

**IN THE MATTER OF AN ARBITRATION UNDER CHAPTER 11 OF  
THE NORTH AMERICAN FREE TRADE AGREEMENT  
AND THE UNCITRAL ARBITRATION RULES**

**MERRILL & RING FORESTRY L.P.**

Investor

v.

**GOVERNMENT OF CANADA**

Respondent

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**MEMORIAL OF THE INVESTOR**

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**PART ONE: OVERVIEW**

1. This is a case about governance gone wrong. It is about government using its regulatory power to take from foreign investors and give to local producers. It is about basic unfairness – about administrative procedures that are opaque, partial, and immune from meaningful review.
2. The Investor, Merrill & Ring Forestry L.P. (“Merrill & Ring” or the “Investor”) is a private US owned limited partnership that operates as a log producer in the province of British Columbia (“BC”).
3. Canada has established a complex regulatory regime to control the export of logs from BC (“Log Export Control Regime”). The purpose of the regime is to ensure that BC log processors have ample access to logs at artificially suppressed prices. The regime forces companies like Merrill & Ring to sell their BC logs to BC sawmills at prices far lower than Merrill & Ring could obtain in the international market. The Log Export Control Regime is unique to BC: in no other Canadian province are there any controls on the export of logs. Thus, Canadian-owned forestry companies operating outside of BC are operating free of its requirements. Furthermore, the various companies operating within BC are unevenly impacted by the regime.
4. The Canadian federal government appears to have failed to live up to its domestic obligations (e.g., by treating BC companies less advantageously than those operating in other provinces). However, what is at issue here is whether the Log Export Control Regime is inconsistent with Canada’s duties to the international community and, in particular, its obligations under the North American Free Trade Agreement (“NAFTA”).
5. By entering into the NAFTA, Canada committed to the following goals:
  - a) Eliminate barriers to trade in, and facilitate the cross-border movement of, goods and services;
  - b) Promote conditions of fair competition;
  - c) Increase investment opportunities to foreigners; and
  - d) Create effective and transparent procedures to achieve these objectives.

In this case Canada has done none of these things; to the contrary it has taken measures to the opposite effect.

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6. As a result, Canada has violated several substantive provisions of the NAFTA, including:
- a) Article 1105 – International Law Standards of Treatment
  - b) Article 1102 – National Treatment
  - c) Article 1106 – Performance Requirements
  - d) Article 1110 – Expropriation

***International Law Standards of Treatment***

7. The Log Export Control Regime is arbitrary, non-transparent and fundamentally unfair for the following reasons:
- a) It establishes different rules for log exports depending on whether the land the logs come from are subject to provincial or federal jurisdiction. Such lands may be adjacent, produce the same type of logs, even owned by the same company; yet subject to different rules. In addition, these rules are often applied inconsistently and at times unlawfully. This is arbitrary.
  - b) The Log Export Control Regime is based in part on rules that are not written down, that are unverifiable and immune to challenge, and the application of which is not open to appeal. The system is non-transparent and unfair.
  - c) The Log Export Control Regime privileges log processors at the expense of log producers, and privileges some log producers *vis-a-vis* their direct competitors. Key administrative bodies operating and overseeing the regime are comprised of individuals acting under conflicts of interest. The regime is inherently unfair.

***National Treatment***

8. Canada's Log Export Control Regime treats Canadian-owned forestry companies more favorably than it does Investors like Merrill & Ring. Simply by virtue of the fact that export controls exist only for BC logs, Canadian log exporters in other provinces are treated more favorably than Merrill & Ring. Some of these log producers are in direct competition with Merrill & Ring in the US market.
9. The Log Export Control Regime is further applied inconsistently among log producers *within* BC. Some Canadian-owned BC log producers have been exempted from the export restrictions, and allowed to freely export their logs. Canada has the authority to provide an equivalent exemption for timber harvested from lands under federal jurisdiction, but refuses to exercise it. Canada has even allowed the BC provincial government to grant exemptions to Canadian-owned companies with federally regulated

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timberlands – companies that are, without question, direct competitors of Merrill & Ring. No equivalent exemptions are available to Merrill & Ring, which is thus placed at a competitive disadvantage in relation to its Canadian competitors.

***The Imposition of Performance Requirements***

10. The Log Export Control Regime gives preferences to domestic content and to locally processed and produced goods. The regime also sets restrictions on export volumes from remote locations in violation of NAFTA protections. These measures constitute specific violations of Canada's performance requirement obligations in NAFTA Article 1106.

***The Duty to Compensate on Expropriation***

11. Canada uses the force of Canadian law to take unilateral physical and economic control of all Merrill & Ring's logs. Canada controls the prices, terms and sale location of logs that do not obtain export permits. The Log Export Control Regime effectively expropriates Merrill & Ring's investments. Every time Merrill & Ring is forced to sell its logs to BC sawmills at artificially suppressed prices, it loses the difference in value between that price and the fair market export price it could have received. Conversely, the purchasing sawmills gain that difference, since they are not paying fair market value for their log supply. Canada is effectively taking Merrill & Ring's financial capital and redistributing it to BC sawmills.
12. Notably, Canada has not only implemented this regime in violation of its NAFTA obligations, it has done so contrary to the recommendations of BC's Royal Commissioner on Forest Resources. To the extent that the regime services Canada's policy objectives, it does so in a way that is unnecessary and far more restrictive on trade than necessary. In short, Canada implemented its Log Export Control Regime knowing full well that it was problematic from numerous perspectives, including its international trade and investment obligations. Canada should compensate Merrill & Ring for transgressing its obligations to Merrill & Ring's detriment.



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**PART TWO: STATEMENT OF FACTS**

13. The following statement of facts is based on the documents cited below and the following witness statements and expert reports filed with this Memorial:
- a) the statement of Norm Schaaf, Vice President of Merrill & Ring describing Merrill & Ring's investment in Canada, its global operations and how the measures have affected its Canadian investment;
  - b) the statement of Paul Stutesman, Vice-President and General Manager of Merrill & Ring Forest Products L.P., regarding the impact of the measures on Merrill & Ring's BC log market operations;
  - c) the statement of Tony Kurucz, President of Progressive Log Sales, regarding the impact of the measures on the Merrill & Ring's BC log market operations;
  - d) the expert report of Professor Peter Pearse, natural resource economist and former BC Royal Commissioner on Forest Resources, addressing public policy considerations relating to the Log Export Control Regime;
  - e) the expert report of economists David Cox and Mark Rasmussen, from Mason, Bruce and Girard, addressing the log export market as it would have operated in the absence of the measures (i.e., if Merrill & Ring had been permitted to sell their BC logs in the same manner as more favourably treated Canadian companies);
  - f) the expert report of Darrel H. Pearson, customs lawyer, addressing the requirement that certain manufacturing content occur in Canada as a precondition to the granting of an export permit; and
  - g) the expert report of Robert Sandy, Chartered Accountant and Chartered Business Valuator from PriceWaterhouseCoopers, confirming the Investor's damages arising from Canada's NAFTA violations.
14. Memorial is laid out as follows:
- a) Part Two will describe the following key facts in detail: Merrill & Ring's corporate structures and business operations; the nature of the Log Export Control Regime; competition under the regime; the unfair advantages to Canadian investments competing against Merrill & Ring under the regime; and Canada's failure to fairly administer and supervise the regime;

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- b) Part Three deals with substantive legal issues;
  - c) Part Four considers the facts applied to the law;
  - d) Part Five deals with damages;
  - e) Part Six deals with jurisdictional issues; and
  - f) Part Seven sets out the relief requested by the Investor.

## **I. The Parties**

### **A. The Investor: Merrill & Ring Forestry L.P.**

#### *i. Worldwide Operations*

- 15. Merrill & Ring is a limited partnership constituted under the laws of Washington state ("Washington").<sup>1</sup> The original predecessor partnership, Merrill & Ring is a forestry and land management company that provides a range of services relating to the purchase and sale of logs for the export and domestic markets, and engages in the purchase and sale of forest land.
- 16. Merrill & Ring is headquartered on Washington's Olympic Peninsula. The partners hold 75,000 acres of productive timberland in BC, western Washington and New Zealand.

#### *ii. Canadian Business Operations*

- 17. The Investor's owners have owned and operated timberlands in BC for more than 100 years, and provide a full range of services relating to the purchase and sale of logs for the export and domestic markets, including harvesting, log marketing, and accounting. Merrill & Ring grows, harvests and markets timber from a number of Canadian investments. Merrill & Ring also engages in the purchase and sale of forest land.
- 18. Merrill & Ring's BC land holdings extend over approximately 7,043 acres, and are located on Vancouver Island and southern and mid-coastal BC. While most of these lands are regulated by the Canadian federal government, 584 acres are regulated by the BC

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<sup>1</sup>Merrill & Ring Certificate of Limited Partnership, October 22, 1991, (Investor's Schedule of Documents at Tab 1); and Washington State Certificate of Amendment to Certificate of Limited Partnership, December 6, 2004, (Investor's Schedule of Documents at Tab 2); Agreement of Limited Partnership, August 28, 1991, (Investor's Schedule of Documents at Tab 3); Amendment to Agreement of Limited Partnership, July 31, 2003, (Investor's Schedule of Documents at Tab 4); Washington State Certificate of Existence / Authorization for Merrill & Ring Forestry, L.P., December 11, 2006, (Investor's Schedule of Documents at Tab 5).

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provincial government.<sup>2</sup> The types of logs produced from Merrill & Ring's federal and provincial lands are the same.

19. Merrill & Ring harvests BC logs of a wide variety of species, sizes and grades. It also buys some logs from other log owners. Its operations are focused on harvesting second-growth hemlock, balsam, Douglas-fir, red cedar, spruce and alder. Second-growth timber is timber that has been planted to replace old growth timber.
20. Merrill & Ring's BC timber inventory for January 2008 was [R-1(b)(ii)].<sup>3</sup> Each year the Investor organizes its operations through an annual harvest plan.<sup>4</sup>
21. Merrill & Ring manages, harvests and markets BC timber for sale within Canada and for export. Up until 2007, Merrill & Ring also harvested and marketed timber from lands now owned by a sister company, Georgia Basin Holdings L.P. Merrill & Ring's primary export markets and clients are located in the Puget Sound area of Washington, Japan and South Korea. Out of Merrill & Ring's total BC harvest, approximately [R-1(b)(ii)] is sold domestically in Canada, [R-1(b)(ii)] goes to the United States, [R-1(b)(ii)] to Japan and the remaining [R-1(b)(ii)] to Korea. Merrill & Ring's individual clients range from small U.S. operations specialty needs to large multinationals that source standardized products.<sup>5</sup>
22. Merrill & Ring is not the only enterprise in BC that sells export logs. In its *Statement of Defence*, Canada says that there are more than 70 companies, that export logs from federal timbermark lands. There are many other companies that export logs from provincially-regulated timberlands under provincial jurisdiction.<sup>6</sup> There are over 20,000 private timberland owners in BC.<sup>7</sup>

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<sup>2</sup> Merrill & Ring Land and Timber Ownership. (Investor's Schedule of Documents at Tab 6).

<sup>3</sup> Canadian Lands timber inventory. (Investor's Schedule of Documents at Tab 8).

<sup>4</sup> Annual Harvest Plan. (Investor's Schedule of Documents at Tab 7).

<sup>5</sup> Witness Statement of Paul Stutesman at para. 12.

<sup>6</sup> *Statement of Defence* at para. 1.

<sup>7</sup> The Expert Report of Prof. Peter Pearse sets out the number of companies harvesting logs from provincial timberlands in British Columbia at para. 7. The general issue of competition in the log export market is examined in the Expert Report from Mason, Bruce & Girard, section VII, at 12-15.

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23. In the coastal region of BC, Merrill & Ring has competitors that cater to the export log market. These competitors include companies with timberlands under federal jurisdictions, and companies with timberlands under provincial jurisdictions as well as companies with the harvest rights to Crown land.

*iii. Corporate Structure*

24. Merrill & Ring is part of a family of companies and partnerships.
25. The Investor operates its log business in Canada both alone and jointly with related companies. It also uses agents such as log brokers. The related companies and agents form an integral part of the Investor's Canadian log operations.
26. Merrill & Ring's General Partner, the Merrill & Ring Family Corporation, is a Washington corporation.<sup>8</sup> Merrill & Ring has two Limited Partners, the Campbell River Partnership and the Merrill Family General Partnership. Both of the Limited Partners are Washington partnerships.

**B. The Investments: Land and Logs**

27. Merrill & Ring owns land in BC.<sup>9</sup> The majority of this land was granted by the federal government of Canada prior to March 12, 1906. It was originally acquired by Merrill & Ring and its predecessors for the purpose of forestry and timber sales. These BC timber lands constitute "real estate" within the meaning of NAFTA Article 1139(g).
28. The Investor harvests timber from its land for sale within Canada and for export. Timber in BC is in itself an investment protected by NAFTA as it is tangible property "acquired in the expectation or used for the purpose of economic benefit or other business purposes" and "interests arising from the commitment of capital or other resources in the territory of a Party to economic activity in such territory" within the meaning of NAFTA Articles 1139(g) and (h).

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<sup>8</sup> Agreement of Limited Partnership, August 28, 1991, (Investor's Schedule of Documents at Tab 3); Amendment to Agreement of Limited Partnership, July 31, 2003, (Investor's Schedule of Documents at Tab 4); Washington State Registration and License of Merrill & Ring Family Corporation, (Investor's Schedule of Documents at Tab 9), Washington State Certificate of Existence / Authorization for Merrill & Ring Family Corporation, December 11, 2006, (Investor's Schedule of Documents at Tab 5).

<sup>9</sup> Merrill & Ring Land and Timber Ownership. (Investor's Schedule of Documents at Tab 6).

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29. The Investor sells logs from its BC lands to purchasers in the BC log market and in international markets. Merrill & Ring's logs constitute an investment in the territory of Canada under NAFTA Article 1139(g) and (h).
  30. The rights to sell its export logs into foreign markets and the right to sell for fair market value both constitute intangible property "acquired in the expectation or used for the purpose of economic benefit or other business purposes" and "interests arising from the commitment of capital or other resources in the territory of a Party to economic activity in such territory" within the meaning of NAFTA Articles 1139(g) and (h).

### C. Government of Canada

31. The Respondent, Canada, is a Party to the NAFTA. Canada has principally acted through its organ, the Department of Foreign Affairs and International Trade ("DFAIT").
32. The mandate of DFAIT is set out in the *Department of Foreign Affairs and International Trade Act*.<sup>10</sup> DFAIT is responsible for the conduct of Canada's external affairs, including international trade and commerce and the administration of Canada's export-related legislation and controls.
33. The Export and Import Controls Bureau ("EICB") is part of DFAIT. The EICB is responsible for administering the *Export and Import Permits Act* ("EIPA") and its regulations.<sup>11</sup>
34. Two Ministers preside over DFAIT: the Minister of Foreign Affairs and the Minister of International Trade. The *EIPA* confers broad discretionary powers to control the flow of goods included on specified lists to the Minister of Foreign Affairs. The Minister for International Trade provides policy direction in most areas involving market access and trade policy.<sup>12</sup>

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<sup>10</sup> *Department of Foreign Affairs and International Trade Act*, R.S.C. 1985, c. E-22. (Investor's Schedule of Documents at Tab 12).

<sup>11</sup> *Export and Import Permits Act*, R.S.C. 1985 c. E-19. (Investor's Schedule of Documents at Tab 13).

<sup>12</sup> EICB Introduction, Website excerpt. (Investor's Schedule of Documents at Tab 14).

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**D. Government of BC**

35. The Government of BC (“BC Govt”) oversees and regulates provincial logs that may be eligible for export through the Ministry of Forests and Range (“BCMOF”). Pursuant to NAFTA Article 105, Canada has assumed international responsibility for the measures taken by the BC Govt.

*i. Ministry of Forests and Range*

36. The BC Govt manages its forest resources through the BCMOF. The BCMOF is responsible for protecting, managing and conserving forest and range values. The Minister of Forests and Range presides over BCMOF.

37. The BCMOF is responsible for the stewardship of 47 million hectares of productive provincial forest land. More than 95 per cent of BC’s forest lands are publicly owned (“BC public forest lands”), which means that the BC Govt plays a much more prominent role in the forest sector than private companies like Merrill & Ring.<sup>13</sup>

*ii. BC Timber Sales*

38. BC Timber Sales (“BCTS”) is a commercial organization that is a part of BCMOF. It was created to sell the rights to cut timber from BC public forest lands. The purpose of BCTS is to develop and sell publicly-owned timber to establish market price and cost benchmarks, and to optimize net revenue to BC. To this end, BCTS shares offices, vehicles and other facilities with BCMOF.<sup>14</sup>

39. BCTS auctions timber from BC public forest lands by sealed bid. On the basis of the highest bid, BCTS sells the harvesting rights to blocks of timber to customers across BC, including market loggers, sawmill operators and timber processors. BCTS uses sealed bids to set the fees the BC Govt charges to harvest logs from BC public forest lands (known as ‘stumpage’ rates). BCTS supplies timber harvest rights to over one thousand operators and licensees.

40. BCTS maintains road and bridge infrastructure programs to provide access to tenure opportunities on BC public forest lands and to “ensure a predictable flow of timber sale

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<sup>13</sup> BC Ministry of Forests, Annual Report 2005-2006 at 9. (Investor’s Schedule of Documents at Tab 15).

<sup>14</sup> BCTS Brochure. (Investor’s Schedule of Documents at Tab 16).

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opportunities to the market.”<sup>15</sup> It contracts with suppliers to perform forestry work and road and bridge construction. BCTS also performs forestry management for BC public forest lands. These infrastructure services are not available to service federally regulated forest lands.

## II. The Canadian Log Export Regime

41. In Canada, exports come under exclusive federal authority. The federal government has exclusive constitutional jurisdiction over international trade.<sup>16</sup> Provincial governments have general authority over the regulation of natural resources and forestry resources. However in BC the federal government retains authority over forest land resources on private lands granted before March 12, 1906.<sup>17</sup>
42. All logs exported from Canada require a federal export permit.<sup>18</sup> In all provinces and territories other than BC, the receipt of an export permit is automatic upon application by an exporter of logs from private lands. BC is the only province where Canada exercises its authority to control export through a log surplus testing procedure. Unless otherwise exempted, under the surplus testing procedure BC logs from both private and public lands must be deemed surplus to provincial needs before they can be exported.
43. The nature and content of the surplus testing procedure differs depending on the type of land upon which BC timber is grown. The BC Govt applies the surplus testing procedure to logs within its jurisdiction (those from BC public forest lands and private lands granted after March 12, 1906), while the federal government applies the surplus testing procedure to logs from private lands granted prior to March 12, 1906, and for logs grown on other federally-regulated land located within BC. In any case, the federal government will only issue an export permit if the logs are deemed surplus to domestic (i.e. the needs of BC log processors) requirements.

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<sup>15</sup> BCTS Brochure. (Investor's Schedule of Documents at Tab 16).

<sup>16</sup> *Constitution Act, 1867*, Section 91(2), (Investor's Schedule of Documents at Tab 17).

<sup>17</sup> *Constitution Act, 1867*, Section 92A, (Investor's Schedule of Documents at Tab 17). Canada also has jurisdiction over the management of timber on its own (federal crown) lands and on lands owned by Canada's First Nations.

<sup>18</sup> *Export and Import Permits Act* (Investor's Schedule of Documents at Tab 13).

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44. BC is the only jurisdiction among industrialized western nations where private forest landowners are not free to sell their logs into the market of their choice.<sup>19</sup> This policy interferes with the fundamental property rights of private forest landowners in BC. The Log Export Control Regime controls how exporters can sell logs, where they can sell them, how they can advertise and organize their private property for sale and even how much they can sell their logs for. As a result, the Log Export Control Regime reduces the returns private landowners realize on their investments in timber production and the market value of their land.

#### A. The History of the Log Export Control Regime

45. The *Constitution Act* of 1867 assigned jurisdiction over natural resources to the provinces,<sup>20</sup> while the federal government retained responsibility for international trade.<sup>21</sup> BC entered the Canadian Confederation in 1871.
46. The BC Govt first restricted the export of BC timber in 1891, when it restricted the export of logs cut from BC public forest lands to use within the province.<sup>22</sup> In 1906 the *Timber Manufacture Act* extended the export ban to include timber cut on private lands granted after March 12, 1906.<sup>23</sup> Thus, as of 1906 the only BC timber not subject to export restrictions were logs from federal government lands and from private lands granted prior to March 12, 1906.
47. During World War I, the BC Govt created the Log Export Advisory Committee ("LEAC") to advise the Lieutenant Governor on log export exemption permits. LEAC permitted log exports only if the harvested logs were considered surplus to the needs of the BC economy. This practice would prove to be remarkably enduring.

<sup>19</sup> David Haley, *Are Log Export Restrictions on Private Forestland Good Public Policy?* at 16. (Investor's Schedule of Documents at Tab 18).

<sup>20</sup> *The Constitution Act, 1867* Sections. 92(5). This was later clarified by the addition of sections 92A(1) and (2) in 1982. (Investor's Schedule of Documents at Tab 17 ).

<sup>21</sup> s. 91(2). (Investor's Schedule of Documents at Tab 17).

<sup>22</sup> C. W. Shinn, *BC Log Export Policy: Historical Review and Analysis*, (Seattle: US Department of Agriculture Forest Service, 1993) at 2, (Investor's Schedule of Documents at Tab 19); C. Lane, *Log Export and Import Restrictions of the US Pacific Northwest and BC: Past and Present*, (Seattle: US Department of Agriculture Forest Service, 1998) at Appendix, (Investor's Schedule of Documents at Tab 20).

<sup>23</sup> C. W. Shinn, *BC Log Export Policy: Historical Review and Analysis*, (Seattle: US Department of Agriculture Forest Service, 1993) at 2. (Investor's Schedule of Documents at Tab 19).



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48. On July 10, 1940, the federal government introduced its own log restrictions under the *War Measures Act*. Prior to that, logs originating from federal government lands or private lands granted before March 12, 1906 were freely exportable.<sup>24</sup> The *War Measures Act* prohibited the export of certain log species for reasons of national security. Thus, by 1942, all BC logs, regardless of land source, were prohibited from export unless specifically exempted.
  49. In 1945, the *War Measures Act* was incorporated into the *National Emergency Transition Power Act* ("NETPA"), which maintained the log export restrictions. Two years later, the restrictive log export provisions were transferred to the *EIPA*. The *EIPA* gave the Federal Minister of Industry, Trade and Commerce authority to issue export permits for items on the *Export Control List* ("ECL"). The *EIPA* remains the statutory basis for federal control of log exports. As logs are listed on the *ECL*, a federal export permit is now required for all logs leaving Canada.
  50. Although the log export restrictions remained in place after World War II, federal government lands and private land granted before March 12, 1906 continued to supply the majority of log exports.<sup>25</sup> In the early post World War II years, federal log export permits were issued largely without restriction and subject only to volume quotas.<sup>26</sup>
  51. A major change occurred in 1969, when the federal government amended its policy to add surplus restrictions to its log export permit process.<sup>27</sup> Thereafter, logs from federal government land and private lands granted before March 12, 1906 were granted export permits by recommendation of LEAC. Federal and provincial export restrictions on BC

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<sup>24</sup> D. Haley, *Are Log Export Restrictions on Private Forestland Good Public Policy?* at page 3, (Investor's Schedule of Documents Tab 18); C.W. Shinn, *BC Log Export Policy: Historical Review and Analysis*, (Seattle: US Department of Agriculture Forest Service, 1993) at 2, (Investor's Schedule of Documents at Tab 19).

<sup>25</sup> C.W. Shinn, *BC Log Export Policy: Historical Review and Analysis*, (Seattle: US Department of Agriculture Forest Service, 1993) at 6, (Investor's Schedule of Documents Tab 19).

<sup>26</sup> C.W. Shinn, *BC Log Export Policy: Historical Review and Analysis*, (Seattle: US Department of Agriculture Forest Service, 1993) at 6, (Investor's Schedule of Documents Tab 19).

<sup>27</sup> B. Dumont and D. Wright, *Generating More Wealth from British Columbia's Timber - A Review of British Columbia's Log Export Policies*, at 87, (Investor's Schedule of Documents Tab 21)

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logs were thus generally harmonized although some differences still exist.<sup>28</sup>

52. In 1974, the federal government revised the focus of the *EIPA* from the promotion of national security (the original basis for log export restrictions) to the promotion of domestic log manufacturing.<sup>29</sup> Promotion of domestic manufacturing had been a longstanding goal of the BC Govt. The promotion of domestic log manufacturing continues to be the goal of the log export restrictions relating to both federally and provincially regulated BC lands.<sup>30</sup>
53. In 1984, the BC Minister of Forests created the Timber Export Advisory Committee (“TEAC”) to review export applications for the criterion of economic need, while LEAC continued to review applications under the surplus test.<sup>31</sup> In 1986, LEAC was disbanded. TEAC took over the functions of the LEAC, handling all export applications for standing and harvested BC timber.
54. The Federal Export Control Regime<sup>32</sup> was successfully challenged in Federal Court in *K.F. Evans Ltd. v. Minister of Foreign Affairs (Canada)*. In that case, a federal landowner challenged the federal government’s refusal to grant an export permit because the owner did not have approval from TEAC. The Court found that the Minister’s failure to exercise his own discretion was an abdication of his responsibility or, at the least, an improper

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<sup>28</sup> One exception was aboriginal lands, which remained unrestricted, see: C.W. Shinn, *BC Log Export Policy: Historical Review and Analysis*, (Seattle: US Department of Agriculture Forest Service, 1993) at 7, (Investor’s Schedule of Documents Tab 19).

<sup>29</sup> C. Lane, *Log Export and Import Restrictions of the US Pacific Northwest and BC: Past and Present*, (Seattle: US Department of Agriculture Forest Service, 1998) at 42, (Investor’s Schedule of Documents at Tab 20); C.W. Shinn, *BC Log Export Policy: Historical Review and Analysis*, (Seattle: US Department of Agriculture Forest Service, 1993) at 8, (Investor’s Schedule of Documents at Tab 19).

<sup>30</sup> Section 1.3 of Notice 102, (Investor’s Schedule of Documents at Tab 22) states “that in order to determine adequate supply, forest products... proposed for export from British Columbia [shall] undergo a surplus testing procedure in consultation with the Provincial government;” Section 4.3(c) states “for the purposes of surplus testing, normally the FTEAC will consider offers only from persons who are involved in log processing. That is, persons who own or operate log processing facilities.”; See also the cross-examination of Thomas Jones of DFAIT’s Export Controls Division during the *Timberwest v. Canada* proceedings, stating that federal restrictions of log exports were intended to maximize domestic value-added and jobs (*Timberwest v. Canada*, Transcript of June 7, 2006, at 1097-1100), (Investor’s Schedule of Documents at Tab 23).

<sup>31</sup> C. Lane, *Log Export and Import Restrictions of the US Pacific Northwest and BC: Past and Present*, at 43 (Seattle: US Department of Agriculture Forest Service, 1998) at Appendix 1, (Investor’s Schedule of Documents at Tab 20).

<sup>32</sup> Notice to Exporters No. 23, January 1, 1986, (Investor’s Schedule of Documents at Tab 24).

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fettering of his discretion.<sup>33</sup>

55. This led to minor adjustments to the old regime and gave rise to the current Log Export Control Regime. This is described in more detail in later sections.

**B. Categories of Land Ownership in BC**

56. BC has one of the largest public forests on earth. Nearly two-thirds of the province's total land base of 95 million hectares is forested.<sup>34</sup> Only five percent of the BC land base is privately-owned.<sup>35</sup> Due to the amount of land constituting BC public forest lands, the BC Govt has a series of statutes, regulations, contracts and administrative practices that collectively constitute the BC Govt's present forest policy.
57. There are four major categories of land ownership for timber in BC:
- a) Provincial government land (i.e., BC public forest lands);
  - b) Federal government land (including, for these purposes, aboriginal lands);
  - c) Private timberland granted before March 12, 1906 (referred to as "federal timberlands" or "federal timbermark lands"); and
  - d) Private timberland granted after March 12, 1906 (referred to as "provincial timberlands" or "provincial timbermark lands").
58. BC logs are subject to different export permit application procedures based on their category of land ownership. Exports from BC public forest lands and private lands granted after March 12, 1906 are controlled by the BC Govt. Log exports from private lands granted before March 12, 1906, and federal government lands are controlled by Canada.
59. Merrill & Ring primarily owns private lands granted before March 12, 1906, and therefore subject to federal government regulation. Merrill & Ring also owns a relatively

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<sup>33</sup> *K.F. Evans Ltd. v. Canada* (Minister of Foreign Affairs), Federal Court of Canada – Trial Division, 1996, 1996 CarswellNat 37, 106 F.T.R. 210 at 2. (Investor's Book of Authorities at Tab 1); *K.F. Evans Ltd. v. Canada* (Minister of Foreign Affairs), Federal Court of Appeal, 1998, 1998 CarswellNat 256 at paras 10-15. (Investor's Book of Authorities at Tab 2).

<sup>34</sup> Ministry of Forests and Range, *Timber Tenures in BC* (BC, 2006), at 2. (Investor's Schedule of Documents at Tab 28).

<sup>35</sup> Ministry of Forests and Range, *Timber Tenures in BC* (BC, 2006), at 2. (Investor's Schedule of Documents at Tab 28).

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small amount of private land granted after March 12, 1906, that is subject to provincial regulation.

**C. Market Players and Competition for Export Logs**

60. By virtue of the amount of land it controls, the BC Govt is by far the largest market player in the BC forestry sector. BC public forest lands extend over 80 million hectares of forests and account for about 95 % of all the productive timberlands in the province. As a result, the BC Govt, as owner of its public forest lands, determines the overall forest sector production.<sup>36</sup> The harvesting of BC public forest lands is managed by BCTS.
61. The remaining 4.1% of productive BC timberlands are held by about 20,000 private landowners.<sup>37</sup> These private forest lands are regulated by Canada or the BC Govt depending on the date when the lands were first granted. The vast majority of BC's private forest lands are owned by Canadian investors, including Timberwest and Island Timberlands, who together hold 75% of all privately-owned timberlands (including both federal and provincial timbermark lands) in the province.<sup>38</sup>
62. Merrill & Ring is one of over 70 private timberland companies under federal jurisdiction in BC.<sup>39</sup> Its share of the log market is less than 0.21%.<sup>40</sup>
63. Mason, Bruce & Girard is an expert forestry consulting firm based in Portland, Oregon. In their Expert Report prepared for this arbitration, they conclude that the types and species of logs harvested from privately owned federal timbermarkland in BC are interchangeable with logs from provincial timbermark lands. All of the timber from BC's private timberland is capable of competing with logs from other Canadian provinces, such as Alberta.<sup>41</sup>
64. The Expert Report of Mason, Bruce & Girard states that "many of the same tree species grow on the BC coast, in the BC interior, Alberta, Western Montana, Northern Idaho, and Eastern Washington. These include western hemlock, balsam, Douglas-fir, red cedar,

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<sup>36</sup> Expert Report of Prof. Peter Pearse at para. 6

<sup>37</sup> Expert Report of Prof. Peter Pearse at para. 7.

<sup>38</sup> Canada's *Statement of Defence* at para. 71.

<sup>39</sup> Canada's *Statement of Defence* at para. 1.

<sup>40</sup> Expert Report of Mason, Bruce & Girard at 3.

<sup>41</sup> Expert Report of Mason, Bruce & Girard at 13.

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spruce and alder, among others. Tree quality is comparable, although in some cases, Canadian trees have a higher quality because they have a higher ring count and greater density. Individual species' characteristics of Douglas fir, hemlock, true fir, and spruce on the west coast of the US and Canada are similar to the same species in the inland US or Canada".<sup>42</sup>

65. For example, second growth spruce, pine, hemlock and fir species sorts are combined and marketed together as inputs for SPF and Hem-Fir lumber. SPF and Hem-Fir lumber is used for structural framing in all types of residential, commercial, industrial and agricultural buildings in domestic and export markets.<sup>43</sup>

66. The Mason, Bruce & Girard Expert Report states:

Lumber manufacturers also incorporate different species into their operations by changing the species mix that is put into the sawmill. For example, one sawmill might run one-hundred percent (100%) Douglas fir-larch while another sawmill might dedicate only fifty percent (50%) of its production capacity to Douglas fir-larch and the other fifty percent (50%) to Hem-fir logs. This occurs through batch processing: logs are stored by species in the log yard, allowing for the same species to be manufactured as a batch, which may take several shifts or even weeks. Such mills therefore use different species interchangeably. And these species can be sourced from the BC coast, the BC interior or Alberta, provided it is economical to do so.<sup>44</sup>

67. According to Mason, Bruce & Girard "Manufacturers' abilities to obtain timber from more distant locations are affected more by economic factors, particularly transportation, than by tree species or manufacturing differences."<sup>45</sup>

68. As a result, public lands operations and private timberland holders are all part of the same business sector supplying logs for similar clients - domestic and international brokers and sawmills for example. These clients in turn, use one or more log species for similar market end-uses and therefore source timber inputs from different regions in BC and Alberta.<sup>46</sup>

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<sup>42</sup> Expert Report of Mason, Bruce & Girard at 14.

<sup>43</sup> Expert Report of Mason, Bruce & Girard at 15. *See also* Witness Statement of Paul Stutesman, at para. 12.

<sup>44</sup> Expert Report of Mason, Bruce & Girard at 16.

<sup>45</sup> Expert Report of Mason, Bruce & Girard at 14.

<sup>46</sup> Expert Report of Mason, Bruce & Girard at 15.

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69. The Expert Report of Mason, Bruce & Girard concludes that:

...Logs from the BC Coast can and do compete in the Northwestern US log market with logs exported from Alberta and from the BC interior.<sup>47</sup>

**D. Related Canada - US Trade Disputes**

70. Log export restrictions in BC have played a minor role in the longstanding forest products disputes between Canada and the US. The major issue has been a dispute over softwood lumber imports from Canada into the US.
71. In May 1992, the US Department of Commerce ("DOC") found BC log export restrictions to constitute a subsidy to Canadian domestic softwood lumber manufacturers. The DOC determination stated that BC log export restraints significantly reduced the domestic price for BC logs. The DOC stated:

In particular, the Margolick and Uhler study submitted on the record demonstrates that the BC log export restrictions have a "direct and discernible effect" upon the domestic price of BC logs. By reducing the demand for BC logs that otherwise exist in the absence of the BC export restrictions, the BC border measures have the effect of reducing the price of logs sold in the BC domestic market....Based upon this study, we determine that there is a relatively high or strong correlation between BC log export restraints and the significant price differential between exported and domestically consumed logs. Stated otherwise, it is highly probable that the BC export restrictions are primarily responsible for, or a "cause" of, this price differential.<sup>48</sup>

72. In August 1992, the government of Canada sought review of the DOC subsidy finding before a panel constituted pursuant to Article 1904 of the US-Canada Free Trade Agreement ("FTA").
73. A decision by the FTA Panel in December 1993 upheld the DOC's finding that BC's log export restraints had a "direct and discernible effect" on domestic log prices:

The Canadian Parties claim that Commerce's studies cannot establish a causal connection between B.C. log restrictions and lower domestic log prices because "none of the models test whether B.C.'s restraints cause a decline in domestic log prices. Each assumes it". The Canadian Complainants are correct in that the studies do not isolate the export restraints as the cause of the depressed domestic prices. Rather, each study demonstrates that if British Columbia removed its log export restraints, domestic prices would rise. The Panel finds this evidence—that lifting the

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<sup>47</sup> Expert Report of Mason, Bruce & Girard at 16.

<sup>48</sup> United States Department of Commerce, *Final Affirmative Countervailing Determination: Certain Softwood Lumber Products from Canada*, May 28, 1992, 57 FR 22570 at 22609-10. (Investor's Book of Authorities at Tab 26).

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restraints results in a rise in domestic log prices—supports, albeit not proving, the causal link Commerce aims to establish. This evidence, in conjunction with Commerce's other evidence in the record, combines to form the "substantial evidence" necessary to satisfy the "direct and discernible effects" test.<sup>49</sup>

74. The FTA Chapter 19 Panel also considered the testimony of BC officials to be persuasive evidence that BC's log export restraints depressed domestic market log prices:

As evidence to support the "direct and discernible effects" of log export restrictions, Commerce cites various B.C. officials, forestry experts, and members of Canadian lumber industry to demonstrate not only that the government intended the log export restrictions to benefit B.C. timber processors, but also that the government believed the log export restrictions had effective results. The Panel finds this testimony persuasive as corroborating evidence of the log export restraints' effects. In its Remand Decision, the Panel noted the B.C. Select Standing Committee on Forests and Lands has stated "[t]he reduced overall demand for logs resulting from arbitrarily restricting log exports provides the domestic processing sector with a lower log price." A committee formed by the B.C. government to study log exports concluded: "Without these restrictions, domestic log prices for most species and grades would certainly be higher than current levels, as domestic mills would be forced to compete for raw materials at higher prices in the world market." Similarly, the First Royal Commission on Forest Resources stated: "The most obvious effect of restrictions on export sales is that demand for logs is reduced, and this inevitably depresses domestic log prices."<sup>50</sup>

The FTA Panel ultimately ruled that there was insufficient evidence to find specific enterprises, industries or groups were intended beneficiaries.<sup>51</sup> During the pendency of this log export restraint dispute, the NAFTA was negotiated. The DOC determination occurred in May 1992. At least 32 drafts of what would become NAFTA Chapter 11 were considered and negotiated after the date of the DOC decision.<sup>52</sup>

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<sup>49</sup> United States-Canada Free Trade Agreement Article 1904 Binational Panel Review, U.S.A.-92-1904-01, *In the Matter of Certain Softwood Lumber Products from Canada*, December 17, 1993, at 98-99. (Investor's Book of Authorities at Tab 80).

<sup>50</sup> *United States-Canada Free Trade Agreement Article 1904 Binational Panel Review*, U.S.A.-92-1904-01, *In the Matter of Certain Softwood Lumber Products from Canada*, December 17, 1993, at 101-102. (Investor's Book of Authorities at Tab 80).

<sup>51</sup> *United States-Canada Free Trade Agreement Article 1904 Binational Panel Review*, U.S.A.-92-1904-01, *In the Matter of Certain Softwood Lumber Products from Canada*, December 17, 1993, at 81. (Investor's Book of Authorities at Tab 80).

<sup>52</sup> A comprehensive list of publicly available negotiating history drafts of NAFTA Chapter 11 is set out in Volume 3 of Barry Appleton, *NAFTA: Legal Text and Interpretative Materials* (West Publishing, 2007) at Vol 3, 17 - 18. (Investor's Book of Authorities at Tab 118).

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75. In the FTA, Canada had exempted log export restraints from the operation of the trade in goods provisions of that treaty.<sup>53</sup> The NAFTA Parties made identical exceptions to the NAFTA trade in goods obligations in NAFTA Chapter 3.<sup>54</sup>
76. In May 2000, Canada challenged the treatment of export restraints under US countervailing duty law before the WTO. According to Canada, the US *Statement of Administrative Action* of the *Uruguay Round Agreements Act* required log export restrictions to be deemed a financial contribution for purposes of subsidy determinations by the DOC. In August 2001, the Panel in *United States - Measures Treating Export Restraints as Subsidies* found against Canada and found that log export restraints did not constitute "financial contribution" under the definition of subsidy under the WTO Agreement on Subsidies and *Countervailing Measures*. Therefore, log restraint measures were not considered by the WTO to be countervailable subsidies.<sup>55</sup>

#### **E. The Purpose of the Log Exports Control Regime**

77. The stated purposes of the *Export and Imports Permit Act* includes ensuring an adequate supply of articles for "other needs" as well as defense, and more specifically "to ensure 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."<sup>56</sup>
78. In March of 1998, a *Memorandum of Understanding Between the Department of Foreign Affairs and International Trade and the British Columbia Ministry of Forests* ("Memorandum") expressly set out the purpose of the current Log Export Control Regime.<sup>57</sup> The Memorandum indicated the purpose of the regime was to "...ensure an

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<sup>53</sup> Article 1203 of the *United States-Canada Free Trade Agreement* set out exceptions for export restraints on logs of all species for both Parties to that treaty. This exception to the United States - Canada Free Trade Agreement did not cover the narrow investment obligations set out Chapter 16 of this Treaty. (Investor's Book of Authorities at Tab 119).

<sup>54</sup> NAFTA Annex 301.3.

<sup>55</sup> *United States - Measures Treating Export Restraints as Subsidies*, Report of the Panel, June 29, 2001, WT/DS194/R, at para. 8.131. (Investor's Book of Authorities at Tab 104).

<sup>56</sup> Expert Report of Prof. Pearse at para. 12.

<sup>57</sup> Memorandum of Understanding between the Department of Foreign Affairs and International Trade and the British Columbia Ministry of Forests, March 30, 1998, (Investor's Schedule of Documents Tab 26) Note the purpose for the Memorandum was explicitly set out within the document but was redacted in the copy obtained by the Investor.



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adequate supply of logs for domestic manufacture.”<sup>58</sup>

79. Notice to Exporters Serial No. 102 (“Notice 102”) is a federal log export policy first promulgated in April 1998. Notice 102 applies only to logs obtained from federally regulated lands in BC. Section 1.3 of Notice 102 states “that in order to determine adequate supply, forest products... proposed for export from British Columbia [shall] undergo a surplus testing procedure in consultation with the Provincial government”.<sup>59</sup>
80. Section 4.3 of Notice 102 makes clear that log export controls also serve to further log processing interest in Canada stating “for the purposes of surplus testing, normally the FTEAC will consider offers only from persons who are involved in log processing. That is, persons who own or operate log processing facilities.”<sup>60</sup>

#### **F. The BC Aspect of the Log Export Control Regime**

81. Logs harvested from provincial timbermark lands (“provincial logs”) are subject to the laws, regulations and administrative procedures of the BC Govt.
82. The key legislation governing the export of provincial timber and logs from BC is the BC *Forest Act*. The procedural requirements for exporting provincial logs are found in the *Province of British Columbia Procedures for Export of Timber 1999: Vancouver and Prince Rupert Forest Regions* (“BC Export Procedures”).
83. Section 127 of the *Forest Act* sets out the general rule: timber from private lands granted after March 12, 1906 must be used or processed in the province, and may not be exported (“Log Restraint General Rule”).<sup>61</sup>
84. Even though the Log Restraint General Rule forms the basis of the BC Govt’s policy for provincial timber and logs, there are three instances in which exceptions may be made, and exports allowed:
- a) when the timber is surplus to the requirements of timber processing facilities in BC;
  - b) when the timber cannot be processed economically in the vicinity of the land from which it is cut, and cannot be transported economically to a processing facility located elsewhere in BC; or

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<sup>58</sup> Expert Report of Prof. Peter Pearse at para. 13.

<sup>59</sup> Notice 102, April 1, 1998 (Investor’s Schedule of Documents, Tab 22).

<sup>60</sup> Notice 102, April 1, 1998 (Investor’s Schedule of Documents, Tab 22).

<sup>61</sup> Canada’s *Statement of Defence* at para. 20.

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- c) when an exemption would prevent the waste of or improve the utilization of timber cut from BC public forest lands.<sup>62</sup>

Nonetheless, exemptions on certain types of timber, including red and yellow cedar, as well as high grade balsam, fir, hemlock or spruce are outright prohibited, as there is an absolute ban on the export of such provincial timber from BC.<sup>63</sup>

85. Exemptions to the Log Restraint General Rule may be granted for provincially regulated timber whether it is already harvested or not. That is, for provincial timber exemptions are available for logs as well as for trees that are still standing. Such exemptions are called “standing green” or “standing timber” exemptions.
86. Exemptions under the first of the three criteria – the surplus criteria – require exporters of provincial logs to demonstrate that the logs are surplus to the requirements of timber processing facilities in BC. To do so, the logs must pass what is called a “surplus testing procedure”. This requires that the exporter advertise its logs for domestic sale on what is called the Provincial Bi-Weekly Advertising List (“Provincial Bi-Weekly List”).<sup>64</sup> Advertisements on the Provincial Bi-Weekly List require that the logs be scaled in accordance with BC laws, regulations and guidelines,<sup>65</sup> as well as sorted and boomed or decked in accordance with “normal log market practices.”<sup>66</sup> Advertised logs must also be marked properly.<sup>67</sup>
87. Once provincial logs are advertised on the Provincial Bi-Weekly List, they must remain in the listed sort, configuration and location for the duration of the entire advertising period.<sup>68</sup> During this time, BC processors such as sawmills may inspect the logs and make offers to purchase them. Once made, offers remain open for a period specified on

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<sup>62</sup> BC *Forest Act*, s.128(3) (Investor’s Schedule of Documents, Tab 65); Canada’s *Statement of Defence* at para. 20.

<sup>63</sup> BC *Export Procedures*, s. 3.11. (Investor’s Schedule of Documents at Tab 31).

<sup>64</sup> BC *Export Procedures*, s. 3.12. (Investor’s Schedule of Documents at Tab 31).

<sup>65</sup> These include Part VI of the BC *Forest Act*, the BC *Scaling Regulation*, and the *Scaling Manual*. See BC *Export Procedures*, s.3.13.(Investor’s Schedule of Documents at Tab 31).

<sup>66</sup> BC *Export Procedures*, s. 3.14. (Investor’s Schedule of Documents at Tab 31).

<sup>67</sup> BC *Export Procedures*, s. 3.15. (Investor’s Schedule of Documents at Tab 31).

<sup>68</sup> BC *Export Procedures*, s. 3.6. (Investor’s Schedule of Documents at Tab 31).

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the Provincial Bi-Weekly List.<sup>69</sup>

88. If a sort of logs does not receive any offers while on the Provincial Bi-Weekly List, an exemption may be granted at the discretion of BCMOF. If, however, the logs do receive an offer, the offer will be reviewed by an administrative body, the Timber Export Advisory Committee ("TEAC"). TEAC is comprised of industry representatives from various regions throughout the province, as well as representatives from BCMOF. It reviews all offers to determine if they are in line with the fair domestic market value of the logs at the time the offers were made.<sup>70</sup> It also considers whether the offeror and the applicant are allowed to engage in the process.
89. For example, TEAC is "not supposed" to consider any offer made by any person who has exported logs directly or indirectly from BC within 90 days of having made the offer. Conversely, it is "not supposed" to consider applications for export made by any person that has submitted an offer for logs listed on the Provincial Bi-Weekly List within the previous 90 days.<sup>71</sup> In the end, if TEAC decides that an offer is in line with domestic market prices, or if the applicant is disqualified from the process, it recommends that the export application be rejected. Otherwise it is supposed to recommend that BCMOF approve the application.<sup>72</sup> This is done by way of a Ministerial Order, which is granted at the discretion of BCMOF.<sup>73</sup>
90. Exemptions under the second of the three exemption criteria – the economic exemption – are sometimes granted to entire regions of the province. This is a type of standing green exemption commonly called a "blanket exemption."<sup>74</sup> As of November 2006, there were five active blanket exemptions for log exports.<sup>75</sup> Blanket exemptions tend to apply only to regions that are quite remote, such that the costs of harvesting are unusually high. Selling timber from such regions at the BC market price would not afford harvesters a

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<sup>69</sup> *BC Export Procedures*, s. 3.7. (Investor's Schedule of Documents at Tab 31).

<sup>70</sup> *Canada's Statement of Defence* at para. 23.

<sup>71</sup> *BC Export Procedures*, s. 3.7. (Investor's Schedule of Documents at Tab 31).

<sup>72</sup> See generally *BC Export Procedures*, s. 3.7. (Investor's Schedule of Documents at Tab 31).

<sup>73</sup> See *BC Export Procedures*, s. 3.8. (Investor's Schedule of Documents at Tab 31).

<sup>74</sup> *BC Export Procedures*, s. 3.92. (Investor's Schedule of Documents at Tab 31).

<sup>75</sup> Bill Dumont and Don Wright, 'Generating More Wealth from British Columbia's Timber - A Review of British Columbia's Log Export Policies' at 16, (Investor's Schedule of Documents at Tab 21).

*Merrill & Ring Forestry L.P.*

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sufficient economic return. Only by allowing such timber to be sold at the higher prices available on the world market can the government induce logging in these areas.

91. All applications for standing green exemptions – including blanket exemptions – are also subject to review by TEAC.<sup>76</sup> Should TEAC recommend the approval of an export permit under a standing green exemption, and should BCMOF agree, approval will be granted by way of an Order In Council.<sup>77</sup> BCMOF almost invariably follows the recommendations of TEAC.
92. Exemptions under the third criteria – the waste prevention exemption – only apply to timber from BC public forest lands (or “Provincial Crown land”). BCMOF has issued such exemptions to encourage the harvest of timber that would otherwise be destroyed by the mountain pine beetle.<sup>78</sup> According to the *BC Forest Act*, however, BCMOF may not issue the same exemptions to federal timber not located in a tree farm license area, even if it faces the same threat.
93. Regardless of the type of exemption at issue, once BCMOF has agreed to exempt timber from the basic rule, any person that wishes to export under an exemption must apply to BCMOF for a permit.<sup>79</sup> An applicant, or its agent, must furnish BCMOF with the appropriate form, including export sales invoices, and, where applicable, an export tariff called a “fee in lieu of manufacture.”<sup>80</sup> The BCMOF will only grant a certificate under its export requirements if it is satisfied that the applicant has met all its obligations. An applicant that receives BCMOF’s approval must then seek an export permit from the federal government.<sup>81</sup> Issuance of a log export permit is a function exclusive to DFAIT.

#### **G. The Federal Export Log Control Regime**

94. The Log Export Control Regime for logs from federal timbermark lands (“federal logs”)

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<sup>76</sup> *BC Export Procedures*, s. 3.9 (Investor’s Schedule of Documents at Tab 31).; Canada’s *Statement of Defence* at para. 24.

<sup>77</sup> *BC Export Procedures*, s. 3.91 (Investor’s Schedule of Documents at Tab 31).; Canada’s *Statement of Defence* at para. 24.

<sup>78</sup> Canada’s *Statement of Defence* at para. 25.

<sup>79</sup> *BC Export Procedures*, s. 5.1. (Investor’s Schedule of Documents at Tab 31).

<sup>80</sup> *BC Export Procedures*, s. 2.4 & 5.1. (Investor’s Schedule of Documents at Tab 31).

<sup>81</sup> *BC Export Procedures*, s. 2.4 & 5.4. (Investor’s Schedule of Documents at Tab 31).

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is substantially similar to that applied to logs from provincial lands. However, there are some critical differences. The following is a description of the federal regime.

*i. Notice 102*

95. Notice 102 has been continuously in effect since April 1, 1998. It governs the export of federal logs. Even though Notice 102 is a federal policy, it only applies to the export of federal logs from BC, as opposed to other provinces. In all other parts of Canada, federal logs automatically receive export permits. Federal logs in BC are unique in having to be subjected to a long and costly export permitting process required by Notice 102.
96. Exporting federal logs requires an export permit from the federal government. To obtain an export permit, export applicants must follow the specific procedures laid out in Notice 102.
- a. Harvesting Requirements
97. Notice 102 lays out how federal logs must be harvested, sorted and boomed or decked to get an export permit. Since it states that "only harvested logs will be considered for export,"<sup>82</sup> federal landholders have to harvest their trees before they can successfully apply for an export permit. Logs from provincial lands may be exempted from this restriction, and assured an export permit for logs before the trees are harvested.
98. Notice 102 requires federal logs to be scaled metrically.<sup>83</sup> Logs sent to the US or Asia do not need to be measured metrically. As a result, any logs federal landowners export to the US or Asia may need to be scaled twice or re-scaled to accord with each system.
99. Notice 102 further places limitations on the size of federal log export applications. In order to be considered for export, the volume of federal logs from remote areas must be at least 2,800 m<sup>3</sup>. Log volumes are always limited to less than 15,000 m<sup>3</sup>.<sup>84</sup>
100. Notice 102 also states that federal landholders have to sort, boom or deck their logs to conform to normal log market practices.<sup>85</sup> Notice 102 does not, however, specify what "normal" market practices are. The federal regime says nothing and provides no

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<sup>82</sup> Notice 102, section 1.5. (Investor's Schedule of Documents at Tab 22).

<sup>83</sup> Notice 102, section 1.6. (Investor's Schedule of Documents at Tab 22).

<sup>84</sup> Notice 102, section 1.4. (Investor's Schedule of Documents at Tab 22).

<sup>85</sup> Notice 102, section 1.5. (Investor's Schedule of Documents at Tab 22).

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guidance on this critical requirement. Instead, on a practical basis, this determination is made by provincial authorities based on provincial practices.

101. Notice 102 delegates the task of inspecting federal logs to BCMOF to ensure that it satisfies all these technical requirements.<sup>86</sup> If federal landholders do not prepare their logs in accordance with what BCMOF – a provincial authority – deems to be “normal” market practices, BCMOF will not allow them to apply for an export permit. However, authority for export permits lies with the Export Control Division of the Department of Foreign Affairs and International Trade (“DFAIT”), a federal government entity.<sup>87</sup>

b. Standing Timber Exemptions are Unavailable for Federal Logs

102. Unlike provincial logs, standing timber exemptions are wholly unavailable to federal logs. Canada claims that this is because it “does not have legal or constitutional authority respecting timber, including timber exemptions.”<sup>88</sup>

103. Canada has acknowledged there is no reason that private landowners subject to federal regulation are not eligible for standing timber exemptions. An internal memorandum noting a meeting between federal and provincial officials responsible for administrating the federal surplus test said:

On the question of Standing Timber, policies exist only with respect to Provincial logs. Federal practice has been to accept only harvested timber applications. No one could say why this is so ...<sup>89</sup>

104. At the meeting, the provincial officials said that they “would like the federal government to adopt similar standing timber policies as applied provincially.”<sup>90</sup> The federal government representative responded:

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<sup>86</sup> Notice 102, section 1.6. (Investor’s Schedule of Documents at Tab 22).

<sup>87</sup> Canada’s *Statement of Defence* at para. 29.

<sup>88</sup> Canada’s *Statement of Defence* at para. 34.

<sup>89</sup> Memo from Thomas E. Jones, Department of Foreign Affairs and International Trade, March 21, 1996. (Investor’s Schedule of Documents at Tab 45).

<sup>90</sup> Memo from Thomas E. Jones, Department of Foreign Affairs and International Trade, March 21, 1996. (Investor’s Schedule of Documents at Tab 45).

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The federal government sees no reason why a standing timber policy cannot be implemented immediately. In other words, we would be prepared to consider both harvested and standing timber exports.<sup>91</sup>

105. Even if BCMOF has granted a standing timber exemption to provincial timber, DFAIT recently stated that it would not, in any event, grant an export permit for such timber if sourced from the south-coast of the province.<sup>92</sup>

c. The Export Application Process

106. Once a private federal landowner has prepared its logs according to specifications and received the approval of BCMOF, it may then apply for an export permit. The export permit application process involves a number of steps.
107. The first step is to submit an export application to the federal government through the Export Controls Online ("EXCOL") system. In this application, private federal landowners have to disclose the characteristics of the logs they want to export. They must indicate the names of the owner and applicant, whether the logs are harvested or standing, the forest region they come from, the applicable timbermark, whether they are from old-growth or second-growth trees, the number of logs, the average length and diameter of the logs, the grades of logs in the application, and the volume of logs for each grade.<sup>93</sup>
108. These application requirements are not specified in Notice 102, which states that export applicants for federal logs must submit a form called EXT1718.<sup>94</sup> Federal log exporters have not had to do this since the EXCOL system was implemented on March 29, 2006. As a result, Notice 102 is clearly out of date, at least in this respect.
109. After it receives an export application, DFAIT must request BCMOF to notify potential domestic purchasers of the logs that are up for sale under what is called the BC Federal Bi-Weekly List ("Federal Bi-Weekly List").<sup>95</sup> During the 14 days the Federal Bi-Weekly

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<sup>91</sup> Memo from Thomas E. Jones, Department of Foreign Affairs and International Trade, March 21, 1996. (Investor's Schedule of Documents at Tab 45).

<sup>92</sup> Letter from Lynn Sabatino to Richard Ringma, (October 12, 2007). (Investor's Schedule of Documents at Tab 74).

<sup>93</sup> Witness Statement of Tony Kurucz, at para. 30.

<sup>94</sup> Notice 102, section 2.1. (Investor's Schedule of Documents at Tab 22).

<sup>95</sup> Notice 102, section 2.2. (Investor's Schedule of Documents at Tab 22).

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List usually remains open, domestic timber processors may make offers on the federal logs.

110. After this 14 day period, if no offers are made on the federal logs, the export application is sent directly to DFAIT. In determining whether to grant an export permit DFAIT considers the fact that the export applicant received no offers, as well as "any other factors".<sup>96</sup> DFAIT has never specified what other factors it considers important.<sup>97</sup>
111. If an offer is made on the federal logs, both the BC and federal governments are notified. Copies of all offers for federal timber are sent to BCMOF and DFAIT. Copies of all offers on provincial timber only go to BCMOF. DFAIT and BCMOF remit all applications for the export of federal logs for review by the Federal Timber Export Advisory Committee ("FTEAC").<sup>98</sup> FTEAC determines whether an offer on Merrill & Ring's logs is in line with prevailing market prices in BC and recommends to DFAIT whether to grant an export permit. All offers are kept secret and reserved only for FTEAC's review. FTEAC meetings – as well as the minutes thereof – are closed to the public.
112. Notice 102 does not specify how FTEAC is to determine whether offers on logs should be accepted. FTEAC will only recommend that DFAIT grant an export permit if FTEAC deems the logs to be surplus to domestic needs. It does this by way of a so-called "surplus testing procedure",<sup>99</sup> the same testing procedure used by TEAC. If FTEAC deems federal logs surplus to domestic needs it recommends to DFAIT that it grant an export permit. Otherwise, it recommends that the applicant be denied an export permit and forced to sell its logs in the domestic market.
113. When it receives FTEAC's recommendation, DFAIT is supposed to consider FTEAC's recommendation plus "other relevant factors" before making a final determination.<sup>100</sup> DFAIT has never specified what factors it considers relevant in this regard.<sup>101</sup> DFAIT

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<sup>96</sup> Notice 102, section 3.0. (Investor's Schedule of Documents at Tab 22).

<sup>97</sup> Witness Statement of Tony Kurucz, at para. 33.

<sup>98</sup> Notice 102, section 4.0. (Investor's Schedule of Documents at Tab 22).

<sup>99</sup> Notice 102, section 1.3. (Investor's Schedule of Documents at Tab 22).

<sup>100</sup> Notice 102, section 4.4. (Investor's Schedule of Documents at Tab 22).

<sup>101</sup> Witness Statement of Tony Kurucz at para. 36.



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almost invariably "rubber stamps" any recommendation FTEAC makes.<sup>102</sup> Should DFAIT allow an applicant to export its logs, the applicant must pay a fee before it can get a permit.<sup>103</sup>

114. Once an export applicant receives a permit, it normally has four months to export its logs. If it is not able to export its logs by that time it loses its export permit. Once an export permit has expired there is no way to get a new one. If the permit holder anticipates that it will not be able to export its logs in time, it must apply for an extension at least five days prior to the expiry date.<sup>104</sup> It used to be two weeks, but was changed to five days on October 30, 2007.<sup>105</sup> Extensions are limited to one month.
115. Many federally regulated lands are adjacent to provincially regulated lands. There may be no discernable difference between the growing conditions or harvesting requirements on such lands. The land may be physically and geographically identical. Nonetheless, otherwise identical logs harvested from neighbouring provincial lands are not subject to Notice 102.

ii. *The Administration of Notice 102: FTEAC*

116. FTEAC is the body charged with reviewing export applications for logs produced from federal lands in BC. It is normally comprised of 8-10 members, plus one representative of the federal government.<sup>106</sup> Apart from the federal representative, FTEAC is comprised of the same membership as TEAC. There are no committees of this nature in any other province in Canada.<sup>107</sup> The federal representative on FTEAC is often not in attendance at their meetings.<sup>108</sup>
117. FTEAC is charged with recommending to DFAIT whether or not to approve an export application for federal logs in BC. While DFAIT is not obliged to follow the

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<sup>102</sup> Witness Statement of Tony Kurucz at para. 36.

<sup>103</sup> Notice 102, section 7.1. (Investor's Schedule of Documents at Tab 22).

<sup>104</sup> Notice 102, section 4.5. (Investor's Schedule of Documents at Tab 22).

<sup>105</sup> Witness Statement of Tony Kurucz at para. 37.

<sup>106</sup> Witness Statement of Tony Kurucz at tpara. 39.

<sup>107</sup> Witness Statement of Tony Kurucz at para. 39.

<sup>108</sup> Witness Statement of Tony Kurucz at para. 39.

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recommendations of FTEAC, in practice it almost invariably does so.<sup>109</sup>

118. To determine whether to recommend that DFAIT approve an export application, FTEAC considers whether any offers received on the logs are in line with prevailing BC prices for similar logs. There are no specific criteria by which FTEAC is required to conduct its assessment.<sup>110</sup>
119. FTEAC is, however, precluded by Notice 102 from considering certain types of matters. These include:
- a) offers made by any person who has exported logs directly or indirectly from Canada within the previous 90 days;
  - b) applications submitted by a company or individual who has submitted a valid offer for logs advertised during the preceding 90 days;
  - c) offers made by persons not involved in log processing; and
  - d) offers that are incomplete.
120. The membership of FTEAC is comprised of market players from various parts of BC. Many FTEAC members have either direct or indirect interests in BC sawmills. Such members have an interest in making sure domestic market prices remain as low as possible. They therefore have an interest in making sure logs do not get approved for export whenever possible. As a result, in determining what is a “fair” offer, FTEAC adopts a biased perspective in favor of BC timber processors. In this respect, FTEAC is like a fox guarding the henhouse.
121. FTEAC does not physically inspect the logs in question when determining whether an offer is “fair”.<sup>111</sup> Each export application refers to a particular grade of log. But within each grade there is a range of quality that is possible. As there is no physical inspection, FTEAC can never know precisely where in the range of quality within a grade a particular application lies. As a result, FTEAC is unable to accurately assess the quality of the logs, and therefore the appropriate market price for those logs.
122. John McCutcheon – a former Chair of FTEAC – has testified that FTEAC’s determination as to what is “fair” occurs in the context of the overriding goal of ensuring

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<sup>109</sup> Witness Statement of Tony Kurucz at para. 40.

<sup>110</sup> Witness Statement of Tony Kurucz at para. 41.

<sup>111</sup> Witness Statement of Tony Kurucz at para. 44.

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that the BC sawmill industry has an adequate supply of logs.<sup>112</sup> It is in the context of this overriding goal that FTEAC has improperly recommended the denial of export permits in a number of situations, including:

- a) where offers are made by companies that are logging at levels below their annual allowed amounts;
- b) where offers are made from mills for log species and/or sorts that are not used by those mills; and
- c) where offers are made by companies that have indirectly exported in the past 90 days.<sup>113</sup>

The federal representative of FTEAC has been made aware of these and other improprieties.<sup>114</sup> Even though the federal government knows about these abuses, it has done nothing to remedy the situation.

123. There has never been anyone on FTEAC with any significant private federal landholdings.<sup>115</sup> This is striking in light of the fact that FTEAC is charged with considering export applications for federal logs.

a. Federal Log Export Control Regime Based on Unknown Criteria

124. The federal government does not publish the criteria considered in FTEAC or DFAIT decision-making. Nor will it provide a list or description of the criteria used by DFAIT officials in determining whether logs are surplus to the domestic market.<sup>116</sup>

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<sup>112</sup> Testimony of John McCutcheon, *TimberWest v. Canada*, June 5, 2006, at p. 785, (Investor's Schedule of Documents at Tab 37).

<sup>113</sup> Witness Statement of Tony Kurucz at para. 45.

<sup>114</sup> Letter from Blair Robertson to Thomas Jones, (December 3, 2002), (Investor's Schedule of Documents at Tab 44).

<sup>115</sup> Testimony of John McCutcheon, *TimberWest v. Canada*, June 5, 2006, at 783, (Investor's Schedule of Documents at Tab 37).

<sup>116</sup> Letter from Norm Schaaf, Merrill & Ring to Lynda Watson, Thomas Jones, Diane Burke, Department of Foreign Affairs and International Trade Re: Federal Procedures Regarding Log Exports from BC, January 30, 1997, (Investor's Schedule of Documents Tab 59); Fax to Thomas Jones, Department of Foreign Affairs and International Trade from Paul Stutesman, Merrill & Ring July 28, 1998, (Investor's Schedule of Documents at Tab 60); Letter from Paul Stutesman, Merrill & Ring to Thomas E. Jones, Ministry of Forests, dated July 30, 1998, (Investor's Schedule of Documents at Tab 61); Letter from Paul Stutesman, Merrill & Ring to Thomas E. Jones, Department of

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b. FTEAC Decisions are Not Transparent

125. There is no transparency or legal security in the FTEAC administrative process. There is no opportunity for private landowners to review offers, make submissions to FTEAC or observe FTEAC meetings. Minutes of FTEAC meetings are not publicly available.
126. In the result, TEAC/FTEAC is able to apply arbitrary and non-specific criteria when determining whether an offer is "fair." On one occasion, one of its members advised that as long as the offer price is within 5% of the domestic market value, that would merit TEAC's/FTEAC's acceptance of the offer.<sup>117</sup>
127. TEAC/FTEAC fails to take into consideration important factors about the "fairness" of any given offer. For example, TEAC/FTEAC does not consider whether the offers assume delivery at the Vancouver log market. Merrill & Ring's logs may, in fact, be far away from the Vancouver log market. Transport entails considerable risk and expense. As a result, export applicants are sometimes forced to incur transport risks and expenses in exchange for a purchase price that does not take them into account.<sup>118</sup>
128. In 1996, Canada recognized that the FTEAC decision-making process was opaque. In a memorandum to the provincial officials administrating the Federal Surplus Test, a federal government official "indicated that we were keen on developing procedures that were transparent."<sup>119</sup> No improvements to the decision-making process were ever made.

c. FTEAC's Members are in Conflicts of Interest

129. Many of the members of FTEAC work for domestic log processors<sup>120</sup> and, therefore, have a direct interest in suppressing the costs of logs available on the BC domestic market.

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Foreign Affairs and International Trade, dated July 31, 1998, (Investor's Schedule of Documents at Tab 61); Letter from Paul Stutesman, Merrill & Ring to Thomas E. Jones, Department of Foreign Affairs and International Trade, dated May 19, 1999; (Investor's Schedule of Documents at Tab 62).

<sup>117</sup> Witness Statement of Tony Kurucz at para. 50.

<sup>118</sup> Witness Statement of Tony Kurucz at para. 49.

<sup>119</sup> Memo from Thomas E. Jones, Department of Foreign Affairs and International Trade, March 21, 1996, (Investor's Schedule of Documents at Tab 45).

<sup>120</sup> Canada admits at para. 84 of its *Statement of Defence* that "the membership of FTEAC consists of primarily domestic log processors."

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More particularly, each of the following FTEAC members (as of May 5, 2006) worked for companies that are domestic log processors:

- Hans de Visser;<sup>121</sup>
- Ken Taylor;<sup>122</sup>
- Jim Probyn;<sup>123</sup>
- Angus Allison;<sup>124</sup>
- Mo Takhar;<sup>125</sup>
- Thomas Pierre;<sup>126</sup> and
- John McCutcheon.<sup>127</sup>

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<sup>121</sup> Hans de Visser is affiliated with Coastland Wood Industries Ltd. See *Generating More Wealth from British Columbia's Timber: a Review of British Columbia Export Policies - December 2006* at 80. (Investor's Schedule of Documents at Tab 21). Coastland Wood Industries owns and operates a sawmill in Nanaimo, British Columbia. See excerpt from execCanada webpage entitled 'Coastland Industries Profile', September 16, 2007. (Investor's Schedule of Documents at Tab 50).

<sup>122</sup> Ken Taylor is affiliated with Pope & Talbot Inc. See *Generating More Wealth from British Columbia's Timber: a Review of British Columbia Export Policies - December 2006* at 81. (Investor's Schedule of Documents at Tab 21). Pope & Talbot Inc. owns and operates sawmills in Fort St. James, Castlegar, Grand Forks and Midway, British Columbia. See excerpt from Pope & Talbot webpage, entitled 'Pope & Talbot Sawmill Locations' (accessed on October 31, 2007). (Investor's Schedule of Documents at Tab 51).

<sup>123</sup> Jim Probyn is Manager of the Log and Marketing division of Probyn Log Ltd., part of the Probyn Group. See excerpt from Probyn Group webpage entitled 'Probyn Log Ltd., Contact Names and Departments'. (Investor's Schedule of Documents at Tab 52). The Probyn Group operates a sawmill in Squamish Valley, British Columbia. See excerpt from Probyn Group webpage entitled 'Probyn Group of Companies BC Sawmills'. (Investor's Schedule of Documents at Tab 53).

<sup>124</sup> Angus Allison is affiliated with Richmond Plywood Corporation Ltd. See *Generating More Wealth from British Columbia's Timber: a Review of British Columbia Export Policies - December 2006* at 81. (Investor's Schedule of Documents at Tab 21). Richmond Plywood Corporation operates a sawmill in Richmond, British Columbia. See webpage of the Canadian Plywood Association - Plywood Mills - Richmond Plywood Corporation Ltd. (Investor's Schedule of Documents at Tab 54).

<sup>125</sup> Mo Takhar is President of Terrace Lumber Ltd., which owns and operates a sawmill in Terrace, British Columbia. See article by Jim Stirling on Terrace Lumber Company published on The Logging and Sawmilling Journal headed 'From Idle to Active', May 2006. (Investor's Schedule of Documents at Tab 55).

<sup>126</sup> Thomas Pierre is Manager of Tanizul Timber Ltd, which operates a sawmill near Fort St. James, British Columbia. See profile of Tanizul Timber available at [www.companylistings.ca](http://www.companylistings.ca). (Investor's Schedule of Documents at Tab 56).

<sup>127</sup> John McCutcheon is affiliated at International Forest Products Limited (Interfor), which operates four sawmills in Hammond, Acorn, Queensboro and Adams Lake, British Columbia. See Interfor's 2006 Annual Report at 52 available at [www.interfor.com/interfor/investors/annual\\_reports](http://www.interfor.com/interfor/investors/annual_reports) (Investor's Schedule of Documents at Tab 57). The Investor has not yet had the opportunity to obtain from Canada information on the number of the Investor's rafts

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Jim Probyn, Thomas Pierre, Ken Taylor and John McCutcheon have additional conflicts of interest arising from the fact that their employers also export logs.<sup>128</sup> Documents about the selection of FTEAC members, its operations and meetings of FTEAC are not available to the public.

130. Canada is aware that members of FTEAC, and its predecessors, have conflicting interests, but has taken no action to address the conflicts. In 1996, a federal government representative “suggested that it might be reasonable if guidelines were developed to deal with potential conflicts of interest in the TEAC context.”<sup>129</sup> The BC government rejected the suggestion as “too constraining”, preferring to maintain “flexibility and allow members to announce when *they* believe that a conflict may exist.”<sup>130</sup> The federal government representative insisted on including a formal recommendation “[t]hat Conflict of Interest Guidelines be developed for members of TEAC.”<sup>131</sup> Canada did nothing in response to this recommendation. Documents concerning FTEAC’s membership and selection processes are not available to the public. A review of such documents is necessary to properly assess these apparent conflicts of interest.

d. FTEAC Decisions are Not Subject to Meaningful Review

131. There is no codified process for appeal or review of an FTEAC recommendation. Although a potential exporter may request an *ad hoc* review from DFAIT, the granting of such a review is entirely discretionary. This *ad hoc* discretionary review process is so

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blocked by companies with whom these FTEAC members are affiliated. The production of this information is required by the Investor to be able to address this issue.

<sup>128</sup> Please see excerpt from Probyn Log’s webpage entitled ‘Probyn Log Ltd., Contact Names and Departments’, (accessed on November 1, 2007), (Investor’s Schedule of Documents at Tab 52). Tanizul Timber exports timber to Japan. See Tanizul Timber company profile at Industry Canada’s webpage [strategis.gc.ca](http://strategis.gc.ca) (Investor’s Schedule of Documents at Tab 58). Pope and Talbot also exports timber to Japan. See excerpt from Pope & Talbot webpage, entitled ‘Pope & Talbot Sawmill Locations’, (Investor’s Schedule of Documents at Tab 51). Interfor exports to Japan, Australia, Asia and Europe. See Interfor’s 2006 Annual Report at 55, available at [www.interfor.com/interfor/investors/annual\\_reports](http://www.interfor.com/interfor/investors/annual_reports) (Investor’s Schedule of Documents at Tab 57).

<sup>129</sup> Memo from Thomas E. Jones, Department of Foreign Affairs and International Trade, March 21, 1996, (Investor’s Schedule of Documents at Tab 45). Note that in 1996, TEAC administered the Federal Surplus Test.

<sup>130</sup> Memo from Thomas E. Jones, Department of Foreign Affairs and International Trade, March 21, 1996, [emphasis added]. (Investor’s Schedule of Documents at Tab 45).

<sup>131</sup> Memo from Thomas E. Jones, Department of Foreign Affairs and International Trade, March 21, 1996, (Investor’s Schedule of Documents at Tab 45).

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inadequate as to amount to no meaningful appeal or review at all.<sup>132</sup>

**H. The Federal Regime does not further Canada's Objectives**

132. Any jobs created in the BC log processing sector as a result of the Log Export Control Regime are offset by losses in the log export sector. Peter Pearse is a Professor Emeritus of Forest Economics and Policy at the University of British Columbia. Professor Pearse is widely acknowledged as a pre-eminent expert in BC forest policy. In a 1976 BC Royal Commission Study, Professor Pearse, sitting as sole Commissioner, concluded that "[t]here is no convincing evidence that total employment in the forest industry would decrease following an elimination of the export restrictions" and that indeed "it might well increase."<sup>133</sup>
133. In his 1976 Royal Commission Report, Professor Pearse, found that even if Canada wanted to increase log *processing* jobs in particular this would not justify the Log Export Control Regime. He concluded:
- ... my evidence and analysis of this issue leads me to the inescapable conclusion that, whatever the benefits of increased manufacturing in the province, encouragement of it by means of restrictions on export of logs reflects a misunderstanding of the full impacts of such policies in the context of the provincial economy.<sup>134</sup>
134. In 2001, Professor Peter Pearse was named Special Advisor to the BC Minister of Forests. Professor Pearse was asked to "review the faltering forest industry in BC's coast region and to investigate the causes of its weakening performance".<sup>135</sup> He authored a report for the Minister setting out his recommendations entitled *Ready for Change: Crisis and Opportunity in the Coast Forestry Industry*.
135. For this arbitration, Professor Pearse prepared an Expert Report providing a detailed

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<sup>132</sup> See Notice 102, s.4.4 "The ECD/DFAIT will review the FTEAC recommendation and other relevant factors in determining whether or not adequate supply exists. (Investor's Schedule of Documents Tab 22).

<sup>133</sup> P. H. Pearse, The Royal Commission on Forest Resources '*Timber Rights and Forest Policy in British Columbia*', (1976), at 310 (Investor's Schedule of Documents at Tab 40); See also BC Special Log Export Policy Committee, at iii, (Investor's Schedule of Documents at Tab 11).

<sup>134</sup> P. H. Pearse, The Royal Commission on Forest Resources '*Timber Rights and Forest Policy in British Columbia*', (1976), at 308 (Investor's Schedule of Documents at Tab 40).

<sup>135</sup> Peter Pearse, *Ready for Change: Crisis and Opportunity in the Cost Forest*, at i. (Pearse Witness Binder at Tab 10)

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examination of the Log Export Control Regime.<sup>136</sup> In his Expert Report, Professor Pearce describes how the Log Export Control Regime fails to accomplish the objective of providing domestic manufacturers with an adequate supply of logs. Professor Pearce points out that the BC Govt owns 95% of productive timberlands under provincial jurisdiction and thereby has definitive control of overall domestic supply. In contrast, the regime impacts only about 3.5% of overall domestic supply coming from private timberlands.<sup>137</sup>

136. Professor Pearce further notes that the Log Export Control Regime fails to take into account the ability of domestic mills to make full use of local production. For example, in a ten year period between 1996 and 2005 mills in the coastal region have been unable to absorb production in excess of 30 million cubic meters.<sup>138</sup> There is clearly no shortage of supply.
137. Professor Pearce concludes that the operation of the Log Export Control Regime is generally inconsistent with Canada's general trade policies, such as those found in the NAFTA.<sup>139</sup> He notes that Canada has, over the last century or so, generally sought to lower trade barriers and gain access to foreign markets for its natural resource products,<sup>140</sup> and that the regime stands in stark contrast to this general policy approach.
- i. *There are less trade restrictive measures available that would better advance Canada's policy concerns*
138. Professor Pearce identifies a number of less restrictive means for achieving Canada's stated public policy goals. He describes how timber supply can be enhanced through implemented programs in forest inventory management, reforestation and silviculture.<sup>141</sup> He also identifies subsidies, tax measures, labor policies and infrastructure development as measures that would advance Canada's objectives.<sup>142</sup>

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<sup>136</sup> Expert Report of Prof. Peter Pearce at paras. 2-9 and paras. 15-19.

<sup>137</sup> Expert Report of Prof. Peter Pearce at paras. 23-24.

<sup>138</sup> Expert Report of Prof. Peter Pearce at para. 25.

<sup>139</sup> Expert Report of Prof. Peter Pearce at paras. 27-29.

<sup>140</sup> Expert Report of Prof. Peter Pearce at para. 28.

<sup>141</sup> Expert Report of Prof. Peter Pearce at para. 60.

<sup>142</sup> Expert Report of Prof. Peter Pearce at para. 21.



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139. As early as 1976, sitting as Royal Commissioner, Professor Pearse concluded that the BC government could increase log processing jobs without sacrificing log export jobs by increasing the harvest of logs from provincial land. The current harvest from provincial land is considerably below the annual allowable limit.<sup>143</sup> His Royal Commission Report also noted that log export restrictions cost the government tax revenue<sup>144</sup> which, if collected would be available to assist any displaced processing workers. In his Expert Report, Professor Pearse reaffirms this view.<sup>145</sup>
140. Paul Stutesman – Vice President and General Manager of Merrill & Ring Forest Products L.P. – also describes a way in which Canada could achieve its policy objective in a less restrictive manner. He maintains that BC processors would maintain an adequate supply of logs in the absence of export restrictions. Because BC manufacturers are closer to the log supply than foreign purchasers, they have an inherent advantage when purchasing logs by having first claim on all logs, provided that they match export prices.<sup>146</sup>

### III. Impact of the Canadian Log Export Control Regime on Merrill & Ring

141. In addition to being inherently discriminatory, the Log Export Control Regime is administered in an unfair manner. As administered, the regime has the following failings and weaknesses:
- A. Merrill & Ring is Subjected to Unfair Harvesting, Sorting and Booming Requirements**
142. Notice 102 requires Merrill & Ring to produce its logs in accordance with so-called “normal” market practices. Notice 102 does not give any guidance or definition to what is meant by the term “normal practices”. The definition of “normal practices” has been left to the BCMOF’s discretion.<sup>147</sup>

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<sup>143</sup> Letter P. H. Pearse to the Honourable Pierre Pettigrew, Minister of International Trade, (2000). (Investor’s Schedule of Documents at Tab 41).

<sup>144</sup> P. H. Pearse, The Royal Commission on Forest Resources *‘Timber Rights and Forest Policy in British Columbia’*, (1976) at 310 (Investor’s Schedule of Documents at Tab 40); See also David Haley, *‘Are Log Export Restrictions on Private Forestland Good Public Policy?’* (2002), (Investor’s Schedule of Documents Tab 18).

<sup>145</sup> Expert Report of Prof. Peter Pearse.

<sup>146</sup> Witness Statement of Paul Stutesman at para. 27.

<sup>147</sup> Witness Statement of Tony Kurucz at para. 51.

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143. While a company producing logs from private lands for sale domestically can sort its logs any way it wants, a company producing logs for export cannot. Coastal logs to be advertised for export must be prepared in accordance with the *Coast Domestic Market End Use Sort Descriptions*.<sup>148</sup> These criteria used do not necessarily match the needs of the export market. The *Coast Domestic Market End Use Sort Descriptions* apply only to logs produced on the coast. Logs produced in the BC interior are not subject to these requirements, and are generally subject to less rigorous review by provincial authorities.
144. For example, Merrill & Ring is forced to scale its logs according to the metric system. Export markets, however, scale logs according to the Scribner system. As a result, Merrill & Ring must re-scale those logs granted export approval. This costs time and money.
145. These provincial criteria may also prevent Merrill & Ring from preparing its logs in the way that will optimally suit its clients' needs. Cutting logs to these provincial criteria may not only result in a loss of log volume, but also in the logs ultimately having to be sold at a discounted international price.<sup>149</sup>
146. Notice 102 requires Merrill & Ring to advertise its logs from remote areas in minimum volumes of 2,800 m<sup>3</sup> and maximum volumes of 15,000 m<sup>3</sup>. Merrill & Ring sometimes has to combine its booms from remote areas to make up the minimum export volume. Because Merrill & Ring is a relatively small operator, it can take time for it to build up the required volumes of the required sorts. In such situations, Merrill & Ring must spend more time and money, and assume more risk, preparing logs that are subject to deterioration during the delay period.

**B. Merrill & Ring Suffers "Blockmail" and an Unequal Playing Field**

147. Both the provincial and federal export application procedures create an unequal playing field in the industry and force Merrill & Ring to have to deal with commercial extortion as part of its day-to-day operations.
148. Merrill & Ring must offer up its logs – from both its provincially and federally regulated lands – for sale on the domestic BC market before it can obtain an export permit for them. As a result, BC sawmills are able to block export applications simply by making an offer on the logs up for export. There is no requirement that such offers be *bona fide*, and often

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<sup>148</sup> Witness Statement of Tony Kurucz at para. 52.

<sup>149</sup> Witness Statement of Paul Stutesman at para. 28.

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they are not.<sup>150</sup>

149. This practice is commonly referred to in the industry as “blockmail.” Domestic sawmills know that by blocking Merrill & Ring’s logs, they can force Merrill & Ring to sell its logs for far less than export prices. Indeed, they sometimes even threaten to block exports when they have no use for the logs.<sup>151</sup> As a result, they often threaten to block Merrill & Ring’s export applications in order to obtain concessions on other logs. Such concessions might include price discounts or commitments to supply certain types of logs cut to order.<sup>152</sup> Log processors sometimes “blockmail” log producers like Merrill & Ring on logs they are not truly interested in.<sup>153</sup>
150. The blockmail system places Merrill & Ring at a distinct competitive disadvantage. The dominant market players have large holdings of both provincial and federal lands. Not only are such companies able to use their market clout to avoid blockmailing, but they are also better positioned to placate blockmailers with provincially regulated logs instead of federally regulated logs. Since provincially regulated logs are subject to special export fees, the lost opportunity cost of selling provincially regulated logs on the domestic market is far less. Because Merrill & Ring has only limited amounts of provincially-regulated lands, it cannot mitigate its damages from blockmailing as well as its larger competitors.<sup>154</sup>
151. Merrill & Ring is also put at a competitive disadvantage by the blockmail system *vis-a-vis* its competitors that also own sawmills.<sup>155</sup> When market prices are high, such companies are able to concentrate on log production, and de-emphasize their log processing

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<sup>150</sup> Witness Statement of Tony Kurucz at para. 57.

<sup>151</sup> Bill Dumont and Don Wright, ‘*Generating More Wealth from British Columbia’s Timber - A Review of British Columbia’s Log Export Policies*’ at 5. (Investor’s Schedule of Documents at Tab 21).

<sup>152</sup> Witness Statement of Tony Kurucz at para. 63.

<sup>153</sup> See Dumont and Wright, at 54, noting that the Log Export Control Regime “...allows purchasers to...[make] “offers” on logs which they were not really interested in order to “coerce” the seller into making other logs available.” (Investor’s Schedule of Documents at Tab 21).

<sup>154</sup> Witness Statement of Tony Kurucz at para. 68.

<sup>155</sup> Bill Dumont and Don Wright, ‘*Generating More Wealth from British Columbia’s Timber - A Review of British Columbia’s Log Export Policies*’ at 43, (Investor’s Schedule of Documents at Tab 21): “The only revenue source that most small tenure holders [like Merrill & Ring] have is log sales, whereas tenure holders with mills can capture other revenues from manufacturing.”

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operations. Conversely, when market prices are low, they are able to stop log production and focus on their milling operations. Instead of supplying their mills with their own logs, these companies can blockmail Merrill & Ring into supplying them with low-cost logs. Merrill & Ring has even been blockmailed by a competitor that was simultaneously exporting its own logs. Merrill & Ring complained about this to the federal government in 2005.<sup>156</sup> Merrill & Ring was forced to mitigate its damages by selling two of its five rafts proposed for export to the blocking company six weeks later when Canada had not yet responded to its complaint.<sup>157</sup>

152. Because Merrill & Ring is exclusively a log producer, and relies solely on log sales for revenue, it does not have any means for defending itself from exploitation under the blockmail system. Merrill & Ring's competitors know this and use it to their advantage. In the result, Merrill & Ring ends up subsidizing its competitors' mill operations.<sup>158</sup>
153. FTEAC has refused to acknowledge this inequity, turning a blind eye to the practice.<sup>159</sup> Both BCMOF and DFAIT are well aware of the practice of blockmailing and thus complicit in its continuation. As far back as 1996, a federal government official recommended requiring "certification that the logs will be used by the mill making the offer."<sup>160</sup> Canada ignored the recommendation. At least one member of FTEAC has described blockmailing as a necessary part of the industry "game" so that timber processors can obtain logs at artificially suppressed prices.<sup>161</sup>

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<sup>156</sup> C-1(b)(ii) and C-1(b)(iv)  
C-1(b)(ii) and C-1(b)(iv)

<sup>157</sup> In its *Statement of Defence* at para. 88, Canada states that "the Claimant was invited to apply for export permits for three of those booms after offers on those booms were withdrawn. The Claimant sold the other two booms in British Columbia." Canada fails to mention that C-1(b)(ii) withdrew its offer on the three booms after Merrill & Ring agreed to sell it two booms - this is an action Merrill & Ring was forced to take to mitigate its loss after DFAIT failed to respond to Merrill & Ring's complaint, Letter from Paul Stutesman, Merrill & Ring to Judy Korecky, Department of Foreign Affairs and International Trade, dated October 11, 2005, (Investor's Schedule of Documents at Tab 46).

<sup>158</sup> Witness Statement of Tony Kurucz at para. 65.

<sup>159</sup> Witness Statement of Tony Kurucz at para. 69.

<sup>160</sup> Memo from Thomas E. Jones, DFAIT, March 21, 1996, at 7, (Investor's Schedule of Documents at Tab 45).

<sup>161</sup> Testimony of John McCutcheon, (former Chairman of FTEAC), *TimberWest v. Canada* hearing Transcript of June 5, 2006, at 767- 768, (Investor's Schedule of Documents at Tab 37.)

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**C. Merrill & Ring's Logs Suffer Damage Before Export Permission**

154. The export process can take a very long time. It can be broken up into three phases:
- a) from harvest to advertisement;
  - b) from advertisement to either domestic sale or export approval; and
  - c) from export approval to export.

The overall time from harvest to export can take up to an entire year.<sup>162</sup>

155. The approval process can take many months. Further, while the TEAC/FTEAC normally meets every 4-6 weeks, it will sometimes cancel meetings arbitrarily and without notice, creating unexpected delays of up to three additional months.<sup>163</sup>
156. Even if export approval is received, it can take many more months to find a purchaser. This is because Merrill & Ring cannot enter into sales agreements until it knows that it can, in fact, export its logs. Further, because export permits are valid for only four months, permits sometimes expire before Merrill & Ring is able to find a purchaser. Extensions are available for one extra month,<sup>164</sup> however, at the expiry of the extension Merrill & Ring is forced to sell the logs it had obtained a permit to export on the domestic market. As a result of this process, Merrill & Ring's logs may spend up to nine months in the water before possible export.<sup>165</sup>
157. Because of the waiting period caused by these procedures and delays, Merrill & Ring's logs suffer various types of damage,<sup>166</sup> including:

- a) Sun-checking and discoloration;
- b) Degradation and rot;

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<sup>162</sup> Witness Statement of Paul Stutesman at para. 16.

<sup>163</sup> Witness Statement of Paul Stutesman at para. 17.

<sup>164</sup> Witness Statement of Paul Stutesman at para. 25.

<sup>165</sup> Witness Statement of Paul Stutesman at para. 15.

<sup>166</sup> Bill Dumont and Don Wright, 'Generating More Wealth from British Columbia's Timber - A Review of British Columbia's Log Export Policies' at 55: "Logs can sit in the water for many weeks while the various stages of the surplus test and export permitting process happen. This ties up significant capital, makes it more difficult to respond to changes in market demand in a timely manner, and can also lead to deterioration in the quality of the logs as they sit in the water." (Investor's Schedule of Documents at Tab 21).

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- c) Teredo infestation; and
  - d) Ambrosia beetle damage.

158. The overall time from harvest to export can take up to an entire year.<sup>167</sup> Just as with any other natural product, the longer the delay from harvest, the more a log will deteriorate.<sup>168</sup> The longer the delay between harvest and export approval, the more the logs diminish in value.

**D. Merrill & Ring Is Forced to Incur Higher Costs**

159. The Log Export Control Regime imposes higher costs on Merrill & Ring. These include the following costs:<sup>169</sup>

- a) Services of a log brokerage company;<sup>170</sup>
- b) Towing logs from remote areas to the Vancouver Log Market;
- c) Storage of logs at advertising sites;
- d) Re-scaling and re-sorting logs for export; and
- e) Extra staffing and overhead.<sup>171</sup>

160. Because of the Log Export Control Regime, Merrill & Ring incurs total extra costs of approximately R-1(b)(ii)<sup>3</sup> of timber.<sup>172</sup>

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<sup>167</sup> Witness Statement of Paul Stutesman at para. 16.

<sup>168</sup> Dumont and Wright at 43:(Investor's Schedule of Documents at Tab 21): "The exporting process for logs, and its current timelines, put log quality in jeopardy and results in significant risk to small holders [like Merrill & Ring]. Booms of export logs on the coast need to be held for some time during the advertising/bidding process."

<sup>169</sup> Dumont and Wright, at 5. (Investor's Schedule of Documents at Tab 21): "...the export processes require [market loggers like Merrill & Ring] to bear additional costs to meet current export regulations, which they may not recover if those logs are blocked from export."

<sup>170</sup> Dumont and Wright, at 43 (Investor's Schedule of Documents at Tab 21): "The complexity of the surplus test and bidding process forces small holders to use brokers rather than manage the exports themselves and fully capture any increase in value after the additional costs of exporting are factored in."

<sup>171</sup> Witness Statement of Norm Schaaf at para. 30.

<sup>172</sup> Witness Statement of Norm Schaaf at para. 31.

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**E. Merrill & Ring must Engage in Backwards Economic Planning**

161. The Log Export Control Regime also prevents Merrill & Ring from harvesting in an efficient and optimal manner, requiring it to employ backwards economic planning.
162. If Merrill & Ring were not constrained by the regime, it would be able to better respond to economic signals. For example, during the US housing boom in 2005-2006, it would have harvested more logs to serve that market and obtain the better prices of the time; under unconstrained conditions Merrill & Ring would reduce its 2007-2008 harvests in light of the slump in the US housing market.<sup>173</sup>
163. Instead of responding to market signals in the normal manner – increasing production when prices are high and decreasing production when prices are low – Merrill & Ring is forced to do the opposite. Because Merrill & Ring stands a better chance of gaining export approval when the domestic market is flooded with logs, it seeks to increase production at these times.<sup>174</sup>
164. In addition, when the difference between the export market price and the suppressed BC market price for a given species is high, Merrill & Ring is compelled to deviate from its harvest plans. Absent the Log Export Control Regime, Merrill & Ring would respond to higher export prices by harvesting more of the species in question. With the export restrictions in place, however, the chances remain high that Merrill & Ring's logs will be blocked from export. Because the difference in the export and suppressed domestic prices is so great, Merrill & Ring will reduce production of that species to avoid incurring such serious opportunity costs.

**F. Merrill & Ring Misses out on Business Opportunities**

165. Because Merrill & Ring can never be certain whether its logs will be blocked, it is unable to enter into long-term supply contracts with its foreign clients. Its clients would be willing to pay on average R-1(b)(ii) for security of supply. Merrill & Ring loses this price premium as a result.<sup>175</sup>
166. In addition, the Log Export Control Regime interferes with Merrill & Ring's ability to take advantage of other business opportunities. These include:

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<sup>173</sup> Witness Statement of Norm Schaaf at para. 37.

<sup>174</sup> Witness Statement of Norm Schaaf at para. 38.

<sup>175</sup> Witness Statement of Paul Stutesman at para. 21.

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- a) conducting bulk sales to clients in Asia;
  - b) entering into spot market export sales agreements on short notice; and
  - c) exporting high value species that are either prohibited from export, or are blocked from export.<sup>176</sup>

**G. Merrill & Ring Does Not Receive Advantages Given to BCTS**

- 167. Provincially-regulated timber holders with a standing exemption do not have to sell their logs in the local market. As a result, provincial competitors operating under an exemption regularly sell in the international market and enjoy higher sale prices.<sup>177</sup> This allows provincially-regulated timber holders to engage in long-term forest planning and enter into long-term contracts with international buyers.
- 168. BCTS manages approximately 20 per cent of the BC Govt's allowable annual cut, or approximately 16 million cubic metres of timber. The primary function of BCTS is to auction off licenses to timber from BC public forest lands "to establish market price and capture the value of the asset for the public".<sup>178</sup>
- 169. Bidders submit sealed bids and BCTS sells the timber to the highest bidder. The wide variety of bidders includes market loggers, sawmill operators, timber processors and major licensees. Ultimately, BCTS supplies timber licenses to over one thousand operators and licensees.
- 170. BCTS sells timber in a way that ensures the prices bid on auctioned timber provide credible data to set the price on all timber harvested from BC public forest lands. To do this, it functions in a manner similar to other licensees, ensuring that sales are representative of the costs and opportunities available on the larger government land base.<sup>179</sup> Thus, BCTS emulates the operations of a private sector forest company, but remains part of the BCMOF.

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<sup>176</sup> Witness Statement of Paul Stutesman at para. 24.

<sup>177</sup> The fee *in lieu* of manufacture used to be based on the difference between the export market value and the domestic value. The fee was set on a case by case basis and was minimal - often as low as one dollar per cubic metre, *see* Haley Report at 6. Now the fee *in lieu* is an absolute amount based on the species of logs. This amount is nominal as compared to the difference between the BC price and the international price for timber.

<sup>178</sup> BCTS Mission Statement at 2. (Investor's Schedule of Documents at Tab 16).

<sup>179</sup> BC Timber Sales, Frequently Asked Questions, Q.24. (Investor's Schedule of Documents at Tab 69).



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171. BCTS uses the amounts contained in the sealed bids to set stumpage rates for logs from BC public forest lands located on the coast of BC.<sup>180</sup>
  172. In order to market licenses for provincial timber, BCTS maintains extensive road and bridge infrastructure programs to provide access to tenure opportunities.<sup>181</sup> BCTS contracts with suppliers to perform forestry work and road and bridge construction.
  173. As a result, the BC Govt grants benefits and advantages to BCTS that are not equally available to federally regulated private landowners. BCTS uses provincial resources for infrastructure development and forest management. Such development and management is of equal import and necessity to private landowners, who must pay for these with their own monies.

#### **H. Merrill & Ring Is Unable to Obtain Standing Timber Exemptions**

174. Standing timber exemptions receive sanction under the BC *Forest Act*, these exemptions are “supposedly” only available for timber on provincially regulated lands. Canada has stated that it has no authority to grant permits for standing timber exemptions on federal timbermark lands. The federal representative on FTEAC once told Merrill & Ring that if it applied for standing timber exemptions for its trees, it would surely be denied.<sup>182</sup>
175. Pluto Darkwoods Corporation (“Pluto Darkwoods”) is an Ontario Corporation that owns forest land in BC.<sup>183</sup> Pluto Darkwoods harvest, sells and exports timber from its lands.<sup>184</sup> Timbermark 30E has been assigned to these lands and has been used by Pluto Darkwoods.<sup>185</sup>

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<sup>180</sup> *Stumpage* is the fee that individuals and firms are required to pay to the government when they harvest Government timber in BC. Stumpage is determined through a complex appraisal of each stand or area of trees that will be harvested for a given timber mark.

<sup>181</sup> BC Timber Sales Brochure at 7. (Investor’s Schedule of Documents at Tab 16).

<sup>182</sup> Witness Statement of Paul Stutesman at para. 16.

<sup>183</sup> Petition to the Court of Pluto Darkwoods Corporation, January 14, 2005 at para 13. (Investor’s Schedule of Documents at Tab 76).

<sup>184</sup> Petition to the Court of Pluto Darkwoods Corporation, January 14, 2005 at para 14. (Investor’s Schedule of Documents at Tab 76).

<sup>185</sup> Petition to the Court of Pluto Darkwoods Corporation, January 14, 2005 at para 16. (Investor’s Schedule of Documents at Tab 76). Pluto Darkwoods acquired these timberlands in 1967. The lands are in the Nelson Land District: PID 007-608-349, subplot 1 of Lot 2381, Group 1, Kootenay District, Plan X74, except (1) part included in

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176. On January 19, 2005, Pluto Darkwoods filed a judicial review petition with the BC Supreme Court, seeking a declaration that its lands were properly within federal jurisdiction and a declaration that it was entitled to issuance of an exportable timber mark under section 85 of the *BC Forest Act*. An exportable timbermark is only awarded by the BC Registrar of Timbermarks to federal timbermark land. The Petition filed on behalf of Pluto Darkwoods describes the lands, timbermark and business.<sup>186</sup>
177. The BC lands held by Pluto Darkwoods and assigned to timbermark 30E were granted before March 12, 1906.
178. The case was settled and the BC Govt paid \$4,000 in costs to Pluto Darkwoods.<sup>187</sup> Shortly thereafter timbermark 30E was confirmed as being “exportable” by the Registrar of Timbermarks. This action confirmed that the lands are federal timbermark lands. This status is further confirmed by a Timbermark Query Report from the BCMOF Harvest Billing System website dated December 20, 2007, which indicates that timber from timbermark 30E is available for export.<sup>188</sup>
179. Canada pleads in its *Statement of Defence* that it has no legal or constitutional authority respecting timber, including timber exemptions. Canada states:

Notice 102 - like Notice 23 before it - does not contain “standing” or “blanket standing” timber exemptions because Canada does not have legal or constitutional authority respecting timber, including timber exemptions.<sup>189</sup>

Notwithstanding Canada’s claim that it has no lawful authority with respect to timber exemptions, the record demonstrates that Canada has in fact been granting export permits for standing timber from federal timbermark lands. Pluto Darkwoods has received export permission from DFAIT for standing timber on its federal timbermark lands.

180. In February 2008, Norm Schaaf contacted Pluto Darkwoods about the apparent grant by DFAIT of export permission for standing timber on its federal timbermark lands. Pluto

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plan 1760 and (2) part in lot 15184 known as “Tramline” MC.

<sup>186</sup> The Petition to the Court of Pluto Darkwoods Corporation, January 14, 2005 is set out in the Investor’s Schedule of Documents at Tab 76.

<sup>187</sup> Consent Dismissal Order, July 22, 2005 (settling the dispute). (Investor’s Schedule of Documents at Tab 77).

<sup>188</sup> BCMOF Harvest Billing System website dated February 5, 2008. (Investor’s Schedule of Documents at Tab 78).

<sup>189</sup> *Statement of Defence* at para. 34.

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Darkwoods' representative disclosed to Mr. Schaaf that Pluto Darkwoods does in fact have a standing timber exemption from the BC Govt in respect of its 30E timbermark lands. This representative confirmed that Canada had been granting export permits to Pluto Darkwoods for standing timber on its federal timbermark lands. Pluto Darkwoods confirmed that it was exporting hemlock, balsam and Douglas-fir logs from its timbermark 30E lands.

181. Canada has also been granting standing exemptions to standing timber originating from aboriginal lands.<sup>190</sup> Logs from such lands are exempt from the advertising requirements of the surplus testing procedure.<sup>191</sup>
182. In April of 1998, Merrill & Ring wrote to DFAIT regarding prospective federal exemptions on its standing timber.<sup>192</sup> In June 1998, the federal government responded, saying it would examine the possibility of standing timber exemptions on a "case-by-case" basis.<sup>193</sup> The federal government has not taken further action to implement standing exemptions.
183. In February 2000, Merrill & Ring once again raised the matter with the federal government,<sup>194</sup> asking that all federally-regulated timber be eligible for the same kind of treatment in receiving export permits for standing timber that the federal government makes available for provincially-regulated timber. DFAIT never responded.
184. The federal government's refusal to grant Merrill & Ring exemptions for standing timber has disadvantaged it against its competitors. Timber right holders operating under a standing exemption enjoy the following advantages:

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<sup>190</sup> The Heiltsuk First Nation were granted standing exemptions in March 2006 through an Order-In-Council for mid-coastal timberlands. Dumont and Wright at 30 (Investor's Schedule of Documents at Tab 21). This is merely one example of how the federal government has granted export permits for standing timber on lands under federal jurisdiction.

<sup>191</sup> Dumont and Wright, at 16. (Investor's Schedule of Documents at Tab 21).

<sup>192</sup> Letter from Norm Schaff, Merrill & Ring Timber & Land Managements to Thomas E. Jones, Department of Foreign Affairs and International Trade, April 13, 1998, (Investor's Schedule of Documents at Tab 66); See also Letter from Clyde R. Davis, Pomerance & Company to Thomas Jones, Department of Foreign Affairs and International Trade Re: Export and Imports Permits Act - Export of Logs from British Columbia, April 18, 1998, (Investor's Schedule of Documents at Tab 67).

<sup>193</sup> Letter from T. Jones, DFAIT to Clyde Pomerance, June 1, 1998, (Investor's Schedule of Documents at Tab 75).

<sup>194</sup> Letter from Paul Stutesman, Merrill & Ring to Thomas Jones, Department of Foreign Affairs and International Trade, March 3, 2000, (Investor's Schedule of Documents at Tab 68).

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- a) They do not have to harvest their timber to apply for an export permit;
  - b) They do not have to cut, sort and scale their logs to meet domestic market requirements;
  - c) They do not have to pass the surplus test,
  - d) They do not have to deal with the risk of blockmail;
  - e) They can organize their business operations to better meet market or particular client needs; and
  - f) They can sell their logs in the international markets.
185. Timber holders operating under an exemption can delay harvest until they have been granted an export permit. They can avoid the cost and time of having to re-process or re-sort their logs for the international market.<sup>195</sup> Such timber holders do not have to incur the financial and transactional costs related to harvesting, sorting and booming their logs to meet local market requirements. Provincial competitors are also spared costs and deterioration related to storing and offering their logs in the local market for periods up to one year.<sup>196</sup>
186. As a result of standing timber exemptions, only one-half to one-third of BC logs exported from provincially-regulated lands are actually subjected to a surplus test.<sup>197</sup> In contrast, *all* of the logs exported from federal government lands and federally regulated private lands are subject to a surplus test according to Notice 102. This gives unfair advantages to Merrill & Ring's competitors.

**I. Merrill & Ring must sell its logs below fair market value**

187. For the reasons discussed above, the surplus test and the administrative practices of TEAC and FTEAC are very problematic. In applying such a loose methodology, TEAC and FTEAC fail to take into consideration important factors about the "fairness" of any given offer. For example, as already described above, TEAC and FTEAC do not factor whether an offer is made at prices that assume delivery at the Vancouver log market.

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<sup>195</sup> Analysis by David Haley, Professor, Faculty of Forestry, University of BC entitled 'Are Log Export Restrictions on Private Forestland Good Public Policy?', at 6 (Investor's Schedule of Documents at Tab 18).

<sup>196</sup> Witness Statement of Paul Stutesman at para. 15.

<sup>197</sup> TimberWest, *Issues, Federal Regulations Restrict BC Private Land Log Exports*; see also *Federal Regulation Restrict BC Private Land Log Exports*, (Investor's Schedule of Documents at Tab 63); see also Article entitled *Federal Regulation Restrict BC Private Land Log Exports*, September 19, 2005, (Investor's Schedule of Documents at Tab 64); Bill Dumont and Don Wright, *Generating More Wealth from British Columbia's Timber - A Review of British Columbia's Log Export Policies*, at 20, (Investor's Schedule of Documents at Tab 21).

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Merrill & Ring is sometimes forced to incur these transportation risks and expenses in exchange for price that does not take them into account.<sup>198</sup>

**J. Merrill & Ring is forced to subsidize BC sawmills**

188. The stated purpose of the Log Export Control Regime is to ensure “an adequate supply of logs for domestic manufacture.”<sup>199</sup> However, there is currently no shortage of supply of logs for domestic sawmills.<sup>200</sup> Moreover, there are other more effective ways the government could achieve this objective.<sup>201</sup> As a result, the benefits enjoyed by BC sawmills come at the direct detriment of log producers.<sup>202</sup> In other words, under the Log Export Control Regime Merrill & Ring is forced to subsidize BC sawmills at its own expense.<sup>203</sup>

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<sup>198</sup> Witness Statement of Tony Kurucz at para. 49.

<sup>199</sup> Expert Report of Prof. Peter Pearse at para. 13.

<sup>200</sup> Expert Report of Prof. Peter Pearse at para. 25; *See* Dumont & Wright at 46-47, noting that there is a “serious undercut situation on the coast,” and that there has been a coastal undercut of 35 million m<sup>3</sup> since 1997. (Investor’s Schedule of Documents at Tab 21).

<sup>201</sup> Expert Report of Prof. Peter Pearse at para. 21; *See also* Witness Statement of Paul Stutesman at para.27.

<sup>202</sup> Expert Report of Prof. Peter Pearse at paras. 32 and 53.

<sup>203</sup> Witness Statement of Paul Stutesman at paras. 30 and 31.

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**PART THREE: SUBSTANTIVE LEGAL ISSUES**

189. The administration and ongoing application of Canada's Log Export Control Regime is inconsistent with Canada's NAFTA obligations. Canada breached its NAFTA obligations, specifically including its obligations to:

- a. provide international law standards of treatment;
- b. provide national treatment;
- c. not engage in prohibited performance requirements; and
- d. provide compensation of acts of taking tantamount to expropriation.

**A. The International Law Standard of Treatment**

*i. Good Faith*

190. NAFTA Article 1105(1) sets out the international law standard of treatment that a Party is obliged to accord to investments of investors from the other Party. It says:

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.

191. The duty to provide treatment that accords with international law ("international law standard") is expressly set out in Article 1105. 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.

192. The duty to act in good faith is perhaps "the" fundamental peremptory norm of international law. Not surprisingly, 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, full protection and security, and other customary aspects.

193. NAFTA Article 1105 recognizes the international law obligation of each NAFTA Party to treat foreign investors fairly and equitably. The NAFTA Parties' obligation to treat investors fairly and equitably is grounded in their obligation to act in good faith<sup>204</sup> -

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<sup>204</sup> O'Connor, J. F., *Good Faith in International Law* (Dartmouth: 1991) at 1. (Investor's Book of Authorities at Tab 120).

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perhaps the most fundamental peremptory norm of international law.<sup>205</sup>

194. Dr. F.A. Mann, has recognized the fair and equitable treatment standard's origin in good faith:

The paramount duty of States imposed by international law is to observe and act in accordance with the requirements of good faith. From this point of view it follows that, where these treaties express a duty which customary international law imposes or is widely believed to impose, they give very strong support to the existence of such a duty and preclude the Contracting States from denying its existence.

These remarks apply, in particular, to the overriding effect of the standard of fair and equitable treatment ...<sup>206</sup>

195. Dr. Mann draws from the fair and equitable standard's foundations in the fundamental peremptory norm of good faith to designate it as the pre-eminent substantive standard in investment treaties:

... it is submitted that the right to fair and equitable treatment goes much further than the right to most-favored-nation and to national treatment .... So general a provision is likely to be almost sufficient to cover all conceivable cases, and it may well be that other provisions of the Agreements affording substantive protection are no more than examples of specific instances of this overriding duty.<sup>207</sup>

196. Modern investor-state tribunals have endorsed Dr. Mann's views, expressly recognizing the duty of good faith and the duty to provide fair and equitable treatment as inter-related and fundamental principles of the international law standard.

- a) The *S.D. Myers* tribunal said "Article 1105 imports into the NAFTA the international law requirements of due process, economic rights, obligations of good faith and natural justice."<sup>208</sup>
- b) Similarly, the *Tecmed* tribunal said that "the commitment of fair and equitable treatment included in Article 4(1) of the [Spain-Mexico] Agreement is an expression and part of the *bona fide* principle recognized

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<sup>205</sup> Thomas Franck, *Fairness in International Law and Institutions* (Clarendon Press: 1995) at 42-43. (Investor's Book of Authorities at Tab 121).

<sup>206</sup> Mann, F.A., "British Treaties for the Promotion and Protection of Investments" 52 *BYIL* 241 (1981) at 249-250 at Tab 78. (Investor's Book of Authorities at Tab 57).

<sup>207</sup> Mann, F.A., "British Treaties" at 243. (Investor's Book of Authorities at Tab 57).

<sup>208</sup> *S.D. Myers Inc. v. Government of Canada*, Partial Award, November 13, 2000, 40 *ILM* 1408 (2001) at para. 134 [emphasis added]. (Investor's Book of Authorities at Tab 39).

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in international law.”<sup>209</sup>

197. Similarly, the term “fair and equitable treatment” has been described as “an expression and part of the *bona fide* principle recognized in international law.”<sup>210</sup> The *Eureko v. Poland* Tribunal subsequently endorsed the *Tecmed* Tribunal’s reliance on the good faith principle in interpreting the obligation to provide fair and equitable treatment.<sup>211</sup>
198. The obligation to act in good faith entails several specific obligations. For the purposes of this NAFTA claim, six obligations are particularly important:
- a. the obligation of fairness and good faith;
  - b. the obligation to provide treatment free from arbitrary and discriminatory conduct;
  - c. the obligation to provide treatment free from abuse of rights;
  - d. the obligation to fulfill legitimate expectations;
  - e. the obligation of transparency as part of fairness; and
  - f. the obligation to provide secure legal environment.

a. Fairness

199. Governments are expected to observe their obligations in good faith. Bin Cheng has noted the *pacta sunt servanda* principle’s foundations in good faith. He said that the principle is “but an expression of the principle of good faith which above all signifies the keeping of faith, the pledged faith of nations, as well as that of individuals.”<sup>212</sup>
200. A state’s obligation to act in good faith is also manifested in a number of specific ways, including the state’s obligation:

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<sup>209</sup> *Tecmed v. Mexico*, ICSID Case No. ARB(AF)/00/2, Award, 2003 WL 240384386 (May 29, 2003) at para. 153. (Investor’s Book of Authorities at Tab 55).

<sup>210</sup> *Tecmed* at para. 153. (Investor’s Book of Authorities at Tab 55).

<sup>211</sup> *Eureko B.V. v. Republic of Poland*, Partial Award, 2005 WL 216281 (19 August 2005) at para. 235: “The Tribunal finds apposite the words of an ICSID Tribunal in a recent decision that the guarantee of fair and equitable treatment according to international law means that: “... this provision of the Agreement, in light of the good faith principle established by international law, requires the Contracting Parties 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...” (Investor’s Book of Authorities at Tab 56). *Tecmed* at para. 154. (Investor’s Book of Authorities at Tab 55).

<sup>212</sup> Cheng, B. *General Principles of Law* (1987) at 113. (Investor’s Book of Authorities at Tab 70).



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- 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.

b. Protection from Arbitrary and Discriminatory Conduct

201. A state breaches customary international law obligations when it acts arbitrarily. A state, therefore, breaches its customary international law obligation when it acts on "prejudice or preference rather than on reason or fact."<sup>213</sup>

202. NAFTA Tribunals have found arbitrary measures to constitute a breach of the international law standard:

Taken together, the *S.D. Myers*, *Mondev*, *ADF* and *Loewen* cases suggest that the minimum standard of treatment of fair and equitable treatment is infringed... if the conduct is *arbitrary*...<sup>214</sup>

203. The subsequent *GAMI* NAFTA decision adopted the *Waste Management* Tribunal's description of the standard.<sup>215</sup> In finding that Mexico breached Article 1105 by refusing on irrelevant grounds to issue a permit to construct a landfill, the *Metalclad* decision also applied the principle that arbitrary conduct breaches Article 1105.<sup>216</sup>

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<sup>213</sup> *Lauder v. Czech Republic*, Final Award, 2001 WL 347860000 (September 3, 2001) at para. 232. (Investor's Book of Authorities at Tab 122).

<sup>214</sup> *Waste Management, Inc. v. United Mexican States*, ICSID Case No. ARB(AF)/00/3, Award, 2004 WL 3249803 (April 30, 2004) at para. 98. (Investor's Book of Authorities at Tab 58).

<sup>215</sup> *GAMI Investments v. Mexico*, Final Award, 2004 WL 3270068 (November 15, 2004) at para. 95. (Investor's Book of Authorities at Tab 59).

<sup>216</sup> *Metalclad Corporation v. United Mexican States*, Award, 2000 WL 34514285 (August 30, 2000) at paras. 86 and 101: "... the authority of the municipality only extended to appropriate construction considerations. Consequently, the denial of the permit by the Municipality by reference to environmental impact considerations ... 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. The Tribunal therefore holds that Metalclad was not treated fairly or equitably under the NAFTA and succeeds on its claim under Article 1105." (Investor's Book of Authorities at Tab 60).

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204. In the *Metalclad Award*, the Tribunal decided Mexico breached its NAFTA Article 1105 obligation by acting on the basis of irrelevant considerations.<sup>217</sup>

205. Other investor - state tribunals have similarly concluded that a State acts arbitrarily or discriminatorily when it acts on the basis of prejudice or preference and not on reason or fact. In *Lauder v. Czech Republic*, for example, the ICSID Tribunal said:

The Treaty does not define an arbitrary measure. According to Black's Law Dictionary, arbitrary means "depending on individual discretion; ... founded on prejudice or preference rather than on reason or fact".... The measure was arbitrary because it was not founded on reason or fact, nor on the law ... but on mere fear reflecting national preference.<sup>218</sup>

206. The *Pope & Talbot* NAFTA Tribunal also found Canada breached Article 1105 by acting on prejudice rather than on reason or fact. Canada breached the obligation by threatening the investor, denying its "reasonable requests for pertinent information" and requiring the investor "to incur unnecessary expense and disruption in meeting SLD's requests for information."<sup>219</sup>

207. Both the *Waste Management* and *GAMI* tribunals recognized an independent obligation under Article 1105 to not act in an arbitrary or discriminatory manner. The *GAMI* tribunal quoted the following passage from *Waste Management II*:

Taken together, the *S.D. Myers*, *Mondev*, *ADF* and *Loewen* cases suggest that the minimum standard of treatment of fair and equitable treatment is infringed by conduct attributable to the State and harmful to the claimant if the conduct is *arbitrary*, grossly unfair, unjust or idiosyncratic, is *discriminatory* and exposes the claimant to sectional or racial prejudice...<sup>220</sup>

208. The *Metalclad* tribunal considered a claim that Mexico breached its Article 1105 obligations through the actions of one of its municipalities. The municipality in question was only legally allowed to consider construction issues when granting or denying building permits. The municipality exceeded that authority when it refused the investor's

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<sup>217</sup> *Metalclad* at para. 92. (Investor's Book of Authorities at Tab 86).

<sup>218</sup> *Lauder* at paras. 221 and 232. (Investor's Book of Authorities at Tab 122).

<sup>219</sup> *Pope & Talbot*, Award on the Merits Phase 2, April 10, 2001 at paras. 177-181. (Investor's Book of Authorities at Tab 42).

<sup>220</sup> *Waste Management* at para. 98, quoted in *GAMI* at para. 89 [emphasis added]. (Investor's Book of Authorities at Tab 58).

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permit on environmental grounds.<sup>221</sup>

209. In finding that this conduct amounted to a breach of Article 1105, the tribunal said:

None of the reasons [for refusing the permit] 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.<sup>222</sup>

The tribunal went on to conclude that “Metalclad was not treated fairly or equitably under the NAFTA and succeeds on its claim under Article 1105.”<sup>223</sup> The tribunal, therefore, found a breach of Article 1105 because Mexico acted on the basis of irrelevant considerations.

210. These cases demonstrate 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.

211. Non-NAFTA Tribunal decisions also demonstrate that the international law standard requires states to avoid acting arbitrarily. As observed by the *CMS* Tribunal “[a]ny measure that might involve arbitrariness ... is in itself contrary to fair and equitable treatment.”<sup>224</sup>

212. Similarly, in finding that Poland failed to provide fair and equitable treatment, the *Eureko* Tribunal said Poland “acted not for cause but for purely arbitrary reasons ...”<sup>225</sup> The *Occidental* Tribunal found that Ecuador breached its obligation to provide fair and

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<sup>221</sup> The *Metalclad* tribunal said at para. 86, Investor’s Book of Authorities (Tab 60): “Even if Mexico is correct that a municipal construction permit was required, the evidence also shows that, as to hazardous waste evaluations and assessments, the federal authority’s jurisdiction was controlling and the authority of the municipality only extended to appropriate construction considerations. Consequently, the 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.”

<sup>222</sup> *Metalclad* at paras. 92 - 93 [emphasis added]. (Investor’s Book of Authorities at Tab 60).

<sup>223</sup> *Metalclad* at para. 101. (Investor’s Book of Authorities at Tab 60).

<sup>224</sup> *CMS Gas Transmission v. Argentine Republic*, ICSID Case No. ARB/01/8, Award, 2005 WL 1201002 (May 12, 2005) at para. 290. (Investor’s Book of Authorities at Tab 53).

<sup>225</sup> *Eureko* at para. 233. (Investor’s Book of Authorities at Tab 56).

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equitable treatment by acting in an arbitrary manner.<sup>226</sup>

213. WTO jurisprudence illustrates the kind of actions that have been found to be arbitrary for purposes of international law. In the *US-Shrimp* case, the Appellate Body considered whether a refusal to issue import certificates fell within the general exceptions of Article XX of the GATT. Measures do not fall within the Article XX exceptions if they amount to “arbitrary discrimination.” The US had refused the certificates because the shrimp had not been caught under a particular form of regulatory program. The Appellate Body found that the US arbitrarily discriminated by “requir[ing] countries applying for certification [to import shrimps] ...[to] adopt a comprehensive regulatory program that is essentially the same as the United States’ program, without inquiring into the appropriateness of that program for the conditions prevailing in the exporting countries.”<sup>227</sup>
214. The Appellate Body stated as follows with respect to the US import certification process:

... with respect to neither type of certification [for import] is there a transparent, predictable certification process that is followed by the competent United States government officials. The certification processes... consist principally of administrative *ex parte* inquiry or verification by staff...<sup>228</sup>

The Appellate Body also noted that the US provided “no formal opportunity for an applicant country to be heard, or to respond to any arguments that may be made against it, in the course of the certification process before a decision to grant or to deny certification is made;”<sup>229</sup> and that “no formal written, reasoned decision, ... is rendered on applications [and] [n]o procedure for review of, or appeal from, a denial of an application is provided.”<sup>230</sup>

215. The Appellate Body concluded that “exporting Members applying for certification whose

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<sup>226</sup> *Occidental Exploration and Production Company v. the Republic of Ecuador*, LCIA Case No. UN 3467, Final Award, 2004 WL 3267260 (July 1, 2004), at para. 163, finding that the investor: ... was confronted with a variety of practices, regulations and rules dealing with the question of VAT. ... this resulted in a confusing situation ... it is that very confusion and lack of clarity that resulted in some form of arbitrariness ...” (Investor’s Book of Authorities at Tab 40).

<sup>227</sup> *United States - Import Prohibition of Certain Shrimp and Shrimp Products* - Report of the Appellate Body, WT/DS58/AB/R, October 12, 1998, at para. 177. (Investor’s Book of Authorities at Tab 62).

<sup>228</sup> *US - Shrimp* at para. 180. (Investor’s Book of Authorities at Tab 62).

<sup>229</sup> *US - Shrimp* at para. 180. (Investor’s Book of Authorities at Tab 62).

<sup>230</sup> *US - Shrimp* at para. 180. (Investor’s Book of Authorities at Tab 62).

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applications are rejected are denied basic fairness and due process, and are discriminated against, *vis-à-vis* those Members which are granted certification.”<sup>231</sup> This decision indicates that a process that denies an applicant a meaningful opportunity to respond to arguments against it or denies it a mechanism to appeal an unreasoned decision is arbitrary and unfair.

c. Protection Against Abuse of Rights

216. Canada has an obligation under the international law standard not to abuse the rights of foreign investors. The *Azinian* NAFTA decision<sup>232</sup> and the writings of eminent scholars Bin Cheng<sup>233</sup> and Sir Hersch Lauterpacht,<sup>234</sup> reinforce this rule as a stand alone obligation under customary international law.
217. Professor Bin Cheng has explained that the obligation to act in good faith includes the obligation not to abuse exclusive privileges:

The principle of good faith requires that every right be exercised honestly and loyally. Any fictitious exercise of a right for the purpose of evading either a rule of law or a contractual obligation will not be tolerated. Such an exercise constitutes an abuse of the right, prohibited by law.<sup>235</sup>

218. Professor Sir Hersch Lauterpacht further expanded on the meaning of this aspect of the international law standard:

The conspicuous feature of these awards is the view that the undoubted right of expulsion degenerates into an abuse of rights whenever an alien who has been allowed to take up residence in the country, to establish his business and set up a home, is expelled without just reason, and that such an abuse of rights constitutes a wrong involving the duty of reparation.<sup>236</sup>

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<sup>231</sup> *US - Shrimp* at para. 181. (Investor’s Book of Authorities at Tab 62).

<sup>232</sup> *Azinian v. Mexico*, Award, November 1, 1999, 39 ILM 537 (2000) at para. 103. (Investor’s Book of Authorities at Tab 68).

<sup>233</sup> Cheng, B. *General Principles of Law* at 123. (Investor’s Book of Authorities at Tab 70).

<sup>234</sup> Lauterpacht, *The Function of Law in the International Community* (1933) at 289. (Investor’s Book of Authorities at Tab 69).

<sup>235</sup> Cheng, B. *General Principles of Law* at 123. (Investor’s Book of Authorities at Tab 70).

<sup>236</sup> Lauterpacht, *The Function of Law in the International Community* (1933) at 289. (Investor’s Book of Authorities at Tab 69).

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219. The NAFTA Investor-State Tribunal in the *Azinian* claim discussed how protection against the abuse of rights was contained within the international law standard guaranteed under NAFTA Article 1105. It stated:

There is a fourth type of denial of justice, namely clear and malicious misapplication of the law. This type of wrong doubtless overlaps with the notion of "pretence of form" to mask a violation of international law.<sup>237</sup>

d. Legitimate Expectations

220. The fair and equitable treatment obligation includes the obligation to protect legitimate expectations.
221. Numerous tribunals interpreting modern investment treaties have affirmed that a State fails to meet the international law standard of treatment when it fails to fulfill the objective legitimate expectations of investors: see *Tecmed v. Mexico*,<sup>238</sup> the NAFTA Chapter 11 tribunal in *Metalclad v. Mexico*,<sup>239</sup> as well as the *MTD v. Chile*,<sup>240</sup> *Occidental v. Ecuador*<sup>241</sup> and *CMS v. Argentina*<sup>242</sup> cases.
222. Tribunals applying the customary international law obligation to protect legitimate expectations have discussed what an objective investor can legitimately expect from a host state. For example, the *Tecmed* tribunal explained that an investor can legitimately expect the host State to act consistently, free from ambiguity and transparently under customary international law.<sup>243</sup> The *Tecmed* Tribunal said that the fair and equitable provision:

... in light of the good faith principle established by international law, requires the Contracting Parties to provide to international investments treatment that does not affect the basic expectations

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<sup>237</sup> *Azinian and Mexico* (NAFTA Investor-State Claim) (2000) 39 ILM 537 at para. 103. (Investor's Book of Authorities at Tab 68).

<sup>238</sup> *Tecmed* at para. 154. (Investor's Book of Authorities at Tab 55).

<sup>239</sup> *Metalclad* at para. 99. (Investor's Book of Authorities at Tab 60).

<sup>240</sup> *MTD Equity Sdn. Bhd. & MTD Chile S.A. v. Chile*, ICSID Case No. ARB/01/7, Award, May 25, 2004, 2004 WL 3254661 at paras. 114-115, 188. (Investor's Book of Authorities at Tab 124).

<sup>241</sup> *Occidental* at para. 184. (Investor's Book of Authorities at Tab 40).

<sup>242</sup> *CMS* at paras. 278-281. (Investor's Book of Authorities at Tab 53).

<sup>243</sup> *Tecmed* at para. 154. (Investor's Book of Authorities at Tab 55).

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that were taken into account by the foreign investor to make the investment.<sup>244</sup>

The *Tecmed* Tribunal noted that legitimate expectations included the expectations that the state will conduct itself in a coherent manner, without ambiguity and transparently, so as to enable the investor to plan its activities and adjust its conduct to the governing statutes or regulations, policies embedded therein, and relevant practices and administrative directions.<sup>245</sup>

223. The *Metalclad Award* supports the application of the *Tecmed* Tribunal's description of the standard to NAFTA Article 1105. The *Metalclad* arbitration arose out of Mexico's refusal to grant a US investor, Metalclad, a permit to construct a landfill. Mexico refused to issue the permit when construction was almost completed, in conflict with earlier representations. Metalclad began arbitration proceedings, claiming that Mexico's conduct breached the international law standard under Article 1105. The Tribunal found that Mexico failed to fulfill its obligation because it affected Metalclad's basic expectations:

Mexico failed to ensure a transparent and predictable framework for Metalclad's business planning and investment. The totality of these circumstances demonstrates a lack of orderly process and timely disposition in relation to an investor of a Party acting in the expectation that it would be treated fairly and justly in accordance with the NAFTA.<sup>246</sup>

224. Recent investor-state arbitration tribunal decisions have affirmed this description of the standard. In *MTD v. Chile*, after expressly adopting the *Tecmed* standard, the Tribunal found that Chile failed to meet that standard by "authorizing an investment that could not take place for reasons of its urban policy."<sup>247</sup>
225. Similarly, the *Occidental v. Ecuador* Tribunal found that, after Occidental had made investments, Ecuador changed its tax law "without providing any clarity about its meaning and extent" and that the state's "practice and regulations were also inconsistent

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<sup>244</sup> *Tecmed* at para. 154. (Investor's Book of Authorities at Tab 55).

<sup>245</sup> *Tecmed* at para. 154. (Investor's Book of Authorities at Tab 55).

<sup>246</sup> *Metalclad* at para. 99. (Investor's Book of Authorities at Tab 60). The *Metalclad Award* was subsequently partially set aside by the Supreme Court of British Columbia in *Mexico v. Metalclad Corporation* (2001) BCSC 664 because NAFTA Chapter 18 exhaustively addressed transparency within the NAFTA. However, only the Tribunal's incorporation of transparency in the international minimum standard was set aside (at para. 72). Their remaining comments on the standard were not questioned. (Investor's Book of Authorities at Tab 64).

<sup>247</sup> *MTD* at paras. 114-115, 188. (Investor's Book of Authorities at Tab 124).

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with [the] changes [to the law].”<sup>248</sup> The Tribunal concluded that these actions fell below the standard established in the *Tecmed* case, and accordingly found a breach of the BIT.

226. The *Occidental* Tribunal, therefore, recognized a state may act inconsistently with an investor’s legitimate expectations, and breach its obligation to treat an investor fairly and equitably, by failing to follow its own laws. This conclusion is consistent with subsequent comments in the *GAMI v. Mexico* dispute. The latter Tribunal found that a state’s failure to implement its laws may result in a breach of Article 1105.<sup>249</sup>
227. The jurisprudence demonstrates that investors can legitimately expect the host state to act fairly, follow the rule of law and enforce its own laws in good faith.

e. Transparency

228. The customary international law standard is breached where a party acts without transparency. As stated by the *Waste Management* Tribunal said:

Taken together, the *S.D. Myers*, *Mondev*, *ADF* and *Loewen* cases suggest that the minimum standard of treatment of fair and equitable treatment is infringed ... if the conduct ... involves a lack of due process leading to an outcome which offends judicial propriety - as might be the case with ... a complete lack of transparency and candour in an administration process.<sup>250</sup>

This approach was confirmed in the subsequent *GAMI* decision.<sup>251</sup>

229. As illustrated by the WTO shrimp import decision, the customary international law obligation to treat foreign investors with transparency overlaps with its obligation to avoid acting arbitrarily. The arbitrary discrimination found by the WTO Appellate Body in that case consisted in part of the US’ failure to provide a transparent procedure for

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<sup>248</sup> *Occidental* at para. 184 (Investor’s Book of Authorities at Tab 40).

<sup>249</sup> *GAMI* at para. 108: “The record shows that Mexico failed to implement key struts of its Sugar Program notwithstanding its duties .... *GAMI* alleges an abject failure to implement a regulatory program indispensable for the viability of foreign investments that had relied upon it. *GAMI* urges that in law this is no different from a violation by the government of the rules of that program. Both action and inaction may fall below the international standard. So far the Arbitral Tribunal is prepared to accept *GAMI*’s proposition.” (Investor’s Book of Authorities at Tab 59).

<sup>250</sup> *Waste Management* at para. 98. (Investor’s Book of Authorities at Tab 58).

<sup>251</sup> *GAMI* at para. 95. (Investor’s Book of Authorities at Tab 59).



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issuing import permits.<sup>252</sup>

230. The obligation to act transparently also overlaps with the obligation to provide fair and equitable treatment. In *Maffezini v. Spain*, for example, the Tribunal found that Spain breached its obligation of fair and equitable treatment when it transferred money out of the investor's account without his permission. The Tribunal said: "... the lack of transparency with which this loan transaction was conducted is incompatible with Spain's commitment to ensure the investor a fair and equitable treatment in accordance with Article 4(1) of the same treaty."<sup>253</sup>
231. Similarly, the *Tecmed* Tribunal found that the obligation to provide fair and equitable treatment, required the parties to treat international investments in accordance with the basic expectations that were taken into account by the foreign investor in making the investment. The foreign investor expects the host state to act in a consistent manner, free from ambiguity and totally transparently in its relations with the foreign investor.<sup>254</sup>
232. The *Metalclad* NAFTA Tribunal found that Mexico breached the NAFTA, in part, through its failure to act transparently. The 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.<sup>255</sup>
233. The *Metalclad* arbitration was held BC. Mr. Justice Tysoe of the Supreme Court of BC set aside a small part of the NAFTA Tribunal's decision because the Tribunal "made decisions on matters beyond the scope of the submission to arbitration by deciding on matters outside Chapter 11."<sup>256</sup> Justice Tysoe did not comment on whether Article 1105 or customary international law themselves establish an obligation of transparency. The

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<sup>252</sup> *US - Shrimp* at para 180: "... with respect to neither type of certification ... is there a transparent, predictable certification process that is followed by the competent United States government officials." See paras 146 to 186 for a fuller description of the Appellate Body's decision that the US measures were arbitrary. (Investor's Book of Authorities at Tab 62).

<sup>253</sup> *Emilio Augustin Maffezini v. The Kingdom of Spain*, ICSID Case No. ARB/9717, Award, 2000 WL 34513944 (November 13, 2000), at para. 83. (Investor's Book of Authorities at Tab 63).

<sup>254</sup> *Tecmed* at para. 154. (Investor's Book of Authorities at Tab 55).

<sup>255</sup> *Metalclad*, Judicial Review, at para. 68: "... 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." (Investor's Book of Authorities at Tab 64).

<sup>256</sup> *Metalclad*, Judicial Review, at para. 67. (Investor's Book of Authorities at Tab 64).

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decision, therefore, is of no assistance in determining the issues in dispute in this arbitration.

234. In any event, the judicial review of *Metalclad* decision was a domestic court decision. A domestic court decision does not affect the weight given to a NAFTA tribunal's decision under international law. The *Metalclad* Tribunal's conclusion that NAFTA Article 1105 obliges Parties to act transparently remains a correct expression of the law.

f. Secure Legal Environment

235. The *Metalclad* decision demonstrates that the Article 1105 obligation to provide the international law standard subsumes an obligation to provide legal security. The Tribunal found that, by refusing to approve a building license on grounds that local law did not allow it, Mexico "failed to ensure a ... predictable framework for Metalclad's business planning and investment" and, therefore, breached Article 1105.<sup>257</sup>
236. The context of Article 1105, which may be used as an interpretative aid under Article 31(1) of the *Vienna Convention*,<sup>258</sup> supports this point. The context of Article 1105 includes NAFTA's preamble, which states that the NAFTA Parties "resolved to ... ensure a predictable commercial framework for business planning and investment."
237. Non-NAFTA decisions also support the conclusion that the Article 1105 international law standard subsumes an obligation to provide legal security. After acknowledging that the content of the fair and equitable treatment standard was the same as the customary international law standard, the *CMS v. Argentina* Tribunal concluded that "[t]here can be no doubt ... that a stable legal and business environment is an essential element of fair and equitable treatment."<sup>259</sup>
238. Similarly, the *Occidental v. Ecuador* Tribunal said that: "[t]he stability of the legal and business framework is ... an essential element of fair and equitable treatment" and the customary international law standard of treatment.<sup>260</sup> The obligation to provide a secure legal environment overlaps with the obligation to provide full protection and security. Tribunals have interpreted "full protection and security" to extend to *legal* security.

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<sup>257</sup> Approved in *Occidental* at para. 185. (Investor's Book of Authorities at Tab 60).

<sup>258</sup> Article 31(1) of the *Vienna Convention on the Law of Treaties* provides that "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." (Investor's Book of Authorities at Tab 41).

<sup>259</sup> *CMS* at para. 274. (Investor's Book of Authorities at Tab 53).

<sup>260</sup> *Occidental* at paras. 183 and 190. [emphasis added]. (Investor's Book of Authorities at Tab 60).

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239. The *CME v. Czech Republic* Tribunal said that, under this obligation, “[t]he host state is obligated to ensure that neither by amendment of its laws nor by actions of its administrative bodies is the agreed and approved security and protection of the foreign investor’s investment withdrawn or devalued.”<sup>261</sup> The *CME v. Czech Republic* decision confirms the obligation extends beyond an obligation to protect physical property and includes the obligation to protect the *legal* security of investments.<sup>262</sup>
240. Similarly, the *Azurix v. Argentina* Tribunal noted that the obligation to provide full protection and security includes an obligation to provide a “secure investment environment.”<sup>263</sup>
241. NAFTA Article 1105 affirms States’ obligation under the international law standard to provide full protection and security to investments.
242. Modern investor-state tribunals also clarify the *standard* of protection owed under the obligation. The *Lauder*, *CME*, *Azurix* and *AAPL* Tribunals have said that the obligation

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<sup>261</sup> *CME Czech Republic B.V. (The Netherlands) v. The Czech Republic*, Partial Award, 2001 WL 34786542 (September 13, 2001) at para. 613. (Investor’s Book of Authorities at Tab 66).

<sup>262</sup> *CME* at para. 613 (Emphasis added) (Investor’s Book of Authorities at Tab 66). The Tribunal said:

The Media Council’s actions in 1996 and its actions and inactions in 1999 were targeted to remove the security and legal protection of the Claimant’s investment in the Czech Republic. The Media Council’s (possible) motivation to regain control of the operation of the broadcasting after the Media Law had been amended as of January 1, 1996 is irrelevant. *The host State is obligated to ensure that neither by amendment of its laws nor by actions of its administrative bodies is the agreed and approved security and protection of the foreign investor’s investment withdrawn or devalued.* This is not the case. The Respondent therefore is in breach of this obligation

<sup>263</sup> *Azurix Corp. v. Argentine Republic*, Award, ICSID Case No. ARB/01/1, 2006 WL 2095870 (July 14, 2006) at para. 408: “The cases referred to above show that full protection and security was understood to go beyond protection and security ensured by the police. It is not only a matter of physical security; the stability afforded by a secure investment environment is as important from an investor’s point of view. The Tribunal is aware that in recent free trade agreements signed by the United States, for instance, with Uruguay, full protection and security is understood to be limited to the level of police protection required under customary international law. However, when the terms ‘protection and security’ are qualified by ‘full’ and no other adjective or explanation, they extend, in their ordinary meaning, the content of this standard beyond physical security. To conclude, the Tribunal, having held that the Respondent failed to provide fair and equitable treatment to the investment, finds that the Respondent also breached the standard of full protection and security under the BIT.” See para. 375 for the Tribunal’s conclusion that Argentina’s failing to allow Azurix to assess tariffs consistent with the concession agreement breached Argentina’s obligation to provide fair and equitable treatment. (Investor’s Book of Authorities at Tab 67).

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requires a state to exercise reasonable due diligence to protect foreign investment.<sup>264</sup>

ii. *The Investor Receives the Protection of Customary International Law*

243. NAFTA Article 1105 sets out a standard of treatment that at a minimum, requires Canada to follow customary international law governing the treatment of aliens. Customary international law is state practice performed through an understanding the practice is required by law (“*opinio juris*”).
244. By the language of Article 1105, the NAFTA Parties signaled their agreement that the content of customary international law would be displayed the two elements of practice and *opinio juris*. Thus, the content can be extracted from the international tribunal awards that have identified and applied customary international law.
245. In supporting this approach, the *Mondev* Tribunal said:
- ... the question is not that of a failure to show *opinio juris* or to amass sufficient evidence demonstrating it. The question rather is: what is the content of customary international law providing for fair and equitable treatment and full protection and security in investment treaties?<sup>265</sup>
246. The *Mondev* tribunal went on to say that “the 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 foreigners.”<sup>266</sup> The tribunal then drew the content of customary international law from international decisions, including the NAFTA

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<sup>264</sup> The *Lauder* Tribunal said:

Article 11(2)(a) of the Treaty provides that “[i]nvestment (...) shall enjoy full protection and security”. There is no further definition of this obligation in the Treaty. *The Arbitral Tribunal is of the opinion that the Treaty obliges the Parties to exercise such due diligence in the protection of foreign investment as reasonable under the circumstances.* *Lauder* at para. 308 (Emphasis added) (Investor’s Book of Authorities at Tab 122).

*Asian Agricultural Products Limited v. Republic of Sri Lanka*, Award of June 27, 1990, 6 ICSID Rev - FILJ 526 (Investor’s Book of Authorities at Tab 99). This arbitration concerned a Hong Kong - Sri Lankan governmental agency joint venture to cultivate and export shrimp to Japan. In 1986 a local insurgency resulted in the loss of governmental control of the area where the shrimp farm was located. In 1987, a counter-insurgency was conducted by the government to regain control. In the process of regaining control of the territory, the investment was destroyed. *CME* at para. 353. (Investor’s Book of Authorities at Tab 66).

<sup>265</sup> *Mondev* at para. 113. (Investor’s Book of Authorities at Tab 49).

<sup>266</sup> *Mondev* at para. 120. (Investor’s Book of Authorities at Tab 49).

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*Azinian* decision.<sup>267</sup> The subsequent *ADF* NAFTA Tribunal specifically endorsed the *Mondev* Tribunal's conclusions that the content of customary international law can be sourced through international tribunal decisions and that the elements of practice and *opinio juris* need not be specifically proven.<sup>268</sup>

247. Tribunals, 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. The *Mondev* NAFTA Tribunal, for example, stated:

In holding that Article 1105(1) refers to customary international law, the FTC interpretations incorporate current international law, whose content is shaped by the conclusion of more than two thousand bilateral investment treaties and many treaties of friendship and commerce. Those treaties largely and concordantly provide for 'fair and equitable' treatment of, and for 'full protection and security' for, the foreign investor and his investments.<sup>269</sup>

248. The *Mondev* Tribunal's comments echo those of the *Pope & Talbot* NAFTA Tribunal, which said:

Canada's views on the appropriate standard of customary international law for today were perhaps shaped by its erroneous belief that only some 70 bilateral investment treaties have been negotiated; however, the true number, now acknowledged by Canada, is in excess of 1800. *Therefore, applying the ordinary rules for determining the content of custom in international law, one must conclude that the practice of states is now represented by those treaties.*<sup>270</sup>

249. The *CMS v. Argentina* Tribunal reached a similar conclusion, holding that the customary international law standard of treatment mandated "fair and equitable treatment" and "full protection and security." The Tribunal said "... the Treaty standard of fair and equitable treatment ... is not different from the international law minimum standard and its evolution under customary law."<sup>271</sup>

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<sup>267</sup> *Mondev* at paras. 126 - 127. (Investor's Book of Authorities at Tab 49).

<sup>268</sup> *ADF Group Inc. v. United States of America*, ICSID Case No. ARB(AF)/00/1, Award, 2003 WL 24083234 (January 9, 2003) at para. 184: "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 case law or other sources of customary or general international law." (Investor's Book of Authorities at Tab 50).

<sup>269</sup> *Mondev* at para. 125. (Investor's Book of Authorities at Tab 49).

<sup>270</sup> *Pope & Talbot*, Award on Damages, at para. 62 [emphasis added]. (Investor's Book of Authorities at Tab 48).

<sup>271</sup> *CMS* at para. 284. (Investor's Book of Authorities at Tab 53).

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250. Judge Stephen Schwebel, former President of the International Court of Justice, has expressed the same view, stating that “when BITs prescribe treating the foreign investor in accordance with customary international law, they should be understood to mean the standard of international law embodied in the terms of some two thousand concordant BITs.”<sup>272</sup>
251. Accordingly, the content of the customary international law standard of treatment can be determined by consideration of international tribunal decisions.
252. Acknowledging that international law standard was “as established in State practice *and in the jurisprudence of arbitral tribunals*,”<sup>273</sup> the *Mondev* Tribunal then drew upon international decisions, including the NAFTA *Azinian* decision, to examine the content of the customary international standard.<sup>274</sup> This approach was subsequently followed by the *ADF Group* Tribunal that found 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*.<sup>275</sup>

iii. Summary

253. NAFTA and non-NAFTA tribunal decisions alike demonstrate that the words of 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.

254. In this case, Canada has failed to accord with the general customary international law standard of treatment with respect to each of these constituent requirements. Further, to

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<sup>272</sup> Schwebel, S. *Investor-State Disputes and the Development of International Law: The Influence of Bilateral Investment Treaties on Customary International Law*, 98 ASIL Proc. 27 at 29-30 (2004). (Investor’s Book of Authorities at Tab 54).

<sup>273</sup> *Mondev* at para. 119 [emphasis added]. (Investor’s Book of Authorities at Tab 49).

<sup>274</sup> *Mondev* at paras. 126 & 127. (Investor’s Book of Authorities at Tab 49).

<sup>275</sup> *ADF* at para. 184: “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.” (Investor’s Book of Authorities at Tab 50).

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the extent that each of these four components is *also* grounded in Article 1105's more specific obligations to provide fair and equitable treatment and full protection and security, Canada has breached those more specific obligations as well.

**B. National Treatment**

255. NAFTA Article 1102 requires the NAFTA Parties to provide national treatment to the investors of the other Party and their investments. The Article states:

**National Treatment**

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

256. There are three elements which an investor or investment must establish to prove that a NAFTA Party has breached NAFTA Article 1102. These are:

- a) the foreign investor or investment must be in like circumstances with local Investor or investments;
- b) the NAFTA Party treats the foreign investor or investment less favorably than it treats local investors or investments; and
- c) the treatment must be with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.

Examining each of these elements demonstrates that a NAFTA Party breaches Article 1102 when it fails to provide equality of competitive opportunities to investors and investments from the other Parties.

*i. Like Circumstances*

257. In its *Statement of Defence* Canada acknowledges that the first step under Article 1102 is

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to identify investors or investments in “like circumstances”.<sup>276</sup> The Investor agrees.

258. The NAFTA does not define the phrase “like circumstances”. However, Article 31(1) of the *Vienna Convention* directs that “[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.”<sup>277</sup> The context of NAFTA Article 1102 demonstrates that investor and investments that compete are in “like circumstances.” for purposes of the provision.

259. NAFTA Tribunals have agreed that investments and investors are in “like circumstances” if they operate in the same business or economic sector. After noting the NAFTA’s objective to “promote ... fair competition,”<sup>278</sup> the *Pope & Talbot* Tribunal said:

... the Tribunal believes that, as a first step, the treatment accorded a foreign owned investment protected by Article 1102(2) should be compared with that accorded domestic investments in the same business or economic sector.<sup>279</sup>

260. Similarly, the *S.D. Myers* Tribunal said:

“[T]he concept of ‘like circumstances’ invites an examination of whether a non-national investor complaining of less favorable treatment is in the same ‘sector’ as the national investor. The Tribunal takes the view that the word ‘sector’ has a wide connotation that includes the concepts of ‘economic sector’ and ‘business sector.’”<sup>280</sup>

261. The Tribunal applied these principles to find that the US investor and its Canadian investment were in “like circumstances” with Canadian investors in the same business sector “PCB waste remediation services.”<sup>281</sup> The Tribunal confirmed its conclusion by noting the competition between the US investor and Canadian comparators.<sup>282</sup>

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<sup>276</sup> Canada’s *Statement of Defence* at para. 65.

<sup>277</sup> *Vienna Convention on the Law of Treaties* Article 31(1) [emphasis added]. (Investor’s Book of Authorities at Tab 41).

<sup>278</sup> *Pope & Talbot*, Award on Merits Phase 2, at para. 70. (Investor’s Book of Authorities at Tab 42).

<sup>279</sup> *Pope & Talbot*, Award on Merits Phase 2, at para. 78. (Investor’s Book of Authorities at Tab 42).

<sup>280</sup> *Myers* at para. 250. (Investor’s Book of Authorities at Tab 39).

<sup>281</sup> *Myers* at para. 251. (Investor’s Book of Authorities at Tab 39).

<sup>282</sup> The *Myers* Tribunal said at para. 251 that the US investor: “was in a position to attract customers that might otherwise have gone to the Canadian operators because it could offer more favorable prices and because it had extensive experience and credibility. It was precisely because [the US investor] was in a position to take business



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262. In *Feldman*, the NAFTA Tribunal also concluded that the foreign and domestic investors were in “like circumstances” because they operated in the same business sector:

In the Tribunal’s view, the “universe” of firms in like circumstances are those foreign-owned and domestic-owned firms that are in the business of reselling/exporting cigarettes.<sup>283</sup>

263. NAFTA Chapter 14 can assist in giving context and meaning to NAFTA Article 1102. Neither NAFTA Chapter 11 nor NAFTA Chapter 12 (dealing with Cross-Border Trade in Services) apply to “measures adopted or maintained by a Party to the extent that they are covered by Chapter Fourteen (Financial Services)”.<sup>284</sup> In order to exclude financial services from the national treatment obligations in NAFTA Chapters 11 and 12, the Parties reproduced these obligations in NAFTA Article 1405 as follows:

1. Each Party shall accord to Investors of another Party treatment no less favorable than that it accords to its own Investors, in like circumstances, with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of financial institutions and investments in financial institutions in its territory.
2. Each Party shall accord to financial institutions of another Party and to investments of Investors of another Party in financial institutions treatment no less favorable than that it accords to its own financial institutions and to investments of its own Investors in financial institutions, in like circumstances, with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of financial institutions and investments in financial institutions in its territory.
3. Subject to Article 1404, where a Party permits the cross-border provision of a financial service it shall accord to the cross-border financial service providers of another Party treatment no less favorable than that it accords to its own financial service providers, in like circumstances, with respect to the provision of such service.

Paragraphs (1),(2) and (3) of NAFTA Article 1405 reproduce the national treatment obligations for both investment and services in NAFTA Articles 1102(1), 1102(2) and 1202(1).

264. The drafters of NAFTA Article 1405 added an explanation of this national treatment obligation to provide interpretative guidance. This explanation reads:

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away from its Canadian competitors that [the Canadian Investor] lobbied the Minister of the Environment to ban exports when the US authorities opened the border.” (Investor’s Book of Authorities at Tab 39).

<sup>283</sup> *Feldman* at para. 171. (Investor’s Book of Authorities at Tab 15).

<sup>284</sup> See also NAFTA Article 1201(2)(a) for the services exclusion.

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5. A Party's treatment of financial institutions and cross-border financial service providers of another Party, whether different or identical to that accorded to its own institutions or providers in like circumstances, is consistent with paragraphs 1 through 3 if the treatment affords equal competitive opportunities.

NAFTA Article 1405(5) indicates that the purpose of the national treatment provision is to provide "equal competitive opportunities." The national treatment provision can only fulfil this purpose by comparing investors and investments that compete.

265. Canada's NAFTA *Statement on Implementation* demonstrates that the competitive equality standard is not *confined* to Chapter 14 and investments in financial service providers. The Statement emphasizes that Chapter 14 captures "general rules" and the "principle" of national treatment.<sup>285</sup> The additional explanatory comments on the meaning of national treatment for investments in financial services were added for greater certainty in light of the sensitivity of this sector.
266. In Annex II to the NAFTA, the Parties set out their reservations for obligations, including national treatment. For each reservation, the NAFTA Parties set out the following information:
- a) the general sector for which the reservation is made (e.g. Transportation);
  - b) the specific sub-sector involved (e.g. Water Transportation);
  - c) the standard industry classification covered by the reservation (e.g. SIC 4543 Marine Towing Industry);
  - d) the obligation to which the reservation is taken (e.g. national treatment);
  - e) a description of the economic activities covered by the reservation (e.g. "Canada reserves the right to adopt or maintain any measure relating to investment in or provision of maritime cabotage services"); and
  - f) any existing measures covered by the reservation.

The use of specific economic sub-sectors to identify reservations to national treatment demonstrates that the identification of the precise economic sector in which the investment operates is the critical first step in the analysis under NAFTA Article 1102. Once firms compete in the same economic sector, then the obligation to provide "treatment no less favorable" applies.

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<sup>285</sup> The *Canadian Statement on Implementation*, Canada Gazette Part 1, January 1, 1994, says at 172 - 173: "The second objective [of Chapter 14] was to move beyond the [Canada-US] FTA by basing market access on a set of *general rules* enshrining national treatment, MFN treatment, the right of consumers to purchase financial services on a cross-border basis and the right to market access through the establishment of a commercial presence. The emphasis on defining *principles*, rather than the *a la carte* approach taken in the FTA, is path-breaking of the best kind, building on progress made in the Uruguay Round negotiations in drafting a General Agreement on Trade in Services [emphasis added]. (Investor's Book of Authorities at Tab 4).

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267. The national treatment obligation for cross-border trade in services contains the same “like circumstances” formulation as NAFTA Article 1102. NAFTA Article 1202(1) reads:

Each Party shall accord to service providers of another Party treatment no less favorable than that it accords, in like circumstances, to its own service providers.

268. In the NAFTA Chapter 20 state-to-state arbitration in *Cross-border Trucking Services*, all three NAFTA Parties agreed that the meaning of “like circumstances” in NAFTA Article 1202 was the same as “like services and service providers.” The Chapter 20 Panel stated:

The Panel, in interpreting the phrase “in like circumstances” in Articles 1202 and 1203, has sought guidance in other agreements that use similar language. *The Parties do not dispute that the use of the phrase “in like circumstances” was intended to have a meaning that was similar to the phrase “like services and service providers” as proposed by Canada and Mexico during NAFTA negotiations.*<sup>286</sup>

269. The language of “like services and service providers” proposed by Canada and Mexico in the NAFTA negotiations, which all three NAFTA Parties agreed was equivalent to “like circumstances”, eventually made its way into the GATS. In that agreement, the Parties expressly confirmed that national treatment requires equality of competitive opportunities - just as in NAFTA Article 1405. Article XVII(1) of the GATS, entitled National Treatment, reads:

... each Member shall accord to services and service suppliers of any other Member, in respect of all measures affecting the supply of services, treatment no less favourable than that it accords to its own like services and service suppliers.<sup>287</sup>

Paragraph 3 of the same Article explains that “[f]ormally identical or formally different treatment shall be considered to be less favourable treatment if it modifies the conditions of competition ...”<sup>288</sup>

270. The NAFTA was negotiated concurrently with the GATS, to which all three NAFTA

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<sup>286</sup> *In the Matter of Cross-Border Trucking Services* (Secretariat File No. USA-MEX-98-2008-01) Final Report of the Panel, February 6, 2001, at para. 249. (Investor’s Book of Authorities at Tab 34).

<sup>287</sup>GATS Article XVII(1). (Investor’s Book of Authorities at Tab 36)

<sup>288</sup>GATS Article XVII(3). (Investor’s Book of Authorities at Tab 36)

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Parties are also party.<sup>289</sup> The meaning of NAFTA's "like circumstances" language in NAFTA Articles 1202 and 1102 must therefore be consistent with the meaning of national treatment in the GATS.

271. The need for a consistent interpretation between NAFTA Chapter 11 and the GATS is reinforced by the fact that the GATS also applies to investments. The GATS defines "the supply of a service" to include services supplied "by a service supplier of one Member, through a commercial presence in the territory of any other Member."<sup>290</sup>
272. Under the NAFTA, the Parties chose to have service suppliers who supply through a commercial presence in the territory protected by NAFTA Chapter 11 rather than NAFTA Chapter 12.<sup>291</sup> They did so because, unlike the Members of the WTO, the NAFTA Parties agreed to provide such investments additional protections (such as protection from expropriation).
273. The NAFTA drafters could not have intended the national treatment protection for an Investor supplying a service through a commercial presence in the territory of another Party to be lower under the NAFTA than under the GATS. They must have intended the protection under NAFTA Chapter 11 to provide a level of national treatment protection that was at least as strong as the one in the GATS. Measures that modify conditions of competition in favor of domestic service providers therefore presumptively violate Article 1102.
274. Indeed, the NAFTA drafters were *under an obligation* to ensure that national treatment protection for an investor who supplies a service through a commercial presence in the territory of another Party was not lower under the NAFTA than under the GATS. Article V of the GATS, entitled "Economic Integration," says:

This Agreement shall not prevent any of its Members from being a party to or entering into an agreement liberalizing trade in services [such as the NAFTA] ... *provided that such an agreement ... provides for the absence or elimination of substantially all discrimination, in the sense of Article XVII* [the GATS national treatment Article].

Article XVII of the GATS protects equality of competitive opportunities for service

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<sup>289</sup> *General Agreement on Trade in Services (GATS)*, World Trade Organization (WTO) Status of Legal Instruments WTO/Leg/1 Supplement 3, October 2002. (Investor's Book of Authorities at Tab 36).

<sup>290</sup> GATS Article I(2). (Investor's Book of Authorities at Tab 36).

<sup>291</sup> Thus, NAFTA Article 1213(2) excludes from the definition of cross-border trade in services "the provision of a service in the territory of a Party by an investment, defined in Article 1139 (Investment - Definitions) in that territory".

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providers that supply services through a commercial presence. Any NAFTA Party interpreting NAFTA Article 1102 to provide less than that level of protection would breach their obligation in Article V of the GATS.

275. The *Cross-border Trucking Services* Panel drew from this background in finding that the same US measure violated the national treatment obligations contained in both NAFTA Articles 1202 and 1102. In reaching this decision, the Panel referred to “similar national treatment obligations” in GATT Article III and the *Section 337* case, which first articulated the “equality of competitive opportunities” test.<sup>292</sup> The NAFTA Chapter 20 Panel specifically discussed the interpretation of NAFTA Article 1102 by reference to “long-established doctrine under the GATT and WTO” that interprets national treatment in goods “to protect expectations regarding competitive opportunities...”<sup>293</sup>
276. In NAFTA’s Preamble, the NAFTA Parties recognized that they had negotiated the Agreement to “build on their respective rights and obligations under the *General Agreement on Tariffs and Trade ...*”. Similarly, in its *Statement on Implementation*, Canada acknowledged that:

The NAFTA and the Uruguay Round agreements cover much of the same ground and the two sets of rules are largely complementary and mutually reinforcing. In many respects, the NAFTA built on progress that had been made in the Uruguay Round while the Round in turn profited from the experience of Canada, the United States and Mexico in negotiating the NAFTA.<sup>294</sup>

277. By the time the NAFTA was negotiated, the GATT had achieved tremendous success in reducing economic protectionism in trade in goods. It did so not only by eliminating tariffs and import quotas, but also by requiring that goods receive national treatment once they crossed the border.
278. The national treatment obligation in GATT Article III countered two forms of economic protectionism. First, Article III:2 addressed discriminatory taxes. Second, Article III:4 addressed discriminatory regulation.<sup>295</sup> At the same time, the GATT allowed for

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<sup>292</sup> *Cross-Border Trucking Services* at para. 251. (Investor’s Book of Authorities at Tab 34).

<sup>293</sup> *Cross-Border Trucking Services* at para. 289. (Investor’s Book of Authorities at Tab 34).

<sup>294</sup> *Canadian Statement on Implementation* at 75. (Investor’s Book of Authorities at Tab 4).

<sup>295</sup> GATT Article III(4):

The products of the territory of any contracting party imported into the territory of any other contracting

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exceptions to these disciplines for both government procurement and subsidies in Article III:8.<sup>296</sup>

279. When NAFTA's drafters negotiated its provisions on trade in goods, they simply incorporated the national treatment obligation in GATT Article III by reference.<sup>297</sup> In doing so, they ensured that they had also incorporated by reference the GATT Article III jurisprudence.
280. However, when negotiating provisions on trade in services and investment, no similar incorporation by reference was agreed upon. For cross border trade in services, Canada and Mexico proposed replicating the GATT Article III "like products" language with "like services and service providers." However, the NAFTA Parties ultimately settled on "like circumstances" language in both NAFTA Articles 1102 and 1202 on the understanding that this was not materially different from that proposed by Canada and Mexico.<sup>298</sup>
281. It is readily apparent that the structure of Article III:4 was used as a model for NAFTA

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party shall be accorded treatment no less favourable than that accorded to like products of national origin in respect of all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use. The provisions of this paragraph shall not prevent the application of differential internal transportation charges which are based exclusively on the economic operation of the means of transport and not on the nationality of the product.

<sup>296</sup> GATT Article III:8:

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

(b) The provisions of this Article shall not prevent the payment of subsidies exclusively to domestic producers, including payments to domestic producers derived from the proceeds of internal taxes or charges applied consistently with the provisions of this Article and subsidies effected through governmental purchases of domestic products.

<sup>297</sup> NAFTA Article 301(1) reads:

Each party shall accord national treatment to the goods of another Party in accordance with Article III of the *General Agreement of Tariffs and Trade* (GATT), including its interpretive notes, and to this end Article III of the GATT and its interpretive notes or any equivalent provision of a successor agreement to which all Parties are party, are incorporated into and made part of this Agreement.

<sup>298</sup> *Cross-Border Trucking Services* at para. 249. (Investor's Book of Authorities at Tab 34).

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Article 1102. It reads:

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

282. GATT Article III:4 and NAFTA Article 1102 have the following similarities:

- a) They identify foreign and domestic economic interests (respectively, products and investments);
- b) They require a party to accord these economic interests “treatment no less favorable”;
- c) This “no less favorable” treatment extends only to economic interests that satisfy a “likeness” requirement;
- d) The “no less favorable” treatment must be accorded throughout the time the economic interest continues in the territory (in the case of a product, from its offering for sale through its transportation and distribution to its final use; in the case of an investment, from its establishment through its conduct and operation to its final disposition); and
- e) The obligation is subject to exceptions for government procurement and subsidies.

283. The words “treatment no less favorable” were adopted for use in NAFTA Article 1102 because their meaning had already been considered extensively in GATT jurisprudence. The GATT jurisprudence had interpreted “treatment no less favorable” as requiring equality of competitive opportunities.<sup>299</sup>

284. Acknowledging Article 1102's origins in, and similarity to, GATT Article III:4, several NAFTA Tribunals have drawn from GATT Article III:4 jurisprudence in interpreting Article 1102.<sup>300</sup> The *Feldman* Tribunal held that GATT Article III:4 is “analogous” to

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<sup>299</sup> See, for example, *United States - Taxes on Petroleum and Certain Imported Substances*, 17 June 1987, 1987 WL 421960 (G.A.T.T.), at para. 5.2.2. (Investor's Book of Authorities at Tab 37); *European Communities - Measures Affecting Asbestos and Asbestos-Containing Products*, Report of the Appellate Body, WT/DS135/AB/R, 12 March 2001, at para. 99. (Investor's Book of Authorities at Tab 38).

<sup>300</sup> *Myers* at para. 244. (Investor's Book of Authorities at Tab 39). *Pope & Talbot, Inc. v. Government of Canada*, Award on the Merits of Phase 2, 2001 WL 34776948 (April 10, 2001) at paras. 68, 69 & footnote 68. (Investor's Book of Authorities at Tab 42). *Feldman v. Mexico*, Award, ICSID Case No. ARB(AF)/99/1, 2002 WL 32818521 (December 16, 2002) at para. 165: “The national treatment/non-discrimination provision is a fundamental obligation of Chapter 11. The concept is not new with NAFTA. Analogous language in Article III of the GATT has

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NAFTA Article 1102.<sup>301</sup>

285. NAFTA Chapter 15 also uses the “like circumstances” language to refer to competitors. Article 1505 defines a “discriminatory provision” as including:

treating:

- (a) a parent, a subsidiary or other enterprise with common ownership *more favorably* than an unaffiliated enterprise; or
- (b) one class of enterprises *more favorably* than another, *in like circumstances* ...

NAFTA Article 1502(3)(d) uses the “discriminatory provision” of a “monopoly good or service” as an example of an anti-competitive practice that may adversely affect an investment of an investor of another Party. By definition, in order to be an anti-competitive practice, the discriminatory provision must involve more favorable treatment of one enterprise over a competitor. Enterprises “in like circumstances” for purposes of Article 1505 are competing enterprises.

286. In summary, the context of NAFTA Article 1102, including its reservations, Articles 1405, 1202 and 1505, and the preambular objective to build on the GATT obligations, demonstrates that investors and investments that compete are in “like circumstances”. Other interpretative tools from the *Vienna Convention* confirm this interpretation.

287. Article 31(1) of the *Vienna Convention* directs that “[a] treaty shall be interpreted in good faith... *in the light of its object and purpose.*”<sup>302</sup> The fact that a key objective of the NAFTA was to “promote conditions of fair competition in the free trade area” also indicates that investors and investments that compete are in “like circumstances” for purposes of Article 1102.<sup>303</sup>

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applied between Canada and the United States since 1947, and with Mexico since 1985, with regard to trade in goods.” (Investor’s Book of Authorities at Tab 15).

<sup>301</sup> *Feldman* at para. 165: “The national treatment/non-discrimination provision is a fundamental obligation of Chapter 11. The concept is not new with NAFTA. Analogous language in Article III of the GATT has applied as between Canada and the United States since 1947, and with Mexico since 1985, with regard to trade in goods.” (Investor’s Book of Authorities at Tab 15).

<sup>302</sup> *Vienna Convention on the Law of Treaties*, Article 31(1). (Investor’s Book of Authorities at Tab 41).

<sup>303</sup> *NAFTA* Article 102(1)(b).



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288. Article 31(3)(c) of the *Vienna Convention* states that “any relevant rules of international law applicable in the relations between the parties” “shall be taken into account”. The *Vienna Convention* also directs that “[a] special meaning shall be given to a term if it is established that the parties so intended.”<sup>304</sup>
289. Chapters 3, 12, 14 and 15 of the NAFTA are part of the context of Article 1102 while the WTO agreements are relevant rules of international law. Taken together, these demonstrate that the Parties did intend to give NAFTA Article 1102 a special meaning. The NAFTA drafters confirmed that intention entitling Article 1102 “National Treatment” and by including national treatment as a principle and rule of the NAFTA in Article 102(1).
290. Similarly, the *Cross Border Trucking Panel* noted the NAFTA’s objective to “promote ... fair competition”<sup>305</sup> before comparing the treatment of Mexican truck service providers with that of US truck service providers.

ii. *Treatment No Less Favorable*

291. Article 31(1) of the *Vienna Convention* directs that “[a] treaty shall be interpreted in good faith in accordance with the *ordinary meaning* to be given to the terms of the treaty.”<sup>306</sup> The ordinary meaning of “treatment no less favorable” is plain on its face. GATT Panels have drawn from this ordinary meaning, and the meaning of “likeness,” to confirm that national treatment is an obligation to provide equality of competitive opportunities. For example, the *Section 337 of the Tariff Act of 1930 Panel* said:

[The] “no less favorable” treatment requirement set out in Article III:4, is unqualified. These words are to be found throughout the General Agreement and later agreements negotiated in the GATT framework *as an expression of the underlying principle of equality of treatment of imported products as compared to the treatment given either to ... domestic products*. The words “treatment no less favorable” in paragraph 4 call for effective equality of opportunities ...<sup>307</sup>

292. The obligation to provide “treatment no less favorable” to investors and investments in “like circumstances” similarly creates an obligation to provide equality of competitive

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<sup>304</sup> *Vienna Convention on the Law of Treaties*, Article 31(4). (Investor’s Book of Authorities at Tab 41).

<sup>305</sup> *Cross-Border Trucking Services* at para. 105. (Investor’s Book of Authorities at Tab 34).

<sup>306</sup> *Vienna Convention on the Law of Treaties*, Article 31(1) [emphasis added]. (Investor’s Book of Authorities at Tab 41).

<sup>307</sup> *United States - Section 337 of the Tariff Act of 1930* (Report by panel adopted on November 7, 1989) (L/6439-365/345), at para. 5.11. (Investor’s Book of Authorities at Tab 43).

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opportunities.

293. The NAFTA Article 1102 obligation to provide no less favorable treatment to foreign investors and investments requires NAFTA Parties to treat foreign investors and their investments as well as the *best* treated domestic investor and investment. NAFTA and GATT/WTO jurisprudence support this conclusion. For example, the *Pope & Talbot* Tribunal said:

The Tribunal also interprets both standards to mean the right to treatment equivalent to the “best” treatment accorded to domestic Investor or investments in like circumstances. The Tribunal thus concludes that “no less favorable” means equivalent to, not better or worse than, the best treatment accorded to the comparator.<sup>308</sup>

Similarly, the GATT Panel in *United States - Measures Affecting Alcoholic and Malt Beverages* said:

The Panel did not consider relevant the fact that many of the State provisions at issue in this dispute provide the same treatment to products of other states of the United States as that provided to foreign products. The national treatment provisions require contracting Parties to accord to imported products treatment no less favorable than that accorded to any like domestic product, whatever the domestic origin. Article III consequently requires national treatment of imported products no less favorable than that accorded to the *most-favored domestic products*.<sup>309</sup>

294. Canada is, therefore, required to accord Merrill & Ring treatment no less favorable as that given to the most favored domestic investors and investments.

iii. *Establishment, Acquisition, Expansion, Management, Conduct, Operation and Sale or Other Disposition of an Investment*

295. NAFTA Article 1102 obliges NAFTA Parties to provide investors and investments treatment as favorable as that provided to others in “like circumstances” with respect to establishment, acquisition, expansion, management, conduct, operation and sale or other disposition of an investment. While the closing phrase relates to the scope of the NAFTA investment chapter national treatment obligations, it is a very broad phrase. While the phrase has yet to receive detailed consideration by a NAFTA tribunal, it is readily apparent that almost all activity reasonably connected with a foreign investor and its investment would fall within its scope.

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<sup>308</sup> *Pope & Talbot*, Award on the Merits Phase 2, at para. 42 [emphasis added]. (Investor’s Book of Authorities at Tab 42).

<sup>309</sup> *United States - Measures Affecting Alcoholic and Malt Beverages* (Report of the Panel adopted on June 19, 1992) (DS23/R) at para. 5.17 [emphasis added]. (Investor’s Book of Authorities at Tab 44).

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iv. *Summary*

296. A NAFTA Party fails to provide national treatment, in breach of Article 1102, when it fails to provide equality of competitive opportunities to investors or investments from the other Parties.

**C. Performance Requirements**

i. *Content of Articles 1106(1) and 1106(3)*

297. NAFTA Article 1106 restricts the imposition of performance requirements on investments or investors. The prohibited practices are specifically set out in Article 1106(1) and Article 1106(3). These prohibitions apply to all investments or investors including those from non-NAFTA parties.

298. Article 1106(1) sets out a general prohibition on performance requirements. It states:

No Party may impose or enforce any of the following requirements, or enforce any commitment or undertaking, in connection with the establishment, acquisition, expansion, management, conduct or operation of an investment of an investor of a Party or of a non-Party in its territory.

- (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 inflows associated with such investment;
  - (e) to restrict sales of goods or services in its territory that such an 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 a 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.
299. Many performance requirements are imposed on investors in connection with the provision of some advantage such as the right to export, a subsidy or preferential market access. Article 1106(3) lists a sub-set of performance requirements that cannot be imposed in connection with the provision of an advantage:

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No Party may condition the receipt or continued receipt of an advantage, in connection with an investment in its territory of an investor of a Party or of a non-Party, on compliance with any of the following requirements:

- (a) to achieve a given level or percentage of domestic content;
- (b) 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;
- (c) to relate in any way the volume or value of imports to the volume or value of exports or to the amount of foreign inflows associated with such investment;
- (d) to restrict sales of goods or services in its territory that such an investment produces or provides by relating such sales in any way to the volume or value of its exports or foreign exchange earning.

300. The interrelationship between NAFTA Articles 1106(1) and 1106(3) was considered by the *Pope & Talbot* Tribunal. It concluded that there were four listed performance requirements in NAFTA Article 1106(1) that could not be conditions for the receipt or continued receipt of an advantage.<sup>310</sup> These four performance requirements are:

- 1106(1)(b) to achieve a given level or percentage of domestic content [prohibited by Articles 1106(1)(b) and 1106(3) (a)];
- 1106(1)(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 [prohibited by Articles 1106(1)(c) and 1106(3)(b) but only with respect to goods and not services and only with respect to goods purchased from producers];
- 1106(1)(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 inflows associated with such investment [prohibited by Articles 1106(1)(d) and 1106(3)(c)];
- 1106(1)(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 earning [prohibited by Articles 1106(1)(e) and 1106(3)(d)].<sup>311</sup>

301. The WTO Panel in *United States - Measures Treating Export Restraints* concluded that log export restraints did not constitute a subsidy as defined by the WTO Agreement on

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<sup>310</sup> *Pope & Talbot v. Canada*, Interim Merits Award, 2000 WL 34514092 (June 26, 2000) at paras. 71 and 72. (Investor's Book of Authorities at Tab 72).

<sup>311</sup> NAFTA Article 1106(3).

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*Subsidies and Countervailing Measures*.<sup>312</sup> In its *Statement of Defence*, Canada stipulated that its Log Export Control Regime did not provide any advantages to Merrill & Ring. Canada further stipulated that Article 1106(3) does not apply in this arbitration.

ii. *The Meaning of Requirement*

302. Article 1106 only applies to commitments, undertakings or requirements. The NAFTA does not define these terms, however international trade jurisprudence assists in interpreting these terms.<sup>313</sup>
303. A WTO dispute panel in *Canada-Measures Affecting the Automotive Industry* considered the term “requirement” as contained in the national treatment obligation set out in GATT Article III:4. Taking into consideration the position a government holds *vis-a-vis* private parties, the Panel concluded the term would include a broad variety of forms of governmental action that could influence the conduct of private parties:

...the word “requirement” has been defined to mean “1. The action of requiring something; a request. 2. A thing required or needed, a want, a need. Also the action or an instance of needing or wanting something. 3. Something called for or demanded; a condition which must be complied with.” The word “requirement” in its ordinary meaning and in light of its context in Article III:4 clearly implies government action involving a demand, request or the imposition of a condition but in our view this term does not carry a particular connotation with respect to the legal form in which such government action is taken. In this respect, we consider that, in applying the concept of “requirements” in Article III:4 to situations involving actions by private parties, it is necessary to take into account that there is a broad variety of forms of government action that can be effective in influencing the conduct of private parties.<sup>314</sup>

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<sup>312</sup> United States-Canada Free Trade Agreement Article 1904 Binational Panel Review, U.S.A.-92-1904-01, *In the Matter of Certain Softwood Lumber Products from Canada*, December 17, 1993, at 101-102. (Investor’s Book of Authorities at Tab 104).

<sup>313</sup> For example, a GATT Panel in *Canada - Administration of the Foreign Investment Review Act* found that undertakings or conditions related to an investment qualified as requirements under the GATT article on national treatment:

[...] The Panel further noted that written purchase undertakings - leaving aside the manner in which they may have been arrived at (voluntary submission, encouragement, negotiation, etc.) - once they were accepted, became part of the conditions under which the investment proposals were approved, in which case compliance could be legally enforced. The Panel therefore found that the word “requirements” as used in Article III:4 could be considered a proper description of existing undertakings. *Canada - Administration of the Foreign Investment Review Act*, Report of the Panel Adopted on 7 February 1984 (L/5504-305/140) at para. 5.4. (Investor’s Book of Authorities at Tab 74).

<sup>314</sup> *Canada - Certain Measures Affecting the Automotive Industry*, Report of the Panel, WT/DS139/R, WT/DS142/R, 11 February 2000, at para. 10.107. (Investor’s Book of Authorities at Tab 75).

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304. A somewhat narrower approach was applied by the *Pope & Talbot* Tribunal. The Tribunal held that the “speed bump” requirement in Canada’s softwood lumber export quota that operated to increase export tariffs based on the investment’s increasing export volumes did not technically constitute a “requirement” to export a given level of goods. Thus the Tribunal concluded that NAFTA Article 1106(1)(a) did not apply. The *Pope & Talbot* Tribunal found that the “speed bump” rule operated as a *deterrent* against increasing exports.<sup>315</sup>
305. The *Pope & Talbot* Tribunal held that the scope of Article 1106(1)(a) dealing with requirements to export at given levels “is not expressly limited to the imposition or enforcement of a *higher* level...of exports, but could admit equally the imposition or enforcement of *any* given level...of those exports.”<sup>316</sup> Thus, where a NAFTA Party has a measure that sets “any given level” of exports, such a measure will be a “requirement” for the purposes of NAFTA Article 1106(1).

**D. Expropriation**

306. Article 1110(1) reads:

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 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.

Paragraph 2 of Article 1110 discusses how market value compensation is to be calculated.

307. NAFTA Article 1110 does not absolutely prohibit a government from taking measures tantamount to expropriation but it does place restrictions on the right and makes it conditional upon the payment of fair market compensation.

*i. The Meaning of Expropriation: Substantial Deprivation*

308. Neither the term “expropriated” or “expropriation” is defined in the NAFTA. Decisions

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<sup>315</sup> *Pope & Talbot*, Interim Award, para. 75. (Investor’s Book of Authorities at Tab 72).

<sup>316</sup> *Pope & Talbot*, Interim Award, para. 74. (Investor’s Book of Authorities at Tab 72).

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of international courts and tribunals help elucidate their meaning. In the *Sola Tiles* case<sup>317</sup> the Iran-US Claims Tribunal gave the following definition of expropriation:

It is well settled in the practice of the Tribunal, as elsewhere, that property may be taken under international law through interference by a State in the use of that property or the enjoyment of its benefits amounting to a deprivation of the fundamental rights of ownership.<sup>318</sup>

309. Five NAFTA tribunals have considered the meaning of NAFTA's expropriation obligation. They have together provided a clear view of how they should be interpreted and applied. The first significant award was made by the *Pope & Talbot* Tribunal, which began by determining that the object of an expropriation under Article 1110 is the "investment of an investor of a NAFTA Party". This term is defined under Article 1138, and includes any of tangible or intangible property interests included therein. It is not limited to any particular form of property, and is intimately tied to the nature of the business in question.<sup>319</sup>
310. Next, the *Pope & Talbot* Tribunal confirmed that the kinds of interference envisaged by NAFTA Article 1110 (including direct nationalization, indirect expropriation and measures tantamount to expropriation) do not depart from those recognized under customary international law.<sup>320</sup> It also concluded that merely because a government claims that its actions are not overtly discriminatory and are justified as an exercise of its "police" (or regulatory) power, does not mean that compensation does not need to be paid under Article 1110(1). In doing so, the Tribunal noted:

Indeed, much creeping expropriation could be conducted by regulation, and a blanket exception for regulatory measures would create a gaping loophole in international protections against [uncompensated] expropriation.<sup>321</sup>

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<sup>317</sup> *Sola Tiles Inc. v. Iran*, (1987) 14 Iran-US C.T.R. 223. (Investor's Book of Authorities at Tab 105).

<sup>318</sup> *Sola Tiles* at para. 29. (Investor's Book of Authorities at Tab 105). The Tribunal went on to cite the following cases as support for this proposition: *Foremost Tehran, Inc v. Islamic Republic of Iran* 10 Iran-US CTR 228 at 243-244 (Investor's Book of Authorities at Tab 106); *Tippetts, Abbett, McCarthy, Stratton v. TAMS-AFFA* 6 Iran-US CTR 217 at 225 (Investor's Book of Authorities at Tab 107); *Phelps Dodge Corp v. Iran*, 10 Iran-US CTR (1986) 121 at 130 (Investor's Book of Authorities at Tab 125); and *Thomas Earl Payne v. Iran.*, 12 Iran-US CTR 1 at 9 (Investor's Book of Authorities at Tab 108).

<sup>319</sup> *Pope & Talbot, Award on the Merits Phase 2*, at paras. 95 & 96-98. (Investor's Book of Authorities at Tab 42).

<sup>320</sup> *Pope & Talbot, Award on the Merits Phase 2*, at paras. 96 & 103 - 104. (Investor's Book of Authorities at Tab 42).

<sup>321</sup> *Pope & Talbot, Award on the Merits Phase 2*, at para. 99. (Investor's Book of Authorities at Tab 42).

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311. Finally, the Tribunal provided an articulation of the current test of what kind of interference constitutes a taking under modern international law, in stating:

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 the inference that the owner will not be able to use, enjoy or dispose of the property...” The *Restatement*, in addressing the question of 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”.<sup>322</sup>

312. The Tribunal in *S.D. Myers* concluded 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.” The *Myers* Tribunal determined that there had been no change to the PCB inventories in Canada available for S.D. Myers to process and that Canada's measure only delayed Myers' entry into the Canadian market for 18 months, rather than completely frustrating it.<sup>323</sup> The Tribunal concluded on those facts that there was no expropriation.

313. By contrast, in *Wena Hotels*, the Tribunal noted that being deprived of access to its investment for only one year was sufficient to have deprived the investor of its enjoyment of the investment in a manner which was more than “ephemeral”.<sup>324</sup> The hotel had been appropriated by a State-sponsored tourist agency, and although control was eventually relinquished, the condition of the facilities upon their return was poor.

314. The “merely ephemeral” standard arises from the jurisprudence of the Iran-US Claims Tribunal in *Tippets, Abbett, McCarthy, Stratton v. TAMS-AFFA*, which the *Wena Hotels* Tribunal cited at paragraph 98 of its award:

[W]hile assumption of control over property by a government does not automatically and immediately justify a conclusion that the property has been taken by the government, thus requiring compensation under international law, such a conclusion is warranted whenever events demonstrate that the owner has been deprived of fundamental rights of ownership and it appears

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<sup>322</sup> *Pope & Talbot, Award on the Merits Phase 2*, at para. 102. (Investor's Book of Authorities at Tab 42).

<sup>323</sup> *S.D. Myers (Partial Award)* at paras. 283 and 287. (Investor's Book of Authorities at Tab 39).

<sup>324</sup> *Wena Hotels Ltd. v. Arab Republic of Egypt*, ICSID Case No. ARB/98/4, Award, 2000 WL 34514091 (December 8, 2000) at para. 99. (Investor's Book of Authorities at Tab 23).



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that this deprivation is not merely ephemeral.<sup>325</sup>

315. The *Oxford English Dictionary* defines the word “ephemeral” as follows:

ephemeral – Beginning and ending in a day; existing for one day only.; or for a very few days, for a short time only; short-lived; transitory.<sup>326</sup>

316. For a government interference to be considered ephemeral - the impact must not be long-lasting. Thus the *S.D. Myers* tribunal came to the conclusion that Canada’s interference with S.D. Myers Inc’s contracts for the remediation of PCB waste from Canada was not substantially interfered with by a 18 month ban since no change had occurred to the volumes of PCB waste available for S.D. Myers Inc.<sup>327</sup> The inventory of PCB waste available was no different at the end of the export ban than at the beginning.

317. In the *S.D. Myers* case, there was no finding that there had been a transfer of benefit caused by Canada’s measures to the third parties or that Canada had any benefit itself from the measure. The *S.D. Myers* Tribunal merely found that there was a delay in opportunity as there was no change in the quantity or quality of the PCB inventories during the period of the export ban.<sup>328</sup> It is very likely that the *S.D. Myers* Tribunal would have come to a different conclusion if there had been a deprivation that was not purely and wholly temporal. The facts of the present case stand in stark contrast to those of *S.D. Myers*, in this particular respect.

318. After reviewing the body of jurisprudence developed around expropriation in the context of bilateral investment treaty practice (including NAFTA Chapter 11 jurisprudence), Professor Andreas Lowenfeld reached the following conclusion:

It seems clear from the cases here excerpted and others that expropriation as governed by the BITs is defined by the deprivation to the investor, not by the gain to the host state. Thus destruction of the investor’s property may come within the definition of expropriation if the actions are attributable to the host state, even if the state does not acquire the property in question. Further, intangible rights, such as the right to import or export a given product or to participate in a given industry, may be subject to the constraints on expropriation set out in the BITs. However, a regulation of temporary duration, or 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, even when it gives rise to liability on the part of the host state for violation of

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<sup>325</sup> *Tippets, Abbett, McCarthy, Stratton v. TAMS-AFFA Consenting Engineers of Iran et. al.*, Iran-US Claims Tribunal, Award No. 141-7-2, June 22, 1984, at para. 225. (Investor’s Book of Authorities at Tab 107).

<sup>326</sup> *The Oxford English Dictionary*, Vol. V at 322.. (Investor’s Schedule of Authorities at Tab 127).

<sup>327</sup> *S.D. Myers* (Partial Award) at paras. 127 and 284. (Investor’s Book of Authorities at Tab 39).

<sup>328</sup> *S.D. Myers* (Partial Award) at para. 287. (Investor’s Book of Authorities at Tab 39).

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national treatment and fair and equitable treatment clauses.<sup>329</sup>

319. The *CME* Tribunal similarly held:

The expropriation claim is sustained despite the fact that the Media Council did not expropriate *CME* by express measures of expropriation. De facto expropriations or indirect expropriations, i.e. measures that do not involve an overt taking but that effectively neutralize the benefit of the property of the foreign owner, are subject to expropriation claims. This is undisputed under international law.<sup>330</sup>

320. The *CME* Tribunal also cited, with approval, the *Metalclad* Tribunal that an expropriation under Article 1110:

... included not only open, deliberate and acknowledged takings of property, such as outright seizure or formal or obligatory transfer of title in favour of the host State, but also covert or incidental interference with 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 even if not necessarily to the obvious benefit of the host State.<sup>331</sup>

321. The *Metalclad* Tribunal was presented with a situation where the investor was led to believe that it had all the necessary federal and state authorizations to operate its newly constructed facility – only to be prevented from doing so through political intrigue and the questionable legal tactics of local and state officials. It was also presented with a bold “ecological decree” issued during the governor’s last days in office which was admittedly designed to ensure the facility never operated. The Tribunal found that the business of the investor had been taken without the payment of appropriate compensation, contrary to NAFTA Article 1110, on both counts.<sup>332</sup>

With respect to the expropriatory impact of the ecological decree, the *Metalclad* Tribunal noted that it did not need to consider the motivation or intent behind its imposition. While Article 1110(1) provides that an expropriation can be undertaken “for a public purpose” it also provides that, in any case, prompt, adequate and effective compensation shall be

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<sup>329</sup> Lowenfeld, A. *International Economic Law* (Oxford, Cambridge: 2002) at 479 - 480. (Investor’s Book of Authorities at Tab 126).

<sup>330</sup> *CME* at para. 604. (Investor’s Book of Authorities at Tab 66). The *CME* Tribunal then referred to Prof. Sacerdoti’s views. G. Sacerdoti at 382 as cited above, referring to numerous precedents such as the *German Interests In Polish Upper Silesia* case, 1926, PCIJ, Series A, No. 7, reprinted in M. Hudson, ed., *I World Court Reports* 475 (1934); see also *Southern Pacific Properties (Middle East) Ltd. v. Egypt*, ICSID Case No. ARB/84/3 (1992), 32 I.L.M. 993, 1993, dealing also with the expropriation of contractual rights of the operating company), (Investor’s Book of Authorities at Tab 109).

<sup>331</sup> *CME* at para. 606. citing *Metalclad* at para. 103. (Investor’s Book of Authorities at Tab 66).

<sup>332</sup> *Metalclad* at paras. 102-112. (Investor’s Book of Authorities at Tab 60).

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paid. The *Feldman* Tribunal similarly found that:

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).<sup>333</sup>

322. However, the *Feldman* Tribunal further noted that not all regulatory actions which indirectly confiscate a business are compensable takings under the customary international law of expropriation as expressed in Article 1110. The *Feldman* Tribunal turned to the commentary (g) to Section 712 of the *Third U.S. Restatement on International Law* for assistance in discerning the line between legitimate acts of governmental regulation and compensable takings under international law. The commentary provides:

A state is responsible as for an expropriation of property under Subsection (1) when it subjects alien property to taxation, regulation, or other action that is confiscatory, or that prevents, unreasonably interferes with, or unduly delays, effective enjoyment of an alien's property or its removal from the state's territory. Depriving an alien of control of his property, as by an order freezing his assets, might be a taking if it is long extended. A state is not responsible for loss of property or for other economic disadvantage resulting from bona fide general taxation, regulation, forfeiture for crime, or other action of the kind that is commonly accepted as within the police power of states, if it is not discriminatory....<sup>334</sup>

323. The definition suggested by commentary is consistent with the definitions used by ICSID investor-state tribunals in *Santa Elena* and the ICSID Tribunal decision in *Biloune*. The *Santa Elena* Tribunal stated:

There is ample authority for the proposition that a property has been expropriated when the effect of the measure taken has been to deprive the owner of title, possession, or access to the benefit and economic use of his property.<sup>335</sup>

324. The *Feldman* Tribunal concluded that the question of whether an expropriation has occurred must be determined on a case-by-case basis, in view of the totality of the facts. On the facts before it, the *Feldman* Tribunal concluded that because the investment enterprises of each investor were still "in business" and under the control of their respective investors, the interference with these investments had simply not been substantial enough to constitute a taking under international law.<sup>336</sup>

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<sup>333</sup> *Feldman* at para. 98. (Investor's Book of Authorities at Tab 15).

<sup>334</sup> *Feldman* at para. 105. (Investor's Book of Authorities at Tab 15).

<sup>335</sup> *Compania del Desarrollo de Santa Elena and Costa Rica*, ICSID case No. ARB/96/1, Final Award, 2000 WL 34551760 (February 17, 2000) at para. 77. (Investor's Book of Authorities at Tab 71).

<sup>336</sup> *Pope & Talbot*, Award on the Merits of Phase 2, at paras. 103-104, (Investor's Book of Authorities at Tab 42); *Feldman* at paras. 102, 106 & 111. (Investor's Book of Authorities at Tab 15).

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325. In addition to whether, viewed in factual context, there has been “a substantial interference with the investment” section 712 of the *Restatement* indicates other factors to be considered in determining whether the interference in question constitutes a compensable taking under international law. These include the overall “reasonableness” of the taking, including the manner of its imposition, and whether there were any discriminatory results. As suggested by the *Feldman* Tribunal’s reasoning: the more arbitrary or discriminatory the measure which takes an investor’s business, the more likely there is a breach of Article 1110.<sup>337</sup>
326. Accordingly, the question of whether government action constitutes a compensable taking, under Article 1110, requires an objective analysis of the facts of each case, focussing on whether there has been a “substantial” detrimental impact given the nature of the investment and its taking and a contextual consideration of the soundness and fairness of the particular government action.

ii. *Method of Deprivation*

327. NAFTA Article 1110 addresses both direct and indirect expropriation. An investment is expropriated, for the purposes of Article 1110, if a NAFTA Party has openly deprived the investor of its ability to make use of its economic rights or if covert or incidental state actions has had the equivalent effect.
328. NAFTA Article 1110(1) states that states must not directly or indirectly expropriate investments. “Indirectly” is not defined. International courts and tribunals have confirmed that “indirect” in this context means that the state act need not disclose any intent to deprive the investor of their ownership rights for the act to amount to an expropriation. For example, in the *Metalclad* Award, the NAFTA Tribunal stated:

...expropriation under NAFTA includes not only open, deliberate and acknowledged takings of property, such as outright seizure or formal or obligatory transfer of title in favor of the host State, but also covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or 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.<sup>338</sup>

329. The *Tecmed* Tribunal approvingly cited this paragraph from the NAFTA Tribunal decision in *Metalclad*<sup>339</sup> before going on to define indirect expropriation in the following manner:

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<sup>337</sup> *Feldman* at para. 99. (Investor’s Book of Authorities at Tab 15).

<sup>338</sup> *Metalclad* at para. 103. (Investor’s Book of Authorities at Tab 60).

<sup>339</sup> *Tecmed* at 43. (Investor’s Book of Authorities at Tab 55).

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Although these forms of expropriation do not have a clear or unequivocal definition, it is generally understood that they materialize through actions or conduct, which do not explicitly express the purpose of depriving one of rights or assets, but actually have that effect.<sup>340</sup>

330. Numerous international tribunals have accepted that expropriation can occur through multiple actions. For example, the *Tecmed* Tribunal stated:

This type of expropriation...may be carried out through a single action, through a series of actions in a short period of time or through simultaneous actions.<sup>341</sup>

331. International courts and tribunals confirm that a government measure still amounts to expropriation even if its effect is to benefit a third party, or if the act does not benefit any party at all. For example, the *Metalclad* Tribunal stated that a State act will amount to expropriation “even if not necessarily to the obvious benefit of the host State.”<sup>342</sup>

332. The *Tecmed* Tribunal stated:

...the term also covers a number of situations defined as *de facto* expropriation, where such actions or laws transfer assets to third parties different from the expropriating State or where such laws or actions deprive persons of their ownership over such assets, without allocating such assets to third parties or to the Government.<sup>343</sup>

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<sup>340</sup> *Tecmed* at para 114. (Investor’s Book of Authorities at Tab 55). Professor Sacerdoti has also approved this definition of “indirect expropriation”: Sacerdoti, *Bilateral Treaties and Multilateral Instruments on Investment Protection* (1997) at 383. (Investor’s Book of Authorities at Tab 109). The definition is also consistent with Section 712, comment (g), of the American Law Institute’s *Third Restatement of the Foreign Relations Law of the United States on “State Responsibility for Economic Injury to Nationals of Other States”*. Section 712, comment (g) of the *Third Restatement* provides that the term “expropriation.” (Investor’s Book of Authorities at Tab 110).

... applies not only to avowed expropriation in which the government formally takes title to property, but also to the other actions of the government that have the effect of “taking” the property, in whole or in large part, outright or in stages (“creeping expropriations”).

<sup>341</sup> *Tecmed* at para 114. (Investor’s Book of Authorities at Tab 55).

<sup>342</sup> *Metalclad* at para 103. (Investor’s Book of Authorities at Tab 60).

<sup>343</sup> *Tecmed* at para 113. (Investor’s Book of Authorities at Tab 55).

iii. *Regulations Depriving the Investor of the Ability to Exercise Its Rights in a License Are Compensable Takings*

333. Tribunals have also consistently applied the principle expressed by the *Santa Elena* Tribunal to protect investors' intangible property rights.<sup>344</sup> Tribunals have held that regulations depriving an investor of the ability to enjoy rights in a license are compensable takings.
334. For example, the *Goetz v. Burundi* Tribunal held that changes to the law which deprived the investor of its license was a compensable taking. In that case, the Belgian claimants owned a Burundian gold refining company that held a license entitling the company to tax exemptions. Burundi subsequently amended its law to exclude mineral companies, including that of the Belgian claimants, from enjoying the tax exemptions. The claimants asserted that Burundi's failure to compensate them for the loss breached Burundi's obligation in the Belgium/Luxembourg-Burundi BIT to compensate Belgian investments for measures depriving or restricting property rights or measures having an equivalent effect.<sup>345</sup> The ICSID Tribunal found that the change in the law amounted to a compensable taking under the Belgium/Luxembourg BIT.<sup>346</sup>

<sup>344</sup> See, for example: *Southern Pacific Properties (Middle East) Limited v. Arab Republic of Egypt*, ICSID Case No. ARB/84/3; Decision on Jurisdiction, 1985 WL 730626 (November 27, 1985) at 164: "Nor can the Tribunal accept the argument that the term 'expropriation' applies only to *jus in rem*." (Investor's Book of Authorities at Tab 111); *Phillips Petroleum Co Iran v. Iran* case (21 Iran-U.S.C.T.R. 79), in which the Iran-U.S. Claims Tribunal held that expropriation gives rise to liability for compensation "whether the expropriation is formal or de facto and whether the property is tangible, such as real estate or a factory, or intangible, such as the contractual rights involved in the present case" at para. 76. (Investor's Book of Authorities at Tab 96); *Mondev* at para. 98: "... it is clear that the protection afforded by the prohibition against expropriation or equivalent treatment in Article 1110 can extend to intangible property interests, as it can under customary international law". (Investor's Book of Authorities at Tab 49).

<sup>345</sup> Article 4 of the *Belgo-Luxemburg-Burundi BIT* (Investor's Book of Authorities at Tab 112) obliges the parties to: ... take no measures depriving or restricting property or any other measure having a similar effect with regard to investments situated on its territory, except for reasons of public purpose, security or exceptionally compelling national interest, in which case the party must comply with the following conditions:

- a) the measures are taken in accordance with the law;
- b) they are not discriminatory or contrary to a particular agreement;
- c) they are accompanied by adequate and effective compensation (our translation).

<sup>346</sup> *Goetz et al. v. Burundi*, ICSID Case No. ARB/95/4, Award Embodying Settlement, 1999 WL 33946448 (February 10, 1999) at paras. 130-133 (Investor's Book of Authorities at Tab 113) and especially para. 130: "In this particular case, the last condition in Article 4 of the Treaty regarding the legality of a "measure having a similar effect" to a measure depriving or restricting property is not for the moment fulfilled, since the revocation of the tax free certificate on 29 May 1995 was not accompanied by adequate and effective compensation on which the

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335. The *Middle East Cement Shipping v. Egypt* ICSID Tribunal reached the same conclusion in considering Egyptian regulations affecting the claimant's license. The claimant had been issued a license to import cement into Egypt for ten years. A subsequent Egyptian decree banned the import of cement three years before the expiry of the ten year period covered by the license. The Tribunal concluded the decree amounted to an expropriation of the claimant's rights in the license:

As also Respondent concedes that, at least for a period of 4 months, Claimant was deprived, by the Decree, of rights it had been granted under the License, there is no dispute between the Parties that in principle, a taking did take place. When measures are taken by a State the effect of which is to deprive the investor of the use and benefit of his investment even though he may retain nominal ownership of the respective rights being the investment, the measures are often referred to as ... measures "the effect of which is tantamount to expropriation." As a matter of fact, the investor is deprived by such measures of parts of the value of his investment. This is the case here, and, therefore, it is the Tribunal's view that such a taking amounted to an expropriation within the meaning of Art. 4 of the BIT and that, accordingly, Respondent is liable to pay compensation therefore.<sup>347</sup>

336. Similarly, in *Tecmed v. Mexico*, the ICSID Tribunal found that a Mexican regulation preventing Tecmed from operating a hazardous waste site was a *de facto* expropriation of Tecmed's license right to operate the site.<sup>348</sup>

iv. *Measures Depriving the Investor of the Ability to Exercise Its Rights about Property Are Compensable*

337. International law protects the right of *owners* of property to use that property. Deprivation of that right amounts to an expropriation and the state is obliged to compensate the property owner for that expropriation.<sup>349</sup>
338. Just as international law protects those occupying property under a *certificate of title*, it protects those occupying property under *other legal instruments*. Tribunals have consistently held that state measures depriving those legally occupying property of the ability to exercise their rights are just as compensable as if the state had expelled the owner from the property. In the *Certain German Interests in Upper Silesia* case, for

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international legality of this revocation depends (our translation)."

<sup>347</sup> *Middle East Cement Shipping* at para. 107. (Investor's Book of Authorities at Tab 92 ).

<sup>348</sup> *Tecmed* at para. 117 (Investor's Book of Authorities at Tab 55).

<sup>349</sup> *Santa Elena* at para. 72. (Investor's Book of Authorities at Tab 71).

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example, the Permanent Court of International Justice held that Poland's interference with the right of a German company to occupy and manage the factory at Chorzów was a compensable expropriation. The Court held that:

it is clear that the rights of the [German company] to the exploitation of the factory ... have been directly prejudiced by the taking over of the factory by Poland. As these rights related to the Chorzów factory and were, so to speak, concentrated in that factory, the prohibition [on expropriation] contained in the last sentence of Article 6 of the Geneva Convention applies in respect to them.<sup>350</sup>

339. In *Revere Copper v. OPIC*, the Tribunal applied the principle captured in the Permanent Court of International Justice's decision to find that Jamaica's actions interfering with Revere Copper's ability to exercise its rights under a mining lease amounted to an expropriation.<sup>351</sup>
340. Tribunals hearing BIT claims have also applied the principle that measures depriving legal occupiers of land of the ability to exercise their property rights amounts to an expropriation. In *Wena Hotels v. Egypt*, for example, an ICSID Tribunal found that Egyptian actions preventing Wena Hotels from occupying and managing two hotels it had leased amounted to an expropriation.<sup>352</sup> A subsequent decision by another ICSID Tribunal, interpreting the original award in *Wena Hotels v. Egypt*, found:

... the Original Tribunal concluded that Egypt had deprived Wena of its 'fundamental rights of ownership, i.e., in the given case where ... no tangible property rights but rather leasehold rights are at stake, Wena's rights to make use of its investments made under the Hotel Leases and to enjoy the benefits thereof in accordance with the Leases.<sup>353</sup>

341. The *Sedelmayer v. Russia* Tribunal reached a similar conclusion in hearing a claim under the Germany-Russia BIT. The Tribunal found that Russia expropriated Mr. Sedelmayer's investment by expelling him from a building he leased in Russia before the lease had

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<sup>350</sup> *Case Concerning Certain German Interests in Polish Upper Silesia (The Merits)*, Series A, No. 7, PCIJ 1926, at 44. (Investor' Book of Authorities at Tab 114).

<sup>351</sup> *Revere Copper & Brass Inc. v. Overseas Private Inv. Corp. (OPIC)*, Award of August 24, 1978, 56 *I.L.R.* 258 (1980) at 291. (Investor's Claimant's Book of Authorities at Tab 115).

<sup>352</sup> *Wena Hotels Ltd. v. Egypt*, ICSID Case No. ARB/98/4, Final Award, 2000 *WL* 34514091 (December 8, 2000) at para. 99. (Investor's Book of Authorities at Tab 23).

<sup>353</sup> *Wena Hotels Limited v. Arab Republic of Egypt*, Decision on the Application for Interpretation of the Arbitral Award, ICSID Case No. ARB/98/4; 2005 *WL* 3814820 (Dec. 8, 2000) at para. 119. (Investor's Book of Authorities at Tab 116).



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expired.<sup>354</sup> The Tribunal found that Russia breached its treaty obligations by not compensating Mr. Sedelmayer the value to him of renting the building for the remainder of the lease as well as the value of the improvements he had made to the building.

342. The *Wena Hotels, Revere Copper, Sedelmayer v. Russia* and *Polish Upper Silesia* decisions confirm that the international law on expropriation protects both owners of property and the legal rights associated with ownership of that property. State interference with these associated rights constitutes a compensable expropriation.
343. NAFTA Article 1110 applies to the broad range of economic interests that are covered by the NAFTA's broad definition of investment found in NAFTA Article 1139. Of particular relevance is paragraph (a), covering "enterprises", and paragraph (g), which states that investment includes "real estate or other property, tangible or intangible, acquired in the expectation or used for the purpose of economic benefit or other business purposes".
344. In considering the scope of NAFTA Article 1110, the *Pope & Talbot* Tribunal held that "the ability to sell softwood lumber from British Columbia to the U.S. is...a very important part of the "business" of the Investment,"<sup>355</sup> and that "[i]nterference 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."<sup>356</sup> The Tribunal then listed the factors that need to be considered in measuring interference for the purposes of Article 1110. Among these is whether Canada:
- a) has taken any of the proceeds of company sales;
  - b) interferes with management activities; and
  - c) has deprived the Investor of full control of its Investment.<sup>357</sup>

The *Pope & Talbot* Tribunal found that on the facts of the case before it, Pope & Talbot had not established this kind of interference. However, the Tribunal did, very significantly conclude that "the Investor's access to the U.S. market is a property interest

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<sup>354</sup> *Sedelmayer v. Russian Federation*, Decision on Jurisdiction and Final Award, 1998 WL 34336629 (July 7, 1998) at page 32: "... the Tribunal finds that the requirement for compensation stipulated in Article 4(1) of the Treaty, i.e. that measures of expropriation or similar measures have taken place, is fulfilled." (Investor's Book of Authorities at Tab 117).

<sup>355</sup> *Pope & Talbot*, Interim Merits Award at para. 96. (Investor's Book of Authorities at Tab 72).

<sup>356</sup> *Pope & Talbot*, Interim Merits Award at para. 98. (Investor's Book of Authorities at Tab 72).

<sup>357</sup> *Pope & Talbot*, Interim Merits Award at para. 100. (Investor's Book of Authorities at Tab 72).

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subject to protection under Article 1110.”<sup>358</sup> Thus, Pope & Talbot had established a form of property right that could be expropriated, but failed to establish an actual expropriation on the fact of its case.

v. *Types of Protected Property Interests*

345. NAFTA Article 1110 provides compensation for the expropriation of investments. The term “investment” is broadly defined in NAFTA Article 1139 as follows:

**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 subparagraph (d); or
  - (j) any other claims to money, that do not involve the kinds of interests set out in subparagraphs (a) through (h);

346. This broad definition applies to “an enterprise,” “an interest in an enterprise that entitles the owner to share in income or profits of the enterprise,” or “real estate or other property,

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<sup>358</sup> *Pope & Talbot*, Interim Merits Award, at para. 96. (Investor’s Book of Authorities at Tab 72).

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tangible or intangible, acquired in the expectation or used for the purpose of economic benefit or other business purposes.”<sup>359</sup> As a result of this very broad definition of investment, NAFTA Article 1110 provides broad protection to investors who have suffered acts tantamount to expropriation of their property.

347. NAFTA Article 201 states that the term “enterprise of a Party means an enterprise constituted or organized under the law of a Party. As a result, the NAFTA provides compensation for acts tantamount to expropriation of corporate vehicles including limited partnerships and other forms of enterprises.
348. Paragraph (g) of NAFTA Article 1139’s definition of investment also covers real property. For example, timberlands and other properties are protected from expropriation under this definition. This same paragraph covers “property, tangible or intangible acquired in the expectation or used for the purpose of economic benefit”. Property such as harvested crops clearly fit into this definition and are thus protected by the terms of NAFTA Article 1110.
349. Furthermore, intangible property interests acquired in the expectation of economic benefit also are protected interests. The *Pope & Talbot* tribunal considered that access to export markets constituted such a protected interest and were protected by the terms of NAFTA Article 1110.<sup>360</sup>
350. There is no requirement that a government expropriate all the investments of an investor for there to be a compensable expropriation. For example under NAFTA, a bakery’s daily production of bread that is expropriated by governmental action requires the payment of compensation even if the government did not disrupt the ownership of the bakery with the investor, and even if the government did not obstruct access to the baker’s ovens. Property used for the purpose of economic benefit is protected by NAFTA. It is abundantly clear that the NAFTA specifically protects investors from the uncompensated taking of many different types of property interests.

#### **E. Conclusion**

351. An investor will successfully establish a breach of NAFTA Article 1110 if it can establish three elements.

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<sup>359</sup> See NAFTA Article 1139 - definition of investment.

<sup>360</sup> *Pope & Talbot*, Interim Award at para. 98. (Investor’s Schedule of Authorities at Tab 72).

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- a) that it has an "investment" protected by the NAFTA in the territory of a NAFTA Party;
  - b) that the investment has been expropriated; and
  - c) that the investment has been expropriated and has not been compensated for in the manner required by NAFTA Section 1110(2-6)

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**PART FOUR: FACTS APPLIED TO THE LAW**

**A. Canada has Violated its Obligation to Provide Treatment in Accordance with International Law**

352. Canada has breached its obligations under NAFTA Article 1105(1) because the Log Export Control 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.
- e) constitutes an abuse of Canada's rights; and

Each of these violations constitutes a failure by Canada to provide Merrill & Ring's investments fair and equitable treatment.

*i. The Regime is Unfairly and Arbitrarily Administered*

353. The Log Export Control Regime is arbitrary and fundamentally unfair for the following reasons:

- a) It formally allows standing green exemptions to be granted for timber on provincial lands (provided those lands are not located in a tree farm license area), but not on federal lands. Even where the ineligible federal land is adjacent to the provincial land that has received a standing green exemption and the lands are identical in every meaningful way, the federal land will not be eligible for a standing green exemption.
- b) It informally allows standing green exemptions to be granted for timber on some federal lands, Such an exemption has in fact been granted to one of Merrill & Ring's competitors, Pluto Darkwoods, for its federal timbermark lands. Canada has denied Merrill & Ring an equivalent exemption and has failed to respond to Merrill & Ring's efforts to raise the issue with it in correspondence. This is arbitrary conduct.
- c) It allows standing green exemptions to be granted for timber on Provincial Crown land for the purposes of waste prevention. BCMOF has granted such exemptions on Provincial Crown lands affected by the mountain pine beetle. Private lands – whether provincial or federal – are unable to obtain

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standing exemptions for this purpose, even if equally affected by the mountain pine beetle.<sup>361</sup> This differentiation is arbitrary.

- d) It requires that Merrill & Ring's export applications for logs located in remote areas of the BC coast be for a minimum volume of 2,800 m<sup>3</sup>, but does not impose the same requirement for logs located in non-remote areas. Merrill & Ring incurs costs, risks, and delays as a result of the minimum volume requirement.<sup>362</sup>
- e) It requires that Merrill & Ring's applications to export provincial and federal logs be approved by TEAC/FTEAC. TEAC/FTEAC makes its decisions based on subjective judgment, and employs loosely formulated criteria to determine if an offer is "fair." For example, it once explained to Tony Kurucz that it will approve offers to block logs even if they are below domestic market value, as long as it is within 5% of that value.<sup>363</sup>
- f) TEAC/FTEAC is comprised of members who have private interests in suppressing the domestic price of logs. Merrill & Ring 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. There is no meaningful procedure by which to appeal TEAC/FTEAC recommendations and TEAC/FTEAC recommendations are almost invariably accepted by BCMOF and DFAIT.<sup>364</sup>

The Federal Court of Canada has concluded that denying exporter applicants like the Merrill & Ring an opportunity to respond to manufacturers' evidence that logs are not surplus is unfair conduct by TEAC/FTEAC:

... the evidence was received from someone adverse in interest to the applicant (i.e., a prospective purchaser of the applicant's logs) without the applicant being given an

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<sup>361</sup> Witness Statement of Tony Kurucz at para. 18.

<sup>362</sup> Witness Statement of Tony Kurucz at para. 56.

<sup>363</sup> Witness Statement of Tony Kurucz at para. 51.

<sup>364</sup> Witness Statement of Tony Kurucz at paras. 17 and 36.

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opportunity to respond. The use of this evidence without notice and an opportunity to respond constitutes a breach of the principles of fairness.<sup>365</sup>

The WTO Appellate Body *US-Shrimp* decision supports the Canadian Federal Court decision. Just as the US shrimp import process provided “no formal opportunity for an applicant country to be heard, or to respond to any arguments that may be made against it,”<sup>366</sup> the surplus testing procedure provides no opportunity to the Investor. Just as “no formal written, reasoned decision, ... [was] rendered on applications [and] [n]o procedure for review of, or appeal from, a denial of an application [was] provided” for US decisions,<sup>367</sup> the surplus testing procedure provides no reasoned decision and allows for no appeal. Just as the US shrimp import process was deemed to be arbitrary and unfair, so too is the process to obtain an export permit under the surplus testing procedure.

- g) TEAC/FTEAC is prone to cancelling meetings without prior notice or stated reasons for periods of up to three months during times of the year when logs are especially likely to be damaged as a result of additional delays in the export process.<sup>368</sup>
- h) DFAIT is prone to change export application rules without consultation, prior notice or stated reasons. For example, in 2005 it suddenly and arbitrarily decided to reduce the time period for export extension permits from four months to one month, and was wholly unresponsive to Merrill & Ring’s requests for it to reconsider.<sup>369</sup>

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<sup>365</sup> *K.F. Evans* (Trial Division) at para. 36. (Investor’s Book of Authorities at Tab 1).

<sup>366</sup> *US - Shrimp* at para. 180. (Investor’s Book of Authorities at Tab 62).

<sup>367</sup> *US - Shrimp* at para. 180. (Investor’s Book of Authorities at Tab 62).

<sup>368</sup> Witness Statement of Paul Stutesman at para. 16.

<sup>369</sup> Witness Statement of Paul Stutesman at para. 22.

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ii. *The Log Export Control Regime is Non-Transparent*

354. The Log Export Control Regime is non-transparent for the following reasons:

- a) Even though it imposes minimum export volumes on logs located in “remote” areas of the coast, nowhere does it specify what areas are considered “remote.” In addition, what is considered to be “remote” changes over time depending on market conditions. These rules are not defined, they have not been made public and may be modified without notice to the producers who are expected to comply with the minimum volume rules.<sup>370</sup>
- b) Notice 102 requires that Merrill & Ring cut, sort and deck its federal logs in accordance with “normal” market practices, but does not indicate what market practices are considered to be “normal.”<sup>371</sup> Yet Merrill & Ring logs can be, and have been rejected for non-compliance with these non-transparent requirements.<sup>372</sup>
- c) The 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.<sup>373</sup>
- d) Ten years ago, a federal government official warned that the Log Export Control Regime was not transparent and recommended publishing criteria to apply to decisions and to determine conflicts of interest. Canada did nothing in response to these serious issues.

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<sup>370</sup> Witness Statement of Tony Kurucz at para. 57.

<sup>371</sup> Witness Statement of Tony Kurucz at para. 52.

<sup>372</sup> Witness Statement of Tony Kurucz at para. 53.

<sup>373</sup> Witness Statement of Tony Kurucz at para. 68.



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iii. *The Log Export Control Regime Creates an Uncertain Legal and Business Environment*

355. The Log Export Control Regime is inconsistent with Canada's obligation to provide a secure legal and business environment for the following reasons:

- a) It is arbitrary and non-transparent, as described above. There can be no legal or business security for Merrill & Ring in such an environment.
- b) It exposes Merrill & Ring to the corrupt practice of "blockmailing," a practice of which Canada is fully aware, and which TEAC/FTEAC has expressly condoned.<sup>374</sup> As a result, at the time Merrill & Ring harvests its trees, it cannot know whether the resulting logs will ever obtain an export permit so that it can supply its foreign clients with the logs they need.
- c) It exposes Merrill & Ring to special targeting by its competitors, in an effort to prevent it from exporting its logs.<sup>375</sup>
- d) It forces Merrill & Ring to adopt sub-optimal harvest plans and employ backwards economic planning to maximize its returns. Because Merrill & Ring's logs have a better chance of obtaining export permits when the supply of such logs in the market is high, it is compelled to produce more of those logs at such times, when a normal response under free market conditions would be to reduce supply.<sup>376</sup>
- e) It forces Merrill & Ring to wait extended periods of time from the time of cutting before it can export its logs, sometimes up to a year.<sup>377</sup> During this time its logs can suffer various types of damage.<sup>378</sup>

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<sup>374</sup> Witness Statement of Tony Kurucz at para. 70; Testimony of John McCutcheon, (former Chairman of FTEAC), *TimberWest v. Canada* hearing Transcript of June 5, 2006, at 767- 768, (Investor's Schedule of Documents at Tab 37.)

<sup>375</sup> Witness Statement of Tony Kurucz at paras. 66, 70

<sup>376</sup> Witness Statement of Norm Schaaf at para. 38.

<sup>377</sup> Witness Statement of Paul Stutesman at para. 15.

<sup>378</sup> Witness Statement of Paul Stutesman at para. 15.

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- f) It imposes extra costs on Merrill & Ring,<sup>379</sup> reduces its revenues,<sup>380</sup> denies it business opportunities,<sup>381</sup> places it at a competitive disadvantage, and forces it to subsidize the operations of its competitors.<sup>382</sup> The business environment this creates for Merrill & Ring is highly insecure. As a result, **R-1(b)(ii)**<sup>383</sup>

iv. *Legitimate Expectations*

356. The Log Export Control Regime is inconsistent with Canada's obligation not to frustrate Merrill & Ring's legitimate expectations for the following reasons:

- a) Merrill & Ring has a legitimate expectation to be able to compete on an equal footing with other log producers and exporters in Canada. Yet the Log Export Control Regime does not treat Merrill & Ring fairly *vis-a-vis* its competitors.<sup>384</sup>
- b) Merrill & Ring has a legitimate expectation to be treated like any other taxpayer in Canada, and not be forced to pay extra to achieve Canada's policy objectives. Every time Merrill & Ring is forced to sell its logs to local log processors at artificially suppressed BC market prices, this expectation is frustrated.<sup>385</sup>
- c) Merrill & Ring has a legitimate expectation to operate free from abusive and corrupt business practices such as "blockmailing," and that Canada would take appropriate measures to discourage such practices. Instead, the

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<sup>379</sup> Witness Statement of Norm Schaaf, sections 3A and 3B.

<sup>380</sup> See generally the Witness Statement of Paul Stutesman.

<sup>381</sup> Witness Statement of Paul Stutesman at paras. 23-24.

<sup>382</sup> Witness Statement of Tony Kurucz at paras. 66-69.

<sup>383</sup> Witness Statement of Norm Schaaf at para. 35.

<sup>384</sup> Witness Statement of Paul Stutesman at para. 19.

<sup>385</sup> Expert Report of Prof. Peter Pearse at para. 38; Witness Statement of Paul Stutesman at para. 31.

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Log Export Control Regime actively encourages and condones "blockmailing."<sup>386</sup>

v. *The Log Export Control Regime is an Abuse of Rights*

357. The Log Export Control Regime is inconsistent with Canada's obligation not to abuse its rights for the following reasons:

- a) TEAC/FTEAC has abused its authority over Merrill & Ring by approving offers that it knew to be below fair market value.<sup>387</sup>
- b) It forces Merrill & Ring to subsidize BC log processors by forcing it to sell its logs to them at artificially low prices.<sup>388</sup>
- c) Canada has exercised its right to grant standing timber exemptions to private federal landholders in a misleading manner. A DFAIT official represented to Merrill & Ring that any application it might make for standing timber exemptions would be denied, because it had federal timbermark lands.<sup>389</sup> Canada has represented to this Tribunal that it has no authority to grant standing timber exemptions.<sup>390</sup> Yet, Canada did, in fact, sanction 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. Canada has engaged in a false pretense of form that amounts to an abuse of rights.

vi. *Conclusion*

358. While the various administrative failings of the Log Export Control Regime identified above, are on their own, inconsistent with NAFTA Article 1105, taken together they form

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<sup>386</sup> Witness Statement of Tony Kurucz at para. 70; Testimony of John McCutcheon, (former Chairman of FTEAC), *TimberWest v. Canada* hearing Transcript of June 5, 2006, at 767- 768, (Investor's Schedule of Documents at Tab 37.)

<sup>387</sup> Witness Statement of Tony Kurucz at para. 51.

<sup>388</sup> Expert Report of Prof. Peter Pearse at para. 38; Witness Statement of Paul Stutesman at para. 31.

<sup>389</sup> Witness Statement of Paul Stutesman at para. 18.

<sup>390</sup> *Canada's Statement of Defence* at para. 34.

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an egregious breach of this NAFTA obligation.<sup>391</sup> Canada's breaches are compounded by its wilful disregard of recommendations, suggestions and requests that it change its administration of Log Export Control Regime.

**B. Canada has Violated its Obligation to Provide National Treatment**

359. Canada has failed to meet its NAFTA Article 1102 obligation to provide national treatment. Canada did not provide Merrill & Ring and its Investments treatment no less favorable as that accorded to its own Investors and their investments in like circumstances with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.

i. *Merrill & Ring and its Investments Are "In Like Circumstances" to Other Log Producers in BC and In Alberta.*

360. Merrill & Ring and its Investments are in "like circumstances" to other timber growers and log producers and their investments in BC, and to other growers and producers operating in Canada but outside BC, for the following reasons:

a) Merrill & Ring and other timber growers and log producers in BC and in other provinces are in the same business and economic sector. They all grow and harvest trees from their lands, as well as sell the resulting logs in both domestic and foreign markets. Canada acknowledges this fact.<sup>392</sup>

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<sup>391</sup> Several investment treaty tribunals have held states breach investment treaty obligations through a composite act: *Tecmed* at para 172 (Investor's Book of Authorities at Tab 55); *Azurix* at para. 377 (Investor's Book of Authorities at Tab 67); *Compañía de Aguas del Aconquija S.A. and Vivendi Universal S.A. v. Argentine Republic*, ICSID Case No. ARB/97/3, Award, 20 August 2007 at para. 7.4.46: "we are in no doubt that Respondent's many acts and omissions cumulatively ... infringed the 'minimum standard of treatment' ...;" and at para. 7.5.33: "... the Province's actions – from the very opening months of the concession, continuing through its wrongful regulatory action and culminating in the unilateral amendments to the 8 April Agreement – had the necessary consequence of forcing CAA to terminate the Concession Agreement." (Investor's Book of Authorities at Tab 76), *PSEG Global Inc. and Konya Ilgin Elektrik Üretim ve Ticaret Limited Şirketi v. Republic of Turkey*, ICSID Case No. ARB/02/5, 2004 WL 235958 (Jan 19, 2007) at para. 253: "... the aggregate of the situations explained raise the question of the need to ensure a stable and predictable business environment for Investor to operate in, as required ... by the Treaty;" (Investor's Book of Authorities at Tab 77); *Siemens A.G. v. The Argentine Republic*, ICSID Case No. ARB/02/8, Award, 6 February 2007 at para. 264: "We are dealing here with a composite act in the terminology of the [ILC] Draft Articles [on State Responsibility]" and para. 271: "The Tribunal has identified a series of measures ... [that] stand as part of a gradual process which ... culminated in the expropriation of Siemens' investment." (Investor's Book of Authorities at Tab 78).

<sup>392</sup> See Canada's Statement of Defense, at para. 67, where it admits that Merrill & Ring and its comparators "...operate in the same business sector..."

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- b) Merrill & Ring harvests logs from only second-growth timber.<sup>393</sup> The species it produces include western hemlock, balsam, Douglas-fir, red cedar, spruce and alder. Many of these species are produced in the BC interior and in Alberta as well. For example, Pluto Darkwoods Corporation is a competitor of Merrill & Ring with federal timberlands in the BC interior that is actively engaged in the export of western hemlock, balsam, Douglas-fir and cedar to the United States.<sup>394</sup>
- c) Log purchasers in the international markets use one or more log species for similar market end-uses and therefore source timber inputs from different regions in BC and Alberta. For example, second growth spruce, pine, hemlock and fir sorts are combined and marketed together as inputs for SPF and Hem-Fir lumber stamps. SPF and Hem-Fir lumber is used for structural framing in all types of residential, commercial, industrial and agricultural buildings in domestic and export markets.<sup>395</sup>
- d) The Expert Report of Mason, Bruce & Girard demonstrates that purchasers in the United States buy logs from the BC coast, the BC interior and Alberta interchangeably, substituting one for the other.<sup>396</sup> These purchasers make no distinction about geographic origins or the regulatory framework governing the land upon which the logs grew. These purchasers are mostly concerned about species, dimension and price.<sup>397</sup> As a result, Merrill & Ring's logs compete directly with logs from the BC interior and Alberta in the export market.

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<sup>393</sup> Witness Statement of Norm Schaaf at para. 14.

<sup>394</sup> Petition to the Court of Pluto Darkwoods Corporation, 5 August, 2005 at para 13.

<sup>395</sup> Expert Report of Mason, Bruce & Girard, at 15.

<sup>396</sup> Expert Report of Mason, Bruce & Girard, at 13

<sup>397</sup> Expert Report of Mason, Bruce & Girard at 15.

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ii. *Merrill & Ring and its Investments Are Treated Less Favorably Than Local Investors and Investments.*

361. In spite of being in the same business sector and in competition with numerous Canadian investors and investments in both domestic and export markets, Merrill & Ring and its logs are treated less favourably for the following reasons:

- a) 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.
- b) Notice 102 forces Merrill & Ring to advertise logs in "remote" areas in minimum volumes of 2,800 m<sup>3</sup>.<sup>398</sup> Logs advertised in "non-remote" areas are not subjected to this minimum volume requirement.
- c) 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.<sup>399</sup>
- d) 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 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.<sup>400</sup> 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

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<sup>398</sup> Notice 102, s.1.4. (Investor's Schedule of Documents at Tab 22).

<sup>399</sup> Witness Statement of Tony Kurucz at para. 53.

<sup>400</sup> Letter from Lynn Sabatino to Richard Ringma, (October 12, 2007). (Investor's Schedule of Documents at Tab 74).

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produces logs that are very similar to Merrill & Ring's logs.<sup>401</sup> A DFAIT official once told Merrill & Ring that if it did apply for a standing timber exemption, it would surely be denied.<sup>402</sup> DFAIT has not responded to Merrill & Ring's suggestions that all federal timber be allowed standing timber exemptions.<sup>403</sup>

- e) Unlike timber harvesters on BCTS lands, Merrill & Ring does not receive the support of BCTS for its silviculture and reforestation operations, the construction and maintenance of roads on its lands, and other possible benefits for which access to BCTS documents is necessary to elaborate upon.
  - f) Finally, Canada has extended less favorable 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.
- iii. *The treatment of Merrill & Ring and its Investments Is With Respect to the Establishment, Acquisition, Expansion, Management, Conduct, Operation, and Sale or Other Disposition of Investments.*

362. The less favourable treatment that Canada has accorded Merrill & Ring and its investments relates to the establishment, acquisition, expansion, management, conduct, operation, sale or other disposition of present and future investments. The reasons for this are as follows:

- a) The Log Export Control Regime impedes the way Merrill & Ring manages its investments. For example, it affects the way Merrill & Ring

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<sup>401</sup> Witness Statement of Paul Stutesman at para. 19.

<sup>402</sup> Witness Statement of Paul Stutesman at para. 18.

<sup>403</sup> Letter from Paul Stutesman, Merrill & Ring to Thomas Jones, Department of Foreign Affairs and International Trade, March 3, 2000, (Investor's Schedule of Documents at Tab 68).

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implements its harvest plans, and compels it to harvest in a backwards economic manner.<sup>404</sup>

- b) The Log Export Control Regime affects the way Merrill & Ring conducts and operates its business. For example, it prevents Merrill & Ring from entering into long-term supply contracts with its foreign clients. In addition, it compels Merrill & Ring to hire a log broker and advisor to help it navigate the complexities of the Regime.<sup>405</sup> These complexities include requirements that Merrill & Ring cut and sort its logs in particular ways,<sup>406</sup> as well as contend with “blockmailers” on a day-to-day basis.<sup>407</sup>
- c) The Log Export Control Regime further affects the sale and disposition of Merrill & Ring’s investments. This is patently clear from the fact that it forces Merrill & Ring to sell its logs on the domestic BC market.

**C. Canada has Violated its Obligation not to Impose Performance Requirements**

363. The Log Export Control Regime imposes performance requirements on Merrill & Ring that are inconsistent with Canada’s obligations under NAFTA Article 1106.

*i. Canada Requires Merrill & Ring to Export at a Given Level*

364. NAFTA Article 1106(1)(a) prohibits Canada from requiring Merrill & Ring to export a given level of goods. However, under the Log Export Control Regime Canada does in fact require Merrill & Ring to export a given level of goods produced in Canada:

- a) Notice 102 requires that all log exports from remote coastal areas be not less than 2800 m<sup>3</sup> or not more than 15,000 m<sup>3</sup>. As a result of these volume requirements, Merrill & Ring must export a given level of goods in order to obtain export permits from logs in remote coastal areas.

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<sup>404</sup> Witness Statement of Norm Schaaf at Section 3C.

<sup>405</sup> Witness Statement of Norm Schaaf Statement at paras. 17 and 26.

<sup>406</sup> Witness Statement of Tony Kurucz at Section B.

<sup>407</sup> Witness Statement of Tony Kurucz at Section C.



ii. *Canada Requires Merrill & Ring to Accord a Preference to Goods Produced in its Territory*

365. Article 1106(1)(c) of the NAFTA prohibits Canada from requiring Merrill & Ring to accord a preference to goods produced in its territory. However, under the Log Export Control Regime Canada does, in fact, do so for the following reasons:

- a) Harvesting live trees and converting them into logs constitutes the production of a “good” in Canadian territory.<sup>408</sup> The Log Export Control Regime requires that these goods have certain characteristics. For example, the *Coast Domestic End Use Sort Descriptions* require that logs Merrill & Ring wants to export be cut, sorted and scaled in particular ways.<sup>409</sup> If Merrill & Ring does not abide by these requirements, it cannot receive an export permit.<sup>410</sup> Under the Log Export Control Regime, Merrill & Ring is not able to produce logs that are optimally suited to the needs of its particular clients.<sup>411</sup> In the absence of the requirement to produce its logs in the manner consistent with the *Coast Domestic End Use Sort Descriptions*, Merrill & Ring would be producing goods of a different nature, since it would be cutting, sorting and scaling its logs differently to better meet the needs of its foreign clients. Under the Log Export Control Regime, Merrill & Ring is required to accord a preference to log sorts (i.e. goods) that match particular characteristics mandated by Canada. These goods are produced in Canadian territory.
- b) Similarly, Notice 102 requires that Merrill & Ring advertise its logs for sale in remote areas in minimum volumes of 2,800 m<sup>3</sup>.<sup>412</sup> The size of a package of logs is an inherently important aspect of the good being offered for sale. Some purchasers want larger packages, others want smaller packages. If Merrill & Ring does not advertise its logs in remote areas to conform to this requirement, its logs will not be eligible for an export permit. Were it not for this requirement, Merrill & Ring would be advertising its logs in remote areas in smaller volumes than 2,800 m<sup>3</sup>. This would eliminate the need for Merrill & Ring to tow its logs to

<sup>408</sup> Expert Report of Darrel H. Pearson at para. 9.

<sup>409</sup> Witness Statement of Tony Kurucz at para. 53.

<sup>410</sup> Witness Statement of Tony Kurucz at para. 53.

<sup>411</sup> Witness Statement of Paul Stutesman at paras. 25-26.

<sup>412</sup> Notice 102, section 1.4. (Investor’s Schedule of Documents at Tab 22).

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“non-remote” areas so that it could be exempt from this arbitrary requirement.<sup>413</sup> Naturally, because the minimum volume requirement of 2,800 m<sup>3</sup> is a precondition for export approval, this good must be produced in Canadian territory.

iii. *Canada Requires Merrill & Ring to Purchase Services from Persons in its Territory*

366. NAFTA Article 1106(1)(c) of the NAFTA also prohibits Canada from requiring Merrill & Ring to purchase goods or services from persons in its territory. However, under the Log Export Control Regime, Canada does in fact do so. The reasons for this are as follows:

- a) In order to cut, sort and scale its logs to the requirements of the *Coastal End Use Sort Descriptions*, Merrill & Ring must hire the services of those who will perform these tasks.<sup>414</sup> For example, under the Log Export Control Regime Merrill & Ring is required to scale its logs metrically. But logs to be exported to markets in the US and Asia need to be scaled according to the Scribner system, not the metric system.<sup>415</sup> Were it not for the Log Export Control Regime, Merrill & Ring would not scale many of its logs metrically at all.<sup>416</sup> As a result, it would not need to hire the services of those who scale its logs metrically. And since logs need to be scaled metrically as a precondition to receiving an export permit, this service necessarily needs to be performed by persons in Canadian territory.
- b) As a result of Merrill & Ring being required to store its logs for extended periods of time while it awaits the results of the Surplus Testing Procedure, it incurs a risk that its booms break up while in storage, strewing its logs over a wide area. When this happens, Merrill & Ring has to hire a service provider to gather its logs, and bundle them together again.<sup>417</sup> Because these logs are awaiting export approval, they are necessarily located in Canadian territory, which means that this is where Merrill & Ring must contract the services to re-collect its logs. Were it not for the

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<sup>413</sup> Witness Statement of Tony Kurucz at para. 56.

<sup>414</sup> Witness Statement of Paul Stutesman at para. 26.

<sup>415</sup> Witness Statement of Tony Kurucz at para. 25.

<sup>416</sup> Witness Statement of Tony Kurucz at para. 25.

<sup>417</sup> Invoices from **C-1(b)(ii)** (Investor's Schedule of Documents at Tab 79).

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Log Export Control Regime, Merrill & Ring would not be required to expose its logs to this risk while awaiting approval under the Surplus Testing Procedure.

iv. *Canada Restricts the Sale of Merrill & Ring's Logs By Relating Its Sales to the Volume of Its Exports*

367. NAFTA Article 1106(1)(e) further prohibits Canada from requiring Merrill & Ring to restrict the sale of goods in Canadian territory that Merrill & Ring's investment produces by relating the sale of such goods to the volume of its exports. Under the Log Export Control Regime, however, Canada does in fact require Merrill & Ring to do this. The reasons for this are as follows:

- a) Again, harvesting live trees and converting them into logs constitutes the production of a "good" in Canadian territory.<sup>418</sup> Merrill & Ring's investments produce these goods. By requiring Merrill & Ring to advertise its logs/goods in remote areas in minimum volumes of 2,800 m<sup>3</sup>,<sup>419</sup> Canada restricts the sale of Merrill & Ring's logs/goods. This is because Merrill & Ring would otherwise sell its logs/goods in smaller volumes. Because this minimum volume requirement for Merrill & Ring's advertisements is a precondition for Merrill & Ring to obtain an export permit, the requirement is inextricably related to the volume of Merrill & Ring's exports.
- b) Similarly, Canada requires that Merrill & Ring advertise its logs/goods in volumes of no more than 15,000 m<sup>3</sup> in order to obtain an export permit, regardless of whether they are in remote areas.<sup>420</sup> By requiring Merrill & Ring to advertise its logs/goods in maximum volumes of 15,000 m<sup>3</sup>, Canada restricts the sale of Merrill & Ring's logs/goods. Because this maximum volume requirement for Merrill & Ring's advertisements is a precondition for Merrill & Ring to obtain an export permit, the requirement is inextricably related to the volume of Merrill & Ring's exports.

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<sup>418</sup> Expert Report of Darrel H. Pearson at para. 9.

<sup>419</sup> Notice 102, section 1.4. (Investor's Schedule of Documents at Tab 22)

<sup>420</sup> Notice 102, section 1.4. (Investor's Schedule of Documents at Tab 22)

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**D. Canada has Expropriated the Investor's Investments**

368. The Log Export Control Regime results in a violation of NAFTA Article 1110 for the following reasons:

- a) It constitutes a measure that is tantamount to expropriation of Merrill & Ring's investments;
  - b) The expropriations are discriminatory;
  - c) The expropriations are not conducted in accordance with due process of law and Article 1105(1); and
  - d) Canada has never paid compensation in accordance with NAFTA Articles 1110(2) - 1110(6).
- i. *The Log Export Control Regime Constitutes a Measure that is Tantamount to Expropriation of Merrill & Ring's Investments*

369. The Log Export Control Regime is a measure tantamount to expropriation for the following reasons:

- a) Canada's Log Export Control Regime substitutes government control in the place of Merrill & Ring's control over critical parts of its business operations particularly in respect of the conduct and control over its investments in logs for export. The administration of the Log Export Control Regime mandates how the Investment has to harvest, process, advertise and then sell its principal products. Canada substantially interferes with Merrill & Ring's ordinary and normal property rights by depriving Merrill & Ring through the operation of its laws, policies and administration procedures, of the physical possession and control of its investments. Canada takes away Merrill & Ring's control to sell these logs at fair market prices. Instead, Canada through FTEAC, takes over this vital operation of Merrill & Ring's business.
- b) The Surplus Testing Procedure requires that Merrill & Ring offer its logs for sale to local log processors before it can receive an export permit. When Merrill & Ring's export application fails the Surplus Testing Procedure, it is forced to sell its logs on the domestic market. Merrill & Ring loses control over its logs during the lengthy administrative process involved and also over the manner in which it sells its investments.<sup>421</sup>

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<sup>421</sup> Witness Statement of Tony Kurucz at para. 64.

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- c) The Log Export Control Regime gives rise to – and indeed condones and encourages – the practice of “blockmailing”. Under the Log Export Control Regime, Merrill & Ring has no choice but to enter into deals to satisfy blockmailers if it wants to export its logs.
- d) Even if Merrill & Ring tries to export logs that are not cut to the shorter length preferences of local log processors – but rather to the longer length preferences of its foreign clients – it runs the risk that these logs get blocked at prices that only reflect the shorter length preferences of local sawmills.<sup>422</sup> To reduce the risk of this occurring, Merrill & Ring is compelled to cut its logs to domestic length preferences, sometimes only to receive export approval in any event. As a result, Merrill & Ring loses the value of the wood that was cut from the log to match local preferences.<sup>423</sup> The damage to Merrill & Ring’s logs in such situations is substantial, irreversible, and amounts to a permanent deprivation of Merrill & Ring’s property.
- e) Even when Merrill & Ring’s export application passes the Surplus Testing Procedure, by the time it is able to export, its logs are simply not the same as when they were first provided to Canada. In every case, Merrill & Ring’s logs are in worse condition if they are returned than they were before being subjected to the procedure. The entire process from harvest to export takes months, and on one occasion took almost an entire year.<sup>424</sup> The longer it takes, the more the logs are damaged.<sup>425</sup> The logs are not the same at the end of the process as they were at the beginning of the process.<sup>426</sup> This change is inevitable as a function of time and the nature of the specific procedures mandated by the Log Export Control Regime. The damage to Merrill & Ring’s logs seeking export is substantial, irreversible, and amounts to a permanent deprivation of Merrill & Ring’s property.
- f) Canada deprives Merrill & Ring of its logs and uses those logs for its own benefit - which is to provide low cost industrial raw materials for domestic BC mills. The fact that Canada confiscates Merrill & Ring’s logs to give

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<sup>422</sup> Witness Statement of Paul Stutesman at para. 25.

<sup>423</sup> Witness Statement of Paul Stutesman at para. 26.

<sup>424</sup> Witness Statement of Paul Stutesman at para. 15.

<sup>425</sup> Witness Statement of Paul Stutesman at para. 15.

<sup>426</sup> Witness Statement of Tony Kurucz at para. 64.

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fact that Canada confiscates Merrill & Ring's logs to give benefit to others has no bearing on whether Canada's actions are confiscatory.

370. In considering the scope of NAFTA Article 1110, the *Pope & Talbot* Tribunal held that "the ability to sell softwood lumber from British Columbia to the U.S. is...a very important part of the "business" of the Investment,"<sup>427</sup> and that "[i]nterference 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."<sup>428</sup> At the same time the Tribunal ultimately concluded that "the Investor's access to the US market is a property interest subject to protection under Article 1110. The Tribunal then listed the factors that need to be considered in measuring interference for the purposes of Article 1110. Among these is whether Canada:
- a) has taken any of the proceeds of company sales;
  - b) interferes with management activities; and
  - c) has deprived the Investor of full control of its Investment.<sup>429</sup>

Unlike the case with the *Pope & Talbot*, the facts of this case trigger the application of all three of these factors.<sup>430</sup>

371. The evidence establishes that other investments operating in BC and outside BC operate in the same economic sector as Merrill & Ring in the sale of logs. The regulatory division between federal and provincial authorities in Canada play no role in the fundamental nature of the log market once logs are in circulation. Accordingly, Merrill & Ring is in like circumstances with all of these other companies engaged in the competitive timber harvest and log sale markets.

ii. *The Expropriation is Discriminatory Against Merrill & Ring*

372. The expropriatory nature of the Log Export Control Regime is not applied equally to all parties, and discriminates against Merrill & Ring. The reasons for this are as follows:

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<sup>427</sup> *Pope & Talbot*, Interim Merits Award at para. 96. (Investor's Book of Authorities at Tab 72).

<sup>428</sup> *Pope & Talbot*, Interim Merits Award at para. 98. (Investor's Book of Authorities at Tab 72).

<sup>429</sup> *Pope & Talbot*, Interim Merits Award at para. 100. (Investor's Book of Authorities at Tab 72).

<sup>430</sup> *Pope & Talbot*, Interim Merits Award at para. 96. (Investor's Book of Authorities at Tab 72).

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- a) The Log Export Control Regime – and particularly the Surplus Testing Procedure and its implications – is by its very nature expropriatory. However, its affects are not felt equally by all log exporters.

Smaller companies like Merrill & Ring are particularly adversely affected. For example, because Merrill & Ring has only small volumes of provincial logs with which to satisfy the demands of its “blockmailers”, it must sacrifice federal logs to do so. Because provincial logs are subject to a *fee-in-lieu* of manufacture when they get exported – and federal logs are not – the opportunity cost this presents to Merrill & Ring is much larger than it is for those who are able to supply their “blockmailers” with provincial logs.<sup>431</sup>

In addition, Merrill & Ring does not have the same market clout enjoyed by its larger competitors to discourage “blockmailing” on their logs in the first place. These consequences of the Log Export Control Regime render the regime discriminatory on a *de facto* basis.

- b) The Log Export Control Regime is also applied unequally between Merrill & Ring and its competitors on a *de jure* basis. This is because it allows Merrill & Ring’s competitors with provincial lands to obtain standing timber exemptions, while denying Merrill & Ring the same benefit.<sup>432</sup> Yet even though Merrill & Ring’s competitors with federal lands are not supposed to be given standing timber exemptions, this has in fact happened. Instead of enforcing its laws appropriately – or otherwise granting Merrill & Ring the same exemptions from the Surplus Testing Procedure and its expropriatory consequences – Canada has turned a blind eye to this impropriety.<sup>433</sup>

iii. *The Expropriation is Arbitrary*

373. The means by which Canada seeks to achieve its policy objectives are arbitrary (in that they do not, in fact, effectively achieve the stated objective and there are, in any event, far less restrictive means by which to achieve the stated objective).
374. Professor Pearce has examined the operations of the Log Export Control Regime for many years. He was the Royal Commissioner for BC on this subject and has examined

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<sup>431</sup> Witness Statement of Tony Kurucz at para. 70.

<sup>432</sup> Witness Statement of Tony Kurucz at para. 18.

<sup>433</sup> Witness Statement of Tony Kurucz at para. 19.

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the issue extensively. In his Expert Report, Professor Pearse found that the Log Export Control Regime was ill-suited to its policy purpose. He states:

Log export controls are clumsy economic instruments, ill-suited to the policy purpose. They are not only inconsistent with the principles of free trade but also discriminatory. As I outline below, these policy measures place an unfair confiscatory burden upon private timberland owners. This is even more problematic in the absence of a reasonable public policy rationale that would support such a burdensome regime.<sup>434</sup>

375. He then assessed whether the Log Export Control Regime was administered fairly. He concluded that its administration was not connected to its policy objective of ensuring the availability of an adequate supply of timber. He states:

The adequacy of timber supply for BC sawmills is measured by the capacity or demands of the mills compared to the quantity of timber available for harvesting. The log export control regime takes no account of either of these factors in any meaningful way. Rather, TEAC and FTEAC passively consider only applications to export logs as they are presented... and regardless of their recommendations, the federal controls affect such an insignificant portion (about 3.5 percent in the fiscal year ending 2006) of the overall supply of timber in BC as to be almost irrelevant to the stated policy concern about the needs of the province's forest products manufacturing sector.<sup>435</sup>

376. Professor Pearse concludes that the export control are unconnected to their purpose as there is no need for them. He states:

In short, the available supply of timber in both the Coast and Interior regions far exceeds the demands of domestic mills.<sup>436</sup>

Professor Pearse found that the Log Export Policy Control Regime was arbitrary, discriminatory and confiscatory. He states:

In short, the federal and provincial log export controls are designed to benefit only the processing sector of the BC forest industry. And it does so at the direct expense of log producers. The net result is a lower value of aggregate economic production than could otherwise be achieved. As a result, the log export control regime is inconsistent with the federal government's broader objective to improve Canada's economic performance, and in particular to increase industrial productivity.<sup>437</sup>

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<sup>434</sup> Expert Report of Prof. Peter Pearse at para. 22.

<sup>435</sup> Expert Report of Prof. Peter Pearse at para. 24.

<sup>436</sup> Expert Report of Prof. Peter Pearse at para. 25.

<sup>437</sup> Expert Report of Prof. Peter Pearse at para. 41.



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377. Professor Pearce concludes on the unfairness of the regime for timber growers:

The main beneficiary of the present log export restrictions is the wood products manufacturing sector, but it cannot be convincingly argued that even this sector depends heavily on the protection from outside buyers. Only a very small fraction of the timber produced in BC is affected, even potentially, by foreign demand for logs. The restrictions have little or no direct effect in most of the province. And the substantial cost of transporting logs always gives local buyers an advantage.<sup>438</sup> .....

The burden of the restrictions is borne most heavily by those involved in the primary sector – those dependent on timber harvesting and related activities and the owners of forestland. The latter includes both private owners and the taxpayers of BC.<sup>439</sup>

378. Finally Professor Pearce identifies that there are many other alternative policies available to Canada that would have been less intrusive to the Investor and its Investments. He states:

Even if the federal government maintained the goal of protecting the manufacturing sector through barriers to log exports (which I do not recommend) there are less cumbersome and restrictive methods available, such as applying a simple export fee like the provincial “fee in lieu”, which would eliminate much of the uncertainty and inefficiency of the present arrangements.<sup>440</sup>

*iv. The Expropriation is Not Conducted in Accordance with Due Process of Law and Article 1105(1)*

379. The Log Export Control Regime is manifestly unfair in its application, administration and effects. The inconsistency of the Log Export Control Regime with NAFTA Article 1105 has been detailed carefully in Parts Three and Four of this Memorial. The Log Export Control Regime – and its inherently expropriatory effects – is not applied in accordance with Canada’s obligations under international law, including its obligation to provide Merrill & Ring fair and equitable treatment.

*v. Canada Has Not Paid Merrill & Ring Compensation in Accordance with NAFTA Articles 1110(2) - 1110(6)*

380. NAFTA Article 1110 is very specific in that Canada is required to provide compensation to the Investor at the Fair Market Value at the time that the logs were taken. Article

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<sup>438</sup> Expert Report of Prof. Peter Pearce at para. 56.

<sup>439</sup> Expert Report of Prof. Peter Pearce at para. 57.

<sup>440</sup> Expert Report of Prof. Peter Pearce at para. 61.

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- 1110(3) states that “compensation shall be paid without delay and fully realizeable.” Canada has never compensated Merrill & Ring for the expropriatory impact of its Log Export Control Regime on Merrill & Ring’s investments.
381. NAFTA Article 1110(2) requires that compensation be provided at Fair Market Value. Article 1110(3) requires that this payment be without delay and fully realizable into currency.
382. Canada fails to pay any compensation when the logs are expropriated under the Log Export Control Regime. This is inconsistent with the requirement of Article 1110(3).
383. Canada also does not pay fully realizable compensation as required by NAFTA Article 1110(3). In some circumstances, Canada returns logs to the Investor but the return of logs which have become damaged and degraded by intervening delays cannot constitute realizable payment.
384. The prices obtained by Merrill & Ring for compulsory domestic log sales under the Log Export Control Regime do not provide Fair Market Value compensation. There is ample evidence to support this fact.
385. In May 1992, the US Department of Commerce (“DOC”) examined the Log Export Control Regime. It made a determination that BC log export restraints significantly reduced the domestic price for BC logs. It said:
- ... the BC log export restrictions have a “direct and discernible effect” upon the domestic price of BC logs. By reducing the demand for BC logs that otherwise exist in the absence of the BC export restrictions, the BC border measures have the effect of reducing the price of logs sold in the BC domestic market....Based upon this study, we determine that there is a relatively high or strong correlation between BC log export restraints and the significant price differential between exported and domestically consumed logs.<sup>441</sup>
386. The Canada-US FTA Panel that reviewed this US government agency determination upheld the DOC’s finding that BC’s log export restraints had a “direct and discernible effect” that reduced the domestic log prices for logs sold in BC below their Fair Market Value:

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<sup>441</sup> United States Department of Commerce, *Final Affirmative Countervailing Determination: Certain Softwood Lumber Products from Canada*, May 28, 1992, 57 FR 22570 at 22609-10. (Investor’s Book of Authorities at Tab 26).

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..... each study demonstrates that if British Columbia removed its log export restraints, domestic prices would rise. The Panel finds this evidence—that lifting the restraints results in a rise in domestic log prices—supports, albeit not proving, the causal link Commerce aims to establish.<sup>442</sup>

387. There is no question that Canada designed the Log Export Control Regime to benefit its domestic wood users at the expense of log growers. The FTA Panel examined the testimony of BC officials to be persuasive evidence that BC's log export restraints were designed to depress domestic market log prices:

Commerce cites various B.C. officials, forestry experts, and members of Canadian lumber industry to demonstrate not only that the government intended the log export restrictions to benefit B.C. timber processors, but also that the government believed the log export restrictions had effective results.

...the B.C. Select Standing Committee on Forests and Lands has stated “[t]he reduced overall demand for logs resulting from arbitrarily restricting log exports provides the domestic processing sector with a lower log price.” A committee formed by the B.C. government to study log exports concluded: “Without these restrictions, domestic log prices for most species and grades would certainly be higher than current levels, as domestic mills would be forced to compete for raw materials at higher prices in the world market.”<sup>443</sup>

388. Professor Peter Pearse concluded in his 1976 Royal Commission on Forest Resources that:

“The most obvious effect of restrictions on export sales is that demand for logs is reduced, and this inevitably depresses domestic log prices.”<sup>444</sup>

Professor Pearse maintains this position in his Expert Report prepared for this Tribunal.<sup>445</sup>

389. The amounts received as proceeds for log sales in the Vancouver log market as mandated by FTEAC under the Log Export Control Regime do not provide Fair Market Value. These proceeds are not the product of an open market but of an artificial one created to

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<sup>442</sup> United States-Canada Free Trade Agreement Article 1904 Binational Panel Review, U.S.A.-92-1904-01, *In the Matter of Certain Softwood Lumber Products from Canada*, December 17, 1993, at 98-99. (Investor's Book of Authorities at Tab 80).

<sup>443</sup> *United States-Canada Free Trade Agreement Article 1904 Binational Panel Review*, U.S.A.-92-1904-01, *In the Matter of Certain Softwood Lumber Products from Canada*, December 17, 1993, at 101-102. (Investor's Book of Authorities at Tab 80).

<sup>444</sup> Pearse, *Timber Rights and Forest Policy in British Columbia*, Report of the Royal Commission on Forest Resources at para. (Investor's Schedule of Documents at Tab 40).

<sup>445</sup> Expert Report of Peter Pearse at para. 50.

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result in low prices. The Fair Market Value is a value where the market freely would set prices. Such a market operates nearby in Puget Sound or in other locations. The Expert Report of Mason, Bruce & Girard demonstrates a sizeable ongoing difference between the artificial price under the Log Export Control Regime and the Fair Market Price.

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## PART FIVE: DAMAGES

390. Under international law, the Investor is entitled to full compensation from Canada for all harm caused to it and to its investments arising from Canada's unlawful actions.
391. The objective for this Tribunal is to place the Investor back into the position it would have been in "but for" the occurrence of the illegal act. Well-established international law compensation principle that **reparation must, as far as possible, wipe out all the consequences of the illegal act and reestablish the situation which would, in all probability, have existed if that act had not been committed.**<sup>446</sup> This compensation principle has been widely applied in international tribunal decisions.<sup>447</sup>
392. The calculation of damages should take into account those cash flows that would have been earned by the Investor and the Investments but for Canada's unlawful actions.
393. The *Independent Valuators' Report* sets out an independent expert opinion on the quantification of the damages sustained by the Investor and Investment.
394. As more fully set out in the *Independent Valuators' Report*, the Investor has suffered a loss in the value of its investment in BC. The total losses to be are CDN\$ 23,992,826.

### A. Legal Issues

395. The international law principle of compensation requires Canada to provide compensation for all harm occasioned to Merrill & Ring and its investments arising out of Canada's violation of its international law obligations.

#### i. The "But For" Test

396. Once a violation has been established the remedial objective of an international tribunal is to place the injured Investor and its Investments in the position they would have occupied but for the illegal conduct. In the words of the *S.D. Myers* NAFTA Tribunal,

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<sup>446</sup> *Case Concerning the Factory at Chorzów* (Merits September 13, 1928) PCIJ, Series A, No. 17, at p. 47 [emphasis added] (Investor's Book of Authorities at Tab 6).

<sup>447</sup> The ICSID Tribunal award in *Amco Asia Corp. v. Indonesia*, ICSID Case ARB/81/1, Award, 1984 WL 590116 (November 20, 1984) at para. 267, adopted the reasoning of the *Chorzow Factory Case*, calling it the "basic precedent" in international law on compensation. (Investor's Book of Authorities at Tab 22).

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“Compensation should undo the material harm inflicted by a breach of an international obligation.”<sup>448</sup>

397. The principle underlying the international law of compensation was enunciated by the Permanent Court of International Justice in the *Chorzow Factory case*. The Court held that:

The essential principle contained in the actual notion of an illegal act ... is that *reparation must, as far as possible, wipe out all the consequences of the illegal act and reestablish the situation which would, in all probability, have existed if that act had not been committed*. Restitution in kind, or, if this is not possible, payment of a sum corresponding to the value which a restitution in kind would bear; the award, if need be, of damages for loss sustained which would not be covered by restitution in kind or payment in place of it - such are the principles which should serve to determine the amount of compensation for an act contrary to international law.<sup>449</sup>

This compensation principle has been adopted and applied by numerous international tribunal decisions.<sup>450</sup>

ii. *Consequential damages*

398. In the *Amoco* case, the Iran-US Claims Tribunal considered the proper application of the *Chorzow Factory Case* principles in the circumstance of an expropriation. Judge Charles Brower took the opportunity in his Concurring Opinion to further clarify the application of the *Chorzow Factory Case* in the context of a modern valuation and business analysis. Judge Brower states:

In my view *Chorzow Factory* presents a simple scheme: If an expropriation is lawful, the deprived property is to be awarded damages equal to ‘the value of the

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<sup>448</sup> *Myers* at para. 315. (Investor’s Book of Authorities at Tab 39).

<sup>449</sup> *Chorzów Factory Case* at 47 [emphasis added]. (Investor’s Book of Authorities at Tab 6).

<sup>450</sup> See, for example, *Myers* at paras. 311 and 317. At para. 311 the Tribunal stated, “The principle of international law stated in the *Chorzow Factory Case* is still recognised as authoritative on the matter of general principle”. Similarly, at para. 317 the Tribunal stated, “In summary, the Tribunal will assess the compensation payable to SDMI on the basis of the economic harm that SDMI legally can establish.” (Investor’s Book of Authorities at Tab 39). See also the ICSID Tribunal award in *Amco* at para. 267, in which the Tribunal adopted the reasoning of the *Chorzow Factory Case*, calling it the “basic precedent” in international law on compensation. (Investor’s Book of Authorities at Tabs 22).

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undertaking' which it has lost, including any potential future profits, as of the date of taking; in the case of an unlawful taking, however, either the injured party is to be actually restored to enjoyment of his property, or, should this be impossible or impractical, he is to be awarded damages equal to the greater of (i) the value of the undertaking at the date of loss (again including lost profits), *judged on the basis of information available as of that date*, and (ii) its value (likewise including lost profits) as shown by its probable performance subsequent to the date of loss and prior to the date of the award, based on actual post-taking experience, *plus* (in either alternative) *any consequential damages*. Apart from the fact that this is what *Chorzow Factory* says, it is the only set of principles that will guarantee just compensation to all expropriated properties.

The substantive test of the judgment of *Chorzow Factory* is consonant with the conclusion that the 'value of the undertaking' includes its potential for earning profits. The Court thus described such value as including '*the cessation of the working and the loss of profit which have accrued*' as encompassing all elements of damages except those that are 'outside the undertaking itself;' and as embracing 'the worth of the enterprise as a whole' or 'the total value of the undertaking' including 'profit.'<sup>451</sup>

399. Similarly, in *Sapphire International Petroleum Arbitration*, the Tribunal found that:

This compensation includes the loss suffered (*damnum emergens*), for example the expenses incurred in performing the contract, and the profit lost (*lucrum cessans*), for example the net profit which the contract would have obtained. The award of compensation for the lost profit or the loss of a possible benefit has been frequently allowed by international arbitral tribunals.<sup>452</sup>

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<sup>451</sup> *Amoco International Finance Corporation v. Iran*, Iran - United States Claims Tribunal, Case No. 56, Award 310-56-3, July 14, 1987, Concurring Opinion of Judge Brower, at 300-2, paras. 17-19. (Investor's Book of Authorities at Tab 81).

<sup>452</sup> *Sapphire International Petroleum Ltd. v. National Iranian Oil Company*, Arbitral Award, March 15, 1963 (1963) 35 ILR 136 at 186. (Investor's Book of Authorities at Tab 82).

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iii. *Lost Profits*

400. Damages for lost profits may be awarded when the loss is a foreseeable consequence of the breach and when such profits can be calculated with reasonable certainty.<sup>453</sup> An array of international law awards have awarded compensation not only for actual losses suffered, but also consequential damages such as the loss of possible business profits.<sup>454</sup> Compensation for lost profits is a common element of international compensation awards.<sup>455</sup>

401. In *The Shufeldt Claim*, the arbitrator stated that the lost profits:

...must be the direct result of the contract and not too remote or speculative ... (but as) may reasonably be supposed to have been in the contemplation of both parties as the probable result of a breach of it.<sup>456</sup>

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<sup>453</sup> In *Greek Telephone Company v. Government of Greece* (1964) BYIL 216 at 221, the Tribunal found that Greece must compensate the investor for the lost profits "for what it would have obtained" had the concession contract been implemented by the State. (Investor's Book of Authorities at Tab 83). In *Sea-Land Service, Inc. v. Iran*, Iran - United States Claims Tribunal, Case No. 33, Award 135-33-1, June 20, 1984, (1984) 6 Iran-US CTR 149, the Tribunal cited its decision in *R. N. Pomeroy et al. v. Iran*, Iran - United States Claims Tribunal, Case No. 40, Award No. 50-40-3, June 8, 1983, 2 Iran-US CTR 372 as a basis for this determination. (Investor's Book of Authorities at Tabs 84 and 85).

<sup>454</sup> Preliminary Administrative Decisions of the German-American Mixed Claims Commission, *British Yearbook of International Law* (1924) at 222-5 (Investor's Book of Authorities at Tab 86); *Laura M. B. Janes v. United Mexican States* (1927), Mexico/USA General Claims Commission, IV RIAA 82. (Investor's Book of Authorities at Tab 87). See also *Lighthouses Arbitration* (France/Greece), 12 RIAA 155 at 245-250; *AGIP Spa v. Congo*, ICSID Case No. ARB/77/1, Award, 30 November 1979, 1979 WL 395348 at para. 98. (Investor's Book of Authorities at Tabs 88 and 89).

<sup>455</sup> In *Sapphire International Petroleum Arbitration* at 186 the Tribunal found that:

This compensation includes the loss suffered (*damnum emergens*), for example the expenses incurred in performing the contract, and the profit lost (*lucrum cessans*), for example the net profit which the contract would have obtained. The award of compensation for the lost profit or the loss of a possible benefit has been frequently allowed by international arbitral tribunals. (Investor's Book of Authorities at Tab 82).

In *The May Case* (Guatemala/United States) (1900) XV RIAA 55 at 72, the Tribunal came to a similar conclusion that compensation should include both the damage suffered and the lost profit. In this case, the investor was "entitled to all the profit to be derived from the railroad until the completion of the term." (Investor's Book of Authorities at Tab 91); Similarly, in *The Shufeldt Claim*, the arbitrator rendered an award on damages that covered both the losses suffered and the lost profits. (Investor's Book of Authorities at Tab 90).

<sup>456</sup> *The Shufeldt Claim* (Guatemala/United States) (1930), II RIAA 1081 at 1099. (Investor's Book of Authorities at Tab 90).



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402. In its discussion of international compensation law, the *Amco Asia* Tribunal noted that the basic principles of international compensation law the methods used to quantify damages in contract law. The Tribunal stated:

The legal bases of calculation of damages will be set up according to the principles governing the matter, where the prejudice to be compensated results from the failure of a party to a contract to fulfill its obligations under the contract.

This method is justified in the instant case, in spite of the relationship between the host state and the investor not being strictly identical to a private law contract, as earlier shown, but merely comparable to such a contract....

Moreover, it could by **no means be contended that if the illegal acts of the State were of delictual nature, the damages to be awarded in compensation of the prejudice should be a lower amount than damages awarded in the framework of contractual liability.**<sup>457</sup>

403. In the *Amoco* case, Judge Brower concluded that it was appropriate for international law to award an investor damages in respect of its “probable performance” in the market. In order to establish a claim for damages, it is necessary to obtain a valuation date with respect to restitution value under the *Chorzow Factory* case standard based on the current value of the damages incurred proximate to the date of the Tribunal’s award.<sup>458</sup>
404. An award compensating the Investor for its lost opportunity of access to cash flow would reflect the damages incurred directly arising from Canada’s unlawful actions. Therefore, the Investor is entitled to receive compensation for its lost opportunities it had to use the cash-flows from its operations to further its business. This direct consequential loss must be based upon the opportunity lost by the Investor by not re-deploying its cash flow from its Canadian-based business operation.

*iv. Mitigation*

405. The duty of mitigation is a general principle of law, which in turn, forms part of the rules of international law.<sup>459</sup> The principle has been recognized by several international

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<sup>457</sup> *Amco* at para. 265 [emphasis added]. (Investor’s Book of Authorities at Tab 22).

<sup>458</sup> *Amoco Case*, Concurring Opinion of Judge Brower, at 300. (Investor’s Book of Authorities at Tab 81).

<sup>459</sup> *Middle East Cement Shipping and Handling Co. S.A. v. Egypt*, ICSID ARB/99/6, Award, April 12, 2002, 2002 WL 32841362 at para 167. (Investor’s Book of Authorities at Tab 92).

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tribunals including the International Court of Justice.<sup>460</sup> For example, in the *Gabcikovo-Nagymaros Project* case, the International Court stated:

It is a general principle of international law that a party injured by the non-performance of another contract party must seek to mitigate the damage he has sustained. It would follow from such a principle that an injured State which has failed to take the necessary measures to limit the damage sustained would not be entitled to claim compensation for that damage which could have been avoided. While this principle might thus provide a basis for the calculation of damages, it could not, on the other hand, justify an otherwise wrongful act.<sup>461</sup>

406. The duty of mitigation is also reflected in the Commentary to Article 31 of the *ILC Articles*. The Commentary to Article 31 notes that mitigation of damage is an element affecting the scope of reparation.<sup>462</sup> It further states: “Even the wholly innocent victim of wrongful conduct is expected to act reasonably when confronted by the injury”. The Commentary also notes that the duty to mitigate is not a positive obligation, rather the failure of the injured party to mitigate may preclude recovery to that extent.<sup>463</sup>

v. *Opportunity Loss: Interest and Costs*

407. It is not sufficient for this Tribunal to award the Investor the actual amount of its loss at the time of Canada’s breach. Such an award would not take into account the harm occasioned to the Investor for being denied its compensation after the time of the breach. International tribunals retain broad discretion to take into account all relevant circumstances, including equitable considerations on a case by case basis, to ensure that

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<sup>460</sup> See for example: Report and Recommendations Made by the Panel of Commissioners Appointed to Review the *Well Blowout Control Claim*, 15 November 1996, S/AC.26/1996/5/Annex at para. 54; reproduced in 36 ILM 1279 (Investor’s Book of Authorities at Tab 93); *Gabcikovo-Nagymaros Project* (Hungary/Slovakia), I.C.J. Reports 1997 at para. 80. (Investor’s Book of Authorities at Tab 94).

<sup>461</sup> *Gabcikovo-Nagymaros Project* at para. 80. (Investor’s Book of Authorities at Tab 94).

<sup>462</sup> *Crawford* at 205. (Investor’s Book of Authorities at Tab 27).

<sup>463</sup> *Crawford* at 205. (Investor’s Book of Authorities at Tab 27).

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full compensation ensues.<sup>464</sup> These types of considerations usually take the form of an award dealing with opportunity loss (that is interest of some form) and awards of costs.

408. Under international law, tribunals can award damages for opportunity loss to a successful party. For example, in its decision in the *Aminoil* case, the Tribunal acknowledged that "...the reasonable rate of return, assessed on a somewhat more liberal scale, constitutes one of the elements of compensation."<sup>465</sup> The *Asian Agricultural Products* case supports the principle that "interest becomes an integral part of the compensation itself, and should run consequently from the date when the State's international responsibility is engaged."<sup>466</sup> The Tribunal in the *Santa Elena* case supported the award of compound interest to the investor in that case, as follows:

... where an owner of property has at some earlier time lost the value of his asset but has not received the monetary equivalent that then became due to him, *the amount of compensation should reflect, at least in part, the additional sum that his money would have earned, had it, and the income generated by it, been reinvested each year at generally prevailing rates of interest.* It is not the purpose of compound interest to attribute blame to, or to punish, anybody for delay in the payment made to the expropriated owner; it is a mechanism to ensure that the compensation awarded the Claimant is appropriate in the circumstances.<sup>467</sup>

409. Similarly the ICSID Tribunal in *Middle East Cement Shipping* wrote:

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<sup>464</sup> *Santa Elena* at paras. 90-92 (Investor's Book of Authorities at Tab 71). This view was also maintained by a number of Iran-US Claims Tribunal awards such as those in the *American International Group, Inc. v. Iran* (1983) 4 Iran-US CTR 96 at 109 (Investor's Book of Authorities at Tab 95); *Phillips Petroleum Co. Iran v. Iran* (1989) 21 Iran-US CTR 77 at paras 111-112 and 157 (Investor's Book of Authorities at Tab 96); and *Starrett Housing Corp. v. Iran* (1983) 4 Iran-US CTR 121 at 157. (Investor's Book of Authorities at Tabs 97).

<sup>465</sup> *Award in the Matter of an Arbitration Between Kuwait and the American Independent Oil Company ("Aminoil")* (1982) 21 ILM 976 at para. 163. (Investor's Book of Authorities at Tab 98).

<sup>466</sup> *Asian Agricultural Products* at para. 114 quoted in *Metalclad* at para. 128 (Investor's Book of Authorities at Tab 60). The Tribunal in *Asian Agricultural Products* was quoting from R. Lillich, "Interest in the Law of International Claims" in *Essays in Honour of Voitto Saario and Toivo Sainio* (Helsinki: International Law Association, 1983) at 55-56. (Investor's Book of Authorities at Tab 100).

<sup>467</sup> *Santa Elena* at para. 104 [emphasis added] (Investor's Book of Authorities at Tab 71). Other international arbitral awards have expressly allowed compound interest to be paid on the award of damages; See *Fabiani's Case* (1905) X RIAA 83 at p. 93 (Investor's Book of Authorities at Tab 101); *Affaire des Chemins de Fer Zeltweg-Wolfsberg*, III RIAA 1795 at p. 1808 (Investor's Book of Authorities at Tab 102). Dr. Mann has similarly concluded that compound interest should be awarded to the claimant as an integral part of damages awards by international tribunals: F.A. Mann, "Compound Interest as an Item of Damage in International Law", *Further Studies in International Law* (Oxford: Clarendon Press, 1990), (Investor's Book of Authorities at Tab 103).

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...international jurisprudence and literature have recently, after detailed consideration, concluded that interest is an integral part of the compensation due after the award and that compound (as opposed to simple) interest is at present deemed appropriate as the standard of international law in such expropriation cases.<sup>468</sup>

Other international Tribunals have taken a similar position, including the ICSID Tribunals in *Wena Hotels and Egypt*,<sup>469</sup> *Santa Elena and Costa Rica*<sup>470</sup> and the NAFTA Tribunal in *Metalclad and Mexico*.<sup>471</sup> Accordingly, this Tribunal should also award compound interest upon a damage award rendered in this claim.

410. The award of interest should compensate the Investor and the Investment from the time of expropriation(s) and other breaches from December 27, 2003 or date of breach (whichever is later) through to the date of the award in this phase. The award of interest should accurately reflect the damages incurred by the Investor and the Investment directly arising from Canada's breach of its NAFTA obligations.
411. The Investor is entitled to interest on its damages. The compound rate of interest should be based on a rate of return equal to, or greater than, the available commercial interest rates. In any event, this rate should not be less than the average yield of one to three year Government of Canada bonds quoted on the Bank of Canada website compounded annually.<sup>472</sup>

#### **B. Summary of Valuation Report**

412. Robert Sandy is a Chartered Business Valuator and a Chartered Accountant with the firm of Pricewaterhouse Coopers. The *Independent Valuator's Report* sets out the opinion of the independent valuator's as to how the Tribunal should quantify the damages caused by Canada's unlawful actions to the Investor and its Investments.<sup>473</sup>
413. The *Independent Valuator's 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

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<sup>468</sup> *Middle East Cement Shipping and Handling* at para. 174. (Investor's Book of Authorities at Tab 92).

<sup>469</sup> *Wena Hotels* at para. 129. (Investor's Book of Authorities at Tab 23).

<sup>470</sup> *Santa Elena* at paras. 96-110. (Investor's Book of Authorities at Tab 71).

<sup>471</sup> *Metalclad* at para. 128. (Investor's Investor's Book of Authorities at Tab 60).

<sup>472</sup> See note 4 of the Summary Table at Schedule 1 of the *Independent Valuator's Report*.

<sup>473</sup> *Independent Valuator's Report* of Robert Sandy.

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Log Export Control Regime. This Past Loss Period only reaches back three years. Before the filing of this Claim.

414. The *Independent Valuator's Report* has relied upon a discounted cash flow methodology to model the future losses occasioned to Merrill & Ring. The report, which applies the DCF method to future losses, discusses the DCF method as follows:
- C.2 The discounted cash flow (DCF) approach, is based on a projection of future cash flows that would have been realized from the ongoing operations of the affected investment (i.e. had the event not occurred).
  - C.3 In applying the DCF approach, cash flows are projected for a specified number of years in the future and discounted to the valuation date by an appropriate discount rate. The projected future cash flows are discounted to determine the value today to the amounts that would have been received in the future.
  - C.4 The discount rate which applies to future cash flows is determined based on the notional investor's risk adjusted required rate of return. The notional investor's risk adjusted required rate of return is defined to be the return on investment necessary to motivate the investor to invest in, i.e., purchase, the affected investment.
  - C.5 Discounting future cash flows recognizes the fact that a dollar received today is worth more than a dollar received at some point in the future because a dollar received today can be invested, earn income and grow. Furthermore, a dollar received today has greater value while there is a risk that a dollar received in the future will not be received. The dollar received today by definition does not have this risk of realization.
  - C-6 In determining the number of years to project future cash flow, i.e. the projection period, an assessment of the reliability of projections is undertaken. The projection period is then the period for which reliable projections are available.<sup>474</sup>
415. The *Independent Valuator's Report* creates three classes of damages. Each class comprises the losses associated with the NAFTA Articles.
- a) Class 1 damages calculates losses arising as a result of Canada's failure to meet its obligations under NAFTA obligations contained in NAFTA Articles 1102, 1105, and 1106(1)(c). The Valuator separately calculates the loss of contribution suffered by Merrill & Ring to date and projected in future.<sup>475</sup>

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<sup>474</sup> *Independent Valuator's Report* at Appendix C.

<sup>475</sup> *Independent Valuator's Report* at 24, section 10.

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- b) In Class 2, the Valuator determines the losses suffered by Merrill & Ring as a result of Canada's violation of its NAFTA obligations contained in Article 1106(1)(a) and Article 1106(1)(e). The loss involves estimating the incremental sorting, towing, storage and logistics costs incurred by the Investor on export-ready logs harvested in the areas above Powell River.<sup>476</sup> In addition, future losses resulting from this violation has been modeled.
- c) Class 3 damages result from Canada's violation of NAFTA Article 1110 for logs affected by the Log Export Control Regime. The Past Loss period includes the Investor's economic losses resulting from Canada's failure to pay compensation on the aggregate difference between the price Merrill & Ring obtained domestically for its logs that Canada required it sell domestically rather than being permitted to export them, and the price Merrill & Ring would have obtained for those same logs internationally.<sup>477</sup> In addition, future losses resulting from the violation has been modeled.

For each Class, the Past Loss Period extends from 2004 to 2007. As well, the Future Loss Period covers damages expected to be incurred between January 1, 2008 and December 31, 2016. To avoid double counting, Class 1 damages encompass Class 2 and Class 3 damages, and are therefore not cumulative. However, in the instance in which a breach of any of the Class 1 obligations is not found, the damages for Class 2 and Class 3 would be cumulative.

416. Merrill & Ring's domestic sales often illustrate mitigation efforts. Sometimes purchasers intimate that they will not block exports if certain species and volumes are made available to them.<sup>478</sup> The Investor may incur a loss in making that timber available, but it is often necessary to facilitate the export process. To do otherwise, Merrill & Ring risks incurring even greater losses by not exporting its timber...
417. Merrill & Ring's forest inventory is used to develop its forest harvest plan. Merrill & Ring has a variety of different species of second-growth trees on its timberlands. Merrill & Ring sets out a detailed harvest plan which describes its projected harvest of logs; this 10-year plan was approved by the board of directors of Merrill & Ring Inc. in May 2005.

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<sup>476</sup> *Independent Valuator's Report* at 26, section 10.10

<sup>477</sup> *Independent Valuator's Report* at 27, section 10.11

<sup>478</sup> Witness statement of Tony Kurucz at paras. 59 and 60.

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Merrill & Ring has a ten-year harvest plan that details Merrill & Ring's cutting plans to 2016.<sup>479</sup>

418. The business operations of Merrill & Ring have had to be modified to deal with the uncertainty created by the Log Export Control Regime. This uncertainty has made it difficult for Merrill & Ring to harvest desirable high-value species such as alder because of the risk of those logs being blocked or ransomed.<sup>480</sup>
419. Merrill & Ring would have harvested significantly higher volumes of alder after the summer of 2006 because of a new alder processing mill that had been established that year in Port Angeles.<sup>481</sup> Because of the risk that alder would be blocked, Merrill & Ring did not increase its cuts of alder and was not able to satisfy well-known market demand.<sup>482</sup>
420. The Investor considers many aspects in its operation, including harvest plans which are integral to its success. There are two types of harvest plans: annual plans which detail species and harvesting locations; and long-term plans which are more general and strategic.<sup>483</sup> Merrill & Ring has comprehensive harvest plans for its BC lands.<sup>484</sup> For each of the three classes of loss, the Future Loss is based on Merrill & Ring's ten-year harvest plan that has been modeled to take into account an environment where the Log Export Control Regime did not apply to Merrill & Ring.
421. The *Independent Valuator's Report's* methodology measured the damages suffered by the Investor in terms of foregone economic benefits. Foregone economic benefits are the difference between economic benefits that would have been realized through Merrill & Ring's operation of its private timberlands in BC without intervention from the Canadian government.
422. The *Independent Valuator's Report* examines the amount of price premium that was foregone as a result of log sales made under the Log Export Control Regime by Merrill & Ring. The foregone Fair Market Prices were confirmed by the Expert Report prepared by

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<sup>479</sup> Projected Harvest Plan and Log Export Restrictions, February 5, 2008 which is based on the strategic harvest plan approved by the Board in May 2005. (Witness Statement of Norm Schaaf at para. 35).

<sup>480</sup> Witness Statement of Norm Schaaf at para. 39.

<sup>481</sup> Witness Statement of Norm Schaaf at para. 39.

<sup>482</sup> Witness statement of Norm Schaaf at para. 41.

<sup>483</sup> Witness statement of Norm Schaaf at para. 18.

<sup>484</sup> Witness statement of Norm Schaaf at para. 20.

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David Cox and Mark Rasmussen of Mason, Bruce & Girard on export log prices.<sup>485</sup> Mason, Bruce & Girard determined the “highest published prices” for the Investor’s logs by reviewing the volumes of logs actually sold by Merrill & Ring during the Past Loss Period.<sup>486</sup> The consulting firm engaged in discussions with management, interviewed other companies and reviewed publicly-available price data on log prices in the Pacific Northwest and the Vancouver log market.

423. An important aspect of this claim involves the determination of the prices that Merrill & Ring could obtain for its logs in export markets if it was not forced to sell its timber. Mason, Bruce & Girard, provided its Expert Report with respect to the issues of: price taking; price elasticity and prices that Merrill & Ring could obtain for its logs in international markets.<sup>487</sup>
424. The Mason, Bruce & Girard experts concluded that “[i]f all of Merrill & Ring’s 150,000 m<sup>3</sup> harvest were exported, either into the US or Asian log markets, the Merrill & Ring volume would account for just 0.21 per cent of the total log market.”<sup>488</sup> Mason, Bruce & Girard concluded that Merrill & Ring is a price taker in the relevant log market.<sup>489</sup> For Merrill & Ring, the relevant market is comprised of primary wood processing mills (sawmills, pulp mills, etc.) in western Oregon and Washington, northern Idaho, and Asia.
425. The *Independent Valuator’s Report* states that:

For each of the years in the Past Loss Period MB&G calculated the difference between the price that the Investor’s sold its logs for and the “highest published prices”. MB&G then calculated, on a per species basis, an annual “highest published price premium” (the “MB&G Premium”) expressed in terms of \$/m<sup>3</sup>. The MB&G Premiums were calculated based on the assumption that if not for the Procedures M&R could have sold its logs for the “highest published price”. The MB&G Premiums are used in our loss claim calculations for the Future Loss period.<sup>490</sup>

426. In addition, the Investor’s losses were increased by certain increased operating cost flowing from Canada’s breaches. During the Past Loss Period as a result of the Procedures, increased operating costs were calculated on the basis of Merrill & Ring’s

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<sup>485</sup> Expert Report of Mason, Bruce & Girard at 8.

<sup>486</sup> Expert Report of Mason, Bruce & Girard at 4; See *Independent Valuator’s Report* at section 11.6.

<sup>487</sup> Expert Report of Mason, Bruce & Girard at 4.

<sup>488</sup> Expert Report of Mason, Bruce & Girard, at 3.

<sup>489</sup> Expert Report of Mason, Bruce & Girard, at 2.

<sup>490</sup> *Independent Valuator’s Report* at para. 11.7.



Merrill &amp; Ring Forestry L.P.

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financial statements, a review of its contracts and invoices and a review of publicly-available information regarding comparative operating costs for forestry companies.

427. The total of the foregone economic benefits represents the Investor's total losses, less interest. Finally, the Investor's losses are augmented by an applicable rate of interest to produce the total losses suffered by the Investor. This sum represents the amount needed to put the Investor in the position it would have enjoyed but for the wrongful acts of Canada as of the date of the filing of the *Independent Valuator's Report* (net of the costs of this arbitration, including professional representation). The *Independent Valuator's Report* calculates interest up until December 31, 2007.
428. The Valuator calculated the individual amounts described above and the total losses incurred by the Investor's according to three scenarios. Each scenario is based on a different determination that could be made by the Tribunal.<sup>491</sup>
429. The *Independent Valuator's Report* provides damages as follows (all amounts shown in US dollars):<sup>492</sup>

|                    | Class 1      | Class 2     | Class 3     |
|--------------------|--------------|-------------|-------------|
| <b>Past Loss</b>   | R-1(b)(ii)   |             |             |
| <b>Future Loss</b> | R-1(b)(ii)   |             |             |
| <b>Total</b>       | \$23,976,806 | \$1,721,754 | \$3,298,325 |

**Note:**  
Interest as included in this schedule represents a composite amount based on the effective date of each of the components of loss. The Tribunal may reach a different conclusion as to the economic loss for one or more of the components as listed above. If so, the interest amount will have to be recalculated to reflect the change in the component economic loss.

<sup>491</sup> *Independent Valuator's Report* at Note 5 to Schedule 1, the Valuator set the losses arising from logs harvested on Merrill & Ring's provincial timbermark lands at R-1(b)(ii) for past losses and R-1(b)(ii) for future losses.

<sup>492</sup> *Independent Valuator's Report* at 8.

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430. In order to return the Investor to the position it would have been in but for Canada's conduct, it is necessary to award full costs of this arbitration to the Investor.
431. In light of the foregoing, the Investor seeks the following amounts of damages to be payable immediately from Canada:
- a) Not less than CDN\$23,976,806 for the value of the Investment to the Investor;
  - b) Appropriate compound interest on this amount at commercial interest rates; and
  - c) An amount to be fixed for the costs and disbursements for professional and experts advisors and the costs of this arbitration.

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## PART SIX: JURISDICTIONAL ISSUES

### A. The Tribunal Has Jurisdiction to Hear this Dispute

#### i. *Merrill & Ring is a US Investor with Investments in Canada*

432. NAFTA Article 1139 defines an investor to include an enterprise of a NAFTA Party that “makes, seeks to make or has made an investment.” The term “investment” is further defined in NAFTA Article 1139 as, among other things, “an enterprise,” “an interest in an enterprise that entitles the owner to share in income or profits of the enterprise,” or “real estate or other property, tangible or intangible, acquired in the expectation or used for the purpose of economic benefit or other business purposes.”<sup>493</sup>
433. Merrill & Ring owns timberlands and timber that meet the definition of “investment” in NAFTA Article 1139. The Investor’s land holdings in BC extend over approximately 7,043 acres. These land holdings are located on Vancouver Island and in other southern and mid-coastal regions of BC.<sup>494</sup>

#### ii. *The Measures*

434. Canada has violated the NAFTA through both continuing and non-continuing measures.

##### a. Continuing Measures

435. Merrill & Ring challenges at least four continuing measures:

- 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;

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<sup>493</sup> NAFTA Article 201 states “enterprise of a Party means an enterprise constituted or organized under the law of a Party”. The term “enterprise” is further defined as “any entity constituted or organized under applicable law, whether or not for profit, and whether privately-owned or governmentally-owned, including any corporation ...”

<sup>494</sup> Merrill & Ring Forestry Limited Partnership, Land and Timber Ownership as of December 31, 2006. (Investor’s Schedule of Documents at Tab 6).

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- 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;
  - c) Canada's unfair administration of the Surplus Testing Procedure, through:
    - i) arbitrary time and sort requirements;
    - ii) encouraging 'blockmailing' by bidders to obtain concessions;
    - iii) encouraging non *bona fide* purchasers to block logs from export;
    - iv) FTEAC's members' conflicts of interest;
    - v) decisions are not transparent;
    - vi) decisions are based on unknown criteria; and
    - vii) there is no appeal or review of decisions.
  - d) the continuing application of Notice 102.

b. Non-continuing Measures

436. Merrill & Ring challenges four categories of non-continuing measures that have occurred since December 27, 2003. Specific examples of measures from each of these categories was set out with particularity within the pleadings already filed by the Investor. These four categories of non-continuing measures are:

- 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.
- 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.
- c) each time since December 27, 2003 that Canada administered the Surplus Testing Procedure unfairly, including the following examples:

- 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;
- ii) allowing 'blockmailing' since December 27, 2003;
- iii) allowing non bona fide 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;
- iv) appointing people with apparent conflicts of interest to sit on the FTEAC since December 27, 2003, **c-1(b)(iv)**  
**c-1(b)(iv)**
- v) decisions to block Merrill & Ring's exports of, at least, the following rafts without explaining the criteria on which those decisions were based:

| Raft         | Blocking Company  | Sale Date |
|--------------|-------------------|-----------|
| MRE-4-97-476 | <b>R-1(b)(iv)</b> |           |
| MRM-4-97-731 |                   |           |
| MRT-4-97-203 |                   |           |
| MRS-5-97-222 |                   |           |
| MRT-5-97-334 |                   |           |
| MRT-5-97-319 |                   |           |

- vi) Canada's failure to provide an appeal or review of the same decisions;

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- d. The specific requirements that Merrill & Ring was required to follow each time after December 27, 2003 in order to apply for an export permit under Notice 102.<sup>495</sup>

iii. *The Impugned Measures Relate to the Investor and its Investments*

437. NAFTA Article 1101(1) defines the scope and coverage of NAFTA Chapter 11. Article 1101 provides that the obligations of NAFTA Chapter 11 apply to “measures adopted or maintained by a Party *relating to*” an investor or investment.<sup>496</sup>
438. In its *Statement of Defence*, Canada admits that Notice 102 relates to all log exporters located in BC.<sup>497</sup> Furthermore the *Statement of Defence* suggests that the BC *Forest Act* relates to BC provincial timberlands.<sup>498</sup> Merrill & Ring is a log exporter in Canada and owns both federal and provincial timberlands.<sup>499</sup> Thus the Log Export Control Regime relates to Merrill & Ring.
439. NAFTA Article 102(2) states that NAFTA provisions must be interpreted in light of NAFTA’s objectives and in accordance with the applicable rules of international law. NAFTA’s objectives include the facilitation of the cross-border movement of services, substantially increasing investment opportunities and promoting conditions of fair competition.<sup>500</sup>

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<sup>495</sup>See Merrill & Ring Notice of Intent at para. 20: and Statement of Claim at para. 51, listing C-1(b)(iv) successfully blocking export of Merrill & Ring’s logs in 2004, 2006 and 2005, respectively

<sup>496</sup> NAFTA Article 1101(1) provides: “ 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.”

<sup>497</sup> *Statement of Defence*, at paras. 35 & 95-96. Paras. 95 and 96 confirm that the Federal Minister decides whether to issue an export permit both from federal and provincial timberlands.

<sup>498</sup> *Statement of Defence*, at paras. 17-20.

<sup>499</sup> Merrill & Ring Land and Timber Inventory, (Investor’s Schedule of Documents at Tab 6).

<sup>500</sup> NAFTA Article 102(2) provides: “The Parties shall interpret and apply the provisions of this Agreement in the light of its objectives set out in paragraph 1 and in accordance with applicable rules of international law.”

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440. NAFTA Article 201(1) broadly defines a “measure” as “any law, regulation, procedure, requirement or practice.”<sup>501</sup> Canada’s measures easily fit this definition by arising directly and exclusively out of a government requirement that is implemented through governmentally administered practice by government officials.
441. *Black’s Law Dictionary* defines “relate” as “to have bearing or concern.”<sup>502</sup> The drafters of NAFTA did not limit “relating to” with prefixes like “directly” or “substantially.” Canada’s *Statement on Implementation* supports the interpretation that NAFTA Article 1101 was intended to broadly bring foreign Investors and investments within Chapter 11’s protection. This statement, issued on the coming into force of the NAFTA, says:

Article 1101 states that Section A covers measures by a Party (i.e., any level of government in Canada) that *affect*:

- Investors of another Party (i.e., the Mexican or American parent company or individual Mexican or American investor);
- investments of Investors of another Party (i.e., the subsidiary company or asset located in Canada); and
- for purposes of the provisions on performance requirements and environmental measures, all investments (i.e., all investments in Canada).<sup>503</sup>

442. The term “affect” is synonymous with “to have bearing or concern.”<sup>504</sup> In *US-Subsidies on Upland Cotton* the WTO appellate body considered this term as follows:

We agree with the Panel that the word “affecting” refers primarily to “the way in which [measures] relate to a covered agreement.” As the Appellate Body stated in *EC – Bananas III*, “[t]he ordinary meaning of the word ‘affecting’ implies a measure that has ‘an effect on’ something else.”<sup>505</sup>

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<sup>501</sup> NAFTA Article 201(1) provides: “For purposes of this Agreement, unless otherwise specified:… measure includes any law, regulation, procedure, requirement or practice.”

<sup>502</sup> *Black’s Law Dictionary*, 5<sup>th</sup> edition, at page 1158. (Investor’s Book of Authorities at Tab 35).

<sup>503</sup> *Canadian Statement on Implementation* at 148 [emphasis added]. (Investor’s Book of Authorities at Tab 4).

<sup>504</sup> *Black’s Law Dictionary* at p. 262: “Concern” means “to affect the interest of”. (Investor’s Book of Authorities at Tab 35).

<sup>505</sup> *United States - Subsidies on Upland Cotton* - Report of the Appellate Body, WT/DS267/AB/R (3 March 2005) at para. 261. (Investor’s Book of Authorities at Tab 5).

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443. The *Methanex* NAFTA Tribunal has found “the phrase ‘relating to’ ... signifies something more than the mere effect of a measure on an investor or an investment...”<sup>506</sup> The *Methanex* Tribunal said that “relating to” “requires a legally significant connection between”<sup>507</sup> the measure and the investment and investor.
444. Methanex challenged the Governor of the State of California’s Executive Order banning the use of the chemical MTBE in gasoline. The claimant supplied methanol to producers of MTBE, who then supplied MTBE to gasoline makers. While MTBE producers were, therefore, directly affected by the Order, Methanex was not. Rather, the Claimant was among a group of suppliers of the ingredients of MTBE who were only indirectly affected.
445. In contrast, the Tribunal in this case faces a very direct and significant connection between Canada’s measures and their impact on the Investor and its investments.
446. NAFTA tribunals have interpreted Article 1101 consistently with its ordinary meaning and NAFTA’s objectives by deciding that a measure “relates to” an investor or investment if it affects the investor or investment. Partly relying on Canada’s *Statement on Implementation*, the *Pope & Talbot* Tribunal rejected Canada’s arguments that the term required the measure to be “primarily directed” at the investor or investment, accepting that “it is also a measure relating to investment insofar as it might affect an enterprise owned by an investor of a Party.”<sup>508</sup>
447. The NAFTA Tribunal in *GAMI Investments v. Mexico* also rejected arguments that the measure must have a direct link to the investor or investment to be “relating to” it. In that case, the US investor claimed damages to its minority shareholding in a Mexican company, which owned five sugar mills. GAMI claimed that Mexico damaged its investment through general measures affecting the sugar industry. Mexico argued that the measure at issue did not “relate to” GAMI’s investment:

The problem for GAMI is that it has not identified a measure that has [a] legally significant nexus with it or its shares. What is true is that the Government of Mexico has not adopted nor has it

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<sup>506</sup> *Methanex v. Unites States of America*, First Partial Award, 2002 WL 32824210 (August 7, 2002) at para. 147. (Investor’s Book of Authorities at Tab 11).

<sup>507</sup> *Methanex* at para. 147. (Investor’s Book of Authorities at Tab 11).

<sup>508</sup> *Pope & Talbot v. Canada*, Award on Measures Relating to Investment Motion, 2000 WL 34510241 (January 26, 2000) at paras. 33 and 34. (Investor’s Book of Authorities at Tab 7).



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maintained nor does it maintain a measure that refers to the legal interest of GAMI protected by the Treaty...<sup>509</sup>

448. In deferring the issue to be considered to the Merits Phase, the Tribunal disagreed with Mexico's interpretation, saying:

... the Arbitral Tribunal is not convinced by the Respondent's thesis with respect to the meaning of the words "related to" (Article 1101(1)) ...<sup>510</sup>

449. This NAFTA jurisprudence is consistent with jurisprudence from tribunals considering other international treaties. In *Indonesia - Automobiles*, the WTO Panel considered a claim that Indonesia breached Article 2.1 of the WTO Trade Related Investment Measures (TRIMs) Agreement. That Article says: "... no Member shall apply any TRIM that is inconsistent with the provisions of Article III or Article XI of GATT 1994."

450. In considering this WTO case, the Panel had to determine whether the impugned measures were "trade related investment measures" and, therefore, whether the measures "related to" trade. The Panel said:

We now have to determine whether these investment measures are "trade-related." We consider that, if these measures are local content requirements, they would necessarily be "trade-related" because such requirements, by definition, always favour the use of domestic products over imported products, and therefore affect trade.<sup>511</sup>

iv. *The Claim Is Timely*

451. NAFTA Article 1116(2) 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 incurred loss or damage.

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<sup>509</sup> *GAMI Investments v. Mexico*, Transcript of Jurisdictional Hearing, September 17, 2003 at page 8. (Investor's Book of Authorities at Tab 8).

<sup>510</sup> *GAMI Investments v. Mexico*, Procedural Order No. 4, September 25, 2003, at page 1. The Tribunal's ultimate decision meant that it did not need to consider the issue at the merits phase. (Investor's Book of Authorities at Tab 9).

<sup>511</sup> *Indonesia - Certain Measures Affecting the Automobile Industry*, Report of the Panel, WT/DS54/R, WT/DS55/R, WT/DS59/R, WT/DS64/R (July 2, 1998) at para. 14.82 [emphasis added]. (Investor's Book of Authorities at Tab 10).

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452. NAFTA Article 1137(1)(c) provides that “[a] claim is submitted to arbitration under this Section when the notice of arbitration given under the UNCITRAL Arbitration Rules is received by the disputing Party.”<sup>512</sup> Canada received Merrill & Ring’s Notice of Arbitration on December 27, 2006. Consequently, Article 1116(2) bars the claim if the Investor first acquired, or should have first acquired, knowledge of the breach and knowledge that it incurred damage before December 27, 2003.
453. Article 1116(2) does not bar the Investor’s claims because the Investor only challenges Canada’s measures occurring after December 27, 2003. Since the measures occurred after December 27, 2003, the Investor first acquired knowledge of the breach caused by those measures, and the resulting damages, after that date, consistent with the Article.
454. The Investor only challenges specific measures occurring after December 27, 2003 because the Investor only challenges:
- a. measures that began before December 27, 2003 but are continuing today; and
  - b. instantaneous measures occurring entirely after December 27, 2003.
- a. Continuing Measures
455. The International Law Commission has confirmed that time limit rules do not prohibit claims challenging acts that are still continuing because time limits only begin at the end of a continuing act.<sup>513</sup> Professor Joost Pauwelyn confirmed this principle in his seminal *British Yearbook of International Law* study of continuing acts. In that study he stated that “[t]he general principle is that a claim can only be inadmissible on the ground of lapse of time once the breach has ceased to exist, that being the earliest date from which any time limit can possibly start to run.”<sup>514</sup>

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<sup>512</sup> *Feldman v Mexico*, Interim Decision on Preliminary Jurisdictional Issues, ICSID Case No. ARB(AF)/99/1, 2000 WL 34535548 (December 6, 2000) at para. 44 confirms that the receipt of the Notice of Arbitration interrupts the running of the limitation period for the purposes of Article 1116(2). (Investor’s Book of Authorities at Tab 12).

<sup>513</sup> Report of the International Law Commission on the work of its thirtieth session 8 May - 28 July 1978, at 91, n. 437: “... in the case of a ‘continuing’ wrongful act, however, this *dies [a quo]* of the time limit can be established only after the end of the time of commission of the wrongful act itself.” (Investor’s Book of Authorities, Tab 13).

<sup>514</sup> Pauwelyn, J. “The Concept of a ‘Continuing Violation’ of an International Obligation: Selected Problems”, 66 *The British Year Book of International Law* 415 (1996) at 431. (Investor’s Book of Authorities at Tab 79).

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456. International tribunals have consistently refused to bar claims challenging acts that are still continuing. In finding that a claim challenging a provision of the Belgian Penal Code passed many years before was not time barred by the six month limitation in the *European Convention on Human Rights*, the European Commission on Human Rights, for example, said:
- ... when the Commission receives an application concerning ... a permanent state of affairs ... the problem of the six months period specified in Article 26 can arise only after this state of affairs has ceased to exist; whereas in the circumstances, it is exactly as though the alleged violation was being repeated daily thus preventing the running of the six months period.<sup>515</sup>
457. The Commission concluded that Article 123 of the Belgian Penal Code was a continuing act.<sup>516</sup> The Commission rejected Belgium's argument that the claim was time barred because, even though the Code was enacted a long time ago, it was still in force at the time of the application.
458. International tribunals have confirmed that, maintaining a law is a continuing act when finding that claims challenging laws beginning before the treaty's entry into force do not violate the rule against retroactivity. The European Commission on Human Rights, for example, has consistently accepted jurisdiction over claims challenging legislation passed before the Convention came into force.<sup>517</sup>
459. The United Nations' Human Rights Committee has also consistently held that maintaining a law is a continuing act. In *Ibrahima Gueye et al. v. France*, for example, the Human Rights Committee considered the Claimant's argument that French legislation breached Article 26 of the International Covenant on Civil and Political Rights by racially discriminating against Senagalese members of the French army. France objected that the

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<sup>515</sup> *De Becker v. Belgium*, Application No. 214/56, Decision of 9 June 1958, Yearbook of the European Convention on Human Rights (1958-9) at 244 (Investor's Book of Authorities at Tab 16). See also the decisions of the European Court and Commission of Human Rights in: *Kevin McDaid and Others v. the United Kingdom*, Application No. 25681/94, Decision of 9 April 1996 (Investor's Book of Authorities at Tab 17): "Insofar as the applicants complain that they are victims of a continuing violation to which the six month is inapplicable, the Commission recalls that the concept of a "continuing situation" refers to a state of affairs which operates by continuous activities by or on the part of the State to render the applicants victims"; *Hilton v. UK*, Application No. 12015/86, Decision of 6 July 1988, at 13: "The Commission further observes that the six months rule does not apply... to a complaint [which] concerns a continuing situation." (Investor's Book of Authorities at Tab 18).

<sup>516</sup> *De Becker* at 231. (Investor's Book of Authorities at Tab 16).

<sup>517</sup> See, for example, *Marckx v. Belgium*, Application No 6833/74, June 13, 1979 at para. 41. (Investor's Book of Authorities at Tab 29).

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Covenant did not enter into force with respect to France until after the Act came into force. The Committee rejected this argument, concluding:

...it remained to be determined whether there had been violations of the Covenant subsequent to the said date, as a consequence of acts or omissions related to the continued application of laws and decisions concerning the rights of the applicants.<sup>518</sup>

460. Similarly, in *Simunek, Hastings, Tuzilova and Prochazka v. The Czech Republic*, the applicants claimed before the Human Rights Committee that Czech legislation also breached Article 26 of the International Covenant on Civil and Political Rights because it was discriminatory. The Committee concluded that because the Act represented a continuing violation of the Covenant, they had jurisdiction to hear the dispute, despite the fact that the Covenant only came into force with respect to the Czech Republic two years after the Act was passed.<sup>519</sup>
461. In *Sandra Lovelace v. Canada*, the Human Rights Committee concluded that a Canadian Act coming into force *one hundred years* before the International Covenant on Civil and Political Rights created a continuing situation that could still breach the Covenant.<sup>520</sup>
462. The Inter-American Commission on Human Rights has also found that laws create continuing situations. In *Andres Aylwin Azocar and Otros v. Chile*, the Inter-American Commission on Human Rights refused to time bar a claim challenging provisions of the Chilean constitution enacted eighteen years before.<sup>521</sup> In so doing it stated:

... in relation to the grounds of inadmissibility contained in Article 46(1)(b) of the Convention, which was alleged by the Chilean State and referred to the six-month period for submitting the complaint, the Commission indicated that the consequences or the legal and factual effects of the Constitutional provisions that have been called into question, as well as their invariable and continuing application ... since 1990, extend to the date of submission of the complaint and even

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<sup>518</sup> *Ibrahima Gueye et al. v. France*, Communication No. 196/1983 (3 April 1989), UN Doc. Supp. No. 40 (A/44/40) at 189 (1989) at para. 5.3. (Investor's Book of Authorities at Tab 30).

<sup>519</sup> *Simunek, Hastings, Tuzilova and Prochazka v The Czech Republic*, Communication No. 516/1992, U.N. Doc. CCPR/C/54/D/516/1992 (31 July 1995) at paras. 4.5 to 5. (Investor's Book of Authorities at Tab 31).

<sup>520</sup> *Sandra Lovelace v Canada*, Communication No. R.6/24 (29 December 1977), U.N. Doc. Supp. No. 40 (A/36/40) at 166 (1981) at para. 7.3. (Investor's Book of Authorities at Tab 32).

<sup>521</sup> *Andres Aylwin Azocar* at para 27. (Investor's Book of Authorities at Tab 21).

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afterwards, which definitely makes the provisions of the American Convention invoked by petitioners applicable to this situation.<sup>522</sup>

463. International tribunals do not apply limitation provisions to continuing acts because prohibiting a claim while the wrongful government action continues would not serve the purposes behind such limitations. Tribunals and commentators generally recognize that time limits, such as NAFTA Article 1116(2), have two main purposes: to enable the respondent to collect evidence in its defence and to provide certainty and stability.<sup>523</sup>
464. Prohibiting claims challenging continuing acts fulfils neither of these purposes. The continuing action continually generates new evidence and the state's continuing breach of its treaty obligations undermines certainty and stability. Aside from failing to fulfil the purposes of time bars, prohibiting claims challenging continuing state action also produces the absurd result that states could breach their obligation forever if potential investors miss their window to claim.

b. NAFTA Article 1116(2) Does Not Bar Claims Challenging Continuing Acts

465. NAFTA Article 1116(2) is consistent with the international law rule that time limit provisions do not bar claims challenging continuing acts. Both the *Feldman* and *UPS* NAFTA Tribunals refused to apply Article 1116(2) to bar claims challenging acts that were still continuing. The Tribunals refused to bar the claims because international law accepts that in continuing an action inconsistent with international law, a state is taken to repeat that action every day and, therefore, commits a separate breach of international law every day. The claimant first becomes aware of this separate breach every day and, therefore, cannot be time barred while the state continues to breach its obligation.
466. Hence, the *UPS* NAFTA Tribunal said:

... continuing courses of conduct constitute continuing breaches of legal obligations and *renew* the limitation period accordingly.<sup>524</sup>

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<sup>522</sup> *Andres Aylwin Azocar and Otros v Chile*, Case 11.863, Report N° 137/99, Inter-American Court of Human Rights, OEA/Ser.L/V/II.106 Doc. 3 rev. at 536 (1999) at para. 27 (Investor's Book of Authorities at Tab 21).

<sup>523</sup> G. Mew, *The Law of Limitations*, 2nd ed., (Markham: Butterworths, 2004) at 12. (Investor's Book of Authorities at Tab 3). *Peter Blaine v. Jamaica* at para. 52 (Investor's Book of Authorities at Tab 19); *Wena Hotels* at paras. 102 - 105. (Investor's Book of Authorities at Tab 23).

<sup>524</sup> *UPS* at para. 28. [emphasis added]. (Investor's Book of Authorities at Tab 14).

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467. The *UPS* Tribunal went on to say:

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 acquired further information confirming the conduct or allowing more precise computation of loss. The Feldman tribunal's conclusion on this score buttresses our own.<sup>525</sup>

468. The *Feldman* NAFTA Tribunal reached the same conclusion. In that case, the Tribunal considered a claim that Mexico had breached its NAFTA obligations by failing to rebate tax expenses to the investor. Mexico first refused to rebate the taxes in 1990, but continued to refuse to rebate until the investor brought a claim in 1999. Even though the investor claimed more than three years after the measure began, the Tribunal rejected Mexico's argument that the claim was time barred and went on to find that Mexico's continuing act breached the NAFTA.<sup>526</sup>

469. These decisions are consistent with the landmark decision of the European Commission on Human Rights in *De Becker*. In that case, the Commission said that, because the act was continuing, "it is exactly as though the alleged violation was being repeated daily thus preventing the running of the six months period."<sup>527</sup> Dozens of subsequent decisions of the European Commission and Court of Human Rights,<sup>528</sup> as well as academics and the ILC,<sup>529</sup> have referred to *De Becker* as authority on the effect of continuing acts.

470. As a result, it is clear that NAFTA tribunals have consistently followed the well-established doctrine of continuous breach.

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<sup>525</sup> *UPS* at para. 28. (Investor's Book of Authorities at Tab 14).

<sup>526</sup> The *Feldman* Tribunal at para. 187 said: "The inescapable fact is that the Claimant has been effectively denied IEPS rebates for the April 1996 through November 1997 period, while domestic export trading companies have been given rebates not only for much of that period but through at least May 2000 ..." The Tribunal went on to say "...the factual pattern in this case ... demonstrates a pattern of official action (or inaction) over a number of years, as well as de facto discrimination that is actionable under Article 1102" (para. 188). (Claimants Book of Authorities, Tab 15).

<sup>527</sup> *De Becker* at 244. (Investor's Book of Authorities at Tab 16).

<sup>528</sup> See, for example, *Thomas McFeeley and Others v. United Kingdom*, Application 8317/78, European Commission of Human Rights, Decision of 15 May 1980, at paras. 24-26. (Investor's Book of Authorities at Tab 24).

<sup>529</sup> Paulwelyn at 431. (Investor's Book of Authorities at Tab 79). Crawford, J. *The International Law Commission's Articles on State Responsibility: Introduction, Text and Commentaries* (Cambridge: Cambridge University Press, 2003) at 136. (Investor's Book of Authorities at Tab 27).

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c. Canada Breaches the NAFTA Through Measures Continuing Today

471. International law commentators and tribunals have consistently affirmed that the maintenance in force of a law is a continuing act. Canada's maintenance in force of the Federal Surplus Test, through Notice 102, is therefore, an act that continues to this day. The Investor's claim challenging the Federal Surplus Test, therefore, cannot be time barred.
472. In general, the Investor's claim challenges three measures that began before December 27, 2003 but are continuing today, namely:
- a) The application of the surplus testing procedure to Merrill & Ring;
  - b) The failure to grant standing timber exemptions to Merrill & Ring; and
  - c) The administration of other aspects of the Federal Log Export Control Regime (apart from the surplus testing procedure) to Merrill & Ring.

These are discussed in greater detail below.

*i. The Application of the Surplus Testing Procedure to Merrill & Ring*

473. Canada's breach of the NAFTA through the surplus testing procedure continues today. The surplus testing procedure has been in place since before the NAFTA came into force in Canada. Canada has breached the NAFTA in a general sense every time it has applied the surplus testing procedure to any exporter applicants logs since that time. These breaches continue to this day. For the particular purposes of this case, however, the breaches manifested each time Canada has applied the surplus testing procedure to Merrill & Ring's logs between December 27, 2003 and December 27, 2006.

*ii. The Failure to Grant Standing Timber Exemptions to Merrill & Ring*

474. The ILC has recognized that omissions are continuing:

As long as it is protracted beyond the date within which such an obligation is due to be performed, non-compliance with an *obligation de faire* is a wrongful act of a continuing character.<sup>530</sup>

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<sup>530</sup> *Preliminary Report on State Responsibility (1988)*, Mr. Gaetano Arangio-Ruiz, ILC Special Rapporteur UN Doc A/CN.4/416 at para 42: "The Special Rapporteur is inclined to believe that omissive wrongful acts may well fall (as well as, and perhaps more frequently than, commissive wrongful acts) into the category of wrongful acts having a continuing character. As long as it is protracted beyond the date within which such an obligation is due to be

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475. Canada's failure to grant standing exemptions to landowners subject to federal regulation is an omission and, therefore, continuing. The Investor's claim challenging Canada's failure to grant standing exemptions to landowners subject to federal regulation, therefore, cannot be time barred.

*iii. The Administration of Other Aspects of the Federal Log Export Control Regime (Apart from the Surplus Testing Procedure) to Merrill & Ring*

476. Each manner in which Canada administers the Log Export Control Regime unfairly continues today:

- a) Notice 102, and its arbitrary requirements, are still in force;
- b) Canada continues to encourage and/or condone 'blockmailing' by bidders to obtain concessions;<sup>531</sup>
- c) Canada continues to encourage and/or condone non *bona fide* purchase offers to block logs from export;<sup>532</sup>
- d) Several of FTEAC's current members have conflicts of interest;<sup>533</sup>
- e) Canada's failure to require decisions that are transparent is an omission and, therefore, still continues while Canada fails to act;
- f) Canada's failure to require decisions based on set criteria is an omission and, therefore, still continues while Canada fails to act;
- g) Canada's failure to provide an appeal or review of decisions is an omission and, therefore, still continues while Canada fails to act.

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performed, non-compliance with an *obligation de faire* is a wrongful act of a continuing character." (Investor's Book of Authorities at Tab 33).

<sup>531</sup> Witness Statement of Tony Kurucz at section C, paras. 58 - 74.

<sup>532</sup> Witness Statement of Tony Kurucz at section C, paras. 58 - 74.

<sup>533</sup> See Memorial section G.ii.c.



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477. Since each manner in which Canada administers the Log Export Control Regime unfairly continues today, the Investor' claim challenging the administration of that Test cannot be time barred.

d. Canada Has Breached the NAFTA through Non-Continuing Measures Occurring Within the Time Limitation

478. In addition to breaching the NAFTA through its measures that are still continuing today, Canada also breached the NAFTA through non-continuing measures occurring since December 27, 2003. Specifically, Canada breached the NAFTA each time after that date that it applied its challenged laws and policies. These measures include:

479. In general, the Investor's claim challenges three measures that began before December 27, 2003 but are continuing today, namely:

- a) The application of the surplus testing procedure to Merrill & Ring;
- b) The failure to grant standing timber exemptions to Merrill & Ring; and
- c) The administration of other aspects of the Federal Log Export Control Regime (apart from the surplus testing procedure) to Merrill & Ring.

These are discussed in greater detail below.

i. *The Log Export Control Regime*

480. Canada breached the NAFTA each time since December 27, 2003 that Canada required the Investor to undergo the procedures set out by the Log Export Control Regime before exporting.<sup>534</sup> Specifically, Canada breached the NAFTA on each occasion after December 27, 2003 that Merrill & Ring applied for an export permit under Notice 102 and Canada applied the federal surplus test in considering that application.

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<sup>534</sup> See Merrill & Ring *Notice of Intent* at para. 20: "... Canada violates its obligations under NAFTA Chapter 11 each time that federal export control requirements force Merrill & Ring to sell its logs at the artificially reduced British Columbia price."

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ii. *Standing Timber Exemptions*

481. Canada breached the NAFTA each time since December 27, 2003 that it failed to grant the Investor standing timber exemptions similar to those given to landowners subject to provincial regulation.<sup>535</sup>

iii. *Unfair Administration of the Log Export Control Regime*

482. Canada breached the NAFTA each time since December 27, 2003 that Canada administered the Log Export Control Regime.<sup>536</sup> Specifically, Canada breached the NAFTA by:

- a) requiring the Investor to undergo arbitrary requirements on each occasion after December 27, 2003 that the Investor applied for an export permit under Notice 102. Appendix 2 details these occasions;
- b) each incident of 'blockmailing' allowed or condoned since December 27, 2003;<sup>537</sup>
- c) allowing non *bona fide* purchaser offers to block logs from export since December 27, 2003. Specifically, Canada breached the NAFTA by:
  - i. failing to reject a competitor's bid in 2005, even though the company was using Canadian logs in its US mills;<sup>538</sup>

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<sup>535</sup> See Merrill & Ring *Notice of Intent* at para. 24: "DFAIT's refusal to allow standing timber exemptions on the same terms as those available to provincially regulated landowners violates NAFTA Chapter 11 provisions ...;" Statement of Claim at para. 37: "... private timber companies are treated more favorably than Merrill & Ring. The private timber companies benefit from standing timber exemptions that are not available to Merrill & Ring;" Notice of Arbitration at para. 10: "This regime is administered in an arbitrary and discriminatory manner that allows the Investor's competitors to benefit from exemptions that are denied to the Investor ...;" and para. 28: "... DFAIT's application of the Federal Surplus Test violates NAFTA Article 1102 by treating Merrill & Ring and its investments less favorably than certain Investor and investments in British Columbia subject to provincial regulation. It does so by denying Merrill & Ring exemptions that are available to exporters from provincially regulated lands."

<sup>536</sup> See Merrill & Ring *Notice of Intent* at para. 26: "The arbitrary and unfair administration of the log export regime violates Canada's obligations under NAFTA Chapter 11 ...;" Statement of Claim at para. 45: "Canada fails to provide Merrill & Ring with the international law standard of treatment. through the operation of six measures: ...;" Notice of Arbitration at para. 10: "This regime is administered in an arbitrary and discriminatory manner that allows the Investor's competitors to ... abuse export permit procedures."

<sup>537</sup> Testimony of John McCutcheon, *TimberWest v. Canada*, Transcript of June 5, 2006, at 767-768, (Investor's Schedule of Documents at Tab 37).

<sup>538</sup> C-1(b)(ii) and C-1(b)(iv)

C-1(b)(ii) and C-1(b)(iv) letter from Paul Stutesman, Merrill & Ring to Judy Korecky, Department of Foreign Affairs and International Trade, dated October 11, 2005, (Investor's Schedule of Documents at Tab 70).

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- ii. failing to reject bids from a subsidiary of a company that regularly purchases logs for export to Japan;<sup>539</sup>
  - d) appointing persons who appear to have clear and direct conflicts of interest to sit on FTEAC from February 6, 2004 and January 14, 2005, respectively;<sup>540</sup>
  - e) individual decisions to block the Investor's exports of the following rafts without explaining the criteria on which those decisions were based.<sup>541</sup>
  - f) Canada's failure to provide an appeal or review of the same decisions.

Since all these acts administrating the Log Export Control Regime unfairly occurred after December 27, 2003, the claims challenging those acts cannot be time barred.

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<sup>539</sup> Letter from Paul Stutesman, Merrill & Ring to Judy Korecky, Department of Foreign Affairs and International Trade, March 13, 2006, (Claimant's Schedule of Documents at Tab 47); See also E-mail from Paul Stutesman to Judy Korecky, May 10, 2006, (Investor's Schedule of Documents at Tab 48); C-1(b) (iv)

C-1(b) (iv)

<sup>540</sup> See Memorial section II.G.ii.c.

<sup>541</sup> See for example: Letter of Michael Rooney, DFAIT to Karen Kurucz, Merrill & Ring, dated November 17, 2004 re Raft MRE-4-97-476, (Investor's Schedule of Documents at Tab 71); Letter of Michael Rooney, DFAIT to Karen Kurucz, Merrill & Ring, dated November 17, 2004, re Raft MRM-4-97-731, (Investor's Schedule of Documents Tab 72); Letter of Michael Rooney, DFAIT to Karen Kurucz, dated November 17, 2004 re Raft MRT-4-97-203, (Investor's Schedule of Documents at Tab 73).

*Merrill & Ring Forestry L.P.*

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**PART SEVEN: RELIEF REQUESTED**

483. In view of the facts and arguments set out in this Memorial, Merrill & Ring respectfully requests that the Tribunal grant the following relief:

- a) A Declaration that Canada has acted in a manner inconsistent with its NAFTA obligations under Articles 1102, 1105, 1106 and 1110.
- b) Damages in the amount of CND\$23,976,806 plus interest from December 31, 2007 at a rate set by the Tribunal.
- c) An award in favor of Merrill & Ring for its costs, disbursements and expenses incurred in the liability phase of the arbitration for legal representation and assistance, plus interest and for the costs of the Tribunal.

ALL OF WHICH IS RESPECTFULLY SUBMITTED



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Appleton & Associates International Lawyers

Date: February 13, 2008