Affidavit*, ¶ 98, Exhibit 38.

⁵⁹⁴ *Korecky Affidavit*, ¶¶ 77, 100.

⁵⁹⁵ *Korecky Affidavit*, ¶ 146, Exhibits 32, 39.

⁵⁹⁶ *Korecky Affidavit*, ¶ 146, Exhibit 32.

⁵⁹⁷ Investor's Memorial, ¶ 153.

⁵⁹⁸ Canada will show in this section that these practices involve private companies and have, therefore, absolutely nothing to do with Canada. It will also be demonstrated that Canada has in fact taken all necessary measures to prevent and sanction these practices.

⁵⁹⁹ Investor's Memorial, FN 156.

⁶⁰⁰ *Korecky Affidavit*, ¶¶ 96-97.

⁶⁰¹ The Investor complains of "blockmailing" on 5 parcels out of the total 1,834 parcels it has advertised since 1998 or only 0.27%.

truly been suffering from such an unbearably “insecure” legal and business environment due to the log export control regime, one would have expected it not to wait some 10 years to file the present claim.

571. In any event, the record shows that there was a constant dialogue between Merrill & Ring and government officials concerning offers made on its logs.⁶⁰² Of all B.C. log exporters operating under Notice 102, Merrill & Ring is the one that has most frequently made representations to FTEAC and DFAIT expressing its concerns about offers made on its logs.

b) The Log Export Regime Is Not Unfairly and Arbitrarily Administered

572. The Investor alleges that Canada violates Article 1105 by “Notice 102, and its arbitrary requirements [that] are still in force.”⁶⁰³ Specifically, the Investor argues that the log export control regime is “arbitrarily and fundamentally unfair” because (1) the “standing green” exception is unavailable to the investor; (2) the minimum volume requirement for the advertisement of logs is arbitrary, and (3) the TEAC/FTEAC recommendation-making process is arbitrary.

(1) The “Standing Green” Exception Has Nothing to do with Arbitrary Conduct

573. The Investor complains that the log export control regime allows so-called “standing green” exemptions for timber on provincial lands, but not on federal lands.⁶⁰⁴ It also alleges that one such exception was nevertheless granted for timber on federal land of the investor’s competitor, Pluto Darkwoods. As already explained above, these complaints are factually inaccurate.

⁶⁰² *Korecky Affidavit*, Exhibit 43.

⁶⁰³ Investor’s Memorial, ¶ 476(a).

⁶⁰⁴ According to the Investor, the fact that the “waste prevention” exemption exists for timber on Provincial Crown land, but not for private lands (whether provincial or federal) is “differentiation [which] is arbitrary” (Investor’s Memorial, ¶ 353(c)).

574. As discussed in the Article 1102 context, it is unclear what the Investor is complaining about. If it is the failure to grant standing exemptions to the surplus test under Notice 102, this is not arbitrary. In fact, the reason why standing green exemptions are not available for the Investor is simply because the federal government does not have the authority under the Constitution to grant any such exemption.⁶⁰⁵ This is a subject-matter under provincial jurisdiction. There is nothing arbitrary about the constitutional inability of the federal government to legislate in an area over which it has no jurisdiction.

575. On the other hand, if the real complaint is that Canada allows timber in the Interior to remain standing while being advertised, there is a very logical, and non-arbitrary explanation for this. As explained in the Article 1102 context, this practice is based on conditions in the Interior including limited storage space for cut logs, faster deterioration of logs on land and transportation difficulties endemic to Interior B.C. and not present on the Coast. These are explained in detail above when discussing the Investor's 1102 claim.⁶⁰⁶

576. The Investor alleges that Canada “failed to respond to [its] efforts to raise the issue with it in correspondence” which is considered as “arbitrary conduct.”⁶⁰⁷ This is also misleading. In a letter dated June 1, 1998 addressed to Merrill & Ring's counsel, DFAIT specifically responded to the Investor's request to consider some form of a “standing green exemption” for timber under federal jurisdiction.⁶⁰⁸ Canada's response certainly does not constitute “arbitrary conduct” as alleged by the Investor.

⁶⁰⁵ *Korecky Affidavit*, ¶¶ 17, 87.

⁶⁰⁶ *Korecky Affidavit*, ¶ 82.

⁶⁰⁷ Investor's Memorial, ¶ 353(b).

⁶⁰⁸ *Korecky Affidavit*, ¶ 126, Exhibit 43. In the letter of 1 June 1998, Mr. Jones first explained that federal export controls applies only to “logs” (harvested timber) and that federal export permits can only be issued for “logs”. He then went on to say that “[w]e are examining whether prior export approval for ‘standing timber’ (which are not yet ‘logs’) could be considered on a case-by-case basis” but that this “might be problematic when looking years into the future” since the federal legislation “requires that there be an adequate supply of logs to meet domestic supply.”

(2) The Minimum Volume Requirement For Advertising Has Nothing to do with Arbitrary Conduct

577. The Investor complains that the minimum volume requirement for the advertisement for logs is arbitrary because “it does not impose the same requirement for logs located in non-remote areas.”⁶⁰⁹

578. As explained in the section addressing the minimum volume requirement and Article 1102, there is nothing arbitrary about the minimum volume requirement for advertising. To the contrary, it is based on the fact that some loggers in remote areas used advertisement in minimum amounts as a tool to avoid inspection and offers on advertised logs. It addresses an actual problem in a fair and appropriate manner, and is in no way arbitrary.

579. In any event, this complaint also has nothing to do with the minimum standard of treatment to be accorded to investors under Article 1105. In fact, the Investor’s complaint is only relevant in the context of its Article 1102 claims and has been fully answered in that context.⁶¹⁰

(3) The TEAC/FTEAC Process Is Not Arbitrary

580. The Investor complains that several aspects of the TEAC/FTEAC recommendation-making process are arbitrary and unfair, contrary to Article 1105. The following allegations will be examined separately:

- a) TEAC/FTEAC members working for sawmills are keeping the log market prices as low as possible;
- b) There are no FTEAC members from private federal landholdings;
- c) Many TEAC/FTEAC members are in conflict of interest;
- d) TEAC/FTEAC meetings are cancelled without prior notice and the federal representative often does not attend such meetings;

⁶⁰⁹ Investor’s Memorial, ¶ 353 (d).

⁶¹⁰ Investor’s Memorial, ¶ 361(b).

- e) TEAC/FTEAC makes recommendations based on loosely defined criteria;
- f) The Investor is not allowed to make submissions to TEAC/FTEAC concerning the fairness of offers made on its logs;
- g) DFAIT “rubber-stamps” TEAC/FTEAC recommendations;
- h) There exists no mechanism to appeal TEAC/FTEAC recommendations; and
- i) DFAIT arbitrarily changed the existing rules on export extension permits.

**(a) TEAC/FTEAC Members Cannot
Influence the Domestic Market Price of
Logs**

581. The Investor states that “many” members of TEAC/FTEAC work for domestic log processors (sawmills),⁶¹¹ and alleges that they “have private interests in suppressing the domestic price of logs.”⁶¹²

582. The issue of TEAC/FTEAC membership is addressed in John Cook’s Affidavit. As explained by Mr. Cook, the Investor grossly mischaracterizes the role of TEAC/FTEAC and the influence of its members on the market price for logs. TEAC/FTEAC is not “the body charged with reviewing export applications for logs produced from federal lands in B.C.”⁶¹³ FTEAC only makes recommendations as to whether an offer made on a federal log export application is fair based on the market price at the time the application is processed.⁶¹⁴

583. The domestic log market price is based strictly on supply and demand in the industry at a given time. At the beginning of each meeting, TEAC/FTEAC members assess market price based on objective information about the conditions prevailing in the market for the past month. In other words, TEAC/FTEAC members do not abstractly and

⁶¹¹ Investor’s Memorial, ¶ 129. See also ¶ 120.

⁶¹² Investor’s Memorial, ¶ 353(f). For the Investor, these members “have an interest in making sure domestic market prices remain as low as possible” and “in making sure logs do not get approved for export whenever possible.” (Investor’s Memorial, ¶ 120).

⁶¹³ Investor’s Memorial, ¶ 116.

⁶¹⁴ Cook Affidavit, ¶ 23 *et seq.*

arbitrarily set the market price. They do not influence the domestic market price of logs. TEAC/FTEAC members are, therefore, not in a position to “suppress” the domestic price of logs.

584. The Investor also alleges that TEAC/FTEAC members who work for domestic log processors (sawmills) have “private interests” in keeping log prices low. This unfounded accusation wrongly portrays these members as “agents” or “representatives” of companies for whom they work. Individuals appointed to TEAC/FTEAC are neutral specialists from the industry; they are not appointed to represent any special interests and do not act in this fashion.⁶¹⁵ As explained by Mr. McCutcheon in his testimony in *TimberWest v. Canada*, TEAC/FTEAC members are expected to “leave their company hats at the door” and “consider what is fair for the Industry as a whole.”⁶¹⁶ The Investor is wrong to portray TEAC/FTEAC as a committee composed of individuals with personal interests.

585. In any event, the market price assessment used to determine if offers are at fair market value is ultimately the result of a collective determination by all members based on objective data and not the interests of different players in the log industry.

(b) Private Landowners Have Been Invited to Join TEAC/FTEAC

586. The Investor states that “[t]here has never been anyone on FTEAC with any significant private federal landholdings.”⁶¹⁷ This ignores the fact that several invitations were made to private landowners to join TEAC. This was explained in the testimony of

⁶¹⁵ *Cook Affidavit*, Exhibit 17. The Terms of Reference states that these individuals must have “suitable background knowledge of the costs, practicalities and economics of conducting logging operations, and a knowledge of the domestic and export log markets.”

⁶¹⁶ *TimberWest v. Canada*, excerpt from the Cross-Examination Transcript of Proceedings before Justice O’Keefe, *Timberwest Forest Corp. v. Her Majesty the Queen, in Right of Canada*, 2007 FC 148, Testimony of John McCutcheon (“*Timberwest – Transcript*”) (Tab 137).

⁶¹⁷ Investor’s Memorial, ¶ 123.

Mr. McCutcheon in the context of *TimberWest v. Canada*.⁶¹⁸ Private landowners have declined such invitations.

587. In his Affidavit, Mr. Cook recites several documented examples demonstrating that FTEAC sought candidates from private landowners.⁶¹⁹ For instance, the Minutes of the Meeting no. 309 of June 1, 2007 contains the following passage:

[REDACTED]

588. In fact, Merrill & Ring was specifically contacted by FTEAC on this matter. This is clear from the following extract of the Minutes of Meeting no. 310 of July 6, 2007:

[REDACTED]

589. John Cook explains in his affidavit that he spoke with the Investor's agent, Karen Kurucz of Progressive Timber Sales. Ms. Kurucz informed John Cook that Merrill & Ring was favourable to [REDACTED] nomination to FTEAC/TEAC.⁶²²

**(c) TEAC/FTEAC Adopted Appropriate
Conflict of Interest Procedures**

590. The Investor alleges that TEAC/FTEAC members working for domestic log processors are in a conflict of interest. The Memorial even includes a list of members

⁶¹⁸ *Timberwest – Transcript*, at 783-784 (Tab 137).

⁶¹⁹ *Cook Affidavit*, ¶¶ 47-48.

⁶²⁰ *Cook Affidavit*, ¶ 47, Exhibit 21.

⁶²¹ *Cook Affidavit*, ¶ 48, Exhibit 22.

⁶²² *Cook Affidavit*, ¶ 49.

who allegedly are conflicted.⁶²³ The description given by the Investor of the past and present affiliation of these individuals is grossly inaccurate. In his Affidavit, Mr. Cook makes the necessary corrections. He also explains in detail why none of them is conflicted, nor do they have any interest in keeping log prices low and in rejecting surplus status to Merrill & Ring's export applications.⁶²⁴

591. The Investor alleges that "Canada [has been] aware that members of FTEAC, and its predecessors, have conflicting interests, but has taken no action to address the conflicts."⁶²⁵ This statement is also misleading and incorrect. TEAC/FTEAC has adopted procedural rules to deal effectively with potential conflict of interest. This is explained by Mr. McCutcheon in testimony given in *TimberWest v. Canada*.⁶²⁶ Whenever a TEAC/FTEAC member has any business relationship with the companies advertising for export or the sawmill making an offer, the member automatically and systematically will be asked to leave the meeting before any discussion on the matter starts.

592. The Cook Affidavit refers to several documented examples demonstrating this procedure was applied.⁶²⁷ For instance, the Minutes of Meeting no. 267 of November 13, 2003 state that "[REDACTED]

[REDACTED]⁶²⁸

593. The Investor's reference to a 1996 DFAIT internal memorandum is also misleading. This is an internal document of the ECD which was drafted before Notice 102 came into force. The selective quotations in the Memorial leave the incorrect impression that the author of the document had identified a "problem" of conflict of interest, and that the B.C. government refused to take any action to solve the "problem."

⁶²³ Investor's Memorial, ¶ 129.

⁶²⁴ Cook Affidavit, ¶ 30 *et seq.*

⁶²⁵ Investor's Memorial, ¶ 130.

⁶²⁶ *Timberwest – Transcript*, at 745-747 (Tab 137).

⁶²⁷ Cook Affidavit, ¶¶ 43-44.

⁶²⁸ Cook Affidavit, Exhibit 19.

In fact, the view of the author of the memorandum is that TEAC/FTEAC deals with conflict of interest in a satisfactory way:

I suggested that it might be reasonable if guidelines were developed to deal with potential conflicts of interest in the TEAC context. BCMOF is of the view that to set down specific rules may be too constraining. At the present time, members excuse themselves from participating/voting on issues where they have a real or perceived conflict of interest. BCMOF would like to maintain this flexibility and allow members to announce when they believe that a conflict may exist. I have personally participated in TEAC meeting where members have actually excused themselves from particular cases. As far as I can see, this appears to work although the semblance of non-conflict of interest is not transparent.⁶²⁹

594. The Investor also misleadingly suggests that in this memorandum “the federal government representative insisted on including a formal recommendation “[t]hat Conflict of Interest Guidelines be developed for members of TEAC.”⁶³⁰ In fact, far from including any “formal recommendation,” the memorandum refers to a mere “proposal to be considered for possible future amendments.”⁶³¹

595. In sum, TEAC/FTEAC has adopted appropriate procedures to resolve potential conflicts of interest involving its members. This manner of proceeding clearly does not violate customary international law.

⁶²⁹ *Cook Affidavit*, Exhibit 19.

⁶³⁰ Investor’s Memorial, ¶ 130.

⁶³¹ Investor’s Schedule of Documents, Tab 45 (Memo from Thomas E. Jones, Department of Foreign Affairs and International Trade, 21 March 1996, at 2-3. The author further explains in the cover letter of the memorandum that such proposals only “require[s] further consideration” as opposed to other proposals “that should be implemented immediately.”)

(d) TEAC/FTEAC Meetings Are Not Arbitrarily Cancelled and the Federal Representative Is Always Present

596. The Investor alleges that “TEAC/FTEAC is prone to cancelling meetings without prior notice or stated reasons for periods of up to three months (...).”⁶³² This allegation is unsubstantiated and wrong. As explained in the Korecky Affidavit, TEAC/FTEAC meetings are generally held every month and have never been arbitrarily cancelled when offers had been received on export applications.⁶³³ Meetings are cancelled only when there are no offers to be discussed.

597. The Investor also alleges that the “federal representative on FTEAC is often not in attendance at their meetings.”⁶³⁴ In his Affidavit, the secretary of FTEAC, Mr. Cook, advises that during his tenure the representative of the federal government has always attended FTEAC meetings (either physically or *via* conference calls).⁶³⁵

(e) TEAC/FTEAC Uses Concrete Criteria to Make Recommendations

598. The Investor alleges that TEAC/FTEAC “makes its decisions based on subjective judgment, and employs loosely formulated criteria to determine if an offer is ‘fair’.”⁶³⁶ This is also incorrect.

599. First, TEAC/FTEAC does not render “decisions.” It only makes “recommendations” to the Minister. The decision-making power remains with the Minister; it has not been delegated to TEAC/FTEAC.

⁶³² Investor’s Memorial, ¶ 353(g).

⁶³³ *Korecky Affidavit*, ¶¶ 178-179. In fact only one meeting was cancelled where offers were to be considered. This was in August 2006. Three offers on Merrill & Ring’s logs were considered at the September 2006 meeting and found to be fair market value. DFAIT subsequently declared the logs to be non-surplus to domestic needs.

⁶³⁴ Investor’s Memorial, ¶ 116.

⁶³⁵ *Cook Affidavit*, ¶ 52.

⁶³⁶ Investor’s Memorial, ¶ 353(e).

600. Second, the criteria on which FTEAC bases its recommendations are concrete, reasonable and well-defined. Notice 102 includes clear standards to determine whether an offer is valid.⁶³⁷ The basic criterion is whether an offer made is fair in light of the market price for logs of a similar type and quality in the domestic market. This fair market value criterion is expressed in Notice 102.⁶³⁸ The FTEAC's Terms of Reference also state that it will "assess the validity of any offers ... and determine whether offers are a fair representation of the domestic market price."⁶³⁹ The general practice adopted by TEAC/FTEAC is that an offer is considered fair market value whenever it closely matches (+/- 5%) the prevailing domestic market price.

601. The Investor is wrong when stating that "TEAC/FTEAC fails to take into consideration important factors about the 'fairness' of any given offer."⁶⁴⁰ To ensure fair market value, TEAC/FTEAC takes into account other relevant criteria. These criteria include weather conditions and the location of logs, which both affect transportation costs. The Investor's assertion that transportation costs are not relevant to TEAC/FTEAC is therefore incorrect.⁶⁴¹ This is clear, for example, from a letter sent on June 11, 1999 by the ECD to Delta Cedar Products regarding offers made on Merrill & Ring's logs.⁶⁴² The letter asked the company whether the price it offered on the logs included the cost of transporting the booms to the mills.

602. Although not expressly set out in Notice 102, these criteria are well-known to participants in the log industry. The Investor, which has been operating under Notice 102 for some 10 years, knows about these criteria. These are not "secret" criteria known only to FTEAC members. In her Affidavit, Ms. Korecky states that she has spoken with Paul Stutesman of Merrill & Ring on various occasions regarding other factors that are

⁶³⁷ Notice 102, section 4.4 (Tab 101).

⁶³⁸ Notice 102, section 4.4 (Tab 101).

⁶³⁹ Cook Affidavit, Exhibit 17 (Point 4 of the Terms of Reference).

⁶⁴⁰ Investor's Memorial, ¶ 127.

⁶⁴¹ Investor's Memorial, ¶ 127.

⁶⁴² Korecky Affidavit, ¶ 113, Exhibit 76.

considered pertinent.⁶⁴³ Mr. Kurucz is therefore wrong when stating in his Witness Statement that “DFAIT has never specified what ‘other factors’ it considers important.”⁶⁴⁴

603. While the Investor complains that the criteria are “arbitrary and non-specific,”⁶⁴⁵ the criteria used by TEAC/FTEAC have a degree of flexibility. Any absolute criteria would be impossible to implement and would lead to unfair results.

604. The Investor states that FTEAC “does not physically inspect the logs in question when determining whether an offer is ‘fair’” and, consequently, it “is unable to accurately assess the quality of the logs, and therefore the appropriate market price for those logs.”⁶⁴⁶ As explained in the Korecky Affidavit, it would be impractical for FTEAC to examine each log boom for which offers are made. This would result in significant delays. It is also not necessary. The key information required to assess the quality of the logs and the fair market price for purposes of Notice 102 is in the exporter’s “Application to Advertise.” Section 2.4 of Notice 102 explains the information a company is required to include when making an offer to purchase logs.⁶⁴⁷

605. In sum, in making recommendations TEAC/FTEAC uses reasonably-defined criteria that are well-known to all log exporters, including Merrill & Ring.

⁶⁴³ *Korecky Affidavit*, ¶ 129.

⁶⁴⁴ *Kurucz Affidavit*, ¶ 33.

⁶⁴⁵ Investor’s Memorial, ¶ 126.

⁶⁴⁶ Investor’s Memorial, ¶ 121.

⁶⁴⁷ *Korecky Affidavit*, ¶ 115, Exhibit 78. DFAIT has declared offers invalid because the information provided in the “Application to Advertise” was not accurate. One good example is the letter of April 10, 2008 sent by DFAIT to [REDACTED] which indicates that an “offer letter must be complete and accurately set out th[e] information [under Section 2.4 of Notice 102] in order to be valid.” In this case, the offer was “considered invalid” because the information on the “application and the boom number [did] not match.”

**(f) The Investor Frequently Makes
Submissions to TEAC/FTEAC
Concerning Offers Made on its Logs**

606. The Investor alleges that it “has never been allowed to make submissions regarding the ‘fairness’ of offers made on its logs to TEAC/FTEAC and has never been permitted to present its views on how to make appropriate fairness determinations.”⁶⁴⁸

607. Not only is the Investor “allowed” to make submissions to TEAC/FTEAC, it frequently does so. The record shows that the Investor has made numerous submissions to FTEAC and DFAIT in which it addressed offers made by sawmills on its export applications. According to Ms. Korecky, of all companies advertising on the Federal Bi-Weekly List, Merrill & Ring is the one that has [REDACTED]

[REDACTED]⁶⁴⁹

608. Soon after Notice 102 came into force, Mr. Jones from the Export Control Division of DFAIT wrote to Merrill & Ring’s counsel and explained that Notice 102 was “designed to ensure a fair and equitable treatment to all potential exporters of logs from B.C.”⁶⁵⁰ The letter also states that log exporters were invited to make submissions to DFAIT on the fairness of offers:

We have suggested to exporters that if they feel that bids on certain proposed exports are unfair, that they should address their concerns to the Export Control Division so that these additional concerns would be considered during the ‘other relevant factors’ DFAIT review as noted in Section C.4 of the Notice.⁶⁵¹

609. In view of this letter, the Investor cannot seriously argue that Notice 102 forbids it from making submissions regarding the fairness of offers. Some 10 years ago, the Investor was specifically invited by DFAIT to do so and the record shows that it has done so numerous times.

⁶⁴⁸ Investor’s Memorial, ¶ 353(f).

⁶⁴⁹ *Korecky Affidavit*, ¶¶ 127, 132.

⁶⁵⁰ *Korecky Affidavit*, ¶ 126, Exhibit 43.

⁶⁵¹ *Korecky Affidavit*, ¶ 126, Exhibit 43.

610. There are several examples of cases where Merrill & Ring made submissions to FTEAC (or DFAIT) before any recommendation had been made. In these letters, the Investor argued that its boom should be considered as surplus since the [REDACTED]

[REDACTED].⁶⁵²

611. In many instances, Merrill & Ring has successfully argued that an offer made on its logs should not be accepted. One illustration is a letter sent by Merrill & Ring to FTEAC on January 8, 2008 concerning an offer made by [REDACTED] on its logs in which it “requested” that the offer be rejected and the boom declared surplus.⁶⁵³ On January 11, FTEAC agreed with the Investor’s assessment and recommended that the logs be deemed surplus because the offer was below the fair market value.⁶⁵⁴

612. Log exporters frequently make submissions to FTEAC concerning other aspects of Notice 102. For instance, log exporters sometimes argue that they are being unfairly targeted by offerors. This issue is discussed below.

613. As further explained in the next section, it is not uncommon for the MFA to make a final decision contrary to an FTEAC recommendation based on observations received from log exporters.

614. In sum, the log export control regime does not prevent the Investor from making submissions to FTEAC or DFAIT with respect to specific export permit applications and the Investor has exercised this right frequently.

⁶⁵² One example amongst many is the letter of June 6, 2006 sent by Stutesman of Merrill & Ring to Korecky: *Korecky Affidavit*, ¶ 136, Exhibit 51.

⁶⁵³ *Korecky Affidavit*, ¶ 137, Exhibit 53.

⁶⁵⁴ *Korecky Affidavit*, ¶ 137, Exhibit 79.

**(g) The Minister Does Not Rubber-stamp
TEAC/FTEAC Recommendations**

615. The Investor alleges that “TEAC/FTEAC recommendations are almost invariably accepted by BCMOF and DFAIT.”⁶⁵⁵

616. The MFA does not “rubber-stamp” TEAC/FTEAC recommendations. These recommendations are only one factor considered by the MFA in making a decision on whether to issue an export permit. Notice 102 states that the MFA “will review the FTEAC recommendation and other relevant factors in determining whether or not adequate supply exists.”⁶⁵⁶

617. This essential feature of the log export control regime was explained by DFAIT to Merrill & Ring in the above-mentioned letter of June 1, 1998 inviting it to make submissions on the fairness of offers. The letter specifically explains that such “concerns would be considered during the ‘other relevant factors’ DFAIT review.”⁶⁵⁷

618. In her Affidavit, Ms. Korecky describes those “other factors.”⁶⁵⁸ They include the price of offers, and, more generally, the interests of all domestic log processors in Canada. The MFA will also consider and examine other booms advertised during a given period of time, the number and nature of offers made by offering companies and any offers made. As further explained below, concerns expressed by log exporters about “blockmailing” and “special targeting” practices are also taken into account by the MFA in his final decision.

619. There are various instances where the MFA disregarded FTEAC recommendations based on such “other factors”.

⁶⁵⁵ Investor’s Memorial, ¶ 353(f). The same assessment is also made elsewhere by the Investor: “When it receives FTEAC’s recommendation, DFAIT is supposed to consider FTEAC’s recommendation plus “other relevant factors” before making a final determination. DFAIT has never specified what factors it considers relevant in this regard. DFAIT almost invariably “rubber stamps” any recommendation FTEAC makes.” (¶ 113).

⁶⁵⁶ Notice 102, ¶ 4.4(a) (Tab 101).

⁶⁵⁷ Korecky Affidavit, ¶ 126, Exhibit 43.

⁶⁵⁸ Korecky Affidavit, ¶ 150.

620. One example involved several offers made by two different companies ([REDACTED]) on Merrill & Ring's logs. In a letter of July 30, 1998 the Investor wrote to DFAIT explaining why these offers should be rejected by FTEAC.⁶⁵⁹ FTEAC recommended, *inter alia*, that the offer made by [REDACTED] on Merrill & Ring's logs be accepted as fair market value. However, in a memorandum dated August 24, 1998, DFAIT recommended that the MFA "disregard" the offer made by the company "by setting aside the relevant FTEAC recommendations and approve the exports of these logs by (...) Merrill & Ring."⁶⁶⁰ The reasons for setting aside the FTEAC recommendation are "the statements [made] by a senior officer of [REDACTED] [REDACTED]" as a result of which "it is difficult to conclude that there is shortage of logs for the [REDACTED] operations."⁶⁶¹ The conclusion reached in the memorandum was based on the information provided by Merrill & Ring in its July 30, 1998 letter. This example shows that factors others than FTEAC recommendations are taken into account by the MFA when making its final decision. It also illustrates the fact that information provided to DFAIT by log exporters, including the Investor, is considered in the decision-making process.

621. Another example where the MFA disregarded an FTEAC recommendation based on "other factors" involves a letter dated October 11, 2005 sent by Merrill & Ring to the MFA asking him to reject 5 offers by [REDACTED] on the Investor's logs.⁶⁶² This is, in fact, one of the only actual instances complained of by the Investor in its Memorial.⁶⁶³ In this case, FTEAC had considered [REDACTED]'s offers to be fair market value. Ms. Korecky drafted a memorandum to the MFA explaining that the "Minister may take into account relevant information additional to FTEAC recommendations when considering an application for a permit to export logs from B.C."⁶⁶⁴ This example is further discussed

⁶⁵⁹ *Korecky Affidavit*, Exhibit 45.

⁶⁶⁰ *Korecky Affidavit*, Exhibit 46.

⁶⁶¹ *Korecky Affidavit*, Exhibit 46.

⁶⁶² *Korecky Affidavit*, Exhibit 49.

⁶⁶³ Investor's Memorial, ¶ 436(c)(iii).

⁶⁶⁴ *Korecky Affidavit*, Exhibit 50.

below in the context of allegations of “blockmailing”. The summary of the memorandum states that “[t]his note seeks your approval for the proposed export of five (5) booms of logs contrary to recommendation of FTEAC that the proposed export be denied.”⁶⁶⁵

622. Another example where the MFA disregarded a FTEAC recommendation involves a Memorandum dated July 31, 1997 sent to the MFA concerning offers made by ██████ on logs proposed for export by Merrill & Ring and ██████.⁶⁶⁶ FTEAC had found the offers were fair in both cases. The memorandum discusses the fact that ██████ had also made offers on other logs from another company (████████████████████), and that the offers had soon after been withdrawn and the logs declared surplus. The memorandum explains that ██████ was “able to obtain a certain quantity of logs from [this company] to satisfy their immediate needs” and that it had withdrawn its offer because it was “unable to use all of the logs proposed for export by ██████.” In other words, the memorandum concludes that ██████ had enough logs. The memorandum explains that “in reviewing the factors surrounding these cases, it became difficult to justify how some ‘like or ‘similar’ logs were found to be surplus while others were found not to be surplus during the same time frame.” It recommended that the MFA approve the proposed export by Merrill & Ring and ██████ as surplus despite the FTEAC recommendation to the contrary. This is another example of the MFA accounting for “other factors.”

623. In sum, the MFA does not simply rubber-stamp TEAC/FTEAC recommendations. In many instances involving Merrill & Ring, the Minister disregarded FTEAC recommendations and rendered a decision favourable to the Investor.

(h) Decisions Can Be Judicially Reviewed

624. The Investor alleges that there is “no meaningful procedure by which to appeal TEAC/FTEAC recommendations.”⁶⁶⁷ According to the Investor, the existing *ad hoc*

⁶⁶⁵ *Korecky Affidavit*, Exhibit 50. It should be noted that in the meantime, the offers had been withdrawn. The MFA therefore never rendered any decision in this case.

⁶⁶⁶ *Korecky Affidavit*, Exhibit 47.

⁶⁶⁷ *Investor’s Memorial*, ¶ 353(f).

review process is “entirely discretionary” and the process “is so inadequate as to amount to no meaningful appeal or review at all.”⁶⁶⁸

625. This description of the log export regime is grossly incorrect. It is true that there is no statutory appeal mechanism of TEAC/FTEAC recommendations *per se*. However, as explained above, log exporters can make meaningful submissions to FTEAC and to DFAIT at any time before the MFA has made a decision. Log exporters (including Merrill & Ring) frequently make submissions contesting FTEAC recommendations. Such submissions have been successful in the past insofar as the MFA has often decided not to adopt FTEAC recommendations.

626. An essential point left unmentioned by the Investor is that it has the right to seek judicial review of a final decision taken by the MFA under the *Export and Import Permits Act* pursuant to s.18.1 of the *Federal Court Act*.⁶⁶⁹ Among the grounds of review that may be brought to the Federal Court are that the decision at issue was without jurisdiction, contrary to procedural fairness, an error of law, an error of fact or otherwise contrary to law.

627. Such judicial review has been taken on three occasions in the past by log companies.⁶⁷⁰ The decision of the Federal Court can also be appealed to the Federal Court of Appeal and ultimately to the Supreme Court of Canada with leave. There is therefore ample opportunity for judicial review of a permit decision.

⁶⁶⁸ Investor’s Memorial, ¶ 131.

⁶⁶⁹ The Federal Court has jurisdiction “(a) to issue an injunction, writ of *certiorari*, writ of prohibition, writ of *mandamus* or writ of *quo warranto*, or grant declaratory relief, against any federal board, commission or other tribunal” and “(b) to hear and determine any application or other proceeding for relief in the nature of relief contemplated by paragraph (a), including any proceeding brought against the Attorney General of Canada, to obtain relief against a federal board, commission or other tribunal.” R.S., 1985, c. F-7.

⁶⁷⁰ For instance, in *K.F. Evans Ltd. v. Canada (Minister of Foreign Affairs)*, [1997] 1 F.C. 405 (T.D.) (“*Evans – Trial Decision*”) (Tab 47). There is also an ongoing judicial review initiated by Island Timberlands on 2 November 2007 of a decision of the Federal government to not allow the advertisement of standing timber on the Coast. The most recent judicial review was initiated by Island Timberlands on 8 April 2008 of a decision of the Federal government to grant Kemp Forest Products status as an operator under Notice 102 and the privilege of making offers on logs proposed for export: *Korecky Affidavit*, ¶ 158.

628. In sum, the Investor is wrong in accusing Canada of “failure to provide an appeal or review of decisions.”⁶⁷¹ Informal appeals are permitted and regularly instituted while formal judicial review is a legal right.

**(i) Rules On Extension of Export Permits
Were Not Changed Arbitrarily**

629. The Investor alleges that DFAIT “is prone to change export application rules without consultation, prior notice or stated reasons.”⁶⁷² Specifically, the Investor says that in 2005 DFAIT “suddenly and arbitrarily decided to reduce the time period for export extension permits from four months to one month” and that DFAIT was “wholly unresponsive” to its “requests for it to reconsider.”⁶⁷³

630. In her Affidavit, Ms. Korecky explains the nature of the minor changes which occurred in 2005 and the good policy reasons why they were made.⁶⁷⁴ In a letter dated February 22, 2002 addressed to all log exporters, including Merrill & Ring, Mr. Jones of the Export Controls Division of DFAIT explained the changes concerning extensions to export permits.⁶⁷⁵ Ms. Korecky personally explained the nature of these changes to Mr. Stutesman from Merrill & Ring.⁶⁷⁶

**(4) The Complaints of Arbitrariness Do Not Reach
the Necessary Threshold For Breach of the
Customary International Law**

631. In conclusion, the Investor fails to prove any of the allegations of arbitrariness in the TEAC/FTEAC recommendation-making process. None of the aspects of the TEAC/FTEAC recommendation-making process complained of by the Investor reaches the necessary threshold for breach of the customary international law minimum standard

⁶⁷¹ Investor’s Memorial, ¶ 476(g).

⁶⁷² Investor’s Memorial, ¶ 353(h).

⁶⁷³ Investor’s Memorial, ¶ 353(h).

⁶⁷⁴ *Korecky Affidavit*, ¶ 166.

⁶⁷⁵ *Korecky Affidavit*, ¶ 165, Exhibit 22.

⁶⁷⁶ *Korecky Affidavit*, ¶ 166.

of treatment of aliens under Article 1105. None of the measures complained of by the Investor can be deemed as “manifest” arbitrariness;⁶⁷⁷ they are clearly not “wholly arbitrary” or “grossly unfair.”⁶⁷⁸ These measures are certainly not “grave enough to shock a sense of judicial propriety and thus give rise to a breach of the minimum standard of treatment.”⁶⁷⁹ In conclusion, the Investor’s claim that the log export control regime contains arbitrary rules that are administered in an arbitrary manner should be dismissed.

c) The Log Export Control Regime is Transparent

632. Alleging that the log export control regime is “non-transparent”⁶⁸⁰ and that it is “administered in a non-transparent manner,”⁶⁸¹ the Investor complains about three features of the regime:

- 1) The unspecified concept of “remote” areas where the regime imposes a minimum volume requirement for the advertisement of logs;
- 2) The unspecified concept of “normal” market practices for cutting, sorting and decking logs; and
- 3) The FTEAC decision-making process.⁶⁸²

(1) “Remote” Area is Reasonably Defined and Known To All Log Exporters

633. The log export control regime imposes a minimum volume requirement for the advertisement of logs located in “remote” areas of the B.C. Coast. However, according to the Investor, the regime does not “specify what areas are considered ‘remote’.”⁶⁸³

⁶⁷⁷ *Thunderbird – Award*, ¶ 197 (Tab 136).

⁶⁷⁸ *Waste Management II – Award*, ¶ 115 (Tab 157).

⁶⁷⁹ *Thunderbird – Award*, ¶ 200 (Tab 136).

⁶⁸⁰ Investor’s Memorial, ¶ 354.

⁶⁸¹ Investor’s Memorial, ¶ 352(b).

⁶⁸² The Investor indicates that “[t]he members of TEAC/FTEAC meet behind closed doors, make decisions based on subjective, ill-specified and unknown criteria, do not produce reasoned decisions and do not make the minutes of their meetings public.” (Investor’s Memorial, ¶ 354(c)). This repeats the earlier allegation that TEAC/FTEAC makes recommendations based on “loosely defined” criteria. This allegation is unsubstantiated.

634. As explained by Mr. Cook in his Affidavit, Merrill & Ring does not operate in any “remote” area of the B.C. Coast and therefore not be affected by whatever geographical uncertainties allegedly exist.⁶⁸⁴ Mr. Schaaf errs in stating that “[t]he majority of [Merrill & Ring’s] properties are in remote areas.”⁶⁸⁵ Contrary to the allegations of Mr. Schaaf⁶⁸⁶ and Mr. Kurucz,⁶⁸⁷ Theodosia Inlet is not considered a remote area.⁶⁸⁸ Since the Investor does not operate from any “remote” area, this portion of its claim is unsustainable.

635. At any rate, the allegation that the concept of a remote area is unspecified is misleading. In his Affidavit, Cook explains that “remote” is defined as any location requiring excessive travelling time and cost to access from the lower mainland log marketplace.⁶⁸⁹ In the past, TEAC has determined that travelling more than half a day (departure and return) and/or a couple of hours air transport is considered “remote.”

636. Log exporters know which areas are considered “remote” by TEAC/FTEAC. Attached to Mr. Cook’s Affidavit is a policy document dated December 5, 1986 describing what is considered “remote” under Notice 23.⁶⁹⁰ Contrary to what is alleged by Mr. Kurucz, there has been no change since 1986 concerning the areas considered to be “remote.”⁶⁹¹ The regime is therefore transparent insofar as log exporters are never taken by surprise. In any event, any potential ambiguity can be clarified by a simple phone call or letter.⁶⁹²

⁶⁸³ Investor’s Memorial, ¶ 354 (a).

⁶⁸⁴ Cook Affidavit, ¶ 81.

⁶⁸⁵ Schaaf Affidavit, ¶ 27.

⁶⁸⁶ Schaaf Affidavit, ¶ 27.

⁶⁸⁷ Kurucz Affidavit, ¶ 57.

⁶⁸⁸ The area is specifically mentioned in the Investor’s Memorial, ¶ 415(b).

⁶⁸⁹ Cook Affidavit, ¶ 76.

⁶⁹⁰ Cook Affidavit, ¶ 77, Exhibit 28.

⁶⁹¹ Kurucz Affidavit, ¶ 57: “the demarcation between ‘remote’ and ‘non-remote’ areas is not defined, and is subject to change.”

⁶⁹² Cook Affidavit, ¶ 83.

637. Mr. Kurucz also alleges that “a BCMOF official” and “a TEAC member” (both unidentified) told him (at an unidentified moment) that Theodosia Inlet was considered a remote area.⁶⁹³ One would normally expect Mr. Kurucz to remember the names of those individuals. Similarly, no weight should be given to Mr. Kurucz’s other allegation that “it has recently come to [his] attention” that the area of Theodosia Inlet “may in fact not be considered ‘remote’.”⁶⁹⁴ It is entirely unclear when and how Mr. Kurucz “recently” found this new information. The alleged consequence that Merrill & Ring “may have been towing its logs to ‘non-remote’ areas for no reason”⁶⁹⁵ also seems unbelievable. One would expect Mr. Kurucz to know with some degree of certainty whether Merrill & Ring has been towing logs for no reason. This portion of the Investor’s claim should therefore be dismissed.

(2) “Normal” Market Practices Are Imposed By the Industry, Not By Notice 102

638. The Investor says that it is required to sort, boom or deck its logs to conform to “normal” log market practices, but “Notice 102 does not ... specify what “normal” market practices are.”⁶⁹⁶ At the same time, Mr. Kurucz concedes that “the definition of ‘normal’ market practices is established by BC provincial authorities.”⁶⁹⁷

639. Notice 102 does require that sorting be done according to “normal log market practices.”⁶⁹⁸ There is no lack of transparency about what constitutes “normal” market practices. “Normal” market practices for sorting are specified in a document entitled *Coast Domestic Market End Use Sort Descriptions*.⁶⁹⁹ This document is the result of a joint effort by log traders, sawmills, log exporters and the B.C. MoF. It was first

⁶⁹³ *Kurucz Affidavit*, ¶ 57. See also: *Schaaf Affidavit*, ¶ 27.

⁶⁹⁴ *Kurucz Affidavit*, ¶ 57.

⁶⁹⁵ *Kurucz Affidavit*, ¶ 57.

⁶⁹⁶ *Investor’s Memorial*, ¶ 100.

⁶⁹⁷ *Kurucz Affidavit*, ¶ 27.

⁶⁹⁸ *Notice 102*, ¶ 1.5 (Tab 101).

⁶⁹⁹ *Coast Domestic Market End Use Sort Descriptions* in *Cook Affidavit*, ¶¶ 55-56, Exhibits 23, 24.

published in 1999 and has been regularly revised since then. Like all players in the industry, Merrill & Ring knows exactly what the “normal” market practices are.⁷⁰⁰

640. Contrary to the Investor’s allegations, while log sorting, booming and decking are requirements of the federal regime, how this is done is defined by industry in collaboration with BCMoF. They are drafted and implemented by the log industry. These “requirements” exist simply because sawmills located in B.C. prefer certain log dimensions and are willing to pay premium prices for optimum sorts.⁷⁰¹

641. The true nature of the Investor’s complaint is that B.C. sawmills may not want the same types of logs as other foreign markets. This is clear from this passage in the Stuteman Affidavit:

What is “normal” in BC, however, is not “normal” in our export markets. As a result, even if we are granted an export permit, our logs have often already been cut and sorted in a way that does not meet our clients’ needs. Our foreign clients typically want logs of different lengths and sizes, or that are sorted in a different way than the export restrictions allow.⁷⁰²

642. This difference in log preference between B.C. sawmills and foreign markets is unrelated to any governmental action. NAFTA Chapter Eleven arbitration is not the appropriate forum for the Investor to raise such concerns.

643. These complaints are nowhere near the gravity required for a breach of Article 1105. None of the “non-transparent” aspects of the log export control regime complained of by the Investor reach the threshold for breach of the customary international law minimum standard of treatment of aliens. In conclusion, the Investor fails to prove that the log export regime is non-transparent and this portion of the claim should be dismissed.

⁷⁰⁰ *Cook Affidavit*, ¶¶ 54, 55; *Stutesman Affidavit*, ¶ 25.

⁷⁰¹ *Cook Affidavit*, ¶ 54.

⁷⁰² *Stutesman Affidavit*, ¶ 25.

**d) The Log Export Control Regime Does Not Create an
Insecure Legal and Business Environment**

644. The Investor alleges that the log export control regime is “inconsistent with Canada’s obligation to provide a secure legal and business environment.”⁷⁰³ The Investor invokes the following “reasons” to explain why the log export control regime is apparently “inconsistent” with Canada’s so-called “obligation to provide a secure legal and business environment”:

- The regime is “arbitrary and non-transparent”;⁷⁰⁴
- The log export regime exposes the Investor to the practices of “blockmailing” and “special targeting”;
- The Investor’s financial difficulties are caused by the insecure legal and business environment prevailing under the log export regime;
- The log export regime imposes long waiting periods between log cutting and exporting causing damage to the investor.

**(1) Canada Is Not Responsible For “Blockmailing”
and “Special Targeting”**

645. The Investor argues that it is “exposed” to the “corrupt practice of ‘blockmailing’⁷⁰⁵ and to “special targeting by its competitors.”⁷⁰⁶ According to the Investor, this feature of the log export regime is “inconsistent with Canada’s obligation to provide a secure legal and business environment.”⁷⁰⁷

⁷⁰³ Investor’s Memorial, ¶ 355.

⁷⁰⁴ Investor’s Memorial, ¶ 355(a). As explained, the log export regime is not “arbitrary” and is transparent. Consequently, the Investor’s allegation about the “insecure” legal and business environment must be dismissed.

⁷⁰⁵ Investor’s Memorial, ¶ 355(b).

⁷⁰⁶ Investor’s Memorial, ¶ 355(c).

⁷⁰⁷ Investor’s Memorial, ¶ 355.

646. Canada is not responsible for these practices of private log companies, does not condone them and takes all necessary measures to prevent and sanction such practices.⁷⁰⁸

647. The allegations about “blockmailing” and “special targeting” relate to actions of private domestic logging companies. Under well-recognized principles of international law, the conduct of private companies making offers on advertised booms is not attributable to Canada. As stated by the International Law Commission (I.L.C.) Commentary to its *Draft Articles on State Responsibility*, “[a]s a general principle, the conduct of private persons or entities is not attributable to the State under international law.”⁷⁰⁹ This principle of international law has been consistently applied by arbitral tribunals in the context of investor-State arbitrations.⁷¹⁰

648. NAFTA Chapter Eleven does not regulate private conduct and this Tribunal does not have jurisdiction over such claims. For this reason, the Investor’s claim about blockmailing and special targeting should be dismissed.

(a) Canada Takes All Necessary Measures to Prevent and Discipline these Practices

649. FTEAC does not “turn[] a blind eye to the practice” of blockmailing and special targeting and DFAIT is not “complicit” in the continuation of such practices.⁷¹¹ In his Affidavit, Mr. Kurucz goes so far as to accuse some FTEAC members of finding blockmailing “acceptable and even desirable.”⁷¹² This accusation is totally

⁷⁰⁸ *Korecky Affidavit*, ¶¶ 97, 120.

⁷⁰⁹ RESPONSIBILITY OF STATES FOR INTERNATIONALLY WRONGFUL ACT 2001, *Report of the International Law Commission, Fifty-Third Session (23 April-1 June and 2 July-10 August 2001)*, Supp. No. 10 (A/56/10), United Nations, New York 2001 (“*ILC Commentary*”) (Tab 60) provide two exceptions to that principle, which find no application to the circumstances of the present case: when private persons are acting on the instructions of the State in carrying out the wrongful conduct and when private persons act under the State’s direction or control.

⁷¹⁰ For instance, the *Lauder* Tribunal stated in no uncertain terms that, “[T]he Treaty [*U.S. – Czech BIT*] does not oblige the Parties to protect foreign investment against any possible loss of value caused by persons whose acts could not be attributed to the State. Such protection would indeed amount to strict liability, which can not be imposed to a State absent any specific provision in the Treaty.” *Lauder – Final Award*, ¶ 308 (Tab 68).

⁷¹¹ Investor’s Memorial, ¶ 153.

⁷¹² *Kurucz Affidavit*, ¶ 73.

unsubstantiated. The witness testimony of Mr. McCutcheon in the *TimberWest* case referred to by Mr. Kurucz⁷¹³ does not support this outrageous accusation. On the contrary, Canada has taken all necessary measures to prevent the practices of blockmailing and special targeting.

650. As explained by Mr. Kurucz, “These deals are ‘under the table’, in the sense that government does not usually know the specific terms, because they are private contracts.”⁷¹⁴ Canada has no control over these private business transactions.

651. Canada’s policy is nevertheless to do all it can to prevent blockmailing. Thus, DFAIT investigates blockmailing whenever it is raised by log exporters. Canada’s policy is well-illustrated by the only specific case of blockmailing referred to by the Investor in its Memorial.⁷¹⁵ This involves a letter dated October 11, 2005 sent by Merrill & Ring to the MFA asking him to reject 5 offers made by [REDACTED] on its logs. In this case, FTEAC had considered [REDACTED]’s offers to be fair market value. Ms. Korecky personally drafted a memorandum to the MFA in which she stated that he “may take into account relevant information additional to FTEAC recommendations” when making his decision. In the memorandum, she explains that the circumstances under which the offers were made involved “blockmailing” and “special targeting”:

[REDACTED]

⁷¹³ *Kurucz Affidavit*, FN 50.

⁷¹⁴ *Kurucz Affidavit*, ¶ 62.

⁷¹⁵ Investor’s Memorial, FN 156; *Korecky Affidavit*, ¶ 135, Exhibits 49, 50.



652. The summary of the recommendation to the Minister is straightforward: [REDACTED]

[REDACTED]⁷¹⁷ This is a clear example where allegations of blockmailing were addressed and resolved by DFAIT.

653. The Investor alleges special targeting but does not detail a single instance where such targeting actually occurred. Mr. Kurucz, Merrill & Ring's log broker, states that "on one occasion" he spoke to Mr. Cook of FTEAC about his "concern" that Merrill & Ring was "being unfairly targeted."⁷¹⁸ Mr. Cook apparently told him that FTEAC had recommended that the offer was fair in that case "because FTEAC felt that [Merrill & Ring] did not 'play the game' properly, by avoiding the block with a side deal ahead of time."⁷¹⁹ This vague statement is unspecified, undated and unsupported by any documentary evidence. Mr. Cook does not recall this conversation and denies that he would have said this. Further, Mr. Cook notes that FTEAC investigated the concern and found it to be unsubstantiated⁷²⁰

654. Canada's policy is to prevent "special targeting" and to investigate any allegation of such practice. In her Affidavit, Ms. Korecky explains that it is not uncommon for the ECD to provide MFA with a historical review of past bids made by an offering company on logs of the advertising company.⁷²¹ Such survey is conducted precisely to detect and

⁷¹⁶ *Korecky Affidavit*, Exhibit 50.

⁷¹⁷ *Korecky Affidavit*, Exhibit 50. It should be noted that in the mean time, the offer had been withdrawn. The Minister therefore never rendered any decision in this case.

⁷¹⁸ *Kurucz Affidavit*, ¶ 71.

⁷¹⁹ *Kurucz Affidavit*, ¶ 71.

⁷²⁰ *Cook Affidavit*, ¶ 110, Exhibit 31.

⁷²¹ *Korecky Affidavit*, ¶ 150.

prevent “special targeting” by offering companies. Ms. Korecky further explains that whenever a review of all factors demonstrates that an exporting company is being unfairly targeted, the ECD will advise the MFA that the FTEAC recommendation should be disregarded and that the logs be declared surplus to domestic needs.⁷²²

655. One example of Canada’s reaction to a situation of special targeting is the letter dated July 30, 1999 sent by DFAIT to [REDACTED].⁷²³ In this letter, DFAIT declared Merrill & Ring’s booms to be surplus because [REDACTED]’s offer was no longer considered valid when no payment had been received for the logs after more than a month. Merrill & Ring is not subject to special targeting.⁷²⁴ Further, Canada has taken all necessary measures to address the issue of blockmailing and special targeting.

**(b) Such Practices Do Not Create an Insecure
Legal and Business Environment**

656. Article 1105 does not include any general obligation to provide a “secure” legal and business environment. No such obligation exists under customary international law minimum standards of treatment of aliens. The practices of blockmailing and special targeting do not result in an environment that is so “insecure” that it reaches the threshold for breach of the customary international law minimum standard of treatment of aliens under Article 1105.

657. The non-NAFTA cases cited by the Investor in support of this so-called obligation to provide a “secure” legal and business environment make it clear that the threshold for breach is high. For instance, in *CMS*, the Tribunal concluded that the suspension by Argentina of a tariff adjustment formula for gas transportation applicable to an enterprise was in breach of the U.S.-Argentina BIT because these measures had “entirely transform[ed] and alter[ed] the legal and business environment under which the



⁷²² *Korecky Affidavit*, ¶ 97.

⁷²³ *Korecky Affidavit*, ¶ 97.

⁷²⁴ *Korecky Affidavit*, ¶ 145.

investment was decided and made.”⁷²⁵ This cannot be compared to the situation complained of by the Investor. The practices of blockmailing and special targeting have not entirely transformed and altered the environment in which Merrill & Ring has been doing business for more than 100 years. The Investor’s claim about blockmailing and special targeting should therefore be dismissed.

**(2) A Secure Legal and Business Environment
Prevails Under the Log Export Control Regime**

658. Another “reason” invoked by the Investor to explain why the log export control regime apparently creates an insecure legal and business environment is that it is “force[d]” (...) to adopt sub-optimal harvest plans and employ backwards economic planning to maximize its returns.”⁷²⁶ The Investor also alleges that the log export control regime “imposes extra costs on Merrill & Ring, reduces its revenues, denies it business opportunities, places it at a competitive disadvantage, and forces it to subsidize the operations of its competitors.”⁷²⁷ As a result of this “highly insecure” business environment, the Investor has apparently “ .”⁷²⁸

659. The log export regime under which the Investor is operating creates a predictable and stable legal and business environment. As previously noted, only a very small percentage of Merrill & Ring’s overall business may be “affected” by the alleged shortcomings of the log export control regime.⁷²⁹ The Investor fails to explain how such a small fraction of the investor’s business can create a “highly insecure” business environment.

⁷²⁵ CMS – Final Award, ¶ 275 (Tab 28).

⁷²⁶ Investor’s Memorial, ¶ 355(d).

⁷²⁷ Investor’s Memorial, ¶ 355(f).

⁷²⁸ Investor’s Memorial, ¶ 355(f).

⁷²⁹ Korecky Affidavit, ¶¶ 98-100, 124, Exhibit 38.

660. As further demonstrated below in the section dealing with damages, the Investor fails to prove that its alleged financial difficulties are a consequence of the alleged “highly insecure” business environment prevailing under the log export regime.

**(3) The Wait Times Are Not Caused By the Log
Export Control Regime**

661. The Investor states that it has “to wait extended periods of time from the time of cutting before it can export its logs, sometimes up to a year” and that “[d]uring this time its logs can suffer various types of damage.”⁷³⁰ Mr. Stutesman states that “on one occasion, it took [Merrill & Ring] almost one year from applying for a permit to finally sell [its] logs.”⁷³¹

662. As explained by Ms. Korecky in her Affidavit, the period of one year mentioned by the Investor is grossly misleading. The typical period of time between advertising and exporting is approximately 35 to 45 days.⁷³² She further explains that in those instances where the time between advertising and the grant of an export permit is longer, it is because Merrill & Ring did not apply for the export permit until months after the surplus letter was issued.⁷³³ In any event, Mr. Cook explains that the “extended periods of time” complained about are clearly not linked to the (alleged) “insecure” business environment.⁷³⁴ These delays are the direct result of log exporters’ own difficulties in finding buyers on the international market.

663. In sum, Canada cannot be liable for damage arising from the waiting period between log cutting and exporting. If anything, such damage is a consequence of the fluctuations on the international log market, not the result of the federal log export control regime. The Investor’s claim related to this alleged extended waiting period should therefore be dismissed.

⁷³⁰ Investor’s Memorial, ¶ 355(e).

⁷³¹ *Stutesman Affidavit*, ¶ 15 [Emphasis added].

⁷³² *Korecky Affidavit*, ¶ 161.

⁷³³ *Korecky Affidavit*, ¶ 162.

⁷³⁴ *Cook Affidavit*, ¶ 93.

664. In conclusion, the Investor failed to prove that any aspect of the log export control regime creates an insecure legal and business environment. The Investor's claim should therefore be entirely dismissed.

e) The Log Export Control Regime Does Not Frustrate the Investor's Legitimate Expectations

665. The Investor argues that the log export control regime is "inconsistent with Canada's obligation not to frustrate [its] legitimate expectations."⁷³⁵ The Investor claims a "legitimate expectation to be able to compete on an equal footing with other log producers and exporters in Canada"⁷³⁶ and to be "treated like any other taxpayer in Canada."⁷³⁷

666. As explained above, the government made no specific representations to Merrill & Ring about the log export control regime. The Investor has provided no evidence demonstrating that its decision to invest in Canada was based on any such assurances or representations. The Investor has been doing business in B.C. for more than 100 years. For the last 10 years, the Investor has operated under Notice 102; for the last 22 years it has been subject to a surplus test.

667. The Investor also alleges that it has a "legitimate expectation to operate free from abusive and corrupt business practices such as 'blockmailing'" and the expectation that Canada "would take appropriate measures to discourage such practices."⁷³⁸ This is a repetition of the Investor's baseless "blockmailing" complaint examined above.

668. In conclusion, the Investor fails to prove that any aspect of the log export control regime frustrates its so-called legitimate expectation. The Investor's claim should therefore be dismissed.

⁷³⁵ Investor's Memorial, ¶ 356.

⁷³⁶ Investor's Memorial, ¶ 356(a).

⁷³⁷ Investor's Memorial, ¶ 356(b).

⁷³⁸ Investor's Memorial, ¶ 356(c).

669. In any event, none of the aspects of the regime complained of by the Investor reaches the threshold for breach of the customary international law minimum standard of treatment of aliens under Article 1105.

f) The Log Export Control Regime Does Not Constitute an Abuse of Rights

670. The Investor alleges that the log export regime is “inconsistent with Canada’s obligation not to abuse its rights.”⁷³⁹ Specifically, the Investor alleges that:

- 1) TEAC/FTEAC approves offers below their fair market value;
- 2) In its Statement of Defense, Canada “engaged in false pretense” that amounts to an abuse of rights.

(1) TEAC/FTEAC Do Not Approve Offers Below their Fair Market Value

671. The so-called abuse of rights alleged by the Investor is based on the false accusation that TEAC/FTEAC has “approv[ed] offers that it knew to be below fair market value.”⁷⁴⁰ The Investor does not present the slightest evidence in support of this accusation.

672. The record shows that whenever TEAC/FTEAC concludes that an offer is below domestic fair market value, it systematically recommends that the logs be deemed surplus to domestic need. In her Affidavit, Ms. Korecky also explains that the general practice at FTEAC is to consider an offer as fair whenever it closely matches (+/- 5%) the current domestic market value.⁷⁴¹ This practice is reasonable. The balanced and flexible approach adopted by FTEAC does not constitute an “abuse of right”.

673. *Black's Law Dictionary* defines the “abuse-of-rights doctrine” as follows:

⁷³⁹ Investor’s Memorial, ¶ 357.

⁷⁴⁰ Investor’s Memorial, ¶ 357(a).

⁷⁴¹ *Korecky Affidavit*, ¶¶ 101, 116.

The principle that a person may be liable for harm caused by doing something the person has a right to do, if the right (1) is exercised for the primary motive of causing harm, (2) is exercised without a serious and legitimate interest that is deserving of judicial protection, (3) is exercised against moral rules, good faith, or elementary fairness, or (4) is exercised for a purpose other than the one it was granted for.⁷⁴²

674. The Investor's allegation that TEAC/FTEAC approves offers below their fair market value should therefore be dismissed.

(2) Canada's Defence is Accurate

675. Finally, the Investor alleges that Canada has "represented to this Tribunal that it has no authority to grant standing timber exemptions,"⁷⁴³ while it has "sanction[ed] standing timber exemptions to a competitor of Merrill & Ring's for timber on private federal lands that is of the same species that Merrill & Ring grows." According to the Investor, Canada has, therefore, "engaged in a false pretense of form that amounts to an abuse of rights."⁷⁴⁴

676. Canada's comment in its Statement of Defence that it has no authority to grant standing timber exemptions is correct. As explained above in the analysis of the Article 1102 claim, the case of Pluto Darkwoods does not constitute an exception to this general principle.⁷⁴⁵ The Investor is therefore wrong to allege that Canada "sanction[ed] standing timber exemptions" to one of its competitors. It did not. Canada's assertion in its Statement of Defence is true, and it follows that Canada has not "engaged in a false pretense of form."⁷⁴⁶ The Investor's allegation that this amounts to abuse of right should, consequently, be dismissed. In conclusion, the Investor fails to prove that any aspects of

⁷⁴² Garner, Bryan A. ed., *BLACK'S LAW DICTIONARY*, 7th ed. (West Publishing Company, 1999), at 10 (Tab 16).

⁷⁴³ The Investor refers to Canada's Statement of Defence, ¶ 34.

⁷⁴⁴ Investor's Memorial, ¶ 357(c).

⁷⁴⁵ This company successfully applied to the B.C. courts to have its land reclassified as federal land. Pluto's logs under application at the time of the 2005 reclassification were designated as federal applications and continued under the federal process.

⁷⁴⁶ Investor's Memorial, ¶ 357(c).

the log export control regime constitute an abuse of rights. The Investor's claim should therefore be dismissed.

4. Conclusion on Article 1105

677. The Investor's Article 1105 claim should be dismissed. The Investor has not only failed to identify any customary legal obligations with respect to treatment of aliens as required by Article 1105. The Investor has also failed to demonstrate that any of the measures complained of have reached the necessary threshold for breach of the customary international law minimum standard of treatment of aliens under Article 1105. Specifically,

- The TEAC/FTEAC recommendation-making process is not arbitrary;
- The log export control regime is transparent;
- The log export control regime does not create an insecure legal and business environment;
- The log export control regime does not frustrate the investor's legitimate expectations; and
- The log export control regime does not constitute an abuse of rights

For all these reasons, the Investor's Article 1105 claim should be entirely dismissed.

C. Performance Requirements – Article 1106

1. Summary of Canada's Position

678. Article 1106(1) lists seven clearly delineated performance requirements that NAFTA Parties may not impose on investments in their territory. Article 1106(5) emphasizes the clear intent of the Parties that the prohibitions in Article 1106(1) be limited to those expressly set out in that Article.

679. The Investor's attempts to characterise the measures complained of as performance requirements ignores the ordinary meaning, context and purpose of NAFTA Article 1106. Its interpretation would lead to the absurd result that every border measure adopted by a State would be a prohibited performance requirement.

680. The measures recited by the Investor as evidence of prohibited performance requirements are contorted to fit its incorrect interpretation of the legal requirement, and are unsustainable on their face. The claims made pursuant to Article 1106 should be rejected.

2. The Requirements of Article 1106(1)

681. The Investor alleges that the log export control regime imposes performance requirements prohibited by NAFTA Article 1106(1)(a), (c) and (e).⁷⁴⁷ Article 1106(1) provides,

1. No Party may impose or enforce any of the following requirements, or enforce any commitment or undertaking, in connection with the establishment, acquisition, expansion, management, conduct or operation of an

⁷⁴⁷ The Investor continues to modify its case at each stage of this arbitration. The allegations of breach of Article 1106 in the Investor's Memorial are significantly different from the allegations in paragraphs 55 and 58 of its Claim. In particular, it has: withdrawn allegations under Article 1106(1)(a) (refusal to grant permits until surplus test satisfied), (b) (domestic content), and (c) (preferring domestic logs); withdrawn allegations under Article 1106(3)(a) (providing a permit conditional on a given level of domestic content); introduced a new allegation of breach of Article 1106(1)(e); and completely changed the nature of its claim under Article 1106(1)(c).

investment of an investor of a Party or of a non-Party in its territory:

- (a) to export a given level or percentage of goods or services;
- (b) to achieve a given level or percentage of domestic content;
- (c) to purchase, use or accord a preference to goods produced or services provided in its territory, or to purchase goods or services from persons in its territory;
- (d) to relate in any way the volume or value of imports to the volume or value of exports or to the amount of foreign exchange inflows associated with such investment;
- (e) to restrict sales of goods or services in its territory that such investment produces or provides by relating such sales in any way to the volume or value of its exports or foreign exchange earnings;
- (f) to transfer technology, a production process or other proprietary knowledge to a person in its territory, except when the requirement is imposed or the commitment or undertaking is enforced by a court, administrative tribunal or competition authority to remedy an alleged violation of competition laws or to act in manner not inconsistent with other provisions of this Agreement; or
- (g) to act as the exclusive supplier of the goods it produces or services it provides to a specific region or world market.

682. Article 1106(1) establishes an exhaustive list of prohibited performance requirements. Paragraphs (a) to (g) of Article 1106(1) list the seven specific requirements, commitments or undertakings that a Party may not impose or enforce in connection with the establishment, acquisition, expansion, management, conduct or operation of an investment in its territory.

683. Article 1106(5) provides,

Paragraphs 1 and 3 do not apply to any requirement other than the requirements set out in those paragraphs.

684. Article 1106(5) emphasizes the intent of the drafters that paragraph 1 apply only to the requirements expressly set out in Articles 1106(1) and (3). The *Pope & Talbot* Tribunal endorsed this position as follows,

... Article 1106(5) is vital to the interpretation of Articles 1106(1) and (3). Consequently, the ambit of those two Articles may not be broadened beyond their express terms. The enumeration of seven requirements in Article 1106(1) and four in Article 1106(3) is limiting in each case.⁷⁴⁸

685. The *S.D. Myers* Tribunal reached the same conclusion, holding that the only limitations or restrictions it could consider were those that fell squarely within the prohibited performance requirements listed in Articles 1106(1) and 1106(3).⁷⁴⁹

3. Interpretation of Article 1106(1)

686. The interpretation of Article 1106(1)(a), (c) and (e) offered by the Investor contradicts the ordinary meaning of these provisions and fails to consider their context or their object and purpose.

a) Ordinary Meaning of Article 1106(1)

687. As explained above, and as explicitly adopted by the *Pope & Talbot* Tribunal in its consideration of Article 1106, "... the analysis and interpretation of Article 1106 of NAFTA is initially informed by the ordinary meaning of its terms."⁷⁵⁰

688. For a measure to breach Article 1106(1), a Party must impose or enforce a requirement or enforce a commitment or undertaking. The ordinary meaning of all these words imports the notion of compulsion: The *Shorter Oxford Dictionary* defines "impose" as "lay or inflict (a tax, duty, charge, obligation, etc.) (*on or upon*) esp. forcibly; compel compliance with."⁷⁵¹ The definition of "enforce" is "compel the occurrence or performance of."⁷⁵² "Requirement" is defined as "something called for or

⁷⁴⁸ *Pope & Talbot – Interim Award*, ¶ 70 (Tab 112).

⁷⁴⁹ *S.D. Myers – First Partial Award*, ¶ 275 (Tab 120).

⁷⁵⁰ *Pope & Talbot – Interim Award*, ¶ 69 (Tab 112). See also *S.D. Myers – First Partial Award* ¶ 277 (Tab 120), considering the substance and effect of the Interim Order as well as the literal wording of Article 1106 to conclude that no requirements were imposed on S.D. Myers Inc.

⁷⁵¹ *Shorter Oxford*, at 1331 (Tab 128).

⁷⁵² *Shorter Oxford*, at 827 (Tab 128).

demanded; a condition which must be complied with.”⁷⁵³ The definition of “commitment” is “the action of committing oneself or another to a course of action etc.”⁷⁵⁴ The definition of “undertaking” is “a pledge, promise; a guarantee”.⁷⁵⁵

689. In addition, to violate Article 1106(1) a Party must compel the observance of a mandatory condition “in connection with the establishment, acquisition, expansion, management, conduct or operation” of an investment.

690. As a result, the ordinary meaning of the wording of Article 1106(1) obliges the Investor to prove that,

- 1) Canada imposed or enforced a specific requirement, or enforced a commitment or undertaking;
- 2) The requirement in question is enumerated in Article 1106(1); and
- 3) The requirement in question was imposed or enforced in connection with the establishment, acquisition, expansion, management, conduct or operation of an investment of an investor of a Party or of a non-Party.

691. None of the measures complained of by Merrill & Ring come within the plain meaning of a requirement, commitment or undertaking to (a) export a given level or percentage of goods; (b) achieve a level or percentage of domestic content; (c) purchase or use domestic goods or services; (d) relate imports or exports to foreign exchange inflows; (e) restrict domestic sales by relating them to export sales or foreign exchange earnings; or (f) transfer technology. Nor were any of the measures in question imposed in connection with the establishment or operation of Merrill & Ring’s investment.

b) Context of Article 1106(1)

692. The context of Article 1106(1), and Article 1106(5) in particular, strictly limit the list of prohibited performance requirements to those expressly enumerated in Article

⁷⁵³ *Shorter Oxford*, at 2542 (Tab 128).

⁷⁵⁴ *Shorter Oxford*, at 460-461 (Tab 128).

⁷⁵⁵ *Shorter Oxford*, at 3432 (Tab 128).

1106(1). Article 1106(5) is crucial to the interpretation of Articles 1106(1)(a), (c) and (e). The Parties have expressed a clear intent in Article 1106(5) that the obligations in paragraph 1106(1) not be interpreted broadly.⁷⁵⁶

693. The only possible interpretation of Article 1106(5) is that the performance requirements expressly mentioned in Article 1106(1) and (3) are prohibited for the purposes of NAFTA Chapter Eleven. Any other interpretation would deprive Article 1106(5) of meaning and cannot have been the intention of the NAFTA Parties. The Investor's attempts to broaden the scope of the requirements prohibited by Article 1106 must be rejected in the face of the explicit language of Article 1106(5).

c) Purpose of Article 1106(1)

694. Performance requirements are a policy tool sometimes used to balance trade, foster regional development and increase exports. They are designed to ensure that foreign investors produce and sell in a manner that protects domestic production. The basic objective of an export requirement is to artificially promote higher levels of export by foreign investors. In other words, the general aim of imposing an export requirement is clearly not to limit an investor's exports.

695. Article 1106 derives from a prohibition on performance requirements in U.S. BITs dating back to the 1980s.⁷⁵⁷ This prohibition was a response to the practice by some host countries of conditioning the establishment or continued operation of a U.S. investment on increasing the revenue brought by those investments to the host country.⁷⁵⁸

⁷⁵⁶ Johnson, Jon, *THE NORTH AMERICAN FREE TRADE AGREEMENT: A COMPREHENSIVE GUIDE* (Canada Law Book Inc., 1994), at 287-88 ("*Johnson*") (Tab 63): "NAFTA 1106(5) makes it clear that the prohibited performance requirements, whether as conditions of investment or receiving an advantage, are confined to those specifically identified."

⁷⁵⁷ For example, see Article II (7) of the 11 January 1982 Draft; Article II (7) of 1 January 1983 Draft; Article II (5) of September 1987 Draft in Kenneth Vandeveld, *UNITED STATES INVESTMENT TREATIES AND PRACTICE* (Kluwer Law and Taxation Publisher, 1992) Annex A-1 to A-4 (Tab 154).

⁷⁵⁸ Sacerdoti, Giorgio, *Bilateral Treaties and Multilateral Instruments on Investment Protection*, *COLLECTED COURSES OF THE HAGUE ACADEMY OF INTERNATIONAL LAW* 1997, at 366-67 (Tab 122); *Sornarajah*, at 237 (Tab 131); *Vandeveld*, at 110 (Tab 154).

696. The purpose of the requirements prohibited by Article 1106 is similar. They prohibit measures designed to oblige an investor to export more than it otherwise would have exported.⁷⁵⁹ As noted by Jon Johnson, “the objective of prohibiting performance requirements is to prevent NAFTA countries from distorting investment decisions in their favour.”⁷⁶⁰

697. Article 1106(1) is irrelevant in the context of the present claim since it concerns the exact opposite situation than the one complained of by the Investor. The purpose of Article 1106(1) is to prevent measures that artificially increase exports; none of the measures complained of by Merrill & Ring artificially increase exports.

698. The Investor relies on the *Pope & Talbot* case to argue that the log export control regime is a prohibited performance requirement because it requires Merrill & Ring to export at a “given level” that is lower than what it would otherwise export. In other words, the Investor wants to export more logs, not less.⁷⁶¹ This argument is completely inconsistent with the objective of performance requirements.

699. Moreover, if the Tribunal were to adopt Merrill & Ring’s proposed interpretation of Article 1106(1), any export restriction imposed by a State would contravene Article 1106(1).

700. The *Pope & Talbot* Tribunal came to the same conclusion when it held that Canada’s Export Control Regime (“ECR”) for softwood lumber did not impose or enforce any performance requirement: “[w]hile the [ECR] undoubtedly deters increased

⁷⁵⁹ *Pope & Talbot – Interim Award*, ¶ 74 (Tab 112).

⁷⁶⁰ *Johnson*, at 288 (Tab 63).

⁷⁶¹ In *obiter*, the *Pope & Talbot – Interim Award* ¶ 74 (Tab 112) stated that “the language of [Article 1106(1)(a)] is not expressly limited to the imposition or enforcement of a *higher* level or percentage of exports of goods and services, but could admit equally the imposition or enforcement at *any* given level or percentage of those exports.” The point is clearly expressed in the *Investor’s Statement of Claim* (¶ 56) where it complains that it “is not permitted to freely export its logs, but may only export the amount or level of logs deemed acceptable by Canada.”

exports to the U.S., that deterrence is not a "requirement" for establishing, acquiring, expanding, managing, conducting or operating a foreign owned business in Canada."⁷⁶²

701. In any event, even under the *Pope & Talbot* Tribunal's interpretation, a State still needs (at the very least) to impose some specific ("given") level or percentage of exports in order for it to be deemed a prohibited export requirement. The regime here does not impose any given level of exports.

4. No Performance Requirements Have Been Imposed by Canada

702. The Investor alleges that four aspects of the log export control regime have the effect of imposing performance requirements. It argues that:

- (a) the minimum volume requirement breaches Article 1106(1)(a) (c) and (e);⁷⁶³
- (b) the maximum volume requirement breaches Article 1106(1)(a) and (c);⁷⁶⁴
- (c) the cut, sort and scale requirements breach Article 1106(1)(c);⁷⁶⁵ and
- (d) the need to hire recovery and salvage personnel breaches Article 1106(1)(c) and (e).⁷⁶⁶

703. Merrill & Ring's argument that the impugned measures have the same effect as prohibited performance requirements is contrived and does not justify a finding of breach of Article 1106.

704. Canadian and foreign log producers operating in Canada are free to sell their logs on both the domestic and the international market. No requirement is imposed on companies to increase (or even to limit) their log exports. The Investor does not even allege that its log business in B.C. is subject to any legal requirement to export a given

⁷⁶² *Pope & Talbot – Interim Award*, ¶ 75 (Tab 112).

⁷⁶³ Investor's Memorial, ¶¶ 364(a), 365(b), 367(a).

⁷⁶⁴ Investor's Memorial, ¶¶ 364(a), 367(b).

⁷⁶⁵ Investor's Memorial, ¶ 365(a).

⁷⁶⁶ Investor's Memorial, ¶ 366(b).

level of logs. In fact, the Investor failed to apply for export permits on 17.4% of the parcels which were declared surplus by the Minister of Foreign Affairs.⁷⁶⁷

**a) The Minimum Volume Requirement Is Not A
Performance Requirement**

705. Paragraph 1.4 of Notice 102 requires that applications to advertise be made for a minimum export of 2,800 m³ of logs in remote areas of the B.C. Coast, failing which the logs must be transported to established log marketing areas before making applications to advertise.

706. This condition for the advertisement of logs exported from remote areas of the B.C. Coast does not apply to the Investor as it has not been operating from a “remote” area in the last three years.⁷⁶⁸ As a result, it does not impose any requirement on Merrill & Ring.

707. Nor does this provision have any impact on the level of goods exported. The “minimum” volume requirement only concerns the advertisement of logs. A minimum volume of logs must be advertised to give potential buyers the opportunity to inspect the goods and to determine their value before buying. A log harvester can make as many applications as it wishes, and its overall volume of exports from remote areas is not limited by this provision.⁷⁶⁹ The minimum volume requirement has nothing to do with capacity to export or the FTEAC permit process.

708. The Investor’s argument that logs “must be produced in Canada” as a result of this minimum volume requirement is illogical. Even if the Investor were to advertise its logs in volumes of less than 2,800 m³, such logs would still be located and “produced” in Canada until authorized for export. The logs are “produced” in Canada because they grow there, not because of any “preference” accorded to logs by Canada.

⁷⁶⁷ As explained above, the Investor applied for export permits for [REDACTED] parcels of logs out of a total of [REDACTED] parcels declared surplus.

⁷⁶⁸ *Cook Affidavit*, ¶ 81.

⁷⁶⁹ *Cook Affidavit*, ¶ 88.

709. In any event, the minimum volume requirement has a sound policy basis in that it prevents avoidance of the log export control regime by log harvesters.⁷⁷⁰ As explained by John Cook, the minimum volume requirement prevents possible abuses from loggers who would advertise in small volumes in remote areas to avoid offers and to increase the likelihood of getting a log export permit. The goal of the requirement is to establish a minimum volume threshold above which it makes sense (from an economic point of view) for potential buyers to inspect booms in remote areas.

710. The minimum volume requirement for the advertisement of logs to be exported in no way restricts the sale of the Investor's logs in Canada.

**b) The Maximum Volume Requirement Is Not A
Performance Requirement**

711. Paragraph 1.4 of Notice 102 states that normally, applications to advertise volumes above 15,000 m³ from any area will not be considered. The Investor is free to submit as many export permit applications as it wants, hence the provision does not impose any overall maximum volume limitation.⁷⁷¹ At any rate, as explained by John Cook, the volume of 15,000 m³ is very high, and far exceeds the average and normal size of booms advertised for export (which is approximately 4,000 m³).⁷⁷² The maximum volume condition does not restrict the Investor's capacity to export logs in any way.

712. As in the case of the minimum volume requirement, the maximum volume requirement for logs to be exported also has no impact on the sale of Merrill & Ring's logs in Canada. The Investor can make unlimited domestic sales of logs if it wishes.

⁷⁷⁰ Cook Affidavit, ¶ 79.

⁷⁷¹ Cook Affidavit, ¶ 88.

⁷⁷² Cook Affidavit, ¶ 87.

**c) The Cut, Sort and Scale Requirement Is Not A
Performance Requirement**

713. The Investor alleges that the *Coast Domestic End Use Sort Descriptions* and the requirement to scale logs using the metric system require Merrill & Ring to accord a preference to logs produced in Canada.

714. In accordance with the *B.C. Forest Act*,⁷⁷³ all logs harvested in B.C. must be scaled using the metric system.⁷⁷⁴ This is simply a measurement requirement that is unrelated to the manufacture and sale of logs. It is not surprising that Canada requires that logs be scaled in accordance with the measurement system applicable in Canada.

715. The Investor's proposition that it is "required" to accord a "preference" to logs "produced" in Canada as a result of this metric scaling requirement since it would otherwise be "producing goods of a different nature"⁷⁷⁵ is illogical.

716. Absent this requirement the Investor would still be "producing" goods of the exact same "nature" (*i.e.*, logs). These logs would still be "produced" in Canada even using a different measurement method (such as the Scribner system). This is because the logs are located, and must remain, in Canada until receipt of an export permit. No Canadian measure compels the Investor to accord a "preference" to logs produced in Canada.

**d) The Need To Hire Recovery and Salvage Personnel In
Canada Is Not A Performance Requirement**

717. Merrill & Ring alleges that having to scale logs using the metric system, and having to store logs in Canada pending export, somehow compels it to purchase services from persons in Canada. This allegation borders on the ridiculous: scaling and log recovery are performed in Canada because the trees grow in Canada. Notice 102 does not prevent Merrill & Ring from hiring workers from outside of Canada.

⁷⁷³ *B.C. Forest Act* 1996, s. 96(1)(b) (Tab 12).

⁷⁷⁴ This requirement is applied to all logs, including those sold domestically.

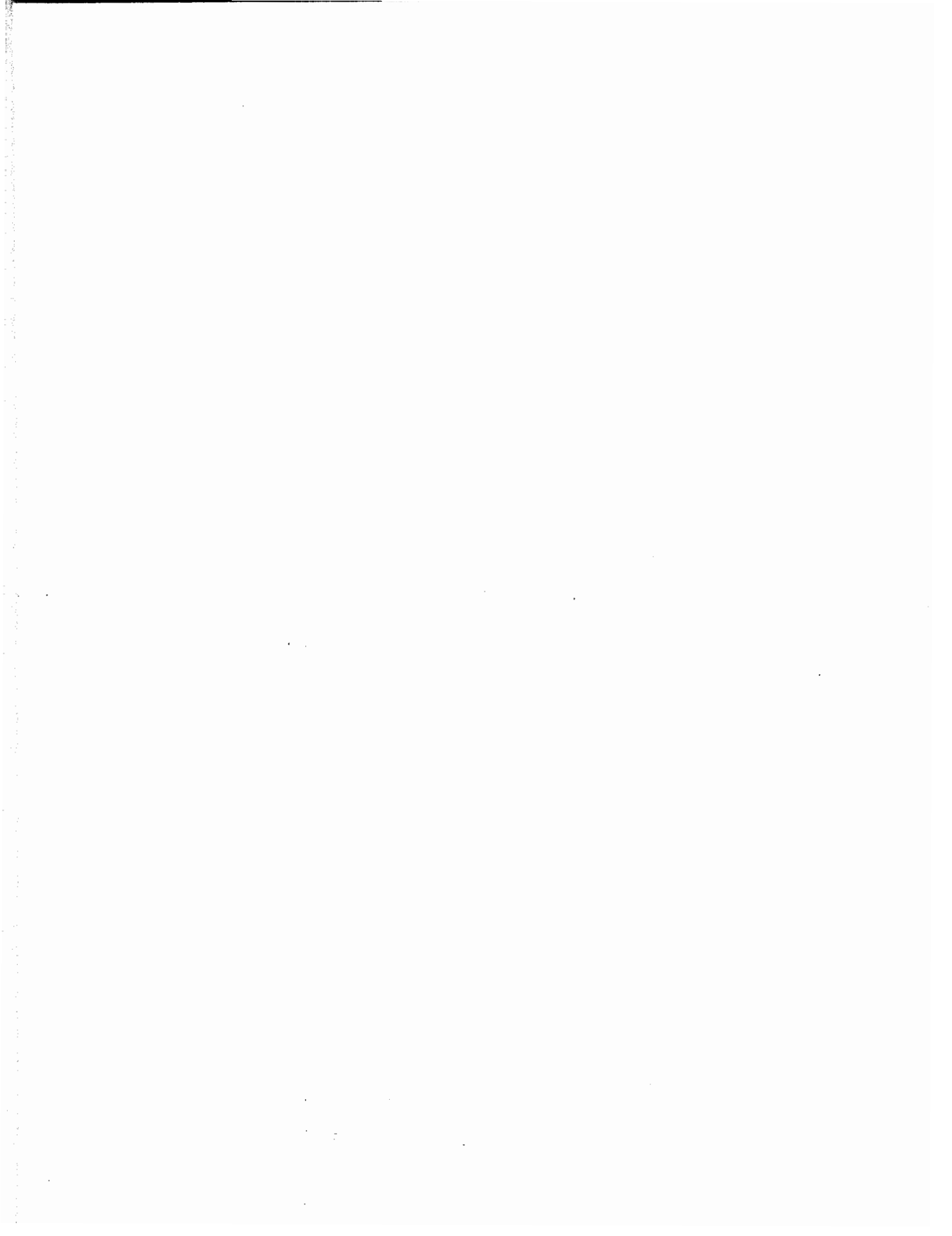
⁷⁷⁵ Investor's Memorial, ¶ 365(a).

718. Nor are these requirements imposed by Canada. As explained by John Cook, “boom breaking” is a risk for the whole Coastal log industry. Log producers under the provincial regime must also hire the services of recovery providers on occasion.⁷⁷⁶ Since logs must remain in Canada until authorized for export, any log recovery job will also have to be performed in Canada. This is all the more so in “remote” areas far from the U.S. border. However, the Investor is always free to hire a non-Canadian service provider to cut, sort and scale its logs or to recover its logs.

5. Conclusion on Article 1106

719. The log export regime does not impose any of the delineated performance requirements under Article 1106. Canada does not impose any requirement on the Investor to achieve a given level of export; to accord a preference to goods produced in Canada; to purchase services from persons in Canada; or to restrict its sale of goods in Canada. Merrill & Ring’s allegations to the contrary ignore the plain language of the treaty, are factually implausible, and should be dismissed.

⁷⁷⁶ Mr. Cook explains that the alleged long waiting period during which logs stays in water has more to do with difficulties in finding international buyer than the surplus permit procedure *per se*: *Cook Affidavit*, ¶ 94.



D. Expropriation - Article 1110

1. Summary of Canada's Position

720. The Investor has not suffered any deprivation, much less a substantial deprivation, of the benefit of its investments under Notice 102. Canada never controlled the Investor's enterprise, directed its operations, took proceeds of sales, intervened in management or shareholder activities or otherwise interfered with the Investor's investments in any way that can be characterised as expropriation or tantamount thereto. To the contrary, the record demonstrates that the Investor controlled all aspects of its operations, sold logs in Canada at fair market value, exported approximately [REDACTED] of its logs from Canada (although granted surplus status for more than it chose to export) and was consistently profitable while subject to Notice 102.

721. The aspects of the log export control regime which the Investor complains about are trivial and have a minimal effect on its operations. Nor can the Investor legitimately claim that the log export control regime deprived it of any right or benefit. In fact, the Investor has been subject to federal log export restraints generally since 1942, subject to a surplus test under Notice 23 since 1986, and subject to Notice 102 since 1998. Canada never made any specific commitment to the Investor that it would refrain from regulating log exports from Canada, and the Investor could not credibly have had any reasonable expectation of operating outside the federal log export control regime while carrying on business in British Columbia. The Tribunal should therefore dismiss the Investor's claim under Article 1110.

2. Expropriation: Definition and methodology

722. NAFTA Article 1110(1) states,

1. No Party may directly or indirectly nationalize or expropriate an investment of an investor of another Party in its territory or take a measure tantamount to nationalization or expropriation of such an investment ("expropriation"), except:

- (a) for a public purpose;
- (b) on a non-discriminatory basis;
- (c) in accordance with due process of law and Article 1105(1); and

(d) on payment of compensation in accordance with paragraphs 2 through 6.

723. The NAFTA does not define “expropriation.” As a result, NAFTA tribunals have defined expropriation on a case-by-case basis referring to applicable rules of international law. A three-step methodology emerges from these cases requiring tribunals to address the following criteria in order:

1. Is there is an interest capable of being expropriated?
2. If so, has that interest been expropriated?
3. And finally, if there is expropriation, is it lawful expropriation under Articles 1110(1)(a) to (d)?

Canada addresses these steps below.

**Step 1: The Investor’s Land, Timber or Logs Are the Only
“Investments” Capable of Being Expropriated in this Case**

724. The first step in determining whether Article 1110 has been breached is to determine whether there is an interest capable of being expropriated. It is important not to conflate the first and second steps of this test: the Tribunal must be satisfied that an investor possesses such an interest before it can consider whether that interest has been expropriated.

725. Article 1110 expressly requires an “investment” to have been expropriated.⁷⁷⁷ If the alleged interest is not within the scope of the definition of “investment” in NAFTA Chapter Eleven, then it cannot be the subject of an expropriation claim under Article 1110.

726. As noted above in the “Definition of Investment” section, the Investor has not demonstrated, and cannot in law demonstrate, that the alleged rights to export to foreign markets or to sell at fair market value are “investments” within the definition of Article

⁷⁷⁷ The Investor’s submission addresses this point in part when it argues about alleged “rights in a license,” (Investor’s Memorial, ¶¶ 333-336), “the ability to exercise their property rights” (Investor’s Memorial, ¶ 340) and “types of protected property interests” (Investor’s Memorial, ¶¶ 345-350).

1139 of the NAFTA. As these alleged interests are not “investments,” they cannot have been expropriated under Article 1110. The Tribunal should dismiss the claims insofar as they are based on expropriation of interests that are not investments.

727. It is only when an investor demonstrates that it possesses interests within the meaning of the definition of “investment” in Article 1139 that the Tribunal can proceed to the second step of determining whether such “investments” have been expropriated. In this case, the lands, logs or timber are the only investments of the Investor capable of being expropriated. The Tribunal’s analysis therefore should be limited to whether the Investor’s land, logs or timber have in fact been expropriated by Notice 102. In any event, Canada submits that no matter how the investments are defined in this case, they have not been expropriated.

728. Further, an investor cannot be deprived of an investment or interest that it never possessed in the first place. In *Feldman*, the Tribunal held that an investor could not recover damages for expropriation of a right that it never had. In that case, the investor alleged that its investment was expropriated when Mexico refused to pay rebates due to Feldman’s failure to provide supporting invoices. However, the Tribunal noted that the invoice requirements were not new and had not changed to the detriment of the claimant at any relevant time. As a result, the claimant could not complain that it had been deprived of a right. The Tribunal commented that,

This is not a situation in which the Claimant can reasonably argue that post investment changes in the law destroyed the Claimant’s investment, since the IEPS law at all relevant times contained the invoice requirement(s). ... Thus, in retrospect, the Claimant’s most intractable problem with regard to cigarette exports was *not* the 0% tax rate, but the technical requirements of the IEPS law with regard to invoices and, much later, the denial of tax rebates for exports to low tax jurisdictions, also clearly stated in the IEPS law during all relevant periods.⁷⁷⁸

⁷⁷⁸ *Feldman – Award*, ¶ 119 (Tab 49).

729. Similarly, in this case the Investor cannot reasonably argue that changes in the law destroyed its investment, since it has been subject to export regulation since 1942. In particular, the Investor has been subject to some form of log export restraints since World War II and subject to a federal surplus test since 1986. That surplus test was found in Notice 23, the precursor to Notice 102, and the requirements imposed by it were very similar to the requirements of Notice 102.⁷⁷⁹ Notice 102 itself has been in effect and unamended since 1998. In these circumstances, it is impossible to say that Canada's continuous application of the surplus policy caused any kind of deprivation of the Investor's investments.

Step 2: Canada Did Not Expropriate Merrill & Ring's Investment

730. The second step in the expropriation analysis consists of determining whether a taking has occurred that reaches the level of interference or deprivation required by international law to amount to an expropriation. Both the Investor and Canada agree that a substantial deprivation is required for a finding of expropriation under Article 1110.⁷⁸⁰

731. The question in this case is whether the investments have been indirectly expropriated or expropriated by a measure "tantamount to" expropriation.⁷⁸¹ NAFTA Tribunals have clearly decided that "tantamount to expropriation" simply means equivalent to expropriation, and does not expand the scope of expropriation beyond its meaning at international law.⁷⁸²

732. Numerous tribunals have considered the definition of indirect expropriation. In *Starrett Housing*, the Iran-United States Claims Tribunal described indirect expropriation in the following manner, using a formulation that has been relied on by numerous subsequent investment arbitration tribunals,

⁷⁷⁹ *Korecky Affidavit*, ¶¶ 31-56.

⁷⁸⁰ Investor's Memorial, ¶ 326.

⁷⁸¹ Investor's Memorial, ¶¶ 327, 328, 368.

⁷⁸² *Pope & Talbot – Interim Award*, ¶ 104 (Tab 112); *S. D. Myers – First Partial Award*, ¶ 285 and Separate Opinion, ¶ 217 (Tab 120); *Feldman – Award*, ¶¶ 98-100 (Tab 49).

It is recognized in international law that measures taken by a State can interfere with property rights to such an extent that these rights are rendered so useless that they must be deemed to have been expropriated, even though the State does not purport to have expropriated them and the legal title to the property formally remains with the original owner.⁷⁸³

There has been no substantial deprivation in this case.

733. For an expropriation claim to succeed, the claimant must demonstrate that the government measure interferes with the investment sufficiently “to support a conclusion that the property has been ‘taken’ from the owner”⁷⁸⁴ Thus, Canada agrees with the Investor that there must be a substantial deprivation in order to find an expropriation.⁷⁸⁵

734. Most cases have focussed on what level of deprivation is “substantial” for the purposes of finding an expropriation. If there has been a deprivation, the question becomes whether that deprivation is substantial. NAFTA tribunals addressing this question have consistently established a high threshold for conduct to amount to deprivation sufficient to be considered an expropriation.

735. For example, in *Pope & Talbot*, the Tribunal rejected the investor’s claim of expropriation because the alleged interference did not amount to a “substantial deprivation.”⁷⁸⁶ Citing both the *Harvard Draft* and the *Third Restatement*, the *Pope & Talbot* Tribunal held,

While it may sometimes be uncertain whether a particular interference with business activities amounts to an expropriation, the test is whether that interference is sufficiently restrictive to support a conclusion that the property has been “taken” from the owner. Thus, the *Harvard Draft* defines the standard as requiring interference that would “justify an inference that the owner *** will not be able to use, enjoy, or dispose of the property...” The

⁷⁸³ *Starrett Housing Corp. v. Iran*, 4 Iran-U.S. C.T.R. 122, 154 (19 December 1983) (“*Starrett Housing*”) at 28, 36 (Tab 132).

⁷⁸⁴ *Pope & Talbot – Interim Award*, ¶ 102 (Tab 112)

⁷⁸⁵ Investor’s Memorial, ¶ 326.

⁷⁸⁶ *Pope & Talbot – Interim Award*, ¶ 102 (Tab 112).

Restatement, in addressing the question whether regulation may be considered expropriation, speaks of “action that is confiscatory, or that prevents, unreasonably interferes with, or unduly delays, effective enjoyment of an alien’s property.” Indeed, at the hearing, the Investor’s Counsel conceded, correctly, that under international law, expropriation requires a “substantial deprivation.” The Export Control Regime has not restricted the Investment in ways that meet these standards.⁷⁸⁷

736. The level or degree of deprivation is, then, critical to a finding of expropriation. It is not mere interference or some deprivation that is required but rather a finding of substantial deprivation. In finding that Canada’s export quotas imposed under the *Softwood Lumber Agreement* 1996 did not amount to a substantial deprivation of the investment, the Tribunal said, “[...] mere interference is not expropriation; rather, a significant degree of deprivation of fundamental rights of ownership is required.”⁷⁸⁸

737. To assess whether that degree of deprivation had been established, the *Pope & Talbot* Tribunal looked to the usual indicia of effective control over an investment, including whether the investor, notwithstanding the measures complained of, still directs day-to-day operations, operates at a profit, and employs officers who are not supervised by the State, and whether the State takes proceeds of sales, interferes with management or shareholder functions, payment of dividends or appointment of directors and managers.⁷⁸⁹

738. The Tribunal in *Waste Management II* also looked at the usual indicia of control in finding that there had been no expropriation in that case. In concluding that the

⁷⁸⁷ *Pope & Talbot – Interim Award*, ¶ 102 (Tab 112). Article 10(3) of the Harvard Draft *Convention on the International Responsibility of States for Injury to Aliens* defined a taking as “any unreasonable interference with the use, enjoyment or disposal of property as to justify an inference that the owner will not be able to use, enjoy, or dispose of the property within a reasonable period of time after the inception of such interference.” (Sohn, Louis B. & R. R. Baxter, *Responsibility of States for Injuries to the Economic Interests of Aliens*, 55 AM. J. INT’L L. 545 (1961) at 553 (Tab 129)). The Third Restatement states that: A state is responsible under international law for “A taking by the state of the property of a national of another state that (a) is not for a public purpose, or (b) is discriminatory, or (c) is not accompanied by provision for just compensation.” It goes on to state that similar to NAFTA Article 1110(a) to (d) the application of §712(a) to (c) are not part of the test to determine whether expropriation has occurred. See Comment (e) for instance (American Law Institute, *RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES* (1986) at §712) (Tab 3).).

⁷⁸⁸ *Pope & Talbot – Interim Award*, ¶ 102 (Tab 112).

⁷⁸⁹ *Pope & Talbot – Interim Award*, ¶ 100 (Tab 112).

Investor's investments had not been expropriated, the *Waste Management II* Tribunal noted that there had been no taking of physical assets and that the investor had control over and use of its investment.⁷⁹⁰

739. The *S.D. Myers* Tribunal also recognized that the degree of deprivation was an important factor on which a determination of expropriation must turn. It required a "lasting removal" of the use of the economic right, though the Tribunal accepted that it need not be a complete or permanent deprivation. It held that,

An expropriation usually amounts to a lasting removal of the ability of an owner to make use of its economic rights although it may be that, in some contexts and circumstances, it would be appropriate to view a deprivation as amounting to an expropriation, even if it were partial or temporary.⁷⁹¹

740. Similarly, the Tribunal in *Fireman's Fund* held that, "[t]he taking must be a substantially complete deprivation of the economic use and enjoyment of the rights to the property, or of identifiable distinct parts thereof (*i.e.*, it approaches total impairment)."⁷⁹² The Tribunal in *Metalclad* also required a significant degree of deprivation for a finding of expropriation under Article 1110. It held that a measure must have "the effect of depriving the owner, in whole or in significant part, of the use or reasonably-to-be-expected economic benefit of property even if not necessarily to the obvious benefit of the host State."⁷⁹³

⁷⁹⁰ *Waste Management II – Award*, ¶¶ 156-160 (Tab 157).

⁷⁹¹ *S. D. Myers – First Partial Award*, ¶ 283 (Tab 120).

⁷⁹² *Fireman's Fund – Award*, ¶ 176 (Tab 51).

⁷⁹³ *Metalclad – Award*, ¶ 103 (Tab 82). The B.C. Supreme Court commented on this definition on the set aside application but did not reverse it. However, its comment related to covert or incidental interference, rather than the high level of deprivation required ("The Tribunal gave an extremely broad definition of expropriation for the purposes of Article 1110. In addition to the more conventional notion of expropriation involving a taking of property, the Tribunal held that expropriation under the NAFTA includes covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or in significant part, of the use or reasonably-to-be-expected economic benefit of property. This definition is sufficiently broad to include a legitimate rezoning of property by a municipality or other zoning authority. However, the definition of expropriation is a question of law with which this Court is not entitled to interfere under the *International CAA*"): *Metalclad – Judicial Review*, ¶ 99 (Tab 83).

741. This view is consistent with tribunals arbitrating expropriation claims pursuant to bilateral investment treaties. In *EnCana*, the Tribunal held that,

[A]lthough the EnCana subsidiaries suffered financially from the denial of VAT and the recovery of VAT refunds wrongly made, they were nonetheless able to continue to function profitably and to engage in the normal range of activities, extracting and exporting oil (the price of which increased during the period under consideration). There is nothing in the record which suggests that the change in VAT laws or their interpretation brought the companies to a standstill or rendered the value to be derived from their activities so marginal or unprofitable as effectively to deprive them of their character as investments.⁷⁹⁴

742. The *EnCana* holding demonstrates how significant the deprivation must be to establish expropriation. Despite suffering significant financial effects due to the government VAT measure at issue, the tribunal held that the companies were not so adversely affected as to be brought to a “standstill” or to a degree that rendered the value of their activities so marginal or unprofitable as to have effectively deprived them of their character of investment.

743. The Tribunal in *CMS Gas Transmission Co.* put it this way: “[t]he essential question is therefore to establish whether the enjoyment of the property has been effectively neutralized.”⁷⁹⁵ Again the degree of deprivation is far from trivial. It is not merely interference; rather, it is the effective neutralization of the enjoyment of the property.

744. Similarly in *PSEG*, the Tribunal relied on the serious deprivation formula in *Pope & Talbot* to say,

The Tribunal has no doubt that indirect expropriation can take many forms. Yet, as the tribunal in *Pope & Talbot* found, there must be some form of deprivation of the investor in control of the investment, the management of day-to-day operations of the

⁷⁹⁴ *EnCana Corporation v. Republic of Ecuador* (UNCITRAL) Award, 3 February 2006 ¶ 174 (Tab 43).

⁷⁹⁵ *CMS – Final Award*, ¶ 262 (Tab 28).

company, interfering with the administration, impeding the distribution of dividends, interfering in the appointment of officials and managers, or depriving the company of its property or control in total or in part.⁷⁹⁶

745. This Tribunal’s holding is instructive not only because it again demonstrates the very high degree of interference required to amount to expropriation, but also because it indicates the type of interference required – interference with the very fundamental aspects of an investment (*i.e.*, its control, management of day-to-day operations, administration, distribution of dividends, appointment of officers, and ownership of property).

746. In the context of the Iran-U.S. Claims Tribunal cases, the Tribunal in *Starrett Housing* dealt with the degree of deprivation and held that only if the state “interfere[s] with property rights to such an extent that these rights are rendered ... useless” can the measure be deemed expropriatory.⁷⁹⁷ Again, the level of deprivation is very high; the interference must render the property rights “useless.”

747. The Investor’s argument that regulations depriving an investor of a right in a licence or a property right constitute expropriation, and the cases cited to support that argument, are not relevant to this case.⁷⁹⁸ In each of the cases cited by the Investor in its Memorial, the investor had been deprived of a vested, legally cognizable right – one which would qualify as an investment under Article 1139. In each of those cases that right was taken away *ex post facto*, after the investor had invested in the respondent State.

748. Further, the investor in those cases invested on the basis of the right being granted to it by the State and in the reasonable expectation that such right would continue consistent with existing laws or representations made by the State to that effect. Finally, the deprivation of the investment in each of those cases was total, in that the investment

⁷⁹⁶ *PSEG – Award*, ¶ 278 (Tab 114).

⁷⁹⁷ *Starrett Housing*, at 36 (Tab 132).

⁷⁹⁸ Investor’s Memorial, ¶ 333-350.

was completely taken by the State and the investor received none of the reasonably to be expected benefit of its investment.

749. The facts in those cases are entirely different from the circumstances of Merrill & Ring. Here the Investor has not been deprived of a legally cognizable investment. Nor does it have an unfettered right to export or sell at any given price. Further, it has never been given any representation to that effect. It has not been subject to any *ex post facto* change in the applicable regime and could never have had any reasonable expectation that it would operate outside the log export control regime.

750. The Investor's own authorities on expropriation likewise support Canada's position that Notice 102 is not expropriatory. As summarised by Professor Lowenfeld, "... a regulation that reduces the profitability of an investment but does not shut it down completely and leaves the investor in control, will generally not be seen as expropriation...".⁷⁹⁹ In this case the Investor has done nothing more than establish that minimal inconvenience and, at most, minimal cost are imposed by Notice 102.

751. The Investor here is by no means analogous to the bakery example posited by it where the baker is deprived of its daily production of bread.⁸⁰⁰ Whether the Investor's investment is its land, its logs or its timber, it is operating without government interference, subject to minimal regulation and reaping substantial profit from its endeavours. As in *Pope & Talbot*, *Feldman*, *S.D. Myers*, *Waste Management II* and *Fireman's Fund*, the Investor has not been substantially deprived of its investment and has no valid complaint under Article 1110.

752. In this case, the effect of Notice 102 on the Investor's investments does not approach the standard of a "substantial deprivation." Any interference by Notice 102 does not render the investment "useless." Nor is the Investor incapable of using, enjoying or disposing of the property. The Investor continues to harvest its logs, to earn profits from its investments and to make domestic and export sales. The Investor has

⁷⁹⁹ Investor's Memorial, ¶ 318.

⁸⁰⁰ Investor's Memorial, ¶ 350.

exported substantial volumes of logs and earned substantial profits from its investments throughout the period it has been subject to Notice 102.

753. To put this matter into proper context, the Tribunal should consider what the Investor has accomplished with its investment while subject to Notice 102. As demonstrated by Ms. Korecky, only [REDACTED] of the Investor's applications to advertise on the Bi-Weekly List have received domestic offers in the period 1998 to present ([REDACTED] offers on [REDACTED] applications).⁸⁰¹ However, some of these offers were deemed invalid, others were deemed too low and yet others were withdrawn. As a result, the Investor's log parcels were deemed surplus to domestic needs on [REDACTED] of its applications ([REDACTED] surplus letters issued on [REDACTED] applications).⁸⁰² Yet, the Investor requested export permits for only [REDACTED] of these surplus log parcels. It is unreasonable to suggest that a substantial deprivation has occurred due to Canadian log export restraints when the Investor has successfully exported [REDACTED]⁸⁰³ of the log parcels it sought to advertise since 1998 and could have exported even more, but chose not to do so. In any event, the Investor's Vice-President, Mr. Stutesman, concedes that only [REDACTED] of its harvest is sold domestically in Canada, leaving [REDACTED] as exported product.⁸⁰⁴

754. By the same token, the Investor has earned significant profits from its log exports every year, notwithstanding Notice 102. As demonstrated by the Reishus Affidavit, the Investor has been profitable from 2004 to 2007 with an impressive [REDACTED] return on equity. Furthermore, the Investor has earned operating margins of, on average, [REDACTED] during this period – roughly twice the [REDACTED] average profit margin of comparable companies.⁸⁰⁵ Had the Investor disclosed proper financial statements for the entire period 1998 to present this Tribunal would have the full measure of how profitable it has been while complying with Notice 102.

⁸⁰¹ *Korecky Affidavit*, ¶ 146, Exhibit 32.

⁸⁰² *Korecky Affidavit*, Exhibit 32.

⁸⁰³ *Korecky Affidavit*, Exhibit 32.

⁸⁰⁴ *Stutesman Affidavit*, ¶ 12.

⁸⁰⁵ *Reishus Affidavit*, ¶¶ 144-145.

755. At paragraph 369 of its Memorial, the Investor provides a laundry list of unsubstantiated accusations offered as proof that Notice 102 substantially deprives the Investor of the use and benefit of its investments and, therefore, that it is a measure tantamount to expropriation. These claims of interference are either false or trivial. For our purposes they can be grouped in the following categories:

- (a) Accusations that Canada, through Notice 102, has taken physical possession and control of the Investor's investment;⁸⁰⁶
- (b) Accusations that Canada, through Notice 102, mandates how the Investor manages and operates its investment;⁸⁰⁷
- (c) Accusations that Canada, through Notice 102, "condones and encourages" alleged "blockmailing,"⁸⁰⁸ and
- (d) Accusations that Canada, through Notice 102, causes the value of the Investor's logs to be reduced by requiring shorter domestic log lengths and by alleged damage sustained during the surplus testing and export permit application procedure.⁸⁰⁹

756. First, as is obvious on reading Notice 102, and as confirmed by Ms. Korecky,⁸¹⁰ Canada never takes physical possession or control of the Investor's logs. Notice 102 simply requires that all logs subject to federal jurisdiction be made ready for sale (*i.e.*, harvested, sorted, scaled, and boomed or decked) before applying for an export permit.⁸¹¹

⁸⁰⁶ See Investor's Memorial ¶ 369(a) the Investor complains Canada substitutes its own control over the Investor's investment in logs for export, deprives the Investor of the physical possession and control of its investment. At 369(b) the Investor complains that it loses control over its logs during the surplus test of Notice 102. At 369(e) the Investor implies that it provides its logs to Canada during the surplus test of Notice 102 and that if they are returned they are in worse conditions; implying an alleged physical granting of its logs to Canada and that there are instances in which Canada does not return some. At 369(f) the Investor states that Canada confiscates its logs and uses them for its own benefits.

⁸⁰⁷ See Investor's Memorial at ¶ 369(a) the Investor complains that Canada substitutes its own control over critical parts of the Investor's business operations particularly in respect of the conduct ... of its investment in logs for export, takes away its control to sell these logs at fair market value and takes over this vital operation of its business. At ¶ 369(b) the Investor claims that Notice 102 forces it to sell its logs on the domestic market and loses control over the manner in which it sells its investments.

⁸⁰⁸ See Investor's Memorial, ¶ 369(c).

⁸⁰⁹ See Investor's Memorial, ¶ 369(d) & (e).

⁸¹⁰ *Korecky Affidavit*, ¶ 187.

⁸¹¹ *Korecky Affidavit*, ¶¶ 84-86; *Notice 102* at 1.5 and 1.6. (Tab 101).

The Investor's characterization of the impact of Notice 102 as a physical taking of its investment thus finds no support, whether documentary or testimonial. Canada, does not take physical possession and control of the Investor's investment in any manner.

757. Second, Canada does not interfere in the business operations of the Investor. The functioning of Notice 102 has been described in detail above and at paragraphs 43 to 155 of Ms. Korecky's affidavit. It is abundantly clear from this evidence that Notice 102 imposes minimal requirements on the Investor. Notice 102 merely requires that logs be ready for domestic sale or export sale (*i.e.*, harvested, sorted, scaled, and boomed or decked). It is only logical that this be done prior to requesting a permit for export.

758. The constraints this might impose on any investor subject to Notice 102 do not amount to mandating how the investment is managed or operated. Contrary to the pleadings of the Investor, Canada does not substitute its control for that of the Investor over the management and operations of its investment. As demonstrated by Ms. Korecky,⁸¹² no official or agent of the Canadian government interferes in the normal business practices of the Investor. There is no interference in selecting the board members or officers of the investment. There is no interference in the decision-making by the Investor to issue dividends to its partners or manage its finances. There is no interference with corporate planning, the development of harvest plans or the utilization of company assets. There is no interference with the day-to-day logging operations of the Investor's investment. There is no interference with the management of its human resources. In short, neither Canada nor Notice 102 interferes with any indicia of ownership.⁸¹³

759. To the contrary, the Investor continues to develop and adjust "comprehensive" annual and long-term plans so that it can maximise revenues.⁸¹⁴ In his affidavit, Merrill & Ring's Vice-

⁸¹² *Korecky Affidavit*, ¶¶ 185-187.

⁸¹³ *Korecky Affidavit*, ¶¶ 185-187.

⁸¹⁴ *Stutesman Affidavit*, ¶¶ 8, 29; *Schaaf Affidavit*, ¶¶ 18, 20, 37.

President Schaaf outlines the Investor's sophisticated corporate approach to all aspects of logging, including planning harvests, marketing, operations, transport of logs and log preparation for purchasers.⁸¹⁵ The Investor is in constant contact with its clients and knows what they need and when they need it.⁸¹⁶ Its board of directors meets annually to review operations, approve budgets and assess staff recommendations. The board is also responsible for making decisions on policy and the direction of the company pertaining to divesting lands and setting harvest plans.⁸¹⁷ [REDACTED]

[REDACTED]⁸¹⁸

760. As in *Pope & Talbot*, the Investor here has remained in control of its investment throughout the relevant period. There has been no interference with its management or any other action to remove the Investor from full ownership and control of its investment.⁸¹⁹ In like circumstances, the *Pope* Tribunal concluded that :

...[w]hile this interference has, according to the Investor, resulted in reduced profits for the Investment, it continues to export substantial quantities of softwood lumber to the U.S. and to earn substantial profits on those sales.

Even accepting (for the purpose of this analysis) the allegations of the Investor concerning diminished profits, the Tribunal concludes that the degree of interference with the Investment's operations due to the Export Control Regime does not rise to an expropriation (creeping or otherwise) within the meaning of Article 1110.⁸²⁰

761. The situation is virtually identical here. While Canada does not agree that the Investor possesses a right to export or to make sales at fair market value within the meaning of the Article 1139 definition of "investment," even if it did and even if it has suffered diminished profits as a result, the degree of interference with the Investment's

⁸¹⁵ *Schaaf Affidavit*, ¶¶ 19-23.

⁸¹⁶ *Stutesman Affidavit*, ¶ 25.

⁸¹⁷ *Schaaf Affidavit*, ¶ 18.

⁸¹⁸ *Schaaf Affidavit*, ¶ 35.

⁸¹⁹ *Pope & Talbot – Interim Award*, ¶ 100 (Tab 112).

⁸²⁰ *Pope & Talbot – Interim Award*, ¶ 102 (Tab 112).

operations due to the log export restraints of Notice 102 “does not rise to an expropriation [...] within the meaning of Article 1110.”

762. Third, Canada neither “condones” nor “encourages” the alleged practice of “blockmailing” or other conduct that the investor claims it is responsible for forcing it to make disadvantageous deals with purchasers.⁸²¹ As demonstrated by Ms. Korecky, when DFAIT is notified of non-adherence with the rules or of practices contrary to legislation, regulations and policy, it has responded by investigating the allegations and, if substantiated, by declaring those offers invalid.⁸²²

763. Nor can Canada be held responsible for commercial conduct by private actors in the forestry industry. The Investor’s log broker grudgingly admits this when he states, “While Notice 102 does not expressly endorse the practice of “blockmailing” and bad faith offers, the practical effect of it is exactly the same as if it did.”⁸²³ Canada disagrees.

764. Finally, as demonstrated by John Cook, requiring metric scaling is not only logical in a jurisdiction where metric is the official measurement system, but it is also the system employed by the Investor’s domestic customers. Furthermore, nothing prevents the Investor or any other logging company from using a secondary measurement to meet the needs of specific customers, whether offshore or domestic. Canada does not control such customer requirements.⁸²⁴

765. With respect to the length of time of the application process, the Investor complains about:

- an alleged instance which took almost a year to process;⁸²⁵
- a one-month delay in the advertising period in 1999;⁸²⁶

⁸²¹ *Korecky Affidavit*, ¶ 120.

⁸²² *Korecky Affidavit*, Exhibit 50 for example.

⁸²³ *Kurucz Affidavit*, ¶ 74.

⁸²⁴ *Cook Affidavit*, ¶¶ 65-74.

⁸²⁵ *Stutesman Affidavit*, ¶ 15; FN 2.

- a 3-month delay in scheduling an FTEAC meeting in 2003.⁸²⁷

766. In reality, the entire process from Application to Advertise to issuance of a permit takes between 35-45 calendar days since the automated Export Controls On-line (“EXCOL”) system was activated on March 31, 2006.⁸²⁸ Prior to EXCOL this process on average could take two weeks longer.

767. With respect to allegation (a) above, as noted by Ms. Korecky, there are insufficient details to address this specific allegation. However, Ms. Korecky also sets out an example of how the process has been extended due to the Investor’s own delayed application for an export permit after having attained surplus status.⁸²⁹

768. With respect to allegations (b) and (c) above, as explained by Ms. Korecky in her affidavit, the complaint of a three month in 2003 is erroneous. The Investor claims FTEAC failed to meet in July, August and September 2003 causing this delay. The evidence demonstrates that FTEAC met and considered all offers in this period⁸³⁰ on July 11 and August 11, 2003. All offers were considered by FTEAC by questionnaire in September 2003.

769. The alleged one month delay in 1999 was due to a cancellation of the August 18, 1999 Bi-Weekly List. It is demonstrated by Ms. Korecky that the August 18, 1999 Bi-Weekly List was issued and advertised Merrill & Ring’s logs for which it received permits for all booms advertised.⁸³¹

770. The Investor also complains that its logs are damaged “from exposure to the elements and infestation” while awaiting the results of the surplus test and permit

⁸²⁶ *Stutesman Affidavit*, ¶ 16.

⁸²⁷ *Stutesman Affidavit*, ¶ 16.

⁸²⁸ *Korecky Affidavit*, ¶ 161.

⁸²⁹ *Korecky Affidavit*, ¶ 162.

⁸³⁰ *Korecky Affidavit*, ¶ 181.

⁸³¹ *Korecky Affidavit*, ¶ 182.

application process.⁸³² First, the Investor provides absolutely no evidence of such damage.

771. Second, as demonstrated by Mr. Cook, storage of logs from the B.C. Coast is in the water. This is common practice on the B.C. Coast and permits logs to maintain their commercial value much longer than if they were stored on dry land.⁸³³ While there is a risk that booms might break up while stored in the water, this risk exists for the entire Coastal forestry sector.

772. Thus, Canada submits the Investor's claims are unfounded. Canada does not interfere in any way with Merrill & Ring's ownership of its investments; any costs the Investor may incur by complying with Notice 102 are minimal. They do not rise to the level of substantial deprivation. In fact, as explained above, the Investor's investments have been profitable from 2004 to present and likely throughout the application of Notice 102 while it has been able to export substantial volumes of logs.

773. The Investor's own damage valuations confirm the substantial value of the Investor's investment while operating under Notice 102. Canada retained valuation experts KPMG to analyze the alleged damages calculations of the Investor. As demonstrated by KPMG, the Investor has revenues totalling almost [REDACTED] from 2004 to 2007.⁸³⁴ It has earned gross profits of [REDACTED] from its sales of logs from 2004 to 2007 or an average of [REDACTED] per year.⁸³⁵ Its net income over this period was over [REDACTED] or on average some [REDACTED] per year. Therefore, the Investor earned a healthy net income averaging [REDACTED] of reported revenues.⁸³⁶

774. Furthermore, the Investor's Vice-President, Mr. Schaaf, agrees that "[REDACTED]
[REDACTED]

⁸³² *Stutesman Affidavit*, ¶ 11.

⁸³³ *Cook Affidavit*, ¶ 92.

⁸³⁴ *Bowie Report*, Section 8.0.

⁸³⁵ *Bowie Report*, Section 8.0.

⁸³⁶ *Bowie Report*, Section 8.0.

[REDACTED]⁸³⁷ The record demonstrates that the Investor has been able to earn revenues far in excess of its incremental costs and has been able to export substantial volumes of its logs to its financial benefit.⁸³⁸

775. The Investor has not suffered any deprivation, much less a substantial deprivation of its investments due to the workings of Notice 102. As a result, Canada submits that the Investor’s claim under Article 1110 is baseless and respectfully requests the Tribunal to reject it.

Step 3: There Is No Expropriation and Hence No Basis to Consider Article 1110(a) to (d)

776. The third step, considering whether the expropriation is lawful or unlawful, will be reached only if an expropriation has been found. As such, the conditions laid out in paragraphs (a) to (d) of Article 1110 are not relevant to a finding of whether the investment was expropriated. In particular, no obligation to compensate exists unless there has been a finding that the investment has been expropriated by the government measure at issue.

777. This conclusion was adopted by the tribunal in *Fireman’s Fund* which held that it is incorrect to begin an expropriation analysis by turning to the four conditions of paragraphs (a) to (d) of Article 1110. It stated,

That would indeed be putting the cart before the horse (“*poner la carreta delante de los caballos*”). Paragraphs (a) through (d) do not bear on the question as whether an expropriation has occurred. Rather, the conditions contained in paragraphs (a) through (d) specify the parameters as to when a State would not be liable under Article 1110.⁸³⁹

⁸³⁷ *Schaaf Affidavit*, ¶ 30.

⁸³⁸ *Bowie Report*, Section 8.0; *Korecky Affidavit*, Exhibit 38.

⁸³⁹ *Fireman’s Fund – Award*, ¶ 174 (Tab 51).

778. The Tribunal's award in *Feldman* also supports this position, although in a more nuanced manner,

[...] the essential determination is whether the actions of the Mexican government constitute an expropriation or nationalization, or are valid governmental activity. If there is no expropriatory action, factors a-d are of limited relevance, except to the extent that they have helped to differentiate between governmental acts that are expropriation and those that are not, or are parallel to violations of NAFTA Articles 1102 and 1105. If there is a finding of expropriation, compensation is required, *even* if the taking is for a public purpose, non-discriminatory and in accordance with due process of law and Article 1105(1).⁸⁴⁰

In other words, the fact that a measure is discriminatory or arbitrary does not make it an expropriation. A substantial taking has to occur first.

779. Here the Investor conflates the determination of whether an expropriation has occurred with the conditions of legality found in paragraphs 1110(a) to (d).⁸⁴¹ For the reasons just provided, this is not appropriate. For example, the fact that an expropriation is for a public purpose (or not) does not make it an expropriation.

780. The Investor's arguments relating to discrimination and lack of due process and compensation – which make up most of its submission on expropriation applied to the facts – do not contribute to the Tribunal's task of determining whether an expropriation has occurred. Further, it should be noted that the Investor's arguments emphasize "arbitrariness" which is not mentioned at all in Article 1110.

781. In this case there is no basis to reach the question of lawful expropriation and the criteria in Article 1110(1)(a) to (d). There has been no expropriation at all.

⁸⁴⁰ *Feldman – Award*, ¶ 98 (Tab 49).

⁸⁴¹ Investor's Memorial, ¶¶ 368-390.

3. Conclusion on Article 1110

782. Notice 102 has not expropriated Merrill & Ring's investment, its timber, logs and land. The Investor has not been substantially deprived of its investment, and to the contrary has maintained control of it at all relevant times while earning substantial profit and exporting substantial volumes of logs under the auspices of Notice 102. For the foregoing reasons Canada requests that this Tribunal dismiss the Investor's claim under Article 1110 of the NAFTA.

VI. RELIEF REQUESTED

A. Damages

1. Summary of Canada's Position

783. At this stage of proceedings, it is difficult, to make complete submissions on damages. Without a ruling on the merits, it is impossible to definitively address all issues, in particular, because damages must flow from the breach found.

784. Even if one were to assume that the measure at issue violated Section A of NAFTA Chapter Eleven, which Canada denies, the Investor has failed to meet its burden of proving it has suffered loss as a result of that measure.

785. First, the Investor's damages estimates are unsupported and undocumented. It has not produced what would normally be expected to support calculations of this nature. As a result, Canada reserves the right to amend these submissions once the evidentiary basis for these estimates has been produced.

786. Second, despite the lack of support and documentation in the Investor's alleged damages estimates, it is clear that they are riddled with methodological errors and faulty assumptions. By applying more reasonable assumptions and correct methodology, Canada and its experts demonstrate below that if the Investor has suffered any loss due to the application of Notice 102, it is nominal at best.

787. Third, the Investor failed to establish that any alleged losses were caused by Notice 102. Canada submits the Investor's entire damages claim must fail as it has not demonstrated that it has suffered loss due to the measure at issue.

2. The Law on Damages

788. NAFTA Article 1135 authorises a tribunal to award damages for breach of Chapter Eleven. It reads,

Article 1135: Final Award

1. Where a Tribunal makes a final award against a Party, the Tribunal may award, separately or in combination, only:

(a) monetary damages and any applicable interest;

(b) restitution of property, in which case the award shall provide that the disputing Party may pay monetary damages and any applicable interest in lieu of restitution.

A tribunal may also award costs in accordance with the applicable arbitration rules.

2. Subject to paragraph 1, where a claim is made under Article 1117(1):

(a) an award of restitution of property shall provide that restitution be made to the enterprise;

(b) an award of monetary damages and any applicable interest shall provide that the sum be paid to the enterprise; and

(c) the award shall provide that it is made without prejudice to any right that any person may have in the relief under applicable domestic law.

3. A Tribunal may not order a Party to pay punitive damages.

789. The only other provision in NAFTA addressing damages is Article 1110(2) – (6) setting out compensation for expropriation (see below).

a) General Principles

790. NAFTA Chapter Eleven tribunals refer to a well-developed corpus of international law governing the assessment of damages for breach of international obligations and, in particular, for breach of investment obligations. These sources establish basic principles, including the following.

791. First, the goal of an award of damages is reparation; the award seeks to put the investor in the position it would have been had the breach not occurred.⁸⁴²

⁸⁴² Crawford – *ILC*, Article 31 “Reparation”, at 201 (Tab 33).

792. A corollary to this principle is that an award cannot exceed what is needed to restore the investor to the *status quo ante*. If an investor recovers on account of more than one obligation or respecting more than one head of damages, the total awarded cannot exceed the investor's actual loss. As noted in *S.D. Myers*, "damages for breach of one NAFTA provision can take into account any damages already awarded under a breach of another NAFTA provision."⁸⁴³

793. Second, the damages awarded must have been caused by the breach found by the Tribunal. The *S.D. Myers* Tribunal summarised this principle as follows,

...[c]ompensation is payable only in respect of harm that is proved to have a sufficient causal link with the specific NAFTA provision that has been breached; the economic losses claimed...must be proved to be those that have arisen from a breach of the NAFTA, and not from other causes...the Tribunal will assess the compensation payable to [the Investor] on the basis of the economic harm that [the Investor] legally can establish.⁸⁴⁴

794. The causation requirement is buttressed by Articles 1116 (and 1117) of NAFTA, which condition the submission of a claim to arbitration on the investor having incurred "loss or damage by reason of, or arising out of, that breach."⁸⁴⁵ The *Feldman* Tribunal invoked Article 1116 to award actual loss incurred by reason of a non-expropriation breach, commenting that, "...if loss or damage is the requirement for the submission of a

⁸⁴³ *S.D. Myers – First Partial Award*, ¶ 316 (Tab 120). See also, Redfern, Alan & Martin Hunter, *LAW AND PRACTICE OF INTERNATIONAL COMMERCIAL ARBITRATION* (4th ed) (2004), at 500-501 ("...in the case of successful claims for expropriation and other treaty breaches, compensation will not be cumulative." at 501.) (Tab 116).

⁸⁴⁴ *S.D. Myers – First Partial Award*, ¶¶ 316-322. See also, *S.D. Myers – Second Partial Award*, ¶¶ 140-145; *Feldman – Award*, ¶ 194 (loss must be "adequately connected" to breach); *Pope & Talbot – Damages Award*, ¶ 80. See also, *Crawford – ILC*, ("...the subject matter of reparation is, globally, the injury resulting from and ascribable to the wrongful act, rather than any and all consequences flowing from an internationally wrongful act.") at 204 (Tab 33).

⁸⁴⁵ Article 1117 of NAFTA is to like effect with respect to claims by an investor on behalf of an enterprise.

claim, it arguably follows that the Tribunal may direct compensation in the amount of loss or damage actually incurred.”⁸⁴⁶

795. The causation requirement also requires that damages not be too remote or speculative;⁸⁴⁷ they must be the proximate, direct and immediate consequence of the breach found.⁸⁴⁸

796. Third, compensation can be awarded for loss of profit insofar as this loss is established. However, assessment of future loss is a speculative endeavour and an award for future loss is not always appropriate. If loss of profit is awarded, interest should not be awarded for the same period of time because capital cannot simultaneously earn interest and generate profit.⁸⁴⁹

797. Fourth, the investor must mitigate its loss. Where the investor fails to mitigate its loss, the claim will be reduced accordingly.⁸⁵⁰

798. Fifth, the investor bears the burden of proving causation, quantum of damages and that the damage is recoverable at law.⁸⁵¹ As expressed by the *UPS* Tribunal, at the remedy stage, “a claimant must not only show that it has persuasive evidence of damage from the actions alleged to constitute breaches of NAFTA obligations but also that the

⁸⁴⁶ *Feldman – Award*, ¶¶ 194, 198 (Tab 49). See also, *Crawford – ILC*, at 219 (...the function of compensation is to address the actual losses incurred as a result of the internationally wrongful act.”) (Tab 33).

⁸⁴⁷ See also, *Crawford – ILC*, at 204-205 (Tab 33).

⁸⁴⁸ *Crawford – ILC*, at 205 (“...a failure to mitigate by the injured party may preclude recovery to that extent.”) (Tab 33). Whiteman, Marjorie M., *DAMAGES IN INTERNATIONAL LAW*, Vol. III (United States Government Printing Office, 1943) (“*Whiteman*”) at 1830 (Tab 161).

⁸⁴⁹ See discussion in *Crawford – ILC*, at 218, 228-230 (“... loss of profits have not been as commonly awarded in practice as compensation for accrued losses. Tribunals have been reluctant to provide compensation for claims with inherently speculative elements”, at 228) (Tab 33).

⁸⁵⁰ *Whiteman*, at 199 (Tab 161).

⁸⁵¹ See also, Cheng, Bin, *GENERAL PRINCIPLES OF LAW AS APPLIED BY INTERNATIONAL COURTS AND TRIBUNALS* (Grotius Publications, 1987), at 328-329 (Tab 22).

damage occurred as a consequence of the breaching Party's conduct within the specific time period subject to the Tribunal's jurisdiction.⁸⁵²

b) Damages for Expropriation

799. Article 1110 of NAFTA addresses assessment of damages for expropriation and would apply if a breach of Article 1110 is found in this case. NAFTA Article 1110(2) to (6) provides:

(2) Compensation shall be equivalent to the fair market value of the expropriated investment immediately before the expropriation took place ("date of expropriation"), and shall not reflect any change in value occurring because the intended expropriation had become known earlier. Valuation criteria shall include going concern value, asset value including declared tax value of tangible property, and other criteria, as appropriate, to determine fair market value.

(3) Compensation shall be paid without delay and be fully realizable.

(4) If payment is made in a G7 currency, compensation shall include interest at a commercially reasonable rate for that currency from the date of expropriation until the date of actual payment.

(5) If a Party elects to pay in a currency other than a G7 currency, the amount paid on the date of payment, if converted into a G7 currency at the market rate of exchange prevailing on that date, shall be no less than if the amount of compensation owed on the date of expropriation had been converted into that G7 currency at the market rate of exchange prevailing on that date, and interest had accrued at a commercially reasonable rate for that G7 currency from the date of expropriation until the date of payment.

(6) On payment, compensation shall be freely transferable as provided in Article 1109.

800. Article 1110(2) directs that damages for expropriation be calculated as the fair market value immediately before the expropriation occurred. Fair market value can be assessed in various ways, including those listed in Article 1110(2) ("going concern value,

⁸⁵² *UPS – Award*, ¶ 38 (Tab 144).

asset value including declared tax value of tangible property, and other criteria”). Tribunals sometimes use a discounted cash flow (DCF) analysis to assess fair market value, especially where the enterprise has a proven track record. On the other hand, a DCF analysis often will not reflect a fair assessment of actual loss, and whether it is apt depends on the facts of the case. For example, in *Metalclad* the enterprise had no proven track record of operations and so the Tribunal looked to the investor’s actual investment as an appropriate measure of damages.⁸⁵³

c) Damages for Non-Expropriation Breach

801. NAFTA tribunals generally have not applied Article 1110(2) to (6) to assess damages for breach of obligations other than expropriation. Rather, assessment of damages for non-expropriation breaches is a matter for the discretion of the tribunal.⁸⁵⁴ The Tribunal in *S.D. Myers* concluded that, “...the drafters of the NAFTA intended to leave it open to tribunals to determine the measure of compensation appropriate to the specific circumstances of the case, taking into account the principles of both international law and the provisions of NAFTA.”⁸⁵⁵

802. In particular, tribunals assessing damages for non-expropriation breaches have rejected “fair market value” as the measure of compensation. Rather, they have made a fact-specific assessment of the actual loss caused by the breach in question. As noted in *Feldman*, absent a finding of expropriation, a tribunal ought not award fair market value or going concern value of the investment as damages.⁸⁵⁶

⁸⁵³ *Metalclad – Award*, ¶ 113 (Tab 82). See also, *Crawford – ILC*, at 218, 225-230 for discussion of different methods of valuing fair market value and when a particular method should be used (Tab 33); *Redfern & Hunter*, at 499-500 (Tab 116).

⁸⁵⁴ *S.D. Myers – Second Partial Award*, ¶ 144 (Tab 121) (“...the NAFTA deals explicitly with the measure of damages for an expropriation and those provisions are not controlling in this case” [breach of Article 1102];) see also, *S.D. Myers – First Partial Award*, ¶¶ 305-309 (Tab 120). In the non-NAFTA context see also: *CMS – Final Award*, ¶¶ 409-410 (Tab 28).

⁸⁵⁵ *S.D. Myers – First Partial Award*, ¶ 309 (Tab 120).

⁸⁵⁶ *Feldman – Award*, ¶¶ 194, 198 (Tab 49). But see, *CME – Partial Award*, ¶ 616 (Tab 27).

803. At this point, the disputing parties do not differ significantly on the law applicable to damages. Rather, the debate between Canada and the Investor centres on the assumptions grounding Merrill & Ring’s damage claim, the calculation of the quantum by the Investor’s expert forestry economist and accountant, Mason, Bruce & Girard, Inc. (MBG) and PricewaterhouseCoopers (PwC) respectively, and the absence of causation.

3. The Investor’s Damages Claim

804. The Investor claims CDN \$23,976,806 in damages for losses allegedly sustained as a result of Notice 102. The Investor bases this claim on the PwC Report. According to the Investor, the PwC Report “calculates the loss of contribution and the increased operating costs incurred by Merrill & Ring during the Past Loss Period as a result of the Log Export Control Regime.”⁸⁵⁷

805. The Investor also claims future losses based on a DCF methodology. This methodology projects the future cash flows of the Investor that allegedly would have been realized from ongoing operations “but for” the measure at issue. The PwC Report attempts to project this amount from December 31, 2007 until December 31, 2016. It then applies a discount rate to determine the present day value of the future cash flow from December 31, 2007 onward.⁸⁵⁸

806. The PwC Report describes three categories of alleged damages: Class 1, Class 2 and Class 3. Class 1 damages purport to calculate past and future loss arising from alleged violation of NAFTA Articles 1102, 1105, and 1106(1)(c). Almost all logs, past and future, are assumed to obtain a higher price “but for” the federal log export control regime. In addition, certain costs are assumed not to occur in the “but for” world and some differences in the harvest are assumed in the “but for” world.⁸⁵⁹

⁸⁵⁷ Investor’s Memorial, ¶ 413.

⁸⁵⁸ Investor’s Memorial, ¶ 414.

⁸⁵⁹ *Sandy Affidavit*, Section 10.0; *Reishus Affidavit*, ¶¶ 160-162; *Bowie Report*, ¶ 17.

807. Class 2 damages purport to calculate past and future loss arising from alleged violations of Articles 1106(1)(a) and (e). Logs harvested north of Powell River, which allegedly have been (and will be) exported or “blocked” from export, are assumed to incur additional costs. Class 2 damages are purportedly the result of minimum volume requirements for the advertisement of logs located in “remote” areas north of the Powell River.⁸⁶⁰

808. Class 3 damages purport to calculate past and future loss arising from the alleged violation of Article 1110. The Investor assumes that logs not exported because they were “blocked” or “ransomed” would have obtained a higher price (net of estimated export costs) “but for” the log export control regime.⁸⁶¹

809. Each class claims to estimate the net present value of the purported lost profits of the Investor. These lost profits are estimated by calculating the difference between the *status quo* and the Investor’s “but for” world.

810. PwC adopted the work of MBG as the foundation for its calculation of Class 1 and Class 3 damages.⁸⁶² Central to the MBG Report is calculation of the so-called “export premium.” This figure is intended to represent “the prices Merrill & Ring could obtain for its logs in export markets if it was not forced to sell its timber [subject to Notice 102].”⁸⁶³

4. Reparation: The Investor’s Claim Is Unsubstantiated, Based on Illogical and Biased Assumptions and Seeks Excessive Damages

811. Canada demonstrates below the significant flaws in the MBG Report, and by extension, the PwC conclusions. The most egregious errors are due to the fact that:

⁸⁶⁰ *Sandy Affidavit*, Section 10.0; *Reishus Affidavit*, ¶¶ 160-162; *Bowie Report*, ¶ 17.

⁸⁶¹ *Sandy Affidavit*, Section 10.0; *Reishus Affidavit*, ¶ 161; *Bowie Report*, ¶¶ 52-54.

⁸⁶² *Sandy Affidavit*, ¶¶ 11.7, 13.4.

⁸⁶³ *Investor’s Memorial*, ¶ 423.

- The Investor’s damage claim is unsupported and undocumented; and
- The Investor’s assumptions are illogical and biased.

a) The Investor’s Damages Estimates Are Unsupported and Undocumented

812. The Investor has not provided much of the necessary data underlying its assessment. Canada will request this data in the upcoming document disclosure stage. Canada and each of its experts have been hampered because the Investor did not provide the basic supporting documentation necessary to assess its claim. This effectively postpones a full response to the Investor’s damage claim by Canada and a properly informed consideration of the claim by the Tribunal until the second stage of pleadings. This also unnecessarily increases the costs in this arbitration.

813. The argument and conclusions below may be subject to adjustment and updating, and exact quantification of certain claims may be revised, once full disclosure is made.⁸⁶⁴ Nonetheless, there are significant errors in the damages assessment submitted by the Investor that can be addressed now and are discussed below.

814. Even based on the partial data provided by the Investor, the inevitable conclusion is that it grossly overstates the alleged economic impact of Notice 102 on its investment. In fact, if the Investor has suffered any losses, they are nominal.⁸⁶⁵ Further data may establish that no loss is attributable to the log export control regime.

815. Of central importance is the data underlying the MBG Report. The MBG Report calculates an export price premium that is crucial to the estimates of Class 1 and Class 3 damages. The MBG “export premium” is based on: detailed raft data, information on market prices for log sorts in the U.S. and B.C., conversion factors between metric and Scribner scaling, and foreign exchange conversions.

⁸⁶⁴ *Reishus Affidavit*, ¶¶ 17-18; *Bowie Report*, ¶ 22; *Jendro Affidavit*, ¶ 1.2.4.

⁸⁶⁵ Comparative international experience confirms that a log export regime may not have a significant impact on price, *Reishus Affidavit*, ¶ 78.

816. In Mr. Reishus' opinion,

[REDACTED]

⁸⁶⁶

817. Mr. Reishus documents examples of supporting information and calculation methods that are not provided in the MGB Report:

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

⁸⁶⁶ *Reishus Affidavit*, ¶ 163.

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

867

818. Similarly, Canada’s forestry economist, Mr. Jendro also noted that the lack of essential information prevented him from making a complete review and analysis.⁸⁶⁸

819. The paucity of support and documentation for the PwC Report also constrained Canada’s forensic accountant, Mr. Bowie, from conducting a full analysis of the damages. In particular, the following is missing:

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

- [REDACTED]

869

820. The failure to provide proper supporting documentation and explanation nullifies the credibility of the Investor’s claim. Without credible evidence, the Investor cannot

⁸⁶⁷ *Reishus Affidavit*, ¶ 164.

⁸⁶⁸ *Jendro Affidavit*, ¶ 1.2.4.

⁸⁶⁹ *Bowie Report*, ¶ 23.

meet its burden of establishing that the measure at issue caused the loss claimed. Its claim, consequently, must be dismissed.

b) The Investor’s “Relevant Market” Is Inflated and Its Theory of Reparation Is Based on a Utopian “But For” World

821. The core of the Investor’s damage claim is an alleged “export premium.” In essence, this is the difference between the price the Investor alleges it would have received “but for” Notice 102, and the price it did receive. However, its analysis is based on a Utopian “but for” world and built on numerous unfounded assumptions.

822. In the Investor’s “but for” world, Merrill & Ring operates outside Canada’s log export control regime, while every other owner of federal private land continues to operate in compliance with Notice 102.⁸⁷⁰ This is an unrealistic assumption. A much more logical “but for” assumption would be that private federal timberland owners in B.C. continue to be treated the same, and that none of them are subject to the log export control regime. The Investor never attempts to quantify what its damages might be if this more realistic “but for” situation prevailed and all of its competitors were as free as Merrill & Ring to export without compliance with Notice 102. Such an assumption would obviously lead to a much lower estimate for damages as the Investor’s exports would be faced with competition from other unfettered exporters, some of which are larger than Merrill & Ring.⁸⁷¹

823. Nor does the Investor suggest possible alternatives if Notice 102 were no longer applicable to federal timberland in British Columbia. For example, although its national treatment claim suggests that it would be better off if it were subject to the B.C.

⁸⁷⁰ See for example, Investor’s Memorial, ¶ 420.

⁸⁷¹ *Jendro Affidavit*, ¶¶ 3.1.1-3.1.3.

provincial log export control regime,⁸⁷² the Investor never assesses the economic impact of being provincially regulated.

824. In fact, the Investor is in a far more advantageous position as a federally regulated timberland owner. Were it provincially regulated, logs that it exported would be subject to a fee-in-lieu of manufacture for Coastal logs. Until 2004 that fee was 100% of the difference between the domestic and the export price. In August 2004 the fee-in-lieu was set at 15% of the domestic log price for douglas fir, 10% for J grade and higher of other species and 5% for everything else.⁸⁷³ For logs from the Interior it was set at \$1/m³. Provincial loggers are also precluded from exporting western red cedar, yellow cypress and high grade logs of other species (all of which are in the Merrill & Ring inventory).⁸⁷⁴ Mr. Reishus assesses the additional cost to Merrill & Ring of being subject to the provincial regime from September 2004 to December 2007 at approximately CDN \$1 million.⁸⁷⁵ Presumably this would impact on future loss of a similar magnitude.

825. The Investor's "but for" world also assumes that 100% of its logs would be exported. This assumption is unsound. Market place evidence demonstrates that even in the absence of export restrictions, many logs will not be exported. In reality, not all logs are exported even where there is an "export premium", and hence an economic incentive, to export. As Mr. Reishus concludes, "[d]espite apparent export premiums, significant portions of log harvests remain in domestic rather than export markets."⁸⁷⁶

826. The Investor's "but for" scenario further assumes that it would receive the highest possible price for its exports. This is an unfounded assumption.⁸⁷⁷ It is economically unsound to assume that every log sale of the Investor would attract the highest price in

⁸⁷² Investor's Memorial, ¶ 361 (d), (e) & (f) suggest the Investor would be more favourably treated if eligible for standing exemptions, received BCTS support or was in the same position as provincial timberland owners.

⁸⁷³ *Reishus Affidavit*, ¶¶ 117, 124-127.

⁸⁷⁴ *Reishus Affidavit*, ¶¶ 115, 117.

⁸⁷⁵ *Reishus Affidavit*, ¶ 127.

⁸⁷⁶ *Reishus Affidavit*, ¶¶ 96-105, Figures 13-16.

⁸⁷⁷ *Reishus Affidavit*, ¶¶ 171-180.

the market, [REDACTED]

[REDACTED].⁸⁷⁸ Further, there is no evidence that Merrill & Ring rafts sold for export are consistently the highest quality rafts (which are the ones that would presumably attract the highest prices).⁸⁷⁹ In fact, the average market price would be the most reliable indicator of the prices that Merrill & Ring would have received in the export market.

827. At the same time, the Investor assumes that it would only receive the average price in the domestic market. This is similarly an unfounded assumption.⁸⁸⁰ The Investor inappropriately compares average domestic log prices to an “export premium” that is based on average or higher export prices. The typical export log tends to get an above average domestic price if sold in the domestic market because such logs are generally of higher quality. As a corollary, it is unreasonable to assume that the average domestic log would obtain the average export price if it had been exported.⁸⁸¹ Any exporter will have logs that are undesirable to export markets yet desirable in the domestic market.

828. The Investor also assumes a deeply flawed “relevant market” for its logs.⁸⁸² The Investor defines “relevant market” extremely broadly to ensure that Merrill & Ring becomes a mere price taker in that market. It compares the volumes of Merrill & Ring’s exports to the volume of the entire western U.S. log harvest plus B.C. log exports. The Investor is then able to conclude that no adjustments need to be made to the market prices used in its “export premium” calculation to account for changes to the *status quo* in its “but for” world because its contribution to this “relevant market” is so small. Thus, its broad “relevant market” definition further skews the results of its “export premium” calculation in its favour.⁸⁸³

⁸⁷⁸ *Reishus Affidavit*, ¶ 181; see also *Korecky Affidavit*, ¶ 149.

⁸⁷⁹ *Reishus Affidavit*, ¶¶ 88-95.

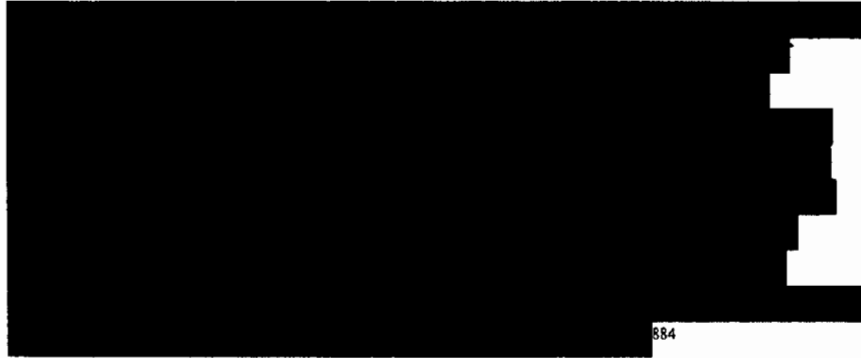
⁸⁸⁰ *Reishus Affidavit*, ¶¶ 185-186.

⁸⁸¹ *Reishus Affidavit*, ¶¶ 185-186.

⁸⁸² *Reishus Affidavit*, ¶¶ 153, 166-167.

⁸⁸³ *Reishus Affidavit*, ¶¶ 166-170.

829. As explained by Mr. Reishus, the Investor contorts the economic meaning of “relevant market,”



830. Mr. Jendro concurs, noting that the Investor’s definition inflates the size of the “relevant market” and dilutes the impact of its own prices in the marketplace.⁸⁸⁵

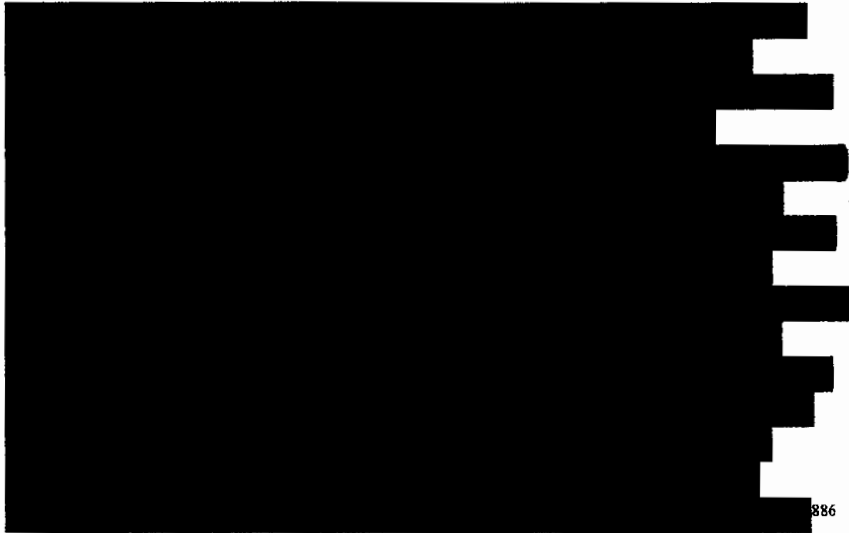
831. The combination of the Investor’s overly broad “relevant market” and its Utopian “but for” world creates the basis for an unjustifiable “export premium” calculation that: (a) makes no adjustment to market prices on the theory that Investor’s log volumes are insignificant in the “relevant market;” (b) ensures Merrill & Ring is the only player in the market free from compliance with Notice 102; (c) assumes 100% of the Investor’s logs would have been (and will be) exported, and (d) assumes the Investor always receives the highest prices available.

832. As demonstrated above, these conclusions are faulty and unrealistic. In actuality, the market for the Investor’s logs is much smaller than suggested and the more likely “but for” world includes all private landowners under federal jurisdiction. In turn a larger overall volume of logs would be liable to export and adjustments need to be made to market prices before any attempt is made to determine whether an export premium exists.

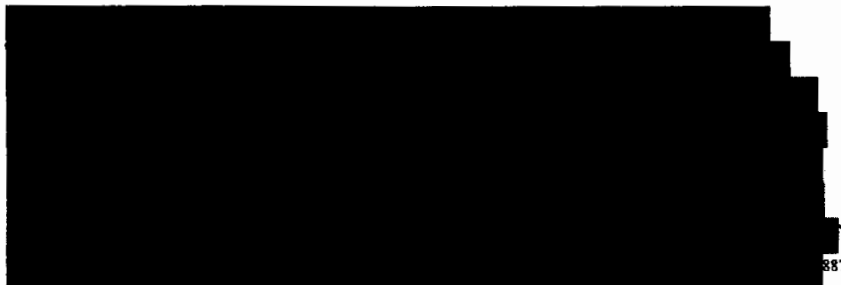
833. As Mr. Reishus puts it,

⁸⁸⁴ *Reishus Affidavit*, ¶ 166 [Emphasis added].

⁸⁸⁵ *Jendro Affidavit*, Section 4.



834. Mr. Reishus continues by providing a compelling view of the “but for” world entirely avoided by the Investor. Under this more plausible scenario, Notice 102 is abolished and all loggers are treated as private loggers on lands under provincial jurisdiction (which Canada maintains are not in like circumstances to the Investor).



c) The Investor’s Export Market Price Is Hopelessly Flawed and Biased

835. As noted above, the cornerstone of the Investor’s damage assessment is its “export premium” calculation. However, its “export premiums” are not calculated on actual loss.⁸⁸⁸

⁸⁸⁶ *Reishus Affidavit*, ¶ 169.

⁸⁸⁷ *Reishus Affidavit*, ¶ 170.

⁸⁸⁸ *Jendro Affidavit*, Section 5.

836. Instead, the Investor attempts to calculate the “export premium” through a complex, 8-step calculation based on the positive difference between export price (represented by U.S. high published prices) and domestic price (based on either Merrill & Ring’s actual price or an estimate of average B.C. domestic price).⁸⁸⁹ This calculation is rife with inappropriate assumptions and incorrect data, all of which bias the calculation in favour of Merrill & Ring.

837. Some of the more egregious errors made by the Investor in calculating the export price ultimately used to derive an “export premium” include:

[REDACTED]

⁸⁹⁰

[REDACTED]

⁸⁹¹

[REDACTED]

⁸⁹²

[REDACTED]

⁸⁸⁹ *Jendro Affidavit*, Section 5 and Figure 5-1 (outline of 8-step calculation).

⁸⁹⁰ *Jendro Affidavit*, ¶¶ 5.3.1 – 5.3.12; see also *Reishus Affidavit*, ¶¶ 18, 33, 84-89 (log grades do not sufficiently summarize the economic value of the log; logs can differ significantly in their economic value within a grade, especially within a high quality grade, hence log sorts are usually inspected).

⁸⁹¹ *Jendro Affidavit*, ¶¶ 5.4-5.4.9.

⁸⁹² *Jendro Affidavit*, ¶¶ 5.4.3.

[REDACTED]

893

[REDACTED]

894

[REDACTED]

895

[REDACTED]

896

838. The Investor makes equally egregious errors when it calculates the domestic price comparator to be used to derive an “export premium.” These errors include use of the VLM average price. The Investor does not explain the apparent inconsistency between

⁸⁹³ *Jendro Affidavit*, ¶¶ 5.5.1-5.6.3; *Reishus Affidavit*, ¶¶ 171-181.

⁸⁹⁴ *Jendro Affidavit*, ¶¶ 5.8.1-5.9.2; *Reishus Affidavit*, ¶¶ 182-186; *Bowie Report*, ¶¶ 38-40.

⁸⁹⁵ *Jendro Affidavit*, ¶¶ 5.10.1- 5.10.11; see also *Reishus Affidavit*, ¶ 25 (on the difficulty of conversion between board feet and cubic meters).

⁸⁹⁶ *Jendro Affidavit*, ¶¶ 5.12.1-5.12.20.

valuing its own logs at the average price when sold into the domestic market yet valuing the same logs at the high U.S. published export price when sold into the export market.⁸⁹⁷

839. The Investor also appears to have erred in using export sort specifications rather than domestic sort specifications for its VLM benchmark.⁸⁹⁸

840. The Investor's experts do not explain how they calculated the number of past sales that should have obtained an "export premium" and their raft volumes used for this purpose are contradictory. The Investor's accountant, PwC used [REDACTED] as the domestic volume that should have been exported at a premium. Canada's experts tried to replicate this analysis and found that the Investor's own analysis by MBG would only yield the substantially lower volume of [REDACTED] that might attract an export premium. Similarly, the Investor has not explained how it assessed differences in grade for the Investor's sorts in making this calculation.⁸⁹⁹

841. Oddly, the Investor applies its "export premium" to all future sales, in essence assuming there would be no domestic sales after 2007. Further, the damage estimates for future sales continue to use U.S. high benchmark prices which, for the reasons explained above, introduce further inaccuracy in the calculations.⁹⁰⁰

842. PwC makes additional ill-founded assumptions on behalf of the Investor that inflate the damage claim. Among them:

[REDACTED]

⁸⁹⁷ *Jendro Affidavit*, ¶¶ 6.1.1-6.5.2.

⁸⁹⁸ *Jendro Affidavit*, ¶¶ 6.4.1-6.4.3.

⁸⁹⁹ *Jendro Affidavit*, ¶¶ 7.2-7.4.

⁹⁰⁰ *Jendro Affidavit*, ¶¶ 7.3.1-7.3.2.

⁹⁰¹ *Jendro Affidavit*, ¶¶ 8.2.1-8.2.3.

[REDACTED]

902

[REDACTED]

903

[REDACTED]

904

[REDACTED]

905

843. The basic assumptions grounding the Investor’s alleged “export premium” calculation are faulty and undermine its entire thesis on damages. Put into the context of its Utopian “but for” world, it calls into question the Investor’s mistaken belief that Notice 102 has caused it any economic loss.

⁹⁰² *Jendro Affidavit*, ¶¶ 8.4-8.4.3.

⁹⁰³ *Jendro Affidavit*, ¶¶ 8.5-8.5.1

⁹⁰⁴ *Jendro Affidavit*, ¶¶ 8.6-8.7.5, Appendix L, Table 8-2.

⁹⁰⁵ *Jendro Affidavit*, ¶¶ 9.1-9.1.7.

d) The Investor's Alleged Loss, If Any, Is Nominal

844. Due to the absence of underlying data, Canada's experts made best efforts to reconstruct the methods employed by MBG and PWC to verify and test their conclusions.

845. Despite the various aspects of the MBG and PwC Reports that are fundamentally flawed or biased (see above), Mr. Bowie was able to conclude that the Investor's:

- Class 1 alleged damages estimates of \$23,976,805 ([REDACTED] for past and [REDACTED] for future) "[REDACTED];"
- Class 2 alleged damages estimates of \$1,721,754 ([REDACTED] for past and \$926,152 for future) "[REDACTED];" and
- Class 3 alleged damages estimates of \$3,298,325 ([REDACTED] for past and [REDACTED] for future) are actually "nominal."⁹⁰⁶

846. In particular, with respect to the Investor's claim for lost "export premiums" in the past lost period calculated into the Investor's Class 1 alleged damages estimates, Mr. Bowie concluded,

PwC's Lost Export Premium for the Past Loss Period, calculated at approximately [REDACTED], appears to be significantly overstated, having regard to:

[REDACTED]

- [REDACTED]

⁹⁰⁷

⁹⁰⁶ Bowie Report, ¶¶ 89-104.

⁹⁰⁷ Bowie Report, ¶ 43.

847. If the smaller volume calculated by Mr. Jendro were used, this alone, absent any other changes would reduce the calculated lost export premium by [REDACTED].⁹⁰⁸ Factoring in the offsetting transaction results in a further reduction of [REDACTED].⁹⁰⁹

848. With respect to the Investor's claim for lost "export premiums" for the future loss period calculated into the Investor's Class 1 alleged damages estimates, Mr. Bowie concluded,

PwC's Lost Export Premium for the Future Loss Period, calculated at approximately [REDACTED], appears to be significantly overstated, having regard to:

[REDACTED]

- [REDACTED]

849. With respect to alleged lost opportunity to sell Alder logs in 2007 calculated into the Investor's Class 1 alleged damages estimates, Mr. Bowie found that PwC erred in applying lost net revenues instead of using lost "export premiums". After correcting this error and correcting the flawed lost export premium calculations, Mr. Bowie was able to calculate a loss of [REDACTED]; far from the [REDACTED] claimed by the Investor.⁹¹¹

850. With respect to the Investor's calculations of export costs, which must be deducted from its Class 1 and 3 alleged damages estimates, Mr. Bowie found significant inconsistencies in how PwC's export cost factor was applied and to the volume of logs it

⁹⁰⁸ Bowie Report, ¶ 40.

⁹⁰⁹ Bowie Report, ¶ 42.

⁹¹⁰ Bowie Report, ¶ 51.

⁹¹¹ Bowie Report, ¶¶ 55-57.

was applied.⁹¹² These problems are also apparent in the Investor's calculations of export costs in its Future Loss Period as well as its entire Class 3 alleged damages estimates. The result is that the export costs associated with past and future Class 1 alleged damages estimates would increase by [REDACTED] while they would increase by [REDACTED] for past and future Class 3 alleged damages estimates.⁹¹³ These increases in export costs further offset the total Class 1 and 3 alleged damages estimates.

851. With respect to the alleged "blocked" or "ransomed" logs calculated in the Investor's Class 3 alleged damages estimates, Mr. Bowie concluded, "that PwC's Lost export Premiums on the blocked and ransomed logs, calculated at approximately [REDACTED] [REDACTED] in the Past Loss Period and [REDACTED] in the Future Loss Period, appear to be significantly overstated" as they are based on the same underlying reasoning as the Investor's flawed Lost Export Premiums analysis.⁹¹⁴ Mr. Bowie unfortunately could not determine the precise effect these errors would have on the alleged damages.

852. With respect to incremental costs calculated into the Class 1 and 2 alleged damages estimates, the Investor claims past and future costs of approximately [REDACTED] [REDACTED] associated with complying with the measure at issue.⁹¹⁵ The Investor also claims a past and future loss of incremental overhead associated with the measure at issue of [REDACTED] calculated into its Class 1 alleged damages estimates.⁹¹⁶

853. However, Mr. Bowie determined that "PwC's calculations of Merrill & Ring's incremental costs are not described in sufficient detail, are not supported by documentation or analysis and appear to be significantly overstated in terms of

⁹¹² Bowie Report, ¶¶ 58-70.

⁹¹³ Bowie Report, ¶¶ 58-70.

⁹¹⁴ Bowie Report, ¶ 54.

⁹¹⁵ Bowie Report, ¶¶ 71-81.

⁹¹⁶ Bowie Report, ¶ 82.

quantum.”⁹¹⁷ Unfortunately, due to these deficiencies, Mr. Bowie could not state with precision how overstated the Investor’s incremental cost assessment is.⁹¹⁸

854. As a result, Mr. Bowie found the Investor’s Class 1 alleged damages estimates “██████████,” its Class 2 alleged damages estimates “██████████” and its Class 3 alleged damages estimates “██████████.” If the Investor had documented its alleged damages adequately, Canada would have provided a definitive view of the reasonableness and accuracy of these calculations to the Tribunal.

5. Causation: The Investor Incorrectly Assumes Its Losses Were Caused By the Alleged Breaches of NAFTA Chapter 11

855. The Investor assumes but does not prove that its alleged damages were caused by the measure at issue. Canada states that no causal link exists and so no damages were suffered. For example, export premiums are not caused by a log export control regime. The absence of this causal link is vividly demonstrated by the fact that export premiums are commonly observed even when there are no export controls on logs or equivalent measures. The persistent differential between export and domestic prices cannot be explained by restraints on the export of logs.⁹¹⁹ The Investor has not proved that Notice 102 caused export premiums, nor can it prove that export premiums would be any different if Notice 102 were repealed. This would be contrary to fundamental economic evidence.

856. Nor has the Investor proved that the existence of Notice 102 prevented it from receiving the highest possible price from its products. As Mr. Reishus explains, “[T]here is no reason to believe that absent export restraints Merrill & Ring’s logs would suddenly receive the highest possible price when that has not been its current experience.”⁹²⁰

⁹¹⁷ *Bowie Report*, ¶ 81.

⁹¹⁸ *Bowie Report*, ¶ 81.

⁹¹⁹ *Reishus Affidavit*, ¶¶ 94-98.

⁹²⁰ *Reishus Affidavit*, ¶¶ 177-180.

857. Similarly, to the extent that there are export premiums in a market sufficient to induce log producers to export, they exist only for a small portion of the harvest. Substantially less harvested timber will be exported than is objectively eligible for export.⁹²¹ Again, this contradicts the Investor's assumption that it would have exported 100% of its logs in the absence of log export restraints. The Investor has not proved that the existence of a log export control regime impedes the volume of exports. Its claim for future loss is based on the economically incorrect thesis that it would export all of its logs in the absence of Notice 102 and must be rejected. As Mr. Reishus concludes, "Merrill & Ring's claims that they would have enjoyed additional economic benefits absent any federal regulation – in the form of higher prices and a substantially greater proportion of exported logs – is inconsistent with basic economics and marketplace evidence."⁹²²

a) The Investor's Definition of Class 1, 2 and 3 Damages Is Illogical

858. A further weakness in the Investor's causation analysis is its classification of damages.

859. The definition of the classes is inconsistent with the Claim. For example, Class 1 is defined as loss attributable to Article 1102, 1105 and 1106(1) (a) and (c). In its explanation of the losses considered for breach of Article 1102, PwC states that it considered log-blocking, the membership of FTEAC and the lack of transparency in the process.⁹²³ None of these has ever been alleged to violate national treatment and cannot properly be assessed as damage for Article 1102.

860. Similarly, PwC estimates the Investor's past and future loss for breach of Article 1105 by considering "the same factors as those considered by us in our consideration of losses arising under National Treatment in Article 1102."⁹²⁴ Again, this is illogical since

⁹²¹ *Reishus Affidavit*, ¶¶ 99-104.

⁹²² *Resihus Affidavit*, ¶ 105.

⁹²³ *Sandy Affidavit*, ¶ 2.4.

⁹²⁴ *Sandy Affidavit*, ¶ 2.8.

the conduct alleged in the Claim to violate Article 1105 is not identical to the conduct alleged to breach Article 1105.

861. Further, the Investor's arbitrary categories of Class 1, 2 and 3 damages are irreconcilable with its theory of "non-continuing" breach. It is incumbent on the Investor to prove that each alleged non-continuing breach caused actual loss and to quantify that loss for each alleged non-continuing breach based on objective and verifiable evidence.⁹²⁵

862. PwC compounds this illogical approach in assessing damages for Article 1106(1)(a) and (c) by simply "consider[ing] the same factors as those considered by us in our estimation of the losses arising under National Treatment in Article 1102 and under International Law Standards of Treatment in Article 1105."⁹²⁶ In short, it appears that PwC has quantified loss on an omnibus "Article 1102 + Article 1105 + Article 1106(1)(a) and (c)" obligation without ever addressing the actual loss caused by a specific breach alleged to violate a defined NAFTA obligation.

863. While admittedly, neither the Investor nor Canada knows which if any breaches to the NAFTA have occurred as a result of the measure at issue, the Investor still bears the burden of proving it was damaged and that such damage was caused by Notice 102. This omnibus approach to Class 1, 2 and 3 damages in no way meets the Investor's evidentiary burden.

864. Furthermore, as Mr. Jendro has aptly demonstrated with respect to a multitude of calculations in the Investor's alleged damages estimates, the impact of Notice 102 is marginal to its stated losses. This in and of itself proves that there is a tenuous causal relationship between the impugned measure and any economic loss suffered by Merrill & Ring.⁹²⁷

⁹²⁵ This further supports Canada's position concerning the entire claim being time barred pursuant to Article 1116(2).

⁹²⁶ *Sandy Affidavit*, ¶ 2.13.

⁹²⁷ *Jendro Affidavit*, ¶¶ 5.1.1, 5.2.3, 5.4.9, 5.5.3 (second bullet), 5.6.3, 5.9.2, 5.12.1, 5.14.1(4), 5.15.3, 7.4.1, 8.1.2, 9.1, 9.2.5.

865. It should also be noted that with respect to Class 3 alleged damages for lost net revenue for “blocked” and “ransomed” logs, the direct cause of these alleged losses are the commercial decisions of the Investor. As demonstrated by Ms. Korecky, Canada addresses situations in which domestic buyers do not make good faith offers to potential exporters when such issues are brought to its attention; otherwise Canada cannot be responsible for conduct between private entities.⁹²⁸

6. Conclusion on Damages

866. Despite significant hardships in analyzing the Investor’s damages claim due to insufficient support and documentation, Canada and its exports have demonstrated above that the claim has no merit.

867. The Investor’s damages submission is riddled with faulty assumptions and methodological errors and is unsupported and undocumented. It lacks credibility and cannot be relied upon at all given the significant inaccuracies. It does not establish that the log export control regime caused the Investor any loss. Canada requests this Tribunal dismiss the Investor’s claim for want of any evidence of damages as a result of Notice 102.

⁹²⁸ *Korecky Affidavit*, ¶¶ 95-97, 126-127.

B. Interest

1. Summary of Canada's Position

868. An award of interest depends on the nature of the breach, and whether interest is necessary to effect full reparation for the breach. Further submissions on this issue may therefore be necessary once the Tribunal makes its determination as to liability.

869. If the Tribunal determines that interest is due on any award, the prevailing Canadian Treasury bill rate or a rate based on average annual yields on 1 to 3 year Government of Canada bonds during the relevant period, are a commercially reasonable measure of interest on Canadian currency. Interest should accrue from the date of the proven breach, or if there is no certain date, from the date of filing of the Notice of Arbitration, and simple, rather than compound, interest should be awarded. Post award interest, if any, should be calculated at the same rate.

2. The Law with Respect to Awards of Interest

870. NAFTA provides little guidance with respect to awards of interest under Chapter 11. Article 1135(1)(a) of the NAFTA simply provides:

[W]here a Tribunal makes a final award against a Party, the Tribunal may award, separately or in combination [. . .] monetary damages and *any applicable interest*. [Emphasis added]

871. In addition, NAFTA Article 1110(4) provides that if payment for an expropriation is made in a G7 currency, compensation for breach of Article 1110 “shall include interest at a commercially reasonable rate for that currency from the date of expropriation until the date of actual payment.” The NAFTA is silent on awards of interest for breach of Articles 1102, 1105 and 1106.

872. The UNCITRAL Arbitration Rules are also silent awards of interest.

873. At international law, there is no automatic right to an award of interest on damages, and whether an award of interest is appropriate turns on the circumstances of

each case, and in particular, on whether interest is necessary to ensure full reparation for the breach found.⁹²⁹

874. The Commentary on the ILC Draft Articles on the Responsibility of States for Internationally Wrongful Acts (“ILC Draft Articles”) specifically provides,

Interest is not an autonomous form of reparation, *nor is it a necessary part of compensation in every case.* (...). Nevertheless, an award of interest may be required in some cases in order to provide full reparation for the injury caused by an internationally wrongful act, and it is normally the subject of separate treatment in claims for reparation and in the awards of tribunals.⁹³⁰

875. Thus, an award of interest is far from pre-determined. Indeed, a tribunal should not award interest unless it is necessary to cure the injury to the non-breaching party. Tribunals have declined to award interest where a lump-sum award was adequate compensation, or where other circumstances made the award of interest unnecessary.⁹³¹ Similarly, an award of interest will be inappropriate if it would effectively allow the investor to obtain double recovery. For example, “a capital sum cannot be earning interest *and* notionally employed in earning profits at one and the same time.”⁹³² In this

⁹²⁹ See *Crawford – ILC* (Tab 33) (“Although the trend of international decisions and practice is towards greater availability of interest as an aspect of full reparation, an injured State has no automatic entitlement to the payment of interest. The awarding of interest depends on the circumstances of each case; in particular, on whether an award of interest is necessary in order to ensure full reparation. This approach is compatible with the tradition of various legal systems as well as the practice of international tribunals.”); *ILC Commentary*, art. 38(1) (Tab 60) (“interest on any principal sum due under this chapter [on reparation for injury] shall be payable when necessary in order to ensure full reparation. The interest rate and mode of calculation shall be set so as to achieve that result.”).

⁹³⁰ *Report of the International Law Commission, Fifty-Third Session* (23 April-1 June and 2 July-10 August 2001), Supp. No. 10 (A/56/10), United Nations, New York 2001, Commentary on Article 38, ¶ 1, at 269 [Emphasis added] (Tab 60); The ILC goes on to note: “Although the trend of international decisions and practice is towards greater availability of interest as an aspect of full reparation, an injured State has no automatic entitlement to the payment of interest. *The awarding of interest depends on the circumstances of each case; in particular, on whether an award of interest is necessary in order to ensure full reparation.*” at ¶ 7 [Emphasis added]

⁹³¹ See the detailed analysis of Chamber Three of the Iran-U.S. Claims Tribunal in *McCullough & Co. Inc. v. Ministry of Post Telegraph & Telephone & Others*, (1986) 11 Iran-US C.T.R. 3 at 26 - 31 (Tab 80); *Libyan American Oil Col. (LIAMCO) v. The Government of the Libyan Arab Republic* (1981), 20 I.L.M. (Tab 72).

⁹³² *ILC Commentary* on Article 38, ¶ 11 (Tab 60) [Emphasis in original].

case, the Investor is asking for both loss of profit and interest on capital. This would amount to double recovery and should not be permitted.⁹³³

3. Whether an Award of Interest Is Appropriate in this Case Will Turn on the Findings of the Tribunal on Liability

876. In this case, Canada submits that an award of interest may not be appropriate, and will in any case depend on the basis upon which any liability is found.⁹³⁴ For example, if the Tribunal finds a breach of Article 1102 of NAFTA by virtue of the fact that the Investor was never eligible for standing timber exemptions,⁹³⁵ interest should only be awarded on those exports eligible for standing exemption but frustrated by virtue of not having been granted a standing exemption. If a breach of Article 1105 is found in the fact that FTEAC did not provide written reasons for its decisions,⁹³⁶ it is arguable that no interest (and indeed no damages) should be awarded because the failure to provide reasons in and of itself does not cause monetary loss. As the basis for liability affects whether an award of interest is appropriate, further submissions on this issue may be necessary once the Tribunal makes its determination as to liability.

4. Calculation of Any Award of Interest

877. Should the Tribunal determine that an award of interest is appropriate, three further elements must be considered: (i) the applicable interest rate; (ii) the date on which

⁹³³ See discussion in *Crawford – ILC*, at 218, 228-230 (“... loss of profits have not been as commonly awarded in practice as compensation for accrued losses. Tribunals have been reluctant to provide compensation for claims with inherently speculative elements”, at 228) (Tab 33).

⁹³⁴ This argument is similar to Canada’s position above concerning damages. The quantum of damages will depend on the exact breach found. Canada suggests that if a breach is found, the disputing parties have the opportunity to address damages, interest and costs in light of the breach actually found by the Tribunal.

⁹³⁵ Investor’s Memorial, ¶ 474.

⁹³⁶ Investor’s Memorial, ¶ 7(b).

the interest begins to accrue; and (iii) whether simple or compound interest should be accorded.⁹³⁷ Canada reviews the principles applicable to these questions below.

a) Applicable Interest Rate

878. If this Tribunal determines that interest should be awarded, Canada agrees that the rate should be a “commercially reasonable rate.” This is a logical benchmark and reflects the standard set out in Article 1110(4).

879. There is no legal or other justification for adopting the investor’s position that this rate of return should be “greater than” the available commercial interest rates.⁹³⁸ Such a rate would give the investor a windfall, and would be contrary to the principle that interest should provide reparation for loss.

880. Investment tribunals frequently use the interest rate on government treasury bills as a proxy for a commercially reasonable interest rate. The treasury bill rate is easily quantifiable and reflects a guaranteed risk-free government return rate, making it free from speculation. For example, in the NAFTA context, the Tribunal in *Feldman v. Mexico* awarded interest based on the rate paid for federal treasury certificates or bonds issued by the Mexican Government.⁹³⁹ A similar approach was taken by a non-NAFTA tribunal in *CMS v. Argentina*. In that case the Tribunal applied the interest rate on U.S. Treasury bills as the commercially reasonable and appropriate interest rate for awards in U.S. currency.⁹⁴⁰

881. The Canadian Treasury bill rates of interest for the time periods under consideration are the following:

⁹³⁷ See, for example, *Metalclad – Award*, ¶ 128 (Tab 82); *CME Czech Republic B.V. v. Czech Republic* (UNCITRAL) Final Award, 14 March 2003, ¶¶ 641-642, (“*CME – Final Award*”) (Tab 26); and *CMS – Final Award*, ¶ 471 (Tab 28).

⁹³⁸ Investor’s Memorial, ¶ 411.

⁹³⁹ *Feldman – Award*, ¶ 211 (Tab 49).

⁹⁴⁰ See, for example, *CMS – Final Award*, ¶ 471 (Tab 28).

Date (first date listed/month)	Canadian Treasury Bills⁹⁴¹
January 2003	2.66
April 2003	3.15
July 2003	3.06
October 2003	2.58
January 2004	2.50
April 2004	2.13
July 2004	1.99
October 2004	2.50
January 2005	2.47
April 2005	2.52
July 2005	2.52
October 2005	2.89
January 2006	3.38
April 2006	3.89
July 2006	4.31
October 2006	4.15
January 2007	4.15
April 2007	4.16
July 2007	4.42
October 2007	3.98
January 2008	3.78

b) Date on Which Interest Begins to Accrue

882. The NAFTA does not specify the date from which interest starts to accrue. The ILC Draft Articles provide some guidance, stating that “[i]nterest runs from the date when the principal sum should have been paid until the date the obligation to pay is fulfilled.”⁹⁴² The Commentary on the ILC Draft Articles further provides,

the date from which interest is to be calculated is the date when the principal sum should have been paid. Interest runs from that date until the date the obligation to pay is fulfilled.⁹⁴³

883. In this case interest should run from the date of the specific breach found, and in no event earlier than December 27, 2003 given the requirement of Article 1116(2) to commence a claim within three years of the date on which the investor first acquired, or

⁹⁴¹ 3-month maturity, found at: www.bankofcanada.ca/en/rates/tbill.html.

⁹⁴² *ILC Commentary*, Art. 38(2), ¶ 10 (Tab 60).

⁹⁴³ *ILC Commentary*, ¶ 10 (Tab 60).

should first have acquired, knowledge of the alleged breach and knowledge that the investor incurred loss or damage.⁹⁴⁴

884. The Investor bears the burden of proving the date upon which each breach commences for the purpose of calculating interest. The approach currently adopted by the Investor makes no such distinction and applies interest to its entire damage claim from December 27, 2003 without addressing fact-specific distinctions as to when the Investor actually incurred each loss and when any loss of ability to use the funds in question actually occurred. For example, the Investor seeks to establish much of its case based on a theory of continuing breach and non-continuing breach, the latter being “each time” action was taken that is part of the continuing breach. However, it does not even attempt to address when the continuing breaches commence or the date relevant to “each time” an action was taken by Canada that allegedly constitutes a non-continuing breach. This blunt approach used by the Investor inflates its claim for interest and exceeds what is required for reparation of loss.

885. If the Tribunal is unable to identify with specificity the actual date of any of the (alleged) breaches of NAFTA Chapter 11, Canada submits that interest could accrue, at the earliest, from the date of filing of the Notice of Arbitration, namely December 27, 2006. This was the approach taken by the Tribunal in *S.D. Myers*.⁹⁴⁵

c) Simple or Compound Interest

886. The Investor argues that it is “entitled” to compound interest on any damages that it is awarded.⁹⁴⁶ This is incorrect. As a general principle, simple interest should be awarded when it will adequately compensate the claimant’s loss.⁹⁴⁷ Otherwise, the

⁹⁴⁴ The Investor appears to agree with this proposition at ¶ 410 of its Memorial.

⁹⁴⁵ *S.D. Myers Inc. v. Canada* (UNCITRAL) Second Partial Award, 21 October 2002, ¶ 303 (“*S.D. Myers – Second Partial Award*”): “interest shall be payable from the date of the Notice of Arbitration (...) until the date of payment of the sums awarded in this Second Partial Award.” (Tab 121).

⁹⁴⁶ Investor’s Memorial, ¶ 411.

⁹⁴⁷ *Case Concerning the Factory at Chorzów* (*Germany v. Polish republic*) (1928), P.C.I.J. (Ser. A) No. 17 at 47 (Tab 24).

Tribunal risks awarding compensation “out of proportion to the possible loss that was incurred.”⁹⁴⁸ As to when it is appropriate to award compound interest, there is no consistent practice at international law.

887. In the NAFTA context, the tribunals in *Pope*,⁹⁴⁹ *Myers*⁹⁵⁰ and *Metalclad*⁹⁵¹ awarded compound interest. On the other hand, the tribunal in *Feldman*⁹⁵² awarded simple interest. Non-NAFTA jurisprudence is informative in this regard. In *CME v. Czech Republic*, for instance, the Tribunal awarded simple interest because it adequately “compensate[d] the loss of use of the principal amount of the award in the period of delay.”⁹⁵³ The *CME* Tribunal reviewed the recent bilateral investment treaty disputes that awarded compound interest. It determined,

... [i]n recent years international arbitral tribunals, particularly those acting under bilateral investment treaties, have increasingly have awarded compound interest essentially in recognition of the prevalent contemporary commercial reality that companies that borrow pay compound interest (see, *Compañía del Desarrollo de Santa Elena S.A. v. Republic of Costa Rica* (ICSID Case No. ARB/96/1), *Metalclad Corporation v. United Mexican States* (ICSID Case No. ARB(AF)/97/1, *Emilio Agustín Maffezini v. Kingdom of Spain* (ICSID Case No. ARB/97/7) and *Wena Hotel Limited v. Arab Republic of Egypt* (ICSID Case No. ARB/98/4).

⁹⁴⁸ *CME – Final Award*, ¶ 644, (Tab 26) drawing from several Iran-US Claims Tribunal cases, including: *Anaconda-Iran Inc. v. Iran* (1986) 13 Iran-US C.T.R. 199 (Tab 5); *R.J. Reynolds Tobacco Co. v. Iran* (1984) 7 Iran-US C.T.R. 181 (Tab 117); and *Sylvania Technical Systems v. Iran* (1984) 5 Iran-US C.T.R. 141. (Tab 133).

⁹⁴⁹ *Pope & Talbot Inc. v. Canada* (UNCITRAL) Award in Respect of Damages, 31 May 2002, ¶ 90 (Tab 111): (“In the circumstances, acting pursuant to Article 1131, the Tribunal awards interest on the principal sum at the rate of 5% per annum compounded quarterly as an appropriate rate, starting at 1 December 1999.”)

⁹⁵⁰ *S.D. Myers – Second Partial Award*, ¶ 307 (“*Myers Second Partial Award*”): “The Tribunal determines that CANADA shall pay to SDMI compound interest on the sum awarded in Chapter VI above at the Canadian prime rate plus 1% over the period referred to above.” (Tab 121).

⁹⁵¹ *Metalclad – Award*, ¶ 128: (“So as to restore the Claimant to a reasonable approximation of the position in which it would have been if the wrongful act had not taken place, interest has been calculated at 6% p.a., compounded annually.”) (Tab 82).

⁹⁵² *Feldman – Award*, ¶ 205 (Tab 49): “The total revised award indicated above of \$9,464,627.50 Mexican Pesos is increased by simple interest calculated from the date the rebates should have been paid (see below) to the date of this decision [. . .].” See also ¶ 206.

⁹⁵³ *CME – Final Award*, ¶ 647 (Tab 26).

(...) Among the circumstances which justify the award of compound interest are back-to-back financing obligations of the investor.⁹⁵⁴

888. As the claimant in *CME* did not demonstrate that it borrowed money from banks and paid compound interest, the Tribunal found that it could not justify an award bearing compound interest, as it would have been contrary to the principle of full compensation under the ILC Draft Articles.⁹⁵⁵

889. Even in *Santa Elena*, which is often quoted as justification for granting compound interest, the Tribunal recognized that compound interest was only appropriate when “warranted by the circumstances of the case”⁹⁵⁶ rather than as a general rule. The Tribunal in this case was considering compensation for losses arising from the claimant’s inability to use its property for some twenty years.

890. Canada submits that the circumstances of this case dictate against an award of compound interest, if interest is awarded. As with the rate of interest and the date of its computation, the guiding principle should be what is required to effect reparation of the loss occasioned by the breach. The Investor has not demonstrated that it faced any economic circumstances that warrant an award of compound interest. It has not alleged that it had to borrow funds at compounded rate of interest as a result of any breach of NAFTA by Canada. Moreover, the claimant has been profitably functioning under Notice 102 for 10 years. Since it does not meet the standard of *Santa Elena*, Canada submits that simple and not compound interest is applicable in this case.

5. Conclusion on Interest

891. In summary, Canada submits that the Claimant has not proved any loss that would justify an award of interest, much less has it discharged its burden of proving the exact

⁹⁵⁴ *CME – Final Award*, ¶ 645 (Tab 26).

⁹⁵⁵ *CME – Final Award*, ¶ 647 (Tab 26).

⁹⁵⁶ *Compañía del Desarrollo de Santa Elena S.A. v. Costa Rica* (ICSID No. ARB/96/1) Final Award, 17 February 2000, ¶ 97 (Tab 34).

loss of interest that would result from each of the breaches alleged. Further, an award of interest is not necessary to effect reparation of loss in this instance.

892. Should interest be awarded, it should be at the Canadian treasury bill rate or the rate of average annual yields on 1 to 3 year Government of Canada bonds in the relevant period, should run from the date of the breach found or the Notice of Arbitration and should be simple, rather than compound, interest.

C. Costs

893. Article 1135 allows a Tribunal to award costs in accordance with the applicable arbitration rules.

894. Articles 38 to 40 of the UNCITRAL Arbitration Rules address awards of costs in arbitrations conducted pursuant to those rules.⁹⁵⁷ They allow awards of costs indemnifying a disputing party for arbitration costs and for reasonable legal costs.

895. In principle, the costs of an UNCITRAL arbitration are borne by the unsuccessful party. However, the Tribunal is entitled to apportion costs between the disputing parties if it is reasonable to do so in the circumstances of the case.

896. Early NAFTA cases under the UNCITRAL Arbitration Rules apportioned costs between the disputing parties, partially reflecting the novelty of Chapter Eleven arbitration, success in the arbitration, and other circumstances of the particular case. The conduct of a party during the arbitration and the reasonableness of the positions taken by a party have been among the circumstances considered relevant by tribunals. More recent NAFTA cases have been more likely to award costs to the successful party, although this has not invariably been the practice.⁹⁵⁸

897. Canada requests that the Tribunal order the Investor to pay the arbitration costs for this claim and to indemnify Canada for its legal costs. Canada respectfully requests the opportunity to submit a more detailed submission on costs at a later stage in the arbitration so that it can fully address the relevant considerations.

⁹⁵⁷ Arbitration Rules of the United Nations Commission on International Trade Law, GA Res. 31/98, 15 December 1976, Articles 38-40 (Tab 140).

⁹⁵⁸ Kinnear, Meg N., Andrea K. Bjorklund & John F.G. Hannaford, *INVESTMENT DISPUTES UNDER NAFTA: AN ANNOTATED GUIDE TO NAFTA CHAPTER 11*, Kluwer Law International (2006, updated to 2007), at 1135-33 to 1135-38.

D. Order Requested

898. For the foregoing reasons, Canada respectfully requests that this Tribunal render an award:

- i) Dismissing the claims of Merrill & Ring in their entirety;
- ii) Ordering that Merrill & Ring bear the costs of the arbitration in full and indemnify Canada for its costs of legal representation.

THE WHOLE RESPECTFULLY SUBMITTED THIS 13TH DAY OF MAY, 2008.

Meg Kinnear

Lori Di Pierdomenico

Patrick Dumberry

Raahool Watchmaker

On behalf of the Respondent, Canada

TABLE OF ABBREVIATIONS USED IN THIS COUNTER-MEMORIAL

ABBREVIATION	DEFINITION
B.C.	British Columbia
BCMof	British Columbia Ministry of Forests and Range
BCTS	British Columbia Timber Sales
BIT	Bilateral Investment Treaty
CDN	Canadian Dollar
Coast	B.C. Coast
DCF	Discounted Cash Flow
DFAIT	Department of Foreign Affairs and International Trade
ECD	Export Controls Division (now known as TIE)
EIPA	Export and Import Permits Act
FTC	Free Trade Commission
FTEAC	Federal Timber Export Advisory Committee
GATS	General Agreement on Trade and Services
GATT	General Agreement on Tariffs and Trade
ICJ	International Court of Justice
ILC	International Law Commission
INAC	Department of Indian and Northern Affairs
Interior	B.C. Interior
Investor	Merrill & Ring Forestry L.P.
LEAC	Log Export Advisory Committee
MBG	Mason, Bruce & Girard
MFA	Minister of Foreign Affairs
MSA	Master Settlement Agreement
OIC	Order-in-Council
PFLA	Private Forest Landowners Association
PwC	PricewaterhouseCoopers
TEAC	Timber Export Advisory Committee
VAT	Value Added Tax
VLM	Vancouver Log Market
WMA	War Measures Act

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