IN THE ARBITRATION
UNDER CHAPTER ELEVEN OF THE NAFTA
AND THE ICSID ARBITRATION (ADDITIONAL FACILITY) RULES

BETWEEN:

MOBIL INVESTMENTS CANADA INC. &
MURPHY OIL CORPORATION

Claimants

AND

GOVERNMENT OF CANADA

Respondent

ICSID Case No. ARB(AF)/07/4

CLAIMANTS' REPLY MEMORIAL

ARBITRAL TRIBUNAL:

Professor Hans van Houtte, President
Professor Merit Janow
Professor Philippe Sands

April 8, 2010

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TABLE OF ABBREVIATIONS AND DEFINED TERMS

1986 Exploration Phase Guidelines	CNLOPB, Guidelines for Benefits Plan Approval and Reporting Requirements for Exploration Activities in the Newfoundland Offshore Area (1986)
1987 Exploration Phase Guidelines	CNLOPB, Exploration Benefits Plan Guidelines: Newfoundland Offshore Area (1987)
1988 Development Application Guidelines	CNLOPB, Development Application Guidelines: Newfoundland Offshore Area (1988)
2006 Exploration Phase Guidelines	CNLOPB, Exploration Benefits Plan Guidance, attached as Appendix I to Canada- Newfoundland and Labrador Benefits Plan Guidelines (Feb. 2006)
CAPP	Canadian Association of Petroleum Producers
CAT	Commissioner General for Supply and Transport
C-CORE	Center for Cold Ocean Research
CM	Claimants' Memorial
CNLOPB	Canada-Newfoundland and Labrador Offshore Petroleum Board

CRA	Canada Revenue Agency
DCF	Discounted Cash Flow
E&T	Education and Training
EIA	US Energy Information Agency
ESAI	Energy Security Analysis, Inc.
FIRA	Foreign Investment Review Act
GATT	General Agreement on Tariffs and Trade
GATS	General Agreement on Trade in Services
Guidelines	CNLOPB, Guidelines for Research and Development Expenditures (Oct. 2004)
Hibernia Benefits Plan	Mobil Oil Canada, Hibernia Canada/ Newfoundland Benefits Plan (Sept. 15, 1985)
HMDC	Hibernia Management and Development Company Ltd.

IEA	International Energy Agency
MAI	Multilateral Agreement on Investment
NAFTA	North American Free Trade Agreement
NEB	National Energy Board
POA	Production Operations Authorization
PRAC	Petroleum Research Atlantic Canada
RM	Respondent's Counter-Memorial
SR&ED	Scientific Research and Experimental Development
R&D	Research and Development
R&D Expenditure Guidelines	CNLOPB, Guidelines for Research and Expenditure Development Expenditures (Oct. 2004) Guidelines
Terra Nova Benefits Plan	Petro-Canada, Terra Nova Development: Canada-Newfoundland Benefits Plan (undated)
TRIMS	Trade-Related Investment Measures

UNCTAD	United Nations Conference on Trade and Development
VCLT	Vienna Convention on the Law of Treaties
WACC	Weighted Average Cost of Capital

I.

INTRODUCTION

1. Claimants' Memorial presented their claims in a direct and straightforward manner. The R & D Expenditure Guidelines issued in 2004 by the Canada-Newfoundland Offshore Petroleum Board ("CNLOPB" or "Board") violated two separate provisions of the North American Free Trade Agreement ("NAFTA"): Article 1106, which prohibits performance requirements, and Article 1105, which guarantees fair and equitable treatment to foreign investors. The Guidelines imposed for the first time mandatory requirements to spend fixed amounts on research and development ("R&D"), and they also imposed a new requirement of pre-approval by the Board of individual R&D expenditures. Previously, the Hibernia and Terra Nova Benefits Plans, to which the Board and Canada had specifically agreed, had merely required that the operators of those projects spend on R & D whatever was required for the project needs, focused especially on the challenging offshore environment in the northern ocean, and that, in doing so, they give priority consideration to local providers on a competitive basis.

2. Canada cannot realistically dispute that, as a result of the Guidelines, Claimants will have to pay out millions of dollars every year in excess of their projects' needs. Indeed, the Hibernia and Terra Nova operators remain in active discussions with the Board about how the projects will spend the combined $45 million shortfall found by the Board for the years 2004-2008 for these two projects, and the means by which they will post bonds to guarantee spending of that shortfall amount. The Guidelines are particularly burdensome to these projects, because they are mature projects for which significant R&D has already been spent in the Province

(approximately $163.7 million prior to the enactment of the Guidelines in 2004). At this stage in their production cycles, reliance on technological innovation will be limited in the future as the Hibernia and Terra Nova project mature.

3. In Canada's Counter-Memorial, it does not dispute the essential facts that Claimants have presented. In attempting to distract the Tribunal from the import and the plain meaning of the NAFTA text, Canada focuses largely on irrelevant facts and sources, uses partial quotations and makes unsupported assertions often contradicted by the documents that are in the record. For example,

- Canada ignores the plain meaning of the term "services" in Article 1106(1)(c) of the NAFTA, which clearly encompasses research and development and education and training, as well as its context in the NAFTA and Canada's own use of the term "services." Canada relies on documents that are entirely unrelated to the NAFTA to argue that Article 1106(1) excludes R&D or education and training ("E&T") from the term "services" — a limitation nowhere suggested by the plain text of the provision.

- Canada argues, without any documentary support, that its own listing of the Accord Acts' requirement that benefit plans include R&D expenditures as a non-conforming measure in Annex I to the NAFTA does not mean that it was actually non-conforming, despite the clear text of the NAFTA to the contrary.

- Canada bizarrely contends that the Guidelines do not violate Article 1106(1) because the projects could spend their mandated tens of millions of dollars on E&T, rather than R&D. This argument not only ignores the focus (indeed, even the title) of

the R&D Expenditure Guidelines, but it also again ignores the plain meaning of the term "services" in Article 1106(1)(c), which includes E&T as well as R&D. Canada pretends that the article prohibits only requirements regarding purchasing of services, when in fact it prohibits the NAFTA parties from requiring investors to "purchase, use or accord a preference" to local services.

- Canada's argument that the Guidelines qualify as an "existing non-conforming measure" under its Annex I reservation to Article 1106 relies on treating the past tense — "adopted or maintained" — as if it referred to the future. The Guidelines issued in 2004 were certainly not existing in 1994. When the NAFTA Parties in fact intended to refer to future measures, they specifically said so and used a different tense.

- Canada regularly pretends, through partial quotes of Article 45, that the Accord Acts directly require expenditures on R&D and E&T. The full text of Article 45 shows that it in fact requires an operator's *benefits plan* to "contain provisions intended to ensure that" expenditures on R&D and E&T shall be made in the province. The Hibernia and Terra Nova Benefits Plans contain provisions meeting this requirement. The Guidelines have imposed radically different obligations from those set forth in the plans.

- Canada provides absolutely no documentary support for its propositions, which are critical to its defenses to the Article 1105 claim, (i) that the monitoring requirements in the Benefits Plans signaled an intent potentially to impose mandatory requirements like the Guidelines and (ii) that the Board imposed the

Guidelines because it was dissatisfied with the R&D spending levels at Hibernia and Terra Nova. Neither the Benefits Plans nor the Guidelines made any such assertions, and contemporaneous documents show the contrary.

- Canada also rests its defense to the Article 1105 claim on a single recent decision, *Glamis*, that is contrary to all the other NAFTA tribunal decisions that have considered Canada's argument that the NAFTA Parties intended to freeze customary international law obligations of fair and equitable treatment as set forth in a 1926 decision, *Neer*, that did not even consider that standard. To the contrary, Article 1105 encompasses at least the standard of fair and equitable treatment as it existed in 1994, which clearly included the doctrine of legitimate expectations.

- Canada argues that Claimants are not entitled to compensation for past damage or forward-looking losses. In making this argument, Canada either misstates, conflates, or completely ignores applicable legal principles, and bases its submissions on exaggerated prophecies. In fact, the Counter-Memorial's rosy predictions that the Board might take a liberal approach to recognizing R&D expenses were contradicted a mere ten days later, when the Board disallowed about [redacted] of the R&D expenditures that Claimants believed fell within the Guidelines.

4. In this Reply Memorial, Claimants will rebut these and the many other assertions that Canada made in its Counter-Memorial. Because Canada had not presented any defense prior to that Counter-Memorial, this Reply Memorial is Claimants' first opportunity to respond to Canada's

positions. As is shown below, when the Tribunal considers the actual text and context of the NAFTA, as opposed to what Canada wishes it says, and the full documentary record, as opposed to the many assertions for which Canada has admitted that it has no factual support, it should find that the Guidelines violate Canada's obligations under Articles 1106 and 1105 of the NAFTA, and that Claimants are entitled to the full damages that this wrongful measure has caused them.

II.

THE FACTS

5. Canada's submission confirms the accuracy of the factual record as presented in Claimants' Memorial. Although the parties may disagree about the interpretation of, and significance to be accorded to, certain facts and issues, the essential factual underpinnings of Claimants' case are undisputed. Claimants are therefore submitting only two additional witness statements, both of which focus on events that have occurred since their Memorial was submitted in August 2009.[1]

6. The parties agree that when the Board gave its approval to develop the Hibernia and Terra Nova oil fields,

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[1] See Second Witness Statement of Paul Phelan (hereinafter "Phelan Witness Statement II"); Second Witness Statement if Andrew Ringvee (hereinafter "Ringvee Witness Statement II"). Claimants are also submitting reply expert reports from Sarah Emerson, regarding oil price forecasts, and Howard Rosen, regarding the calculation of damages. *See* Second Expert Report of Sarah A. Emerson (hereinafter "Emerson Report II"); Second Expert Report of Howard N. Rosen (hereinafter "Rosen Report II"). Claimants have also prepared a brief timeline of events which is included as Annex B to this Memorial.

the R&D and E&T obligations of the project operators were limited to those set forth in the Accord Acts themselves and the Board's decisions approving the Hibernia and Terra Nova Benefits Plans. The parties further agree that neither the Accord Acts nor the Board's decisions approving the Hibernia or Terra Nova Benefits Plans established any requirement to meet a prescribed level of expenditures on R&D or E&T.

7. Rather, the Accord Acts simply required submission by the project proponent and approval by the Board of a benefits plan with provisions intended to ensure expenditures on R&D and E&T in the Province.[2] The Acts left it to the project proponent to propose in the benefits plans, and to the Board to review and approve, R&D and E&T plans tailored to the individual project. The Acts allowed the investors to act in accordance with the commercial considerations of the projects.

8. Both the Hibernia and Terra Nova Benefits Plans, as approved by the Board, contained two types of commitments with respect to R&D and E&T. *First*, each Plan pledged adherence to two fundamental principles embodied in the Accord Acts: full and fair opportunity to Canadians and first consideration to Newfoundlanders in the procurement of goods and services on a competitive basis.[3] *Second*, each Plan identified potential areas where research might be undertaken to address problems unique to the Arctic offshore environment, such as development of iceberg detection,

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[2] **CA-11**, *Canada-Newfoundland Atlantic Accord Implementation Act*, S.C., 1987, c. 3 (hereinafter "*Federal Accord Act*"), § 45; **CA-12**, *Canada-Newfoundland and Labrador Atlantic Accord Implementation Newfoundland and Labrador Act*, R.S.N.L. 1990, c. C-2 (hereinafter "*Provincial Accord Act*"), § 45.

[3] **CE-45**, Hibernia Benefits Plan, § 2.1 (Sept. 15, 1985); **CE-168**, Terra Nova Benefits Plan, § 2.3.

tracking and management systems.[4] Such problems were important commercial and technical considerations for the projects. Neither Plan contained any quantitative standards for R&D or E&T or any commitment to carry out research in any particular area. The operators would undertake an unspecified amount of research in the course of project operations to address legitimate technical and commercial needs, and in so doing, would look first to local providers to perform the work on a competitive basis. Canada does not argue otherwise.[5]

9. Canada tries to read into the Hibernia and Terra Nova Benefits Plans a possibility that the Board might someday impose additional requirements with respect to R&D and E&T.[6] This ignores the context in which the Benefits

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[4] **CE-45**, Hibernia Benefits Plan, § 3.5.4; **CE-168**, Terra Nova Benefits Plan, § 7.2. The record requires clarification with respect to the Terra Nova Benefits Plan. In connection with their initial Memorial, Claimants introduced a document labeled **CE-56**, which they believed at the time to constitute the entire Terra Nova Benefits Plan. In fact, that document is only a portion of the Plan. The complete Terra Nova Benefits Plan, which contains the R&D commitments discussed at paragraph 78 of the Memorial, is provided in connection with this Reply Memorial as **CE-168**. Because Claimants were in fact aware of those commitments and simply were mistaken as to the manner in which they had been communicated to the Board, Claimants' analysis of the commitments relating to the Terra Nova project does not change. *See* Claimants' Memorial (hereinafter "CM") ¶ 78.

[5] Canada attempts to deny that the Benefits Plans as approved by the Board in fact granted project operators discretion to undertake R&D and E&T expenditures only as needed, see Respondent's Counter-Memorial (hereinafter "RM") ¶¶ 48, 72, but Canada is unable to point to any language in the Benefits Plans or the Board's decisions that suggests otherwise.

[6] RM ¶¶ 45-47; 71-72; *see infra*, ¶¶ 153-165.

Plans were negotiated and in which Canada had accepted, and publicly represented, that undertakings such as those in a benefits plan had to be consistent with what was commercially reasonable.[7] There can be no dispute, however,

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[7] In 1985, it was Canada's practice to request foreign investors in Canada to submit undertakings as part of the approval process under both the Foreign Investment Review Act (FIRA), and the Investment Canada Act, which was adopted in June of that year. Canada is on the record as stating in 1984, one year prior to the submission of the Hibernia Benefits Plan, that "it was *highly unlikely* that purchase undertakings [requirements] would either be offered or sought that *departed significantly from the purchasing practices the investor would follow in the absence of the undertaking*. Where undertakings were given, they reflected a decision by the investor about how he intended to conduct his business in Canada." *See* **CA-88**, *Canada - Administration of the Foreign Review Act*, GATT Panel Report, L/5504 - 30S/140, ¶ 3.6 (Feb. 7, 1984) (emphasis added). If an investor committed to a specific undertaking, it was asked at regular intervals for a progress report. Canada's practice was to review the investor's undertakings approximately every five years. If an investor was unable to fulfill an undertaking, this would lead to "discussions … and perhaps to the negotiation of new undertakings. Like any contract, an undertaking can be modified with the *consent* of both parties." *Id.* ¶ 2.11 (emphasis added). While Canada's submissions to the GATT Panel concerned the FIRA, the same mechanisms for approval of foreign investments were largely continued under the Investment Canada Act. *See* **CA-81**, *Investment Canada Act*, R.S. 1985, c. 28 (1st Supp.) (hereinafter "*Investment Canada Act*"), §§ 25, 39(1), 39.1, 40(1). *See also* **CA-82**, Industry Canada, *Investment Canada, Guidelines – Administrative Procedures*, www.ic.gc.ca/eic/site/ica-lic.nsf/eng/lk00064.html (last checked April 5, 2010); **CA-137**, Stephen Globerman, *An Evaluation of the Investment Canada Act and its Operations*, pp. 7-13 (March 2008). The Tribunal will recall that Canada made a specific reservation with regard to this Act in its Annex I reservation to the NAFTA. **CA-7**, NAFTA, Annex I, Schedule of Canada, exception for Investment Canada Act et al.

that the Board never did so until it promulgated the R&D Expenditure Guidelines at issue in this arbitration. Thus, even accepting *arguendo* that — setting aside NAFTA-based prohibitions — the Board enjoyed some latent authority, under the Accord Acts or otherwise, to impose supplemental R&D and E&T requirements, it is undisputed that the Board did not exercise that authority until 2004, two decades after approving the Hibernia Benefits Plan and a full decade after the NAFTA froze the nature of Claimants' R&D and E&T obligations at a moment in time.[8]

10. Prior to promulgation of the R&D Expenditure Guidelines, the Board's only guidelines relating to R&D and E&T applied exclusively to the exploration phase of projects.[9] These guidelines only provided guidance to project operators *in the preparation of benefits plans*. They specifically ceased to apply once a benefits plan was approved and the development phase of the project commenced.[10] Accordingly, even if the Board had followed through on its intention, noted

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[8] Although the Terra Nova Benefits Plan was not submitted or approved until after the NAFTA went into effect, Canada's Annex I reservation for the Federal Accord Act permitted the Board to implement its Section 45 requirement to provide for R&D and E&T in a benefits plan. **CA-7**, NAFTA, Annex 1, Schedule of Canada.

[9] **CE-32**, 1986 Exploration Phase Guidelines, § 1.0; **CE-33**, 1987 Exploration Phase Guidelines, § 1.0; **RE-9**, 1988 Development Application Guidelines, § 5.0. Canada takes issue with Claimants' failure to address the 1988 guidelines in their Memorial, but the terms related to R&D are substantively indistinguishable from the terms of the 1987 Exploration Phase Guidelines, which also continued to apply. *See infra* note 12.

[10] RM ¶ 51 ("Like the 1986 Exploration Phase Guidelines, the 1987 Guidelines applied only to the exploration phase of projects and did not apply to the subsequent development and production phases."); *see also id.* ¶ 38.

in its 1986 Exploration Phase Guidelines, to develop guidelines for R&D expenditure amounts, those guidelines would have applied only to aid project operators in preparing benefits plans for consideration by the Board. They would not have augmented the R&D and E&T terms of approved benefits plans.[11]

11. Canada does not deny that the R&D Expenditure Guidelines established, by design, a fundamentally different and more onerous regulatory requirement than the pre-existing regime. Like the Accord Acts themselves and the FIRA mechanism of undertakings, the prior exploration phase guidelines had simply called for project proponents to describe in their benefits plans their intentions with regard to R&D and E&T.[12] However, the R&D Expenditure Guidelines have imposed a prescribed expenditure requirement intended to generate artificial demand for R&D and E&T services in the Province. That requirement applies equally to projects with and without previously approved benefits plans, and it will result in millions more dollars per year in R&D and E&T expenditures than the Hibernia and Terra Nova project owners

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[11] Canada disputes the notion that the Board "abandoned" its plans to develop guidelines for R&D expenditure amounts in the development phase when it issued the 1987 Exploration Phase Guidelines, *see* RM ¶¶ 53, 285. However, the fact is that it removed any indication that it might do so from the 1987 version. **CE-33**, 1987 Exploration Phase Guidelines. While the Board indicated that it might revise the 1987 Guidelines from time to time, RM ¶ 53, it did not do so until February 2006. *See* **CE-34**, 2006 Exploration Phase Guidelines; CM ¶¶ 51, 175-176. Thus, it is undisputed that when the NAFTA took effect in 1994, the Board had no guidelines for R&D expenditure amounts in the development phase and no stated plans to issue any.

[12] **CE-32**, 1986 Exploration Phase Guidelines, § 3.5; **CE-33**, 1987 Exploration Phase Guidelines, § 3.5; **RE-9**, 1988 Development Application Guidelines, § 5.2.5.

otherwise would make pursuant to their approved Benefits Plans.

12. Because Canada cannot effectively defend against Claimants' case on these undisputed facts, Canada fills its submission with an extended discussion of factual points that either do not matter to the legal issues presented or that lack even a modicum of support in the evidentiary record. These arguments are but a distraction. Indeed, Canada does not even attempt to tie many of its factual claims to its legal arguments. Other factual statements by Canada are plainly inconsistent with the contemporaneous evidence. The fact that Canada must rely on these kinds of arguments to frame its defense reveals the actual weakness of its case.

13. Although the integrity of the record requires a response to some of the more egregious of Canada's claims, Claimants do not wish to distract the Tribunal by addressing those issues in depth upfront. Accordingly, Claimants have included an Annex at the end of this submission that addresses in greater detail Canada's treatment of facts that ultimately are irrelevant to the issues in dispute.

14. Other facts are discussed in reference to the arguments below to which they relate.

III.

THE GUIDELINES VIOLATE CANADA'S OBLIGATIONS UNDER ARTICLE 1106

15. Article 1106(1) of the NAFTA prohibits, in clear terms, the imposition and enforcement of performance requirements. Claimants' Memorial establishes that the R&D Expenditure Guidelines, and the Board's enforcement of those Guidelines against the Hibernia and Terra Nova projects, violate this article by compelling investors in offshore

petroleum projects to purchase, use or accord a preference to R&D and E&T services in the Province.[13] Canada does not dispute that the Guidelines will compel Claimants to spend millions of dollars more per year on R&D and E&T activities than will be justified by the commercial or technical needs of the project.

16. Canada's three defenses to this claim do not withstand scrutiny. *First*, the plain text of Article 1106 refutes Canada's assertion that Article 1106(1) excludes R&D or E&T services. Canada ignores the plain meaning of the word "services," which includes R&D, and the fact that the NAFTA and the NAFTA Parties repeatedly recognized that R&D was a type of "services." Canada also ignores Article 1106(4), the only provision in the article that specifically addresses "carry[ing] out research and development" and "training ... workers." Canada also does not mention that during the negotiation of Article 1106, it proposed the reading it now advances, but the NAFTA Parties definitively rejected it. The text, context and preparatory work of Article 1106(1) thus cannot be reconciled with Canada's reading of the Article.

17. Rather than focus on the sources of interpretation prescribed by the Vienna Convention on the Law of Treaties,

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[13] Article 1106(1) of the NAFTA provides as follows:

> No party may impose or enforce any of the following requirements, or enforce any commitment or undertaking, in connect 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:
>
> ***
>
> (c) to purchase, use or accord a preference to goods produced or services provided in its territory, or to purchase goods or services in its territory.

Canada bases its argument that "a requirement to conduct or support R&D is a different type of performance requirement" on treaties that did not exist at the time the NAFTA's investment chapter was negotiated, that were concluded between different parties, or that have a text, context and history different from that of the NAFTA. Canada also seeks to rely on a United Nations Conference on Trade and Development ("UNCTAD") report on a different topic that does not purport to state views of any NAFTA Party. These sources do not support Canada's position in any event.

18. *Second*, Canada's assertion that the Guidelines do not really require expenditures on R&D and therefore do not require Claimants "to purchase, use or accord a preference to . . . services from persons in its territory" is unreasonable, contrary to the terms and intent of the NAFTA and the Guidelines, and unsupported. Among other reasons, the Tribunal need look no further than the title of the Guidelines — "Guidelines for Research and Development Expenditures" — to see how desperate an argument this is. In any event, the prohibition in Article 1106(1)(c) applies equally to E&T as it does to R&D.

19. *Third*, there is no merit to Canada's contention that the Guidelines adopted in 2004 were an "existing measure" covered by the Annex I reservation Canada took ten years earlier.

A. Article 1106(1) Clearly Prohibits Requirements to Purchase or Accord a Preference to Local Services

20. As this Tribunal observed in its decision on Claimants' document requests, "the Vienna Convention on the Law of Treaties attach[es] the greatest importance for the interpretation to the ordinary meaning of the treaty provisions,

taken in their context."[14] The treaty text, context, object and purpose lead to an interpretation of Article 1106 diametrically opposed to that which Canada advances.

1. The Text of Article 1106(1) Does Not Support Canada's Interpretation

21. Canada's Counter-Memorial reveals some common ground between the parties on the ordinary meaning of Article 1106(1). Canada does not contest either that the Guidelines constitute a "requirement" "impose[d]" by it as a NAFTA Party, or that this requirement applies "in connection with the establishment, acquisition, expansion, management, conduct or operation of an investment of an investor of a Party" in its territory. These are important concessions by Canada that limit the Tribunal's inquiry.

22. The differences between the parties concentrate on subparagraph (c) of Article 1106(1), which prohibits the following performance requirement:

> 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[.][15]

Relying on the provision in Article 1106(5) that "paragraphs 1 and 3 do not apply to any requirement other than the requirements set out in those paragraphs," Canada erroneously contends that because the words "research and development" and "education and training" do not appear in Article 1106(1)(c), it must not encompass R&D or E&T.[16]

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[14] Tribunal Ruling of March 27, 2010 on Claimants' Request No. 6.

[15] **CA-3**, NAFTA, Article 1106 (1)(c).

[16] RM ¶ 157.

23. *First*, Canada's argument evades the central inquiry under the Vienna Convention: the ordinary meaning of the text of the Treaty. Article 1106(1)(c) applies, in unqualified terms, to requirements "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." It addresses "services" without any stated limitation or exclusion.

24. The ordinary meaning of the term "services" is as follows:

> useful labor that does not produce a tangible commodity - usu. used in pl. (railroads, telephone companies, and physicians perform services although they produce no goods).[17]

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[17] **CA-175**, Webster's Third New International Dictionary, p. 2075 (1993); *see also* **CA-176**, Webster's Ninth New Collegiate Dictionary, p. 1076 (1991) ("providing services (the [services] trades – from filling stations to universities)"); **CA-173**, New Shorter Oxford English Dictionary, p. 2789 (1993) ("[t]he sector of the economy that supplies the needs of the consumer but produces no tangible goods, as banking or tourism."). Canadian dictionaries provide a similar definition of "services." *See, e.g.* **CA-168**, The Canadian Oxford Dictionary, p. 1322 (2001) ("the sector of the economy that supplies the needs of the consumer but produces no tangible goods, as banking or tourism … a business which provides a specified service to the public (runs a water taxi service)"; **CA-167**, David Crane, The Canadian Dictionary of Business and Economics, p. 572 (1993) ("Examples of services include … education."). Industry definitions for the term are equally broad. *See* **CA-171**, InvestorWords.com, definition of "service" ("A type of economic activity that is intangible, is not stored and does not result in ownership. A service is consumed at the point of sale …."); **CA-169**, Encyclopedia of Business and Finance, entry for "economics" ("Services are provided in numerous ways and are an intangible activity …. It is important to understand that because

Research and development and education and training services are clearly "services" within the ordinary meaning of that term, as Canada has itself repeatedly recognized both in the context of the NAFTA and in its own conduct and regulations. Each consists of "useful labor that does not produce a tangible commodity."

25. The context of the term "services" in the NAFTA confirms that it includes R&D and E&T services.[18] Like Article 1106(1)(c), the scope-and-coverage provision of the NAFTA's chapter on government procurement referred to "goods" and "services."[19] That provision allowed the Parties to except specific categories of goods and services from their procurement chapter obligations by listing them in annexes.[20]

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goods and services utilize resources that are limited, goods and services are also scarce .... If individuals can't have everything they want, they must decide which of the goods and services are most important and which they can do without."). This last definition highlights the point that Claimants do not have unlimited resources to spend on R&D, so that requiring Claimants to spend mandatory amounts on R&D, when such expenditure is not required by the projects, necessarily redirects money that would otherwise be spend on other items or R&D from non-Canadian suppliers.

[18] *See* **CA-9**, Vienna Convention on the Law of Treaties (hereinafter "VCLT"), art. 31(2).

[19] *See* **CA-69**, NAFTA, art. 1001(1). As in other chapters of the NAFTA dealing at some length with services (such as **CA-72**, Chapter 12 (Cross-Border Trade in Services) and **CA-73**, Chapter 14 (Financial Services)), the term "services" is nowhere defined. Nothing in the NAFTA suggests that the Parties intended a content for the term "services" different in one chapter from that in another. In any event, Article 1112 of NAFTA's investment chapter provides that "[i]n the event of any inconsistency between this Chapter and another Chapter, the other Chapter shall prevail to the extent of the inconsistency." *See* **CA-3**, NAFTA, art. 1112.

[20] *Id.*

With respect to services, the Parties agreed on a common classification system to use for reporting purposes.[21] This classification system explicitly included R&D services, as it established a series of detailed codes for such services introduced by the following definition:

> Procurement of *research and development services* include the acquisition of specialized expertise for the purposes of increasing knowledge in science; applying increased scientific knowledge or exploiting the potential of scientific discoveries and improvements in technology to advance the state of art; and systematically using increases in scientific knowledge and advances in state of art to design, develop, test, or evaluate new products or services.[22]

The NAFTA Parties' common classification system also included a group entitled "Educational and Training Services," which included subclasses such as "Lectures for Training," "Tuition, Registration, and Membership Fees," "Faculty Salaries for Schools Overseas" and "Other Education and Training Services."[23]

26. Illustrating that Canada understood well at the time that the term "services" included research and development and education and training unless otherwise specified, it listed in its procurement-chapter schedule of "Service Exclusions by Major Service Category" the following exclusions:

> **A. Research and Development**
>
> All classes

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[21] *See* **CA-70**, NAFTA, Annex 1001.1b-2, sec. A, ¶ 2.

[22] **CA-71**, NAFTA, Appendix 1001.1b-2-B, sec. A (emphasis added).

[23] *See id.* sec. U.

...

U. Education and Training Services

U010 Certifications and accreditations for Educational Institutions[24]

27. Canada's other Annex reservations similarly evidenced its, and the other NAFTA Parties', understanding that R&D and E&T services are "services."[25] Canada's January 1994 Statement of Implementation of the NAFTA underscored this point with reference to the Scientific Research and Experimental Development ("SR&ED") tax incentive program mentioned in the Guidelines:

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[24] *Id.* sec. B, Schedule of Canada. After the NAFTA entered into force, the parties adopted The North American Industry Classification System (NAICS). This classification system was designed to provide common definitions of the industrial structure of the three countries and a common statistical framework to facilitate the analysis of the three economies. The Canadian government relies on the NAICS as its standard industry classification. "Education," "training" and "research and development" are all classified as "services" under the NAICS. *See* **CA-129**, Statistics Canada, *North American Industry Classification System (NAICS) – Canada*, www.statcan.gc.ca/subjects-sujets/standard-norme/naics-scian/2007/introduction-eng.htm (last visited April 2, 2010).

[25] *See, e.g.,* **CA-74**, NAFTA, Annex II, Schedule of Canada, exception for social services sector ("Canada reserves the right to adopt or maintain any measure with respect to ... the following services to the extent that they are social services established or maintained for a public purpose: ... public education, public training ..."); **CA-7**, NAFTA, Annex I, Schedule of Canada, exception for Accord Acts; *see also* **CA-72**, NAFTA, art. 1210(5) & Annex 1210.5, sec. C (addressing engineers as "professional service providers").

> As the provisions of paragraph 4(a) [of NAFTA Article 2103 on taxation] are not to be construed to prevent a Party from conditioning the receipt or continued receipt of an advantage relating to the purchase or consumption of particular services on a requirement to provide the service in its territory, a Party may condition the receipt of income tax benefits in connection with the purchase of *research and development services* on the requirement that the service be provided in its territory.[26]

28. Finally, similar instruments from the Uruguay Round,[27] which was negotiated *contemporaneously* with the

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[26] **CA-127**, Department of Foreign Affairs and International Trade Canada, Statement on Implementation, *Canada Gazette* 216 (Jan. 1, 1994); *see also* **CE-1**, CNLOPB, Guidelines for Research and Development Expenditures, § 3.3 (Oct. 2004) (hereinafter "2004 R&D Guidelines"). Likewise, a paper presented at a multi-stakeholder roundtable hosted by the Canadian Department of Foreign Affairs and International Trade to coincide with the annual meeting of the NAFTA Free Trade Commission clearly noted that "services" in the context of the NAFTA include R&D and E&T. *See* **CA-148**, Pierre Paul Proulx, *Canada-U.S. Trade and Investment Relations within NAFTA: A few chosen general facts and hypotheses*, p. 5 (Oct. 6, 2003), *available at* www.international.gc.ca/trade-agreements-accords-commerciaux/agr-acc/nafta-alena/proulx.aspx?lang=en (noting that "US shares of [Canada's] commercial services trade are highest among services trade" and that "R&D services are the fastest growing component"); *id.* (referring to "educational … services").

[27] *See, e.g.*, **CA-131**, Trade Negotiations Committee, Communication from Canada: Services Offer by Canada on Market Access, WTO Doc. No. MTN/TNC/W/55, Annex I (Dec. 4, 1990) (Canada's services offer for GATS covered both "[t]raining services" and "research services"); **CA-130**, Trade Negotiations Committee, Communication from Canada: Conditional Offer by Canada of Specific Commitments in the Uruguay Round Negotiations on Trade in Services: Revision, WTO Doc. No.

NAFTA,[28] and similar, contemporaneous efforts to classify services for trade purposes,[29] also confirm that the ordinary

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MTN.TNC/W/55/Rev.1, sec. 1(C) (Feb. 14, 1992) (Canada also made specific commitments for "Research and Development" services); *see also* **CA-126**, Council for Trade in Services, Communication from Canada: Revised Conditional Offer on Services, WTO Doc. No. TN/S/O/CAN/Rev.1, p. 39 (May 23, 2005) (Canada's 2005 Revised Conditional Offer on Services includes offers under the heading of "Research and Development" with respect to "[r]esearch and experimental development services on social sciences and humanities, including law, economics, except linguistics and language (CPC 852*).").

[28] *See* **CA-127**, Canadian Statement of Implementation, *Canada Gazette*, at 75 (Jan. 1, 1994) ("Since the conclusion of the negotiations of the NAFTA, ... the successful conclusion of the Uruguay Round of GATT multilateral negotiations has considerably expanded and broadened international trade and investment rules. 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."); **CA-141**, Meg N. Kinnear et al., *Introduction*, in *Investment Disputes Under NAFTA: An Annotated Guide to NAFTA Chapter 11*, at 30-31 (Kluwer 2006) (similar description of interplay between NAFTA and Uruguay Round negotiations). *See also* **CA-1**, NAFTA art. 103(1) ("The Parties affirm their existing rights and obligations with respect to each other under the *General Agreement on Tariffs and Trade* and other agreements to which such Parties are party.").

[29] **CA-136**, GATT Secretariat, Services Sectoral Classification List: Note by the Secretariat, WTO Doc. No. MTN.GNS/W/120, sec. 1(c) (July 10, 1991) (including in sectoral classification of services listing for "Research and Development Services"); *id.* sec. 5 (same for "Educational Services"); **CA-155**, UN Department of International Economic and Social Affairs, Provisional Central Product Classification, UN Doc. No.

meaning of the term "services" at the time of the NAFTA encompassed R&D and E&T services.

29. In sum, the ordinary meaning of the term "services" includes R&D and E&T. Moreover, there can be no doubt that the Guidelines, in regulating R&D expenditures, view eligible R&D activities as services. The R&D Work Expenditure Application Form reproduced as the last page of the Guidelines provides a concrete idea of the R&D services that the Guidelines cover. The form provides check-boxes for "Engineering," "Design," "Computer Programming," "Mathematical Analysis" and "Testing or Psychological Research," among other classifications.[30] Each of these clearly falls within the ordinary meaning of "services"; each provides a classic example of useful labor that does not result in the production of a good. Similarly, Statistics Canada's compilation of international trade statistics, tracks and reports

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ST/ESA/STAT/Ser.M/77, p. 144 (1991) (including classification entries for "Research and Development Services"); *id.*, p. 153 (same for "Education Services"). *See also* **CA-120**, Panel Report, *United States – Measures Affecting the Cross-Border Supply of Gambling and Betting Services*, WT/DS285/R, ¶ 4.7 (April 20, 2005) (Canada observed that the WTO Members' reliance on the Services Sectoral Classification List and UN CPC in preparing their GATS Schedules suggests that "there is agreement among the Members that, in general, the classification of sectors and sub-sectors in a Schedule should be based on the W/120 Classification List and the corresponding CPC numbers referred to in it."); **CA-121**, Appellate Body Report, *United States – Measures Affecting the Cross-Border Supply of Gambling and Betting Services*, WT/DS285/AB/R, ¶ 204 (April 20, 2005) (The Services Sectoral Classification List provided "a common language and structure which, although not obligatory, was widely used and relied upon.").

[30] **CE-1**, 2004 R&D Guidelines, at EM0000007.

Canadian "research and development" transactions as services.[31]

30. *Second*, Canada errs in relying on Article 1106(5) to argue for a "restrictive approach" to reading the performance requirements provision.[32] Paragraph 5 of Article 1106 makes clear that, in contrast to the United States's prior policy in its

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[31] **CA-125**, Statistics Canada, CANSIM Database, *Table 376-0033 - International transactions in services, commercial services by category – research and development*, http://cansim2.statcan.gc.ca/cgi-win/cnsmcgi.exe?Lang=E&CNSM-Fi=CII/CII_1-eng.htm (last checked April 1, 2010). Elsewhere, Canada recognizes that R&D activities constitute services. For example, Canada's governmental Educational and Research and Development Services Working Group is currently focusing on "commercial education and training services" and "R & D services in the natural and social sciences, humanities, and interdisciplinary fields." *See* **CA-128**, Department of Foreign Affairs and International Trade Canada, *Trade in Services*, www.international.gc.ca/trade-agreements-accords-commerciaux/services/sector/education.aspx?lang=en (last checked April 3, 2010). Canadian industry groups also clearly view R&D and E&T as services. For example, in 2005 the Canadian Advanced Technology Alliance issued a report entitled "Impacts of Free Trade on R&D Services in Canada." **CA-163**, Kevin Wennekes, CATA, *Impacts of Free Trade on R&D Services in Canada*, p. 8 (Oct. 2005) ("For the past decade, trade in R&D services has been almost fully open under NAFTA with only limited but key protections in place, such as not taking any commitments in public education services and committing not to do so in the future. With over 10 years of open and thriving trade in R&D services under NAFTA and no challenges or negative impacts on the education front, Canada is considering making similar commitments with respect to R&D services under the General Agreement on Trade in Services (GATS)."); *see also* references to "R&D services" at *id.*, 2, 3, Appx. B-4.

[32] RM ¶ 152.

investment treaties,[33] the NAFTA's performance-requirements prohibitions are a closed list. The fact that a trade agreement provides for a closed list of prohibited conduct, however, does not mean that the provision is to be interpreted restrictively. As the WTO Appellate Body has repeatedly held, terms in a closed list are to be interpreted in accordance with the Vienna Convention and to achieve the goals of the treaty, and not in a restrictive manner.[34]

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[33] *See* **CA-160**, Kenneth J. Vandevelde, *U.S. Bilateral Investment Treaties: The Second Wave*, 14 Mich. J. Int'l L.621, 689 (1993) ("the United States resists attempting to compile an exhaustive list of what it considers to be performance requirements …").

[34] *See* **CA-119**, Appellate Body Report, *United States – Countervailing Duty Investigation on Dynamic Random Access Memory SemiConductors (DRAMS) from Korea*, WT/DS296/ABR/R, ¶¶ 114-115 (July 20, 2005) (rejecting an overly narrow interpretation of terms in a closed list of measures defined as "subsidy" in Article 1 of the Subsidy and Countervailing Measures Agreement). *See also* **CA-122**, Appellate Body Report, *United States – Subsidies on Upland Cotton*, WT/DS267/AB/R, ¶ 616 (Mar. 21, 2005) (rejecting a narrow approach to the definition of "export subsidies" in Article 10 of the Agreement on Agriculture, and noting that "Article 10.2 must be interpreted in a manner that is consistent with the aim of preventing circumvention of export subsidy commitments that pervades Article 10."); **CA-88**, *Canada-FIRA* GATT Panel Report, ¶¶ 5.4-5.6 (refusing to subscribe to Canada's narrow definition of "requirements" under Article III:4 of the GATT, and finding that the "purchase undertakings" at issue did constitute prohibited requirements under Article III:4 because they achieved the same illicit goal. The Panel held that "private contractual obligations" entered into by investors "should not adversely affect the rights which contracting parties … possess under Article III:4 of the General Agreement and which they can exercise on behalf of their exporters.").

31. Thus, while Claimants agree with Canada that the only requirements prohibited under Article 1106(1) are those listed in that provision, that observation does not illuminate the content of Article 1106(1), which clearly includes "services." The Vienna Convention provides the framework for establishing that content. As demonstrated above, the ordinary meaning of "services" includes services for R&D and E&T purposes.

32. *Third*, Canada's argument that Article 1106(1)(c) implicitly excludes R&D and E&T services because these are "different types of performance requirements"[35] must be recognized for what it is: not an argument based on ordinary meaning, but one for a *special* meaning different from the ordinary sense of the words used in Article 1106(1)(c). The Vienna Convention does recognize that the ordinary meaning of a term of a treaty can be put aside and the term granted a special meaning "if it is established that the parties so intended."[36] However, the Convention places the "burden of proof on the party who invokes the special meaning of the term."[37] Canada thus bears the burden of establishing that, in using the unqualified term "services" in Article 1106(1)(c), the NAFTA Parties intended to signify "services except for research and development and education and training services."

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[35] RM ¶¶ 160 *et seq.* (arguing, based principally on later treaties not among the NAFTA Parties, that the NAFTA Parties should have included a specific prohibition of R&D had they wished to address it).

[36] **CA-9**, Vienna Convention on the Law of Treaties, art. 31(4).

[37] **CA-159**, U.N. Int'l Law Comm'n, Yearbook of the ILC, 1966, Vol. II, No. 17, p. 242.

33. As demonstrated above and in the discussion that follows, Canada has not, and cannot, discharge its burden of establishing that the Parties silently intended to exclude from the unqualified term "services" all R&D and E&T services.

2. The Context of Article 1106(1) and the Object and Purpose of the NAFTA Refute Canada's Reading

34. The context of Article 1106(1) and the NAFTA's object and purpose further illustrate the lack of support for Canada's reading of Article 1106(1)(c).

35. *First*, Canada's reservation for the R&D and E&T provisions of the Federal Accord Act in its Schedule to Annex I forms part of the context for Article 1106(1) under the Vienna Convention.[38] As noted in Claimants' Memorial and clearly stated in the Notes to Annex I, the Annex was to list "existing measures that *do not conform*" with obligations imposed by that Article, among others, and the Parties were required to describe in their schedules "the *non-conforming aspects* of the existing measures for which the reservation is taken."[39] By listing the Accord Act and specifically describing its R&D and E&T requirements in its Schedule to Annex I, Canada clearly recognized that those requirements "do not conform" with Article 1106 and, necessarily, that Article 1106(1) applied to R&D and E&T services.

36. Canada asserts, without offering any support, that it did not really believe at the time that the explicit reservation it took for the R&D and E&T requirements was necessary, and that it included a reference to these requirements only in a

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[38] *See supra* note 18.

[39] **CA-6**, NAFTA, Annex I, Interpretative Note §§ 1, 2(g) (emphasis added); **CA-3**, NAFTA, art. 1108(1) (emphasis added); CM ¶¶ 153-154.

"belt and suspenders approach."[40] In discovery, Claimants asked Canada to produce documents sufficient to support this assertion, but Canada refused to do so, claiming irrelevance and institutional sensitivity of the negotiating history.[41] In doing so, Canada conceded that in fact it has no evidentiary support for its position and that it bases its "belt and suspenders" theory on its own reading of the reservation in its "proper context."[42]

37. Canada's unsupported, *post-hoc* assertion cannot be reconciled with the ordinary terms of the treaty. In Article 1108(1) and again in sections 1 and 2(g) of the Interpretative Note to Annex I, the treaty makes clear that the Annex is for *non-conforming* measures — not, as Canada now asserts, for measures that *do indeed conform with* the NAFTA. Indeed, Canada's communication of its Annex I schedule on provincial measures illustrates that it amply understood how to state that it was adopting a belt-and-suspenders approach.[43] The absence of any such statement here leads to the conclusion that the Accord Acts reservation was precisely what it purported to be: a reservation for a measure that did not conform to Article 1106(1).

38. *Second*, Canada's Annex I reservation for the Investment Canada Act similarly demonstrates that the prohibition in Article 1106(1) included R&D and E&T services. Paragraph 12 of that Annex reservation states in pertinent part:

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[40] RM ¶ 213.

[41] Redfern Schedule, December 15, 2009, Request No. 6.

[42] *Id.*; *see also* RM ¶ 205.

[43] **RE-11**, Government of Canada exchange of letters with other NAFTA parties, p. 1 (Mar. 29, 1996) ("The listing of a measure in Annex I is without prejudice to a future claim that Annex II may apply to the measure or some application of the measure.").

> *Article 1106(1)* shall not be construed to apply to any requirement, commitment or undertaking imposed or enforced in connection with a review under the Investment Canada Act, to locate production, *carry out research and development*, employ or *train* workers, or to construct or expand particular facilities, in Canada.[44]

39. The clear implication of this reservation is that (a) it was necessary precisely because Article 1106(1) otherwise did prohibit local content requirements for R&D and E&T services; (b) the limited exception it provides for requirements imposed under Investment Canada Act reviews does not apply to requirements imposed under other legal regimes in Canada, such as the Accord Acts; and (c) had the NAFTA Parties intended, as Canada now contends, to exclude R&D and E&T services from Article 1106(1), they knew how to do so and quite deliberately did *not* do so for measures other than under the Investment Canada Act. (As will be demonstrated in the following section, the negotiating history of the NAFTA confirms this conclusion: the Parties considered a proposal by Canada to exclude R&D and E&T from Article 1106(1) and rejected it for the main provision but allowed such an exclusion only for the Investment Canada Act.)

40. *Third,* it is remarkable that Canada nowhere discusses the only express reference to R&D and training in Article 1106: that in paragraph 4 of the Article, which provides as follows:

> Nothing in *paragraph 3* shall be construed to prevent a Party from conditioning 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 a requirement to locate production, provide a service, *train* or employ

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[44] **CA-7**, NAFTA, Annex I, Schedule of Canada, exception for Investment Canada Act et al., ¶ 12 (emphasis added).

> workers, construct or expand particular facilities, or to *carry out research and development*, in its territory.

Paragraph 4 is an avoidance-of-doubt provision: it provides no exception to any obligation — because none of the matters referenced in it are on their face encompassed by paragraph 3 — but instead provides guidance in the form of a rule of construction.

41. Canada does not address Article 1106(4) because that provision cannot be reconciled with Canada's view that Article 1106(1) does not cover R&D. Article 1106(4) applies only to the second of the two performance-requirement prohibitions in the NAFTA: that stated in paragraph 3 of Article 1106. It does not apply to the prohibition at issue here: that stated in paragraph 1 of the Article. To understand why this is so, it is useful to review the pertinent differences between the two prohibitions.

42. The prohibition in paragraph 1 of Article 1106 applies to the *imposition or enforcement* of any of the seven categories of requirements specified in subparagraphs (a) through (g) of that paragraph, including "services" as specified in subparagraph (c). By contrast, the prohibition in paragraph 3 of the Article applies to the *conditioning of the receipt or continued receipt of an advantage* on compliance with any of the four categories of requirements specified in subparagraphs (a) through (d) of that paragraph. In particular, subparagraph (b) of Article 1106(3) differs in important respects from the comparable requirement stated by Article 1106(1)(c), as it refers only to "goods" and not to "services."

43. With this background, the import of Article 1106(4) is clear: because "carry[ing] out research and development" and "train[ing] … workers" are *services*, "[n]othing in paragraph 3" prohibits conditioning an advantage on a requirement that such services take place in Canadian

territory. In other words, because Article 1106(3) does not apply to services, it cannot be construed to prevent a Party from adopting measures with respect to R&D or E&T services.

44. It is significant that Article 1106(4) in no way suggests that Article 1106(1), which explicitly refers to "services," should similarly be construed to permit R&D or E&T local content requirements. As Article 1106(5) demonstrates, the NAFTA Parties clearly understood how to refer to both prohibitions in Article 1106 when they thought it desirable.[45] The reference in Article 1106(4) only to paragraph 3 was therefore a purposeful one.

45. The clear inference from Article 1106(4) is that paragraph 1 of the Article *does prohibit* such requirements. This element of the context of Article 1106(1)(c) thus reinforces the ordinary meaning of the provision: it prohibits all measures imposing or enforcing local content requirements for services, including those involving R&D and E&T services.

46. *Finally*, interpreting Article 1106(1)(c) to mean what it says — a prohibition of measures imposing or enforcing local content requirements for goods and services, including R&D and E&T services — fully accords with the object and purpose of the NAFTA. Article 102 of the NAFTA provides in pertinent part:

> 1. The objectives of this Agreement … are to:
>
> a) eliminate barriers to trade in, and facilitate the cross-border movement of, goods and services between the territories of the Parties; …

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[45] *See* **CA-3**, NAFTA, art. 1106(5) ("Paragraphs 1 and 3 do not apply to any requirement other than the requirements set out in those paragraphs.").

> c) increase substantially investment opportunities in the territories of the Parties; …
>
> 2. 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.

47. The Government of Canada in another context has described the purpose of Article 1106(1) in the following terms:

> Article 1106 derives from a prohibition on performance requirements in U.S. BITs dating back to the 1980s. This prohibition was a response to the practice by some host countries of conditioning the establishment or continued operation of a U.S. investment on increasing the revenue brought by those investments to the host country. … As noted by Jon Johnson, "the objective of prohibiting performance requirements is to prevent NAFTA countries from distorting investment decisions in their favour.[46]

48. Interpreting Article 1106(1)(c)'s prohibition to apply to all goods and services accords with the NAFTA's objective of "eliminat[ing] barriers to trade in, and facilitat[ing] the cross-border movement of, goods and services between the territories of the Parties." It more effectively "create[s] an expanded and secure market" for R&D and E&T services in the territory of the NAFTA Parties, "reduce[s] distortions to trade" and substantially "increase[s] … investment opportunities" by allowing investors and

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[46] **CA-102**, *Merrill & Ring Forestry L.P. v. Government of Canada*, Counter-Memorial of the Government of Canada, ¶¶ 695-696 (May 13, 2008) (footnotes omitted) (quoting **RA-21**, Jon Johnson, *The North American Free Trade Agreement: A Comprehensive Guide*, p. 288 (Ontario: Canada Law Book Inc., 1994)).

investments to make decisions based on commercial need rather than government-imposed local content requirements.[47] Reading Article 1106(1)(c) to address R&D and E&T services would, consistent with Canada's description of the purpose of Article 1106(1), prohibit a requirement that "condition[s] the establishment or continued operation of a U.S. investment on increasing the revenue brought by those investments to the host country" and would serve to "prevent NAFTA countries from distorting investment decisions in their favour."

3. The Negotiating History of Article 1106 Confirms That Article 1106(1)(c) Includes R&D and E&T Services

49. Under Article 32 of the Vienna Convention, "[r]ecourse may be had to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of article 31 ...." The preparatory work of the NAFTA confirms that Article 1106(1)(c) includes R&D and E&T services.

50. *First*, in the July 10, 1992 negotiating draft of the investment chapter, Canada proposed an exception for R&D and E&T to the main prohibition now reflected in Article 1106(1), in addition to the predecessor of the text now reflected in Article 1106(4).[48] By the August 4, 1992 negotiating draft, Canada's proposal and that predecessor read as follows:

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[47] **CA-68**, NAFTA, Preamble (emphasis omitted); **CA-1**, NAFTA, art. 102(1)(c).

[48] **CA-75**, NAFTA, Chapter 11, Trilateral Negotiating Draft Text, Doc. No. INVEST.710, pp. 10-11 (July 10, 1992).

> [CDA][2. *Notwithstanding paragraph 1*, a Party may *nonetheless* condition the establishment or acquisition of an investment, and its subsequent conduct or operation, on commitments to locate production, *carry out research and development*, *train* or employ workers, construct or expand particular facilities in its territory.]
>
> ...
>
> 3. For greater clarity, the provisions of paragraph 3 do not apply to conditions related to the receipt of an advantage that an investor or investment locate production, provide a service, train or employ workers, construct or expand particular facilities, carry out research and development, in its territory.[49]

51. Canada's proposed text was bracketed to indicate that it was not accepted by the other two negotiating parties.[50] In fact, it was forever dropped from the text in the following draft of the chapter, dated August 11, 1992.[51] It is notable that the text proposed by Canada focused on "establishment or acquisition of an investment," which is also the focus of the Investment Canada Act.[52] It is also notable that the text

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[49] **CA-76**, NAFTA Chapter 11, Trilateral Negotiating Draft Text, Doc. No. INVEST.805, p. 9 (Aug. 4, 1992) (emphasis added) (the performance requirements article appears as Article 2109 in this draft).

[50] *See* **CA-142**, Kinnear, *Article 1101*, p. 1101-3 n. 13 ("The use of square brackets signified that the enclosed text was not agreed upon by all three negotiating states. The State or States that proposed or accepted the enclosed language would generally be reflected in the superscript immediately preceding the opening bracket.").

[51] **CA-77**, NAFTA Chapter 11, Trilateral Negotiating Draft Text, Doc. No. INVEST.811, p. 8 (Aug. 11, 1992).

[52] **CA-7**, NAFTA, Annex I, Schedule of Canada, exception for Investment Canada Act et al., ¶ 1 ("Under the *Investment*

corresponds to similar text that appears in the final version of Canada's Annex I exception for the Investment Canada Act.[53] One may readily conclude from these facts that the compromise adopted by the NAFTA Parties was to reject Canada's proposal to add this text to Article 1106(1), but to allow Canada to take a reservation in Annex I along these lines limited to the Investment Canada Act.[54]

52. This preparatory work of the NAFTA is important for several reasons. *First*, it demonstrates that, at the time of the negotiation of the NAFTA, Canada's negotiators were acutely aware of the fact that Article 1106(1)(c)'s reference to "services" included R&D and E&T services. *Second*, it shows that the NAFTA Parties together considered the argument that Canada advances here — that Article 1106(1) should not cover R&D or E&T services — and that the three Parties definitively rejected that argument. *Third*, it shows that by August 4, 1992, the Parties understood Canada's proposal to be an *exception*, while Article 1106(4) was a

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Canada Act, the following acquisitions of Canadian businesses by 'non-Canadians' are subject to review by Investment Canada: ...").

[53] *Id.* ¶ 12 ("Article 1106(1) shall not be construed to apply to any requirement, commitment or undertaking imposed or enforced in connection with a review under the *Investment Canada Act*, to locate production, carry out research and development, employ or train workers, or to construct or expand particular facilities, in Canada.").

[54] The negotiating drafts of the Annexes to the NAFTA are not available to the public, and Claimants therefore are not in a position to confirm this conclusion through reference to those drafts. Although Claimants did ask Canada to provide the drafting history of Annex I in the course of discovery, Canada refused to do so. The Tribunal ultimately decided not to order production on the ground that "unilateral 'travaux préparatoires'" were unnecessary to interpret Canada's reservation. Tribunal Ruling of March 27, 2010 on Claimants' Request No. 6.

provision "[f]or greater clarity" — confirming that Article 1106(1) otherwise applied to the matters addressed in Canada's proposed exception. *Finally*, it shows that — consciously or not — Canada is attempting to go back on the compromise to which it agreed with the other NAFTA Parties and to obtain, through its arguments before this Tribunal, what it could not obtain at the negotiating table.

53. It is also noteworthy that the performance requirements prohibition in NAFTA was negotiated against the background of an important trade dispute between the United States and Canada involving performance requirements imposed by the predecessor to the Investments Canada Act. That dispute resulted in the General Agreement on Tariffs and Trade ("GATT") Panel's *Canada-FIRA* decision, in which the Panel found the predecessor act to violate Canada's obligations under the GATT.[55] While the Panel did not address R&D performance requirements under the predecessor act because the GATT did not apply to services or investment, the Panel's reasoning would have found such requirements to be a violation under any treaty that, like the NAFTA, did address investment and services.[56] The *FIRA* Panel's broad-based approach further shows that the NAFTA negotiators would have understood that the text of Article 1106(1)(c) barred local content requirements for services, including R&D services.

4. The Potpourri of Sources Relied Upon by Canada Does Not Sustain Its Position

54. As demonstrated above, the text, context, object and purpose, and negotiating history of the NAFTA all repeatedly confirm that the term "services" in Article 1106(1)(c) includes

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[55] **CA-88**, *Canada - FIRA* GATT Panel Report.

[56] *Id.* ¶¶ 1.4, 3.3, 5.21.

services for R&D and E&T purposes. Curiously, in its contrary argument that "R&D is a different type of performance requirement," Canada does not rely on the text, context or negotiating history of the NAFTA; instead, it exclusively focuses on other treaties and sources.[57]

55. In determining that certain preparatory works for the NAFTA were insufficiently probative to warrant production, this Tribunal correctly observed as follows:

> The Tribunal moreover reminds the Parties that Articles 31 and 32 of the Vienna Convention on the Law of Treaties attach the greatest importance for the interpretation to the ordinary meaning of the treaty provisions, taken in their context. In view of the above, the Tribunal does not envisage to take into account unilateral "travaux préparatoires" to interpret Canada's reservation.[58]

Unlike the preparatory works the Tribunal found insufficiently probative, the sources relied upon by Canada *do not even relate to the NAFTA*. Instead, they all concern other treaties and instruments. The Tribunal's ruling on NAFTA preparatory works well illustrates just how far out of bounds Canada's sources are.

56. These sources cannot discharge Canada's burden of establishing a special meaning for "services" in Article 1106(1)(c) that excludes R&D and E&T services.

57. *First,* none of Canada's sources — an UNCTAD World Investment Report from 2005, the 1994 Trade-Related Investment Measures ("TRIMS") Agreement, and certain bilateral investment treaties concluded by one of the NAFTA

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[57] RM ¶¶ 157-158, 160-182.

[58] Tribunal Ruling of March 27, 2010 on Claimants' Request No. 6.

Parties with other parties after the signature of NAFTA, among other things — qualifies among the primary sources of treaty interpretation stated in Article 31 of the Vienna Convention. At best, these sources might be characterized as supplementary means of interpretation under Article 32 of the Convention — although even that is unlikely since all but one postdates the conclusion of the NAFTA by several years or more.

58. Article 32 of the Vienna Convention does not permit reference to supplementary means of interpretation for the purpose proposed by Canada. Article 32 permits use of supplementary means to determine the meaning of a treaty provision only "when the interpretation according to article 31: (a) leaves the meaning ambiguous or obscure; or (b) leads to a result which is manifestly absurd or unreasonable."

59. The clear conclusions stated above, based on the primary means of interpretation set out in Article 31, render inadmissible Canada's arguments for a different interpretation based on supplementary means of interpretation. As the International Court of Justice has observed:

> If the relevant words in their natural and ordinary meaning make sense in their context, that is an end of the matter. If, on the other hand, the words in their natural and ordinary meaning are ambiguous or lead to an unreasonable result, then, and then only, must the Court, by resort to other methods of interpretation, seek to ascertain what the parties really did mean when they used these words.[59]

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[59] **CA-89**, *Competence of Assembly Regarding Admission to the United Nations*, 1950 I.C.J. 4, Advisory Opinion of March 3, 1950, p. 8; *see also* **CA-90**, *Continental Casualty v. Argentina*, ICSID Case No. ARB/03/9, Decision on Preliminary Objection to Application for Annulment of October 23, 2009, ¶ 28; **CA-92**,

60. *Second*, and in any event, the potpourri of sources relied upon by Canada does not support its arguments. Treaties in force for fewer than all of the parties have been considered, at best, tangentially relevant only where the text was materially the same as that in question.[60] International tribunals have rejected reliance on treaties that are not in force for any party and mere proposed treaty texts, whether from failed negotiations (such as the Multilateral Agreement on Investment) or otherwise.[61]

61. *The Canada-U.S. Free Trade Agreement*. Canada relies not on the Canada-US FTA as such, but rather on a unilateral Canadian statement concerning that treaty that Canada published after the fact.[62] As this Tribunal has already observed, unilateral statements such as these are of little relevance to interpretation of treaty text even when they

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Enron Corp. v. Argentina, ICSID Case No. ARB/01/3, Decision on Continued Stay of Enforcement of Award of October 7, 2008, ¶ 72.

[60] *See, e.g.*, **CA-107**, *Oil Platforms (Iran v. U.S.A.)*, I.C.J. Reports 1996 I.C.J., 803, Decision on Preliminary Objection of December 12, 1996, pp. 814-15.

[61] *See* **CA-83**, *Access to Information under Article 9 of the OSPAR Convention (Ireland v. U.K.)*, Final Award of July 2, 2003, ¶¶ 104-105 (majority op. of Professor Reisman and Lord Mustill) (rejecting arguments that tribunal should apply draft proposal for an EC directive or a convention that had not entered into force for either party; only instruments relevant under Article 31 of the Vienna Convention could be considered); *see also* **CA-123**, *Yukos Universal Ltd. v. Russia*, PCA Case No. AA-227, Interim Award of November 30, 2009, ¶ 415 ("The principles of international law, which have an unquestionable importance in treaty interpretation, do not allow an arbitral tribunal to write new, additional requirements – which the drafters did not include – into a treaty …").

[62] RM ¶¶ 180-182.

relate to the treaty at issue.[63] The unilateral statement Canada invokes does not relate to the NAFTA and does not support Canada's proposition.

62. Unlike Article 1106 of the NAFTA, the performance requirement prohibition in the Canada-US FTA did not prohibit investment incentives conditioned on performance requirements. It also prohibited commitments imposed on an investor only if the commitment "could have a significant impact on trade between the two Parties."[64] The portion of the unilateral Canadian statement relied upon by Canada reads as follows:

> The *negotiation* of product mandate, research and development, and technology transfer requirements with investors, however, will not be precluded. Moreover, this Article does not preclude the *negotiation* of performance requirements attached to subsidies or government procurement.[65]

63. The unilateral statement relied upon by Canada thus does not support its proposition. It states unremarkably that Canada remained free to negotiate a requirement related to R&D services. The statement says nothing about the imposition of a requirement to that effect, such as that of the requirement imposed by the Guidelines here.

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[63] Tribunal Ruling of March 27, 2010 on Claimants Document Request No. 6 ("the Tribunal does not envisage to take into account unilateral 'travaux préparatoires' to interpret Canada's reservation").

[64] **RA-9**, Canada-US Free Trade Agreement art. 1603(2); *compare id.* art. 1603 *with* **CA-3**, NAFTA art. 1106(3). Both the United States and Canada suspended operation of the Canada-US Free Trade Agreement when the NAFTA came into effect. *See* **CA-80**, *U.S. Dep't of State, Treaties in Force* (2009), p. 46 n.2.

[65] **RA-9**, CUSFTA, Synopsis, at 375 (emphasis added).

64. *The 1994 Model U.S. BIT.* As a preliminary matter, Canada errs in suggesting that the 1994 Model United States investment treaty was "developed at the same time as the NAFTA."[66] Contrary to Canada's suggestion, the 1992 Model BIT was the prototype the United States developed at the time the NAFTA's investment chapter was being negotiated in 1991-1992.[67] U.S. policy for its BITs at that time was to "resist[] attempting to compile an exhaustive list of what it considers to be performance requirements."[68] The 1994 Model was concluded in April 1994, almost 18 months after the NAFTA was concluded and concurrently with the entry into effect of the WTO Uruguay Round treaties.[69]

65. Canada's reliance on the 1994 U.S. Model BIT and later treaties is thus contrary to the principle of inter-temporality as applied to treaty interpretation. As the International Law Commission noted in its commentary on the predecessor to the Vienna Convention, the elements of interpretation in Article 31 of the Vienna Convention — namely, the ordinary meaning of the terms, the context, and the object and purpose of the treaty — "all relate to the agreement between the parties *at the time when or after it*

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[66] RM ¶ 174.

[67] *See* **CA-160**, Vandevelde, at 627 ("The model negotiating text was revised again in September 1987 ..., in February 1991 ..., and once more in February 1992 ..."); *id.*, at 646 ("[A]s this article goes to press, negotiators for the United States, Canada and Mexico have reached agreement on the North American Free Trade Agreement, which contains more extensive investment provisions.").

[68] *Id.*, at 689.

[69] **CA-135**, U.S. Senate Hearing Doc. 104-289, Comm. On Foreign Relations, p. 7 (Nov. 30, 1995) (prepared statement of Daniel Tarullo, Assistant Secretary of State for Economics and Business Affairs) (hereinafter, "Tarullo Statement").

received authentic expression in the text."[70] As the Chairman of the Drafting Committee for the Vienna Convention observed:

> Unless a different intention is stated in the treaty, the ordinary meaning must be that of the time of the conclusion of the treaty. ... It is difficult to presume that the parties to a treaty used, from a linguistic point of view, words in an unknown and perhaps unforeseeable sense that the words might acquire in the future.[71]

Of course, none of the drafters of the NAFTA investment chapter or the other government officers and representatives whose review of the text ultimately led to the treaty's signature in December 1992 could have had access to or considered a model BIT from two years later. Canada's reliance on this and other post-1992 authorities should be rejected as anachronistic and inadmissible.

66. In any event, the record does not support Canada's assertion that United States policy on performance requirements changed significantly from the NAFTA to the 1994 Model U.S. BIT. To the contrary, according to official statements by the U.S. authorities, the revisions in the 1994 Model were intended to incorporate the "new policy features and higher standards of investment protection" developed in

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[70] **CA-159**, U.N. Int'l Law Comm'n, Reports of the Commission to the General Assembly, Y.B. Int'l L. Comm., 2 (1966), p. 220 (emphasis in original).

[71] **CA-164**, M. K. Yasseen, *L'interprétation des traités d'après la Convention de Vienne sur le droit des traités*, 1976 Recueil des Cours 1, 26-27 (1978) (translation by counsel) (citing *Rights of Nationals of the United States in Morocco (France v. United States)* 1952 I.C.J. 176, Judgment of August 27, 1952, p. 189).

the NAFTA.[72] While both the innovations of the 1994 Model and performance requirements were recurring subjects in a 1995 congressional hearing on the first treaties concluded based on that Model, nothing in the proceedings of that hearing supports Canada's present assertion that the 1994 Model prohibited a "new" performance requirement not addressed in the NAFTA.[73] To the contrary, the hearing testimony underscored that the new model was based on and equally protective of U.S. investors as the NAFTA.[74]

67. Most importantly, Canada errs in suggesting that the local content prohibitions of the NAFTA and the 1994 U.S. Model BIT were identical. On that false basis, Canada argues that something additional was intended by the Model BIT's

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[72] **CA-135**, U.S. Senate Hearing Doc. 104-289, Comm. On Foreign Relations, p. 7 (Nov. 30, 1995) (prepared statement of Daniel Tarullo, Assistant Secretary of State for Economics and Business Affairs) ("The 1994 prototype embodies the same basic principles as its predecessors. Changes in language and format were made for three major reasons. First, we wanted to capture best practices. Investment negotiations in NAFTA, as well as the BIT practice of the U.S. and other OECD countries, had generated new policy features and higher standards of investment protection, which we wanted to incorporate in our BITs."). The NAFTA was the sole source of the performance requirement innovation in the 1994 Model, since at the time no other country addressed performance requirements in its investment treaties. *See id.*, at 8 ("No other country has used its BITs to limit other parties' performance requirements on its investors.").

[73] *See id.*, at 12, 13, 24, 26, 30, 32 (discussing performance requirements).

[74] *See id.*, at 48-49 (USCIB recommendation that the NAFTA performance requirements be adopted in the MAI, without any suggestion that those of the 1994 Model were more protective than the NAFTA).

additional subparagraph on "carrying out research and development."[75] Article 1106(1)(c) prohibits requirements:

> 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*; . . .

By contrast, Article VI(a) of the 1994 Model BIT uses significantly different terms for its prohibition. It prohibits requirements:

> to purchase, use or otherwise give a preference to products or *services of domestic origin* or from any *domestic source*; . . .

68. The public record does not state why the text was changed from the NAFTA to this formulation in the 1994 Model BIT.[76] Thus, the fact that the local content prohibitions of the NAFTA and the 1994 Model are framed in different terms renders it difficult to draw reliable conclusions based on a comparison of the two. Canada has presented no evidence to support its position regarding the language in the 1994 Model. Its reliance on the change in formulation in the Model is therefore flawed.

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[75] *See* RM ¶ 174.

[76] The text of Article VI(a) of the 1994 Model tracks that of paragraph 1(a) of the WTO Trade-Related Investment Measures (TRIMs) Agreement, which referred to "the purchase or use by an enterprise of products of domestic origin or from any domestic source, . . ." It is possible that the BIT text was changed to conform loosely to that of the TRIMs Agreement in order to make the Model BIT "easier to ... explain" during negotiations with potential treaty partners that had already agreed to the TRIMs Agreement. **CA-135**, U.S. Senate Hearing Doc. 104-289, Comm. On Foreign Relations, p. 7 (Nov. 30, 1995) (prepared statement of Daniel Tarullo, Assistant Secretary of State for Economics and Business Affairs).

69. *The Failed Multilateral Agreement on Investment and Japanese Treaties.* To support Canada's argument that Article 1106(1)(c) silently excludes services for R&D purposes, Canada also relies on treaties concluded in 1998-2004 by States other than the NAFTA Parties (principally Japan) and a consolidated negotiating draft from 1998 for a multilateral agreement on investment that was never even approved by the negotiating group convened for that purpose. Canada argues based on these texts that "there is a generally understood distinction between a requirement to *purchase* local goods or services and a requirement to *achieve* a certain level or value of R&D and E&T."[77]

70. Again, Canada relies on texts from 1998-2004 that were obviously not available to NAFTA negotiators and governments in 1991 and 1992 when the NAFTA investment chapter was prepared and the NAFTA concluded. Canada's attempt to draw inferences from these later treaties is particularly misplaced given that no investment treaty in 1992 contained a detailed performance requirement provision, and US policy when the NAFTA was negotiated was against including a definitive list of performance requirements.[78]

71. Moreover, the intent of the NAFTA Parties certainly cannot be understood from what other nations subsequently negotiated. As the *OSPAR* Tribunal observed:

> [T]he application of international law rules on interpretation of treaties to identical or similar provisions of different treaties may not yield the same results, having regard to, *inter alia*, differences in the

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77 RM ¶¶ 175-179 (emphasis added).

78 *See supra* note 68.

> respective contexts, objects and purposes, subsequent practice of parties and *travaux préparatoires*.[79]

What Japan and Korea had in mind in a 2002 treaty cannot, under the Vienna Convention, be ascribed to Canada, Mexico and the United States in a treaty entered into in 1992.

72. The proposition Canada apparently seeks to establish by reference to these treaties and failed treaties — that *purchasing* services is not the same thing as *achieving* a certain level of R&D — has only tangential relevance to the Guidelines at issue here. The Accord Acts specifically require that "*expenditures* ... be made for research and development to be carried out in the Province."[80] The term "expenditures" denotes payment for services not implicated by achieving a level of R&D internally.[81] The distinction Canada seeks to

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[79] **CA-83**, *Access to Information under Article 9 of the OSPAR Convention (Ireland v. U.K.)*, Final Award of July 2, 2003, ¶ 141 (quoting Int'l Tribunal on Law of Sea Order of Dec. 3, 2001).

[80] **CA-11**, *Federal Accord Act*, s. 45(3)(c) (emphasis added); *see also* **CA-12**, *Provincial Accord Act*, s. 45(3)(c).

[81] *See* **CA-166**, BusinessDictionary.com, definition of "expenditure" (defining term as "Actual payment of cash or cash-equivalent for goods or services, or a charge against available funds in settlement of an obligation as evidenced by an invoice, receipt, voucher, or other such document. A revenue expenditure is cash used in payment for goods and services consumed in a short period. A capital expenditure is cash used in purchase of fixed assets that last one year or more."). Canadian dictionaries provide a similar definition. *See* **CA-168**, The Canadian Oxford Dictionary, p. 488 (2001) ("the process or instance of spending or using up ... a thing (esp. a sum of money) expended"). Other dictionaries and thesauri emphasize that the ordinary meaning of "expenditure" relates to spending money. *See, e.g.*, **CA-174**, Princeton University, WordNet, definition of "expenditure" *available at* wordnet.princeton.edu/ (defining "expenditure" as "money paid out; an amount spent," "the act of spending money for goods or services"

draw based on the Multilateral Agreement on Investment ("MAI") and the Japanese treaties between purchasing local R&D services and achieving levels of R&D internally is without relevance to the measures presented here.[82]

73. In any event, the documents upon which Canada relies do not support its proposition. The tentative, unapproved draft of the MAI that Canada references supports the opposite conclusion.[83] Notably, the draft states as follows:

> It is agreed to transform the previous paragraph 3 in the special topics report into an interpretative footnote to paragraph 1 with the same legal standing and which reads:
>
> "*For the avoidance of doubt, nothing in paragraph . . . 1(c) . . . shall be construed to prevent a Contracting Party from conditioning the receipt or continued receipt of an advantage . . . on compliance with a requirement, commitment or undertaking to . . . carry out research and development in its territory.*"[84]

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and "the act of consuming something"); **CA-165**, AmericanBanker.com, Banker's Glossary, definition of "expenditures" ("Decreases in net financial resources. Expenditures include current operating expenses requiring the present or future use of net current assets.").

[82] Indeed, a requirement to carry out R&D internally in a Party's territory would not be permissible under the NAFTA.

[83] *See* **RA-36**, OECD, The Multilateral Agreement on Investment: Draft Consolidated Text, p. 2 ("This document consolidates the text of the agreement considered in the course of the MAI negotiations so far. The texts reproduced here result mainly from the work of expert groups and have not yet been adopted by the Negotiating Group. They are presented with footnotes and proposals that are still under consideration.").

[84] **RA-36**, MAI Draft Text, at 22 n.29.

74. If it were clear, as Canada suggests, that paragraph 1(c)'s prohibition of requirements "to purchase, use or accord a preference to goods produced or services provided in [a Contracting State's] territory" had nothing to do with R&D requirements, it is difficult to understand why the MAI negotiators would have agreed to an interpretative footnote stating that that same prohibition did not prevent conditioning an advantage on carrying out R&D.

75. *UNCTAD 2005 Report on "Transnational Corporations and the Internationalization of R&D."* Canada's desperation to find supporting material, despite the text and context of the NAFTA, can best be shown in its attempted reliance on a 2005 report on a different topic prepared by the staff of UNCTAD and not endorsed by any Member State.[85] That report suggests in passing, without discussion or analysis, that Article 1106(1) does not address R&D.[86]

76. Such a report does not constitute State practice and has no particular standing in international law. It represents no more than a statement of opinion on the issue before this Tribunal. For all of the reasons explored above, Claimants respectfully submit that the unsupported statement by this report is not persuasive. As noted in the Memorial, in other reports that do address the subject at hand — performance requirements — UNCTAD has classified local R&D requirements as performance requirements.[87] The isolated

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[85] RM ¶ 165 *et seq.*; *see also* **RA-69**, UNCTAD, *World Investment Report 2005: Transnational Corporations and the Internationalization of R&D*, p. vi (report prepared by staff; describing sources of comments on report, which do not include endorsement by any State).

[86] RM ¶ 165.

[87] CM ¶ 152.

excerpt referenced by Canada in a report on a different topic is erroneous and not entitled to weight.

B. Canada's Suggestion That the R&D Expenditure Guidelines Do Not Require Expenditures on R&D Is Without Merit

77. Canada's contention that the Guidelines do not require prohibited expenditures on R&D is without merit, for several reasons.[88]

78. *First*, as noted above, Article 1106(1)(c) applies to "services," including both E&T services and R&D services. To the extent that Canada suggests that E&T is somehow exempted from Article 1106(1)(c),[89] that suggestion cannot be sustained for the same reasons discussed in the preceding section.

79. *Second*, to the extent that Canada's argument is based on the *form* of the transaction by which expenditures on E&T are made, the argument is not supported by the plain text of Article 1106(1)(c). Contrary to Canada's contention, that provision is not limited to "the purchase of local goods or services."[90] Instead, it applies to requirements:

> 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; ...[91]

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[88] RM ¶¶ 186 *et seq.*

[89] *See, e.g., id.* ¶ 197 ("Accordingly, the option exists for participants to make expenditures *only* on E&T and *none* on R&D.") (emphasis in original).

[90] *Id.* ¶¶ 198-199.

[91] **CA-3**, NAFTA art. 1106(1)(c) (emphasis added). The ordinary meaning of the terms "purchase," "use," "accord" and

The phrase "purchase, use or accord a preference to" indicates an intent on the part of the drafters broadly to address local content requirements, irrespective of the form of the transaction encompassed by such requirements.

80. Canada thus fundamentally errs in arguing that funding a professorial chair, scholarships, classroom furnishings, and various research and education projects in the Province do not fall within Article 1106(1)(c)'s prohibition because they do not involve the "purchase" of local goods or services.[92] The Guidelines' requirement for such spending clearly "accord[s] a preference" to educational services provided in the Province.[93]

"preference" can be elucidated from dictionary definitions of those terms. To "purchase" means to "obtain by paying money or its equivalent." *See* **CA-176**, Webster's Ninth New Collegiate Dictionary, p. 956 (1991). *See also* **CA-170**, FreeDictionary.com, definition of "purchase" ("(Business / Commerce) to obtain (goods, etc.) by payment."). The word "use" means to "put into service; make work or employ for a particular purpose or for its inherent or natural purpose." *See* **CA-174**, Princeton University, WordNet. *See also* **CA-177**, YourDictionary.com, definition of "use" ("to put or bring into action or service; employ for or apply to a given purpose"). To "accord" is defined as to "accord, allot, grant (allow to have) '*grant a privilege*.'" *See* **CA-174**, Princeton University, WordNet (emphasis in original). The word "preference" means to "grant of favor or advantage to one over another (especially to a country or countries in matters of international trade, such as levying duties)." *See* **CA-174**, Princeton University, WordNet. *See also* **CA-177**, YourDictionary.com, definition of "preference" ("a giving of priority or advantage to one person, country, etc. over others, as in payment of debts or granting of credit").

[92] RM ¶¶ 198-199.

[93] *See* **CA-71**, NAFTA Appendix 1001.1b-2-B, sec. U (common classification system established by NAFTA Parties included a group entitled "Educational and Training Services" that

81. *Third*, Canada's present contention that the Guidelines are really just requirements for educational donations does not square with the record. It beyond doubt that a drive to increase demand for R&D, as opposed to E&T, services in the Province was the principal rationale for the Board's decision to promulgate the Guidelines.

82. As an initial matter, the Board titled the measure "R&D Expenditure Guidelines" — not "E&T Expenditure Guidelines" or even "R&D and E&T Expenditure Guidelines." The contemporaneous evidence also supports this understanding. For example, a provincial government official at the time explained that the Board took the step of enacting the Guidelines in order "to extract greater commitment to *R&D* from the oil and gas sector."[94]

83. For this reason, the Board based the Guidelines expenditure requirement on a statistical index for nationwide *R&D* spending by the oil and gas sector. As Canada readily concedes, the Statistics Canada benchmark does not in any way take account of spending by oil and gas companies on *E&T*.[95] Furthermore, in defending the Guidelines before the Canadian courts — and, indeed, before this Tribunal — the Board and Canada attempted to frame the Guidelines as reasonable based in large part on the use of this statistical

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encompassed subclasses such as "Lectures for Training," "Tuition, Registration, and Membership Fees," and "Faculty Salaries for Schools Overseas").

[94] **CE-197**, Letter from P. Tobin, Assistant Deputy Manager, Industrial Benefits Division, Newfoundland and Labrador Ministry of Natural Resources, to B. Saunders, Deputy Minister (Jan. 21, 2004) (emphasis added). *See also, e.g.*, **CE-163**, Presentation by CNLOPB to Governments (June 2002) (in an early presentation of the Guidelines to the governments, the Board focused almost exclusively on R&D).

[95] RM ¶ 122.

benchmark for *R&D* spending.[96] And though the alleged reasonableness of the Guidelines does not matter to this arbitration for reasons stated below,[97] the fact that the Guidelines incorporated a metric for average industry expenditures on *R&D* was essential to the Canadian courts' finding that the Guidelines were permissible as a matter of Canadian administrative law.[98]

84. In suggesting that Claimants can now avoid any conflict with the NAFTA by making expenditures exclusively on E&T, Canada seeks to promote a convenient end-run around the treaty, which is both ineffective given the prohibition in Article 1106(1)(c) of local content requirements for services (including E&T services), and disingenuous in view of the clear orientation of the Guidelines to expenditures on R&D.

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[96] *Id.* ¶¶ 112-122; **CA-124**, *Hibernia and Petro-Canada v. C-NOPB*, Supreme Court of Newfoundland and Labrador Court of Appeal, Factum on Behalf of the Respondent, ¶¶ 203-212.

[97] *See infra* Annex ¶¶ 19-21.

[98] *See, e.g.*, **CA-52**, *Hibernia and Petro-Canada v. C-NOPB*, Supreme Court of Newfoundland and Labrador Trial Division, 2007 NLTD 14, ¶ 83 (Jan. 22, 2007) (hereinafter "*Hibernia I*") ("the Board's decision to tie research and development expenditures to industry norms in fulfilment of its obligation to determine what would be a reasonable and sufficient level of expenditure on research and development is a reasonable approach."); **CA-53**, *Hibernia and Petro-Canada v. C-NOPB*, Supreme Court of Newfoundland and Labrador Court of Appeal, 2008 NLCA 46, ¶ 110 (per Justice Welsh) (hereinafter "*Hibernia II*") ("[T]he applications judge did not err in concluding that … [t]he parameters set out in the Guidelines are reasonable.").

C. The R&D Expenditure Guidelines Do Not Fall Within Article 1108(1)'s Exception for Measures Existing in 1994

1. Article 1108(1) Does Not Include Future Measures, Subordinate or Otherwise

85. There is also no merit to Canada's contention that the Guidelines qualify under Article 1108(1)'s exception for certain "existing non-conforming measures" at the time of entry into force of the NAFTA in 1994. Canada's argument again cannot be reconciled with the ordinary meaning of Article 1108(1) or with that provision's context or the object and purpose of the NAFTA.

86. As a preliminary matter, there is no dispute that Canada bears the burden of establishing the applicability of an exception to Article 1106(1).[99] Canada has not come close to discharging its burden here. Its principal argument — that the Guidelines are "subordinate" to the Accord Acts and therefore qualify as a measure existing in 1994 — fails for several reasons.

87. *First*, this argument cannot be reconciled with the ordinary meaning of the operative text of the treaty, which Canada does not directly apply. The exception upon which Canada relies is set out in Article 1108(1), which provides as follows (emphasis added):

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[99] CM ¶ 162 & n. 306; RM ¶¶ 215-223. As noted further below, Claimants agree that the maxim that exceptions to treaty obligations are construed restrictively is not a primary means of treaty interpretation under VCLT art. 31. It nonetheless qualifies as a supplemental means of interpretation under VCLT art. 32 and may appropriately be relied upon to confirm the meaning arrived at under art. 31.

> Articles 1102, 1103, 1106 and 1107 do not apply to:
>
> (a) any *existing* non-conforming *measure* that is *maintained* by
>
> (i) a Party at the federal level, as set out in its Schedule to Annex I or III,
>
> (ii) a state or province, for two years after the date of entry into force of this Agreement, and thereafter as set out by a Party in its Schedule to Annex I in accordance with paragraph 2, or
>
> (iii) a local government; …

88. The terms "existing" and "measure," in turn, are defined in Article 201 as follows:

> **existing** means in effect on the date of entry into force of this Agreement; …
>
> **measure** includes any law, regulation, procedure, requirement or practice; …

89. Under the ordinary meaning of the terms of Article 1108(1), for the exception to apply the following elements must be established: (i) a measure within the broad terms of Article 201 (ii) that is *in effect* on January 1, 1994, the date of entry into force of the NAFTA and (iii) is maintained by a Party at the federal or state or provincial level and listed in its Schedule to Annex I or III.

90. While the Guidelines indisputably are a measure within the meaning of Article 201, it is equally indisputable that they were not in effect on the date of the NAFTA's entry into force.[100] They therefore cannot qualify as "existing" within the definition in Article 201.

91. Canada argues that one element of the *context* of Article 1108(1) leads to an interpretation diametrically

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[100] CM ¶ 169.

opposed to the ordinary meaning of its terms. Canada contends that the Interpretative Note to Annex I implicitly creates a contrary rule that allows future measures to be covered if they are subordinate to the measure listed in the schedule to the Annex. Canada's argument hinges upon the reference to subordinate measures in the Interpretative Note to Annex I.[101] The Annex is entitled "Reservations for Existing Measures and Liberalization Commitments." That Note provides in pertinent part (emphasis added):

> 1. The Schedule of a Party sets out, pursuant to Articles 1108(1) (Investment), ... the reservations taken by that Party with respect to *existing measures* that do not conform with obligations imposed by: ...
>
> (d) Article 1106 (Performance Requirements), ...
>
> 2. Each reservation sets out the following elements: ...
>
> (f) **Measures** identifies the laws, regulations or other measures, as qualified, where indicated, by the Description element, for which the reservation is taken. A measure cited in the Measures element
>
> (i) means the measure as amended, continued or renewed as of the date of entry into force of this Agreement, and
>
> (ii) includes any *subordinate measure adopted or maintained* under the authority of and consistent with the measure; ...

92. Canada's contention is that the reference to subordinate measures should be read to encompass not only *existing measures*, but also subordinate measures that might be adopted in the future. Under Canada's reading, although a NAFTA Party could not make the principal measure listed in Annex I more restrictive in the future, it could achieve the

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[101] RM ¶¶ 226-232.

same result by adopting a more restrictive future *subordinate* measure.

93. Canada's contention is baseless. *First*, as noted above, it cannot be reconciled with the ordinary meaning of the operative text — that of Article 1108(1). The text stating the exception clearly applies only to existing measures.

94. *Second*, Canada twists all logic by arguing that the past tense "subordinate measure[s] *adopted or maintained*" — in fact refers to *future* measures.

95. By contrast, in Article 1108(3), where the Parties clearly intended to address measures that might be adopted in the future, they did not use the past tense: "Articles 1102, 1103, 1106 and 1107 do not apply to any measure that a Party *adopts or maintains* with respect to sectors, subsectors or activities, as set out in its Schedule to Annex II."[102] In turn, the Interpretative Note to Annex II, which is entitled "Reservations for Future Measures," begins with the following statement (emphasis added):

> 1. The Schedule of a Party sets out, pursuant to Articles 1108(3) (Investment) ... , the reservations taken by that Party with respect to specific sectors, subsectors or activities *for which it may maintain existing, or adopt new or more restrictive, measures* that do not conform with obligations imposed by: ...

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[102] By contrast, Article 1108(1) does not contain any variant of the word "adopt," underscoring that it applies only to existing measures. Moreover, it uses the present tense, not the past tense, to describe the existing measures: "Articles 1102, 1103, 1106 and 1107 do not apply to: (a) any existing non-conforming measure that *is maintained* by..." a Party at any level of government. NAFTA art. 1108(1) (emphasis added). This differs from the clause of the Interpretative Note to Annex I, which uses the past tense: "measures adopted or maintained." *Compare* **CA-3**, NAFTA, art. 1108(1) *with* **CA-6**, NAFTA, Annex I, Interpretative Note.

(d) Article 1106 (Performance Requirements); ...

96. Thus, the NAFTA Parties clearly understood the difference between existing and future measures, and also understood how to make clear when they wished to address one, the other, or both. The Interpretative Note to Annex II on "Future Measures" clearly states the Parties' intention for it to apply to measures that may be adopted in the future as well as existing measures. The Interpretative Note to Annex I on "Existing Measures" equally clearly states the Parties' intention that it apply to existing measures. In sum, neither the text nor the context of Article 1108(1) supports Canada's view that *future* measures are included in Article 1108(1) if they are subordinate to the measure listed.

97. *Third*, the Interpretative Note itself states that each "Schedule of a Party sets out ... the reservations taken by that Party with respect to *existing measures* that do not conform with obligations imposed by" Article 1106. This statement describes the *scope* of the reservations in the schedules. By contrast, the subordinate measures clause on which Canada relies describes only how the measure identified in the schedule should be understood. The Note could not be clearer that it applies to existing measures, not future measures.

98. *Fourth*, the comparison of "maintained" in Article 1108(1) and "adopted or maintained" in the subordinate measures clause, on which Canada relies, does not support its argument.[103] The temporal frame of reference for the term "maintained" in Article 1108(1) is the date of entry into force of the NAFTA. "Existing measures," which are covered by a party's Annex I reservation, are those measures previously

[103] *See* RM ¶ 227 ("Consequently, the NAFTA parties not only reserved subordinate measures that existed at the time the NAFTA went into force and were *maintained* but also subordinate measures that were *adopted* after this date.") (emphasis in original).

adopted and maintained when the NAFTA entered into force. By contrast, the temporal frame of reference for "adopted or maintained" in the subordinate measures clause is the date on which "*the measure*" under the authority of which the subordinate measure exists was implemented. The formulation "adopted or maintained" reflects the NAFTA Parties' recognition that subordinate measures may be put into place before the listed measure's enactment and maintained thereafter under the authority of the provision, or they may be adopted under the authority of the measure and subsequent to its enactment. While the Parties intended to encompass subordinate measures adopted after a listed measure's enactment within the scope of a party's Annex I reservation, they did not intend to encompass subordinate measures adopted after the entry into force of the NAFTA. As stated above, a Party's Annex I reservation only encompasses measures existing when the NAFTA entered into force.[104] It is notable that, where the NAFTA Parties intended to encompass measures "adopted" (in the past tense) after the date of the Agreement, they were explicit about this.[105] Their failure to do so in the subordinate measures clause speaks volumes.

99. *Fifth,* Canada's reading cannot be reconciled with the object and purpose of the NAFTA. In addition to the objectives of "eliminat[ing] barriers to trade in, and facilitat[ing] cross-border movement of, goods and services" and "increas[ing] substantially investment opportunities"

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[104] *See supra* ¶¶ 85-105.

[105] *See* **CA-3**, NAFTA art. 1108(4) ("No Party may, under any measure *adopted after the date of entry into force* of this Agreement and covered by its Schedule to Annex II, require an investor of another Party, by reason of its nationality, to sell or otherwise dispose of an investment existing at the time the measure becomes effective") (emphasis added).

referenced above, Article 102(1) also sets as an objective "creat[ing] effective procedures for the implementation and application of this Agreement ..." The Preamble to the NAFTA further recites among the purposes of the treaty to "establish clear and mutually advantageous rules governing [the NAFTA Parties'] trade" and to "ensure a predictable commercial framework for business planning and investment." (Emphasis omitted.)

100. Canada's reading of "existing non-conforming measures" to encompass future subordinate measures would render Article 1108(1) ineffective, allow a Party to evade its NAFTA obligations at will, muddy previously clear rules agreed by the Parties as to what measures were excepted by Article 1108(1) and destroy predictability in the framework of business and investments to which a measure listed in a schedule to Annex I applies. Under Canada's reading, any Party can, at any time, undo the difficult compromises made in the schedules to Annex I simply by putting in place a more restrictive measure that happens to be of a lower order than that listed in the schedule. This result cannot be reconciled with the NAFTA's object and purpose of effectiveness, clarity, and predictability.

101. Nor can it be reconciled with the clear division that the Parties had in mind in establishing the treaty's annexes. Annex I covers existing measures that cannot become more burdensome. Following a highly transparent negative-list approach, the Annex specifically lists the measures not covered so that investors are on notice as to what they are. The measures are subject to the "ratchet rule" of Article 1108(1)(c): they may be amended but not made more restrictive. By contrast, Annex II covers sectors where a NAFTA Party is not bound by the relevant investment chapter prohibitions and where measures may become more restrictive in the future.

102. Canada's reading effectively transforms an Annex I exception into one under Annex II and eliminates the differences between the two annexes. Indeed, it is difficult to imagine, under Canada's reading, when a subordinate measure could *ever* fall within the principal mechanism provided in Article 1108(1) for future measures: subparagraph (c)'s ratchet rule for amendments. This is clearly contrary to the intent of the drafters and would leave a gaping hole in the ratchet rule for Annex I exceptions.

103. *Sixth*, Canada's reading should be rejected because it would lead to manifestly absurd and unreasonable results.[106] Since all state and provincial measures were ultimately listed in Annex I without specificity,[107] any provincial measure below the constitutional level (and therefore subordinate) adopted at any point in time would be exempt from national treatment, most-favored-nation treatment, and other obligations pursuant to Article 1108(1). However, future

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[106] *See, e.g.*, **CA-17**, *Amoco Int'l Fin. Corp. v. Iran*, Partial Award of July 14, 1987, ¶ 109 (treaty interpretation that leads to manifestly absurd or unreasonable result "cannot be admitted."); **CA-117**, *Territorial Dispute (Libya v. Chad)*, I.C.J. Reports 1994 6, Judgment of February 3, 1994, ¶ 84 (separate opinion of Judge Ajibola) (referring to "cardinal principle of interpretation that a treaty should be interpreted in good faith and not lead to a result that would be manifestly absurd or unreasonable.") (quotation omitted); **CA-109**, *Polish Postal Service in Danzig*, 1925 P.C.I.J. (ser. B) No. 11, Judgment of May 16, 1925, p. 39 ("It is a cardinal principle of interpretation that words must be interpreted in the sense which they would normally have in their context, *unless such interpretation would lead to something unreasonable or absurd.*") (emphasis added).

[107] **RE-11**, Government of Canada exchange of letters with other NAFTA parties, p. 3 (Mar. 29, 1996) (listing "[a]ll existing non-conforming measures of all provinces and territories" in "measures" element of Annex I exception).

subordinate measures by local governments, since they are not included in Annex I, would not benefit from Canada's reading and would not be exempt. While future measures in a sector provided for in Annex II cannot, under Article 1108(4), cause an investor to sell or dispose of an existing investment, no such restriction would apply to future Annex I subordinate measures having that effect. Under Canada's view, Canada would be precluded from enacting the Guidelines as an amendment or modification of the Accord Acts, but it is free to achieve exactly the same result through requirements in the form of Board guidelines.

104. Canada has not attempted to explain what policy consideration could possibly have led the NAFTA Parties to adopt the rule it espouses. Notably, none of these unreasonable results would follow if "existing measures" in Article 1108(1) were read to mean what it says: measures existing in 1994.

105. *Seventh*, it is notable that GATT panels interpreting a similar exception for "existing legislation" have found that the listing in an annex of a measure granting rule-making authority did not mean that a rule later adopted under that authority was covered by the annex exception. These panels interpreted the grandfathering exception referring to "existing legislation" in GATT 1947 to apply only to "mandatory legislation," *i.e.*, legislation that imposed requirements on executive authority that could not be modified by executive action. Subsequent measures that, like the Guidelines here, were discretionary acts were not covered by the exception. [108]

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[108] *See* **CA-115**, GATT Panel Report, *Spain – Measures concerning Domestic Sale of Soyabean Oil*, L/5142 (unadopted) (June 17, 1981) (holding that post-GATT 1947 legislation by which the Commissioner General for Supply and Transport ("CAT") regulated the oil marketing season was not covered by the "existing

2. The Disputing Parties Agree That the R&D Expenditure Guidelines Are Not an Amendment Within Article 1108(1)(c)'s "Ratchet Rule"

106. Canada concedes that the Guidelines are not an amendment to the Accord Acts, so Article 1108(1)(c)'s "ratchet rule" cannot resolve the Guidelines' non-conformity with Article 1106(1).[109]

107. Canada does not attempt to support its alternative argument that, "even if the Guidelines are somehow an amendment," they qualify under the "ratchet rule" because they do not decrease the conformity of the measure with Article 1106.[110] In their Memorial, Claimants demonstrated at length that the Guidelines impose far more restrictive local content requirements on investments than had been the case under the preexisting regime and supported that demonstration with ample evidence.[111] For the convenience of the Tribunal, the Claimants summarize that showing in the following table:

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legislation" exception because the pre-GATT 1947 law merely authorized the CAT to take specific measures to regulate the oil marketing season and some of the CAT's decisions needed approval from the Council of Ministers); **CA-106**, GATT Panel Report, *Norway – Restrictions on Imports of Apples and Pears*, L/6474 – 36S/306 (June 22, 1989) (finding that post-GATT 1947 decrees prohibiting imports of apples and pears were not covered by the "existing legislation" exception because the pre-GATT legislation was not mandatory, *i.e.*, it gave discretion to the King to prohibit the importation of apples and pears).

[109] RM ¶ 239.

[110] *Id.* ¶ 240.

[111] CM ¶¶ 179-193.

	Pre-Guidelines	Post-Guidelines
Substantive Commitment	Project operator will undertake some unspecified amount of R&D/E&T to address the commercial and technical needs of the project unique to operating in the Canadian offshore environment, and must give priority consideration to local providers on a competitive basis in the procurement of those services.	Project operator must achieve a prescribed level of expenditures on R&D/E&T irrespective of the commercial and technical needs of the project, amounting, in practice, to millions more dollars per year than would otherwise be spent. The mandated amounts are not tied to the commercial or technical needs of the project, nor are they tied to the technical needs of the offshore Newfoundland environment.
Board Monitoring Function	Project operator must periodically provide high-level report to the Board on R&D/E&T activity. These periodic reports allowed the Board to monitor the operators' undertakings, as contained in their benefits plans.	At the end of each Production Operations Authorization ("POA") period, project operator must provide detailed accounting of R&D/E&T expenditures during that POA period. Board assesses each claimed expenditure

	Pre-Guidelines	Post-Guidelines
		and determines whether it counts toward the Guidelines expenditure requirement. In the event of a shortfall in spending, the project owners must provide a plan to spend down the gap, a financial instrument to guarantee the shortfall, and an agreement with sufficient triggers for the Board to realize upon the instrument.
Pre-Approval Requirement	No Board pre-approval; the Board does not pass judgment on individual R&D/E&T expenditures.	Project operator must seek Board pre-approval of each R&D/E&T expenditure that it plans to undertake.
Relationship Between R&D/E&T Activity and POA	None.	POA conditioned on compliance with the Guidelines.

Retroactive Effect of the Board's Determinations	Operators spent the amount required by the commercial and technical needs of the project on R&D and E&T.	Board calculates expenditure requirements at the end of each POA period. Thus, an operator does not know how much it was required to expend during a POA period until that period is over. Because the expenditure amount applicable to a given period is calculated after the fact, operators cannot effectively plan their R&D/E&T activity to avoid a deficit or a surplus in spending.

Canada has presented no meaningful response to this factual showing.

108. That the Guidelines were more non-conforming than the preceding regime is also illustrated by the GATT Panel Report in the *Canada-Administration of the Foreign Investment Review Act* dispute between the United States and Canada[112] — a dispute that shaped the two Parties' approach to performance requirements in the NAFTA. That dispute concerned the application of GATT Article III(4), a generalized prohibition on goods-related performance

[112] **CA-88**, *Canada – FIRA* GATT Panel Report.

requirements. The panel condemned Canada's practice of soliciting voluntary undertakings, akin to the commitments contained in Claimants' Benefits Plans, from investors even where there were no formal guidelines or regulations concerning that practice. It found the practice to constitute a prohibited "requirement" within Article III(4), as it rejected Canada's "view that the word 'requirements' in Article III:4 should be interpreted as 'mandatory rules applying across-the-board.'"[113]

109. In contrast to the "soft" requirements at issue in that case, the R&D Expenditure Guidelines do indeed put into place "mandatory rules applying across-the-board." They are different in kind as well as in effect from the earlier regime. They cannot be justified under the ratchet rule of Article 1108(1)(c).

110. This conclusion is significant because, in the final analysis, it is clearly the framework of the ratchet rule that the NAFTA Parties had in mind for assessing future measures amending those listed in Annex I. The fact that the Guidelines cannot meet the standard of the ratchet rule confirms that, as a policy matter, they are precisely the kind of measure the NAFTA Parties intended to prohibit.

* * *

111. For the foregoing reasons, and for those demonstrated in the Memorial, the record here amply establishes a violation by Canada of its obligations under Article 1106 of the NAFTA.

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[113] *Id.* ¶¶ 5.4-5.5.

IV.

THE GUIDELINES VIOLATE ARTICLE 1105(1)'S GUARANTEE OF FAIR AND EQUITABLE TREATMENT

112. Claimants' Memorial demonstrated that Article 1105(1) of the NAFTA requires protection of an investor's legitimate expectations, including through provision of a stable and transparent regulatory environment, and that a number of other NAFTA tribunals have so held.

113. Canada rejects that proposition. Indeed, Canada has consistently fought, in other NAFTA cases as here, to confine Article 1105 to the "shocking and egregious" standard articulated by the *Neer* Tribunal in the 1920s. Those efforts have failed in all but one case: *Glamis*. That much-criticized decision represents an inexplicable departure from a substantial body of arbitral jurisprudence and should not influence the outcome of this case.

114. In any event, despite Canada's (largely unsupported) attempts to rationalize its actions after the fact, the record clearly demonstrates that the promulgation of the Guidelines represented a fundamental departure from the regulatory framework that existed at the time of Claimants' investment, particularly the Benefit Plans that the Board had adopted pursuant to the Accord Acts.[114] This departure undermined Claimants' legitimate expectations, repudiated the agreement

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[114] As noted above, at the time of Claimants' investment in the Hibernia project, the practices adopted under the FIRA also formed part of the relevant context with regard to investor benefits commitments in Canada, and thus informed Claimants' expectations that their R&D commitments under their Benefits Plan would define the scope of their expenditure obligations for the life of the investment. *See supra* note 7.

contained in the projects' Benefits Plans, and reneged on specific assurances made by the government that the Benefits Plans would define the scope of Claimants' R&D expenditure obligations. As a result, Canada has violated Article 1105 *regardless* of the standard of treatment this Tribunal elects to apply.

A. The Customary International Law Minimum Standard of Treatment Encompasses Protection of Legitimate Expectations

115. The parties agree that Article 1105 requires the application of the customary international law minimum standard of treatment of aliens. The parties also agree that the content of the minimum standard is not static, but rather evolves over time.[115] Claimants' Memorial demonstrated how the minimum standard of treatment has evolved, shaped by the requirements of fair and equitable treatment included in bilateral investment treaties. Indeed, numerous investment treaty tribunals and commentators have concluded that there is no difference between the fair and equitable treatment standard contained in such treaties and the customary minimum standard of treatment. Multiple investment treaty awards demonstrate that these standards protect investors' legitimate expectations and oblige states to provide a stable regulatory regime for foreign investments.

116. According to *Glamis*, on which Canada now heavily relies, the customary international minimum standard of treatment is frozen in amber in 1926, its content still accurately articulated in the *Neer* award of that era. As is demonstrated below, *Glamis* is the only case in which a NAFTA party has succeeded in restricting Article 1105 to the *Neer* standard. No other NAFTA Tribunal has accepted the

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[115] RM n. 364.

proposition that the *Neer* minimum standard of treatment should be applied to modern-day investor-state arbitrations, despite Canada's frequent and failed attempts to persuade them otherwise. [116] The *Glamis* decision is impossible to reconcile with the preponderance of arbitral jurisprudence, and it should have no bearing on the outcome of this dispute.

1. The Article 1105 Standard Articulated in *Glamis* Should Not Control the Tribunal's Decision

117. The *Glamis* Tribunal explicitly recognized that its decision "effectively freezes the protections provided for in [Article 1105(1)] at the 1926 conception of egregiousness."[117] It is for that reason that *Glamis* has rightly been criticized for straying "off the beaten path"[118] and for "declining to recognize any evolution in the minimum standard of treatment since 1928, despite the fundamental transformations of international law in the post-war era [including] the

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[116] *See, e.g.*, **CA-36**, *Mondev International Ltd. v. United States of America*, ICSID Case No. ARB(AF)/99/2, Award of October 11, 2002, ¶ 115; **CA-16**, *ADF Group Inc. v. United States of America*, ICSID Case No. ARB (A)/00/1, Award of January 9, 2003, ¶ 181; **CA-110**, *Pope and Talbot Inc. v. Canada,* (UNCITRAL) Award in Respect of Damages of May 31, 2002, ¶¶ 46-47. *See also* **CA-144**, Ian Laird, "Betrayal, Shock and Outrage – Recent Developments in NAFTA Article 1105," in T. Weiler (ed.), *NAFTA Investment Law and Arbitration: The Early Years* (2004), p. 56 (noting the "strained and torturous strategy" adopted by the NAFTA parties, and Canada in particular, to limit Article 1105 to the minimum standard of treatment articulated in *Neer*).

[117] **CA-32**, *Glamis Gold, Ltd. v. United States of America*, (UNCITRAL) Award of May 16, 2009, ¶ 604.

[118] **CA-161**, Erik Wasson, *Glamis Ruling Sets Stricter Standard, Departs from Other Tribunals*, Inside US Trade, Vol. 27, July 10, 2009.

proliferation of investment treaties (which signal a universal commitment to robust protection of foreign investment)." [119] Even now Canada appears to concede that the minimum standard can evolve.[120]

118. This Tribunal is not bound to follow *Glamis*. The overwhelming weight of other NAFTA awards and sound legal logic clearly suggest that it should not do so.[121]

2. The Tribunal's Decision in *Glamis* Cannot Be Reconciled with the Decisions of Other NAFTA Tribunals

119. Prior to the issuance of the FTC Note of Interpretation,[122] Chapter 11 tribunals acknowledged the breadth of Article 1105[123] and confirmed that it required both

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[119] *See, e.g.,* **CA-134**, Charles H. Brower II, *Hard Reset vs. Soft Reset: Recalibration of Investment Disciplines under Free Trade Agreements*, available at kluwerarbitrationblog.com (posted December 16, 2009).

[120] RM n. 364.

[121] *See* **CA-134**, Brower, *Hard Reset* ("[O]ne may observe that the decentralized character and inconsistent results of arbitration by a series of unrelated tribunals (often cited as flaws) supply the flexibility required to make u-turns from undesirable trends."); **CA-161**, Wasson ("'The Tribunal clearly strayed off the beaten path with its legal analysis of the Article 1105 standard, but it likely doesn't signal any sort of a sea change. Fair and equitable treatment cases are highly fact-dependent and Glamis just didn't have a convincing case - regardless of the legal standards available to the Tribunal.'") (quoting Todd J. Weiler).

[122] **CA-8**, NAFTA Free Trade Commission, *Notes of Interpretation of Certain Chapter 11 Provisions*, § 2(1) (July 31, 2001).

[123] **CA-44**, *S.D. Myers Inc. v. Government of Canada*, (UNCITRAL) Partial Award of November 13, 2000, ¶ 265-66.

provision of a transparent and predictable legal framework[124] and protection of an investor's legitimate expectations.[125]

120. In *Pope & Talbot*, the Tribunal issued two decisions on the merits of the investor's Article 1105 claim: one before the Note of Interpretation was promulgated and one after. In its first Award, the Tribunal rejected Canada's argument that the *Neer* standard applied under Article 1105 and held that "Article 1105 requires that covered investors and investments receive the benefits of the fairness elements under ordinary standards applied in NAFTA countries, without any threshold limitation that the conduct complained of be 'egregious,' outrageous' or shocking,' or otherwise extraordinary."[126] Applying this standard, the Tribunal found that Canada had violated the provision.[127]

121. The NAFTA parties "reacted in dramatic fashion" to this decision "by issuing the FTC Note of Interpretation two months later."[128] Canada subsequently requested that the *Pope & Talbot* Tribunal reconsider its decision on Article 1105.[129] The timing of the Note, issued while a number of

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[124] **CA-35**, *Metalclad Corporation v. Mexico*, ICSID Case No. ARB(AF)/97/1, Award of August 30, 2000, ¶¶ 74-101

[125] **CA-35**, *Metalclad*, ¶¶ 85-99. *See also* **CA-144**, Laird, at 61 ("The [*S.D. Myers*] case is an example, much like *Metalclad*, of a breach of the legitimate expectations of a foreign investor in establishing and operating its investment, as well as arbitrary and discriminatory conduct by government officials.").

[126] **CA-42**, *Pope and Talbot Inc. v. Canada*, (UNCITRAL) Award on the Merits of Phase 2 of April 10, 2001, ¶ 118.

[127] **CA-42**, *Pope & Talbot II*, ¶ 181.

[128] **CA-144**, Laird, p. 65.

[129] **CA-110**, *Pope & Talbot III*, ¶ 3. *See also* **CA-144**, Laird, at 65 ("With this new interpretation in hand, Canadian officials decided to take the unorthodox step of essentially demanding the

Chapter 11 tribunals were considering claims under Article 1105, has been heavily criticized. Most notably, Sir Robert Jennings described it as a breach of the "most elementary rules of due process."[130] The *Pope & Talbot* Tribunal also made known its disapproval of the FTC Note in its Award on Damages. In particular, the Tribunal opined that it would have found the Note to constitute an unlawful amendment of Article 1105, had it been required to decide the issue.[131]

122. However, the Tribunal did reconsider the investor's Article 1105 claim in light of the FTC Note of Interpretation. It found that the seriousness of the facts alleged was sufficient to found a violation of Article 1105 even under the *Neer* standard.[132] For reasons that will be articulated below, the same decision is warranted in this case.

123. The tribunal also criticized Canada's reticence in providing the Claimants and the Tribunal with the negotiating history of Article 1105. Counsel for Canada had previously assured the tribunal that such documents did not exist. These assurances were subsequently shown to be "uninformed" with the production of "1,500 pages of documents, reflecting over 40 different drafts" of Article 1105.[133] The Tribunal relied on this negotiating history as support for its conclusion that the

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Pope tribunal to reconsider its merits findings based on Article 1105, rather than leaving the matter for future cases.").

[130] **CA-103**, *Methanex Corp. v United States of America*, (UNCITRAL) Second Opinion of Sir Robert Jennings, Sept. 6, 2001, p. 5. *See also* **CA-144**, Laird, at 55 ("One could argue, as a number of NAFTA claimants and Sir Robert Jennings did, that the FTC Note of Interpretation was intended to pre-empt a number of the on-going NAFTA Article 1105 arbitrations.").

[131] **CA-110**, *Pope & Talbot III*, ¶ 47

[132] *Id.* ¶ 69.

[133] *Id.* ¶ 38; *see also id.* ¶¶ 28-42.

FTC Note would have constituted a *de facto* unlawful amendment to Article 1105.[134]

124. Subsequent to the issuance of the Note of Interpretation, Chapter 11 tribunals have remained resistant to the contention that the *Neer* standard should be applied under Article 1105. As one commentator notes, the *Mondev* and *ADF* Tribunals rendered awards in which "one can detect an implicit challenge ... to the NAFTA parties' attempt to narrow the ambit of Article 1105."[135] Both Tribunals accepted that the FTC Note mandates them to apply the customary international law minimum standard of treatment to Article 1105 claims. However, both refused to adopt the position that this standard is fully expressed in *Neer*.[136] Indeed, this holding is reflected in all post-Note of Interpretation decisions, except for *Glamis*.[137]

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[134] *Id.* ¶¶ 43-47. The *Pope & Talbot* Tribunal found that the negotiating history supported its earlier conclusion that the fair and equitable treatment standard contained in Article 1105 was intended to be *additive to* the customary international law minimum standard of treatment rather than merely expressive of the latter. Canada's former Senior General Counsel and Director General of the Trade Law Bureau, Meg Kinnear, has confirmed that the travaux do *not* reveal a clear intention on the part of the NAFTA parties to equate the requirement to accord fair and equitable treatment under Article 1105 with the customary international law minimum standard of treatment. *See* **CA-58**, Kinnear, *Article 1105*, p. 1105-7 (noting that, prior to the adoption of the final formulation of Article 1105, the negotiating history was "ambiguous" as to whether the fair and equitable treatment standard had independent content or was simply an example of international law).

[135] **CA-144**, Laird, p. 66.

[136] **CA-36**, *Mondev*, ¶ 115; **CA-16**, *ADF*, ¶ 181.

[137] *See* **CA-42**, *Pope & Talbot II*, ¶¶ 46-47 ("Based upon its submissions in these proceedings ... Canada considers that the

3. The Customary International Law Minimum Standard of Treatment Has Evolved Beyond the Standard Expressed in *Neer*

125. In *Neer*, the General Claims Commission defined the conduct required of a state to constitute an actionable "international delinquency." Nowhere in the award does the Commission describe "fair and equitable treatment" or "full protection and security" as forming part of this definition. Rather, it required a state's conduct to reach the threshold of an "outrage," "bad faith," or of "willful neglect of duty."[138] The language employed in the award leads to two conclusions. First, the Commission was clearly describing the customary minimum standard applicable in *denial of justice* cases. Second, the obligation to accord fair and equitable treatment did not form part of that standard.

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principles of customary international law were frozen in amber at the time of the *Neer* decision. The Tribunal rejects this static conception of customary international law ... ."). While the four other NAFTA tribunals that have applied Article 1105 since the FTC Note of Interpretation was issued did not explicitly reject the submission that the *Neer* standard continues to apply, they did so implicitly. *See* **CA-33**, *International Thunderbird Gaming Corporation v. United Mexican States*, (UNICTRAL) Award of January 26, 2006, ¶ 194; **RA-28,** *Methanex Corporation v. United States of America*, (UNCITRAL) Award of August 3, 2005, Part IV, Chap. C; **RA-26**, *The Loewen Group Inc. v. United States of America*, ICSID Case No. ARB(AF)/98/3, Award of June 26, 2003, ¶ 133; **CA-51**, *Waste Management, Inc. v. United Mexican States*, ICSID Case No. ARB(AF)/00/3, Award of April 30, 2004, ¶¶ 93, 98-99.

[138] **CA-105**, *Neer v. United Mexican States*, ¶ 4.

126. Article 1105(1) provides that:

> 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.[139]

The FTC Note of Interpretation states that Article 1105(1) "prescribes the customary international law minimum standard of treatment of aliens as the minimum standard of treatment to be afforded to investments of investors of another Party."[140]

127. The only logical conclusion supported by reading the FTC Note together with Article 1105(1) is that the obligation to accord fair and equitable treatment today forms part of the customary minimum standard. The text of Article 1105(1) therefore makes clear that the contemporary minimum standard requires something more than the standard articulated in *Neer*. It requires states to accord fair and equitable treatment to the investments of foreign investors.[141] The FTC Note does not, and does not purport to, prescribe the application of the customary minimum standard as it stood in

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[139] **CA-3**, NAFTA, Chapter 11, Article 1105(1) (emphasis added).

[140] **CA-8**, NAFTA Free Trade Commission, *Notes of Interpretation of Certain Chapter 11 Provisions*, § 2(1) (July 31, 2001).

[141] *See* **CA-144**, Laird, at 62 ("'The terms fair and equitable treatment envisage conduct which goes far beyond the minimum standard and afford protection to a greater extent and according to a much more objective standard than any previously employed form of words .... [A tribunal] will have to decide whether in all the circumstances the conduct in issue is fair and equitable or unfair and inequitable.'") (quoting F.A. Mann, *British Treaties for the Promotion and Protection of Investments*, (1981) 52 Brit. Y.B. Int'l L., 241, at 243-44).

1926.[142] As noted above, the *Neer* award does not even mention the term "fair and equitable treatment" as an element of that standard. Thus, the *Neer* award cannot define the content of the contemporary minimum standard of treatment, which, as the NAFTA makes clear, includes the obligation to provide fair and equitable treatment.

128. As the *Mondev* Tribunal stated:

> [T]he FTC interpretation makes it clear that in Article 1105(1) the terms 'fair and equitable treatment' and 'full protection and security' are, in the view of the NAFTA Parties, references to existing elements of the customary international law standard and are not intended to add novel elements to that standard .... [I]t does not follow that the phrase 'including fair and equitable treatment and full protection and security' adds nothing the meaning of Article 1105(1), nor did the FTC seek to read those words out of the article ...[143]

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[142] **CA-36**, *Mondev*, ¶ 125 ("the term "customary international law" refers to customary international law as it stood no earlier than the time at which NAFTA came into force. It is not limited to the international law of the 19th century or even of the first half of the 20th century"). *See also* **CA-16**, *ADF*, ¶ 179 ("The FTC Interpretation of 31 July 2001 ... refers to customary international law 'as it exists today.'").

[143] **CA-36**, *Mondev*, ¶ 122. **CA-110**, *Pope & Talbot III*, ¶ 53 ("The [FTC] Interpretation does not require that the concepts of 'fair and equitable treatment' and 'full protection and security' be ignored, but rather that they be considered included as part of the minimum standard of treatment that it prescribes. Parenthetically, any other construction of the Interpretation whereby the fairness elements were treated as having no effect, would be to suggest that the Commission required the word 'including' in Article 1105(1) to be read as 'excluding.'"); **CA-134**, Brower, *Hard Reset* (noting that the *Glamis* award ignores fundamental transformations in

129. Simply put, "unfair and inequitable treatment" does not, in any ordinary sense of the words, equate with the outrageous or the egregious.[144] Adoption of the latter terms as the threshold to be applied under Article 1105 would render the provision void of meaningful protection.[145]

130. The fact that modern customary international law incorporates positive guarantees of "fair and equitable treatment" and "full protection and security" to foreign investments is further supported by state practice, in particular the NAFTA Parties' BIT practice.[146] State practice, such as

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international law "includ[ing] the specific phrasing of NAFTA Article 1105 and similar treaties, which recognize that the international minimum standard positively guarantees 'fair and equitable treatment' and, thus, represents an improvement over the prohibition against 'egregious,' 'outrageous,' and 'shocking government' conduct").

[144] *See* **CA-36**, *Mondev*, ¶ 116. *See also* **CA-16**, *ADF*, ¶ 180.

[145] *See* **CA-144**, Laird, at 57.

[146] In *Mondev*, the Tribunal noted that "numerous transmittal statements" by the United States of BITs containing similar language to Article 1105 contain general language to the effect that "the guarantee of fair and equitable treatment 'sets out a minimum standard of treatment based on customary international law.'" **CA-36**, *Mondev*, ¶ 111 (quoting the transmittal statement with respect to the United States-Ecuador BIT of 1993, 103d Congress, 1st Session, Treaty Doc. 103-15 (Washington, 1993), p. ix). *See* **CA-147**, Newcombe and Paradell, *Law and Practice of Investment Treaties* (2009), pp. 267-68 (citing Hearing Before the Committee on the Foreign Relations, United States Senate, 102nd Congress, Second Session, 4 Aug. 1992, S. HRG. 102-795, at 62). *See also* **CA-78**, Canadian Model Foreign Investment Protection and Promotion Agreement, Art. 5 ("Each party shall accord to covered investments treatment in accordance with customary international law, including fair and equitable treatment … ."); **CA-79**, 2004 U.S. Model BIT, Art. 5 (same).

treaty practice, confirms the existence of *opinio juris* with regard to customary norms of international law.[147] Where the practice is as widespread as the treaty practice obliging states to accord fair and equitable treatment to foreign investments, this argument acquires particular force. As the *Mondev* tribunal confirmed: "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."[148]

4. The Current Customary International Law Minimum Standard of Treatment Encompasses Protection of Legitimate Expectations

131. Article 1105(1) thus permits reference to state treaty practice and arbitral decisions to determine the content of the "fair and equitable treatment" standard. As Claimants have conclusively shown in their Memorial,[149] that standard imposes an obligation on states not to frustrate an investor's legitimate expectations. The decisions of numerous arbitral tribunals confirm that a breach of legitimate expectations can violate the minimum standard of treatment and Article 1105.

132. As stated by the NAFTA Tribunal in *Thunderbird*, "the concept of 'legitimate expectations' relates, within the context of the NAFTA framework, to a situation where a Contracting Party's conduct creates reasonable and justifiable

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[147] *See, e.g.*, **CA-154**, Tudor, The Fair and Equitable Treatment Standard in the International Law of Foreign Investment (2008), p. 81 ("The practice of States may be understood as the confirmation of *opinio juris*.").

[148] **CA-36**, *Mondev*, ¶ 125.

[149] CM ¶¶ 194-203.

expectations on the part of an investor (or investment) to act in reliance on said conduct, such that a failure by the NAFTA Party to honour those expectations could cause the investor (or investment) to suffer damages."[150] Similarly, the Tribunal in *Waste Management* held: "In applying [the minimum standard of treatment] it is relevant that the treatment is in breach of representations made by the host State which were reasonably relied on by the claimant."[151]

133. As shown in Section III.B below, the mandated spending requirements of the Guidelines are completely contrary to the provisions of the Hibernia and Terra Nova Benefits Plans, approved by the Board, on which Claimants relied in making their investments, and are contrary to the Government's practice under FIRA, where undertakings, which are like the benefits plans, did not oblige companies to depart from commercially sound practices.[152]

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[150] **CA-33**, *Thunderbird*, ¶ 147.

[151] **CA-51**, *Waste Management*, ¶ 98; see also **CA-16**, *ADF*, ¶ 189 (noting, but denying, the investor's claim that its legitimate expectations had been frustrated, as "any expectations that the Investor had … were not created by any misleading representations made by authorized officials of the U.S. Federal Government but rather … by legal advice received by the Investor, from private U.S. counsel").

[152] This practice is also contrary to how Canada treats foreign investment under the Investment Canada Act where undertakings are reviewed consistent with the original expectations and subsequent economic circumstances. The original expectations were that, with regard to R&D, the spending would be related to the needs of the project. With regard to the subsequent economic circumstances both Hibernia and Terra Nova are mature fields, with declining needs for R&D.

5. Customary International Law Prohibits State Violations of Foreign Investment Contracts in Certain Circumstances; Protection of Legitimate Expectations Is an Outgrowth of This Branch of Law

134. Claimants' Memorial described the agreements into which they entered with the Board and the provincial and federal governments.[153] These explicit agreements were essentially contracts between Claimants and different entities of the Canadian government, enshrined in the projects' Benefits Plans, the 1988 Statement of Principles and the Framework Agreement for Hibernia.[154] Under these contracts, Claimants undertook to confer various benefits on the province and Canada. In return, Claimants were granted the right to engage in offshore exploration, development and oil production. As the Board's promulgation of the Guidelines constituted a unilateral amendment of that contract, Canada's international responsibility for breach of contract is engaged.

135. Customary international law expresses a longstanding and well-established concern for contractual relations between states and aliens. It has been long recognized that contracts between States and foreign investors fall within the its purview, and that breach of such a contract can constitute a violation of international law in certain circumstances.[155] The United Nations General Assembly gave

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[153] CM ¶¶ 57-67; 69-79; 211-212.

[154] *See infra* ¶¶ 182 - 184.

[155] *See* **CA-132**, American Law Institute, *Restatement of the Law Second: Foreign Relations Law of the United States* (1965), § 193 (hereinafter "*Restatement II*, § 193"); **CA-133**, American Law Institute, *Restatement of the Law Third: Foreign Relations Law of the United States* (1987) (hereinafter "Restatement III"), § 712.

expression to the principle underlying this rule of international law:

> Foreign investment agreements freely entered into by, or between sovereign States shall be observed in good faith … .[156]

This resolution was considered to constitute evidence of customary international law at the time it was passed.[157] International arbitral awards dating from the first half of the twentieth century also embrace the idea that international law prohibits state violations of contracts with foreign investors.[158] In the 1970s, at least one international tribunal found that international law had evolved to encompass an "international law of contracts."[159]

136. A state's breach of a foreign investment contract will constitute a violation of international law in a number of instances. The most widely accepted example is where the breach is effected in a manner that is discriminatory or

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[156] **CA-156**, General Assembly Resolution on permanent sovereignty over natural resources, UN Doc. No. GA/RES/1803, ¶ 8.

[157] **CA-139**, Christopher Greenwood, *State Contracts in International Law – the Libyan Oil Arbitrations*, (1982) 58 BYIL 27, p. 42.

[158] **CA-113**, *Singer Sewing Machine Co. (United States v. Turkey)*, Nielsen's Op. and Rep. 490, 491. *See also* **CA-97**, *Hoffman and Steinhardt (United States v. Turkey)*, Neilsen's Op. and Rep. 286, 287 ("International tribunals have frequently rendered awards in cases involving the failure of a government to fulfill contractual obligations, although the law of nations does not embrace any "Law of Contracts," such as is found in the domestic jurisprudence of nations … .").

[159] **CA-118**, *Texaco Overseas Petroleum Co. v. Government of the Libyan Arab Republic*, (1978) 17 I.L.M. 1, ¶ 32.

arbitrary.[160] Another well-established example is where the breach amounts to an expropriation of the investor's property rights, and the State fails to compensate the investor for the expropriation.[161] Other tribunals have found that international law is engaged where the state-investor contract is sufficiently "internationalized."[162] One tribunal has justified international law's concern with breaches of foreign investment contracts on the basis of "the general principle of international law that aliens are entitled to rights secured under domestic law."[163]

137. In sum, Canada cannot deny that where a state breaches a foreign investment contract, its international responsibility may be engaged under the international minimum standard of treatment. The concern under international law with regard to such agreements is that an

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[160] **CA-99**, *Jalapa Railroad and Power Co.*, American-Mexican Claims Commission, 1948, 8 Whiteman, Digest of International Law 908-909 (1976); **CA-98**, *International Fisheries Co. (United States v. Mexico)*, (1951) 4 Rep. Int'l Arb. Awards 694, p. 699; *Restatement II*, § 193; **CA-145**, F.A. Mann, State Contracts and State Responsibility, (1960) 54 AJIL 572, p. 574 (surveying state practice and noting that where a state's breach of contract involves "the arbitrary exercise of sovereign power, coupled with the disregard of the alien's legitimate interests," this behavior constitutes "an international tort of the traditional type").

[161] **CA-97**, *Hoffman*, at 288; **CA-108**, *Phillips Petroleum Co. v. Iran*, Award of June 29, 1989, ¶¶ 75-76.

[162] *See* **CA-118**, *Texaco*, ¶¶ 40-45 (noting that "the internationalization of contracts entered into between States and foreign private persons can result in various ways," including (i) where the contract contains a choice of law provisions referring to "the general principles of law"; (ii) where the contract refers disputes arising thereunder to arbitration; and (iii) where the agreement between the investor and state is an "economic development agreement").

[163] **CA-97**, *Hoffman*, at 288,

investor requires protection against legislative uncertainties or any government measures that could result in abrogation of the contract.[164] One distinguished commentator has stated that international law protects an alien's contractual rights in order to protect its legitimate and "fundamental" expectation that the state will abide by its contract.[165] In other words, the state's international legal responsibility is engaged because its breach of contract results in the frustration of legitimate, investment-backed expectations held by the investor.

138. This line of customary international law provides a strong foundation for the conclusion that the minimum standard of treatment encompasses the protection of an investor's legitimate expectations. Where, as here, the investor has come to an agreement with the host state as to the terms that will govern its investment, fair and equitable treatment of that investment requires that the state abide by the terms of its agreement and respect any expectations the investor legitimately has as a result.

B. The Record Unequivocally Demonstrates That Canada Has Violated Article 1105(1)

139. Claimants' Memorial explained how their decisions to invest in the Hibernia and Terra Nova projects were based upon a series of assurances from the Board and the federal and provincial governments. Claimants were assured that the R&D expenditure commitments articulated in their Benefits Plans satisfied the Accord Acts and would define the scope of their obligations going forward.

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[164] **CA-118**, *Texaco*, ¶ 45.

[165] **CA-153**, Stephen M. Schwebel, *International Protection of Contractual Arrangements*, (1959) 53 ASIL Proceedings, 266, 269-70.

140. The carefully negotiated Benefits Plans established the following regime for Claimants' R&D-related obligations: (i) R&D spending was based on technical project needs; (ii) no minimum or fixed amount or percentage of money or revenue was required to be spent on R&D; (iii) the projects were not required to obtain pre-approval, by the Board or any other government agency, for R&D expenditures; and (iv) in conducting the necessary research and development in Canada to solve problems "unique" to the "Canadian offshore environment," the projects were to support local research institutions by giving priority to them and others when possible. The Board's actions in approving the Benefits Plans constituted an agreement between the parties. This agreement engendered Claimants' legitimate expectation that the Benefits Plans' provisions would define the operators' R&D expenditure obligations for the life of the investment. Claimants' expectations were reinforced when the federal and provincial governments approved the Board's decisions.[166]

141. Claimants' legitimate expectations that their R&D expenditure obligations would be defined by their Benefits Plans were further reinforced by their additional agreements with the federal and provincial governments; the Board's history of action, and inaction, in promulgating benefits-related guidelines; and the Board's actions in approving amendments to the projects' Development Plans.[167] Indeed, Canada's general practice at the time Hibernia submitted its Benefits Plan to the Board was to negotiate both an investor's undertakings with regard to local benefits and any amendments to those undertakings. When the Claimants decided to invest in the Terra Nova project, they relied on their experience with the Board's administration of the

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[166] CM ¶¶ 205-207.

[167] CM ¶¶ 208-210.

regulatory regime for Hibernia. In addition, they relied on Canada's commitment in the NAFTA not to enact more restrictive requirements with regard to R&D.

142. Claimants' expectations in this regard were also informed by the foreign investment practices in place when Hibernia submitted its Benefits Plan. As described by Canada before the GATT Panel in the *Canada-FIRA* case, foreign investors would often offer certain local purchase undertakings as part of the federal government's approval review process of the investment. Canada stated before the Panel that the investment screening procedures were not intended or applied so as to provide protection to Canadian manufacturers or to oblige companies to depart from commercially sound practices. Canada also represented:

> Since both the investor and the Canadian government had to act in the context of markets ... it was highly unlikely that purchase undertakings [requirements] would either be offered or sought that departed significantly from the purchasing practices the investor would follow in the absence of the undertaking. Where undertakings were given, they reflected a decision by the investor about how he intended to conduct his business in Canada. Undertakings would only represent a cost to the investor if they did not reflect his business intentions.[168]

143. All investments that were allowed subject to FIRA were monitored by the government of Canada. The investor provided progress reports at regular intervals, and the government would review the investor's compliance with its undertakings normally after the fifth anniversary of the date on which the permission to invest was granted. If a progress report revealed that an investor had failed to comply with an undertaking, the investor would be "asked to provide a more

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[168] **CA-88**, *Canada-FIRA* GATT Panel Report, ¶ 3.6.

detailed explanation. … [U]nfulfilled undertakings [have] been either postponed or waived, or … replaced by revised undertakings."[169] When FIRA was enacted in 1973, the Minister responsible for the Act stated before Canadian Parliament that:

> In normal circumstances the inability to fulfil undertakings will lead to discussions … and perhaps to the negotiation of new undertakings. Like any contract, an undertaking can be modified with the *consent* of both parties. If, however, the failure to comply with an undertaking is clearly the result of changed market conditions … the person would not be held accountable.[170]

144. Thus, when Claimants decided to invest in Hibernia in 1985, contemporary practice in Canada was consistent with an understanding that (i) they would not be required to make expenditures on R&D and E&T beyond what was required by the commercial and technical needs of the projects; (ii) the reporting and monitoring obligations with regard to Claimants' R&D commitments would be limited to ensuring that they complied with the commitments contained in their Benefits Plans; and (iii) any change to the undertakings contained in their Benefits Plans would be negotiated with the Board, and not unilaterally imposed.

145. In sum, Claimants' legitimate expectations were that their Benefits Plans would define the scope of their R&D expenditure obligations. Those expectations were based on their agreements with, and assurances made by, the Board and the government, and they were consistent with Canada's practices under the FIRA. At no point prior to Claimants' decision to invest in the Hibernia or Terra Nova projects —

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169 *Id.* ¶ 2.11.

170 *Id.* ¶ 2.10.

indeed, at no point prior to 2003 — did the Board or the government suggest that these expectations were misguided or unreasonable. The promulgation of the Guidelines, which require Claimants to spend a mandatory minimum amount during each POA period on R&D and E&T in the province — an amount that is totally divorced from their Benefits Plan commitments and the legitimate commercial needs of the projects — thus repudiated Claimants' legitimate expectations and violated Article 1105(1).[171]

1. Canada Has Failed to Rebut Claimants' Case That the Guidelines Frustrated Their Legitimate Expectations

146. Canada's attempts to argue that the Guidelines have not transformed Claimants' R&D and E&T expenditure obligations are futile. Further, in a number of critical instances, Canada is unable to cite even a single document in support of its claims. It relies instead on self-serving witness testimony that not only lacks reference to the documentary record, but in some cases is inconsistent with the contemporaneous evidence. In the interest of completeness, Claimants sought in discovery a variety of documents that would enable them to test the validity of Canada's arguments. Although Canada did not object to the requests in question and purported to produce responsive documents, Canada's production was similarly devoid of support for its factual claims. The Tribunal should disregard Canada's unproven factual claims, including the self-serving and unsupported testimony of its witnesses.

147. Canada relies on the provisions of the Atlantic Accord and the Accord Acts to argue that Claimants' expectations that their obligations to spend on R&D were

[171] *See supra* ¶ 107; CM ¶¶ 205-212.

enshrined in their Benefits Plans were unreasonable.[172] In fact, Canada perpetuates a misreading of the Accord Acts that the Board adopted in promulgating the Guidelines. Canada pretends, by ignoring certain critical language, that the Acts directly require expenditures on R&D and E&T irrespective of the content of an approved benefits plan. By so arguing, Canada attempts to negate the significance of the Board's decisions approving the Hibernia and Terra Nova Benefits Plans. These decisions contained no requirement to spend on R&D or E&T in excess of the commercial and technical needs of the projects and provided no basis to impose a supplemental expenditure requirement in the future.

148. However, the Accord Acts do not establish any obligation to make expenditures on R&D and E&T separate and apart from what is agreed to in an approved benefits plan. The Acts clearly provide that:

> *A Canada-Newfoundland Benefits Plan shall contain* provisions intended to ensure that ... expenditures shall be made for research and development to be carried out in the Province and for education and training to be provided in the Province[.][173]

Conveniently, Canada omitted any reference at all to the requirement to provide for R&D and E&T *in a benefits plan* when it told the Tribunal that "According to section 45(3)(c)

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[172] RM ¶¶ 273-277.

[173] **CA-11**, *Federal Accord Act*, § 45(3)(c); **CA-12**, *Provisional Accord Act*, § 45(3)(c) (emphasis added); *see also* **CA-53**, *Hibernia II*, ¶ 1 (per Welsh, J.) ("A company seeking authority to operate in the offshore petroleum industry adjacent to this Province is legislatively required to submit a benefits plan for the approval of the Canada-Newfoundland and Labrador Offshore Petroleum Board. The plan must include provision for expenditures to be made by the company for research and development to be carried out in the Province.").

of the Acts, 'expenditures shall be made for research and development to be carried out in the Province and for education and training to be provided in the Province.'"[174]

149. Claimants asked Canada in the course of discovery to produce any available documents in support of its interpretation of the Accord Acts. After vigorous objection by Canada, it produced only one document in response to this request. This document confirms that the only requirement imposed by section 45(3)(c) of the Accord Acts is that the operator includes provisions addressing R&D and E&T in its benefits plan. In a summary of the Federal Accord Act bill, a federal government official stated that "[b]efore the Board may approve any development plan or authorize any work or activity, the Board must approve a Canada-Newfoundland Benefits plan. The plan is to contain provisions addressing ... education and training, and research and development."[175]

150. Ignoring the plain statutory language, Canada seeks to persuade the Tribunal that Section 45(3)(c) is itself related to targets and outcomes. Far more appropriate is Canada's concession that "to a large extent, the benefits requirements under the Accord Acts are process oriented rather than related to prescribed targets and outcomes."[176] The Board's approval

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[174] RM ¶ 2. The Board used the same erroneous formulation of the Accord Acts in the text of the Guidelines. **CE-1**, 2004 R&D Guidelines, § 1.0.

[175] **CE-161**, Memo from J. Carruthers, Canada Oil and Gas Lands Administration, to D. Kilmartin, Parliamentary Liaison, attaching A Summary of Bill C-6: The Canada-Newfoundland Atlantic Accord Implementation Act, pp. 5-6 (Nov. 13, 1986).

[176] RM ¶ 76.

of a benefits plan containing provisions for R&D and E&T in the Province is one such procedural requirement.[177]

151. The Board's decision to approve a benefits plan thus defines the scope of an operator's obligations with respect to R&D and E&T. It is irrelevant whether, barring international law prohibitions such as are present here, the Board can augment those benefits terms by later promulgating guidelines.[178] Here, the Board did not exercise its statutory authority to promulgate R&D Expenditure Guidelines before the NAFTA took effect. Claimants' R&D and E&T commitments were therefore frozen at a moment in time by the provisions of the NAFTA. As a result, the relevant R&D and E&T undertakings are those set forth in the Hibernia and Terra Nova Benefits Plans and the Board's decisions approving those plans. For this reason, Claimants' expectations that their R&D expenditures could not be unilaterally augmented by the Board were reinforced when the NAFTA entered into force.[179]

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[177] **CE-200**, Fred Allen, Senior Policy Analyst, Newfoundland & Labrador Ministry of Mines & Energy, *Canada-Newfoundland Benefits Under the Atlantic Accord Agreement and the Accord Implementation Acts*, p. 7 (April 1999) (hereinafter "Allen, *Canada-Newfoundland Benefits*") ("[C]ertain legislative obligations govern the benefits plan process. These obligations require a proponent to submit to the Board, for approval, a benefits plan … and, to adhere to the principles of first consideration for employment and procurement requirements relating to the specific development."). This statement is also consistent with Canada's prior practice under the FIRA.

[178] *See infra* Annex ¶¶ 11-14.

[179] Although the Terra Nova Benefits Plan was not submitted or approved until after the NAFTA went into effect, Canada's Annex I reservation for the Federal Accord Act permitted the Board to implement the Section 45 requirement to provide for R&D and

152. Try as Canada might to distort the scope of R&D and E&T obligations incumbent on the Hibernia and Terra Nova operators, those efforts are futile. The fact is that neither project's Benefits Plan established any basis for the Board to require expenditures on R&D or E&T above actual project needs.[180] Both Benefits Plans were clear that: (1) consistent with the Accord Acts, the nature of the operators' R&D and E&T commitments would be process-oriented, and (2) actual expenditures would flow from pioneering work undertaken to develop and adapt technologies to confront the unique challenges of the Canadian offshore environment, such as iceberg detection and management.[181] Both Benefits Plans envisioned that the operators would make *some* expenditures on R&D and E&T over the lifetime of the projects to address commercial and technical needs in these potential areas of research. However, it is equally clear that neither contemplated imposition of an artificial expenditure target, let alone one calibrated to average R&D spending nationwide.[182]

E&T in a benefits plan. **CA-7**, NAFTA, Annex I, Schedule of Canada. The Annex did not permit a unilateral amendment if a previously approved benefits plan.

[180] CM ¶¶ 72, 81.

[181] **CE-45**, Hibernia Benefits Plan, §§ 2.1, 2.2, 3.5.4; **CE-46**, Mobil Oil Canada, Supplementary Canada/ Newfoundland Benefits Plan: Hibernia Development Project, pp. 1, 7 (May 28, 1986) (hereinafter "Hibernia Supplementary Benefits Plan"); **CE-168**, Terra Nova Benefits Plan, § 7.2.

[182] The record is replete with references to the intended focus of R&D being on the offshore environment. *See* **CE-200**, Allen, *Canada-Newfoundland Benefits*, p. 6 ("Offshore related research and development is fundamental to increasing the level of domestic participation in future offshore developments."); **CE-169**, Letter from B. Power, Environment Canada, to D. Burley, CNLOPB, p. 3 (Sept. 23, 1997) ("EC strongly encourages offshore operators to fund applied research in areas that are specific to their operating

Further, neither Plan mandated that expenditures be made in every single year or POA period. These obligations were generally consistent with those faced by operators, including Claimants, in other Canadian provinces, where expenditures on R&D and E&T were based on commercial and technical considerations of the projects.

153. Canada also relies on the monitoring and reporting requirements contained in the projects' Benefits Plans to support its claims. Canada argues that the obligation to report periodically on compliance with benefits commitments somehow signals an intention by the Board to intervene and fundamentally change the terms of the Benefits Plans if ever it were to deem R&D or E&T expenditures insufficient. Therefore, Canada urges that any expectations that Claimants had to the contrary were unreasonable.[183]

154. However, Canada is unable to point to any provision in the Benefits Plans themselves, or in the Board's decisions approving those Plans, which required or even envisioned expenditures of the magnitude it now seeks to impose. In fact, this argument was freshly minted without factual support for purposes of the Canadian court litigation and is repeated here with particular vigor. While the argument was, to some extent, accepted by the Canadian courts, a factual finding by a

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environment"); **CE-164**, Letter from F. Way, CNLOPB, to W. Roach, Husky Oil, p. 2 (Sept. 25, 2002) ("It is the Board's view that Section 45(3)(c) of the Act … requires expenditures for R&D/E&T in the Province …. Initiatives in these areas could be project specific, or have a broader application to the *offshore petroleum sector*.") (emphasis added). The introduction of a benchmark based on average R&D spending by oil companies across all of Canada, therefore, is another radical departure from the terms of the Hibernia and Terra Nova Benefits Plans.

[183] RM ¶¶ 278-282.

domestic court is not binding on this Tribunal, and the Tribunal should undertake its own analysis on this issue.[184]

155. Moreover, these arguments made to and adopted by the Canadian court are inconsistent with the representations Canada made in the *FIRA* case, which represented its contemporaneous practice when the Hibernia Benefits Plan was adopted. As Canada itself stated in that case, its practice then was to include monitoring and reporting requirements as a means to ensure that the investor was complying with its voluntary benefits undertakings. If it was not complying, undertakings could be postponed or waived, especially if the deficiency was due to adverse market conditions. Alternatively, the investor would negotiate revised undertakings with the government.[185]

156. If, in fact, the reporting and monitoring function originally was intended to function as Canada now suggests, one would expect contemporaneous evidence to that effect,

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[184] *See* **CA-158**, International Law Commission, Draft articles on Responsibility of States for Internationally Wrongful Acts, art. 3 (2001) ("The characterization of an act of a State as internationally wrongful is governed by international law. Such characterization is not affected by the characterization of the same act as lawful by internal law."); **CA-85**, *Amco Asia Corp. v. Republic of Indonesia*, ICSID Case No. ARB/81/1, Award of November 20, 1984, ¶ 177 (finding that "an international tribunal is not bound to follow the result of a national court," rather, "the judgments of a national court can be accepted as one of the many factors which have to be considered by the arbitral tribunal"); **CA-91**, *Case Concerning Elettronica Sicula S.p.A. (ELSI) (United States v. Italy)*, ICJ Reports 1989,p. 15, Judgment of July 20, 1989, ¶ 99 ("Whether regarded as findings of Italian law or as findings of fact, the decisions of the courts of Palermo *simply constitute additional evidence of the situation* which the Chamber has to assess.") (emphasis added).

[185] *See supra* ¶ 143.

whether in the Board's communications with the project operators, its own internal documents, or otherwise. Canada has presented no such evidence, either in this proceeding or in the Canadian court litigation, and Claimants are aware of none. In the interest of completeness, Claimants asked Canada in the course of discovery to produce any available documents in support of this contention. Canada had no objection to the request. However it was able to produce only a single document in response and it does not support Canada's position.[186] Its only support is a witness statement that is unsupported by any documentary evidence,[187] and is patently inconsistent with the plain language of the Benefits Plans, the Board's decisions approving those Plans, and Canada's practices under the FIRA. This contention therefore cannot be sustained.

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[186] Redfern Schedule, December 15, 2009, Request No. 13. The only document produced that contemplates Board intervention in response to benefits monitoring is a 1985 briefing on the Hibernia project by the proponent for the Canadian Deputy Minister and Mines. The briefing notes that the Hibernia Benefits Plan, which at that stage had not yet been approved, provided for monitoring of the operator's performance in achieving minimum benefits levels and a "trigger mechanism built-in to allow intensification of monitoring where appropriate." **CE-167**, Hibernia Development Project, Briefing to De Montigny Marchand (Dec. 23, 1985), p. EM0002898. This discussion does not specifically pertain, however, to the R&D or E&T commitments reflected in the Benefits Plan. *See* **CE-45**, Hibernia Benefits Plan, §§ 3.5.4, 3.6. In any event, this document was preliminary to the Board's consideration of the actual Benefits Plan and says nothing as to the Board's or the proponents understanding of the reporting provisions that ultimately were incorporated into the Plan.

[187] First Witness Statement of Frederick Way, ¶ 41 (hereinafter "Way Statement I").

157. The Hibernia Benefits Plan contained only a very general commitment to monitor benefits results in support of an effective annual review process.[188] There was no specific commitment with respect to R&D or E&T reporting. Equally, there was no suggestion that the Board might revisit the R&D and E&T terms of the Benefits Plan as a result of its monitoring function. Rather, in approving the Hibernia Benefits Plan, the Board specifically stated that "it is neither necessary, nor productive, to monitor and approve all the Proponent's procurement decisions."[189] The Board resolved instead to concentrate its monitoring activity on "key" procurement decisions, which typically do not include R&D or E&T expenditures.[190] Indeed, from project sanction in 1990 until the production phase began in 1997, Hibernia did not even include R&D expenditure data in its annual benefits reports to the Board.[191] Moreover, even with respect to "key" decisions that it did plan to monitor more closely, the Board signaled only that it would seek to identify and address any potential problems with specific procurement decisions. There was no indication that the Board would fundamentally

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[188] **CE-45**, Hibernia Benefits Plan, § 3.6.1.

[189] **CE-47**, CNLOPB, Hibernia Decision 86.01, § 2.5 (June 18, 1986) (hereinafter "Hibernia Decision 86.01"). The Board stated generally that "effective monitoring and reporting will be necessary to ensure that the Benefits Plan objectives are accomplished during execution of the project." *Id.* Of course, the Hibernia Benefits Plan objectives with respect to R&D were simply to support local research institutions consistent with the principles of full and fair consideration and first opportunity and to promote R&D to solve problems unique to the Canadian offshore environment. **CE-45**, Hibernia Benefits Plan, § 3.5.4; **CE-46**, Hibernia Supplementary Benefits Plan, p. 7; *see also* CM ¶¶ 58-63.

[190] **CE-47**, Hibernia Decision 86.01, § 2.5.

[191] First Witness Statement of Ted O'Keefe (hereinafter "O'Keefe Statement I"), ¶¶ 9-10.

change the terms of the Benefits Plan if ever problems were identified.[192]

158. The Terra Nova Benefits Plan and the Board's Decision 97.02 approving that Plan did contain reporting provisions specific to R&D. However, these provisions said nothing of revisiting the terms of the Benefits Plan based on the results of the reporting. In the Plan itself, the proponent simply pledged to report annually to the Board "on the benefits plan performance" and, within that context, to include a summary of R&D expenditures reported by program and total expenditure.[193] The Board "concur[red] generally with the proposed scope of the annual benefits reports[.]"[194]

159. The only supplemental requirement that the Board imposed was for the Terra Nova proponent to report annually, beginning in 1998, "its plans for the conduct of research and development and education and training in the Province, including its expenditure estimates, for a three-year period and on its actual expenditures for the preceding year." It did so because it was troubled by the notion, put forth in the Benefits Plan, that the proponent might not conduct *any* R&D in connection with the project. In the Board's view, it could not, consistent with the Accord Acts, approve a benefits plan without provisions to ensure that *some* expenditures would be made on R&D and E&T in the Province.[195] Rather than

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[192] **CE-47**, Hibernia Decision 86.01, § 2.5 ("An effective monitoring and reporting system, in the Board's view, should concentrate on key procurement decisions and provide for early disclosure of the Proponent's plans so that potential problems can be detected at an early date and corrective measures taken.").

[193] **CE-168**, Terra Nova Benefits Plan, § 9.2.2.

[194] **CE-57**, CNLOPB, Terra Nova Decision 97.02, § 3.6 (Dec. 1997) (hereinafter "Terra Nova Decision 97.02").

[195] *Id.* § 3.5.3.

requiring the proponent to commit in advance to what that R&D and E&T would be, the Board required annual updates to keep it apprised. Based on the commitment that the operator showed to R&D in 1998 and 1999, the Board Chairman recommended that this additional reporting condition be deemed satisfied.[196]

160. Thus, neither the Benefit Plans nor other contemporaneous documents indicated that the Board might impose fixed expenditure requirements in response to its monitoring of R&D or E&T expenditures at Hibernia and Terra Nova.[197] Instead, the monitoring was simply designed to enforce compliance with the relevant commitments actually made in the Benefits Plans. For example, the Board would monitor whether the proponents' commitments to principles of full and fair opportunity for Canadians and first consideration for local providers were not being met.[198]

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[196] **RE-20**, Memorandum from H. Stanley, CNLOPB, to Board Members, p. 2 (Feb. 11, 2000) ("I recommend that, based on the foregoing and continued submission of annual R&D and E&T reports, the Board inform the Proponent that Condition 7 has been satisfied.").

[197] As discussed above, the Board indicated in the 1986 Exploration Phase Guidelines that it might develop R&D expenditure guidelines to aid project proponents in the preparation of benefits plans. However, the Board did not issue any such guidelines by the time the Hibernia and Terra Nova Benefits Plans were approved — and, even if it had, guidelines intended to aid in the preparation of benefits plans would not have had any continuing impact once a benefits plan was approved. *See supra* ¶ 10.

[198] *See* **CA-53**, *Hibernia II*, ¶ 148 (Rowe, J., dissenting) ("In my view, the proper interpretation of 97.02 is that the Board required the operators to report on R&D, that the Board would monitor what R&D was being done and might act further if the operators were failing to carry out R&D in the province that could

161. Unlike Canada's position, this interpretation finds substantial support in the contemporaneous evidence. For example:

- In a 1988 presentation describing its mandate with regard to benefits aspects of the Hibernia project, the Board explained that it was developing a monitoring system for the project "[t]o ensure that the partnership's commitments and undertakings *contained in the Hibernia Benefits Plan and the Statement of Principles* will be met[.]"[199]

- The 1988 Development Application Guidelines issued by the Board explicitly stated that monitoring and reporting "are necessary to ensure that *the principles of the Benefits Plan* are being followed and *its commitments* are being met."[200]

- In 2001, Natural Resources Canada issued a guide to regulatory approvals for oil and gas projects in the Newfoundland offshore area that described the

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be carried out in the province *and that related to the needs of the Terra Nova project.*") (emphasis in original).

[199] **CE-199**, CNLOPB, Draft Presentation Hibernia Supplier Development Seminar, p. 4 (Nov. 23, 1988) (emphasis added). For a discussion of the Statement of Principles, see CM ¶ 70.

[200] **RE-9**, 1988 Development Application Guidelines, § 5.5.2. To that end, the 1988 Guidelines provided that monitoring and reporting requirements would be established in consultation with the proponent after submission of a benefits plan. *Id.* In other words, the reporting requirements would be crafted to correspond to the substantive obligations undertaken in the benefits plan. These Guidelines again highlight the similarities between the FIRA practices in place when Hibernia submitted its Benefits Plan, and the regime governing Claimants' R&D commitments prior to the adoption of the R&D Expenditure Guidelines.

Board's monitoring and reporting procedures as intended "to ensure that *the requirements of the Benefits Plan* are being adhered to throughout each stage of the project."[201]

- In approximately 2002, the Board described the procedures for benefits reporting and monitoring as being intended "to ensure that processes established *in a Benefits Plan* for a project are followed."[202]

Based on these documents, it is clear that the Board itself, like others in the Canadian government, always understood its monitoring function as enforcing compliance with the undertakings contained in the benefits plans.

162. The manner in which the Board actually discharged its monitoring mandate further confirms this understanding. Canada was only able to identify one instance where the Board voiced the slightest bit of dissatisfaction with an operator's discharge of its benefits commitments. It is highly significant that the Board's criticism in that case concerned an express pledge that the Terra Nova proponent had made in its Benefits Plan.

163. In 1999, the Board wrote to the Terra Nova operator to ask that greater opportunities be given to local providers to participate in an R&D program. This program fell within a research area that was specifically identified in the Terra

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[201] **CE-201**, Oil and Gas Approvals in Atlantic Canada Newfoundland Offshore Area, ¶ 10-B (June 2001) (emphasis added).

[202] **CE-165**, CNLOPB, Canada-Newfoundland Benefits Plan, at EM0002861 (emphasis added). Although this document is undated, it is clear on its face that it was authored after submission of the White Rose Benefits Plan in 2001, and it appears to have been authored before the draft R&D Expenditure Guidelines were issued in 2003.

Nova Benefits Plan as a potential subject for further R&D (ice-seafloor interaction).[203] The Board noted that the technical requirement for so-called "glory holes" — which have to do with iceberg management and ice-seafloor interaction issues — is "unique to the offshore Newfoundland and Arctic operating environments." Further, ice-seafloor interaction was one of the areas that the proponent identified in the Terra Nova Benefits Plan as a potential subject for continued R&D. The Board did concur with the operator's decision to direct a first phase of research to a Dutch provider — presumably because local providers could not do the work on a competitive basis, as is required for benefits commitments to materialize under the Accord Acts and the Benefits Plan. However, it felt that the Terra Nova owners should attempt to involve Canadian providers in development of future glory hole technology.[204]

164. The Board's letter went no further than to remind the Terra Nova operator to consider Newfoundland and Canadian institutions when research needs arise relating to ice-seafloor interaction. The Board's approach to its monitoring function therefore was to ensure compliance with the express commitments made in the project's Benefits Plan.

165. In this respect too, Claimants' obligations prior to the promulgation of the Guidelines were similar to those of the foreign investors under the FIRA. To enforce foreign investors' undertakings, the Canadian government would monitor the investors' compliance *with their undertakings*. Canada's statements before the GATT Panel illustrate how the

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[203] **RE-18**, Letter from H. Stanley, CNLOPB, to G. Bruce, Petro-Canada (Feb. 3, 1999); **CE-168**, Terra Nova Benefits Plan, § 7.2.

[204] **RE-18**, Letter from H. Stanley, CNLOPB, to G. Bruce, Petro-Canada (Feb. 3, 1999).

system worked. Although, the Minister charged with administering FIRA could apply to the courts for a remedial order if an investor failed to comply with its undertaking,[205] the usual practice was to waive or postpone compliance, or to negotiate a revised undertaking.[206] This practice was found to violate the GATT, demonstrating the trade-restrictive effect of even supposedly voluntary performance requirements.[207]

166. Canada's claim that the Board issued the Guidelines in response to inadequate R&D expenditures by the Hibernia and Terra Nova proponents beginning in 2001 is similarly devoid of documentary support.[208] The factual record simply cannot sustain this assertion. The Guidelines themselves make no such statement, but instead simply extol the virtues of R&D spending in the province. Prior to the issuance of the Guidelines, the Board had not indicated any dissatisfaction with the Hibernia and Terra Nova projects' R&D expenditures, even though Hibernia has been submitting benefits reports since 1986 and Terra Nova began submitting R&D and E&T reports in 1998.[209]

167. Rather, the record is clear — and Canada concedes — that the Board began to consider enacting fixed expenditure requirements in connection with its consideration of the White Rose Benefits Plan, in an apparent effort to create demand for R&D services in the Province.[210] The

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205 **CA-88**, *Canada-FIRA GATT Panel Report*, ¶¶ 2.2-2.11.

206 *See supra* ¶ 143.

207 **CA-88**, *Canada-FIRA GATT Panel Report*, ¶¶ 5.8-5.11.

208 RM ¶¶ 4, 87-89.

209 *See* **CE-60** through **CE-97**.

210 *See* CM ¶ 99; **CE-35**, White Rose Canada-Newfoundland Benefits Plan Decision, § 3.2.2.3 (Nov. 26, 2001). *See also, e.g.*, **CE-197**, P. Tobin, Assistant Deputy Manager, Industrial Benefits Division, to B. Saunders, Deputy Minister, p. 1 (Jan. 21, 2004)

Board issued its decision approving that Plan, and noting its intention to promulgate new guidelines, months before either Hibernia or Terra Nova reported R&D and E&T expenditure levels for 2001.[211] Thus, the Board's plans to issue guidelines predated its knowledge that Hibernia had decreased R&D expenditures in 2001 and that Terra Nova, which had higher-than-ever expenditures in 2001, forecasted decreased expenditures for 2002 through 2004.

168. Canada's attempt to frame the R&D Expenditure Guidelines as a response to inadequate spending also makes no empirical sense. For the five years up to and including 2000, Hibernia reported average R&D expenditures of approximately [redacted] per year. According to Canada, this level of activity was sufficient.[212] Now, under the Guidelines, the Board is requiring Hibernia to spend an average of approximately $14 million per year on R&D and E&T.[213] On

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("The Board has [taken the step of developing R&D guidelines] in the aftermath of the White Rose Decision Report where the stage was set to extract greater commitment [sic] to R&D from the oil and gas sector."); **CE-198**, Memorandum from G. Anderson, Natural Resources Canada, to R. Efford, Minister, Natural Resources Canada, p. 1 (Jan. 28, 2004) ("The CNOPB took the opportunity to focus on Section 45(3)(c) of the [Accord Act] during the writing of the White Rose Decision Report."); RM ¶¶ 89-90; First Witness Statement of Frank Smyth (hereinafter "Smyth Statement I"), ¶ 6; *see also* CM ¶¶ 96-100.

[211] *See* **CE-35**, CNLOPB, White Rose Decision 2001.01, § 3.2.4 (Nov. 26, 2001) ("The Board will proceed in the coming months to revise its Benefits Guidelines along the lines described in this document."); **CE-73**, Hibernia 2001 Benefits Report (April 15, 2002); **CE-90**, Terra Nova 2001 Benefits Report (March 2002).

[212] RM ¶ 87.

[213] *See* **CE-116**, Letter from F. Smyth, CNLOPB, to P. Sacuta, HMDC (Feb. 26, 2009).

these facts, it strains credulity for Canada to position the Guidelines as a curative measure meant purely to clarify a pre-existing obligation.[214]

169. Had the Board legitimately been dissatisfied with the R&D or E&T activity reported by Hibernia or Terra Nova, one also would expect it to have made its views known at the time. Again, however, there is no contemporaneous evidence of the Board ever having taken issue with the level of expenditures reported by either project. The Board did not issue any communication to that effect in response to any benefits reports submitted by either project operator. The Board did not claim dissatisfaction when it met with industry representatives to present its rationale for promulgating the Guidelines. Most significantly, the Board also did not reference any concerns about past expenditure levels when it explained, in the Guidelines or in other contemporaneous documents,[215] its rationale for enacting them.

170. In the interest of completeness, Claimants asked Canada to produce evidence of any instance where the Board was dissatisfied with the level of R&D and E&T expenditures reported for Hibernia and Terra Nova. This request included production of documents sufficient to support Canada's claim that the Board "immediately" told the Hibernia and Terra Nova operators in 2001 that it "expected expenditures

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[214] RM ¶ 89; Smyth Statement I, ¶ 46 ("The R&D Guidelines do not impose new obligations on the Operators. They merely establish a benchmark, a more precise way to measure and ensure fulfillment of already existing expenditure obligations.").

[215] *See* **CE-162**, CNLOPB, Report on 2000-01 Business Plan, p. 6, *attached to* Letter from H. Stanley, CNLOPB, to P. Harrison, Natural Resources Canada, and B. Maynard, Department of Mines and Energy, p. 6 (Sept. 4, 2001) (earliest known reference to development of R&D Expenditure Guidelines makes no reference to inadequate operator expenditures).

consistent with average expenditures on R&D by oil extracting companies in Canada."[216] Canada had no objection to the request.[217] However, it was unable to identify any responsive documents from the 2001 time period or, for that matter, anytime before.[218]

171. Instead, the documents that Canada produced show that the Board was satisfied with the level of R&D and E&T activity reported by Hibernia and Terra Nova around the time it developed the Guidelines. For example, in a 2003 letter from Hibernia Management and Development Company Ltd. ("HMDC") to the Board protesting its plans to promulgate the Guidelines, HMDC noted that the pre-existing regulatory framework under the Hibernia Benefits Plan had resulted in "significant expenditures" in the Province on both R&D and E&T. In response, Frank Smyth, a witness for Canada and then manager of Industrial Benefits Policy and Regulatory Coordination for the Board, made a handwritten notation in the margin of the letter: "We recognize this. Very much so."[219]

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[216] RM ¶ 4.

[217] Redfern Schedule, December 15, 2009, Request No. 16.

[218] The only documents Canada produced that contain any suggestion of inadequate spending post-date introduction of the draft Guidelines in 2002. Thus, the Board might well have developed the inadequacy argument in response to protests from industry as to the appropriateness of the Guidelines. **CE-132**, Meeting Minutes, CNLOPB/Industry Representatives, at EMM0002238 (October 28, 2003). Moreover, none of the documents in question appears to have been authored by the Board; **CE-166**, CNLOPB Draft Guidelines for Research and Development Expenditures, p. 2 (Mar. 3, 2003) (handwritten marginalia of unknown origin).

[219] **CE-194**, Letter from T. Cutt, HMDC, to H. Stanley, CNLOPB, p. 1 (22 Sept., 2003). In response to an inquiry by Claimants, Canada identified the handwriting as that of Mr. Smyth.

172. In 2000, the Board Chairman was so satisfied with R&D and E&T activity reported by Terra Nova that he recommended that the Board consider Condition 7 to approval of the Terra Nova Benefits Plan satisfied.[220] It is difficult to imagine that by 2001 the situation had changed so dramatically that the Board suddenly needed to promulgate new Guidelines. The far more plausible explanation — indeed, the only explanation supported by the record — is that Canada's justification for imposing the Guidelines on Hibernia and Terra Nova was formulated after the fact to defend the Board's objectionable action.

173. Canada's other attempts to create an expectations by Claimants of the requirements imposed by the R&D Expenditure Guidelines are similarly unavailing. For example, Canada points to the findings of the Hibernia and Terra Nova environmental assessment panels[221] and to a series of guidelines established in 1986, 1987, and 1988 to help project proponents prepare benefits plans for submission to the Board.[222] None of these sources formed part of the regime governing Claimants' R&D and E&T expenditure obligations. Thus, none was a source of Claimants' reasonable expectations as to the content and stability of that regime. By the Board's own admission, the exploration guidelines ceased to apply after a benefits plan was approved,[223] and the work of

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[220] *See supra* ¶ 159. Condition 7 to the Board's approval of the Terra Nova Benefits Plan required that "[t]he Proponent report to the Board by March 31 of each year, commencing in 1998, its plans for the conduct of research and development and education and training in the Province, including its expenditure estimates, for a three-year period and on its actual expenditures for the preceding year." **CE-57**, Terra Nova Decision 97.02, § 3.5.3.

[221] RM ¶ 295.

[222] *Id.* ¶¶ 285-288.

[223] *Id.* ¶¶ 278, 285-288.

the environmental panels *preceded* the Board's approval of the Benefits Plans. Further, while the Board found that the Panel's recommendation that the Terra Nova proponents fund basic research was consistent with the "thrust" of the relevant provisions of the Accord Acts, it did not find that funding research was required by the legislation. More importantly, the Board did not require the proponents to fund basic research as a condition to its approval of either Benefits Plan.[224]

174. Canada's reliance on the domestic court decisions in *HMDC v. CN-OPB* to argue that Claimants' expectations were unreasonable is also misplaced.[225] The Canadian courts did accept Canada's argument regarding the significance of the monitoring and reporting requirements[226] as a premise on which to draw an inference in support of their decisions.[227] However, that analysis, as a factual finding in connection with a matter of domestic law, is not binding upon the Tribunal here.[228] Claimants do not dispute the Court of Appeal's finding that the Board's decision to issue the R&D Expenditure Guidelines and the content of those Guidelines were "reasonable" interpretations of its authority under domestic law. However, the Board's authority to issue the Guidelines is simply irrelevant to the validity of Claimants' expectations prior to their promulgation. The Board's "reasonable interpretation" of its own authority did not dictate Claimants' expectations. The domestic Courts did not pronounce on whether this "reasonable interpretation" was ever communicated to Claimants. Indeed, Justice Welsh

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224 *See* **CE-168**, Terra Nova Benefits Plan § 3.5.

225 RM ¶¶ 276, 302.

226 *See supra* ¶¶ 153-154.

227 *See, e.g.*, **CA-53**, *Hibernia II*, ¶ 67.

228 *See supra* note 184.

found that "[t]he 2004 Guidelines are a departure from the approach adopted in the initial stages of development of the offshore petroleum industry," and insofar as the Guidelines apply to companies already in the production phase, they "alter the earlier basic principles approach set out in the originally approved benefits plans."[229] In a strong dissent, Justice Rowe found that the Guidelines impose additional R&D requirements on the Claimants.[230] He also stated that the Board's decision to promulgate the Guidelines had resulted in an "unstable" offshore management regimes as the decisions approving the Claimants' projects had been "fundamentally altered."[231]

175. Canada seeks to deny that Claimants in fact believed that their R&D expenditure obligations were restricted to their Benefits Plan commitments. Canada argues that Claimants' history of support for the local oil and gas research industry signifies some sort of concession that they understood their R&D obligations to be broader in scope.[232] As Canada correctly notes, Claimants have made substantial contributions to the development of the provincial economy through their expenditures on R&D and E&T.[233] Without any

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229 **CA-53**, *Hibernia II*, ¶ 62, (per Justice Welsh).

230 *Id.* ¶ 150 (per Justice Rowe, dissenting).

231 *Id.* ¶ 171. *See also id.* ¶¶ 170-174.

232 RM ¶ 282.

233 *Id.* ¶ 80; *see also* **CE-215**, Community Resource Services Ltd., *Socio-Economic Benefits from Petroleum Industry Activity in Newfoundland and Labrador* (Nov. 2003) ("In addition to education and training programs and initiatives, a significant amount of innovative petroleum related research and development work is being done in Newfoundland and Labrador.... These activities sustain and build the local research and development community, assisting them in serving local interests in the petroleum and other industries."); **CE-216**, J. Whitford, *Socio-Economic Benefits from*

meaningful basis, Canada offers the self-serving supposition that some of these contributions were not necessary for the projects and, hence, that they evidence an understanding on Claimants' part that they were obligated to spend in excess of project needs. In so doing, Canada attempts to turn Claimants' good deeds against them.

176. With respect to Hibernia, Canada simply speculates, without any evidentiary support, that five E&T expenditures over the lifetime of the project were allegedly unnecessary. Canada does not even attempt to argue that Hibernia engaged in any unnecessary R&D spending. As for Terra Nova, Canada does not posit a single specific expenditure that it believes was unnecessary. Instead, from the entire history of the project, Canada attempts to leverage a total of two words — "or" and "also" — from a pair of 1999 benefits reports to show that Terra Nova engaged in spending to develop the local industry without immediate practical application for the project.[234] Even assuming *arguendo* that Canada's interpretation of these expenditures is consistent with the operator's intended meaning,[235] they still will not support

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Petroleum Industry Activity in Newfoundland and Labrador, 2003 and 2004, p. 13 (Nov. 2005) (R&D work related to the petroleum industry has "helped develop Newfoundland and Labrador as a center of excellence in such topics as cold oceans engineering, distance technologies and marine science"); **CE-219**, Stantec, *Socio-Economic Benefits from Petroleum Industry Activity in Newfoundland and Labrador, 2005-2007*, p. 17 (Feb. 13, 2009) ("In the Newfoundland and Labrador offshore petroleum industry, research and development is an example of ongoing collaboration between institutions, research institutes, and industry partners.").

[234] RM ¶¶ 82-83.

[235] As explained in Claimants' initial Memorial, Petro-Canada, as operator of the Terra Nova project, is uniquely responsible for submitting benefits reports to the Board. CM ¶ 85. Claimants had

Canada's argument. Indeed, Canada's reliance on these expenditures betrays a lack of understanding as to why proponents might engage in R&D and E&T spending of general, if not specific, relevance to the projects.

177. A certain level of support for the local industry is consistent with Claimants' policy of good corporate citizenship. As noted in Claimants' initial submission, the Hibernia operating budget typically includes a line item for community support such as charitable contributions to local universities.[236] These contributions tend to be relatively modest in the context of the project's total R&D and E&T spending. However, they can prove meaningful in terms of, for example, public relations and personnel recruitment.[237] They are therefore in the best interest of the project, even if they are not intended to respond to specific and identifiable technical project needs.

178. For much the same reason, individual owner companies may have community investment programs above and beyond project-level contributions. For example, ExxonMobil regularly invests in the communities where it does business.[238] [redacted]

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no hand in drafting this language and cannot speak to Petro-Canada's intended meaning.

[236] First Witness Statement of Paul Phelan, ¶ 7 (hereinafter "Phelan Statement I").

[237] Second Witness Statement of Paul Phelan, ¶ 27 (hereinafter "Phelan Statement II").

[238] *See* **CE-217**, ExxonMobil, 2008 Corporate Citizenship Report, at 9, 29, 34, 37, 39 (2009). *See also* **CE-131A**, Letter from S. Davis, Chevron, to H. Stanley, CNLOPB (Oct. 8, 2003) ("Should we operate in Newfoundland and Labrador we would make these [community support] expenditures … because this type of support to communities is part of our fundamental corporate values.").

[redacted].[239] Clearly, these contributions were not made out of a sense of obligation. Any benefits commitments incumbent upon the participants in the Hibernia and Terra Nova projects run to the operator, not individual interest owners. Indeed, most of these contributions were made before Hibernia and Terra Nova began complying with the Guidelines. In any event, the Imperial Oil Foundation has no interest in, or obligation with respect to, the Hibernia or Terra Nova projects.[240] Moreover, ExxonMobil makes these kinds of contributions worldwide, including in places without regulatory requirements to engage in R&D or E&T. [redacted].[241] Alberta has no mandatory expenditure requirement comparable to the Guidelines.

179. Furthermore, even assuming *arguendo* that Claimants had in fact made these contributions out of some sense of obligation, it is undisputed that Claimants were not at

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[239] **CE-218**, [redacted].

[240] The expenditure requirements under the Guidelines are obligations accruing to the ownership consortiums as a whole. *See* CM ¶¶ 28, 34; **CE-116**, Letter from F. Smyth, HMDC, to P. Sacuta, HMDC (Feb. 26, 2009) (announcing the expenditure requirement applicable to HMDC, the operator of the Hibernia project). Expenditures made by individual owner companies, such as ExxonMobil Canada and Petro-Canada, may, however, count toward a project's expenditure requirement.

[241] **CE-218**, [redacted].

the time subject to any fixed expenditure requirement for R&D or E&T. Therefore, the Guidelines still represent a radical departure from the pre-existing regulatory regime and Claimants' expectations as to that regime. Canada's theory as to the purpose of these contributions therefore has no bearing on the ultimate issue: Claimants' expectations as to their R&D expenditure obligations over the life of the investments.

180. Industry's immediate response to the Board's presentation of the Draft Guidelines in 2003 illustrates the actual expectations of offshore operators in the province. For example, at a meeting with the Board that took place on May 26, 2004, ExxonMobil protested that "the rules have changed" as a result of the Guidelines.[242] In a letter dated November 16, 2004, HMDC noted that "[a]ny attempts to impose further obligations on the Hibernia owners which exceed those embodied in the approved Benefits Plan is in excess of the C-NOPB's jurisdiction and *amounts to a unilateral change in the agreed fiscal regime upon which the Hibernia project was founded.*"[243] Claimants' expectations, and the assertions of

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[242] **CE-136**, Meeting Minutes, CNLOPB/ExxonMobil, p. 2 (May 26, 2004).

[243] **CE-43**, Letter from J. Taylor, HMDC to F. Way, CNLOPB, p. 2 (Nov. 16, 2004). *See also* **CE-130**, Letter from G. Carrick, Petro-Canada, to H. Stanley, CNLOPB, at EMM0002233 (Sept. 19, 2003) ("we do not believe the C-NOPB has authority to retrospectively require commitments of R&D expenditures ... where an Operator is proceeding pursuant to an previously approved Benefits Plan" in part because "[s]ection 45 does not impose an absolute power obligation to make R&D expenditures"); **CE-131**, Letter from T. Cutt, HMDC, to H. Stanley, CNLOPB, at EMM0002235 (Sept. 22, 2003) ("In its approval of the Hibernia Benefits Plan in 1986, the Board accepted HMDC's plans related to research and development as well as education and training as fully satisfying the legislative requirements."); **CE-195**, Letter from W. Roach, Husky Oil, to H. Stanley, CNLOPB, p. 1 (Oct. 7, 2003) (In

their witnesses, are thus well supported by contemporaneous documents in the record, in stark contrast to Canada's many unsupported assertions.

181. In sum, only by mischaracterizing Claimants' obligations under the pre-2004 regulatory regime and by asserting arguments without documentary support could Canada hope to refute Claimants' argument that their legitimate expectations were repudiated by the promulgation of the Guidelines. The reality is that the Guidelines fundamentally transformed the R&D expenditure obligations of operators with approved benefits plans in the province, and thus violated Claimants' legitimate expectations.

2. Canada Also Violated Claimants' Legitimate Expectations Based on the Agreement Reached Between the Parties, Which Did Not Provide for Mandatory R&D Spending

182. The Board's promulgation of the Guidelines was also a unilateral violation of the agreement between the parties as to how Claimants' R&D commitments would be regulated. This agreement was explicit in both the Claimants' Benefits Plans and the financial agreements entered into with the provincial and federal governments. It was also implicitly and continuously reinforced through a course of dealing

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response to the draft Guidelines, Husky wrote that "it would be unfair to impose any additional financial obligations on the White Rose partnership after it has committed to the White Rose Project based [on] its understanding at Project Sanction"); **CE-131A**, Letter from S. Davis, Chevron, to H. Stanley, CNLOPB (Oct. 8, 2003) (The proposed Guidelines "represent an additional financial burden that further erodes the financial viability of marginal economic projects.").

lasting nearly twenty years.[244] This agreement simply did not provide for mandatory expenditure on R&D or for the proponents to undertake any R&D that their the commercial and technical needs of the project did not require.[245]

183. The Claimants engaged in careful negotiation regarding their benefits commitments with the Canadian government on the local, provincial, and federal levels. These negotiations resulted in agreement among all parties as to the scope of the benefits commitments that Claimants would undertake in exchange for the right to produce oil at the Hibernia and Terra Nova fields. After the Hibernia Benefits Plan was submitted to the Board for consideration, the Board held discussions with the proponents in order to clarify and refine the requirements that would be contained therein. The Board agreed to approve the Plan following the submission of a Supplemental Benefits Plan. This agreement was further elaborated in 1988 and 1990, when the Hibernia project owners negotiated a set of binding agreements with the federal and provincial governments, in which they undertook additional benefits commitments in exchange for loans and subsidies. The governments declined to impose additional R&D requirements. Equally careful negotiations ensued with regard to the submission and approval of the Terra Nova Benefits Plan.[246]

184. As noted above and in Claimants' Memorial, for the first twenty years of the life of this agreement, Claimants had no mandatory expenditure on R&D.[247] The Guidelines impose far more onerous obligations on Claimants than those to which they were subject under their agreements with the

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[244] CM ¶¶ 209-211.

[245] *See supra* ¶ 107.

[246] CM ¶¶ 57-79, 205-208.

[247] *See supra* ¶¶ 150, 152; CM ¶¶ 72, 81, 204-212.

Board and the governments.[248] Therefore, Claimants' "fundamental expectation"[249] that Canada would abide by the terms of its agreements was repudiated by the promulgation of the Guidelines in 2004. This explicit repudiation of a series of agreements that have guided project operations for twenty years engages Canada's responsibility under Article 1105 for its arbitrary breach of contract.[250]

3. Even if *Glamis* Provides the Applicable Customary International Law Minimum Standard of Treatment, Claimants Have Demonstrated That Canada Acted in Violation of Article 1105

185. Finally, if the Tribunal does decide that *Glamis* accurately summarizes the applicable standard under Article 1105, it still should find that Canada acted in violation of that provision. Canada's argument that Claimants have not alleged conduct on Canada's behalf that rises to the "egregious and shocking" threshold is belied by the very award on which they rely.[251] Even the *Glamis* Tribunal held

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248 *See supra* ¶ 107.

249 **CA-153**, Schwebel, pp. 269-70

250 *See supra* ¶¶ 134-138.

251 RM ¶ 249. Indeed, if one looks to the ordinary meaning of the terms "egregious," outrageous" and "shocking" and "extraordinary" it becomes clear that Canada's conduct violates even the standard set by *Neer* and *Glamis*. *See, e.g.*, **CA-172**, Merriam-Webster's Collegiate Dictionary, at 369 (2002) (defining "egregious" as "conspicuous; esp: conspicuously bad : flagrant"); *id.*, p. 412 (defining "extraordinary" as "out of course" or "going beyond what is usual, regular, or customary"); *id.*, at 824 (defining "outrageous" as "exceeding the limits of what is usual" and "going beyond the standards of what is right or decent"); *id.*, at 1079 (defining "shocking" as "extremely startling, distressing, or offensive"). Canada's actions in reneging on a twenty-year old

that, while "[m]erely not living up to expectations cannot be sufficient to find a breach of Article 1105," the relevant question is "whether the State made any specific assurances or commitment to the investor so as to induce its expectations."[252] In other words, a breach of Article 1105 "may be exhibited by … the creation by the State of objective expectations in order to induce investment and the subsequent repudiation of those expectations."[253] Claimants have demonstrated a violation of Article 1105 on the basis of "specific assurances or commitments" made to them by Canada to induce their expectation that their R&D expenditure obligations would be limited to their Benefits Plan undertakings, and therefore to expenditures required for the commercial needs of the project.

186. The assurances made by the Canadian entities in this case, and their subsequent repudiation, far exceed the US government conduct that was found not to violate Article 1105 in *Glamis*. The Claimant in *Glamis* pointed to general measures, such as prior legislation and practice by the State authorities, as the foundation of its Article 1105 claim but not to any specific agreement between itself and the United

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agreement can certainly be described as "out of course," "going beyond what is usual, regular or customary" and "exceeding the limits of what is usual." A simple comparison between the Claimants' obligations under the Guidelines with their Benefits Plan undertakings, *see supra* ¶ 107, equally demonstrates that the Board has gone beyond what is "usual, regular or customary." Indeed, Claimants' Benefits Plan undertakings represented a continuation of the Canadian government's practices under FIRA with regard to foreign investor benefits undertakings. The Guidelines represent an "extraordinary" break from that regime. *See supra* ¶¶ 142-144.

252 **CA-32**, *Glamis*, ¶ 620.

253 *Id.* ¶ 627.

States.[254] As the Tribunal held, "the federal government did not make specific commitments to induce Claimant to persevere with its mining claims."[255]

187. In this case, Claimants' expectations were generated by specific assurances made by Canadian state officials on the local, provincial, and federal levels. These assurances were made in the context of specific agreements between Claimants and the government. When these assurances and agreements are coupled with the wording of the Accord Acts and the practice of the Board and other state agencies over a twenty-year period, it is clear that Canada's conduct reaches the egregiousness threshold set by *Glamis*.[256]

- As demonstrated above, the Hibernia and Terra Nova Benefits Plans and approval decisions were the product of careful negotiation between the Claimants and the Board.[257] The Plans did not make provision for mandatory expenditure on R&D, nor did they indicate that the Board retained authority to impose mandatory expenditure levels on operators with pre-approved benefits plans. Instead, the project operators were left to decide how much to spend on R&D and E&T based on the commercial needs of the project and subject to the requirement

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254 *See id.* ¶¶ 633-37, ¶¶ 689-94.

255 **CA-32**, *Glamis*, ¶ 767; *see also id.* ¶ 807 (holding that "no specific assurances were provided to Claimant by the State of California so as to create a duty on behalf of the State to not upset Claimants' reasonable expectations").

256 CM ¶¶ 204-212.

257 *See supra* ¶¶ 182-184

that they would look first to local providers as part of the procurement process.[258]

- This regime represented a continuation of the practices under the FIRA, in accordance with which foreign investors would offer undertakings with regard to local benefits. These practices formed the context for the submission of the Hibernia Benefits Plan in 1985. Indeed, just a year before, the Canadian government had made important statements before the GATT Panel regarding how those undertakings would be monitored and enforced. Of particular importance, the government stated that (i) such undertakings were usually in accordance with the commercial needs of the investment; and (ii) any amendments to the undertakings would be the product of negotiation and required the consent of the investor and the government.[259] In addition, Canada stated that "[l]ike any contract, an undertaking can be modified with the consent of both parties."[260]

- In the context of the Terra Nova Benefits Plan submission and approval process, Petro-Canada met with the Board and specifically asked how the Board would apply the provisions of the Accord Acts that relate to R&D. The Board's response did not indicate that mandatory expenditure levels would form part of its approach.[261]

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258 *See supra* ¶¶ 107; CM ¶¶ 72, 81.

259 *See supra* ¶¶ 142-144.

260 *Canada-FIRA* GATT Panel Report, ¶ 2.10.

261 CM ¶ 74.

- The 1988 Statement of Principles and the 1990 Framework Agreement were also the product of careful negotiation between the Hibernia project owners and the federal and provincial governments. Again, the agreements contained no provision for mandatory expenditure on R&D or E&T, and therefore reinforced the specific assurances made to the Claimants in the context of the benefits plan approval process.[262]

- The amendments to the Hibernia and Terra Nova Development Plans, and the issuance of the POAs to the project operators, afforded the Board a number of opportunities to raise the issue of inadequate R&D and E&T expenditures with the Claimants.[263] The fact that it did not do so in either context represented further assurances that the Board would not do so in the future.

- In 1998, Claimants began submitting annual benefits reports, which summarized, among other things, R&D expenditures in the prior year. At no point prior to the Board's circulation of the draft Guidelines did it indicate that it was dissatisfied with these expenditures.[264]

188. Canada's assurances with regard to R&D and E&T spending, both prior to the Claimants' investments in the Hibernia and Terra Nova projects and throughout the life of those investments, were made specifically to Claimants. They provided a secure foundation for Claimants' legitimate expectations that their R&D and E&T expenditure obligations

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262 *See supra* ¶¶ 182-184; CM ¶¶ 69-71, 208.

263 CM ¶¶ 68, 80, 210.

264 *Id.* ¶¶ 84-95, 89-91

were set by their Benefits Plans. Claimants further expected, based on those assurances, that no measure would be taken unilaterally to increase the burden of their obligations through mandatory expenditure requirements. The Board's promulgation of the Guidelines arbitrarily repudiated these specific assurances. Claimants therefore respectfully submit that, should they be required to prove "egregious," "outrageous" and "shocking" conduct on the part of Canada, these specific assurances, which induced Claimants to invest in the projects, and their subsequent repudiation, constitute a violation of Article 1105.

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189. In sum, Claimants respectfully submit that, whichever standard the Tribunal finds to constitute the true content of the customary international law minimum standard of treatment, Claimants have demonstrated that Canada's conduct violates Article 1105(1).

V.

CLAIMANTS ARE ENTITLED TO DAMAGES THAT ELIMINATE ALL CONSEQUENCES OF CANADA'S TREATY VIOLATIONS

190. According to the Respondent, even if the Tribunal concludes that Canada has breached its obligations under the NAFTA, Claimants are not entitled to any compensation. As to past damage, it is said that the Claimants' claim for compensation is premature (RM ¶¶ 309-10, 373), that Claimants have suffered no loss (*id.* ¶ 309), and alternatively that the claim is overstated (*id.* ¶¶ 312-324). As to forward-looking compensation, Canada suggests that such a remedy is not even available in principle under the NAFTA or international law (*id.* ¶¶ 328-339) or, alternatively, that the

sums claimed are too speculative to be recoverable (*id.* ¶¶ 340 *et seq*).

191. As demonstrated below, Canada's approach to compensation is flawed: applicable legal principles are either misstated, conflated, or ignored altogether. Moreover, Canada's submissions on damages, together with the expert evidence it offers in support, are characterized by exaggerated prophecies—a fact laid bare by the manner in which the Board administered the Guidelines, arriving at its decision as to the eligibility of Claimants' past R&D and E&T expenditures for Guidelines credit just 10 days after Canada submitted its Counter-Memorial. Canada's arguments are submissions of pure convenience: not only does Canada seek to rely upon and exploit uncertainties for which it alone is responsible, but it also now suggests that Claimants should give credit for unspecified and unquantified "benefits" said by Canada to accrue from their wholly unnecessary expenditures in the Province. Indeed, Canada's expert bypasses his role altogether by failing to provide any alternative model for damage assessment.[265]

192. None of these arguments undermines Claimants' case for full compensation.

193. As to the period from April 1, 2004 to December 31, 2008, the Board has now made its decision on eligibility. That is a complete answer to Canada's "ripeness" complaint. Moreover, at the Board's request, Claimants have also made their proposal with regard to compliance with the Guidelines and will shortly have in place financial instruments to cover those obligations. Canada must now abandon its argument that Claimants have suffered no loss. Finally, although attempts have been made to chip away at Claimants' losses for that period, primarily through the bald assertion that

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[265] Rosen Report II, ¶ 12.

Claimants will benefit from their enforced additional spending in the Province, Canada has failed to demonstrate that any such benefits will in fact accrue.

194. As to the period after December 31, 2008, Canada's suggestion that forward-looking compensation is not even available in principle finds no support in the text of the NAFTA or in any arbitral award of which Claimants are aware. It is also impossible to reconcile with fundamental principles of international law and compensation, including that reparation must eliminate *all* consequences of a state's wrongful actions. Commentaries and arbitral awards specifically confirm that future expenditure is a recoverable damage in its own right. As to the proof of those losses, the authorities uniformly confirm that all reasonably certain economically measurable loss is recoverable and that future-damage projections are only dismissed as "speculative" when based upon immature economic activities or plans that progressed little further than anticipation. Given both the maturity and operating experience of Hibernia and Terra Nova, and the fact that most of Claimants' claimed damages have already occurred, Claimants are able to demonstrate both the likelihood and extent of their post-December 2008 losses to the standard required under international law.

195. There have been significant factual developments since Claimants filed their initial Memorial. The Board has issued its decision as to the eligibility of past R&D for Guidelines credit, and HMDC and Suncor have very recently submitted proposals to the Board with regarding to the spending of their respective shortfalls ("Work Plans"). Given that these events are still unfolding—the Board is reconsidering the eligibility of a discreet number of past expenditures for Guidelines credit and has not yet approved or pre-cleared the Work Plans—Claimants propose to update their damages assessment nearer to the hearing date rather

than providing a provisional update at this stage. Accordingly, in this Reply Memorial together with the responsive reports prepared by Claimants' experts on damages and oil price forecasting, Claimants describe recent factual developments and explain why the arguments raised by Canada do not undermine their entitlement to full compensation.

A. Claimants' Losses for the Period from April 1, 2004 to December 31, 2008 Can Be Assessed Now and With Reasonable Certainty

196. In their initial Memorial, Claimants assessed their losses for the period from April 1, 2004 to December 31, 2008 on the principle that they were entitled to be placed in the economic position they would have enjoyed but for the introduction of the Guidelines: in other words, the difference in value between the R&D expenditures that they are required to have undertaken through December 31, 2008 to comply with the Guidelines and the level of R&D expenditure in fact undertaken over that same period.[266]

197. In arriving at his preliminary assessment of these losses, Claimants' damages expert, Mr. Rosen, used as his starting point Claimants' total expenditure requirements under the Guidelines through December 31, 2008 ($26.359 million in the case of Hibernia and $11.574 million for Terra Nova).[267] From that sum, Mr. Rosen first deducted the Development Credit applicable to the projects as calculated by

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[266] *See* First Expert Report of Howard N. Rosen, ¶¶ 26 *et seq.* (hereinafter "Rosen Report I").

[267] *See* **CE-116**, Letter from F. Smyth, CNLOPB, to P. Sacuta, HMDC, at EMM002116 (Feb. 26, 2009); **CE-117**, Letter from F. Smyth, CNLOPB, to G. Vokey, Petro-Canada, at EMM0002120 (Mar. 3, 2009).

the Board.[268] As of the date of his first report, the Board had indicated that Terra Nova's balance could be applied upfront against its 2004-2008 shortfall. Mr. Rosen's calculations reflected this credit. No such assurance had yet been provided with regard to Hibernia, so that Claimants' damages model allocated the remaining Development Credit for Hibernia from 2009 onwards based on anticipated production over time.[269]

198. To calculate Claimants' net exposure under the Guidelines, Mr. Rosen next deducted a sum to represent those R&D expenditures likely to be deemed eligible by the Board for Guidelines credit. Mr. Rosen based that assessment on the data collected by Claimants and submitted to the Canadian Revenue Agency ("CRA") with a view to obtaining tax credits under the SR&ED incentive program during the applicable period.[270]

199. In those circumstances, Mr. Rosen preliminarily quantified Claimants' damages for the period from April 1, 2004 to December 31, 2008 as [redacted]. Mr. Rosen anticipated that adjustments to that figure might be required once the Board's approach to administration of the Guidelines became clearer and to the extent that any cash savings would accrue to Claimants through their future incremental spending that would be required by the Guidelines.[271]

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[268] Mr. Rosen determined that, as at January 1, 2009, Hibernia and Terra Nova had a Development Credit balance of $12.48 million and $4.77 million respectively. *See* Rosen Report I, ¶ 40.

[269] CM ¶ 218 (fifth bullet); Rosen Report I, ¶ 40.

[270] Rosen Report I, ¶ 56(i); *infra* ¶¶ 207-215.

[271] Rosen Report I, ¶ 60.

1. Claimants Damages for the Period from April 1, 2004 to December 31, 2008 Have Crystallized

200. In light of two key events that have transpired since Claimants filed their initial Memorial — communication by the Board of its decision on eligibility and submission by Claimants of their proposals for addressing their commitments under the Guidelines — Canada can no longer argue that an assessment of Claimants' damages for the period 2004-2008 is premature.

201. Claimants' net shortfall under the Guidelines through December 31, 2008 is now known because the Board has delivered its decision as to the eligibility of Claimants' past R&D and E&T expenditures for Guidelines credit and, as far as Hibernia is concerned, upfront application of Development Phase credit. In outline:

- *Hibernia*: The Board had previously confirmed HMDC's expenditure obligation to the end of 2008 as $66.52 million.[272] On September 30, 2009, HMDC submitted its final report to the Board detailing R&D and E&T expenditures of [redacted].[273] On December 10, 2009, the Board formally communicated that it had rejected as ineligible R&D and E&T expenditure [redacted].[274]

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[272] *See* **CE-116**, Letter from F. Smyth, CNLOPB, to P. Sacuta, HMDC, at EMM002116 (Feb. 26, 2009).

[273] **CE-175**, Letter from P. Phelan, HMDC, to J. Bugden, CNLOPB (Sept. 30, 2009); **CE-176**, Letter from P. Phelan, HMDC, to J. Bugden, CNLOPB (Oct. 22, 2009); **CE-177**, Letter from P. Phelan, HMDC, to J. Bugden, CNLOPB (Nov. 12, 2009).

[274] **CE-179**, Letter from J. Bugden, CNLOPB, to P. Sacuta, HMDC (Dec. 10, 2009); **CE-178**, CNLOPB, Staff Analysis of the Research and Development Education and Training Report Hibernia

Having confirmed that the remaining development phase credit of $10.1 million could be applied towards HMDC's outstanding obligations, on January 8, 2010, the Board confirmed HMDC's net shortfall at $43,556,526.[275] On March 9, 2010, [redacted] the Board confirmed that the R&D expenditure shortfall for the Hibernia project had been further reduced to $32,718,226.[276]

- *Terra Nova*: On March 3, 2009, the Board advised Suncor (then Petro-Canada) that its expenditure requirements for the Terra Nova Project from April 1, 2004 – December 31, 2008 were $34,040,000.[277] On October 1, 2009, Suncor submitted a report detailing R&D and E&T expenditures of [redacted]

Project (April 2004 to December 2008) (Dec. 1, 2009) (hereinafter "Hibernia Staff Analysis"). The Tribunal's Staff Analyses for the Hibernia and Terra Nova projects were provided to the respective project operators at the time of the Board's decision on the eligibility of Hibernia's and Terra Nova's R&D expenditures under the Guidelines for the period 2004 – 2008. While these documents clearly fell within the scope of the Tribunal's March 27, 2010 ruling on Claimants' document requests, they were not produced to Claimants by Canada, perhaps because Canada knew they were already in Claimants' possession. Tribunal Ruling of March 27, 2010 on Claimants' Request No. 33.

[275] *See* **CE-183**, Letter from J. Bugden, CNLOPB, to P. Phelan, HMDC (March 9, 2010) and *infra* ¶¶ 211-213.

[276] **CE-117**, Letter from F. Smyth, CNLOPB, to G. Vokey, Petro-Canada, at EMM0002120 (Mar. 3, 2009).

[277] **CE-117**, Letter from F. Smyth, CNLOPB, to G. Vokey, Petro-Canada, at EMM0002120 (Mar. 3, 2009).

[redacted].[278] On December 15, 2009, the Board formally communicated that it had rejected as ineligible R&D and E&T expenditures of [redacted].[279] Having confirmed that all remaining development phase credit could be applied upfront against Terra Nova's obligations, the Board confirmed Suncor's net shortfall as $11,860,092.[280]

202. Canada purports to resist the Claimants' claim for compensation on the basis that Claimants "have made no payments under the Guidelines."[281] Canada ignores the fact that the implementation of the Guidelines had *already* created an obligation for the period from April 1, 2004 up to the present date.[282] In any event, that obligation has now crystallized for the period from April 1, 2004 to December 31, 2008. In its letters of December 10 and 15, 2009, the Board required HMDC and Suncor to provide by March 31, 2010 a Work Plan detailing their shortfall spending proposals and reinforced that obligation by requiring them to provide a

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[278] *See* **CE-187**, Letter from G. Vokey, Suncor Energy Inc., to F. Smyth, CNLOPB (Oct. 1, 2009), *attaching* Suncor, Research and Development Education and Training Report: April 2004 to December 2008 (hereinafter "Suncor Report").

[279] **CE-189**, Letter from J. Bugden, CNLOPB, to G. Vokey, Suncor Energy Inc. (Dec. 15, 2009); **CE-188**, Terra Nova Staff Analysis.

[280] *See* **CE-190**, Letter from J. Bugden, CNLOPB, to G. Vokey, Suncor Energy Inc. (Jan. 8, 2010). [redacted]

[281] RM ¶ 309.

[282] *See* Rosen Report I, n 17.

financial instrument to which the Board must have unrestricted access.[283] (The Board has since extended the deadline for provision of the financial instrument until April 30, 2010.)[284] Indeed, those requirements were then added as additional and express conditions to HMDC's Operations Authorization.[285] The Board's requirement of a bond to cover these shortfall amounts is surprising and unduly onerous given the financial standing of the operators and the projects' owners.[286]

203. HMDC and Suncor have recently submitted their Work Plans to the Board.[287] In his second witness statement, Mr. Ringvee describes the very considerable efforts expended by industry participants to contrive meaningful spending opportunities in the Province.[288] He also addresses the many

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[283] **CE-179**, Letter from J. Bugden, CNLOPB, to P. Sacuta, HMDC (Dec. 10, 2009); **CE-189**, Letter from J. Bugden, CNLOPB, to G. Vokey, Suncor Energy Inc. (Dec. 15, 2009).

[284] **CE-185**, Letter from M. Rucklokke, CNLOPB, to P. Sacuta, HMDC (March 24, 2010).

[285] **CE-172**, Letter from F. Smyth and H. Pike, CNLOPB, to P. Sacuta, HMDC, attaching HMDC's Operations Authorization (Dec. 15, 2009).

[286] **CE-185**, Letter from M. Ruelokke, CNLOPB, to P. Sacuta, HMDC (Mar. 24, 2010). Phelan Statement II, ¶ 13.

[287] **CE-212**, HMDC, Hibernia R&D Work Plan to Meet C-NLOPB R&D Guidelines (Mar. 31, 2010); **CE-213**, Suncor Energy Inc., Terra Nova R&D and E&T Work Plan: CNLOPB Submission (Mar. 31, 2010). A fuller description of the Work Plan and the efforts the industry-wide R&D Task Force charged with coordinating a joint strategy for long term compliance with the Guidelines is given in Mr. Ringvee's second witness statement. Ringvee Statement II, ¶¶ 19-20. The Board has now lifted the POA condition related to provision of HMDC's and Suncor's Work Plans.

[288] Ringvee Statement II, ¶ 4-14.

practical issues and obstacles facing industry representatives as they attempt to coordinate strategies and proposals for satisfying their Guidelines obligations in the long term.[289]

204. Both the Hibernia and Terra Nova Work Plans identify potential joint industry initiatives, project-specific initiatives and owner-specific initiatives. For Hibernia, the Work Plan comprises participation in a number of joint industry projects [redacted] in addition to identifying several new potential projects for Hibernia [redacted]. In addition, the plan describes E&T and capacity development initiatives, [redacted]. The Board has established a performance deadline of March 31, 2015, at which time it will draw down from the project owners' financial instruments any unspent shortfall and transfer it to "a recognized research or education agency."[290]

205. Claimants' obligations to undertake the research and development described in the Work Plans deal only with the shortfall found by the Board for years 2004-2008. In addition, from now until 2015, when the Work Plans are intended to be established, the Hibernia and Terra Nova projects must carry out not only whatever research and development they would ordinarily undertaken during those years, but also additional R&D and E&T necessary to meet the Guidelines' requirements for those years.

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[289] *Id.* ¶¶ 4, 13-14.

[290] **CE-185**, Letter from M. Rucklokke, CNLOPB, to P. Sacuta, HMDC (March 24, 2010).

206. The Board is still (re)considering the eligibility of a discreet number of past expenditures for Guidelines credit. It also must approve the Work Plans submitted for the projects and pre-qualify them for Guidelines credit. Given that, by the time of the hearing, the Board's response to HMDC's and Suncor's Work Plans should be known, Claimants propose to update their damages assessment nearer to the hearing date.

2. The Board's December 2009 Decisions on Eligibility Fully Vindicate Claimants' Approach to Damages

207. Canada suggests that Claimants have inflated their 2004-2008 claim by understating their R&D and E&T expenditures during that period.[291] The "understatement" is said to consist of Claimants' presentation in the arbitration of only those R&D expenditures accepted by the CRA as SR&ED eligible, figures said to be lower than those submitted by Claimants to the Board when seeking Guidelines credit. This argument cannot be sustained in light of the Board's decision on eligibility, a development that entirely vindicates Claimants' approach to quantum.

208. Claimants' actual R&D spending over that reference period is detailed in HMDC's and Suncor's submissions to the Board dated September 30, 2009, October 22, 2009, and November 12, 2009.[292] [redacted]

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[291] RM ¶¶ 312 *et seq.*

[292] **CE-175**, Letter from P. Phelan, HMDC, to J. Bugden, CNLOPB (Sept. 30, 2009); **CE-176**, Letter from P. Phelan, HMDC, to J. Bugden, CNLOPB (Oct. 22, 2009); **CE-177**, Letter from P. Phelan, HMDC, to J. Bugden, CNLOPB (Nov. 12, 2009); **CE-187**, Suncor Report.

[292] *See* Phelan Statement II, ¶ 6. [redacted]

[redacted]

209. The Board has consistently said that it will give Guidelines credit only to those projects accepted by the CRA as eligible for SR&ED tax credits.[293] [redacted]

[294]

[redacted]

[295]

210. Remarkably, Canada has chosen to challenge Claimants' approach, despite it being fully consistent with the Board's stated position that it will in effect apply SR&ED standards when considering eligibility for the purposes of the Guidelines. Specifically, Canada sought to question Claimants' presentation of their historical R&D spending on the basis that, by using the "narrow" definition of R&D employed in the Income Tax Act, Claimants have omitted

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[redacted] *See* First Witness Statement of Ed Graham (hereinafter "Graham Statement I"), ¶ 15; First Witness Statement of Rod Hutchings, ¶ 17 (hereinafter Hutchings Statement I); Phelan Statement I, ¶ 20

[293] Phelan Statement I, ¶ 20; Hutchings Statement I, ¶ 25; *see also* **CE-140**, CAPP, CNLOPB R&D Guidelines Industry Considerations, Slide 6 (Dec. 16, 2008).

[294] See Phelan Statement II, ¶ 6. [redacted] *See* Graham Statement I, ¶ 15; Hutchings Statement I, ¶ 17; Phelan Statement I, ¶ 20

[295] Rosen Report II, ¶ 90.

from the equation "other expenditures in the normal course of business which have not been approved by the CRA but may nevertheless qualify under the Guidelines."[296] Indeed, both Canada and its expert, Mr. Walck, speculated that the Board might accept as eligible *all* of HMDC and Suncor's R&D expenditures, [redacted].[297] That would have been a most welcome outcome for Claimants, and Claimants of course agree that the Board should have treated all of these expenditures as R & D under the Guidelines.

211. Instead, just days after Canada submitted its Memorial, the Board did the exact opposite of what Canada and its expert had predicted. [redacted][298]

212. In fact, the Board's initial approach was even more restrictive than that of the CRA. [redacted][299]

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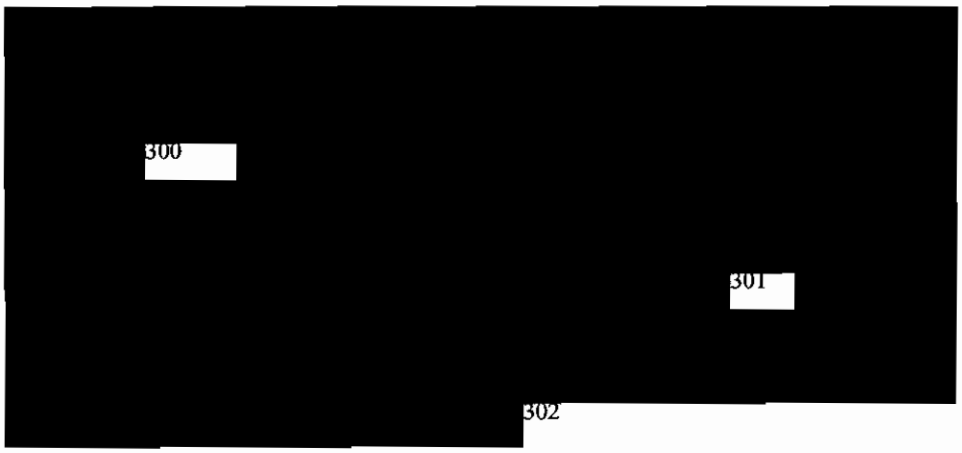
[296] RM ¶ 313.

[297] First Expert Report of Richard Walck, ¶120 (hereinafter "Walck Report I").

[298] **CE-178**, Hibernia Staff Analysis, at 3.

[299] **CE-178**, Hibernia Staff Analysis, at 4; *see also* **CE-181**, Letter from P. Phelan, HMDC, to J. Budgen, CNLOPB, at EMI00001705 (Mar. 5, 2010); **CE-179**, Letter from J. Budgen,



213. HMDC asked the Board to reconsider its decision on these and other expenditures in view of the more favorable treatment by the CRA.[303] On March 10, 2010, the Board confirmed that the R&D expenditure shortfall for the Hibernia

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CNLOPB, to P. Sacuta, HMDC (Dec. 10, 2009); **CE-182**, HMDC, Chart: HMDC SR&ED Results (undated).

[300] **CE-178**, Hibernia Staff Analysis, at 3; *see* **CE-181**, Letter from P. Phelan, HMDC, to J. Budgen, CNLOPB, at EMI00001705 (Mar. 5, 2010); **CE-179**, Letter from J. Budgen, CNLOPB, to P. Sacuta, HMDC (Dec. 10, 2009); **CE-182**, HMDC, Chart: HMDC SR&ED Results (undated).

[301] Hibernia Staff Analysis, at 4; *see* **CE-181**, Letter from P. Phelan, HMDC, to J. Budgen, CNLOPB, at EMI00001705 (Mar. 5, 2010); **CE-179**, Letter from J. Budgen, CNLOPB, to P. Sacuta, HMDC (Dec. 10, 2009); **CE-179**, HMDC, Chart: HMDC SR&ED Results (undated).

[302] *See* **CE-142**, Canada Revenue Agency, *What is the SR&ED Program?*, http://www.cra-arc.gc.ca/txcrdt/sred-rsde/bts-eng.html (last visited July 28, 2009) ("To qualify for the SR&ED program, work must advance the understanding of scientific relations or technologies, address scientific or technological uncertainty, and incorporate a systematic investigation by qualified personnel.").

[303] **CE-181**, Letter from P. Phelan, HMDC, to J. Budgen, CNLOPB (Mar. 5, 2010).

Project would be reduced by [redacted], presumably accepting that its initial approach was inconsistent with its stated position on SR&ED-eligible expenditures.

214. This experience raises serious questions as to the Board's approach to administering the Guidelines. It is now beyond doubt that the Board's application of the R&D definition is less favorable to project operators than Canada suggests in its Counter-Memorial. Insofar as the Board's initial decision indicates a misunderstanding of the statutory definition of SR&ED, which is incorporated in the Guidelines, this experience highlights the uncertainty and risks Claimants face in qualifying any R&D expenditure.

215. The Board's decision also discredits to a very substantial extent the various assumptions and predictions made by Canada's damages expert, Mr. Walck. That the Board accepted as eligible only [redacted] of HMDC's total expenditure betrays the full extent of Mr. Walck's exaggerated prophecies. The Board's decision fully vindicates Claimants' approach to quantum in this arbitration and confirms that Claimants' assessment of their past losses is reasonable, reliable, and accurate.

3. Canada Has Failed to Demonstrate That Any Deductions to Claimants' 2004-2008 Damages Are Warranted

216. Canada also seeks to chip away at Claimants' 2004-2008 damages by suggesting that deductions should be made to reflect any "benefits" accruing to Claimants from their wholly unnecessary additional spending in the Province.

217. Canada's submissions consist of three bald assertions. First, Canada claims that any expenditure made by Claimants "may," if directed to R&D, generate tax credits under the SR&ED program (Respondent's Counter-Memorial,

¶ 317). Second, Canada asserts that any (hypothetical) future R&D or E&T spending "may" provide Claimants with reductions to their royalty payments (*id.* ¶ 320). Third, Canada claims that Claimants will enjoy certain "other benefits" from their imposed spending requirements and that they should give credit accordingly (*id.* ¶ 322).

218. None of these unsupported assertions warrants a deduction to Claimants' past damages. Preliminarily, it is not yet known how Claimants will meet their shortfall obligations. Although HMDC and Suncor have submitted Work Plans to the Board, their proposals are dependent on the Board's own decision as to whether or not to accept them and the feasibility of the potential projects identified (including the Province's capacity to absorb them).[304] To the extent that any of the proposals proceed to implementation, it is unclear over what period of time the projects will take place, when expenditures will be incurred, precisely how they will be allocated as among the various industry participants, and what their overall costs will be. For these reasons, Mr. Rosen confirms that it is neither appropriate nor indeed possible to address Claimants' proposals in his damages assessment at this time.[305] Even Mr. Walck concedes that the hypothetical offsets suggested by Canada cannot be calculated until the relevant expenditures are made.[306]

219. In any event, Canada will not be able to sustain its argument that deductions should be made to the future spending component of Claimants' 2004-2008 damages, as

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[304] Ringvee Statement II at ¶ 20. Mr Rosen does not address Claimants' March 31, 2010 proposals to the Board in his second report for that reason.

[305] Rosen Report II, ¶ 4.

[306] Walck Report I, ¶ 102.

reflected in the Work Plans that have just been submitted to the Board.

220. *SR&ED Credit*: Canada's claim that Claimants' may achieve tax credits through meeting the shortfall exposes Canada's submissions to be those of pure convenience. While Canada proposes deductions to Claimants' past damages to reflect any SR&ED credit accruing from future *R&D* expenditure in the Province, elsewhere Canada seeks to suggest that Claimants could fulfill their entire Guidelines expenditure requirement through expenditures on *E&T* (to which the SR&ED program does not apply) in order to avoid the NAFTA consequences of enforced spending on R&D.[307] Canada cannot have it both ways.

221. [redacted].[308] As Mr. Rosen explains in his second report, the Claimants' prospects of obtaining even comparable SR&ED treatment for the contrived and unnecessary R&D spending mandated by the Guidelines are even less, because none of this spending is required by the projects' themselves.[309] Finally, Claimants' proposals are contingent on the Province's capacity to absorb further substantial R&D expenditures. To the extent that there is insufficient capacity or Claimants' proposals prove to be unfeasible, the possibility of receiving tax credits may not arise at all.[310]

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[307] RM ¶ 186.

[308] Rosen Report I, ¶ 56(i).

[309] Rosen Report II, ¶ 81.

[310] Claimants articulated their concerns as to the Province's limited capacity in their Memorial, ¶ 126; **CE-141,** CAPP, CNLOPB R&D Guidelines, Administration of Unspent R&D Obligations, Industry Feedback to C-NLOPB, Slide 2 (Feb. 26,

222. *Royalty Payment Reductions*: Canada suggests that to the extent Claimants can find eligible R&D or E&T opportunities "directly related to the project, necessary for the project and paid for through the project's accounts," such expenditure might reduce the revenue base on which royalties are calculated, thereby reducing Claimants' royalty payments to the Province.

223. No serious attempt has been made by Canada to quantify the overall effect of this alleged benefit on Claimants' past damages. As Canada itself acknowledges, not all R&D expenditure is relevant for the purposes of royalty assessment. R&D may potentially be relevant if it is "directly related to the project" and "necessary to the project." The additional R&D mandated by the Guidelines is unnecessary to the projects and would not have been undertaken in the absence of that measure. In addition, the bulk of HMDC's and Suncor's Work Plans focus on industry-wide and owner-specific initiatives that are in any event unlikely to satisfy those narrow criteria. Under the circumstances, there is no foundation for Canada's suggestion that Claimants will benefit from supposedly favorable royalty treatment in future years.

224. *"Other Benefits":* Finally Canada suggests that Claimants will enjoy "other benefits" from their imposed spending requirements in the Province, including costs savings (not quantified) to the extent that Claimants can relocate existing R&D projects (none identified) to the Province.[311] As with Canada's other arguments, this assertion

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2009); **CE-140**, CAPP, CNLOPB R&D Guidelines Industry Considerations, Slide 2 (Dec. 16, 2008); First Witness Statement of Andrew Ringvee, ¶ 13 (hereinafter "Ringvee Statement I"); Phelan Statement I, ¶ 30; Graham Statement I, ¶ 10; Ringvee Statement II, ¶ 4.

[311] RM ¶ 322-324, 376; Walck Report I ¶¶ 104-106.

is advanced without substance or specificity. Even Canada's expert makes no attempt to place a value on these alleged benefits.

225. In the absence of any concrete evidence as to the net economic value of the alleged benefits said by Canada to accrue from increased spending in the Province, the Tribunal should simply ignore Canada's hypotheticals and decline to make any deductions to Claimants' assessment of their past damages.

B. Claimants Are Also Entitled to Compensation Post-December 2008 and Beyond

226. The Permanent Court of International Justice formulated the relevant customary international law standard of reparation eighty years ago in its judgment in the *Chorzów Factory* case:

> The essential principle contained in the actual notion of an illegal act – a principle which seems to be established by international practice and in particular by the decisions of arbitral tribunals – is that reparation must, so 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.[312]

227. Consistent with that universally acknowledged standard,[313] Claimants seek damages to offset all financial

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[312] **CA-28**, *Factory at Chorzów*, 1928 P.C.I.J. (Ser. A) No. 17, Decision of September 13, 1928, at 47.

[313] *See, e.g.*, **CA-15**, *ADC Affiliate Ltd. v. Republic of Hungary*, Award of September 27, 2006, ¶ 493 (reviewing numerous decisions and concluding that "there can be no doubt about the present vitality of the *Chorzów Factory* principle, its full current vigor having been repeatedly attested to by the International

consequences of their compliance with the Guidelines. This necessarily involves consideration of Claimants' prospective financial exposure: Claimants will be required to make R&D expenditures in the Province far in excess of their actual business needs throughout the remaining life of the projects. To make Claimants whole, Claimants must receive compensation to cover the costs of complying with the additional financial burden created by the Guidelines, expenditures that Claimants would not have incurred in the usual course of project operations *but for* the introduction of the Guidelines.

228. The "but for" approach to compensation adopted by Claimants is widespread in economic practice[314] and finds support in those non-expropriation cases in which fair market value is used to address significant long-term consequences of treaty violations.[315] Many tribunals have applied this method on the basis of the customary law standard of full reparation

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Court of Justice."); **CA-44**, *S.D. Myers*, ¶ 311; **CA-22**, *Compañiá de Aguas del Aconquija S.A. & Vivendi Universal v. Argentine Republic*, ICSID Case No. ARB/97/3, Award of August 20, 2007, ¶ 8.2.4-8.2.5; **CA-46**, *Siemens A.G. v. Argentine Republic*, ICSID Case No. ARB/02/8 Award of February 6, 2007, ¶ 351; **CA-21**, *CMS Gas Transmission Company v. Argentine Republic*, ICSID Case No. ARB/01/8, Award of May 12, 2005, ¶ 400; **CA-17**, *AMOCO International Finance Corporation v. Iran*, Award of July 14, 1987, ¶ 191; **CA-48**, *Starrett Housing Corp. v. Iran, Case No. 24*, Award of August 14, 1987, ¶ 264.

[314] *See* **CA-146**, Irmgard Marboe, *Calculation of Compensation and Damages in International Investment Law*, ¶ 5.172 (Oxford International Arbitration Series 2009).

[315] *See*, for example, **CA-21**, *CMS*. Claimants do not propose a fair market value approach in this case and Canada's submissions on an appropriate discount rate are, accordingly, misconceived. This issue is addressed in further detail at *infra* ¶¶ 266 *et seq*.

as articulated above.[316] It is the *only* available approach that purports to make Claimants whole in accordance with the *Chorzów Factory* standard.[317] In any event, no rival or alternative approach is put forward by Canada's damages expert.

229. To put Claimants' prospective losses into context, however, it bears particular emphasis at the outset that most of Claimants' damage occurs either in the past or in the near term. About 59% of Claimants' damages arise from the period 2004-2010. An additional 22% of Claimants' damages arise in the period through December 31, 2015.[318] Indeed, the percentage of total damages in each year sharply declines after 2010, to 6.7% of total damages per year in 2011 and 2012, further reducing to approximately 2% per year as of 2015, 1% as of 2022 and less than 1% per year from 2025 onwards as the following chart demonstrates:[319]

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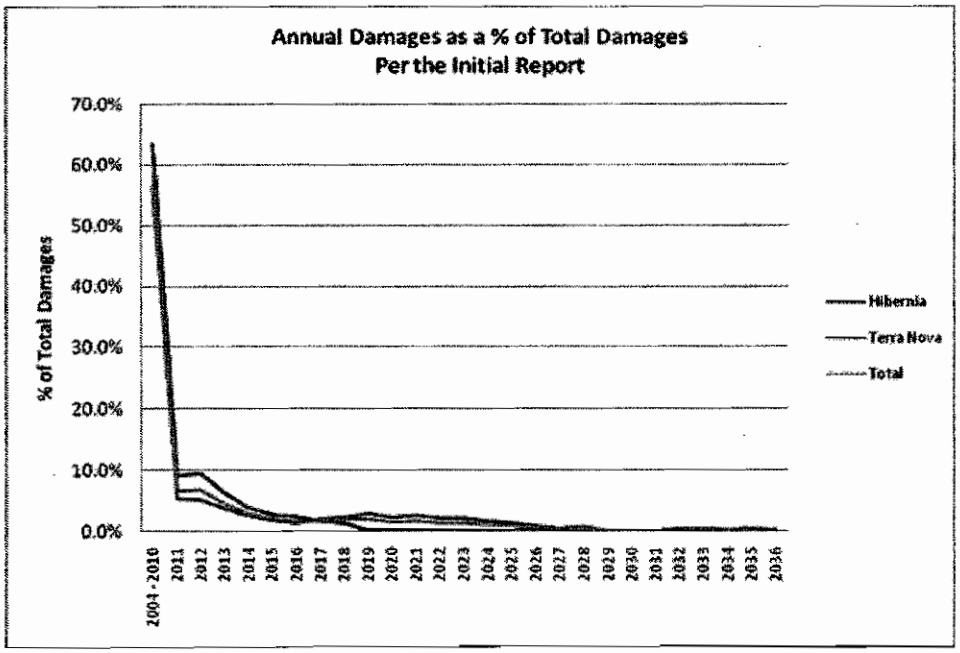
[316] *See*, for example, **CA-34**, *LG&E Energy Corp. v. The Argentine Republic*, ICSID Case No. ARB/02/1, Decision on Liability of October 3, 2006.

[317] As reinforced by NAFTA Article 1134, the Tribunal has no ability to enjoin future application of the Guidelines to the Claimants. *See* **CA-3**, NAFTA, art. 1134. Further, even the Claimants' preferred approach can only purport to make Claimants whole: in seeking to bring finality to this dispute, Claimants risk understating their losses and exposing themselves to a possibly significant shortfall.

[318] Rosen Report II, at 18.

[319] *Id.*



230. Accordingly, although in seeking to be made whole projections must inevitably be extended through 2018 for Terra Nova and 2036 for Hibernia, the impact of these later years is marginal. Under the circumstances, Canada greatly overstates both the relevance and the consequences of any "uncertainty" inherent in long-term forecasting.

231. Canada suggests that Claimants are not entitled to any compensation for their prospective financial exposure under the Guidelines. First, it is said that this exposure is not a "loss incurred" for the purposes of the NAFTA and so falls beyond the scope of available treaty protection. It is then suggested that an award of forward-looking compensation would be inconsistent with applicable principles of international law, which confine compensation to "actual losses" or "loss sustained." Finally, it is said that Claimants' future losses are too speculative to be recoverable in any event.[320]

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[320] RM ¶¶ 328 *et seq.*

232. Canada's objections ignore that this *is* a claim for a "loss incurred." Claimants' loss consists in the spending obligations created through the Board's implementation of the Guidelines. Those obligations *already* exist. Mr. Rosen's report merely quantifies them.

233. Further, Canada's extreme proposition that forward-looking compensation is not even available in principle ignores the widely acknowledged distinction in international law between loss sustained, on the one hand, and future, consequential, or anticipated loss on the other. All are *prima facie* recoverable.

234. Finally, Canada's objections apparently derive from a conflation of two distinct legal principles: first, the available categories of damages that can be awarded in principle under international law (including future expenditure) and second, the evidentiary hurdle applicable to such categories. As a matter of law, there can be no serious doubt that Claimants are entitled to compensation for the damage resulting from Canada's prospective application of the Guidelines through the end of the projects. Indeed, commentaries and arbitral awards specifically confirm that future expenditure is a recoverable damage in its own right.

235. As to the applicable evidentiary hurdle, it is well established that forward-looking compensation is available under international law where the fact, and to a lesser degree, extent, of such future loss can be demonstrated with reasonable certainty. Arbitral tribunals frequently engage in future-damage projections, particularly in the context of lost-profits analyses. The unifying theme of such authorities (including those cited by Canada), insofar as they are relevant to an analysis of future expenditure, is that such projections are only dismissed as "speculative" where the enterprise or activity concerned is immature or has otherwise failed to progress beyond the planning stage. Such a charge could not

hope to be sustained against the Hibernia and Terra Nova fields. Canada's repeated claims of "speculation" are, under the circumstances, entirely misconceived.

1. An Obligation to Be Met by Future Conduct or Expenditure Is a "Loss Incurred" for the Purposes of the NAFTA

236. In four short paragraphs, Canada concludes that Claimants' claim for forward-looking compensation must fail because "*an award of damages not yet incurred is inconsistent with the NAFTA.*"[321] Support for this proposition is said to be found in NAFTA Article 1116.[322]

237. However, Article 1116 is a standing or claims-enabling provision.[323] It does not speak to the rules applicable to compensation.[324] Instead, it establishes that the existence

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[321] *Id.* ¶¶ 328-331 *et seq.*

[322] Article 1116 provides as follows: "1. An investor of a Party may submit to arbitration under this Section a claim that another Party has breached an obligation under: (a) Section A or Article 1503(2) (State Enterprises), or (b) Article 1502(3)(a) (Monopolies and State Enterprises) where the monopoly has acted in a manner inconsistent with the Party's obligations under Section A, and that the investor has incurred loss or damage by reason of, or arising out of, that breach. 2. An investor may not make a claim if more than three years have elapsed from the date on which the investor first acquired, or should have first acquired, knowledge of the alleged breach and knowledge that the investor has incurred loss or damage."

[323] **CA-143**, Kinnear, *Article 1116*, at 1116-3.

[324] **CA-149**, Sergey Ripinsky and Kevin Williams, *Sources of International Law on Damages*, in *Damages in International Law*, p. 22 (BIICL 2009): "Standing or claims-enabling provisions do not speak to the rules applicable to compensation."

of loss or damage is a prerequisite to bringing a claim under the NAFTA.

238. Canada has not advanced a jurisdictional objection under Article 1116, nor could it. Claimants' loss and damage consist in the obligations created through the Board's implementation of the Guidelines. Those obligations *already* exist.[325] The fact that some of their effects will not be felt until later years, or indeed that Claimants' obligations are to be met in part through future conduct or expenditure, is irrelevant. The NAFTA Tribunal in *Grand River Enterprises Six Nations Ltd et al. v United States* has confirmed this proposition:

> At the hearing, the Parties exchanged dueling dictionary definitions of the word or concept "incurred." The Claimants advocated an interpretation conveying the idea that loss or damage is only incurred when funds are actually paid out. The Respondent countered that "incurred" means to become liable or subject to something, noting that in everyday language, a person may "incur" an expense or obligation to pay even before payment is actually required. In many sources, the verb is regularly taken to mean "become liable to." Judicial dicta likewise suggest that one incurs a loss when liability accrues; a person may "incur" expenses before he or she actually dispenses any funds. In the Tribunal's view, this interpretation corresponds most closely to the ordinary meaning of the term. The verb "to incur" in ordinary usage is often used to describe situations where there is no immediate outlay of funds by the affected party. *A party is said to incur losses, debts, expenses or obligations, all of which may significantly damage the party's interests, even if there is no immediate outlay of funds or if the obligations are to be met through future conduct.*

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325 *See* Rosen Report I, n. 17.

> *Moreover, damage or injury may be incurred even though the amount or extent may not become known until some future time.*[326]

239. Under the circumstances, to the extent that Article 1116 is relevant at all, *Grand River* unequivocally confirms that, through the obligations to which Claimants are exposed by virtue of the Board's implementation of the Guidelines, Claimants have already "incurred loss or damage" for the purposes of the NAFTA.

2. Numerous Arbitral Awards Confirm the Considerable Discretion Available to NAFTA Tribunals When Approaching Compensation

240. Rather than having its hands tied when approaching the issue of compensation, as Canada seeks to suggest, this Tribunal in fact enjoys very considerable discretion.

241. In a case on which Canada itself relies, the *Feldman* Tribunal acknowledged that the NAFTA itself only addresses the measure of compensation to be awarded in a case of lawful expropriation. It is silent as to the measure of damages to be awarded following treaty violations other than Article 1110. Other tribunals have confirmed that this silence indicates the intention of the treaty drafters "to leave it open to tribunals to determine a measure of compensation appropriate to the specific circumstances of the case."[327]

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[326] **CA-95**, *Grand River Enterprises Six Nations Ltd v United States*, (UNCITRAL) Decision on Objections to Jurisdiction of July 20, 2006 (emphasis added).

[327] **CA-44**, *SD Myers*, ¶ 309, endorsed in **CA-26**, *Enron Corporation and Ponderosa Assets, L.P. v. Argentine Republic,* ICSID Case No. ARB/01/3, Award of May 22, 2007, ¶ 360. *See also* **CA-19**, *Azurix v. Argentine Republic*, ICSID Case No. ARB/01/12, Award of July 14, 2006, ¶ 422. It is the Claimants'

242. Referring to the *S. D. Myers* and *Pope & Talbot* cases,[328] the *Feldman* Tribunal also observed that those NAFTA tribunals had "exercised considerable discretion in fashioning what they believed to be reasonable approaches to damages consistent with the requirement of NAFTA."[329] "That discretion is unsurprising given the limitations imposed by Article 1134 of the NAFTA, by which tribunals have no ability to enjoin the operation of the measure forming the subject of the claim. Claimants' approach to their prospective losses is therefore fully consistent with the NAFTA, whose silence on the issue of compensation was intended to afford tribunals wide discretion when approaching that issue.

3. International Law Demands Reparation That Eliminates the Past and Future Financial Consequences of the Guidelines

243. An award to reflect the future financial consequences of the Guidelines is also fully consistent with the "applicable rules of international law" guiding the Tribunal's approach to compensation.[330]

244. In the *Chorzów Factory* case, the Permanent Court confirmed that, in awarding compensation, a tribunal's

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submission that the "but for" approach to compensation is appropriate in this case, as is further explained *infra* ¶¶ 243 *et seq.*

[328] **CA-44**, *S.D. Myers*; **CA-110**, *Pope & Talbot III.*

[329] **CA-29**, *Feldman v. Mexico*, ICSID Case No. ARB(AF)/99/1, Award of December 16, 2002, ¶ 197. That proposition was endorsed by the tribunal in *Azurix*, **CA-19**, *Azurix*, ¶ 421

[330] *See* **CA-3**, NAFTA, art. 1131(1); **CA-162**, Todd Weiler and Luis Miguel Diaz, *Causation and Damages in NAFTA Investor-State Arbitration*, in T. Weiler (ed.), *NAFTA Investment Law and Arbitration*, at 187 (Transnational, 2004).

overriding objective is to put the claimant back into the same position that it would have been in "but for" the wrongful act: "reparation must, as far as possible, wipe out all the consequences of the illegal act and re-establish the situation which would, in all probability, have existed if that act had not been committed."[331] The Tribunal in *AMT v. Zaire* described this as a requirement "to restore to [the investor] the conditions previously existing as if the event had never occurred or taken place."[332]

245. In arriving at a restitution value consistent with the *Chorzów* standard, this Tribunal must look to "wipe out all the consequences" of the Guidelines whether already felt or in all probability to be felt in the future.

(a) Claimants' Losses Have Already Been Incurred

246. Canada ventures that an award of damages to reflect the Claimants' post-December 2008 exposure under the Guidelines would be "inconsistent with international principles of compensation," which extend only to "loss sustained," "actual loss," and "damage suffered."[333]

247. Even if Canada's characterization of international principles of compensation were correct, which it is not, Claimants' loss *has* already been incurred and consists of the obligations created through the Board's implementation of the Guidelines.[334] The fact that some effects will not be felt until later years, or indeed that Claimants' obligations are to be met

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331 **CA-28**, *Chorzów*, at 47.

332 **CA-86**, *AMT v. Zaire*, ICSID Case No. ARB/93/1, Award of 21 February 1997, ¶ 6.21.

333 RM ¶¶ 332-334.

334 *Supra* ¶¶ 246-248.

in part through future conduct or expenditure, is irrelevant to that analysis.

248. Indeed, that fact distinguishes the present case from *Occidental v. Ecuador*, a decision upon which Canada places great reliance.[335] In *Occidental*, the Claimant's prospective economic harm did not arise out of a loss subsisting as at the date of the award (or earlier). Although the Tribunal confirmed the investor's *right* under applicable laws to VAT refunds in the future, Occidental had not incurred a loss in that regard as at the date of the award. Its loss would not be incurred unless and until a future rebate was sought and then denied by Ecuador. The Claimants' position in this case is very different. They are already exposed to a loss, which consists in the ongoing obligations created through the Board's implementation of the Guidelines. Those substantial obligations are actionable now and already involve the Respondent in NAFTA violations. Moreover, in *Occidental*, the tribunal in fact required Ecuador to refund in the future the VAT to which the investor was entitled when future applications were filed.[336] Such an order cannot, however, be made by a NAFTA tribunal — a limitation which further justifies Claimants' claim for an award of future damages.

(b) International Principles of Compensation Extend to Future Harm

249. Even ignoring Canada's mischaracterization of Claimants' loss as one "not yet incurred," international principles of compensation are not as restrictive as Canada seeks to suggest in any event. They extend both to losses suffered (*damnum emergens*) and to future or consequential

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[335] **CA-39**, *Occidental Exploration and Production Company v. Ecuador*, LCAI Case No UN 3467, Award of July 1, 2004.

[336] *Id.* ¶ 143, Relief awarded ¶ 3.

damage (*lucrum cessans*). As one commentary explains in unequivocal terms: "In principle, international law allows recovery of both past and future losses."[337]

250. The availability of forward-looking compensation is confirmed in Article 36 paragraph 2 of the Draft Articles on State Responsibility (in which the ILC provided that "compensation shall cover any financially assessable damage, including loss of profit insofar as it is established")[338] and the UNIDROIT Principles of International Commercial Contracts, for example, which confirm that "compensation is due for harm, *including future harm*, that is established with a reasonable degree of certainty."[339]

251. This understanding is similarly confirmed in many international arbitral awards. In *Sapphire International*

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[337] **CA-150**, Ripinsky, *Cross-cutting Issues, at 115*. That compensation can be sought in respect of both actual and prospective harm is also confirmed in a leading commentary on NAFTA Investment Law and Arbitration: "In cases where a claim can be made for lost profits ... the quantification of value relates directly to the lost past and future economic benefits to the investor and its investment ... This concept has generally been referred to in international law under the rubric of 'anticipated future profits.' Damages for lost profits may be awarded when the loss of profits is a foreseeable consequence of an international law breach and when such profits can be calculated with reasonable certainty. Under international law, the aggrieved party would, accordingly, be said to be entitled not only to compensation for actual losses suffered (*damnum emergens*) but also for consequential damages such as the loss of possible business profits (*lucrum cessans*)." **CA-162**, Weiler, at 203.

[338] **CA-158**, International Law Commission, *Draft Articles on State Responsibility*, UN Doc. No. A/56/10 (2001).

[339] **CA-157**, UNIDROIT, *Principles of International Commercial Contracts*, art. 7.4.3 (2004).

Petroleum, for example, the Tribunal emphasized that "compensation includes the loss suffered (*damnums 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."[340] Indeed, it explains the scores of arbitral awards in which tribunals have awarded damages for future or anticipated lost profits, whether as part of a DCF analysis or otherwise.[341]

(c) Future Expenditure Is a Recognized Damage in Its Own Right

252. Contrary to the position advocated by Canada, commentators and arbitral awards also confirm that future expenditure is a recoverable damage under international law in its own right: "In principle, international law allows recovery of both past and future losses. Future losses encompass losses that lie in the future both in relation to the breach and in relation to the arbitral award, and usually manifest themselves in the form of loss of profits or incidental expenses."[342]

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[340] **CA-111**, *Sapphire International v. National Iranian Oil Companies*, Award of March 15, 1963.

[341] *See*, eg, **CA-101**, *LIAMCO v. Government of Libya*, Award of April 12, 1977; **CA-94**, *Government of Kuwait v. Aminoil*, Award of March 24, 1982; **CA-17**, *Amoco v. Iran*, Award of July 14, 1987; **CA-108**, *Phillips Petroleum*; **CA-85**, *Amco*; **CA-84**, *AGIP v. Congo*, Award of November 30, 1979; **CA-15**, *ADC Affiliate Ltd. v. Republic of Hungary*, Award of September 27, 2006; **CA-44**, *SD Myers*; **CA-112**, *SIAG v Egypt*, ICSID Case No. ARB/05/15, Award of June 1, 2009, amongst many others

[342] *See* **CA-150**, Ripinsky, *Cross-cutting Issues*, at 115. *See further* **CA-151**, Ripinsky, *Heads of Damage*, at 305.

253. One example of an award of likely future expenditure is to be found in *SOABI v. Senegal*.[343] Following Senegal's breach of SOABI's contract, the investor was exposed to potential claims at the suit of its architect sub-contractor. The Tribunal found that, although Senegal owed the investor nothing under this claim at the time of the award, if a decision or settlement subsequently established the liability of the investor to its sub-contractor, then Senegal must indemnify SOABI with respect to those possible losses.[344]

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254. In sum, for the various reasons outlined above, there are no conceptual or legal impediments to the Claimants' claim for compensation to reflect the future expenditure required by the Guidelines. Indeed, arbitral tribunals have specifically confirmed that such losses are *prima facie* recoverable.

4. Future Damage Need Only Be Proved with Reasonable Certainty

255. Canada cites, among others, the decision of the tribunal in *LG&E v. Argentina* in support of its (erroneous) proposition that "an international tribunal may only award compensation for damages already incurred." In fact, that case speaks to a very different issue. *LG&E*, together with many other decisions, simply confirms that damages, whether

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[343] **CA-114**, *SOABI v. Senegal*, ICSID Case No. ARB/82/1, Award of February 25, 1988.

[344] *See id.* ¶ 12.05(b). *See also* **CA-46**, *Siemens*, ¶¶ 329, 403 (ordering Argentina to indemnify Siemens with respect to possible claims at the suit of the investor's sub-contractors, an award unlimited as to both time and quantum).

historic or prospective, must be established with reasonable certainty. The *LG&E* decision addresses the evidentiary hurdle that any claimant must meet in seeking to establish the extent of its losses. It does not question the availability of prospective damages as a matter of principle, a proposition that must be beyond any doubt for the reasons already given.

256. As one commentator observes: "A commonly accepted standard for awarding forward-looking compensation … is that damages must be proved with reasonable certainty."[345] Claimants endorse that proposition.

257. Further, reasonable certainty is required only as to the fact of damage — proof that there would have been, for example, future profits in the absence of the illegal act. Once this level of certainty is established, "less certainty is required (perhaps none at all) in proof of the amount of damages. While the proof of the fact of damages must be certain, proof of the amount may be an estimate, uncertain or inexact."[346]

258. Accordingly, in *LG&E*, having confirmed the availability in principle of both accrued losses and lost future profits, the Tribunal proceeded to reject one element of the Claimants' claim for lost future profits, alleged lost future dividends, on the basis that the likelihood of such losses occurring had not been established with reasonable certainty (principally due to the risk of double-recovery):

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[345] *See* **CA-140**, Mark Kantor, *Valuation for Arbitration*, at 75 (Wolters Kluwer Law 2008).

[346] *Id.*, at 72 (citing Dunn, *Recovery of Damages for Lost Profits*, § 1.6, at 17). In **CA-22**, *Compañiá de Aguas*, ¶ 8.3.3, the tribunal noted that the various awards relied upon by the investor indeed distinguished the level of certainty required as to the fact of future probability of lost profits from the proof required as to the extent of such losses.

> The uncertainty concerning lost future profits in the form of lost dividends results from the fact, noted above, that Claimants have retained title to their investments and are therefore entitled to any profit that the investment generates and could generate in the future. Any attempt to calculate the amount of the lost dividends in both the actual and "but for" scenario is a highly speculative exercise. If the Tribunal were to compensate LG&E for lost future dividends while it continues to receive dividends distributed by the Licensees at a hypothetical low amount, a situation of double recovery would arise, unduly enriching the Claimants.[347]

259. Other arbitral tribunals confirming the "reasonable certainty" standard include those in *Karaha Bodas* ("the issue confronting the Arbitral Tribunal in the present case is that it is requested to *assess with a reasonable degree of confidence* the level of profits which the Claimant might have legitimately expected to earn")[348] and the *Vivendi* 2007 ICSID panel (the investor must provide "*convincing evidence*" of its ability to produce profits).[349]

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[347] **CA-34**, *LG&E Corp.*, ¶ 90.

[348] **CA-100**, *Karaha Bodas Co., LLC v. Pertamina & Others*, (UNCITRAL) Award of 18 December 2000, ¶ 124 (emphasis added).

[349] **CA-22**, *Compania de Aguas*, ¶ 8.3.8 (emphasis added). Accordingly, in *Feldman*, a case on which Canada relies, the claim for forward-looking compensation was rejected not because of the unavailability of future damages as a principle, but because claimant had failed to meet his burden of proof. The tribunal held that, on the evidence, the claimant had not demonstrated the likelihood of any future profits in the absence of the treaty violations of which he complained. The tribunal found that the investor's business was not profitable, including because he had no significant customer base

260. Contrary to the untenable position assumed by Canada's damages expert, international law and arbitral tribunals have never required that forward-looking compensation be established to a standard of absolute certainty.[350] Not only would such a standard be impossible to achieve—"valuation is in essence, a prophecy as to the future"[351]—even a high level of certainty unfairly burdens the injured party and benefits the party whose conduct has made it so hard to calculate the loss.[352]

261. Absence of absolute certainty is no answer to a claim for monetary compensation. That proposition has been confirmed by arbitral tribunals, including those in *Himpurna California Energy v. PLN* ("in this case, as in so many others, it is impossible to establish damages as a matter of scientific certainty. This does not, however, impede the course of justice"),[353] *Southern Pacific Properties v. Egypt* ("it is well settled that the fact that damages cannot be settled with certainty is no reason not to award damages when a loss has

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and had apparently relied upon sales made to a fictitious company (**CA-29**, *Feldman*, ¶¶ 200-201).

[350] **CA-140**, Kantor, at 71 ("National laws and international law do not require that future revenues, expenses or profits be proved with absolute certainty.").

[351] *Id.*, at 7.

[352] *See* **CA-138**, John Y. Gotanda, *Assessing Damages in International Commercial Arbitration: A Comparison with Investment Treaty Disputes*, in Andrea Bjorkland et al, *Investment Treaty Law: Current Issues III*, at 80 (BIICL 2009).

[353] **CA-96**, *Himpurna California Energy v. PLN*, (UNCITRAL) Award of May 4, 1999, ¶ 237.

been incurred"),[354] *SOABI v. Senegal*,[355] and *MINE v. Guinea*.[356]

262. Canada also suggests that Claimants' damages are too speculative to be recoverable in any event. In making that claim, Canada wrongly conflates speculation with reasonable assumptions. There is an important distinction, as explained by the *Himpurna* Tribunal in the context of its discounted cash flow ("DCF") analysis:

> There is no reason to apologise for the fact that this approach involves approximations; they are inherent and inevitable. Nor can it be criticised as unrealistic or unbusinesslike; it is precisely how business executives must and do proceed when they evaluate a going concern. The fact that they use ranges and estimates does not imply abandonment of the discipline of economic analysis; nor, when adopted by the arbitrators, does this method imply abandonment of the discipline of assessing the evidence before them.[357]

263. Further, although Canada claims that Claimants' forward-looking losses are "speculative," lost profits cases confirm that damage projections will only be dismissed as speculative when based on immature or demonstrably unprofitable activities.[358] Accordingly, in *SPP v Egypt*, a case

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[354] **CA-116**, *SPP v. Egypt*, ICSID Case No. 84/3, Award of May 20, 1992, ¶ 215.

[355] **CA-114**, *SOABI*, ¶ 150.

[356] **CA-104**, *MINE v. Guinea*, ICSID Case No. ARB/84/4, Award of January 6, 1988, ¶ 75.

[357] **CA-96**, *Himpurna*, ¶¶ 375-376.

[358] **CA-140**, Kantor, at 77 (quoting Dunn, *Recovery of Damages for Lost Profits*, ¶ 728 at 607) ("When the courts label a damages projection as speculative, this is something more than a mere catchall for a negative result. The unifying idea in the cases

on which Canada relies, the Tribunal held that a DCF calculation was not appropriate because the project was in its infancy, and, as a result, there was little history on which to base projected revenues. In those circumstances, the tribunal declared that the long-term (18-year) losses alleged were "too uncertain and ha[d] not been adequately proven."[359] A similar result followed for the very same reasons in *Autopista v. Venezuela*.[360]

264. In this case, Claimants' losses arise in connection with long term, mature activities. Oil production at Hibernia began in 1997 and peaked in 2005, at which point 200,000 barrels were produced per day. As of the date of Claimants' first memorial, by which time production was in decline and averaged 140,000 barrels per day, approximately 642 million barrels had been produced. Production is expected to continue through 2036. Production at Terra Nova began in 2002, peaked in 2007, and is expected to continue through 2018. As of the date of Claimants' first memorial, approximately 275 million barrels had been produced.[361]

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cited seems to be that the claimed losses derived not from an enterprise or activity that has come into existence, but from plans that never went further than anticipation. Recovery of lost profits damages on these tenuous facts has consistently been denied. If the business exists only in the contemplation of the plaintiff, proof of lost profits is likely to be speculation. Nonetheless, if plaintiff can point to some tangible activity, past or present, the likelihood of recovery increases.")

[359] **CA-116**, *SPP*, ¶ 39.

[360] **CA-87**, *Autopista Concesionada de Venezuela CA (Aucoven) v Venezuela*, ICSID Case No ARB/00/5, Award of Sept. 23, 2003.

[361] *See generally* CM ¶¶ 22-34.

265. Under the circumstances, Canada's allegations of "speculation" are entirely misconceived. Moreover, as shown below, each element of Claimants' analysis is well supported and demonstrably meets the reasonable certainty standard.

5. The Evidence Convincingly Demonstrates the Likelihood and Extent of Claimants' Future Losses

266. To make Claimants whole under the *Chorzów Factory* standard, they must receive compensation to offset the additional financial burden created by the Guidelines: expenditures that Claimants would not have incurred in the usual course of project operations *but for* the introduction of that measure. The Tribunal must therefore identify and compare the level of R&D expenditure that would have been undertaken by Claimants in the ordinary course of business with that likely to be required under the Guidelines in the future.

267. The fact that Claimants *will* suffer losses as a result of Canada's future application of the Guidelines cannot seriously be in doubt. Although Canada has purported to raise uncertainty as to the future application of this measure, no evidence whatsoever is offered in support, and the assertion is flatly contradicted by the record.

268. In Claimants' initial Memorial, they presented both fact and expert evidence as to the R&D expenditures that they would have undertaken but for the introduction of the Guidelines.[362] Assessing the cost of compliance with the Guidelines simply requires application of the formula set forth in the Guidelines themselves: the percentage of annual

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[362] CM ¶ 218 (fifth and sixth bullets); Phelan Statement I, ¶ 26; Graham Statement I, ¶¶ 15, 18; Rosen Report I, ¶¶ 28-47.

revenues to be spent on R&D each year as determined by application of the benchmark (the most recent five-year average of R&D expenditure data published by Statistics Canada).

269. Accordingly, in their Memorial, Claimants set out the facts and reasonable assumptions upon which their projections as to the expenditures likely to be required by reason of the Guidelines are based.[363] 59% relate to expenditures incurred through 2010, and a further 22% relates to the period to 2015.[364] Therefore, long-term projections were of limited relevance to that analysis. In any event, the fact that some forward projection is required does not render the exercise "speculative," as Canada seeks to suggest. With mature assets such as the Hibernia and Terra Nova fields, the Tribunal need only be satisfied that Claimants' assumptions are reasonable given the circumstances of those investments and their operating history.

270. Canada does not offer an alternative damages model. Instead, Canada seeks to chip away at Claimants' projections through a variety of unsubstantiated, legally irrelevant, or exaggerated propositions, each intended to create uncertainty in the eyes of the Tribunal. Canada is even prepared to rely upon uncertainties of its own creation in furtherance of that goal. These alleged uncertainties are in any event greatly exaggerated. In effect, Canada's damages expert, Mr. Walck, invites this Tribunal to accept that project participants were prepared to make enormous capital investments ($5.8 billion in the case of Hibernia and $2.985 billion for Terra Nova)[365] on the basis of a venture so

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363 CM ¶218

364 Rosen Report I, Schedule I; *see also* CM ¶ 220.

365 CM ¶¶ 23 and 31, respectively.

speculative that it had no determinable value.[366] That proposition is not remotely credible.

271. In sum, as the following paragraphs demonstrate, the Claimants base their assessment of future damages on reasonable criteria and assumptions commonly used in business and frequently accepted by international arbitral tribunals.

(a) Claimants Have Reasonably Estimated Their Likely R&D Expenditure in the Absence of the Guidelines

272. In estimating the R&D expenditures that Claimants would have undertaken in the absence of the Guidelines, Claimants' expert used a normalized average of Claimants' R&D expenditures in the period from April 1, 2004 to December 31, 2008, with projected expenditures decreasing towards the end of the life of each Project. This approach is appropriate in his view given the maturity of the projects. Because the projects are beyond mid-cycle, it is reasonable to assume that they will have consistent R&D needs relative to anticipated production levels each year. This approach is supported by the expert report of W. David Montgomery, who confirms that little R&D would be expected in the mature production phase of a project and would, in any event, only be required to meet a specific and unanticipated challenge.

273. Canada does not offer any expert evidence to refute Mr. Montgomery's report. Instead, Canada first suggests that Claimants' historical R&D expenditures have fluctuated and are thus not consistent enough to allow for meaningful

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366 Walck Report I, ¶ 136.

projections as to the future.[367] It is also suggested that Claimants have understated their future R&D requirements.[368]

274. As to the supposed "fluctuation" in Claimants' historical R&D expenditures, Canada remarks that annual R&D expenditures have ranged from [redacted] to [redacted] million in the case of Hibernia and from [redacted] to [redacted] at Terra Nova. [redacted] That one project is an anomaly in otherwise consistent figures, which averaged approximately [redacted] per year.[369] As to Terra Nova, a [redacted] to [redacted] range is hardly a "fluctuation" in the context of that project's gross annual expenditures of approximately [redacted].

275. Further, although Canada suggests an understatement by Claimants of their future R&D needs, Canada presents no alternative calculation of future R&D, nor does it quantify the financial effect of any additional future R&D on Claimants' damages.

(b) Claimants Can Predict With Reasonable Certainty the Cost of Complying With the Guidelines

276. In assessing the likely cost of their compliance with the Guidelines going forward, Claimants' analysis begins with the past: more specifically, the operating history of Hibernia and Terra Nova since the Guidelines became effective in 2004. This history includes production volumes as agreed by

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367 RM ¶ 364; Walck Report I, ¶¶ 91, 94.

368 RM ¶¶ 365-366.

369 Rosen Report I, Schedule II.

the Board; historic oil prices as agreed by the Board; the statistical benchmark calculated by the Board for that period; the amount of development phase credit calculated and applied by the board between 2004 and 2008; and eligible R&D and E&T expenditures during that same period. As one commentator observes: "Arbitral practice has "strongly relied on those [past] data as they seem to represent a solid and unspeculative basis."[370]

(i) *Oil production forecasts*

277. The Claimants have made reasonable forecasts as to future oil production. In his second report, Mr. Rosen explains that oil production figures for the 2004-2008 period were based on actual production as confirmed in correspondence between the Projects and the Board.[371] A significant portion (41% for Hibernia and 47% for Terra Nova) of each Project's oil production relates to that reference period. As Mr. Rosen confirms, "[t]here is no uncertainty associated with these figures and the Walck Report does not contest the use of these figures."[372]

278. As to the future, Mr. Rosen's calculations were based on production profiles created by the operators of Hibernia and Terra Nova in 2008 and submitted to the Board in 2009, estimates confirmed by the Board to be reasonable.[373]

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[370] *See* **CA-146**, Marboe, ¶ 5.116.

[371] Rosen Report II, ¶ 25.

[372] *Id.* ¶ 26. Although Mr. Walck seeks to exploit the "sensitivity" of oil production profiles (and other forecasts), his own calculations appear to be flawed in that they apparently fail to acknowledge that there is no uncertainty associated with Claimants' past data. *See further id.* ¶¶ 28-29.

[373] *Id.* ¶ 22 *et seq.*; **CE-178**, Hibernia Staff Analysis, at 7.

279. Notwithstanding the Board's acceptance of these profiles, Canada claims in the arbitration that they are an inappropriate tool for estimating Claimants' future expenditures because "[h]istorically, there has been significant fluctuation between forecasted and actual oil production."[374] In support of this conclusion, Canada's damages expert (who also ignores the Board's acceptance of the forecasts used by Claimants in this arbitration) compared actual production figures to estimates prepared at the inception of the projects — forecasts thus based on little or no production data or experience. For example, Mr. Walck uses as a point of comparison estimates prepared for the Hibernia project in 1985 and 1996.[375] However, the 1985 estimate was prepared five years prior to the construction of the Hibernia drilling and production facility, and twelve years prior to the start of oil production at the field. The 1996 estimate was also prepared before oil production began.[376] Likewise, Mr. Walck relies on 1996, 1997 and 2002 production estimates for Terra Nova to support his point.[377] Again, Mr. Walck's reliance on these figures ignores the fact that construction of the Terra Nova facilities began in 1999, and oil production did not begin before 2002.[378] In other words, many of the estimates relied on by Mr. Walck were prepared before the first wells were drilled; indeed, before the project operators had gained any experience of drilling in the Newfoundland offshore area. As Mr. Rosen explains in his second report, reference to pre-production or otherwise preliminary oil production forecasts is wholly inappropriate: "By including such preliminary oil production forecasts, Mr. Walck distorts his analysis and

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374 RM ¶ 353.

375 Walck Report I, ¶¶ 40-41.

376 CM ¶ 24.

377 Walck Report I, ¶¶ 52-54.

378 CM ¶¶ 31-32.

arrives and conclusions which are not representative of the Project operators' abilities."[379]

280. Simply put, the best estimate of future production is to be found in those forecasts made most recently, forecasts based on information obtained over many years' involvement in the Projects. Indeed, the Board itself recognizes that the acquisition of information from drilling and production activities leads to a better understanding of the fields and thus allows operators to better estimate oil reserves.[380] Mr. Rosen proposes to use the most up-to-date forecasts available when he updates his assessment of Claimants' damages nearer to the Hearing date.

(ii) *Oil price forecasting*

281. Canada claims that oil-price forecasting is complex, inherently uncertain, and therefore too speculative to be relied upon in a damages assessment. In seeking to dismiss such forecasts out of hand, Canada ignores the fact that price forecasting is a legitimate, necessary, and reliable exercise, frequently used by sophisticated economic actors and governments alike (including Canada) for the purposes of long-term planning and budgeting.[381] Many investment and financing decisions are made on the basis of predictions as to the likely future cost of oil and gas. As is explained by Claimants' expert, Sarah Emerson, an economist specializing in oil market analysis and price forecasting, in her second report:

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379 Rosen Report II, ¶ 46.

380 Rosen Report II, ¶ 33.

381 Second Expert Report of Sarah Emerson, ¶ 4 (hereinafter Emerson Report II).

> The production, refining and delivery of petroleum are high fixed cost activities that require significant capital and long lead times for development. Mr. Davies, himself, suggests that new investment in oil production may take as long as 7 to 10 years. As a result, it is essential for industry and government to develop long term views of the future of oil prices when planning their investments, developing policies or considering the role of energy in the economy. Indeed, MIT economist, Morris Adelman, has written, "many public and private investment decisions affecting a significant fraction of world income, depend on the expected price of crude oil." For these reasons, many governments, including the U.S. and Canadian governments, develop and publish long term oil price forecasts.[382]

282. Canada's own National Energy Board ("NEB") is charged with developing and using energy forecasts .383 As the foreword to its 2009 report, "Reference Case Scenario: Canadian Energy Demand and Supply to 2020," explains: "The National Energy Board ... is an independent federal agency whose purpose is to promote safety and security, environmental protection, and efficient energy infrastructure and markets in the Canadian public interest within the

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[382] *Id.* ¶ 2.

[383] In response to Claimants' request for documents constituting oil price forecasts made by the Canadian government, Respondent replied that the NEB "is an independent regulator and any forecasts that it produces are not those of the Government of Canada." Redfern Schedule, December 15, 2009, Request No. 39. However, the NEB's website makes clear that it is a Canadian governmental entity; indeed, it is "accountable to Parliament through the Minister of Natural Resources Canada." **CE-221**, National Energy Board, *Who we are & our governance*, http://www.neb-one.gc.ca/clf-nsi/rthnb/whwrndrgvrnnc/whwrndrgvrnnc-eng.html (last checked April 5, 2010).

mandate set by Parliament in the regulation of pipeline, energy development, and trade."384 To that end, "[t]he NEB provid[es] energy supply and demand projections to Canadians" and "publishes periodic assessments to inform Canadians on trends, events and issues which may affect Canadian energy markets .... The NEB has a long history of providing energy supply and demand projections to Canadians."385

283. Even Canada's own expert, Peter Davies, a former economist with BP, was invited to address industry leaders on this very topic in the throes of the global financial crisis, and made his own predictions in that connection.[386] Under the circumstances, there can be no doubt of the critical importance industry attaches to such price projections and that price forecasting is a legitimate economic tool regularly employed for long-term planning.

284. Canada cites the decision in *Amoco v. Iran* in support of its argument that oil-price projections cannot be relied upon for the purposes of future-damage projections.[387] That case is not a reasonable point of reference for this tribunal. Although the *Amoco* tribunal was troubled by the discrepancy between price projections and actual prices over the reference period (1979-1987), that period represented a fundamental transformation in the global oil market from one during which oil prices were set by oil producing countries to

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384 **CE-221**, Canadian National Energy Board, *Reference Case Scenario: Canadian Energy Demand and Supply to 2020*, at vii (2009).

385 *Id.*

386 **CE-220**, Professor Peter Davies, Presentation to the Annual Dinner of the Association of British Independent Oil Exploration Companies (Nov. 26, 2008).

387 RM ¶ 342.

one in which prices were set by market forces. As Ms. Emerson explains, that reference period is not a reliable period or conclusion on which to dismiss the efficacy of price forecasting in computation calculations:

> In sum, the period from the late 1970s to the mid 1980s ... is a period during which the global oil system was undergoing remarkable change. Spot, forward and futures markets were emerging and growing, fixed prices were finally abandoned, and the global oil market, as we know it today, was just taking shape. By contrast, the period covered in *ESAI's Price Forecast of Hibernia and Terra Nova: 2009-2036* is one during which the global oil market is well established and spot and futures prices have determined the price of international oil transactions for more than 20 years. Short-term oil transactions and long-term oil contracts will continue to be based on spot or futures market prices. The utility of price forecasting as a basis for damages calculations today should not be dismissed on the basis of conclusions drawn from the 1979-1987 period.[388]

285. In any event, the *Amoco* Tribunal approached compensation on the basis that anticipated future profits were not compensable in a lawful expropriation case, and a DCF analysis was accordingly rejected.[389] That approach to compensation was not accepted by subsequent tribunals, and it has been greatly criticized in academic writings.[390]

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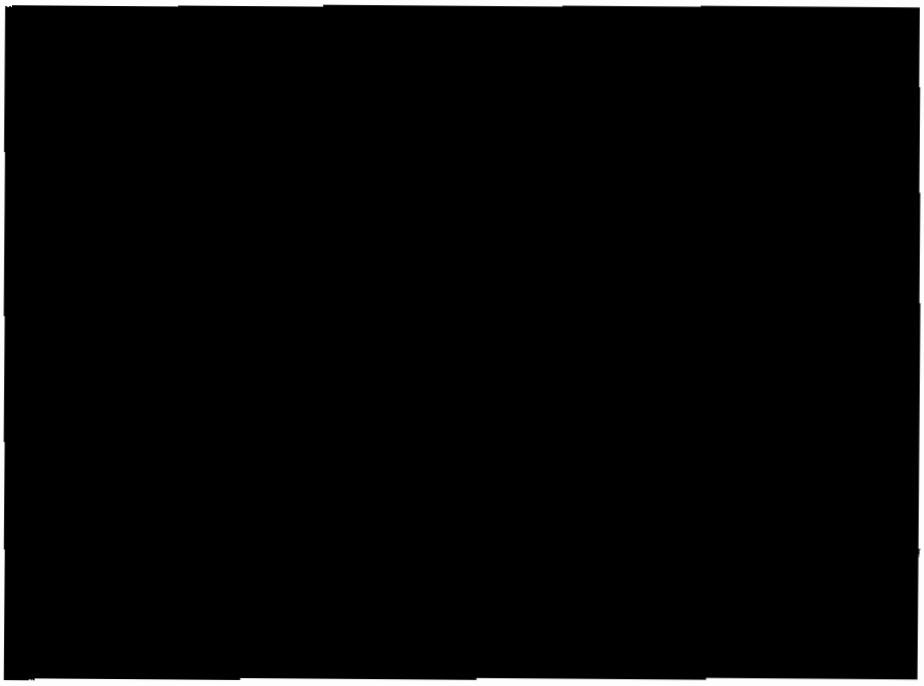
[388] Emerson Report II, ¶ 51.

[389] The tribunal in fact awarded an amount for future prospects as part of the *damnum emergens*.

[390] *See* **CA-85A**, *AMOCO International Finance Corporation v. Iran*, Award of July 14, 1987 (concurring opinion of Judge Brower), ¶¶ 15-31; **CA-150A**, Ripinsky, *Investment Valuation*, at 208-210.

286. Under the circumstances, the findings of the *Amoco* Tribunal have no bearing on this case and do not accurately reflect prevailing arbitral practice with respect to the treatment of future losses.

287. With her first report, Ms. Emerson submitted oil-price forecasts developed on the same basis as for her firm's corporate clients. Those forecasts were based upon data available as of June 2009. They remain conservative forecasts, despite Canada's attempts to demonstrate otherwise. Indeed Ms Emerson's forecasts were *below* the reference case forecasts of the US Energy Information Administration ("EIA") and the International Energy Agency ("IEA"), *below* the IEA's most aggressive climate change forecast and *below* the Canadian Government's own (NEB) forecast.[391] In these circumstances, it is difficult for Canada to claim that ESAI's forecast is overly optimistic, as the following chart from Ms. Emerson's second report demonstrates:



[391] Emerson Report II, ¶ 36.

288. Canada's expert, Mr. Davies, sought to undermine Ms. Emerson's report on the following grounds:

- It relies on uncertain predictions of OPEC's future spare capacity, in itself an inappropriate forecasting tool;
- It was generated without reference to historical oil price experience;
- It does not contain explicit assumptions about critical political drivers of oil markets;
- It is inconsistent with move towards sustainable climate; and
- It is not conservative and is consistent with the highest forecasts published by the US EIA.

289. In fact, as demonstrated in Ms. Emerson's second report:

- As to Mr. Davies' purported rejection of the impact of OPEC spare capacity oil prices, the relationship between spare capacity and pricing is a phenomenon well understood by market analysts and economists.[392] Indeed, outside this arbitration, Mr. Davies has repeatedly acknowledged the role played by the absence of spare crude production capacity in supporting prices.[393] The text of Mr. Davies' own report apparently concedes the significance of OPEC spare capacity in any event: "Oil prices are influenced

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392 Emerson Report II, ¶¶ 15-18.

393 *Id.* ¶ 16.

by OPEC's willingness or otherwise to produce its spare oil and to invest in their vast oil reserves."[394]

- ESAI's forecast implicitly factors in the uncompetitive nature of the oil market, the role of OPEC, the impact of geopolitics, policies and financial prices. Ms. Emerson's forecast is not simply mean reverting based on historical prices.

- Although Mr. Davies criticizes the report for failing sufficiently to acknowledge the climate agenda, a charge refuted by Ms. Emerson in her second report, elsewhere Mr. Davies claims that environmental policies will not materially impact global oil prices for at least the next decade.[395]

- Although it is asserted that Ms. Emerson's forecasts are high, in fact her forecasts are below the forward curve, at the lower end of those of the 2009 EIA (US Government) survey and are lower still than the EIA's newest forecast including that which assumes an aggressive climate change policy. The fact that Ms. Emerson's forecast is conservative compared to these official forecasts no doubt explains Mr. Davies' reluctance to offer his own forecast: such a forecast would have had to come in very substantially below all of the above forecasts to support Mr. Davies' opinion that Ms. Emerson's projections are "likely high."

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[394] First Expert Report of Peter Davies, ¶ 26 (hereinafter "Davies Report I").

[395] **CE-220**, Professor Peter Davies, Presentation to the Annual Dinner of the Association of British Independent Oil Exploration Companies (Nov. 26, 2008).

290. In sum, there is no credible reason why this Tribunal should not rely on oil-price forecasts for the purpose of this damages calculation. Ms. Emerson will provide an updated forecast nearer to the hearing date.

(iii) *Future exchange rate*

291. Claimants' damages expert, Mr. Rosen, based his foreign-exchange projections on actual and third party short-term forecasts. Mr. Walck sought to criticize this approach, suggesting that Mr. Rosen had ignored the potential impact of historical exchange-rate swings. In fact, historical fluctuations, and the many factors which might have produced such variations, were taken into account in the May 2009 forecast upon which Mr. Rosen based his calculations.[396]

(c) Canada's Approach to the Discount Rate Is Inappropriate

292. Canada's expert has chosen to approach the calculation of damages in this case as if he had been asked to place a value on Hibernia and Terra Nova, including by assessing the extent of their future profit-generating potential and any risks associated with such future profits. That approach is wholly inappropriate, as Mr. Rosen explains in both his reports.[397]

293. Specifically, Mr. Rosen dismisses as inappropriate and irrelevant the use of a weighted average cost of capital ("WACC") or cost of equity in this analysis. In his second report, Mr. Rosen explains that reference to WACC is only appropriate when valuing an asset or business interest by reference to the present value of its expected future net cash

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[396] Rosen Report II, ¶ 61.

[397] Rosen Report I, ¶ 49-50 ; Rosen Report II, ¶¶ 99-103.

flows. That is not the approach required in this case. Instead, the parties must address what the position would have been but for the introduction of the Guidelines. In this connection, the position is analogous to valuing the impact of a increased royalty. A royalty is based on a gross revenue stream (which has less risk attached to it), not operational cash flows. In the present case, there is certainty that there will be such an additional cost (Canada's continued application of the Guidelines) and that it will be paid. According to Mr. Rosen, Canada should not benefit from the cost of capital of the Claimants, and Claimants should not be burdened with the risks of changes in variables which form the very basis of the measure in issue.[398]

294. In sum, Mr. Rosen's use of a risk-free rate is appropriate because Claimants are not seeking future lost profits. Instead, Claimants require compensation to offset the impact of their future expenditure requirements. Mr. Walck's approach, a discount rate based upon the cost of equity, is inappropriate given the nature of Claimants' loss and is punitive to Claimants, because an investment in the operations of the Project is subject to greater risk than that of a risk-free investment. In addition, Mr. Walck's approach wrongly assumes that there will be no shortage of opportunities within the Projects' mature operations that would yield a sufficient return to fund future shortfalls in spending.[399] As Mr. Rosen succinctly concludes: "a calculation of damages based upon the WACC or cost of equity of the Projects would fail to place the Claimants in the same position they would have enjoyed, but for the Guidelines".[400]

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398 Rosen Report II, ¶ 109.

399 Rosen Report II, ¶¶ 104-108.

400 Rosen Report II, ¶ 108.

(d) Canada's Reliance on Uncertainties of Its Own Creation

295. Finally, in its convenient, but self-contradictory, submissions, Canada seeks to challenge the "certainty" of Claimants' assumptions in large part by reference to uncertainties of its own creation, including the Statistics Canada benchmark and the benefits of credits said to arise from Claimants' enforced spending commitments. Remarkably, Canada also seeks to create uncertainty through a wholly unsupported suggestion that the Board may (in ways unexplained) modify the Guidelines in such a way as to render a present estimate of future damages speculative. Thus far, the Board has not intimated (much less confirmed) any such proposal, nor has it suggested (much less confirmed) that it intends to repeal the Guidelines or to lower the expenditure requirement. In fact, the record reveals that the Board has insisted on maintaining the financial commitment level built into the current formula.

296. It is inappropriate and unfair to require Claimants to bear the burden of an alleged uncertainty wholly within Canada's control. As one commentator observes: "Doubts are generally resolved against the party in breach. A party who has, by his breach, forced the injured party to seek compensation in damages should not be allowed to profit from his breach where it is established that a significant loss has occurred."[401]

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[401] **CA-140**, Kantor, p. 72; *see also* **CA-111**, *Sapphire*, at 187 ("It is not necessary to prove exact damage suffered in order to award damages. On the contrary, *where such proof is impossible, particularly as a result of the behaviour of the author of the damages*, it is enough for the judge to be able to admit sufficient probability of the existence and extent of the damage.") (emphasis added).

6. The Tribunal Must Award Both Past and Prospective Compensation to Bring Finality to This Dispute

297. Claimants have already suggested on multiple occasions that Canada can neutralize any uncertainty as to long-term oil prices and other variables by agreeing not to enforce the Guidelines against Hibernia and Terra Nova if the Tribunal finds that they violate the NAFTA. Alternatively, Canada could agree periodically to refund Claimants' share of the cost of compliance for those projects. To the extent that Canada refuses to pursue such an arrangement, it cannot be heard to complain that an assessment of Claimants' future exposure under the Guidelines at this point is too uncertain. Canada's suggestion that Claimants receive no remedy or redress whatsoever in respect of those losses cannot prevail.

298. If Canada refuses to pursue the arrangements proposed above, Claimants urge the Tribunal to assess their future damages, as Claimants have reasonably proven, at this point, in order to bring both certainty and finality to this issue. In this connection, the Tribunal should bear in mind that in advocating finality at this juncture, Claimants risk understating their potential exposure under the Guidelines. However, any other outcome will necessarily result in the parties regularly having to present themselves before further arbitral tribunals, a prospect fraught with practical obstacles and which would further unfairly burden Claimants for Canada's treaty violations. There is no legitimate reason why Claimants should carry that burden: their request for compensation is largely confined to either historical losses or to their exposure to the obligations created by the Guidelines through 2015. As Mr. Rosen explains in his second report, Claimants' damages sharply decline after 2010 in any event. By 2015, their total damages claim reduces to approximately 2% per year thereafter through the remaining life of the

projects. In those circumstances, Canada's protestations as to the uncertainties inherent in future predictions are greatly exaggerated and should not prevail particularly in circumstances where those "uncertainties" are of Canada's own making.

299. If the Tribunal is not inclined to make such an award, Claimants respectfully request that the Tribunal declare Canada to be in breach of its treaty obligations through its application of the Guidelines and award compensation for Claimants' past damage as of the date of the award. The Claimants further request that, to minimize the likelihood of future disputes, the Tribunal make specific findings that, but for the introduction of the Guidelines, Claimants' R&D future expenditure in the ordinary course would have been as indicated in Mr. Rosen's report and that Claimants are entitled to the difference in value between those sums and its actual obligations under the Guidelines as confirmed by the Board from time to time. The Tribunal should further invite Canada to agree periodically to compensate Claimants in the amount of that differential, or alternatively agree to be bound by an independent assessment of the same, using as the benchmark this Tribunal's findings as to Claimants' R&D spending in the ordinary course.

VI.

RELIEF REQUESTED

300. If the Tribunal finds Canada liable for its treaty violations, it has the duty and the tools to make Claimants whole in accordance with elementary principles of international law. It cannot be seriously in controversy that under international law Claimants are entitled to compensation representing both their past and future losses.

Claimants are entitled to the fullest remedies available under the NAFTA and international law.

301. In order to protect Claimants' rights and reduce the possibility of future disputes, Claimants request the Tribunal:

a) Find that the promulgation and enforcement of the R&D Expenditure Guidelines constitute a performance requirement within the meaning of Article 1106(1) of the NAFTA, and that Canada has breached its obligations under the Article as a result;

b) Find that the R&D Expenditure Guidelines are not covered by Article 1108(1) of the NAFTA or Canada's Annex I reservation to the treaty for the Federal Accord Act;

c) Find that Canada has breached its obligations under Article 1105(1) of the NAFTA by failing to provide Claimants and their investments the guarantee of fair and equitable treatment in accordance with international law;

d) Order Canada to pay to Claimant Mobil Investments Canada Inc., or alternatively, to its indirectly controlled enterprises, money damages in an amount to be established at the hearing, plus interest as applicable when the Tribunal issues its final award, to compensate Claimant Mobil Investments Canada for the cost of its compliance with the Guidelines including through the remaining life of the Hibernia and Terra Nova projects, in which it is an investor;

e) Order Canada to pay to Claimant Murphy Oil Corporation, or alternatively, to its directly or indirectly controlled enterprises, money damages

in an amount to be established at the hearing, plus interest as applicable when the Tribunal issues its final award, to compensate Claimant Murphy Oil Corporation for the cost of its compliance with the Guidelines including through the remaining life of the Hibernia and Terra Nova projects, in which it is an investor;

f) Order Canada to pay to Claimants the full measure of legal fees and costs, to be determined at the conclusion of the proceedings, that they will have incurred as a result of this arbitration;

g) Find that Claimants are entitled to recover all costs incurred in seeking to enforce the Tribunal's Award, including any costs incurred in seeking compensation in respect of the Board's future application of the Guidelines to the Projects; and

h) Order such further relief as it deems appropriate.

Respectfully submitted,

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ANNEX A:
CLAIMANTS' RESPONSE TO CANADA'S TREATMENT OF CERTAIN FACTS

1. At the outset of its Counter-Memorial, Canada devotes substantial attention to issues that are not in dispute or are otherwise legally insignificant to this arbitration. For example, it begins its treatment of the facts with an involved discussion of 1970s and 1980s policy objectives that led to enactment of the Atlantic Accord and the Accord Acts. It concludes with a discussion of the findings of the Canadian courts on matters of domestic statutory law. It also devotes a full two (out of five) witness statements plus an expert report to the capacity of the local R&D industry to absorb increased expenditures. Yet none of these topics or various others that Canada emphasizes actually matters to the issues before the Tribunal. Indeed, Canada does not even attempt to tie many of the factual claims it makes to its legal arguments.

2. This Annex address the many issues that Canada has raised that are ultimately irrelevant to the Tribunal's decision, but which should nevertheless be corrected..

1. Policy Objectives Underlying the Atlantic Accord and the Accord Acts Do Not Inform the Tribunal's Analysis of Whether the Guidelines Violate the NAFTA

3. Canada devotes substantial focus at the outset of its submission to the policy objectives underlying the Atlantic Accord and the Accord Acts.[1] It also attempts to justify the Guidelines as giving effect to those policy objectives.[2] The fact is, however, that policy considerations such as the

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1 RM ¶¶ 13-21, 25.

2 *Id.* ¶¶ 169-170.

"sustainable development" of the Province are not determinative of the issues in dispute in this case, nor is the notion of "sustainable development" even aptly invoked in this instance.

4. The concept of sustainable development reflects the "need to reconcile economic development with protection of the environment."[3] The Guidelines, on their face and in practice, have nothing to do with protecting the environment. They are instead exclusively directed toward promoting economic development. The doctrine of sustainable development, therefore, is not properly engaged.[4]

5. To be sure, the Claimants respect the Province's interest in developing its economy and have been very supportive of the local R&D industry since the outset of the Hibernia and Terra Nova projects. Canada does not dispute Claimants' faithful compliance with the commitments made in the Hibernia and Terra Nova Benefits Plans to accord priority to local providers in the procurement of R&D and E&T services. Nor does Canada contest the fact of Claimants' resulting expenditure of over $97 million on R&D services in the Province through 2007 absent any fixed

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[3] **CA-93**, *Case Concerning the Gabčíkovo-Nagymaros Project* (Hungary v. Slovakia), Judgment, I.C.J. Reports 1997, p. 78, ¶ 140; *see also* **CA-152**, Philippe Sands, *Principles of International Environmental Law*, at 253 (CUP 2003) (noting that the concept of sustainable development is comprised of four recurring elements, each of which concerns the relationship between economic development and the environment).

[4] If Canada genuinely believed this dispute to concern sustainable development, presumably it would have invoked Article 1106(6) of the NAFTA, which permits Parties a certain latitude to adopt measures necessary to protect the environment or conserve natural resources. **CA-3**, NAFTA, art. 1106(6).

expenditure obligation.[5] Canada's papers are replete with statements as to how successfully the local R&D industry has grown since the Hibernia and Terra Nova projects began.[6] Of course, the procurement of R&D services is only one of many kinds of benefits conveyed. When benefits such as employment of the local workforce, infrastructure development, and procurement of other goods and services are taken into account, the contribution of the projects to the provincial economy rises exponentially.[7]

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[5] CM ¶¶ 84-85. Claimants' *pro rata* share of the reported $225 million in Hibernia-related R&D expenditures and $23.5 million in Terra Nova-related R&D expenditures is approximately $97.15 million. Taking into account 2008 Hibernia expenditures, Claimants' collective spending on R&D rises to $97.7 million. *See* **CE-170**, 2009 Hibernia Benefits Report (March 2010) (reporting $226.3 million in R&D expenditures through 2008).

[6] RM ¶¶ 80, 125; First Witness Statement of Charles Randell (hereinafter "Randell Statement I"), ¶ 17; First Witness Statement of Raymond Gerard Gosine (hereinafter "Gosine Statement I"), ¶¶ 11-16.

[7] *See* **CE-215**, Community Resource Services Ltd., *Socio-Economic Benefits from Petroleum Industry Activity in Newfoundland and Labrador*, at v (Nov. 2003) (estimating the oil and gas industry to have had an average annual GDP impact of approximately $1.4 billion and to have created 8,800 person-years of employment per annum over the 1999 to 2002 period); **CE-216**, J. Whitford, *Socio-Economic Benefits from Petroleum Industry Activity in Newfoundland and Labrador, 2003 and 2004*, at 2 (Nov. 2005) ("industry expenditures totaled over a billion dollars in both [2003 and 2004], as they have every year since 1999 inclusive"); **CE-219**, Stantec, *Socio-Economic Benefits from Petroleum Industry Activity in Newfoundland and Labrador, 2005-2007*, at 2-3 (Feb. 13, 2009) ("The scale of industry expenditures has continued to be impressive over the period covered by this report. Overall, they totaled over a billion dollars in each of 2005, 2006 and 2007, with the greatest expenditures occurring in 2006 at $1.59 billion.").

6. In any event, none of the policy considerations that Canada raises relates to the text or the object and purpose of the NAFTA, which is what the Tribunal is in fact called upon to analyze. For purposes of Claimants' Article 1106 claim, the Tribunal must consider such issues as whether the term "services" as used in Article 1106(1) includes R&D and E&T. For purposes of the Article 1105 claim, the Tribunal must consider whether a series of instruments that enshrined an agreement to benefits terms for the Hibernia and Terra Nova projects, among other things, engendered a legitimate expectation on the part of the Claimants that the Board would honor those terms throughout the lifetime of the projects.

7. Indeed, in opposing one of Claimants' document requests, Canada itself acknowledged the irrelevance of the policy objectives underlying the Accord Acts to this case.[8] Specifically, in response to a request for documents concerning the legislative history and intent of Section 45 of the Acts, which Claimants sought in order to probe whether the Accord Acts establish an affirmative obligation to make expenditures on R&D and E&T above and beyond the commitments set forth in an approved benefits plan, Canada argued that the subjective motivation underlying government action has no bearing on an arbitral tribunal's analysis of a treaty claim. Canada cited, for example, the decision of the NAFTA Panel in *US – Cross Border Trucking Services*, which "decline[d] to examine the motivation" for the challenged government action and instead "confine[d] its

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When one considers these numbers on a per capita basis, the extent of the operators' contributions to the Province is thrown into sharp relief. Newfoundland and Labrador's population numbers approximately 500,000 people.

[8] Redfern Schedule, December 15, 2009, Request No. 1.

analysis to the consistency or inconsistency of that action with the NAFTA."[9]

8. As the NAFTA Panel noted, in the portion of its decision that Canada quoted, its approach was "fully consistent with the practice of the WTO Appellate Body, which ... has declined to inquire into the subjective motivations of government decision-makers, or examine their intent."[10] The NAFTA Panel cited, for example, the decision of the WTO Appellate Body in *Chile – Taxes on Alcoholic Beverages*, wherein it observed that "'[t]he *subjective* intentions inhabiting the minds of individual legislators or regulators do not bear upon the inquiry, if only because they are not accessible to treaty interpreters.'"[11] On this basis, Canada refused to produce any documents concerning the legislative history or legislative intent of Section 45 of the Accord Acts.

9. Claimants, of course, agree with Canada that the subjective intent underlying such measures is outside the scope of the Tribunal's analysis and, on that basis, clarified that they did not seek to discover documents concerning the overall motivation for enacting the legislation or other aspects of legislative intent. Rather, they sought only to discover documents that shed light on the manner in which the benefits plan requirement of Section 45 was intended to function. This approach was vindicated by the Tribunal's discovery ruling of

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[9] **CA-24**, *In the Matter of Cross-Border Trucking Services*, Final Report of the Panel of February 6, 2001, ¶ 214.

[10] *Id.* (*citing Japan – Taxes on Alcoholic Beverages*, Appellate Body Report, WT/DS8/AB/R (Oct. 4, 1996) and *Chile – Taxes on Alcoholic Beverages*, Appellate Body Report, WT/DS87/AB/R (Dec. 13, 1999)).

[11] *Id.* (quoting *Chile – Taxes on Alcoholic Beverages*) (emphasis in original).

March 27, 2010. The Tribunal ordered the Respondent to produce the documents responsive to the request, while limiting the universe of responsive documents to those directly related to the legislative intent behind section 45(3) of the Accord Acts. In doing so, the Tribunal noted that it would "in the first instance, consider the text of the legislative acts and only give their legislative history and the drafters' intent the weight which it deems necessary under the circumstances."[12]

10. It is difficult to understand how Canada, itself having challenged the relevance of legislative intent and having invoked the foregoing authority, can in good faith ask this Tribunal to take account of the policy rationale underlying the Atlantic Accord, the Accord Acts, or even the Guidelines themselves.[13] This entire discussion is nothing more than a distraction, intended to engender sympathy, if not legal support, for Canada's position.

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[12] Tribunal Ruling of March 27, 2010 on Claimants' Request No. 1. As noted above, Canada produced only one document in response to this request. *See supra* ¶ 149.

[13] In their response to Canada's objection to the document request, Claimants argued that it was not appropriate or fair for Canada to raise the challenge that it did, having put legislative history and legislative intent into issue by devoting substantial attention to the same in its RM and witness testimony. Claimants also challenged the relevance of the authorities that Canada cited, including the decisions of the NAFTA Panel and the WTO Appellate Body, because Claimants were not seeking documents concerning the overall motivation for enacting Accord Acts. Instead, Claimants sought documents that might shed light on how the benefits plan requirement in Section 45 was intended to function.

2. The Board's Domestic Law Authority to Promulgate and Enforce Guidelines Is Not at Issue in This Arbitration

11. The Board's statutory authority to promulgate regulations under the Accord Acts is also not at issue in this arbitration, nor is the Board's authority as a matter of Canadian law to apply the Guidelines to projects, such as Hibernia and Terra Nova, with pre-existing benefits plans. The Canadian courts found that the Board does enjoy this authority; that, however, does not speak to the inconsistency of the Board's action with the international law obligations that Canada undertook when it entered into the NAFTA. Canada greatly exaggerates the significance of the Canadian court decisions, which were addressed exclusively to these domestic law issues and shed little light on the international law questions now before this Tribunal.[14]

12. Claimants raised the Board's conditioning of POAs on compliance with the Guidelines as one of many facts to demonstrate, in support of their Article 1106 claim, that the Guidelines establish mandatory obligations. Since Canada concedes that the Guidelines constitute a requirement, this particular issue is not in dispute. Canada's attention to the Board's statutory powers with respect to POAs lends nothing

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[14] RM ¶¶ 131-141. Canada's attempt to frame this arbitration as an appeal of the Canadian court decisions is wholly without merit. *Id.* ¶ 7. Setting aside the central fact that this arbitration raises fundamentally different issues, it also was filed a full ten months before the Canadian appellate court rendered its decision and fifteen months before the Supreme Court of Canada denied leave to appeal. *See* CM ¶ 143 (Request for Arbitration filed Nov. 1, 2007); *id.* at n.248 (Court of Appeal decision issued Sept. 4, 2008); *id.* ¶ 122 (Supreme Court of Canada denied leave to appeal on Feb. 19, 2009).

to the analysis that the Tribunal is in fact called upon to undertake.[15]

13. The fact that the Board has promulgated various other guidelines also is immaterial.[16] Again, Claimants do not take issue with the Board's statutory authority to issue guidelines *per se*. Rather, they are challenging the incompatibility of the R&D Expenditure Guidelines, in particular, with the obligations that Canada undertook when it entered into the NAFTA. As far as Claimants can discern, none of the other guidelines listed in Canada's Counter-Memorial raise comparable concerns as applied to the Hibernia or Terra Nova projects.[17]

14. Canada's disproportionate attention to the Board's regulatory powers, and the Canadian courts' confirmation of the same, is another diversion from the issues actually in dispute in this arbitration.

3. It Is Irrelevant Whether Other Countries Impose Expenditure Requirements

15. Canada attempts to defend the imposition of R&D expenditure targets by pointing to foreign jurisdictions with comparable requirements.[18] This argument lacks the slightest bit of relevance to this arbitration. Needless to say, neither Norway nor Brazil, the two countries that Canada mentions, is

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[15] RM ¶¶ 31-35.

[16] *Id.* ¶ 30.

[17] *Id.* n. 34. Should Claimants determine that any of these other guidelines do run afoul of Canada's NAFTA obligations, they reserve their right to challenge the measure or measures in question consistent with the dispute resolution procedures outlined in the treaty.

[18] *Id.* ¶ 124; *see also id.* ¶ 121(a).

a party to the NAFTA. Their practices with regard to R&D expenditure requirements are therefore of no concern.

4. Canada Greatly Exaggerates the Relevance of the Local R&D Industry's Capacity to Absorb the Increased Spending Required by the Guidelines

16. As a general rule, it makes no commercial sense for a company in need of R&D or E&T services to look anywhere other than to the best, brightest, and most cost-effective providers of those services. A performance requirement such as that set forth in the Guidelines is trade distorting not only because it compels expenditures that a project operator otherwise would not make, but also because it forces project operators to make uneconomic decisions about the procurement of the requisite R&D and E&T services. This is precisely against which the prohibition on performance requirements in Article 1106 of the NAFTA stands guard.

17. Industry leaders have estimated, perhaps conservatively, that the Guidelines will require operators to spend an additional $600 million on R&D and E&T over the lifetime of the offshore petroleum projects already in existence or under development in Newfoundland, including Hibernia, Terra Nova, White Rose, and Hebron.[19] There is

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[19] **CE-140**, CAPP, CNLOPB R&D Guidelines Industry Considerations, Slide 13 (Dec. 16, 2008). This estimate assumes a price of $80 per barrel of oil, which was the actual price per barrel around the time the calculation was made. That price — which the Task Force qualified as being "for perspective only" — is lower than the average price per barrel forecast for the remaining life of the projects. In addition, the estimate is based on a Statistics Canada benchmark factor of 0.36%, which was current at the time of the calculation but also is lower than the average 0.39% forecast for the remaining life of the projects. *See* Rosen Report I, Schedules II and III.

widespread concern among project operators — and, indeed, among some Canadian government officials[20] — that the local R&D industry lacks sufficient capacity to effectively absorb this level of expenditures.[21] Claimants raised this concern as a relatively minor point in their Memorial, simply to show that any potential benefit to the projects of the incremental spending mandated by the Guidelines will be diminished if, for example, they are compelled as a result of limited capacity to meet their Guidelines requirement by depositing money into a Board-administered fund or underwriting a capital infrastructure project rather than funding research with some practical application for Hibernia or Terra Nova.[22]

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[20] **CE-196**, Memorandum from K. Sahay, Natural Resources Canada, to R. Cameron, Natural Resources Canada, at 3 (Jul. 18, 2003) ("NRCan questions whether the province has the capacity to absorb this level of expenditure."); **CE-134**, Memorandum from F. Way, CNLOPB, to Board Members, CNLOPB, at 2 (Jan. 28, 2004) ("[t]he feds expressed research capacity concerns").

[21] **CE-140**, CAPP, CNLOPB R&D Guidelines Industry Considerations, Slide 2 (Dec. 16, 2008) ("Current lack of HR and infrastructure capacity in NL to handle additional R&D spending from producing projects."); **CE-210**, Email from A. Ringvee, ExxonMobil, to A. Brown, Suncor et al. (Feb. 25, 2010), *attaching* Industry NL R&D Steering Committee, Industry NL R&D / E&T Plans: Update for C-NLOPB, Slides 2, 7 (major joint industry projects aim to "build local R&D capacity"; industry, assets and owners will "hold discussions on … capacity building opportunities"); *see also* Ringvee Statement II, ¶ 4.

[22] CM ¶ 126. Any incremental spending above project needs necessarily has insufficient value to the owners relative to the size of the expenditure. Otherwise, the operators would undertake the spending absent a Guidelines requirement. Nonetheless, faced with the obligation to comply with the Guidelines, operators naturally are looking for spending opportunities with at least some potential benefit to industry.

18. Canada responded to this simple point by dedicating a full two (out of five) witness statements, an expert report, and a section of its Counter-Memorial to the question of capacity. This vastly distorts the significance of the issue. As Claimants noted in their objections to certain of Canada's document requests, the capacity of the local R&D industry to absorb increased expenditures is of limited legal significance, because irrespective of any such limitations, Claimants still will be required to meet the expenditure levels mandated by the Guidelines. Indeed, Canada itself views R&D capacity as "irrelevant since Claimants can fulfil their obligation under the Guidelines by spending entirely on E&T."[23] Canada's disproportionate attention to the capacity question despite this concession once again reveals the weakness of its case.

5. Canada Pays Undue Attention to the Alleged Reasonableness of the Guidelines and Their Relation to Industry Norms

19. Claimants explained in their opening Memorial that, given the overwhelming evidence of Canada's breach of Article 1106(1), they anticipated that Canada's would attempt to raise a defense under Article 1108(1), which provides a

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[23] RM ¶ 126. Canada further notes that Claimants have not challenged the E&T capacity of the Province. This has to do with the nature of E&T spending as compared to R&D. In view of Canada's assertion that Claimants could discharge their Guidelines requirement simply by writing a check to a local university or funding capital projects such as construction of a building, each of which would qualify as E&T under the Guidelines, it seems to go without saying that there will always be opportunities to direct funding to E&T projects, even if they are not business-logical expenditures. R&D activity, by contrast, requires the availability of suitable facilities and personnel with requisite expertise to address highly specialized questions.

limited exception to Article 1106 for non-conforming measures in existence when the NAFTA took effect that are covered by a Party reservation to the treaty in Annex I (e.g., the Federal Accord Act).[24] Article 1108(1)(c) exempts amendments to such non-conforming measures provided that they do "not decrease the conformity of the measure, as it existed immediately before the amendment[.]"[25]

20. As Claimants demonstrate above, the Guidelines would fail this so-called "ratchet rule" if Article 1108 applied — which it plainly does not — based on the simple fact that they require increased expenditures on R&D and E&T.[26] However, Claimants presented additional arguments in their Memorial regarding the problems implicit in the Board's reliance on an R&D expenditure benchmark developed using data obtained from Statistics Canada to underscore this self-evident proposition.[27] As Canada now concedes that the Guidelines do not constitute an amendment to the Accord Acts,[28] it no longer matters for the purposes of Article 1106 that the Board's use of the Statistics Canada data yields an arbitrary expenditure requirement. Nevertheless, Canada devotes substantial attention to its view that the Guidelines formula is in fact reasonable and consistent with oil and gas industry norms.[29] With the ratchet rule no longer relevant,

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[24] CM ¶¶ 162-168.

[25] **CA-3**, NAFTA, art. 1108(1)(c); *see also* CM ¶¶ 165, 179.

[26] *See supra* ¶¶ 106-110; CM ¶¶ 181-183; *see also generally* **CA-53**, *Hibernia II*, ¶ 150 (Rowe, J., dissenting) ("[I]t is beyond question that the Guidelines impose additional R&D requirements inconsistent with 97.02 and, as such, cannot be valid as regards the Terra Nova project. The same is true regarding 86.01 and the Hibernia Project.").

[27] CM ¶¶ 113-114, 184-186.

[28] RM ¶ 239.

[29] *Id.* ¶¶ 104-127.

this is yet another distraction. Indeed, Canada does not even attempt to tie the discussion of reasonableness to any of its legal arguments in connection with Articles 1106 or 1005.

21. That said, given Canada's extended treatment of the issue, the integrity of the record requires a brief response to certain of Canada's claims.

- Canada attempts to frame the Guidelines as a flexible requirement by noting that operators may be permitted to make up any shortfall in R&D and E&T spending in a given POA period in ways other than by placing the deficit into a Board-administered fund.[30] This comes as cold comfort. The fact remains that operators will have to make up the shortfall one way or another. Indeed, the Board, as a condition to continuance of the Hibernia and Terra Nova POAs, required the operator of each project to provide by March 31, 2010 "a commitment in the form of a financial instrument in the full amount of the shortfall [from the 2004-2008 period] that is acceptable to the Board to cover this deficit."[31]

- Canada also notes that operators may propose an alternate R&D and E&T program in lieu of fulfilling

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[30] **CE-1**, CNLOPB, Guidelines for Research and Development Expenditures, § 4.2 (Oct. 2004) (hereinafter "2004 R&D Guidelines"); RM ¶ 110 (second bullet).

[31] **CE-179**, Letter from J. Bugden, CNLOPB, to P. Sacuta, HMDC (Dec. 10, 2009) ("HMDC should provide the following by March 31, 2010 ... a commitment in the form of a financial instrument in the full amount of the shortfall that is acceptable to the Board to cover this deficit"); **CE-189**, Letter from J. Bugden, CNLOPB, to G. Vokey, Suncor Energy Inc. (Dec. 15, 2009) (same with regard to Terra Nova); *see also supra*, ¶¶ 201-202.

their Guidelines expenditure requirements.[32] Canada makes no suggestion, however, nor could it, that the Board would accept a program that resulted in an expenditure commitment any less onerous than what the Guidelines presently require. Indeed, Canada's own witness, Frank Smyth, makes clear that the Board can only be expected to consider an alternative proposal if the value thereof is equivalent to the Guidelines expenditure requirement.[33]

- Canada claims that operators can fulfill their Guidelines obligation through expenditures incurred by contractors and sub-contractors. This is only partially true. Operators can indeed claim credit for R&D and E&T activity that is invoiced to them by contractors and sub-contractors. Very often, however, these providers undertake R&D at their own expense and do not even inform the operators that they are conducting the work so that they can retain any ensuing intellectual property rights.[34] As a result, for the 2004 to 2008 period, only [redacted] of the R&D and E&T claimed by Hibernia for Guidelines credit, and [redacted] of that claimed by Terra Nova, was

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[32] RM ¶ 110 (chapeau).

[33] Smyth Statement I, ¶ 14; *see also* **CE-135**, Meeting Minutes, CNLOPB/Industry Representatives, at EMM0002250 (May 11, 2004) ("If Industry can present something consistent with [the Board's] 0.6% then [the Board] may consider it."); **CE-137**, Meeting Minutes, CNLOPB/Industry Representatives, at EMM0002254 (June 3, 2004) ("[O]perators should understand we are not prepared to go back to a solution which has no measure or quantifiable commitment associated with it."); **RE-31**, Meeting Minutes, CNLOPB/Petro-Canada (July 23, 2004) ("Maintaining the 0.6% amount in any presentation would be key.").

[34] Phelan Statement II, ¶ 28.

attributable to contractor and sub-contractor spending. Further, with the exception of [redacted], the claimed contractor costs all pertained to E&T as opposed to R&D.[35]

- Canada notes that operators can claim Guidelines credit for expenditures incurred during a project's exploration phase.[36] True as this may be, it has no bearing on the Hibernia and Terra Nova projects, which were already in their production phase when the Guidelines took effect. While a witness for Canada states that "[n]either Hibernia nor Terra Nova have identified exploration phase credits and they have not made a claim in this regard,"[37] as Canada also notes, the Guidelines do not operate retroactively.[38] Therefore, neither Hibernia or Terra Nova have applied for credit for the exploration phase expenditures.

- Canada notes that operators can determine their distribution of spending between R&D and E&T.[39] While technically true, this line of argument is

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[35] **CE-178**, Hibernia Staff Analysis, at 1; **CE-188**, Terra Nova Staff Analysis, at 1.

[36] RM ¶ 110 (third bullet); Smyth Witness Statement I, ¶ 35. For a discussion of the various phases of a petroleum development project, *see* CM, ¶ 35.

[37] Smyth Witness Statement I, ¶ 35.

[38] RM ¶ 107. Exploration phase expenditures differ from development phase expenditures in that development phase expenditures (or a rough approximation thereof) are built in as a credit to the production phase expenditure requirement. There is no such provision for exploration phase expenditures. *Compare* **CE-1**, 2004 R&D Guidelines, § 2.2.1 *with id.* § 2.2.

[39] RM ¶ 110 (fifth bullet).

disingenuous given Canada's suggestion that the Claimants fulfill their entire Guidelines expenditure requirement through expenditures on E&T to avoid the NAFTA consequences of forced spending on R&D.[40] To be clear, Canada is incorrect when it states that Claimants have not challenged E&T as a prohibited category of performance requirements. Claimants' Memorial made clear that reference therein to the term R&D included E&T except where otherwise specified,[41] and Claimants most assuredly contend that any requirement to make expenditures in the Province on E&T violates Canada's obligations under Article 1106(1).[42]

- Canada attempts to portray the Guidelines definition of R&D as broad and flexible. It notes, for example, that the definition includes, but is not limited to, R&D expenditures that qualify for credit under the SR&ED tax incentive program.[43] In reality, the Guidelines definition is not as permissive or easy to navigate as Canada suggests. Indeed, despite the plain language of the Guidelines and multiple communications from the Board to the industry pledging to give Guidelines credit for any R&D expenditures meeting the definition of SR&ED, the Board initially failed to credit certain expenditures that were in fact deemed eligible for SR&ED credit when it reviewed Hibernia's R&D expenditures for the 2004-2008 period.[44]

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40 *Id.* ¶ 186. *See supra* ¶¶ 77-84.

41 CM n. 201.

42 *See supra* ¶¶ 77-84.

43 RM ¶ 110 (last bullet).

44 *See supra* ¶¶ 207-215; Phelan Statement II, ¶ 6.

- Canada touts the Guidelines pre-approval process as providing security to the operators in deciding whether to move forward with specific R&D and E&T activities.[45] Setting aside the fact that no such security was needed in a pre-Guidelines environment because the Board did not pass judgment on individual expenditures,[46] the pre-approval mechanism hardly eliminates the business uncertainty created by the Guidelines. In particular, Canada fails to grapple with the fact that the use of Statistics Canada data to derive the Guidelines benchmark prevents the Board from determining an operators' expenditure requirement until after the end of the period to which it applies, because Statistics Canada does not publish its reports until months after the end of the first calendar year for which the Board will use a given report to derive the benchmark factor.[47] Operators therefore cannot

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45 RM ¶ 111.

46 CM ¶¶ 188-191.

47 *Id.* ¶ 186. By way of example, the 2007 Statistics Canada report, which the Board will use to calculate the benchmark factor for 2008 through 2012, was not published until September 2008. **CE-159**, Statistics Canada, Industry Research and Development: Intentions 2007 (Sept. 2008). The Board's use of price and production volume data also introduces an element of uncertainty insofar as those data are not known in advance. These variables are more predictable, however, than the Statistics Canada benchmark, and operators can keep track of them in real-time and adjust their Guidelines expectations accordingly.

effectively plan for their R&D and E&T activity levels to meet their Guidelines requirements.[48]

- Canada's attempt to justify application of the Statistics Canada benchmark to Hibernia and Terra Nova misses the mark. As an initial matter, Canada's lead arguments in defense of the benchmark presume that the Hibernia and Terra Nova Benefits Plans require R&D expenditures in excess of project needs.[49] As discussed in greater detail below, this is a perversion of the record.[50] Furthermore, many of Canada's arguments in defense of the benchmark simply make no sense. It is therefore Canada, not Claimants, who betrays a misunderstanding of the benchmark statistics.[51]

  For example, Canada attempts to dismiss the fact that Statistics Canada publishes its annual report before the Canada Revenue Agency ("CRA") has fully reviewed the more substantial SR&ED claims

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[48] **CE-181**, Letter from P. Phelan, HMDC, to J. Bugden, CNLOPB (Mar. 5, 2010); **CE-183**, Letter from J. Bugden, CNLOPB, to P. Phelan, HMDC (Mar. 9, 2010).

[49] RM ¶¶ 115-116.

[50] *See supra* ¶¶ 153-164.

[51] RM ¶ 115. Canada responds only selectively to Claimants' critique of the Statistics Canada benchmark, ignoring, for example, the effect of Statistics Canada's failure to distinguish between R&D spending of offshore operators and the more R&D-intensive oil shale and tar sands mining projects in Western Canada. *See* CM ¶ 113 (first and second bullets); *id.* ¶ 114. In view of the diminished importance of the issue given Canada's concession that the Guidelines do not constitute an amendment to the Accord Acts, *see supra* ¶ 106, Claimants will not address those lapses in greater depth here.

reflected therein by noting that Statistics Canada relies on the performing companies' responses to its survey rather than data obtained directly from the CRA for those amounts.[52] Even if that is so, a company does not know when it completes the survey whether the CRA will approve as SR&ED the full amount of R&D reported. [redacted], yet the data submitted by Claimants to Statistics Canada have been incorporated into the benchmark, such that all Newfoundland operators will be required to calibrate their R&D expenditures to an arguably inflated target.[53]

Canada also claims in error that Statistics Canada revises its data in response to successful SR&ED

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[52] RM ¶ 118. Canada's defense on this point simply does not support its claim that Claimants' statement at paragraph 113 of the CM is "incorrect."

[53] [redacted] *See* Phelan Statement I, ¶ 20; Hutchings Statement I, ¶ 25; *see also* **CE-140**, CAPP, CNLOPB R&D Guidelines Industry Considerations, Slide 6 (Dec. 16, 2008); *cf supra* ¶¶ 207-215; Phelan Statement II, ¶ 6.

claim appeals.[54] In support of this proposition, Canada points to two charts *other* than the one chart that the Board actually relies upon to generate the Guidelines benchmark factor.[55] In any event, Canada concedes that any revisions by Statistics Canada to data published in previous years are not incorporated into the Guidelines benchmark. Canada attempts to diffuse the consequences of this approach by noting that the benchmark is an average of five years worth of Statistics Canada data.[56] In practice, however, this means that the Board compounds the effect of any error made by Statistics Canada by applying the slanted data over the course of five years to derive the Guidelines benchmark.

Canada attempts to cloak the Statistics Canada data in an air of heightened reliability by noting that companies have a legal obligation to respond and to respond accurately to its survey.[57] Yet Statistics Canada itself anticipates that some companies will nonetheless fail to report or to accurately report data.[58] Canada notes that there are penalties for failure to do so, but makes no claim as to the frequency with which such penalties are enforced. Canada also claims that Statistics Canada follows up

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54 RM ¶ 119.

55 *See id.* at n. 206. Canada references tables 7-5 and 7-7, which provide R&D expenditure data by country, not by industry. The Board instead uses table 7-6, which reports R&D expenditures at the industry level and is not updated. **CE-160**, Statistics Canada, Industry Research and Development: Intentions 2008 (March 2009).

56 RM ¶ 120.

57 *Id.* ¶ 117.

58 CM ¶ 113 (sixth bullet).

on anomalies in the reported data,[59] though in Claimants' experience, this has not been the case.

Finally, Canada attempts to derive significance from the fact that Claimants did not raise concerns about the Board's use of the Statistics Canada data in the period leading up to enactment of the Guidelines.[60] The fact is that Claimants were, at that time, singularly focused on opposing the promulgation of *any* prescribed expenditure requirement. They did not take issue with the Statistics Canada data in particular or propose an alternate expenditure benchmark because they felt that the Board's entire effort, as applied to projects with previously approved benefits plans, was misguided.[61] Claimants only came to focus on the problems with the benchmark factor later on, as they began to grapple with the challenge of planning for compliance with the Guidelines.

22. As noted, the foregoing critiques are offered simply to protect the integrity of the record, although the alleged reasonableness of the Guidelines no longer matters in view of Canada's concession that the Guidelines do not constitute an amendment to the Accord Acts.[62]

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[59] RM ¶ 117.

[60] *Id.* ¶ 121.

[61] Phelan Statement II, ¶¶ 29-30; **CE-41**, Letter from F. Way, CNLOPB, to J. Taylor, HMDC, at EMM0000466 (Nov. 5, 2004) ("On October 18, 2004, industry advised that it has not been able to reach a consensus on an alternative approach.").

[62] *See supra* ¶ 106.

ANNEX B:
TIMELINE: CLAIMANTS' INVESTMENTS IN HIBERNIA AND TERRA NOVA

Date	Event
1973	Foreign Investment Review Act entered into force
1979	Hibernia oil field discovered
1984	Terra Nova oil field discovered
February 7, 1984	The GATT Council adopts the Panel Report in the *Canada - Administration of the Foreign Review Act* case
February 11, 1985	The Atlantic Accord: Memorandum of Agreement Between the Government of Canada and the Government of Newfoundland and Labrador on Offshore Oil and Gas Resource Management and Revenue Sharing
June 30, 1985	Investment Canada Act entered into force
September 15, 1985	Mobil submits the Hibernia Benefits Plan to the Board
1986	The Board issues the 1986 Exploration Phase Guidelines
April 18, 1986	Hibernia project participants issue the Memorandum of Understanding: Canada/Newfoundland Benefits — Hibernia Development Project
May 28, 1986	Mobil submits the Supplementary Benefits Plan to the Board

Date	Event
June 18, 1986	The Board issues Decision 86.01 approving the Hibernia Benefits Plan and Development Plan
1987	The Federal Accord Act is enacted
1987	The Board issues the 1987 Exploration Phase Guidelines
April 20, 1987	Hibernia submits its first Benefits Report to the Board. During the development phase HMDC submits monthly reports on benefits commitments; when the production phase begins in 1998, HMDC replaces these monthly reports with quarterly reports
1988	The Board issues the 1988 Development Phase Guidelines
July 1988	The Hibernia project owners and the Provincial and Federal governments enter into the Statement of Principles: Hibernia Development Project
1990	Provincial Accord Act enters into force
November 10, 1990	The Hibernia project owners and the Provincial and Federal governments enter into the Hibernia Development Project: Framework Agreement
December 17, 1992	NAFTA signed

Date	Event
January 1, 1994	NAFTA enters into force, including Canada's Annex I Schedule for Existing Measures and Liberalization Commitments
August 5, 1996	Petro-Canada submits the Terra Nova Benefits Plan to the Board
November 1997	Oil production begins at Hibernia
December 1997	The Board issues Decision 97.02 approving the Terra Nova Benefits Plan and Development Plan
1999	Hibernia submits its 1998 Benefits Report, its first annual benefits reports summarizing benefits expenditures in the prior year, including R&D; these reports continue to be submitted annually
March 1999	Terra Nova submits its 1998 Benefits Report, R&D Report and E&T Report, its first annual benefits report summarizing benefits expenditures in the prior year, including R&D, and its estimate for R&D spend over the following three-year period; these reports continue to be submitted annually
November 26, 2001	The Board issues Decision 2001.01 approving the White Rose Benefits Plan and Development Plan
January 2002	Oil production begins at Terra Nova

Date	Event
July 2003	The Board issues a consultation draft of the R&D Guidelines, and makes presentations to the operators of Hibernia and Terra Nova
November 5, 2004	The Board transmits the R&D Expenditure Guidelines to the Hibernia and Terra Nova operators, indicating that they are effective retroactively to April 1, 2004
February 4, 2005	HMDC and Petro-Canada file a domestic action before the Newfoundland courts arguing that the Board acted in excess of its authority when it promulgated the Guidelines
February 2006	The Board issues the 2006 Exploration Phase Guidelines
November 1, 2007	Claimants file their Request for Arbitration with ICSID
February 19, 2009	The Supreme Court of Canada denies HMDC's and Petro-Canada's leave to appeal the Newfoundland Court of Appeal's decision, which found that the Board acted within its authority in promulgating the Guidelines
February 26, 2009	The Board issues a letter to HMDC calculating Hibernia's expenditure requirements under the Guidelines from April 1, 2004 through December 31, 2008 at $66.52 million A meeting takes place between the Board and industry representatives, at which

Date	Event
	industry presents its response to the Board's request for feedback as to how R&D obligations under the Guidelines should be administered
March 3, 2009	The Board issues a letter to Petro-Canada calculating Terra Nova's expenditure requirements under the Guidelines from April 1, 2004 through December 31, 2008 at $34,040,000
March 11, 2009	[redacted]
August 3, 2009	Claimants file their Memorial
September 30, 2009	HMDC submits Hibernia's R&D and E&T report from April 1, 2004 through December 31, 2008, detailing R&D and E&T expenditures [redacted]
October 1, 2009	Suncor submits Terra Nova's R&D and E&T report from April 1, 2004 through December 31, 2008, detailing R&D and E&T expenditures [redacted]
October 22, 2009	HMDC submits an update to Hibernia's R&D and E&T report from April 1, 2004 through December 31, 2008
October 23, 2009	A meeting takes place between the Industry R&D Steering Committee and the Board, at which the Committee provides an update on the work and activities of the

Date	Event
	R&D Task Force
November 12, 2009	HMDC submits a final update to Hibernia's R&D and E&T report from April 1, 2004 through December 31, 2008
November 17-18 2009	The R&D industry Task Force holds a workshop on potential industry arctic R&D projects
December 1, 2009	Respondent files its Counter-Memorial
December 1, 2009	The Board completes the Staff Analyses of Hibernia and Terra Nova's R&D and E&T expenditure reports under the Guidelines, detailing its decision of the eligibility of the projects' R&D expenditures
December 1-2, 2009	The R&D industry Task Force holds a workshop on potential industry subsurface R&D projects
December 10, 2009	The Board informs HMDC that [redacted] of its reported expenditures are ineligible under the Guidelines, and that it requires HMDC to provide by March 31, 2010 a Work Plan detailing their shortfall spending proposals reinforced by provision of a financial instrument to which the Board must have unrestricted access
December 15, 2009	The Board informs Suncor [redacted] of Terra Nova's reported expenditures are ineligible under the Guidelines, and that it

Date	Event
	requires Suncor to provide by March 31, 2010 a Work Plan detailing their shortfall spending proposals reinforced by provision of a financial instrument to which the Board must have unrestricted access The Board also amends the conditions to the Hibernia and Terra Nova Productions Operations Authorizations, making provision of a financial instrument to cover the R&D expenditure shortfall, and submission of a work plan to meet that shortfall, conditions of operation
December 21, 2009	HMDC requests that the Board apply the project's full development phase credit upfront
January 8, 2010	The Board confirms that the remaining development phase credit of $10.1 million could be applied towards HMDC's outstanding obligations under the Guidelines, and re-calculates HMDC's net shortfall at $43,556,526
January 8, 2010	The Board confirms that all remaining development phase credit could be applied upfront against Terra Nova's obligations, and re-calculates Terra Nova's net shortfall at $11,860, 092. Terra Nova's shortfall is later reduced again to $8,972,126.

Date	Event
February 26, 2010	A meeting takes place between the Board and the R&D industry Task Force, at which the Task Force provides an update on the work and activities of its work
March 5, 2010	HMDC asks the Board to reconsider its decision on certain R&D expenditures [redacted].
March 9, 2010	[redacted] recalculates HMDC's net shortfall at $32,718,226
March 24, 2010	The Board informs HMDC that the financial instrument required to guarantee expenditure of the shortfall amount must take the form of a promissory note secured by a letter of credit, and that the Board must enjoy unrestricted access to the instrument in the event that HMDC fails to spend down the shortfall
March 31, 2010	The Hibernia and Terra Nova project operators meet with the Board to present their plans to address the shortfall in R&D and E&T expenditures from the April 1, 2005 through December 31, 2004 period
April 1, 2010	The Board informs HMDC that Condition 31 of Hibernia's POA, regarding provision of a work plan to address the R&D spend shortfall, is satisfied

Date	Event
April 30, 2010	The Board's deadline for the provision of a financial instrument by HMDC and Suncor to guarantee their R&D expenditure shortfall
March 31, 2015	Deadline established by the Board, at which time it will draw down from the project owners' financial instruments any unspent shortfall and transfer it to a recognized research or education agency