

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

BETWEEN:

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

Investor

AND

**GOVERNMENT OF CANADA**

Respondent

**INVESTOR'S REPLY MEMORIAL**

**December 15, 2008**

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**I. OVERVIEW**

1. Canada has established a complex regulatory regime to control the export of logs from British Columbia (“Log Export Control Regime”). The Log Export Control Regime is unique to BC: in no other Canadian province are there any controls on the export of logs. The purpose of the Regime is to ensure that British Columbia (“BC”) log processors have ample access to logs at artificially suppressed prices. Canada has placed the very log processors who benefit from the enforcement of this unfair regime as the administrators of this regime. The regime forces companies like Merrill & Ring to sell their BC logs to BC sawmills at prices far lower than Merrill & Ring could obtain in the international market.
2. This is a case about basic unfairness. It is about how foreign investors are forced by the state to prop up a domestic industry. It is about an administrative process that creates a culture in which unseemly conduct is encouraged to fester. The evidence will show that log industry-style blackmail, secret decisions, avoiding written communication - all are part of the daily business environment in which Merrill & Ring is forced to operate.

***Jurisdiction***

3. Canada has raised a defense that parts of this claim are not admissible. Canada has mischaracterized the Investor’s claim as being solely about *Notice 102*. It then relies on this fundamental mischaracterization to argue that this Tribunal does not have the authority to rule on this claim, because of time limitations discussed in NAFTA Article 1116(2). Of course, the Investor’s own materials make it abundantly clear that this arbitration is about much more than one federal regulation.
4. NAFTA Article 1116(2) discusses how this Tribunal has authority over claims that have been submitted to it within three years of when an Investor first knew or ought to have known of a breach of the NAFTA and of loss arising therefrom. Canada exerts much effort in discerning the meaning of “first” in NAFTA Article 1116(2). In its focus on “first”, it fails to appreciate that the event that triggers the calculation of the time limit is a “measure”. A measure is broadly defined in the NAFTA and its plain meaning in light of the context, object and purposes of the NAFTA supports the proposition that there are several measures at issue in this dispute. It is only once a “measure” is established that the calculation required by NAFTA Article 1116(2) can be undertaken. Having established the

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measure, the Tribunal is then required to establish the first point in time in which knowledge of the breach by the measure and the knowledge of loss occasioned by the measure intersect. It is from this point that the three years should be calculated.

5. The measures at issue in this dispute all occur within three years before the filing of the Notice of Arbitration. Some of these impugned measures are continuing, that is, their breach pre-dated and continued into the three year time period. However the loss occasioned by these measures first became known during the three year period. Thus the Tribunal has jurisdiction over all these measures. Other impugned measures that first arose after December 26, 2003 are non-continuing, that is, both their breach and the loss occasioned by them occurred instantaneously within the three-year time period. The Tribunal also has jurisdiction over these measures.
6. Much of Canada's legal argument with respect to the meaning of NAFTA Article 1116(2) has been made through a legal opinion produced by Professor Michael Reisman. Since Professor Reisman's legal opinion is about the interpretation of the NAFTA, which is the governing law of this arbitration,<sup>1</sup> the Investor has objected to the appropriateness of addressing these legal issues by way of expert evidence. The Investor has submitted a responsive expert opinion on these same issues produced by Professor Robert Howse from New York University. Professor Howse's legal opinion is proffered with a proviso: that should the Tribunal rule that Professor Reisman's legal opinion is more appropriately legal argument than the subject of an expert report, then the Investor will also submit Professor Howse's argument as part of its legal argument rather than as an expert legal opinion.

### ***National Treatment***

7. In its Counter-Memorial, Canada has advanced a highly artificial construction of national treatment. Canada's construction is obviously designed to assist its defense of this case, but Canada's theory is inconsistent with the fundamental principles which underscore the meaning of national treatment. Furthermore, Canada's approach is inconsistent with the context, meaning and objectives of the treaty. By comparison, the Investor sets out a detailed definition of the national treatment obligation that is based on careful examination

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<sup>1</sup> NAFTA Article 1131 makes the NAFTA and applicable rules of international law the governing body for this arbitration.



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of the negotiating history of the NAFTA, the NAFTA's text, principles, rules and objectives, and upon the decisions of other international tribunals.

8. The evidence produced by the Investor demonstrates that Merrill & Ring is in "like circumstances" with log producers who export logs from other parts of Canada and from other parts of the province of British Columbia. In addition, Merrill & Ring is also in "like circumstances" with other log producers who export logs, including those located on the coast of British Columbia. As a result, this Tribunal must take into account situations where more favourable treatment has been provided to log producers who are in "like circumstances" with Merrill & Ring.
9. Log producers in other parts of Canada are not subjected to the onerous and confiscatory requirements of the Log Export Control Regime as practiced in British Columbia. They are obviously treated more favourably. Moreover, other log producers who operate in the province of British Columbia are treated more favourably. This more favourable treatment occurs with respect to mandatory regulations which are imposed on log producers like Merrill & Ring.
10. Of particular note is the issue of the provision of standing export exemptions for log producers, which are known as standing green exemptions. These standing green exemptions, and their associated standing applications, give a tremendous advantage in treatment to those only granted the ability to sell their trees once they know they are able to obtain export approval. Standing exemptions are of enormous value to log producers since they represent an automatic bypassing of the log control regime which enables the guaranteed export of uncut logs. There are several reasons for this.
  - a) Since log producers with standing exemptions know ahead of time that they will be able to export their logs, they can enter into predictable supply contracts with their customers;
  - b) Log producers with standing exemptions that have them are immune from the ever-present threats of "blockmail" and special targeting;

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- c) The logs of log producers with standing exemptions will not deteriorate from infestation and exposure to the elements as they wait for export approval; and
  - d) Since standing exemptions represent a guarantee to log producers that they will be able to export their logs, they know they will be able to receive the best market price for their logs, not the artificially suppressed BC market price.
  - e) Log exporters with standing exemptions can cut their logs to meet the needs of their customers, and are not required to cut, sort and scale them to the preferences of BC log processors.
11. This is a very straightforward matter. Canada forbids Merrill & Ring from obtaining standing exemptions for its lands. At the same time, Canada grants standing exemptions to Merrill & Ring's competitors. As a result, there can be no doubt that by denying Merrill & Ring even the possibility of obtaining standing exemptions, Canada accords Merrill & Ring "less favorable treatment" for the purposes of Article 1102.
12. Much of the damage caused to companies like Merrill & Ring occurs from the lack of predictability and customization to customer preferences that is lost by Canada's requirement with respect to how logs are produced in order to obtain an export permit. These requirements are a disguised form of market subsidization to log processors located in the province of British Columbia. These are all policy objectives which fly in the face of the free trade objectives of the NAFTA.
13. In particular, Canada fails to meet its NAFTA obligations to provide national treatment to Merrill & Ring because it fails to provide most favourable treatment under the Log Export Control Regime with respect to:
- a) The requirement to be subjected to the surplus testing prior to being granted an exemption to export their timber;
  - b) Merrill & Ring's ineligibility to obtain standing applications and/or obtain standing exemptions;

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- c) The requirement to cut and sort timber from their federally regulated properties to artificial “normal market practices”;
  - d) The requirement to follow the additional rules for Merrill & Ring properties located in the remote Coastal region;
  - e) The requirement to scale all timber metrically even when such scaling is unnecessary; and
  - f) The requirement to remit the Fee-in-lieu on provincial rafts that are exported.

***International Law Standards of Treatment***

- 14. Canada has advanced a meaning to the international law standard of treatment contained in NAFTA Article 1105 that is narrow and simply not in keeping with the text of the treaty. The meaning of the international standard is well known and has been well canvassed by international tribunals, including other NAFTA tribunals. Canada argues for a threshold standard of breach that is inconsistent with the principles of state responsibility set out by the International Law Commission and by previous international investor-state tribunals. If Canada’s approach were to be followed, there would be no effective protection for rule of law and fundamental fairness issues within the NAFTA.
- 15. Canada fails to meet its obligations under the Log Export Control Regime as Merrill & Ring is subjected to unfair and inequitable treatment including:
  - a) The requirement to be subjected to the Surplus Testing Procedure prior to being granted an export permit for its logs;
  - b) Merrill & Ring’s ineligibility to obtain standing applications and/or obtain standing exemptions;
  - c) The requirement to cut and sort timber from its federally regulated properties to artificial “normal market practices”;

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- 
- d) The requirement to follow the additional rules for Merrill & Ring properties located in the remote Coastal region; and
  - e) The requirement to scale all timber rafts metrically even when such scaling is unnecessary; and
  - f) The requirement to remit the fee-in-lieu on provincial rafts that are exported.
16. The Log Export Control Regime is administered in a highly secretive and non-transparent manner that flies in the face of the most fundamental aspects of the rule of law. The Surplus Testing Procedure administered by TEAC/FTEAC is completely enshrouded in secrecy from beginning to end. Yet some of the most essential elements of Merrill & Ring's fundamental business operations are completely controlled by this non-transparent administration of the Log Export Control Regime.
  17. Canada is entirely aware of highly improper practices known as "blockmailing" which are taken by log processors to further extract concessions from log producers. Those log producers who have standing exemptions or standing applications are exempt from the application of these unethical practices which are enabled by Canada's administration of the Log Export Control Regime.
  18. Furthermore, there are serious questions about the natural justice and due process which occurs with respect to TEAC/FTEAC on account of its composition. No private log producers are permitted to sit on this body whereas log processors are always represented despite their obvious interest in maintaining artificially low log prices and onerous conditions which benefit them at the cost of private log producers like Merrill & Ring.
  19. The onerous requirements under the Log Export Control Regime with respect to the mandatory cutting and storage of logs as they await export certification compounds the fundamental unfairness of the regime. Requirements to cut, sort and scale logs to the preferences of local mills prevent log producers from being able to enter into long term supply contracts with foreign customers. This results in highly impaired market operations and significant losses for domestic log producers who are federally regulated.

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20. The elements of unfairness inherent in the Log Export Control Regime are cumulative to each other. While each is individually harmful, when taken together these elements are all the more harmful to private landowners while benefiting of domestic British Columbia log producers.

***The Imposition of Performance Requirements***

21. The NAFTA contains specific and carefully drafted rules to prohibit the imposition of performance requirements upon foreign investors. Under NAFTA Article 1106, the NAFTA Parties agreed not only to prohibit these industrial policy measures against investors from each of the three NAFTA Parties, but they actually agreed to ban these performance requirements completely, against investors from any country in the world.

The Log Control Export Regime fails to meet Canada's obligations under NAFTA Article 1106 as they impose:

- a) The requirement to cut and sort timber from their federally regulated properties to "normal market practices";
- b) The requirement to scale all timber rafts metrically even when such scaling is unnecessary; and
- c) The requirement to follow the additional rules for Merrill & Ring properties located in the remote Coastal region

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

22. Canada agrees with Merrill & Ring on the analytical steps necessary at international law to establish an act of expropriation. Since in the context of expropriation the only investment at issue is Merrill & Ring's interest to realize fair market value for its logs on the international market, the only requirement in examining the issue is simply to ask whether Merrill & Ring has such an interest.
23. Canada applies an outdated conception of property rights by denying that this Tribunal has jurisdiction over Merrill & Ring's intangible investments. This concept is contrary to the

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plain meaning of the NAFTA, previous NAFTA decisions and common sense. It is clear that the intangible rights at issue in this claim are part and parcel of the business of Merrill & Ring. This Tribunal should therefore reject Canada's arguments. It has authority to rule on the tangible and intangible elements of Merrill & Ring's investment.

24. Canada has taken acts tantamount to the expropriation of property interests owned by Merrill & Ring. Canada has not provided Merrill & Ring with fair market value compensation. The Log Export Control Regime substantially interferes with Merrill & Ring's ability to realize fair market value of its logs on the international market. Canada takes away value from Merrill & Ring and redistributes it to other private interests in a manner contrary to the obligations of due process and NAFTA Article 1105.
25. In particular, the Log Export Control Regime is inconsistent with Canada's obligation to provide fair market value compensation upon an act tantamount to expropriation due to:
  - a) The requirement to be subjected to the Surplus Testing Procedure prior to being granted an exemption to export their timber;
  - b) The requirement to cut and sort timber from their federally regulated properties to "normal market practices";
  - c) The requirement to scale all timber rafts metrically even when such scaling is unnecessary;
  - d) The ineligibility to submit standing applications and/or obtain standing exemptions; and
  - e) The requirement to remit the Fee-in-lieu on provincial rafts that are exported.

***Damages***

26. The Investor has set out an independent valuation report done by Mr. Robert Low of Deloitte & Touche LLP. R-1(b)(i) [REDACTED]

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R-1(b)(i) [Redacted]

27. The Low Report has calculated the losses related to Canada’s failure to meet its NAFTA Article 1102 national treatment obligations as including:

- a) R-1(b)(i) [Redacted]
- b) R-1(b)(i) [Redacted]
- c) R-1(b)(i) [Redacted]
- d) R-1(b)(i) [Redacted]

28. The Low Report has calculated the losses related to Canada’s failure to meet its obligation to provide international law standards of treatment under NAFTA Article 1105 as including:

- a) R-1(b)(i) [Redacted]
- b) R-1(b)(i) [Redacted]
- c) R-1(b)(i) [Redacted]

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<sup>2</sup> Low Expert Report, December 14, 2008 at para. 1.38.

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d) R-1(b)(i) [REDACTED]

29. The Low Report has calculated losses related to Canada's imposition of performance requirements prohibited under NAFTA Article 1106 as including R-1(b)(i) [REDACTED]

[REDACTED]

The Low Report has considered the loss related to NAFTA Article 1106 to be R-1(b)(i) [REDACTED]

[REDACTED]

30. The Low Report has calculated the losses related to Canada's failure to pay compensation in accordance with the obligations set out in NAFTA Article 1110 include:

a) R-1(b)(i) [REDACTED];

b) R-1(b)(i) [REDACTED]

c) R-1(b)(i) [REDACTED].<sup>5</sup>

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<sup>3</sup> Low Expert Report at para. 1.42.

<sup>4</sup> Low Expert Report at para. 1.46.

<sup>5</sup> Low Expert Report at para. 1.50.




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31. The damages reported in the Low Report can be summarized as follows:

NAFTA Article	Damages Amount (C\$)
Article 1102	\$16,804,068
Article 1105	\$16,804,068
Article 1106	\$16,756,272
Article 1110	\$18,682,368

The Low Report points out that these R-1(b)(i)  <sup>6</sup>

32. Merrill & Ring has incurred losses on past actual sales. Mr. Low identifies that these past losses are:

a) R-1(b)(i) 

b) R-1(b)(i) 

c) R-1(b)(i) 

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<sup>6</sup> Low Expert Report at para. 2.29.

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d) R-1(b)(i) [Redacted]

e) R-1(b)(i) [Redacted]

f) R-1(b)(i) [Redacted]

g) R-1(b)(i) [Redacted]

33. Merrill & Ring incurs additional costs to comply with the Log Export Control Regime. These costs include:<sup>7</sup>

R-1(b)(i) [Redacted]

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<sup>7</sup> Low Expert Report at para. 2.16.

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34. R-1(b)(i) [REDACTED]

35. Mr. Low finds that the losses related to NAFTA Article 1102 include:

R-1(b)(i) [REDACTED]

Based on these four categories, Deloitte calculates Merrill & Ring's losses due to the breach of NAFTA Article 1102 as \$16,804,068.<sup>8</sup>

36. Mr. Low finds that the losses related to NAFTA Article 1105 include:

a) R-1(b)(i) [REDACTED]

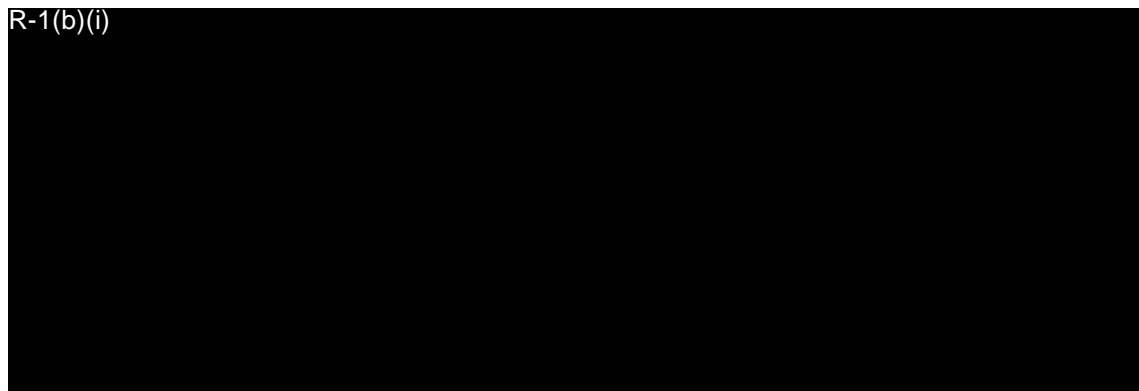
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<sup>8</sup> Low Expert Report at paras. 1.38 1.39.

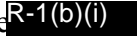

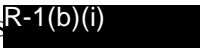
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R-1(b)(i)

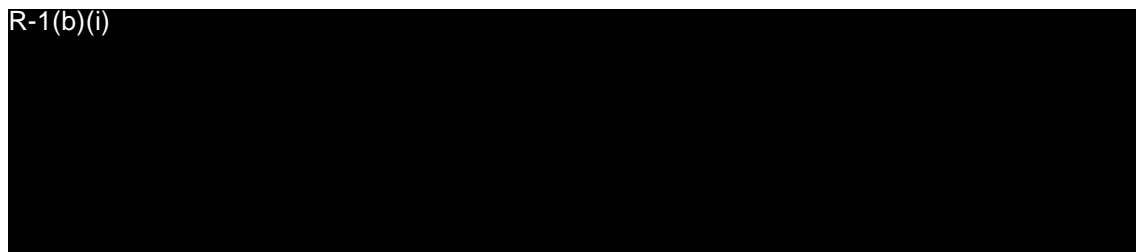


Based on the above, the Low Report calculates Merrill & Ring's losses due to the breach of NAFTA Article 1105 as \$16,804,068.<sup>9</sup>

37. Mr. Low finds that the losses related to NAFTA Article 1106 include the R-1(b)(i)   
  
". Based on this Deloitte calculates Merrill & Ring's losses due to the breach of NAFTA Article 1106 as R-1(b)(i) 

38. Mr. Low calculates the losses related to NAFTA Article 1110 determined on the basis of fair market value as at December 27, 2008 include:

R-1(b)(i)



Based on the above, Mr. Low calculates Merrill & Ring's losses due to the breach of NAFTA Article 1110 as \$18,682,368.<sup>11</sup>

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<sup>9</sup> Low Expert Report at paras. 1.42 1.43.

<sup>10</sup> Low Expert Report at paras. 1.46 1.47.

<sup>11</sup> Low Expert Report at paras. 1.50 1.51.

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39. In furtherance of its arguments made in this Reply Memorial, the Investor relies on the following statements, reports and legal opinions:

- a. **C-1(b)(ii) WITNESS STATEMENT:** C-1(b)(ii) is the C-1(b)(ii), a lumber manufacturer located in C-1(b)(ii) that has obtained logs used to manufacture lumber from the coast and interior of British Columbia, Alberta and the United States. C-1(b)(ii) identifies that logs from the BC coast and interior, Alberta, and the United States all have the same end uses;
- b. **BRANTER EXPERT STATEMENT:** Keith Branter is a Registered Professional Forester and a member of the College of Alberta Professional Foresters based in Alberta. Mr. Branter explains that similar species of trees are grown in Alberta, and that private forest landowners in Alberta are not subject to any of the Log Export Control Regime;
- c. **HOWSE LEGAL OPINION:** Professor Robert Howse is the Lloyd C. Nelson Professor of International Law at New York University. Professor Howse responds to legal issues raised by Professor Michael Reisman. Professor Howse's opinion is made subject to specific observations made by the Investor in this Reply Memorial;
- d. **KURUCZ REPLY WITNESS STATEMENT:** Tony Kurucz is President and owner of Progressive Timber Sales Ltd. Mr. Kurucz responds to Canada's assertion that towing logs to non-remote areas is not an imposition and provides the circumstances under which he was told by a member of TEAC/FTEAC that Merrill & Ring's logs from its Theodosia location are considered remote;
- e. **LOW EXPERT REPORT.** Robert Low is a Chartered Business Valuator at Deloitte and Touche, LLP. Mr Low provides a valuation report in response to observations made by Canada on damages including those made by Mr. Bowie of KPMG, Mr. Jendro of Jendro & Hart and Mr. Reishus;
- f. **MACPHERSON EXPERT STATEMENT:** Stuart Macpherson is a forestry consultant and the Executive Director for the Private Managed Land Council. Mr. Macpherson responds to Canada's claim that it is well-known that Merrill &

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Ring's Theodosia lands are remote. He also provides an observation on the sustainability of the policies underpinning the Log Export Control Regime. Additionally, Mr. Macpherson has undertaken a review of TEAC/FTEAC Minutes and Provincial Orders-in-Council ("OICs") for blanket standing timber exemptions to respond to certain issues raised by Canada;

- g. **MATKIN EXPERT LEGAL WITNESS STATEMENT:** James Matkin QC is a former Deputy Minister of Intergovernmental Affairs in the Government of British Columbia and one of the drafters of the amendments to the Canadian constitution in 1981. Mr. Matkin provides a legal opinion under Canadian law on Canada's claim that it has no constitutional authority to grant standing exemptions for federal lands in British Columbia;

- h. **C-1(b)(ii) WITNESS STATEMENT: C-1(b)(ii)** provides his understanding of remoteness and his experience of blockmailing. He also highlights the extra costs as a result of the Log Export Control Regime and the export premium;

- i. **RUFFLE EXPERT REPORT:** Doug Ruffle is a Registered Professional Forester based in British Columbia. Mr. Ruffle responds to issues raised by David Jendro and considers other issues raised by Canada and David Reishus. In addition, Mr. Ruffle has also done an independent review of the Merrill & Ring forest inventory in Canada;

- j. **C-1(b)(ii) WITNESS STATEMENT: C-1(b)(ii)** is the **C-1(b)(ii)** own lands in the Wet Belt area of the British Columbia interior. In his witness statement, **C-1(b)(ii)** describes the extraordinary lengths which **C-1(b)(ii)** takes to prevent its logs from being blockmailed under the Log Export Control Regime;

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- k. **SCHAAF REPLY WITNESS STATEMENT:** Norm Schaaf is the Vice-President of Timberlands and Administration for Merrill & Ring Inc. Mr. Schaaf addresses the extra cost of the Log export Control Regime and how it affects Merrill & Ring's harvest plans;
  
  - l. **STUTESMAN REPLY WITNESS STATEMENT:** Paul Stutesman is the Vice-President and General Manager of Merrill & Ring Forest Products LP. Mr. Stutesman responds to Canada's assertion that TEAC/FTEAC meetings are cancelled in only the most extraordinary circumstances, that the Minister of Foreign Affairs regularly disregards TEAC/FTEAC recommendations, and that TEAC/FTEAC properly assesses fair market value on Merrill & Ring's logs. Mr. Stutesman also explains the factors regarding decisions to export logs. Mr. Stutesman also explains that Merrill & Ring does not sort its export logs any differently than it sorts its domestic logs and that Merrill & Ring's Canadian logs are virtually identical to its American logs.

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## II. JURISDICTION

40. There are three requirements for this Tribunal to assume jurisdiction over this dispute. First, the Tribunal must be satisfied that Merrill & Ring qualifies as an “investor” under NAFTA Article 1139. Second, the Tribunal must be satisfied that Merrill & Ring has an “investment”, also under NAFTA Article 1139. And third, the Tribunal must be satisfied that Merrill & Ring has initiated this claim on a timely basis under NAFTA Article 1116(2).<sup>12</sup> Merrill & Ring has satisfied all three requirements for this Tribunal to assume jurisdiction over this dispute. As such, this Tribunal must assume jurisdiction and consider the dispute on the merits.
41. Much of Canada’s legal argument with respect to the meaning of NAFTA Article 1116(2) has been made through a legal opinion produced by Professor Michael Reisman. Since Professor Reisman’s legal opinion is about the interpretation of the NAFTA, which is the governing law of this arbitration,<sup>13</sup> the Investor has objected to the appropriateness of addressing these legal issues by way of expert evidence. The Investor has submitted a responsive expert opinion on these same issues produced by Professor Robert Howse from New York University. Professor Howse’s legal opinion is proffered with a proviso: that should the Tribunal rule that Professor Reisman’s legal opinion is more appropriately legal argument than the subject of an expert report, then the Investor will also submit Professor Howse’s argument as part of its legal argument rather than as an expert legal opinion.

### 1. Jurisdiction *Ratione Personae*: Merrill & Ring is an “Investor”

42. Merrill & Ring has demonstrated that it is as an “investor” as defined by NAFTA Article 1139.<sup>14</sup> Canada has not contested this fact nor presented arguments to the contrary. As a result, there is no dispute that this Tribunal has jurisdiction *ratione personae*.

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<sup>12</sup> The Investor continues to rely on the jurisdictional arguments made in the Investor’s Memorial, February 13, 2008 at paras. 432-482.

<sup>13</sup> NAFTA Article 1131 makes the NAFTA and applicable rules of international law the governing body for this arbitration.

<sup>14</sup> Investor’s Memorial at paras. 432-433.



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**2. Jurisdiction *Ratione Materiae*: Merrill & Ring has an “Investment”**

43. This Tribunal has jurisdiction *ratione materiae*. That is, not only is Merrill & Ring clearly an “investor”, but it also clearly has “investments” as defined by NAFTA Article 1139 of the NAFTA.

*a. Canada Concedes that Merrill & Ring’s BC Lands, Timber and Logs are “Investments”*

44. Merrill & Ring has various types of investments.<sup>15</sup> The first two types of investments Merrill & Ring has involve “real estate” and “tangible property,” as recognized under NAFTA Article 1139(g). First, Merrill & Ring has BC timberlands, which clearly constitutes “real estate”. Second, Merrill & Ring has property located on, and flowing from its BC timberlands. This includes its timber, as well as the logs that come from its timber. These clearly qualify as “tangible property”.

45. Canada has conceded that Merrill & Ring’s BC timberlands qualify as investments.<sup>16</sup> Canada has also conceded that the timber located on Merrill & Ring’s BC timberlands, and the logs that come from that timber, also constitute investments under NAFTA Article 1139(g).<sup>17</sup> As a result, there is no question that this Tribunal has jurisdiction *ratione materiae* with respect to Merrill & Ring’s BC timberlands, timber and logs.

*b. Merrill & Ring’s Interest in Realizing Fair Value for Its Logs on the International Market is Covered by NAFTA Article 1139(h)*

46. Merrill & Ring has another type of investment that is less “tangible” than its lands, timber and logs. This relates to its interest in realizing fair value for its BC logs on the export

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<sup>15</sup> Investor’s Memorial at paras. 432-433.

<sup>16</sup> Canada’s Counter Memorial at para. 263.

<sup>17</sup> Canada’s Counter Memorial at para. 264.

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market.<sup>18</sup> Canada denies that this qualifies as an investment under Paragraph (h) of the definition of investment in NAFTA Article 1139.<sup>19</sup>

47. NAFTA's definition of investment is contained in NAFTA Article 1139. Paragraph (h) of the definition includes the following within the definition of "investment":

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

- (i) contracts involving the presence of an investor's property in the territory of the Party, including turnkey or construction contracts, or concessions; or
- (ii) contracts where remuneration depends substantially on the production, revenues or profits of an enterprise.

48. Canada has argued that the definition of investment cannot be interpreted to mean that Merrill & Ring has an investment in its ability to sell its products to its markets. In so doing, it engages in all sorts of linguistic contortions that strain the limits of credibility. For example, Canada tries to restrict the meaning of "interest" by ascribing to it a technical and narrow legal definition from the *Shorter Oxford English Dictionary*.<sup>20</sup> What Canada fails to mention, however, is that the same dictionary endorses many other broader definitions of "interest", including "[a] thing that is of some importance to a person, company, state, etc." This commonsense meaning is confirmed in the full length version of the *Oxford English Dictionary*, in which the very first definition of "interest" offered is as follows: "makes a difference, concerns, matters, is of importance."<sup>21</sup> Merrill & Ring's interest in realizing fair value for its logs on the world market clearly "makes a difference", "concerns", "matters", and "is of importance" to it.

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<sup>18</sup> Investor's Memorial at para. 30.

<sup>19</sup> Canada's Counter Memorial at para. 265.

<sup>20</sup> Canada's Counter Memorial at para. 268.

<sup>21</sup> The Oxford English Dictionary, 2<sup>nd</sup> ed., Vol. VII, at 1099, Investor's Book of Authorities (Tab 128).

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49. Canada goes on to suggest that the interests referred to by Paragraph (h) of the definition of investment is limited to interests such as contracts and concessions.<sup>22</sup> There is simply no reasonable basis for this strained interpretation either. Paragraph (h) is clear and broad. The interests listed therein are mere examples in what is otherwise an open-ended list. Had the drafters intended to limit the types of interests covered by Paragraph (h) only to contracts and concessions, they could have easily done so with express wording to that effect. If one wanted to restrict the scope of “interests” referred to in Paragraph (h), it would be reasonable to suggest that they may be limited to commercial interests, since these clearly arise from the commitment of capital. To suggest, however, that they are limited only to contracts and concessions is far too restrictive, is not at all supported by the overall wording of Paragraph (h), and not consistent with the objects and purposes of the Treaty.
50. Finally, Canada argues that the other types of investment listed in NAFTA Article 1139 demonstrate that the interests referred to must be concrete, capable of being bought, sold, traded or borrowed against.<sup>23</sup> The definition of investment in NAFTA Article 1139 does not cover only concrete investments. This is clear from the fact that Paragraph (g) lists “intangible property” as a protected investment. In any event, it is for the very reason that the other types of investment listed in Article 1139 speak of investments that are capable of being bought and sold, and that the interests referred to in Paragraph (h) include other types of investment.
51. Yet even if it were true that Paragraph (h) was only meant to cover investments that can be bought and sold, Merrill & Ring’s interest in realizing fair value for its logs on the export market still qualifies. Merrill & Ring’s interest in realizing fair value for its logs on the export market is inextricably linked to the value, for example, of its goodwill. If Merrill & Ring were not subject to the various requirements of the Log Export Control Regime, it would be able to add value to its logs in several ways. For example, it would be able to cut and sort its logs to the preferences of its export customers instead of to the

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<sup>22</sup> Canada’s Counter Memorial at para. 269.

<sup>23</sup> Canada’s Counter Memorial at para. 270.

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preferences of BC sawmills.<sup>24</sup> Merrill & Ring would also be able to guarantee its customers security of supply, delivering its logs on time when and where its export customers need them,<sup>25</sup> and at reduced expense to their customers.<sup>26</sup> This enhanced service, in turn, would translate into increased goodwill with its customers. This goodwill would be reflected on Merrill & Ring's books, and in the value of its brand. It is obvious that companies invest in goodwill. It is equally obvious that Merrill & Ring's "interests" under Article 1139(h) include the concept of goodwill, and that this interest is in fact capable of being bought and sold.

52. In any event, Article 1139 is clear as to what does *not* constitute an investment:

...investment does not mean:

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

53. Unlike the list of what *does* constitute an investment, the list of what does *not* constitute an investment under NAFTA Article 1139 is closed, limited to what is expressly contained in the list. The drafters only intended that the bread and butter of trade in goods such as claims to money be excluded from consideration nothing else. Merrill & Ring's interest in realizing fair market value for its logs on the international market is not a claim to money. Rather, it is an interest arising from its commitment of capital to economic activity in Canada. Since unlike claims to money this interest is not expressly excluded by NAFTA Article 1139, it must be covered.

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<sup>24</sup> Stutesman Witness Statement, February 8, 2008 at para. 25.

<sup>25</sup> Stutesman Witness Statement, February 8, 2008 at para. 13.

<sup>26</sup> C-1(b)(ii)

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54. The centrepiece to Canada's defence is its claim that any "investment" covered by Article 1139 must qualify as a "stand alone" investment.<sup>27</sup> Nowhere does NAFTA's definition of investment contained in Article 1139 support Canada's claim. Merrill & Ring has not advanced any such argument. Canada has apparently invented this "requirement" and attempted to make it appear as if it is in fact somehow a requirement of Article 1139 that investments "stand alone". In the process, however, Canada presents an emaciated and wholly inadequate vision of what constitutes an investment. And in so doing, it seriously weakens the scope of the NAFTA itself.
55. Investments cannot so easily be broken down into discrete packages. Modern investments consist of whole bundles of assets, rights and interests, all of which are interrelated. This is the case with Merrill & Ring's interest in realizing fair value for its logs on international markets. Once Canada concedes as it has done that Merrill & Ring holds investments in the form of land, timber, and logs, then it must also acknowledge that the value of these investments depends on Merrill & Ring's ability to realize fair market value for them on international markets. Any restriction imposed on Merrill & Ring's ability to do so will have a direct impact on the value of its land, timber and logs.
56. This ordinary meaning of the term "investment" has been expressly recognized in NAFTA jurisprudence. As Canada concedes, the *Pope & Talbot* Tribunal *did* recognize that "the investment's access to the US market is a property interest subject to protection under Article 1110."<sup>28</sup> As Canada also rightly points out, the *Pope & Talbot* Tribunal went on to say that:

...the ability to sell softwood lumber from British Columbia to the US is a very important part of the "business" of the Investment. Interference with that business would necessarily have an adverse effect on the property that the Investor has acquired in Canada, which, of course, constitutes the Investment. While Canada's focus on the "access to the US market" may reflect only the Investor's own terminology, that terminology should not mask the fact that the true

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<sup>27</sup> Canada's Counter Memorial at para. 275, 278.

<sup>28</sup> *Pope & Talbot v. Canada* at para. 96, as quoted by Canada in its Counter Memorial at para. 273, Respondent's Book of Authorities (Tab 110).

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interests at stake are the Investment's asset base, the value of which is largely dependent on its export business.<sup>29</sup>

Of course, the same is true of logs, not just lumber.

57. This same vision of what constitutes an investment was expressed by the Tribunal in *Methanex*. Again, as Canada rightly points out, the Tribunal in that case had the following to say on the matter:

Certainly, the restrictive notion of property as a material "thing" is obsolete and has ceded its place to a contemporary conception which includes managerial control over components of a process that is wealth producing. In the view of the Tribunal, items such as goodwill and market share may...constitute an element of the value of an enterprise and as such may have been covered by some of the compensation payments. Hence...these items may figure in the valuation.<sup>30</sup>

Clearly, the *Methanex* Tribunal did not share Canada's view that investments must be concrete, and only protected if they are capable of being bought and sold. Indeed, that Tribunal recognized that the definition of investment in NAFTA Article 1139 covers "managerial control over components of a process that is wealth producing".<sup>31</sup> Merrill & Ring has obviously been deprived managerial control over that part of the process that is most wealth producing sales. Accordingly, following the view of the *Methanex* Tribunal, Merrill & Ring's ability to sell its logs for fair value on the international market would most certainly qualify as an integral aspect of its investment.

58. Contrary to what Canada suggests, the *Feldman* Tribunal did nothing to undermine the clear meaning espoused by the Tribunal in *Pope & Talbot* that the term "investment" in Article 1139 covers an investor's access to the US market. While that Tribunal may have expressed some doubt that the Investor in that case had a "right" of access to the US

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<sup>29</sup> *Pope & Talbot* at para. 98, as quoted by Canada in its Counter Memorial at para. 273, Respondent's Book of Authorities (Tab 110).

<sup>30</sup> *Methanex v. The United States of America*, Final Award on Jurisdiction and Merits, 2005 WL 195 0817 (August 3, 2008) Chapter D at 7 8 at para. 17, as cited by Canada in its Counter Memorial at para. 275, Respondent's Book of Authorities (Tab 85).

<sup>31</sup> *Methanex v. The United States of America*, Final Award on Jurisdiction and Merits, 2005 WL 195 0817 (August 3, 2008) at para. 17.

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market, it did not deny that the Investor had an “interest” in selling its products on the export market. In any case, the *Feldman* Tribunal ultimately went on to apply the *Pope & Talbot* ordinary meaning standard of investment to the facts of the case before it, thereby sanctioning it as the standard to follow.<sup>32</sup>

59. Canada further makes reference to two non-NAFTA cases *Occidental v. Ecuador* and the *Oscar Chinn Case* to support its contention that Merrill & Ring’s interest in realizing fair value for its logs on the export market is not covered by NAFTA Article 1139.<sup>33</sup> Neither of these, however, is salient to the present case in the manner Canada suggests. Since neither claim was made under the NAFTA, neither was guided by the express wording of Article 1139.
60. The *Occidental* case involved a dispute over whether the claimant had an investment in certain VAT refunds. That dispute was governed by the Ecuador-US BIT. The claimant in that case argued that it had a “right” to certain VAT refunds under Article I(1)(a) of the BIT, which expressly included certain property rights within the definition of “investment”.<sup>34</sup> The claimant argued that its right to the VAT refunds was an investment *per se*.<sup>35</sup> On the facts of that case, however, it was highly questionable whether the claimant did in fact have a “right” to the VAT refunds. Accordingly, it was not at all certain that this constituted an “investment” under Article I(1)(a) of the BIT.
61. Unlike the claimant in *Occidental*, Merrill & Ring is arguing that it has an “interest” not a “right” to realize fair value for its logs on the international markets. Unlike the Ecuador-US BIT, such interests are expressly protected by the NAFTA. And unlike the claimant in *Occidental*, Merrill & Ring is not arguing that its interest in realizing fair value for its logs on the international markets is an investment *per se*. Rather, Merrill & Ring is claiming that its interest in realizing fair value for its logs on the international market is part-and-parcel of a larger investment an investment that is protected by

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<sup>32</sup> *Feldman v. Mexico* at para. 152, Respondent’s Book of Authorities (Tab 49).

<sup>33</sup> Canada’s Counter Memorial at paras. 279-280.

<sup>34</sup> *Occidental Petroleum v. Ecuador* at para. 81, Investor’s Book of Authorities (Tab 40).

<sup>35</sup> *Occidental* at para. 86, Investor’s Book of Authorities (Tab 40).

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Article 1139. Merrill & Ring is not claiming that this interest is a stand alone investment on its own; rather, its claim is that this is an inextricable part of a bundle of rights and interests that make up its investment.

62. In the *Oscar Chinn Case* the Permanent Court of International Justice was guided by the St. Germain-en-Laye Treaty of 1919, as well as by a Special Agreement between Britain and Belgium.<sup>36</sup> Unlike the NAFTA, these provided no definition as to what constitutes an “investment”. Accordingly, in considering whether the governing treaty and agreement provided the claimant the type of protection he was seeking, the Court was not instructed to consider his economic “interests”; rather, it looked to see what he had by way of “vested rights”. Having determined that the claimant had no such rights, the Court was unable to extend the protections of the Treaty and Agreement to him. Of course, in the 75 years that have elapsed since the time of that case, investment protection treaties like the NAFTA have emerged such that they not only expressly contemplate the types of investments they protect, but actually extend protection to intangible investment interests. Had the Court in the *Oscar Chinn Case* been guided by a modern investment protection treaty such as the NAFTA, the outcome would likely have been very different.
63. In the final analysis, in contrast to Canada’s strained efforts to narrow the definition of “interest” in Paragraph (h) of NAFTA Article 1139 and of “investment” in NAFTA Article 1139 more generally a simple and plain reading of this provision clearly shows that Merrill & Ring’s interest in realizing fair value for its logs on the export market does in fact qualify as an investment. Referring back to the wording of Paragraph (h), there is no doubt that Merrill & Ring has committed capital in Canadian territory for the purpose of conducting economic activity in Canada. There can be no doubt that Merrill & Ring has an “interest” arising from the commitment of that capital to sell its logs at fair market value on the world markets. Accordingly, this interest is obviously an “investment” under Paragraph (h) of NAFTA Article 1139 plain and simple.

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<sup>36</sup> *Oscar Chinn Case*, Permanent Court of International Justice, Britain and Belgium, Judgement (December 12, 1934), Canada’s Book of Authorities (Tab 23).



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### 3. Jurisdiction *Ratione Temporis*: Merrill & Ring's Claim is Timely

64. While Canada is ready to concede that Merrill & Ring is both an “investor” and has “investments” for the purposes of NAFTA Article 1139, the main thrust of its objection to this Tribunal’s jurisdiction relates to NAFTA Article 1116(2). Specifically, Canada’s entire jurisdictional objection rests on the contention that Merrill & Ring has not brought this claim forth on a timely basis. The facts of this claim make clear that Canada’s arguments are not well-taken.
65. These arguments stem in their entirety from the Opinion of Michael Reisman. The investor formally objects, as a matter of form, for Canada’s improper introduction of Prof. Reisman’s legal argument on the scope and application of Article 1116(2) by way of expert evidence. NAFTA Article 1131 provides that the NAFTA and international law govern this arbitration. Prof. Reisman’s paper is simply a legal argument on his view about the interpretation of the governing law. It is highly improper to submit expert evidence about the governing law to a tribunal who must decide under that law. That is the job of legal counsel to the disputing parties. As a result, Prof. Reisman did not offer evidence based on his study of the negotiating text of the NAFTA nor based on some other area where expert evidence may be properly considered. Instead, he has simply filed arguments, which should properly be considered by this Tribunal in the argument portion of the hearing. Prof. Reisman should properly be considered as counsel to Canada, and his opinions treated as legal argument. Given the limited time to present arguments and examine witnesses at the hearing, it would be prejudicial to Merrill & Ring to have to spend its time cross-examining Prof. Reisman as if he were a *bona fide* expert or witness. Instead, Merrill & Ring will deal with Mr. Reisman’s legal arguments as if they were part-and-parcel to Canada’s legal argument in its Counter-Memorial.

a. *There are Several Related “Measures” at Issue in this Dispute*

66. In order to understand how this fits with the requirements of the NAFTA, it is crucial to have an understanding of exactly what measures Merrill & Ring’s claim are based on.

67. Canada asserts that there is one, and only one, measure at issue in this dispute – namely, *Notice 102*<sup>37</sup> – and that specific applications of the administrative requirements of *Notice 102* do not constitute “measures”.<sup>38</sup> Canada is plainly mistaken. There are indeed several measures at issue in this dispute, some of which relate to *Notice 102*, others that do not. This basic misunderstanding by Canada goes to the very root of its misplaced objections to the timeliness of this claim.

68. NAFTA Article 201(1) defines the term “measure” in the NAFTA in very broad terms:

For the purpose of this Agreement, unless otherwise specified...**measure** includes any law, regulation, procedure, requirement or practice. (Emphasis in original)

As is clear from the express wording of this provision, the list of measures is non-exhaustive; it “includes” – but is not limited to – laws, regulations, procedures, requirements or practices. There are, therefore, other governmental acts that are not listed on the face of Article 201(1) which may also qualify as “measures”.

69. As is also evident from the spectrum of measures laid out in NAFTA Article 201(1), a measure may range from something that is formal and “legal” in nature such as a “law” or “regulation”, to something that is more informal such as a “requirement” or “practice”. Clearly, the range of measures contemplated by Article 201(1) is very broad.<sup>39</sup>

70. The broad scope of the ordinary meaning of the term “measure” has been confirmed time and again in international jurisprudence. In the *Fisheries Jurisdiction Case*, Canada itself argued that the term “measure” is a “generic term”.<sup>40</sup> In its decision, the International Court of Justice had the following to say:

<sup>37</sup> See, for example, Canada’s Counter Memorial at para. 206, where it refers to the “measure” Merrill & Ring seeks to arbitrate. This use of the term “measure” in singular form demonstrates that Canada thinks there is only one measure at issue.

<sup>38</sup> Reisman Legal Opinion, April 22, 2008 at para. 3 B (ii).

<sup>39</sup> *Loewen*, Award on Jurisdiction at para. 40, Respondent’s Book of Authorities (Tab 75).

<sup>40</sup> *Fisheries Jurisdiction* at para. 65, Investor’s Book of Authorities (Tab 129).

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...in its ordinary sense the word [measure] is wide enough to cover any act, step or proceeding, and imposes no particular limit on their material content or on the aim pursued thereby.<sup>41</sup>

For the ICJ, then, it is clear that there are few restrictions on the meaning of the term “measure”. This understanding is reflected in the very words of NAFTA Article 201(1).

71. The breadth to be accorded the term “measure” in NAFTA Article 201(1) was confirmed in the NAFTA context by the Tribunal in *Ethyl*. That Tribunal stated as follows:

In addressing what constitutes a measure, the Tribunal notes that Canada’s Statement on Implementation of the North American Free Trade Agreement... (at 80) states that: “The term measure is a non-exhaustive definition of the ways in which governments impose discipline in their respective jurisdictions.”... This is borne out by Article 201(1)...Clearly, something other than a “law”, even something in the nature of a “practice”, which may not even amount to a legal stricture may qualify.<sup>42</sup>

72. Beyond the express wording of Article 201(1), the objectives of the NAFTA also indicate that it is meant to apply to a broad spectrum of measures. The objectives of the NAFTA are laid out in Article 102(1). These objectives include:

- eliminating barriers to trade in, and facilitating the cross-border movement of, goods and services between the territories of the Parties;
- promoting conditions of fair competition in the free trade area; and
- creating effective procedures for the implementation and application of the NAFTA, for its joint administration and for the resolution of disputes.

NAFTA Article 102(2) goes on to specify that these objectives are to be used to guide the interpretation and application of the various provisions of the NAFTA, including Articles 201(1) and 1116(2).

73. Using the NAFTA’s objectives to guide the meaning of Article 201(1) suggests that the term “measure” should be interpreted broadly. Any other approach would defeat the

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<sup>41</sup> *Fisheries Jurisdiction* at para. 66, Investor’s Book of Authorities (Tab 129).

<sup>42</sup> *Ethyl Corp v. Canada* (Jurisdiction Award) at para. 66, Respondent’s Book of Authorities (Tab 45).

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purpose and object of the NAFTA by allowing “loop-holes” through which those forms of governmental conduct not expressly laid out in Article 201(1) but that otherwise still violate the substantive obligations the NAFTA would fall through. The result would be that various forms of governmental action that are inconsistent with the NAFTA would be immune from challenge, simply because it was not expressly captured by Article 201(1). This would not only be inconsistent with the plain wording of Article 201(1), but also with the fundamental objectives of the NAFTA.

74. The overall context of the NAFTA provides further support for a broad interpretation of the term “measure”. As the Tribunal in *Loewen* noted:

The text, context and purpose of Chapter Eleven combine to support a liberal rather than a restricted interpretation of the words “measures adopted or maintained by a Party”, that is, an interpretation which provides protection and security for the foreign investor and its investment.<sup>43</sup>

75. The context provided by the various provisions of the NAFTA demonstrate that a measure need not be singular and distinct in-and-of-itself; rather one measure can relate to and derive from another measure. For example, in laying out the scope and coverage of the NAFTA’s Chapter 9 on standards related measures, Article 901(1) states:

This Chapter applies to standards related measures of a Party...that may, directly or indirectly, affect trade in goods or services between the Parties, *and to measures of the Parties relating to such measures*.<sup>44</sup>

We can see that the drafters intended the NAFTA to cover not only governmental measures *per se*, but also to cover measures relating to those measures.

76. That one measure may derive from another measure is also evidenced throughout Annex 301.3 to the NAFTA. Annex 301.3 lays out the various exceptions to NAFTA’s obligations relating to trade in goods set out in Articles 301-309. Section A of Annex 301.3 lists the exceptions with respect to Canadian measures. Paragraph 4 of this Section provides as follows:

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<sup>43</sup> *Loewen*, Award on Jurisdiction at para. 53, Respondent’s Book of Authorities (Tab 75).

<sup>44</sup> NAFTA Article 901(1). [emphasis added]

Articles 310 and 309 shall not apply to quantitative import restrictions on goods...for as long as the measures taken under the *Merchant Marine Act* of 1920... and the *Merchant Marine Act* of 1936...apply.

From this section, it is clear that one measure may not only relate to, but also derive from another measure. Since it is legislation, there can be no dispute that the *Merchant Marine Act* is a “measure” within the scope of Article 201(1). And since this paragraph expressly addresses “measures taken under the *Merchant Marine Act*”, it is clear that one measure may derive from another, yet still be a distinct measure in-and-of-itself.

77. Annex 1010.1 of the NAFTA together with a whole array of other Annex provisions<sup>45</sup> clarifies that not only may one measure derive from another, but that the subsidiary measure can be a judicial decision, or even an administrative ruling or procedure. Section B of NAFTA Annex 1010.1 lays out the various publications for what it refers to as “Measures in Accordance with Article 1019 (Provision of Information)”. Paragraph 2 of this section lists the publications for “precedential judicial decisions”. This makes clear that judicial decisions are considered to be “measures”. Similarly, paragraph 3 lists the publications for “administrative rulings and procedures”. This makes plain the fact that such rulings and procedures also constitute “measures”.<sup>46</sup> Since judicial decisions, as well as administrative rulings and procedures are all made pursuant to either statute or regulation, it is clear from Annex 1010.1 that the drafters intended the NAFTA to apply to a wide variety of “measures”, many of which may relate to and derive from other “measures”.
78. The understanding that particular administrative applications of a regulatory regime can and do constitute “measures” for the purposes of Article 201(1) is further supported by the *International Law Commission’s Articles on State Responsibility* (“ILC Articles”). Article 1 of the ILC Articles states:

*Every internationally wrongful act of a State entails the international responsibility of that State.*<sup>47</sup>

<sup>45</sup> See NAFTA Annex 301.3, Section A, para. 4; Annex 301.3, Section B, para. 2(a); Annex I and Annex V.

<sup>46</sup> *S.D. Myers v. Canada*, First Partial Award, 40 ILM 1408 at para. 322, Investor’s Book of Authorities (Tab 39).

<sup>47</sup> *ILC Articles*, Art. 1 [emphasis added], Investor’s Book of Authorities (Tab 130).

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As Article 1 makes clear, it is not just *some* wrongful acts that give rise to State responsibility as Canada would have it but rather *every* wrongful act. This includes not only the legislative and policy framework of the Log Export Control Regime, but also *every* administrative application of that framework to Merrill & Ring.

79. Article 2 of the ILC Articles lends further support to this view:

There is an internationally wrongful act of a State when *conduct* consisting of an action or omission:

- (a) is attributable to the State under international law; and
- (b) constitutes a breach of an international obligation of the State.<sup>48</sup>

That international responsibility flows from State “conduct” implies that such responsibility does not just stem from the existence of a regulatory regime, but also from the application of that regime in concrete circumstances.

80. While Articles 1 and 2 strongly suggest that the measures at issue in this dispute need not be confined to the legislative and policy framework of the Log Export Control Regime itself, and do in fact include administrative applications of that Regime in particular circumstances, Article 12 provides definitive support:

There is a breach of an international obligation by a State when an act of that State is not in conformity with what is required of it by that obligation, *regardless of its origin or character*.<sup>49</sup>

From this, it is clear that for the purposes of this international dispute, and consistent with the broad definition of “measure” in NAFTA Article 201(1), individual administrative actions taken pursuant to the Log Export Control Regime do constitute “measures” in-and-of-themselves.

81. All the foregoing provides cogent support for the notion that the general presumption at play here is exactly the reverse of what Mr. Reisman proposes; measures that nullify and

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<sup>48</sup> *ILC Articles*, Art. 2 [emphasis added], Investor’s Book of Authorities (Tab 130).

<sup>49</sup> *ILC Articles*, Art. 12 [emphasis added], Investor’s Book of Authorities (Tab 130).

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impair benefits under a treaty are not only comprised of laws and policies *per se*, but also the individual application of those laws and policies in particular circumstances.<sup>50</sup> And while it is true that this approach is consistent with international law generally, it is important to remember that, at a fundamental level, it is supported by a plain and commonsense understanding of the measures expressly contemplated by NAFTA Article 201(1). On its face, NAFTA Article 201(1) recognizes both “laws” and “regulations” as measures. It is irrefutable that a regulation (which is one type of measure) may derive from a law (which is another type of measure). It is also clear that both a law and a regulation are measures that may run afoul of the NAFTA in-and-of-themselves. The validity of the one does not necessarily imply the validity of the other. Just because a “law” may be in conformity with the NAFTA does not mean that a regulation or administrative decision taken pursuant to that law is also in conformity with the NAFTA. Each are distinct measures that need to be taken on their own terms.

82. Nowhere is this more important than in dealing with the temporal limitations of NAFTA Article 1116(2). While one measure may be seen to run afoul of the three year time-bar, another measure may not. Thus, in considering this matter it is important to be very clear about exactly what the various measures in dispute actually are.

*b. There are Both Continuing and Non-Continuing Measures at Issue in this Dispute*

83. Merrill & Ring has clearly asserted that there are two general types of measures at issue in this dispute: (i) continuing measures; and (ii) non-continuing measures. There are several measures within each category. In the following sections, we shall thresh out exactly what measures fit within each category.

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<sup>50</sup> Prof. Robert Howse considers this same issue and comes to a same conclusion as the Investor. See the Expert Legal Opinion of Robert Howse at paras. 14–20.

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i. There are Several Continuing Measures in Dispute

84. As Merrill & Ring has pointed out, continuing measures are well recognized under international law.<sup>51</sup> This is recognized by Article 14(2) of the ILC Articles:

The breach of an international obligation by an act of a State having a continuing character extends over the entire period during which the act continues and remains not in conformity with the international obligation.<sup>52</sup>

85. Despite this general principle, States may draft treaties in such a way as to avoid liability for regulatory regimes that predate the entry into force of a treaty that would otherwise violate the terms of those treaties. For example, some treaties contain provisions that “grandfather” some or all statutory and/or regulatory schemes in existence at the time the treaty enters into force.<sup>53</sup> Other treaties contain reservations that allow the Parties to maintain pre-existing regulatory regimes that would otherwise violate the terms of those treaties. The effect of such provisions is that the treaty Parties can continue to apply the schemes in question even if doing so would otherwise violate the provisions of a treaty.

86. The drafters of the NAFTA were well aware of techniques such as these. Thus, if they wanted to limit state responsibility for post-NAFTA conduct flowing from pre-NAFTA regulatory regimes, they knew how to do so expressly. And indeed, they chose to do so expressly in the Parties’ respective Schedules to Annex I of the NAFTA. This provides conclusive evidence that the drafters did not intend to nullify the principle of continuing breach in its entirety in the context of the NAFTA, but rather chose to manage that principle in particular contexts through the use of reservations.<sup>54</sup>

87. That the drafters of the NAFTA intended for it to apply to continuing measures is also evident in specific provisions of the NAFTA itself. In particular, NAFTA Article 1101

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<sup>51</sup> Investor’s Memorial at paras. 455-462. See also the Expert Legal Opinion of Robert Howse at para. 28.

<sup>52</sup> *ILC Articles*, Art. 14(2), Investor’s Book of Authorities (Tab 130).

<sup>53</sup> See Expert Legal Opinion of Robert Howse at paras. 29-32.

<sup>54</sup> Prof. Howse has given consideration to this issue and has come to similar conclusions. See the Expert Legal Opinion of Robert Howse at paras. 33-36.



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specifies that Chapter 11 applies to measures that are “maintained” by a Party. These are measures that a Party initiates at one point in time, and maintains over a longer period of time. Continuing measures relate to the existence of certain laws, regulations, procedures, requirements and practices *per se*. In the context of the present dispute, continuing measures are those that were brought into existence before December 27, 2003, but that Canada maintained beyond that date.

88. Despite all evidence to the contrary, Canada denies that the law of continuing breach applies in the NAFTA context, arguing that Article 1116(2) is *lex specialis* that wholly displaces this general legal principle.<sup>55</sup> This stands in stark contrast to Canada’s admission that the NAFTA “authorises investors to make Chapter Eleven claims based on continuing measures.”<sup>56</sup> As we have seen, it is also at odds with the plain wording of NAFTA Article 1101 which recognizes measures that are “maintained” by a Party as well as with the treaty drafting practices of the NAFTA Parties themselves.
89. The measures at issue in this dispute that are of a continuing nature can be broken down into three categories:
- i) those taken exclusively by the federal government;
  - ii) those taken exclusively by the BC provincial government; and
  - iii) those taken jointly by the federal and provincial governments.
90. The continuing measures at issue in this dispute that have been and continue to be taken exclusively by the federal government all relate to *Notice 102*. *Notice 102* came into effect on April 1, 1998. *Notice 102* has been in continuous effect ever since that date, and continues to apply today.
91. While *Notice 102* is itself a continuing measure, so too are the various requirements associated with its administration. These requirements include the following:

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<sup>55</sup> Reisman’s Affidavit, April 22, 2008 at para. 38.

<sup>56</sup> Canada’s Counter Memorial at para. 161.

- the requirement to advertise federal logs in accordance with the “remoteness” rule;<sup>57</sup>
- the requirement to subject federal logs to the Federal Surplus Testing Procedure and sell those logs on the BC market;<sup>58</sup>
- the requirement to cut and sort federal logs according to so-called “normal market practices”, such as the *Coast Domestic Market End Use Sort Descriptions*;<sup>59</sup> and
- the requirement to scale federal logs according to the metric system.<sup>60</sup>

Like *Notice 102* itself, each of these requirements has been in continuous effect since April 1, 1998.

92. The continuing measures at issue in this dispute that have been and continue to be taken exclusively by the BC government all relate to the *BC Export Procedures*. *BC Export Procedures* came into effect in July 1999. This policy has been in continuous effect ever since that date, and continues to apply today.
93. Like *Notice 102*, while the *BC Export Procedures* is itself a continuing measure, so too are the various requirements it embodies. These requirements include the following:
- the requirement to subject provincial logs to the Provincial Surplus Testing Procedure and sell those logs on the BC market;<sup>61</sup>

<sup>57</sup> *Notice 102*, s. 1.4, Investor’s Schedule of Documents (Tab 22).

<sup>58</sup> *Notice 102*, s. 2.0, Investor’s Schedule of Documents (Tab 22).

<sup>59</sup> *Notice 102*, s. 1.5, Investor’s Schedule of Documents (Tab 22).

<sup>60</sup> *Notice 102*, s. 1.6, Investor’s Schedule of Documents (Tab 22).

<sup>61</sup> *BC Export Procedures*, s. 3.7, Investor’s Schedule of Documents (Tab 31).

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- the requirement to cut and sort provincial logs according to so-called “normal market practices”, such as the *Coast Domestic Market End Use Sort Descriptions*;<sup>62</sup>
  - the requirement to scale provincial logs according to the metric system;<sup>63</sup> and
  - the requirement to pay a fee-in-lieu-of-manufacture for provincial logs upon export.<sup>64</sup>

94. Finally, the continuing measures at issue in this dispute that have been and continue to be taken jointly by the federal and BC governments relate only to the issue of standing timber. There are three measures that fall within this category:

- the measures allowing standing applications only for timber in the BC Interior, and not for timber on the BC Coast;
- the measures allowing standing exemptions only for provincial lands, and not for federal lands; and
- the measures allowing standing exemptions for provincial lands only outside the South-Coastal region of BC.

All three of these decisions/policies were made prior to December 27, 2003, have applied continuously ever since, and continue to apply today.

ii. There are Several Non-Continuing Measures in Dispute

95. In contrast to continuing measures, non-continuing measures are contemplated by NAFTA Article 1101 as measures that are “adopted”, and not those measures that are

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<sup>62</sup> *BC Export Procedures*, s. 3.14, Investor’s Schedule of Documents (Tab 31).

<sup>63</sup> *BC Export Procedures*, s. 3.13, Investor’s Schedule of Documents (Tab 31).

<sup>64</sup> *BC Export Procedures*, s. 5.3, Investor’s Schedule of Documents (Tab 31).

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“maintained”. They are measures that are adopted at a discrete point in time. Unlike the continuing measures at issue in this claim, the non-continuing measures do not arise from the very existence of a law, regulation, procedure, requirement or practice *per se*; rather, they arise from the specific application of such a law, regulation, procedure, requirement or practice to a foreign investor. Non-continuing measures are not applied over a period of time. They are adopted once, and only once. In the context of the present claim, non-continuing measures are the particular application of the rules of the Log Export Control Regime to Merrill & Ring at particular points in time between December 27, 2003 and December 27, 2006.

96. Canada denies that Merrill & Ring may bring a claim with respect to non-continuing measures in this case. Canada’s argument is summarized as follows:

Where the measure alleged to have caused the breach is a long-standing and routinely applied regulatory regime and the investor had or should have had knowledge of both the regime and the economic costs of its routine application from prior applications, that investor may not evade the three year limitation and challenge the lawfulness under NAFTA of the regulatory regime by claiming that the “measure” is actualized or materialized in each recurring, routine and proper *application* of that regulatory regime.<sup>65</sup>

This position is wholly unsupported and amounts to a novel proposition of law. This position flies in the face of the broad definition of “measure” in NAFTA Article 201(1), particularly in the context of the objects and purposes of the NAFTA. It also stands in stark contrast to general principles of international law, as enshrined by Articles 1, 2 and 12 of the *ILC Articles*.

97. Just as with the continuing measures, the non-continuing measures at issue in this dispute may also be split up into three categories:
- i) those taken exclusively by the federal government;
  - ii) those taken exclusively by the BC provincial government; and

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<sup>65</sup> Reisman Legal Opinion, April 22, 2008 at para. 3 A (iv).

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iii) those taken jointly by the federal and provincial governments.

98. Just as with the continuing measures, the non-continuing measures in this dispute taken exclusively by the federal government all relate to *Notice 102*. However, while on the one hand the continuing measures are the policies and requirements of *Notice 102*, on the other hand, the non-continuing measures are the distinct applications of those policies and requirements to Merrill & Ring between December 27, 2003 and December 27, 2006. Thus, the federal non-continuing measures at issue in this dispute are as follows:

- each time between December 27, 2003, and December 27, 2006, that Merrill & Ring was required to advertise its logs in conformity with the so-called “remoteness rule”, or otherwise circumvent that rule;
- each time between December 27, 2003, and December 27, 2006, that Merrill & Ring was required to subject its federal logs to the Federal Surplus Testing Procedure and sell those logs on the BC market;
- each time between December 27, 2003, and December 27, 2006, that Merrill & Ring was required to cut and sort its federal logs according to so-called “normal market practices”; and
- each time between December 27, 2003, and December 27, 2006, that Merrill & Ring was required to scale its federal logs according to the metric system.

99. Similarly, just as with the continuing measures, the non-continuing measures in this dispute taken exclusively by the provincial government all relate to the *BC Export Procedures*. The difference between the continuing and non-continuing provincial measures is the same as the difference between the continuing and non-continuing federal measures. Thus, the non-continuing provincial measures are as follows:

- each time between December 27, 2003, and December 27, 2006, that Merrill & Ring was required to submit its provincial logs to the Provincial Surplus Testing Procedure;

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- each time between December 27, 2003, and December 27, 2006, that Merrill & Ring was required to cut and sort its provincial logs according to so-called “normal market practices”, such as the *Coast Domestic Market End Use Sort Descriptions*;
  - each time between December 27, 2003, and December 27, 2006, that Merrill & Ring was required to scale its provincial logs according to the metric system; and
  - each time between December 27, 2003, and December 27, 2006, that Merrill & Ring was required to pay a fee-in-lieu-of-manufacture for provincial logs upon export.

100. Finally, just as with the continuing measures, the non-continuing measures at issue that were taken jointly by the federal and provincial governments all relate to the issue of standing timber. Again, the same distinction between continuing and non-continuing measures applies. Thus, the non-continuing measures taken jointly by the federal and provincial governments include the following:

- each time between December 27, 2003, and December 27, 2006, that Merrill & Ring was not allowed to advertise its logs under a standing application (i.e. each time Merrill & Ring was required to advertise logs as opposed to standing timber on either the Federal or Provincial Bi-Weekly Lists);
- each time between December 27, 2003, and December 27, 2006, that Merrill & Ring was disallowed from exporting its federal logs under a standing exemption due to the policy of not allowing standing exemptions for federal lands (i.e. each time Merrill & Ring was required to sell its federal logs domestically); and
- each time between December 27, 2003, and December 27, 2006, that Merrill & Ring was disallowed from exporting its provincial logs under a standing exemption due to the policy of not allowing standing exemptions for any lands on the BC South-Coast.

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iii. Continuing and Non-Continuing Measures May be Based on the Same Factual Background

101. Contrary to what Canada asserts, there is nothing contradictory about a measure having both a continuing and non-continuing inflection to it.<sup>66</sup>
102. For example, the Surplus Testing Procedure for federal logs was enshrined into *Notice 102* on April 1, 1998. Since it is a “procedure”, it clearly qualifies as a “measure” under NAFTA Article 201(1). The Surplus Testing Procedure has been in effect on a continuous basis ever since *Notice 102* was implemented. This measure has been continuously applied to Merrill & Ring every time it has sought to export its logs since that time.
103. The Surplus Testing Procedure has a double aspect: one that is of a continuing nature the other that is of a non-continuing nature. On the one hand, the continuing nature of the Surplus Testing Procedure stems from its existence *per se*. On the other hand, the non-continuing nature of the Surplus Testing Procedure derives from its discrete application to Merrill & Ring in particular, and concrete circumstances.
104. The very existence of the Surplus Testing Procedure has a serious impact on the log production industry as a whole. By forcing aspiring log exporters to first offer up their logs on the domestic market, this measure suppresses the domestic market price of logs. This occurs since domestic supply is increased (because it stems the flow of logs overseas), while domestic demand remains unaffected. Basic economics tells us that the result is a decrease in the domestic price of logs. This artificially suppressed domestic market price sets the price at which all log producers sell when they offer their logs on the domestic market. Every time Merrill & Ring is forced to enter in a “blockmail” deal, or is otherwise forced to sell its logs on the domestic market, it is the continuous application of this measure that results in Merrill & Ring having to sell at the suppressed market price. As a result, Merrill & Ring continuously incurs damage from the continuing existence of this measure.

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<sup>66</sup> Canada’s Counter Memorial at para. 234.

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105. By contrast, the non-continuous nature of the Surplus Testing Procedure stems from its specific application to Merrill & Ring. This occurs each time Merrill & Ring actively applies to export its logs. Each and every time it wants to export, it is required to submit its logs to the Surplus Testing Procedure. As a result, each application of the Surplus Testing Procedure to Merrill & Ring constitutes a “requirement” under NAFTA Article 201(1). Each and every time Canada requires Merrill & Ring to submit its logs to this procedure, it applies a measure to Merrill & Ring. Merrill & Ring incurs damage each and every time such a measure is applied to it.

*c. Merrill & Ring’s Claim is Not Time-Barred by NAFTA Article 1116(2)*

106. NAFTA Article 1116(2) places a limitation period on claims brought forth under NAFTA Chapter 11. It states:

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

107. There are two prerequisite conditions for the timing to commence on the three year limitation period in NAFTA Article 1116(2). First, the investor must have acquired actual or constructive knowledge of the breach at issue. Second, the investor must have acquired knowledge that it has incurred loss or damage as a result of that breach. It is only the point in time when the investor has acquired knowledge in both of these respects that the limitation period begins to run.

108. According to Canada, the plain wording of NAFTA Article 1116(2) indicates that under no circumstance may an investor bring forth a claim three years after first acquiring actual or constructive knowledge of both the alleged breach, and loss flowing from that breach.<sup>67</sup> To support its argument, Canada places great weight on the word “first” as it appears in Article 1116(2).<sup>68</sup>

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<sup>67</sup> Canada’s Counter Memorial at para. 5.

<sup>68</sup> Canada’s Counter Memorial at paras. 149-151.



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109. Canada also relies heavily on the decision of the Tribunal in *Grand River*.<sup>69</sup> While timing was a key issue before the *Grand River* Tribunal, that Tribunal's decision was based on facts and arguments that are significantly different than those at issue in the present case. Accordingly, the decision in *Grand River* is of only limited pervasive value for the issues raised in the present arbitration.<sup>70</sup>
110. *Grand River* was a case in which a Canadian company that together in association with various First Nations groups manufactured and traded in cigarettes in the US. The basic measure in *Grand River* was a 1998 agreement entered into between various US states and cigarette manufacturers to settle a Tobacco litigation dispute. This agreement required the signatory companies to pay into a central account a certain amount of money for each cigarette sold, the sum of which would be divided between the participating US states.<sup>71</sup> The claimants were not a party to the agreement.<sup>72</sup> The agreement further stipulated that participating US states would adopt escrow legislation that would require non-participating companies to pay an amount roughly equal to what they would have had to pay if they were parties to the agreement.<sup>73</sup> All of the participating US states adopted this escrow legislation in 1999 and 2000.<sup>74</sup> Thereafter, in 2001 and 2002 participating states enacted complementary legislation to strengthen enforcement of the escrow laws,<sup>75</sup> which were then amended in 2003 and 2004.<sup>76</sup> These all constituted subsequent measures taken pursuant to the original agreement and the escrow laws. The claimants brought

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<sup>69</sup> Canada's Counter Memorial at paras. 224-233.

<sup>70</sup> See also the Expert Legal Opinion of Robert Howse at paras. 38-40.

<sup>71</sup> *Grand River*, Jurisdiction Decision at para. 8, Respondent's Book of Authorities (Tab 57).

<sup>72</sup> *Grand River*, Jurisdiction Decision at para. 10, Respondent's Book of Authorities (Tab 57).

<sup>73</sup> *Grand River*, Jurisdiction Decision at para. 12, Respondent's Book of Authorities (Tab 57).

<sup>74</sup> *Grand River*, Jurisdiction Decision at para. 12, Respondent's Book of Authorities (Tab 57).

<sup>75</sup> *Grand River*, Jurisdiction Decision at para. 15, Respondent's Book of Authorities (Tab 57).

<sup>76</sup> *Grand River*, Jurisdiction Decision at para. 16, Respondent's Book of Authorities (Tab 57).

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forth their claim under NAFTA Chapter 11 in March 2004, some six years after the original agreement, and some four to five years after the escrow laws.<sup>77</sup>

111. As Canada rightly points out, the Tribunal in *Grand River* ruled that the claimant was time-barred from seeking recourse to a number of the measures in dispute.<sup>78</sup> What Canada neglects to mention, however, is that the *Grand River* Tribunal did not strike out those measures that were taken within three years of the initiation of the claim, even though those measures were inextricably linked to the previous measures the Tribunal did strike out.<sup>79</sup>
112. Canada also underemphasizes the importance of the quantifiability of the loss suffered by the investor in *Grand River*. In deciding that the investor's challenge to the escrow statutes was time-barred, the Tribunal had the following to say:

The Tribunal believes that becoming subject to a clear and precisely quantified statutory obligation to place funds in an unreachable escrow for 25 years...is to incur loss or damage as those terms are ordinarily understood.<sup>80</sup>

While the investor in *Grand River* may not have been able to quantify in exact terms what the extent of its loss would be at the time the escrow statutes were passed, it was as the Tribunal put it subject to a "clear and precisely quantified statutory obligation". This stands in stark contrast to the facts of the present dispute. There was nothing clear and precise about the losses Merrill & Ring would suffer at the time the *Notice 102* and the *BC Export Procedures* were adopted. Such losses could only be quantified with any degree of predictability or precision at the time these measures were applied to Merrill & Ring in specific instances.

113. Yet perhaps the most crucial distinction between *Grand River* and the present claim has to do with the particular measures at issue in each case. Specifically, all the measures

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<sup>77</sup> *Grand River*, Jurisdiction Decision at paras. 1 & 4, Respondent's Book of Authorities (Tab 57).

<sup>78</sup> *Grand River*, Jurisdiction Decision at para. 83, Respondent's Book of Authorities (Tab 57).

<sup>79</sup> *Grand River*, Jurisdiction Decision at para. 87, Respondent's Book of Authorities (Tab 57).

<sup>80</sup> *Grand River*, Jurisdiction Decision at para. 82, Respondent's Book of Authorities (Tab 57).

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impugned by the investor in *Grand River* were the various statutes and laws themselves.<sup>81</sup> Unlike Merrill & Ring, the investor in that case made no attempt to challenge the specific application of those statutes and laws to it in particular circumstances as separate measures in-and-of-themselves. That is, unlike the present case, none of the measures at issue in *Grand River* involved administrative decisions or procedures taken pursuant to laws and regulations; rather, the only measures at issue were the laws and regulations themselves. As a result, Canada's assertion that *Grand River* fully answers Merrill & Ring's claim about non-continuing measures is patently false.<sup>82</sup>

114. In contrast to its heavy reliance on *Grand River*, Canada seeks to have this Tribunal turn a blind-eye to the recent finding by the *UPS* Tribunal that recognizes that Article 1116(2) does not place an absolute limit on claims in the way Canada suggests. Given that the *UPS* Tribunal rendered its decision after *Grand River*, it obviously chose to disregard that case. As the Tribunal in *UPS* made abundantly clear, “continuing courses of conduct constitute continuing breaches of legal obligations and *renew* the limitation period accordingly.”<sup>83</sup>
115. In the context of NAFTA Article 1116(2), this Tribunal must pay attention to all the measures at issue in this dispute. It is important to keep in mind the basic distinction between the continuing and non-continuing measures at play.
116. There is no doubt that Merrill & Ring knew of each of the continuing measures before December 23, 2003. Merrill & Ring knew about *Notice 102* together with its various requirements back in 1998. Merrill & Ring also has known for a long time about the *BC Export Procedures* in 1999.
117. The issue with the continuing measures in this dispute is not when Merrill & Ring became aware of the measures themselves, but rather when it became aware of the loss flowing from these measures. The question here is: what type of knowledge of loss

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<sup>81</sup> *Grand River*, Jurisdiction Decision at paras. 89 & 90, Respondent's Book of Authorities (Tab 57).

<sup>82</sup> Canada's Counter Memorial at para. 229.

<sup>83</sup> *United Postal Service v. Canada*, Merits, June 11, 2007 at para. 28 [emphasis added], Investor's Book of Authorities (Tab 14).

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flowing from the continuing measures is Merrill & Ring required to have? Is it sufficient for the purposes of Article 1116(2) that Merrill & Ring knew that it incurred loss in some abstract sense? Or must Merrill & Ring instead have concrete knowledge of the actual loss it has incurred as a result? As the decision in *Grand River* suggests, Article 1116(2) must be interpreted to mean that Merrill & Ring must have concrete knowledge of actual loss, or at least be able to predict with some degree of certainty what its loss flowing from a continuous measure will be. Such was not the case.

118. NAFTA Article 1116(2) appears on its face only to require that Merrill & Ring have acquired knowledge of loss in an abstract sense. However, when viewed in light of the objects and purposes of the NAFTA as required by Article 31(1) of the *Vienna Convention* it becomes evident that concrete knowledge of actual loss *is* what is required. This is because one of the basic objectives of the NAFTA as set out in Article 102 is “to create effective procedures...for the resolution of disputes.” If it were true that the limitation period envisaged by Article 1116(2) could begin to run once a foreign investor had only an abstract sense that it was incurring loss from a certain measure, this would run counter to the objective of creating effective procedures for the resolution of disputes. Without actual knowledge of quantifiable loss, a foreign investor would not be able to specify the damages it seeks to recover in any given claim. Without being able to specify damages, any claim an investor might bring forth would be pointless. Accordingly, if the limitation period of NAFTA Article 1116(2) were to commence before the foreign investor had actual knowledge of the quantifiable loss, the dispute resolution provisions of Chapter 11 would be ineffective. This would not only run counter to the basic objectives of the NAFTA, but would indeed give rise to an absurd result.
119. It is precisely at this point where the concept of continuing breach dovetails with that of non-continuing breach. Merrill & Ring could not know of the loss it incurred from Canada’s continuing measures until those measures were actually applied to it in concrete situations. That is, the time-bar on continuing measures could not possibly start to run until those measures were applied to Merrill & Ring in particular circumstances. And since the application of continuing measures in particular circumstances constitute separate “non-continuing” measures in-and-of-themselves, the clocks on both continuing and non-continuing measures start to run at exactly the same time. It is here where continuing breaches and non-continuing breaches elide one into the other and become, for all practical intents and purposes, indistinguishable.

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120. Merrill & Ring has brought forth this claim within the limitation period envisaged by NAFTA Article 1116(2). Each application of the various rules and policies of the Log Export Control Regime (i.e. the “continuing” measures) to Merrill & Ring constitutes a separate “non-continuing” measure in-and-of-itself. For each non-continuing measure Merrill & Ring acquired instantaneous knowledge of both the breach itself, and the loss flowing from that breach. Thus, the clock on the three year limitation period for the non-continuing measures at issue in this dispute started as soon as the measures were taken. The only non-continuing measures Merrill & Ring impugns are those that were taken between December 27, 2003 and December 27, 2006. Since Merrill & Ring initiated this claim on December 27, 2006, there can be no dispute that all of the non-continuing measures at issue in this claim fall within the three year limitation period.

*d. Merrill & Ring’s Claim Represents a Balanced Approach to the Limitation Period Envisaged by Article 1116(2)*

121. Not only does Merrill & Ring’s interpretation of the limitation period envisaged by Article 1116(2) stay true to the wording of the provision in light of its objects and purpose, but it also makes practical sense. Indeed, this interpretation strikes a careful and appropriate balance between the rights and responsibilities of the NAFTA Parties, on the one hand, and, on the other, those of foreign investors.
122. Canada suggests that Merrill & Ring’s approach “would render NAFTA Article 1116(2) ineffective.”<sup>84</sup> Canada fears that sanctioning Merrill & Ring’s arguments would open up the floodgates to Chapter 11 claims based on measures that predated the NAFTA,<sup>85</sup> thereby creating legal uncertainty and instability for the NAFTA Parties.<sup>86</sup> Canada’s fears are not well-founded.
123. NAFTA Article 1116(2) represents an attempt to balance two sets of competing interests. On the one hand, it recognizes the interest of foreign investors to seek recourse to Chapter 11 arbitration for wrongs they have suffered at the hands of a NAFTA host state. On the

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<sup>84</sup> Canada’s Counter Memorial at para. 233.

<sup>85</sup> Canada’s Counter Memorial at para. 171.

<sup>86</sup> Canada’s Counter Memorial at para. 167.

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other hand, Article 1116(2) recognizes the interest of the NAFTA Parties not to be subject to potentially limitless claims by foreign investors for measures taken too far back in the past – particularly those taken prior to the entry into force of the NAFTA. Article 1116(2) strikes a balance between these competing interests by establishing a three year limitation period for foreign investors to bring forth their claims.

124. Merrill & Ring acknowledges that this balance does not allow a foreign investor to reach back in time more than three years from the time it first acquired, or should have acquired knowledge of the alleged breach, and first acquired knowledge that it had incurred damage as a result. Nothing in Merrill & Ring’s arguments suggest that a foreign investor could seek compensation for losses it suffered as a result of measures taken more than three years prior to initiating a claim, provided that it was also able to quantify the damage that flowed therefrom more than three years prior to that claim. Thus, nothing in Merrill & Ring’s argument would render NAFTA Article 1116(2) ineffective, or otherwise open up the floodgates to Chapter 11 claims and potentially limitless liability.
125. Indeed, Merrill & Ring’s approach fully acknowledges that NAFTA Article 1116(2) *does* provide boundaries to the potential liability faced by NAFTA Parties for their otherwise unlawful acts – namely, three years of damages. This is reflected on the very facts of this claim: Merrill & Ring is only seeking compensation for the damages it suffered between December 27, 2003 and December 27, 2006. In light of the limitations of Article 1116(2), Merrill & Ring is not seeking damages for the losses it suffered prior to December 27, 2003, even though it did indeed suffer such losses. Merrill & Ring advances an approach that appropriately recognizes the fundamental balance sought by NAFTA Article 1116(2).
126. By contrast, Canada argues for an asymmetrical approach to NAFTA Article 1116(2) that would absolve it of any and all liability for any future NAFTA violations it perpetrates against Merrill & Ring. According to Canada, if a foreign investor fails to bring forth a claim within three years – regardless of whether or not the investor was actually able to quantify the loss it suffered – a Party should be excused from liability for any and all actions taken pursuant to that measure *ad infinitum* into the future. For Canada, there can be no measures taken pursuant to other measures. For Canada, it makes no difference if it maintains a measure beyond the three year limitation period, and continues to inflict damage upon a foreign investor by adopting other distinct measures pursuant to the original and continuing measure. If a foreign investor does not bring forth its claim

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within three years of the original measure, it forever loses its right to seek recourse to Chapter 11 arbitration even for related measures taken at a later time. For Canada, once the three year window on the original measure closes, it is free to continue to violate its NAFTA obligations forever with impunity, irrespective of any further measures it may take pursuant to the original measure. There is no balancing of rights and interests in this vision of NAFTA Article 1116(2). Canada's approach cannot and does not represent the balance between state and investor rights sought by NAFTA Article 1116(2), nor is this view consistent with the objects and purposes of the NAFTA.

127. For all the foregoing reasons, Merrill & Ring has brought forth its claim in a timely manner that is not barred by NAFTA Article 1116(2). The Tribunal should assert its rightful jurisdiction and consider the merits of this claim accordingly.

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### III. ARTICLE 1102 - NATIONAL TREATMENT

#### 1. Overview

128. Through the Log Export Control Regime, there can also be no doubt that Canada has violated its obligation under NAFTA Article 1102 to accord Merrill & Ring "national treatment".<sup>87</sup>
129. The purpose of national treatment is to ensure that investors and the investments of investors from the United States or Mexico receive treatment equivalent to that provided to the most favorably treated Canadian investor or its investment. The purpose of the obligation is clear: it is to ensure that Canadian governments do not find ways to provide better treatment to locals than that provided to foreigners. Similarly, NAFTA Article 1103 provides a similar obligation to provide the best treatment provided to investors of a third state. Through NAFTA Article 1104, it is clear that the NAFTA's intent is to provide the investments of an investor from another NAFTA party with the best treatment provided in like circumstances in the jurisdiction.
130. The principle of national treatment is well-known in international law. It is so well-known that this obligation appears in six NAFTA chapters and it is one of three interpretative principles and rules of the NAFTA pursuant to NAFTA Article 102(2).
131. In its Counter-Memorial Canada has advanced a highly artificial construction of national treatment. Canada's construction is obviously designed to assist its defense of this case, but Canada's theory is inconsistent with the fundamental principles which underscore the meaning of national treatment. Furthermore, Canada's approach is inconsistent with the obvious context, meaning and objectives of the treaty. By comparison, the Investor sets out a detailed definition of the national treatment obligation that is based on careful examination of the negotiation history of the NAFTA, the NAFTA's text, principles, rules and objectives and upon the decisions of other international economical law tribunals.

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<sup>87</sup> The Investor continues to rely on the arguments made in the Investor's Memorial, February 13, 2008 at paras. 359-362.



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132. The evidence produced by the Investor demonstrates that Merrill & Ring is in “like circumstances” with log producers who export logs from other parts of Canada and from other parts of the province of British Columbia. In addition, Merrill & Ring is also in “like circumstances” with other log producers who export logs, including those located on the coast of British Columbia. As a result, this Tribunal must take into account situations where more favourable treatment has been provided to log producers who are in “like circumstances” with Merrill & Ring.
133. Log producers in other parts of Canada are not subjected to the onerous and confiscatory requirements of the Log Export Control Regime as practiced in British Columbia by Canada. There are obviously treated more favourably. Moreover, other log producers who operate in the province of British Columbia are treated more favourably. This more favourable treatment occurs with respect to mandatory regulations which are imposed on log producers like Merrill & Ring.
134. Of particular note is the issue of the provision of standing export exemptions for log producers, which are known as standing green exemptions. These standing green exemptions, and their associated standing applications, give a tremendous advantage in treatment to those granted the ability to only harvest their trees once they know they are able to obtain export approval. Standing exemptions are of enormous value to log producers, since they represent an automatic bypassing of the log control regime which enables the guaranteed export of uncut logs. There are several reasons for this:
- a) Log producers with standing exemptions know ahead of time that they will be able to export their logs, they can enter into predictable supply contracts with their customers;
  - b) Standing exemptions allow logs to bypass the Surplus Testing Procedure, log producers that have them are immune from the ever-present threats of “blockmail” and special targeting;
  - c) Standing exemptions allow logs to bypass the Surplus Testing Procedure, exempted logs will not deteriorate from infestation and exposure to the elements as they wait for export approval; and

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- d) Standing exemptions represent a guarantee to log producers that they will be able to export their logs, they know they will be able to receive the best market price for their logs, not the artificially suppressed BC market price.

As a result, there can be no doubt that log producers that obtain standing exemptions are granted more favorable treatment than those who cannot obtain them.

- 135. Much of the damage caused to companies like Merrill & Ring occurs from the lack of predictability and customization to customer preferences that is lost by Canada's mandatory requirement with respect to how logs are produced in order to obtain an export permit. These requirements are a disguised form market subsidization to log processors located in the province of British Columbia. These are all policy objectives which fly in the face of the free trade objectives of the NAFTA.
- 136. This is a very straightforward matter. Canada forbids Merrill & Ring from obtaining standing exemptions for its lands. At the same time, Canada grants standing exemptions to Merrill & Ring's competitors. As a result, there can be no doubt that by denying Merrill & Ring even the possibility of obtaining standing exemptions, Canada accords Merrill & Ring "less favorable treatment" for the purposes of Article 1102.
- 137. In particular, Canada's fails to meet its NAFTA obligations to provide national treatment to Merrill & Ring because it fails to provide most favourable treatment under the Log Export Control Regime with respect to:
  - a) The requirement to be subjected to the surplus testing prior to being granted an exemption to export their timber;
  - b) Merrill & Ring's ineligibility to obtain standing applications and/or obtain standing exemptions;
  - c) The requirement to cut and sort timber from their federally regulated properties to artificial "normal market practices";
  - d) The requirement to follow the additional rules for Merrill & Ring properties located in the remote Coastal region; and

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- e) The requirement to scale all timber rafts metrically even when such scaling is unnecessary.

## 2. GATT/WTO Experience is Important in Interpreting Article 1102

138. National treatment is one of three interpretative principles informing the meaning of the entire NAFTA.<sup>88</sup> National treatment is a fundamental principle supporting the NAFTA, which is used to fulfill its objective to liberalize trade and investment. In addition to its use in NAFTA Article 1102, several other NAFTA provisions oblige the Parties to accord national treatment.<sup>89</sup>
139. While appearing several times throughout the NAFTA, the term “national treatment” is not further defined. It is a term of art. Although the obligation originated over a century ago, the main influences on NAFTA Article 1102 are equivalent provisions in the WTO's GATT and GATS.<sup>90</sup> The relationship between the NAFTA and the GATT is expressed in the preamble of the NAFTA, in which the NAFTA Parties recognized that the NAFTA is built on “their respective rights and obligations under the General Agreement on Tariffs and Trade.”<sup>91</sup> Prof. Robert Howse has described the inter-connection of sources of international economic law through the term "systemic integration". His points are particularly important for an international agreement such as the NAFTA whose text and context specifically point to other international agreements and meanings from international law to give effect to the NAFTA's own obligations.<sup>92</sup>

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<sup>88</sup> NAFTA Article 102(1).

<sup>89</sup> For example, there are national treatment obligations for goods (Article 301), for energy (Article 602), for services (Article 1202) and for financial services (Article 1405).

<sup>90</sup> The interpretive principle of Most Favoured Nation Treatment contained in NAFTA Article 102 would also strongly support a relationship between these agreements and NAFTA. So does Article 103 which specifically addresses that relationship. This is further canvassed in the Legal Opinion of Prof. Robert Howse at paras. 9-10.

<sup>91</sup> Investor's Memorial at para. 276. The preamble forms an integral part of the NAFTA and it must be given meaning in the interpretation of the NAFTA pursuant to NAFTA Article 102 and the *Vienna Convention*.

<sup>92</sup> The full argument on systemic integration is set out in the Expert Legal Opinion of Robert Howse at paras. 7-11.

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140. The NAFTA and WTO national treatment provisions are virtually identical. GATT Article III:4 states:

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

Similarly, Article XII of the GATS says:

... each Member shall accord to services and service suppliers of any other Member, in respect of all measures affecting the supply of services, treatment no less favorable than it accords to its own like services and service suppliers...

Both articles contain similar elements to those contained in NAFTA Article 1102.<sup>93</sup> The requirement of “no less favorable” treatment is the same. Both articles limit the measures in which they apply, albeit in different ways. Finally, NAFTA Article 1102 applies to investors and investments in “like circumstances,” whereas the GATT and GATS articles apply respectively to “like products” and “like services”.<sup>94</sup>

141. NAFTA Article 1102’s application to all investors and investments in like circumstances means that it is a broader obligation than the GATT and GATS articles. In recognizing this broader application, the UNCTAD has said:

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

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<sup>93</sup> Indeed, the *Pope & Talbot* Tribunal described Article 12 of the GATS as “identical” to NAFTA Article 1102(2): *Pope & Talbot*, Award on the Merits of Phase 2, 10 April 2001 at para. 52, Investor’s Book of Authorities (Tab 42).

<sup>94</sup> These GATT and GATS obligations are subject to WTO public policy exceptions which permit public policy exceptions for certain specified reasons if such measures are the least trade restrictive possible and do not constitute an arbitrary means of discrimination (for example, see GATT Article XX), Investor’s Book of Authorities (Tab 61).

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wider categories of economic transactions may be subjected to national treatment disciplines under investment agreements than under trade agreements.<sup>95</sup>

142. NAFTA Article 1102 also fulfills a similar purpose to its equivalent GATT and GATS articles. The GATT *US - Petroleum* Panel recognized that the purpose of Article III is to protect expectations of equality and of competitive opportunity. The Panel said the purpose of the Article is:

to protect expectations of the contracting parties as to the competitive relationship between their products and those of the other contracting parties[,] ... to protect current trade [and] to create the predictability needed to plan future trade.<sup>96</sup>

143. Canada disdains any relevance of the GATT and WTO practice to give meaning to the NAFTA.<sup>97</sup> Canada cites the *Methanex* Tribunal in support of its proposition. Canada misinterprets the *Methanex* Tribunal's position. That Tribunal did not say that the treaty text and jurisprudence of the GATT could not be used to understand the purpose and structure of NAFTA Chapter 11 in general, and Article 1102 in particular. Instead, what the *Methanex* Tribunal suggested was for the purposes of determining the universe of "investments in like circumstances" in the course of interpreting Article 1102, a tribunal should not simply *substitute* the test under GATT national treatment jurisprudence of whether there are directly competitive and substitutable *products*. Such a wholesale substitution would indeed be inappropriate, since Article 1102 also applies to investors and investments that produce *services* not just products.
144. Canada further cites the *Occidental* Tribunal to support its fanciful notion that GATT and WTO jurisprudence is somehow of limited assistance in interpreting the national treatment provisions of investment treaties.<sup>98</sup> The *Occidental* Tribunal said nothing to

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<sup>95</sup> United Nations Conference on Trade and Development, *National Treatment* (New York: United Nations, 1999) at 9 [Emphasis added], Respondent's Book of Authorities (Tab 106).

<sup>96</sup> *United States - Taxes on Petroleum and Certain Imported Substances*, 17 June 1987 at para. 5.2.2., Investor's Book of Authorities (Tab 37).

<sup>97</sup> Canada makes this clearly incorrect assertion at para. 322 of its Counter Memorial.

<sup>98</sup> Canada's Counter Memorial at para. 323.

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that effect. Rather, what that Tribunal *did* say was that the purpose of the national treatment obligation in the GATT and WTO context is more limiting than that in the investment treaty context, and that this difference needs to be borne in mind when interpreting a provision such as NAFTA Article 1102.

145. Despite Canada's attempts to denigrate the influence of the GATT and WTO practice in the NAFTA context, Canada's own *Statement of Implementation* acknowledges the influence of the GATT/WTO on the NAFTA:

The NAFTA and the Uruguay Round agreements cover much of the same ground and the two sets of rules are largely complementary and mutually reinforcing. In many respects, the NAFTA built on progress that had been made in the Uruguay Round while the Round in turn profited from the experience of Canada, the United States and Mexico in negotiating the NAFTA.<sup>99</sup>

It is clear from Canada's own statements on the NAFTA, made in connection with the implementation of the NAFTA, that GATT and the NAFTA negotiations were inter-connected and inter-dependent.

146. The origins of NAFTA Article 1102 in GATT Article III, the similar wording in the provisions, the equivalent purposes, and Canada's acknowledgement of the influence of the WTO provisions on the NAFTA, ensures that GATT/WTO national treatment jurisprudence informs the meaning of the three elements of NAFTA Article 1102. It is for this reason that several NAFTA tribunals have drawn from GATT/WTO jurisprudence to interpret the elements of NAFTA Article 1102.<sup>100</sup>
147. At the time of the negotiation of the GATT, the GATS and the NAFTA, Canada was applying similar principles, including national treatment, to the central areas of economic activity, including trade in goods, trade in services and national treatment to investment.

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<sup>99</sup> *Canadian Statement of Implementation* at 75, Investor's Book of Authorities (Tab 4).

<sup>100</sup> *S.D. Myers*, First Partial Award, 12 November 2000 at para. 244, Investor's Book of Authorities (Tab 39). *Pope & Talbot*, Award on the Merits of Phase 2, 10 April 2001 at para. 68–69, footnote 68, Investor's Book of Authorities (Tab 42). *Feldman v. Mexico*, Award at para. 165: "The national treatment/non discrimination provision is a fundamental obligation of Chapter 11. The concept is not new with NAFTA. Analogous language in Article III of the GATT has applied between Canada and the United States since 1947, and with Mexico since 1985, with regard to trade in goods.", Respondent's Book of Authorities (Tab 49).

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It is clear that the principle of national treatment was well-known to Canada at this time and that this treatment was best expressed around international trade law concepts.

148. In any event, that national treatment experience in the GATT/WTO context is relevant to the interpretation of NAFTA Article 1102's underscored by Article 31(3)(c) of the *Vienna Convention*. That provision requires that a treaty be interpreted in light of "any relevant rules of international law applicable in the relations between the parties." If this provision were to be construed to permit consideration of other relevant rules of international law in the interpretation of treaties only where those other rules were expressed in *identical* language, it would be rendered largely inutile, since the only situations in which it would apply would be ones of actual direct *incorporation*. In such situations, however, Article 31(3)(c) of the *Vienna Convention* would be inapplicable, since the intent of the parties to import one legal regime into another would be manifestly clear.
149. For the foregoing reasons, there can be no doubt that this Tribunal can legitimately draw from the GATT/WTO experience with national treatment to interpret the content and scope of NAFTA Article 1102.

### 3. NAFTA Article 1102 - The Analytical Steps

150. NAFTA Article 1102(1) and (2) read as follows:
1. Each Party shall accord to investors of another Party treatment no less favorable than that it accords, in like circumstances, to its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation and sale or other disposition of investments.
  2. Each Party shall accord to investments of investors of another Party treatment no less favorable than that it accords, in like circumstances, to its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation and sale or other disposition of investments.
151. As is evident from the express wording of these provisions, there are three key aspects to the national treatment obligation. First, Canada must accord foreign investors and/or their investments treatment that is "no less favorable" than that which it accords to its own investors and investments. Second, the differential treatment must be with respect to

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investors and/or investments “in like circumstances”. Third, the differential treatment must be “with respect to the establishment, acquisition, expansion, management, conduct, operation and sale or other disposition of investments.” For an investor to establish a successful claim based on Article 1102, it must satisfy each of these three elements.

152. While NAFTA Article 1102 makes the three elements of national treatment analysis abundantly clear, it is less clear about the order in which the analysis must proceed. Merrill & Ring has suggested that the order should be as follows:<sup>101</sup>
1. Determine whether the Investor and/or its investments are in “like circumstances” to certain domestic investors and/or their investments;
  2. If so, determine whether the Investor and/or its investments has been accorded “less favorable treatment” than those investors and/or investments; and
  3. If so, determine whether the “less favorable treatment” is "with respect to the establishment, acquisition, expansion, management, conduct, operation and sale or other disposition of investments."
153. Canada admitted in its *Statement of Defence* that the first step of the analysis is to determine whether Merrill & Ring is in “like circumstances” to certain other domestic investors.<sup>102</sup> Without explanation, Canada now advocates a different approach, arguing that the analysis should proceed in the following steps:<sup>103</sup>
1. Determine whether Canada has accorded "treatment" to Merrill & Ring and to domestic investors;
  2. If so, determine whether Merrill & Ring and said domestic investors are in "like circumstances"; and

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<sup>101</sup> Investor’s Memorial at para. 256.

<sup>102</sup> Canada’s Statement of Defence at para. 65.

<sup>103</sup> Canada’s Counter Memorial at para. 286.



3. If so, determine whether the treatment Merrill & Ring received as compared to domestic investors in like circumstances was “less favorable”.

Canada implicitly suggests that there should also be a fourth step to the analysis, namely to determine whether any “less favorable treatment” accorded to Merrill & Ring was motivated by discriminatory intent based on nationality. This obligation is not contained in the NAFTA text, and has been explicitly rejected in GATT and WTO jurisprudence on national treatment.

154. In its Counter-Memorial, Canada opposes the Investor's interpretation of the national treatment obligation. It advocates a subjective and narrow construction of national treatment replete with wide public policy exceptions not contained within the NAFTA. This interpretation is contrary not only to NAFTA Chapter 11 jurisprudence, but also to that of the GATT and WTO as well.
155. Canada begins by stating that NAFTA Article 1102 must be interpreted according to the rules set out in Article 31 of the *Vienna Convention*.<sup>104</sup> However, Canada then proceeds to ignore each and every one of these rules:
  - a) **Interpretation in Good Faith in Accordance with Ordinary Meaning:** Canada picks meanings of the words "treatment" and "like circumstances" out of thin air. It then presents these meanings to the Tribunal as if they were self-evidently true, notwithstanding the repeated decisions of international tribunals to the contrary.
  - b) **Context:** Canada ignores the fact that the national treatment obligation appears throughout the NAFTA and the WTO agreements, which were negotiated concurrently with NAFTA. It purports to distinguish the applicability of the WTO jurisprudence on the grounds that the words "like circumstances" have a different meaning from the WTO language of "like goods", "like services" and "like service providers". As discussed in Merrill & Ring's Memorial, Canada's approach is contrary to the

<sup>104</sup> Canada's Counter Memorial at para. 131.

representations of all three NAFTA Parties made to the Panel in the NAFTA Chapter 20 state-to-state arbitration, *In the Matter of Cross Border Trucking Services*.<sup>105</sup>

- c) **Object and Purpose:** Nowhere in Canada's discussion of national treatment is there any mention of the objects and purpose of the NAFTA, including the objective of promoting "conditions of fair competition in the free trade area".<sup>106</sup> Canada's statement that the national treatment obligation only prevents nationality-based discrimination is simply not correct. Measures can violate the national treatment obligation even if motivated by legitimate non-discriminatory public policy purposes.<sup>107</sup>
- d) **Special Meaning:** Canada summarily dismisses the suggestion that national treatment is a "term of art" in international trade and investment law.<sup>108</sup> It offers no reasons for doing so, even though Merrill & Ring's Memorial has demonstrated how the term was used in international treaty practice for decades before the NAFTA was negotiated.

156. After referring to *Vienna Convention* principles, Canada contends that the Investor has not identified the "treatment" at issue. This is merely another attempt to repackage Canada's arguments that this Tribunal adopt a restrictive view of the notion of a "measure".<sup>109</sup> Treatment is merely the result of a measure relating to an investment.

<sup>105</sup> *In the Matter of Cross Border Trucking Services* (Secretariat File No. USA Mex 98 2008 01) Final Report of the Panel, February 6, 2001, Investor's Book of Authorities (Tab 34). This is addressed at paras. 268-275 of the Investor's Memorial.

<sup>106</sup> NAFTA Article 102(b).

<sup>107</sup> Canada's Counter Memorial at para. 616.

<sup>108</sup> Canada's Counter Memorial at para. 322. Indeed, the *Methanex* tribunal accepted that the term "like products" used in the GATT national treatment obligation for goods constituted a "term of art" under the *Vienna Convention*. *Methanex* Final Award, Part IV, Chapter B at para. 29, Respondent's Book of Authorities (Tab 85). If the "like products" sub test is a term of art, then certainly it stands to reason that the term "national treatment" must also be considered to be a term of art as well under the *Vienna Convention*.

<sup>109</sup> Canada's Counter Memorial at para. 11.

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Merrill & Ring described the measures at great length in its Memorial,<sup>110</sup> and to avoid any possible uncertainty has done so again in this Reply.<sup>111</sup>

157. Canada's suggested analytical approach is unprincipled and incoherent. It does not even follow the plain wording of NAFTA Article 1102. On the one hand, Canada's approach completely ignores the requirement to determine whether the "less favorable treatment" is "with respect to the establishment, acquisition, expansion, management, conduct, operation and sale or other disposition of investments." On the other hand, Canada's approach adds steps to the analysis outside the wording of Article 1102.
158. By contrast, the framework applied by Merrill & Ring is characterized by analytical clarity and provides a principled, commonsense approach to NAFTA Article 1102 analysis. It is practical to start off the analysis by looking to see if Merrill & Ring is in "like circumstances" to domestic investors, since a determination that an investor or investment is not in "like circumstances" would be quickly dispositive, leaving no need for the Tribunal to look any further.
159. In addition, starting with the consideration of likeness immediately focuses the analysis on what the comparator group should be. It makes little practical sense to determine whether "less favourable treatment" has been accorded without deciding this matter first. It is simply impossible to make a meaningful determination of "less favourable treatment" until the comparator group by which to measure such differential treatment has already been established. It is for this reason that most NAFTA Tribunals have made this the first step of their NAFTA Article 1102 analyses,<sup>112</sup> with the *Methanex* Tribunal stating that the

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<sup>110</sup> Investor's Memorial at para. 94 131.

<sup>111</sup> *Methanex*, Final Award, Part IV, Chapter A, sections A 3 a i & A 3 a ii, Respondent's Book of Authorities (Tab 85).

<sup>112</sup> See, for example, *Methanex*, Final Award, Respondent's Book of Authorities (Tab 85). *ADM Company v. Mexico*, Investor's Book of Authorities (Tab 131), and *Feldman v. Mexico*, Respondent's Book of Authorities (Tab 49). Also see the carefully reasoned analysis of the specific issue by Dean Ronald A. Cass in *UPS v. Canada*, Investor's Book of Authorities (Tab 14).

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"like circumstances" inquiry is the "very threshold" of the Article 1102 analysis.<sup>113</sup>

160. Ultimately, it is abundantly clear that it makes little practical sense to first enquire as to whether there is simply “treatment”. The existence of “treatment” flows naturally from the existence of a “measure”. The question of whether there is a “measure” in dispute is a question to be considered as a matter of jurisdiction. The question is not whether there has simply been “treatment”, but rather whether the treatment is “less favorable” than that accorded to domestic investors and/or their investments. This question properly forms the second step of NAFTA Article 1102 analysis.

*a. Step 1: “Like Circumstances” Analysis*

161. The method for determining when a foreign investor is in "like circumstances" with domestic investors for the purposes of NAFTA Article 1102 is not expressly laid out in the NAFTA. While there has been some jurisprudence on this matter, this jurisprudence is in disarray. As a result, this issue remains unsettled. This is reflected in the disputing parties' vastly different positions in the context of this dispute.

162. Merrill & Ring offers a principled and practical approach to the "like circumstances" analysis that is consistent with the express wording of NAFTA Article 1102, as well as faithful to the objectives of the NAFTA.

*i. “Like Circumstances” Requires a Comparison Between Investors in Competition with One Another*

163. Merrill & Ring has pointed out that to determine whether a foreign investor is in “like circumstances” to a domestic investor, NAFTA Tribunals have given great weight to whether they are in the same business or economic sector.<sup>114</sup> Merrill & Ring has also provided evidence from the drafting history and the documents that give context to the NAFTA, that investors are in “like circumstances” when they are in direct competition in

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<sup>113</sup> *Methanex*, Part IV, Chapter B at para. 29, Respondent’s Book of Authorities (Tab 85).

<sup>114</sup> Investor’s Memorial at paras. 259-262.

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the marketplace.<sup>115</sup>

164. Although Canada admits that examining whether the foreign Investor and domestic investors compete in the same economic sector is relevant to a determination as to whether they are in “like circumstances”, it nonetheless suggests that it is wrong to make this the sole focus of “like circumstances” analysis.<sup>116</sup>
165. Canada plainly misunderstands Merrill & Ring's argument. Merrill & Ring's position is that whether investors are in the same business and economic sector is a *strong indicator* as to whether they are in “like circumstances”. Nowhere does Merrill & Ring suggest that this is in-and-of-itself determinative of “likeness”. Rather, what *is* determinative is whether the investors are in direct competition in the marketplace. Assessing whether investors are in direct competition with one another, in turn, requires an examination to see if their investments generate products that are directly substitutable for one another in the marketplace. “Likeness” analysis is commonly considered in GATT and WTO jurisprudence. Merrill & Ring draws from a rich history of GATT law to guide its argument.
166. Despite Canada's apparent misapprehension of Merrill & Ring's argument, it nonetheless suggests that drawing from GATT law to instruct “like circumstances” analysis in the NAFTA context is improper and impermissible.<sup>117</sup> Canada asserts that NAFTA tribunals have “uniformly” rejected the relevance of GATT law to the interpretation of “like circumstances” in Article 1102 although it is only able to cite *Methanex*, which, as we have already pointed out, Canada misinterpreted.<sup>118</sup>
167. Canada also neglects to mention Arbitrator Ron Cass' analysis of similar arguments made by Canada in the *UPS* case:

The most natural reading of NAFTA Article 1102...gives substantial weight to a showing of competition between a complaining investor and an investor of the respondent Party in respect of

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<sup>115</sup> Investor's Memorial at para. 286.

<sup>116</sup> Canada's Counter Memorial at para. 313.

<sup>117</sup> Canada's Counter Memorial at para. 321.

<sup>118</sup> Canada's Counter Memorial at para. 322.

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the matters at issue in dispute under Article 1102...A showing that there is a competitive relationship and that two investors or investments are similar in that respect establishes a prima facie case of like circumstances.<sup>119</sup>

This reading clearly does not suggest that GATT law is devoid of any instructive value in the context of NAFTA Article 1102, as Canada would have it.

168. Canada further suggests that examining the “likeness” language used in the General Agreement on Trade in Services “GATS”, as interpreted in the NAFTA context, is also without merit.<sup>120</sup> As Merrill & Ring has made clear, the national treatment obligation in the GATS also uses the phrase “like circumstances”, which is not only mirrored in the “likeness” test used in NAFTA Article 1102, but also in NAFTA Article 1202(1).<sup>121</sup> As Merrill & Ring has explained, the Parties to the GATS have confirmed that the national treatment obligation in the GATS is to be taken to require equality of competitive opportunities.<sup>122</sup> As Merrill & Ring has further pointed out, the Parties to the GATS are under a legal obligation not to enter into other agreements that offer a standard of protection that is lower than that offered by the GATS.<sup>123</sup> The GATS was negotiated concurrently with the NAFTA, and, as such, the protections offered in the NAFTA must be interpreted to provide at least the same level of protection as to that offered in the GATS<sup>124</sup> a level of protection that extends to Chapter 11 of the NAFTA.<sup>125</sup>
169. Canada reduces its response to Merrill & Ring’s extensive arguments to a simple suggestion that merely because the two agreements were negotiated at the same time does not prove that the meaning of national treatment in GATS and in NAFTA Chapter 11 are

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<sup>119</sup> *UPS*, Separate Statement of Dean Ronald A. Cass, May 24, 2007 at para. 17, Investor’s Book of Authorities (Tab 14).

<sup>120</sup> Canada’s Counter Memorial at para. 320.

<sup>121</sup> Investor’s Memorial at para. 267.

<sup>122</sup> Investor’s Memorial at para. 269.

<sup>123</sup> Investor’s Memorial at para. 274.

<sup>124</sup> Investor’s Memorial at para. 273.

<sup>125</sup> Investor’s Memorial at para. 272.

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the same.<sup>126</sup> Although the two agreements were negotiated at the same time, this does not prove that the meaning of national treatment in GATS and NAFTA Chapter 11 are the same.<sup>127</sup> Canada has nothing further to offer. Canada does not address the impact of its own Public Interpretative *Statement on the Implementation of the NAFTA* that acknowledges this relationship. Canada does not address the clear findings on this issue of the NAFTA Chapter 20 Interpretative Panel decision in *Cross-Border Trading*. There is one simple explanation for Canada's inability to put forth an adequate response: it simply cannot refute the logic of Merrill & Ring's overall argument.

170. In its Counter-Memorial, Canada misconstrues *Occidental*, which it uses to suggest that investment treaty tribunals have refused to base their determinations of “like circumstances” on whether the investors are in the same business or economic sector.<sup>128</sup> In *Occidental*, Ecuador advanced a similar reading of the “likeness” test as does Merrill & Ring in the present case. However, on the facts of that case, the purpose of Ecuador's reading was to *narrow* the meaning of “like circumstances.” The Tribunal in *Occidental* would not accept a narrowing interpretation, since it ran counter to the objects and purposes of the treaty in question. In explaining its decision, the Tribunal stated:

... the purpose of national treatment is to protect investors as compared to local producers, and this cannot be done by addressing exclusively the sector in which that particular activity is undertaken... the purpose of national treatment... is to avoid exporters being placed at a disadvantage in foreign markets... no exporter ought to be put in a disadvantageous position as compared to other exporters.<sup>129</sup>

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<sup>126</sup> Canada's Counter Memorial at para. 320.

<sup>127</sup> Canada's Counter Memorial at para. 320.

<sup>128</sup> Canada's Counter Memorial at para. 317.

<sup>129</sup> *Occidental v. Ecuador* at paras. 173, 175 and 176, Investor's Book of Authorities (Tab 40).

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On this view of national treatment, the Tribunal concluded that the foreign exporter in that case was in fact put in a disadvantaged position compared to a domestic exporter. In light of the objects and purposes of the treaty in question, the Tribunal then went on to find that Ecuador had violated its duty to accord the foreign investor national treatment.

171. Applying the approach adopted by the Tribunal in *Occidental* to “like circumstances” analysis to this case as Canada has suggested the Tribunal do yields a markedly different result than Canada hopes for. As laid out in NAFTA Article 102, the objectives of the NAFTA, “as elaborated through its principles and rules, including national treatment”, include:

- Eliminating barriers to trade in, and facilitating the cross-border movement of, goods and services between the territories of the Parties; and
- Promoting conditions of fair competition in the free trade area.<sup>130</sup>

Like the objectives of the treaty in *Occidental*, the objectives of the Treaty in the NAFTA support a purposive interpretation of “like circumstances”. Indeed, they clearly support the interpretation offered by Merrill & Ring, which focuses on the competitive relationship of the investors being compared. Yet, far from being “expansive”, this purposive interpretation is natural, reasonable and supported by the context and the purposes of the NAFTA.

172. Nonetheless, Canada suggests that Merrill & Ring’s interpretation seeks to give a “special meaning” to the term “like circumstances”,<sup>131</sup> and that it has not adduced any evidence to support this “special meaning”.<sup>132</sup> Again, Canada seems to have paid little attention to Merrill & Ring’s arguments. Merrill & Ring has performed an in-depth analysis of the content, context and purpose of the NAFTA, and provided a detailed explanation as to why it is that “like circumstances” analysis comes down to a determination of whether the

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<sup>130</sup> NAFTA, Article 102(1)(a) & (b).

<sup>131</sup> Canada’s Counter Memorial at para. 314.

<sup>132</sup> Canada’s Counter Memorial at para. 314.



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investors are in a competitive relationship.<sup>133</sup> In so doing, it has furnished ample evidence to support its interpretation.

173. Canada, on the other hand, has offered absolutely no evidence to counter Merrill & Ring's argument. This omission is conspicuous in light of the fact that Canada is the only disputing Party with access to materials that would evidence its true interpretation of "like circumstances" when it signed the NAFTA. Absent of any such evidence, and absent any cogent response, the Tribunal should draw an appropriate inference from Canada's silence, and accept Merrill & Ring's reasoned, principled, and practical interpretation of the meaning of "like circumstances" for the purposes of NAFTA Article 1102.

ii. "Like Circumstances" Does Not Mean "Identical" or "Most Like" Circumstances

174. In suggesting an alternative approach to "like circumstances" analysis, Canada argues that the Tribunal should look first to see if there are investors in "identical" circumstances,<sup>134</sup> and, in the alternative, look for investors in the "most like" circumstances.<sup>135</sup> Canada's suggested approach is not correct. There are several reasons for this.

175. Canada's approach simply ignores the plain and ordinary wording of NAFTA Article 1102. This provision clearly states that foreign investors are to be accorded "treatment no less favorable" than domestic investors "in like circumstances". Had the drafters of the NAFTA intended national treatment in NAFTA Article 1102 to protect only foreign investors or investments in "identical" or "most like" circumstances, they would have said so.

176. This ordinary reading is supported by the overall context in which the words "like circumstances" in NAFTA Article 1102 appear. NAFTA Article 1102 affords protection "with respect to the establishment, acquisition, expansion, management, conduct, operation and sale or other disposition of investments." From the broad circumstances of

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<sup>133</sup> Investor's Memorial at paras. 260-290.

<sup>134</sup> Canada's Counter Memorial at para. 300.

<sup>135</sup> Canada's Counter Memorial at para. 298 & 302.

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the application of this national treatment obligation, it is clear that the protections of NAFTA Article 1102 are meant to be extended to foreign investors from host government measures that adversely impact them. This suggests that the protections of NAFTA Article 1102 were meant to be broad indeed. Restricting these protections by reading in a highly restrictive meaning to “like circumstances” where “like” really means “identical” or the “most like” certainly must run counter to the specific context of the entire obligation as worded in NAFTA Article 1102.

177. Canada’s approach is not supported by the objectives of the NAFTA. As already stated, these objectives include:
- Eliminating barriers to trade in, and facilitating the cross-border movement of, goods and services between the territories of the Parties; and
  - Promoting conditions of fair competition in the free trade area.<sup>136</sup>

In contrast to these objectives, Canada offers a highly restrictive interpretation of NAFTA Article 1102 that would greatly reduce the protection it is meant to provide foreign investors.

178. Canada’s approach would lead to ambiguous, absurd and unreasonable results. Unlike Merrill & Ring’s interpretation, Canada’s approach does nothing to clarify what investors or investments are to be compared to. Canada’s approach provides no guidance as to what “identical” or “most like” investors actually means. In addition, following Canada’s approach would lead to absurd results. For example, assume that there are two potential domestic investors by which to compare the treatment accorded to the foreign investor. Assume further that the first candidate is somehow deemed to be “more like” the foreign investor than the second candidate, even though both are clearly in the same business and economic sector as the investor, as well as in a directly competitive relationship. Under Canada’s approach, NAFTA Article 1102 would offer the foreign investor no protection if the first domestic investor received the same treatment, even though the second domestic investor clearly received more favorable treatment. Such a result would be inconsistent with the underlying principle of national treatment, and would be capable of

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<sup>136</sup> NAFTA, Article 102(1)(a) & (b)

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undermining the fundamental free trade purposes of the NAFTA. By consequence, Canada's suggested approach cannot be correct.

179. In trying to advance its argument, Canada also misreads the *Methanex* Tribunal's decision.<sup>137</sup> In *Methanex*, the Tribunal based its determination that the claimant and domestic producers of ethanol were not in "like circumstances" on considerations of the directness or closeness of the competitive relationship. The Tribunal held that where possible, the foreign investor should be compared to a domestic investor in the identical product market, not some related, but different market. Since on the facts of that case there were investors in that identical product market namely, the MTBE market the Tribunal rejected the claimant's argument that it should be compared with producers in a different product market namely, the ethanol market. This approach implies the proposition that where the competitive relationship between investors is defined in terms of product competition, the "likeness" inquiry should be directed towards establishing whether there are domestic investors engaged in producing identical products. That is, the *Methanex* Tribunal's approach is ultimately one that actually supports a focus on the competitive relationship in the inquiry into "likeness". Incidentally, this is precisely the relationship between all of the Investor's proposed comparators in the present case, all of which produce logs.
180. Given the fact that Canada's interpretation so clearly runs counter to not only the express wording of NAFTA Article 1102, but also to the objects and purposes of the NAFTA, it is clear that Canada seeks to introduce a "special meaning" to the term "like circumstances". Under Article 31(4) of the *Vienna Convention*, such a "special meaning" may only be applied where the party advancing it can demonstrate that it reflects the intention of the Parties. Canada has provided no such evidence.
181. Regardless of its incompatibility with the plain wording of NAFTA Article 1102, as well as the objectives of the NAFTA, on its face, Canada's approach makes no sense. It is futile to look for investors in "identical" circumstances. As Arbitrator Cass noted in his careful consideration of this NAFTA obligation in the *UPS* case:

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<sup>137</sup> Canada's Counter Memorial at paras. 299-300.

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NAFTA does not require the sort of near identity of circumstances urged by Canada, a test that if adopted would substantially undermine the efficacy of Article 1102. Canada's approach would require an excessively close fit between the complaining investor or investment and the compared domestic investment. National treatment protection would be dramatically reduced under that approach, as it would eliminate any right to protection whenever there were differences between the complaining party and the compared investment or investor even if those differences were slight enough not to affect the competitive relationship that Article 1102 was designed to protect.<sup>138</sup>

The majority in *UPS* said nothing to the contrary.

182. Even identical twins have differences between them. No two investors are ever in identical circumstances; there are always an infinite number of ways to differentiate one from the other. Moreover, there is no practical way to delineate how investors are “more like” than others. Adapting Canada's proposed “identical twin” test would only create greater uncertainty to investors and to governments. Merrill & Ring's interpretation of “like circumstances” analysis is eminently practical and supported by the context of the treaty and the jurisprudence. This interpretation places appropriate boundaries on language that, on its own terms, provides little guidance as to what should be considered “like”, and, conversely, what should be considered “unlike”. Focussing NAFTA Article 1102 analysis on the competitive relationship between investors is not only consistent with the context and purposes of the NAFTA, but it also provides a principled approach to provide much needed clarity both to investors and governments alike.

iii. “Like Circumstances” Analysis Should Not Factor In Policy Objectives

183. Canada further suggests that policy objectives are a relevant factor for the purposes of “like circumstances” analysis.<sup>139</sup> Again, Canada's position is not supportable.
184. To buttress its position, Canada points to one OECD publication, as well as one UNCTAD study that refers to the very same OECD publication.<sup>140</sup> Canada exaggerates

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<sup>138</sup> *UPS v. Canada*, Separate Statement of Dean Ronald A. Cass at para. 14. Investor's Book of Authorities (Tab 14).

<sup>139</sup> Canada's Counter Memorial at para. 305.

<sup>140</sup> Canada's Counter Memorial at paras. 305 & 306.

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the support that this publication provides for its position; far from endorsing Canada's view, this publication merely states that policy objectives "could" be taken into consideration in "like circumstances" analysis not that policy objectives "must" or even "should" be taken into consideration.<sup>141</sup> Canada also fails to mention that this OECD publication is from 1993 more than a year after these obligations were already drafted. The NAFTA's negotiating history shows that in 1992 the "like circumstances" language had been used for national treatment in investment.<sup>142</sup> Since the provisions of any treaty provision must be interpreted according to its plain and ordinary meaning, and in light of the treaty's object and purpose, this publication has little if any relevance to the NAFTA.

185. Similar to Canada's suggestion that "like circumstances" actually means "identical" or "most like" circumstances, its submission that non-specified public policy objectives are a relevant consideration to "like circumstances" analysis runs counter to the express wording of NAFTA Article 1102 itself. Nowhere in NAFTA Article 1102 did the Parties make any suggestion that the national treatment obligation is conditioned by the policy objectives of the host state. Had that been the intention, the Parties could have easily achieved this result, for example with the following wording:

Each Party shall accord to investors of another Party treatment no less favorable than that it accords, in like circumstances, to its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation and sale or other disposition of investments, *provided that such treatment does not run counter to the legitimate policy objectives of that Party.*

Yet despite the ease with which this condition could have been included as part of Article 1102, the Parties clearly chose to leave it out.

186. Indeed, the NAFTA Parties clearly decided *against* allowing broad categories of public policy exceptions from applying to the NAFTA Investment Chapter's obligations. The

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<sup>141</sup> Declaration, National Treatment for Foreign Controlled Enterprises, OECD: 1993 at 22, Respondent's Book of Authorities (Tab 106).

<sup>142</sup> Barry Appleton, *NAFTA Legal Text and Interpretive Materials*, (West Publishing, 2007). The relevant negotiating texts are set out in Volume 3. The very first draft of the NAFTA dating from December 1, 1991 contains a National Treatment obligation for investment to receive "treatment no less favourable than that granted in like circumstances" in draft Article 2102, Investor's Book of Authorities (Tab 132).

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NAFTA Parties knew how to make such exceptions. Such broad exemptions are contained in GATT Chapter XX and were specifically applied to other parts of the NAFTA through the NAFTA's Exemptions in NAFTA Chapter 21. They specifically do not apply to the Investment or Services Chapters in the NAFTA.

187. Instead, the NAFTA drafters applied a different mechanism to allow public policies to be exempted. NAFTA Article 1102 is already subject to exceptions permitted by NAFTA Article 1108. Because the NAFTA Parties rejected general public policy exceptions for the Investment Chapter in the NAFTA, they created specific listed exemptions. The Parties were also able to express reservations to be filed in their respective Schedules to Annexes I and II of the NAFTA. Canada made numerous reservations to the application of NAFTA Article 1102 to sectors of its economy, each of which was based on an underlying policy rationale. For example, Canada reserved whole swathes of its economy from the future application of NAFTA Article 1102, including the following sectors:

- Telecommunications;<sup>143</sup>
- Government finance;<sup>144</sup>
- Minority affairs;<sup>145</sup>
- Social services;<sup>146</sup>
- Air transportation;<sup>147</sup> and
- Water transportation.<sup>148</sup>

There are many other reservations taken by Canada and by other NAFTA Parties. Conspicuously absent from this list is any mention of the forestry or lumber processing sectors.

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<sup>143</sup> Reservation at II C 3 and II C 5, Investor's Book of Authorities (Tab 133).

<sup>144</sup> Reservation at II C 7, Investor's Book of Authorities (Tab 133).

<sup>145</sup> Reservation at II C 8, Investor's Book of Authorities (Tab 133).

<sup>146</sup> Reservation at II C 9, Investor's Book of Authorities (Tab 133).

<sup>147</sup> Reservation at II C 10, Investor's Book of Authorities (Tab 133).

<sup>148</sup> Reservation at II C 11, Investor's Book of Authorities (Tab 133).

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188. It is therefore clear that the Parties turned their minds to the need to reserve various economic sectors from the application of NAFTA Article 1102. It is equally clear that Canada made able use of its ability to do so. These reservations are all fundamentally predicated on Canada's desire to pursue particular social and economic policies but were subject to negotiation with all the NAFTA parties. By excluding the forestry and lumber processing sectors from its list of reservations, Canada implicitly accepted that NAFTA Article 1102 would apply to investments in the forestry and lumber sector. Thus, to introduce a new unwritten public policy exception into the "likeness" analysis runs counter to the express wording of NAFTA Article 1102, and is inconsistent with the clear intention of the Parties at the time they negotiated and signed the NAFTA.
189. This commonsense reading is also supported by the overall wording of NAFTA Article 1102, which evinces a context that supports an expansive not a restrictive interpretation of national treatment protections. NAFTA Article 1102 affords protection "with respect to the establishment, acquisition, expansion, management, conduct, operation and sale or other disposition of investments." This demonstrates that the drafters intended the protections of NAFTA Article 1102 to protect foreign investors from measures that have almost any sort of negative impact on them. The protections of NAFTA Article 1102 were always meant to be broad. Restricting these protections by reading in an unbridled new policy exception runs counter to this intention, as evinced in the context of the overall wording of NAFTA Article 1102.
190. That policy considerations do not properly belong in "like circumstances" analysis is further evidenced by the fact that such an approach would run counter to the objectives of the NAFTA itself. These objectives include:
- Eliminating barriers to trade in, and facilitating the cross-border movement of, goods and services between the territories of the Parties; and
  - Promoting conditions of fair competition in the free trade area.<sup>149</sup>

NAFTA Article 102 expressly calls for national treatment to be interpreted in accordance with these objectives. Nowhere does NAFTA Article 102 say that national treatment is to be interpreted in accordance with policy considerations. Room for such considerations

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<sup>149</sup> NAFTA, Article 102(1)(a) & (b).

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for Chapter 11 obligations was amply provided for in NAFTA Article 1108 exceptions and in the reservations made in the Parties' respective Schedules to Annexes I and II.

191. Allowing policy objectives to play a role in “like circumstances” analysis would further lead to absurd or unreasonable results. This is for the simple reason that doing so would allow Canada to rely upon its own policies to absolve it of liability arising from those very same policies. Generally, international law does not accept “self-judging” of justifications for nullification or impairment of benefits set out in a treaty. Furthermore, the *ILC Articles* do not permit Canada to rely on municipal law obligations to justify failure to comply with its international law obligations.<sup>150</sup> Canada’s wish to have the Tribunal sanction this absurd result can be seen in its response on the issue of log scaling. According to Canada, Merrill & Ring is in “like circumstances” to all other BC log producers, since they are all subject to the same scaling requirements.<sup>151</sup> It is clear that for Canada, what places two investors in “like circumstances” is actually the way in which Canada treats them. If Canada treats them the same, then they are in “like circumstances.” If Canada treats them differently, then they are not in “like circumstances.” This approach improperly conflates the “likeness” analysis with “treatment” analysis, and conveniently creates a test whereby Canada could never be in violation of NAFTA Article 1102. On the one hand, any differential treatment would render the investors “unlike”, and, on the other hand, any investors in “like circumstances” could not possibly be subject to differential treatment. This would lead to the absurd result of allowing a mistaken and discriminatory policy to absolve Canada of liability for that very same policy. The end result would be to deprive NAFTA Article 1102 of any meaning whatsoever.
192. Given the fact that Canada’s suggested inclusion of a policy exception to NAFTA Article 1102 so clearly runs counter to not only the express wording of Article 1102, but also the objects and purposes of the NAFTA, it is clear that what Canada seeks to do is to introduce a “special meaning” to the term “like circumstances”. As mentioned, under Article 31(4) of the Vienna Convention, such a “special meaning” may only be applied

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<sup>150</sup> *ILC Article 32* provides that a state may not rely on the provisions of its own internal law as justification for its failure to comply with its obligations, Investor’s Book of Authorities (Tab 130). This obligation is also set out in Article 27 of the *Vienna Convention* of the Law of Treaties, Investor’s Book of Authorities (Tab 41).

<sup>151</sup> Canada’s Counter Memorial at para. 385.



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where the party advancing it can demonstrate that it reflects the intention of the Parties. Unlike Merrill & Ring, Canada has access to the whole *travaux préparatoires* and drafting history of the NAFTA yet it has provided no such evidence in support of the “special meaning” for “like circumstances” it proposes.

193. Nonetheless, Canada rightly points out that to date three Tribunals have in fact considered Respondent States’ policy objectives in the course of their “like circumstances” analyses.<sup>152</sup> For all the foregoing reasons, however, we respectfully submit that these Tribunals were wrong to do so. Neither the wording of Article 1102, nor the objects and purposes of the NAFTA suggest that this approach is appropriate or consistent with the treaty.
194. In the end, it is important to remember that Canada itself has already asserted that “Article 1102...must be applied as drafted by the NAFTA Parties”,<sup>153</sup> and that “like circumstances” “means what it says”.<sup>154</sup> If Canada is to be taken at its word, then this Tribunal must not sanction an approach to “like circumstances” analysis that reads new words into NAFTA Article 1102 words that were clearly and consciously omitted by the Parties. Such a reading of NAFTA Article 1102 would not only run counter to the plain wording of the provision, but would also run counter to the objectives of the NAFTA. Indeed, it would lead to unjustifiable and absurd results. This Tribunal should not let that happen.

*b. Step 2: "Treatment No Less Favorable"*

195. The second step of the NAFTA Article 1102 analysis is the obligation to accord a foreign Investor and its investments with “treatment no less favorable” than that provided to domestic investors in like circumstances.

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<sup>152</sup> Canada’s Counter Memorial at paras. 307-309.

<sup>153</sup> Canada’s Counter Memorial at paras. 325.

<sup>154</sup> Canada’s Counter Memorial at paras. 312.

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i. “Treatment No Less Favorable” Means Equality of Competitive Opportunities

196. Merrill & Ring has argued that Canada’s obligation to provide “no less favorable treatment” to foreign Investors as compared to domestic investors amounts to an obligation to provide the investors with equality of competitive opportunities.<sup>155</sup> As mentioned, Merrill & Ring’s argument is based on a detailed review of the negotiating history of the NAFTA together with the GATS, a careful look at the NAFTA text, including the interrelationship between the various NAFTA chapters, and the findings of previous NAFTA tribunals.<sup>156</sup>
197. Nonetheless, Canada refutes this argument, and suggests that “treatment no less favorable” cannot be taken to require it to provide foreign investors with equality of competitive opportunities.<sup>157</sup> Canada provides no reasoned argument in support of its position. Instead, and in stark contrast to Merrill & Ring’s well documented arguments, it merely suggests that it is unreasonable to draw from the rich history of GATT law to inform an interpretation of NAFTA Article 1102.<sup>158</sup> It would seem that Canada would have the Tribunal believe that the NAFTA was negotiated in a vacuum, and, as such, that the rich history of GATT law which obviously formed an important backdrop to the NAFTA is of absolutely no value in any effort to interpret the provisions of the NAFTA. Canada would also have us ignore the textual context in the NAFTA discussing how the national treatment principle includes equality of competitive opportunities. Canada’s argument is not only unsupported and undeveloped, but is on its face, plainly unreasonable.
198. By contrast, it is entirely reasonable to interpret “treatment no less favorable” to mean treatment that accords investors equality of competitive opportunities. This interpretation is clearly supported by the plain and ordinary meaning of the phrase “treatment no less

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<sup>155</sup> Investor’s Memorial at para. 292.

<sup>156</sup> Investor’s Memorial at paras. 267-275.

<sup>157</sup> Canada’s Counter Memorial at para. 340.

<sup>158</sup> Canada’s Counter Memorial at para. 340.

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favorable.” That is, if a domestic investor receives one type of favorable treatment, a foreign investor should receive “treatment no less favorable” than that plain and simple. This, in turn, dovetails nicely with the vision of “like circumstances” offered by Merrill & Ring. Merrill & Ring hold that where the domestic investor and foreign investor are in a directly competitive relationship and therefore in “like circumstances,” an interpretation of “treatment no less favorable” to mean equality of competitive opportunities makes perfect sense. A holistic and coherent approach to NAFTA Article 1102 analysis begins to take form.

ii. “Treatment No Less Favorable” Means “Best” Treatment

199. Merrill & Ring has argued that Canada’s obligation to provide it with “treatment no less favorable” requires that Canada accord it treatment that is the same as the best treatment received by domestic investors that are in direct competition with Merrill & Ring in the marketplace.<sup>159</sup> This is not only supported by the jurisprudence already highlighted by Merrill & Ring,<sup>160</sup> but also by the plain wording of NAFTA Article 1102(3) itself:

The treatment accorded by a Party under paragraphs 1 and 2 means, with respect to a state or province, treatment no less favorable than *the most favorable treatment* accorded, in like circumstances, by that state or province to investors, and to investments of investors, of the Party of which it forms a part.<sup>161</sup>

200. As the Tribunal in *Pope & Talbot* noted, while this obligation on its face applies only to the actions of states and provinces, it actually provides the interpretive basis for the conclusion that the national governments are also required to accord the best treatment to foreign investors and their investments under NAFTA Articles 1102(1) & (2). In the words of that Tribunal:

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<sup>159</sup> Investor’s Memorial at para. 293.

<sup>160</sup> Investor’s Memorial at para. 293.

<sup>161</sup> NAFTA, Article 1102(3). [emphasis added]

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...like states and provinces, national governments cannot comply with NAFTA by according foreign investments less than the most favorable treatment they accord their own investors.<sup>162</sup>

201. Canada has responded to Merrill & Ring’s arguments by asserting that the issue is irrelevant, since, based on the facts, it claims to treat all investors “in exactly the same fashion.”<sup>163</sup> Canada is mistaken. While this shall be made abundantly clear once we consult the facts, it is clear that Canada has not disputed its legal obligation under NAFTA Article 1102 to provide foreign investors with the best treatment received by domestic investors in like circumstances.

iii. “Less Favorable Treatment” Does not Require Discriminatory Intent

202. Canada seeks to introduce a fourth element to NAFTA Article 1102 analysis, namely, that any “less favorable” treatment accorded to foreign investors in like circumstances to domestic investors must be motivated by discriminatory intent based on nationality.<sup>164</sup> This is what Canada calls NAFTA Article 1102’s “overriding purpose”. Neither the plain wording, nor the context of NAFTA Article 1102, evince any such requirement or purpose.

203. It is plain on its face that NAFTA Article 1102 is not worded so as only to protect foreign investors from discriminatory treatment based upon- and motivated by their foreign nationality. Had the Parties so intended, they could have easily drafted NAFTA Article 1102 differently. For example, if this were in fact the intention of the Parties, we might expect Article 1102 to contain a provision such as the following:

*For the purposes of subsections 1 3, a Party may accord to investors of another Party, and to investments of investors of another Party, treatment less favorable than that it accords, in like circumstances, to its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation and sale or other disposition of investments, provided that such*

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<sup>162</sup> *Pope & Talbot*, Award on the Merit of Phase 2, April 10, 2001 at paras. 39 42. Investor’s Book of Authorities (Tab 42).

<sup>163</sup> Canada’s Counter Memorial at para. 342.

<sup>164</sup> Canada’s Counter Memorial at paras. 343 352.

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less favorable treatment is not motivated by discriminatory intent based on the nationality of the investor of the other Party.

NAFTA Article 1102 contains no such wording, nor does any such language appear anywhere else in the NAFTA.

204. That “less favorable treatment” need not be motivated by discriminatory intent based on nationality is not only supported by a plain reading of the term, it is also buttressed by the overall wording of NAFTA Article 1102, which provides a context that supports an expansive not a restrictive interpretation of national treatment protections. NAFTA Article 1102 grants protection “with respect to the establishment, acquisition, expansion, management, conduct, operation and sale or other disposition of investments.” Thus, it is obvious that the drafters had in mind a vision of NAFTA Article 1102 that protects foreign investors from any sort of differential and adverse government interference. This shows that Article 1102 was always meant to afford broad protection. Curtailing that protection by reading in a requirement that “treatment” may only be considered to be “less favorable” if it is motivated by discriminatory intent based on nationality flies in the face of that intention.
205. The addition of this novel fourth element to NAFTA Article 1102 analysis also runs counter to the objectives of the NAFTA. As mentioned, these objectives include:
- Eliminating barriers to trade in, and facilitating the cross-border movement of, goods and services between the territories of the Parties; and
  - Promoting conditions of fair competition in the free trade area.<sup>165</sup>

Restricting the protections of NAFTA Article 1102 only to discriminatory treatment motivated by the nationality of the foreign investor does nothing to further these objectives. On the contrary, it runs counter to these objectives, since it would allow for trade barriers and unfair conditions of competition provided that these were not specifically motivated by discriminatory intent based on nationality. Indeed, this would amount to nothing short of an absurd result, since a NAFTA Party would be absolved of liability for taking measures that while perhaps not *de jure* discriminatory are discriminatory on a *de facto* basis.

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<sup>165</sup> NAFTA, Article 102(1)(a) & (b).

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206. Contrary to what Canada asserts, the jurisprudence does not confirm that the protections of the national treatment provision are so restricted. Canada misconstrues the jurisprudence on this matter.
207. For example, Canada relies on *Feldman* as supporting its position.<sup>166</sup> What Canada neglects to mention, however, is that the *Feldman* Tribunal only suggested that the question of nationality-based discrimination is an “interpretive hurdle” in the general context of Article 1102. In dealing with this question more concretely, it concluded that:
- ...it is not self evident, as the Respondent argues, that any departure from national treatment must be...shown to be a result of the investor’s nationality. There is no such language in Article 1102.<sup>167</sup>
208. This view was confirmed by the Tribunal in *Thunderbird*, which stated:
- It is not expected from *Thunderbird* that it show...that the less favourable treatment was motivated because of nationality. The text of Article 1102 of the NAFTA does not require such a showing.<sup>168</sup>
209. These findings have been echoed in the non-NAFTA context as well. In *Occidental*, in examining the requirements of a similarly worded national treatment provision, the Tribunal found that the Claimant had received less favourable treatment than that accorded to investors of the Respondent State. In reaching its conclusion, the Tribunal held that Ecuador had taken measures in breach of its national treatment obligation even though the Tribunal was “convinced that this has not been done with the intent of discriminating against foreign-owned companies.”<sup>169</sup>
210. Rejecting the notion that NAFTA Article 1102 offers foreign investors protection only from overt discrimination that is, discrimination an Investor could actually prove was

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<sup>166</sup> Canada’s Counter Memorial at para. 348.

<sup>167</sup> *Feldman v. Mexico* at para. 181, Respondent’s Book of Authorities (Tab 49).

<sup>168</sup> *International Thunderbird Gaming Corporation*, para. 177, Respondent’s Book of Authorities (Tab 136).

<sup>169</sup> *Occidental v. Ecuador* at para. 177, Investor’s Book of Authorities (Tab 40).

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motivated by discriminatory intent based on nationality. Arbitrator Cass, in his Separate Opinion in *UPS*, held that such an interpretation of NAFTA Article 1102 “would be of little value to investors.”<sup>170</sup> Professor Cass then went on to say that the requirements of Article 1102 “plainly extend beyond formal parity” and instead “commands an effective parity of foreign and domestic investors and investments.”<sup>171</sup> The Majority Decision in *UPS* said nothing to the contrary.

211. The fact that the jurisprudence does not support Canada’s position also reflects a deeper understanding by tribunals that this position does not fit with the overall architecture of the NAFTA. Specifically, if NAFTA Article 1102 were to be reduced to an obligation not to treat foreign investors less favourably only on the basis of nationality, this provision would become redundant. This is because such an obligation already exists under the customary international law standard of “fair and equitable treatment”. It is clear that Article 1102 is not worded so as to be a simple affirmation of customary international law with respect to discrimination towards aliens. That obligation is properly found in NAFTA Article 1105 – not Article 1102.
212. In addition, there are also good policy reasons that Article 1102 ought not be restricted in the way Canada suggests. As the Tribunal in *Feldman* noted:
- ... requiring a foreign investor to prove that discrimination is based on his nationality could be an insurmountable burden to the Claimant, as that information may only be available to the government. It would be virtually impossible for any claimant to meet the burden of demonstrating that a government’s motivation for discrimination is nationality rather than some other reason.<sup>172</sup>
213. In the end, the protections of NAFTA Article 1102 are not limited to state actions that are motivated by discriminatory intent based on the nationality of the foreign investor. Such a reading is not only contrary to the plain wording of NAFTA Article 1102, but also runs counter to the objects and purposes, as well as the architecture of the NAFTA. In addition to the good policy grounds for refusing such an interpretation, it is for these

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<sup>170</sup> *UPS v. Canada*, Separate Opinion of Dean Ronald A. Cass at para. 58, Investor’s Book of Authorities (Tab 14).

<sup>171</sup> *UPS v. Canada*, Separate Opinion of Dean Ronald A. Cass at para. 59, Investor’s Book of Authorities (Tab 14).

<sup>172</sup> *Feldman v. Mexico* at para. 183, Respondent’s Book of Authorities (Tab 49).

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reasons that NAFTA tribunals have rightly refused to interpret Article NAFTA 1102 in this way.

*c. Step 3: “With Respect to the Establishment, Acquisition, Expansion, Management, Conduct, Operation, and Sale or Other Disposition of Investments”*

214. Once a tribunal has disposed of the questions relating first to “like circumstances”, and next to “less favorable treatment”, then, consistent with the plain wording of NAFTA Article 1102, it must then ensure that the treatment in question is “with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.” As Merrill & Ring has noted, this is a very broad aspect of the provision that seemingly encompasses almost any measure reasonably connected with the investment.<sup>173</sup>

#### **4. Merrill & Ring is in “Like Circumstances” to Domestic Investors**

215. Using this principled and pragmatic vision of NAFTA Article 1102 analysis as a compass, we shall now demonstrate that, on the facts of this case, Canada has violated its national treatment obligations. The first step, of course, is to demonstrate that Merrill & Ring is in "like circumstances" to domestic investors. The facts clearly demonstrate that this is the case.

*a. Merrill & Ring Is in “Like Circumstances” with Log Producers in the BC Interior and Alberta*

216. Merrill & Ring’s operations are located exclusively on the BC South-Coast.<sup>174</sup> The trees Merrill & Ring grows are of various species, including hemlock, balsam, Douglas-fir, red cedar, yellow cedar, spruce, alder, maple, lodgepole pine, white pine, paper birch, and

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<sup>173</sup> Investor’s Memorial at para. 295.

<sup>174</sup> Schaaf Witness Statement, February 12, 2008 at para. 9.



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cottonwood.<sup>175</sup> Log producers in both the BC Interior and Alberta grow many of these same species.<sup>176</sup>

217. Many log producers on the BC South-Coast harvest old-growth trees.<sup>177</sup> Old-growth trees have characteristics that make them very different from second-growth trees, and the two may have different end-uses.<sup>178</sup> Merrill & Ring, however, harvests only second-growth trees.<sup>179</sup> Log producers in both the BC Interior and Alberta also harvest logs that are primarily second-growth,<sup>180</sup> although old growth is also harvested in the BC Interior.<sup>181</sup> This means that the logs Merrill & Ring grows, and the logs grown by producers in the BC Interior and Alberta have the same end-uses, with most of them destined for processing in sawmills and pulpmills. C-1(b)(ii) group of lumber mills. C-1(b)(ii) explains in his witness statement, this is why he has used Merrill & Ring logs and logs from the BC Interior and Alberta interchangeably in his sawmills.<sup>182</sup>

218. There is one particular area in the BC Interior known as the “wet belt” that provides a perfect example of the interchangeability of Merrill & Ring’s logs with logs produced in the BC Interior. The wet belt is located in the Kootenay region of BC, very near the Canada-US border.<sup>183</sup> The growing conditions in the wet belt are very similar to those on

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<sup>175</sup> Schaaf Witness Statement, February 12, 2008 at para. 14.

<sup>176</sup> Branter Witness Statement, December 9, 2008 at para. 4; See also C-1(b)(ii)

<sup>177</sup> Ruffle Expert Report, December 11, 2008 at para. 4.6.4.

<sup>178</sup> Ruffle Expert Report, at para. 4.6.4.

<sup>179</sup> Schaaf Witness Statement, February 12, 2008 at para. 14.

<sup>180</sup> C-1(b)(ii) Branter Witness Statement, December 9, 2008 at para. 4.

<sup>181</sup> C-1(b)(ii)

<sup>182</sup> C-1(b)(ii)

<sup>183</sup> C-1(b)(ii)

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the BC South-Coast.<sup>184</sup> As a result, log producers in the wet belt grow trees of the same species and grades as the trees grown by log producers on the BC South-Coast, including Merrill & Ring.<sup>185</sup> Trees grown in the wet belt have the exact same end-use as trees grown on the BC South-Coast; they are either sold to domestic log processors, or else they are exported to log processors in the US.<sup>186</sup> These logs are directly substitutable for one another in the market.

219. The substitutability of Merrill & Ring’s logs with those of log producers in the BC Interior is further evidenced by the fact that they are placed up for sale on the very same Bi-Weekly List, with log purchasers comparing them one against the other when making offers on the logs that are listed.

220. Just like Merrill & Ring, log producers in the BC Interior set harvest plans to organize their operations ahead of time. Just like Merrill & Ring, log producers in the BC Interior are subject to “blockmailing” and special targeting.<sup>187</sup> Just like Merrill & Ring, log producers in the BC Interior have to scale their logs according to the metric system.<sup>188</sup> Just like Merrill & Ring, log producers in the BC Interior cannot enter into long-term supply contracts with US purchasers as a result of the Log Export Control Regime.<sup>189</sup> Just like Merrill & Ring’s logs, logs in the BC Interior are subject to damage as they wait to clear the Surplus Testing Procedure and gain export approval.<sup>190</sup> And just like Merrill & Ring, log producers in the BC Interior export their logs to the US if they can eventually obtain an export permit from Canada under the Surplus Testing Procedure. Of course,

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<sup>184</sup> C-1(b)(ii)

<sup>185</sup> Ruffle Expert Report, at para. 4.6.4.

<sup>186</sup> C-1(b)(ii)

<sup>187</sup> C-1(b)(ii)

<sup>188</sup> Schaaf Reply Witness Statement, December 12, 2008 at para 4; C-1(b)(ii). Indeed, Canada confirms that insofar as log scaling is concerned, Merrill & Ring is in “like circumstances” with all other log producers in BC. See Canada’s Counter Memorial at para. 385.

<sup>189</sup> C-1(b)(ii)

<sup>190</sup> C-1(b)(ii)

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log producers in Alberta do not face these difficulties since they are not subject to any of the restrictions of the Log Export Control Regime.<sup>191</sup>

221. As Merrill & Ring has pointed out, log sorting requirements on the BC Coast are different than sorting requirements in the BC Interior and Alberta.<sup>192</sup> Canada has responded by alleging that this difference is due to the simple fact that “normal market sorting practices” in these areas differ.<sup>193</sup> What Canada is trying to do is to portray the differences in sorting requirements as something natural and immutable. Canada has it backwards: these differences are not the result of any natural or immutable force; they are the result of the Log Export Control Regime itself, which requires log producers in these different regions to sort their logs differently. These differences do not render Merrill & Ring “unlike” log producers in the Interior or Alberta, since these differences are the result of governmental not natural forces.

222. For all these reasons, Merrill & Ring and its investments are in “like circumstances” to log producers and their logs in the BC Interior and in Alberta.

*b. Merrill & Ring Is in "Like Circumstances" with Log Producers on the BC Coast*

223. For similar reasons, Merrill & Ring is *a fortiori* in “like circumstances” to log producers on the BC Coast, whether they are located on the South-Coast or not.

224. The trees Merrill & Ring grows are of exactly the same species and grades as other log producers on the BC Coast. There is no difference between the logs Merrill & Ring produces and the logs domestic investors produce on the BC Coast.

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<sup>191</sup> Branter Expert Statement, December 9, 2008 at paras. 5 & 6.

<sup>192</sup> Investor’s Memorial at para. 143.

<sup>193</sup> Canada’s Counter Memorial at para. 378.

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225. Just like logs produced on the BC South-Coast, logs produced on the entire BC Coast have exactly the same end-use in the market.<sup>194</sup> Logs from the BC South-Coast appear on the same Bi-Weekly List as logs from other parts of the Coast. The logs are completely interchangeable. Log processors will simply purchase the logs they need at the best price they can.
226. Just like Merrill & Ring, log producers from other parts of the BC Coast set harvest plans to organize their operations ahead of time. Just like Merrill & Ring, log producers from other parts of the BC Coast are subject to “blockmailing” and special targeting.<sup>195</sup> Just like Merrill & Ring, log producers from other parts of the BC Coast have to scale their logs according to the metric system and sort them in accordance with the *Coastal End Use Sort Descriptions*.<sup>196</sup> Just like Merrill & Ring, log producers from other parts of the BC Coast cannot enter into long-term supply contracts with US purchasers as a result of the Log Export Control Regime.<sup>197</sup> Just like Merrill & Ring's logs, logs from other parts of the BC Coast are subject to damage as they wait to clear the Surplus Testing Procedure and gain export approval.<sup>198</sup> And just like Merrill & Ring, log producers from other parts of the BC Coast gladly export their logs to the US and Asia if they can eventually clear the Surplus Testing Procedure.
227. For all these reasons, Merrill & Ring and its investments are in “like circumstances” to log producers and their logs from other areas of the BC Coast.

c. *Policy Rationale Does Not Render Merrill & Ring "Unlike" Domestic Investors in Alberta, the BC Interior, or the BC Coast*

228. A basic element of Canada’s “like circumstances” argument is that the rationale underlying a number of its policies somehow leads to the conclusion that Merrill & Ring

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<sup>194</sup> C-1(b)(ii) [REDACTED]

<sup>195</sup> C-1(b)(ii) [REDACTED]

<sup>196</sup> C-1(b)(ii) [REDACTED]

<sup>197</sup> C-1(b)(ii) [REDACTED]

<sup>198</sup> C-1(b)(ii) [REDACTED]

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is not in “like circumstances” to other log producers. This is falsely premised on the notion that Canada’s own discriminatory policies can serve to absolve it of liability for those very same policies. Canada makes this argument in four specific contexts.

229. First, Canada argues that “BC is in entirely unlike circumstances from all other provinces with respect to the need for, and application of, *Notice 102*.”<sup>199</sup> On this point it is evident that Canada is fundamentally confused about how to approach “like circumstances” analysis. The thrust of Canada’s argument seems to be that BC is “unlike” other provinces. However, this is totally beside the point. The issue is whether Merrill & Ring is in “like circumstances” to domestic investors. Whether or not BC is “like” or “unlike” other provinces is entirely irrelevant for the purposes of Article 1102.
230. Canada implies that since *Notice 102* is crafted for the logging industry in BC, there is a rational connection between this measure and its stated purpose, thereby placing Merrill & Ring in “unlike circumstances” to log producers in other provinces. Even assuming that there was some logical coherence to this argument, it would not actually work in the context of this case. As Canada has rightly pointed out, the stated purpose of *Notice 102* is:

...to ensure that there is an adequate supply and distribution of [logs] in Canada for defence and other needs.<sup>200</sup>

Canada admitted in the document production process, that it has no documents of any kind to suggest that there has ever been any shortage of logs anywhere in Canada related to either the needs of national defence or of domestic sawmills.<sup>201</sup> In fact, we know that in recent years the problem in BC has been to generate enough processing capacity to deal with wood created as a result of an infestation of Mountain pine beetle.<sup>202</sup> This is partly

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<sup>199</sup> Canada’s Counter Memorial at para. 358.

<sup>200</sup> Canada’s Counter Memorial at para. 358; *Notice 102*, section 1.2, Investor’s Schedule of Documents (Tab 22).

<sup>201</sup> This is why Canada was unable to produce any documents in response to Merrill & Ring’s Document Request #10, Investor’s Schedule of Documents (Tab 83), which requested “[d]ocuments evidencing any shortage of logs anywhere in Canada related to (a) the needs of national defence; or (b) log supplies for domestic sawmills.”

<sup>202</sup> Ruffle Expert Report, at para. 4.6.8.

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why log production has fallen well short of the annual allowable cut in every part of the province in recent years.<sup>203</sup> In short, the problem is not on the supply side it is on the demand side.<sup>204</sup>

231. The second context in which Canada seeks to rely on its own policies to excuse it from liability under NAFTA Article 1102 for those very same policies relates to the issue of differential sorting requirements on the BC Coast as compared to the BC Interior. For Canada, the fact that it forces Merrill & Ring to sort its logs differently than log producers in the BC Interior means that Merrill & Ring is not in “like circumstances” to those log producers.<sup>205</sup> Canada suggests that the different sorting requirements it imposes on log producers on the BC Coast as compared to the BC Interior are merely a reflection of “normal market practices”<sup>206</sup> that they are “industry driven and not a government initiative.”<sup>207</sup> This is plainly false. *Notice 102* itself imposes the requirement that logs be sorted in booms comprised of “not less than 90% of a single species.”<sup>208</sup> *Notice 102* is a government initiative, not “industry driven”. In any event, in explaining the rationale behind these sorting requirements, Canada lays bare just what it means by “industry driven”. Canada’s “rationale” is made clear when it explains that the differential sorting requirements on the BC Coast exist because “[m]ills require preferred log dimensions.”<sup>209</sup> In other words, when Canada states that this policy is “industry driven”, what it really means is that it caters to the domestic preferences of local B.C. log processors. These local preferences are different from preferences in other markets.<sup>210</sup> This, however, comes at the expense of log producers like Merrill & Ring.

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<sup>203</sup> Ruffle Expert Report, at para. 4.6.2.

<sup>204</sup> Canada’s former Royal Commissioner, Professor Peter Pearse, concluded that the Log Export Control Regime could not be a plausible policy connected to addressing the adequacy of domestic timber supply in paras. 23-26 of his Witness Statement filed in this arbitration dated February 6, 2008.

<sup>205</sup> Canada’s Counter Memorial at paras. 378-382.

<sup>206</sup> Canada’s Counter Memorial at para. 378.

<sup>207</sup> Canada’s Counter Memorial at para. 376.

<sup>208</sup> *Notice 102*, section 1.5, Investor’s Schedule of Documents (Tab 22).

<sup>209</sup> Canada’s Counter Memorial at para. 380.

<sup>210</sup> Stutesman Witness Statement, February 8, 2008 at para. 25.

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232. The third example where Canada seeks to rely on its own policies to excuse it from liability under NAFTA Article 1102 for those very same policies can be seen in its explanation for allowing log producers in the BC Interior to advertise standing timber, while preventing log producers on the BC Coast from doing the same. According to Canada, the fact that it can offer a policy rationale for this differential treatment means that Merrill & Ring is not “in like circumstances” to log producers in the BC Interior.<sup>211</sup> Again, Canada attempts to frame the issue to suggest that the difference in treatment is a reflection of “normal market practices”. And again, Canada has it backwards. The difference in treatment is not a result of “normal market practices”; rather, these so-called “normal market practices” are a result of the difference in treatment.
233. The fourth example where Canada seeks to rely on its own policies to excuse it from liability under NAFTA Article 1102 for those same policies arises in its explanation of the rationale behind the so-called “remoteness rule”. Again, for Canada, the fact that it can offer a policy rationale for the differential treatment it accords log producers in “remote” areas as opposed to “non-remote” areas means that these log producers are not “in like circumstances” to one another.<sup>212</sup> Canada explains that requiring log producers in “remote” areas to advertise their logs in minimum volumes of 2,800 m<sup>3</sup> is a policy that is designed to make it economical for log purchasers to travel the distances required to inspect the logs. The ultimate goal is apparently to prevent log producers from circumventing the Surplus Testing Procedure by advertising their logs in sufficiently small volumes to discourage offers from log producers.<sup>213</sup>
234. In any event, as Former Royal Commissioner Peter Pearse points out in his Expert Report, the objective of the Log Export Ban policy - the provision of an adequate supply of logs in British Columbia for domestic production and the use of an export ban - is unsustainable.<sup>214</sup> Though the Federal Government has maintained this policy, British

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<sup>211</sup> Canada’s Counter Memorial at para. 402.

<sup>212</sup> Canada’s Counter Memorial, para. 369.

<sup>213</sup> Canada’s Counter Memorial at para. 370.

<sup>214</sup> Peter Pearse Expert Report, February 6, 2008 at para. 23.

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Columbia has found itself with a growing surplus of logs on the British Columbia Coast over the past 10 years. In addition, the current glut of timber has been exaggerated by the pine beetle infestation in the Interior. In short, the available supply of timber in both the Coast and Interior regions far exceeds the demands of domestic mills.<sup>215</sup> Pearse concludes:

The absence of a clear, substantive rationale for these federal controls aggravates public debate about the policy, and gives rise to charges of unfair discrimination by the federal government against private owners of forestland in this province. But it has more tangible effects as well: it lowers the value of private forest resources and forest production, weakens property rights, and narrows markets for timber.<sup>216</sup>

235. This policy is a perfect example of a regulatory regime run amok. The fundamental purpose of the Log Export Control Regime is “to ensure that there is an adequate supply and distribution of [logs] in Canada for defence and other needs.”<sup>217</sup> There is no shortage of supply of logs for the needs either of defence or log processors. In addition, this policy is environmentally unsustainable. This runs against any number of Canadian policies.<sup>218</sup> Canada has admitted that the purpose of the so-called “remoteness” rule is to prevent log producers from circumventing the Surplus Testing Procedure.<sup>219</sup> In light of the fact that there has never been a shortage of supply, there is no rational connection between this “rule” and the underlying purpose of the Log Export Control Regime. Canada must not be allowed to rely on such misguided policies to avoid liability under Article 1102.

*d. Inter-regional Log Flows*

236. Douglas Ruffle is a registered Professional Forester in the Province of British Columbia. Mr. Ruffle provided an expert report which has been set out with this Reply Memorial. Mr. Ruffle has considered the issue of inter-regional log flows and also the comments on

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<sup>215</sup> Peter Pearse Expert Report, February 6, 2008 at para. 25.

<sup>216</sup> Peter Pearse Expert Report, February 6, 2008 at para. 32.

<sup>217</sup> Canada’s Counter Memorial at para. 358; *Notice 102*, section 1.2, Investor’s Schedule of Documents (Tab 22).

<sup>218</sup> Macpherson Expert Statement, December 14, 2008 at Section III.

<sup>219</sup> Canada’s Counter Memorial at para. 370.



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that subject made by Canada's experts. He was able to conclude that there are four forest-sawmilling regions in BC and the US. These are:

- a. the US Coast western Washington, western Oregon (west of the Cascade Mountains) and northwestern California;
- b. the BC Coast (west of the Coast Mountains);
- c. the US Inland northeastern Washington (east of the Cascades), northern Idaho and western Montana; and
- d. the BC Interior southern BC portion (east of the Coast Mountains).<sup>220</sup>

237. While log flows between these regions have generally been low, this is not the natural state of the market. On the contrary, this state of affairs is the result of three factors that keep these regions separate in terms of log markets.

238. The first factor is transportation distances and costs.<sup>221</sup> Long transportation distances and high trucking and rail costs usually make it uneconomical to move logs from west to east across the mountains in both BC and the US. This is why sawmills in the US Inland and BC Interior source only small volumes of logs from the BC Coast. However, this is not the case with respect to Merrill & Ring's logs as very low water transportation costs (rafting and barging) make log flows very economic between US Coastal mills and logs from the BC Coast.

239. The second factor is the different forests (species and log sizes), which also affect end-product market. Generally the size and species of most Coastal logs are incompatible with many Interior and Inland sawmills and this limits the shipments of logs from the BC Coast to the BC Interior and US Inland. There is however an important exception to this.<sup>222</sup> Some Interior mills and many more mills in the Inland Region saw Douglas-fir

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<sup>220</sup> Ruffle Expert Report, Section 4 at para. 4.6.1.

<sup>221</sup> Ruffle Expert Report, Section 4 at para. 4.6.1.

<sup>222</sup> Ruffle Expert Report, Section 4 at para. 4.6.2.

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and hemlock logs. There are significant supplies of small diameter Coastal logs, primarily in the gang and chip-n-saw sorts of Douglas-fir and hem-bal, which are suitable for Interior and Inland mills.

240. Merrill & Ring produces these small diameter logs which are also produced in the Interior Wet Belt. The Wet Belt sub-region of the Interior has a climate similar to the Coast in terms of higher rainfall and more moderate temperatures compared to most other areas in the Interior.<sup>223</sup> As a result western hemlock, red cedar and Douglas-fir are found in significant volumes in the Wet Belt and they have the same log characteristics as their counterpart species found on the Coast. Logs harvested in the Wet Belt in terms of species are very similar and could be interchanged with those produced by Merrill & Ring and other producers on the Coast. This is evidenced by the fact that there are sawmills in the Merritt and Kamloops areas of the Interior of BC, which have sourced logs from the BC Coast.<sup>224</sup>
241. The third factor is the operation of the Log Export Control Regime. The reason greater log volumes are not exported south is because of the log export regulations. This is a key reason that the log markets of the Interior and US Inland Regions have not been integrated. The difference is the log export regulations and not any differences between the forests, sawmills or lumber products, as there are really none.<sup>225</sup> The export regulations restrict the north-south movement of logs to mills and prevent the more complete integration of free trade in log markets that would otherwise occur.

## 5. Merrill & Ring is Treated “Less Favorably” Than Domestic Investors

242. Canada has treated Merrill & Ring “less favorably” than these domestic log producers.

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<sup>223</sup> Ruffle Expert Report, Section 4 at para. 4.6.4.

<sup>224</sup> Ruffle Expert Report, Section 4 at para. 4.6.2.

<sup>225</sup> Ruffle Expert Report, Section 4 at para. 4.6.6.

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a. *Merrill & Ring is Forced to Observe the Requirements of Notice 102 Other Log Producers in BC and Alberta Are Not*

243. The most obvious way Canada has accorded Merrill & Ring “less favorable treatment” is by forcing it to comply with the various requirements of *Notice 102*. Since *Notice 102* only applies to log producers in BC, log producers in other Provinces such as Alberta are not subject to its requirements.<sup>226</sup> Canada does not dispute the fact that *Notice 102* does not apply to log producers outside of BC.<sup>227</sup>

244. In addition, since *Notice 102* only applies to log producers with federal lands, it does not apply to log producers with provincial lands, even if those lands are in BC. As a result, Merrill & Ring receives “less favorable treatment” than log producers in Alberta, as well as log producers with provincial lands in BC.

b. *Merrill & Ring is Forced to Sell its Logs Domestically Log Producers in Alberta are Not*

245. *Notice 102* requires Merrill & Ring to offer its logs for sale on the domestic market before it can obtain export approval. This means that Merrill & Ring must advertise its federal logs on the Federal Bi-Weekly List for a period of two weeks. If a log processor places an offer on the advertised logs, those logs are subjected to the Surplus Testing Procedure as administered by TEAC/FTEAC. If TEAC/FTEAC determines that any offer placed on Merrill & Ring’s logs is within 5% of domestic market value, then Merrill & Ring is effectively required to sell its logs at said price to the offering log processor.<sup>228</sup> The price at which Merrill & Ring is forced to sell its logs is invariably well below the price it could receive on the export market.

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<sup>226</sup> Branter Witness Statement, December 9, 2008 at para. 5.

<sup>227</sup> Canada’s Counter Memorial at para. 355.

<sup>228</sup> Affidavit of Judy Korecky at para. 101.

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246. Since *Notice 102* does not apply to log producers in Alberta and other Provinces, there is no regulatory impediment to log producers in those Provinces exporting their logs.<sup>229</sup> As a result, they are spared all the agonies of the Surplus Testing Procedure, and are free to export their logs at will at premium prices.

247. There can be no doubt that forcing Merrill & Ring to sell its logs on the domestic market *does* constitute a form of “treatment”, and that this treatment is in fact “less favorable” than that received by log producers in Alberta and other provinces.

*c. Merrill & Ring is Forced to Sell its Logs under "Blockmail" Log Producers in Alberta are Not*

248. Because *Notice 102* forces Merrill & Ring to advertise its logs for sale on the domestic market before it can apply for export approval, it creates the conditions that make it possible for log processors to subject Merrill & Ring to “blockmail”. Indeed, it would be impossible for log processors to blockmail Merrill & Ring were it not for this requirement. Because of blockmail, not only is Merrill & Ring forced to incur the costs associated with managing this threat,<sup>230</sup> but it is also forced to sell logs to log processors some of which they are in direct competition with<sup>231</sup> at suppressed domestic market prices.

249. Since *Notice 102* does not apply to log producers in Alberta and other provinces, they are not exposed to the illicit practice of “blockmail”.<sup>232</sup> As a result, neither do they have to incur the additional costs of dealing with blockmail, nor are they able to be coerced into selling their logs on the domestic market.

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<sup>229</sup> Branter Expert Statement at para. 5.

<sup>230</sup> Schaaf Witness Statement, February 12, 2008 at para 30.

<sup>231</sup> Kurucz Witness Statement, February 11, 2008 at para. 67.

<sup>232</sup> Branter Expert Statement at para. 6.

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250. However, Canada argues that since it is log processors who actually “blockmail” Merrill & Ring, it is not responsible for the effects of this extortive practice.<sup>233</sup> By this, Canada may be presumed to mean that there is no “treatment” here. This argument places form over substance, and amounts to a denial of reality. Though it may be that Canada does not actively blockmail Merrill & Ring itself, it is still responsible for enabling this practice. The “treatment” Canada has accorded Merrill & Ring is the requirement to abide by *Notice 102* and the Surplus Testing Procedure. Blockmail is the direct consequence of this treatment.

*d. Merrill & Ring is Forced to Cut, Sort, and Scale its Logs in a Particular Way Log Producers in the BC Interior and Alberta Are Not*

251. As Merrill & Ring has argued, Canada further accords Merrill & Ring “less favorable treatment” by requiring it to cut, sort, and scale its logs in a particular way. This is mandated by *Notice 102*, which requires logs to be scaled metrically,<sup>234</sup> as well as sorted so as to conform to what are referred to as “normal log market practices”,<sup>235</sup> which include the *Coast Domestic Market End Use Sort Descriptions*.

252. Canada has responded by arguing that the sorting requirements on the BC Coast to which Merrill & Ring must adhere are “industry driven”, and, as such, that it has not accorded Merrill & Ring any “treatment” in this respect.<sup>236</sup> Canada’s attempt to portray sorting requirements as “industry driven” is misleading and incorrect. The differential sorting requirements are sanctioned by *Notice 102*. Canada cannot deny that *Notice 102* constitutes a “measure” that accords Merrill & Ring particular “treatment”. However, to the extent that scaling and sorting requirements may be seen to be driven by industry at all, it is important to remember that they are driven by the log *processing* industry, not the log *producing* industry. In any event, BCMOF enforces these sorting requirements, and

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<sup>233</sup> Canada’s Counter Memorial at para. 646.

<sup>234</sup> *Notice 102*, section 1.6, Investor’s Schedule of Documents (Tab 22).

<sup>235</sup> *Notice 102*, section 1.5, Investor’s Schedule of Documents (Tab 22)

<sup>236</sup> Canada’s Counter Memorial at para. 376.

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has done so with Merrill & Ring on many occasions.<sup>237</sup> The enforcement of sorting requirements by a governmental body most certainly constitutes “treatment” for the purposes of Article 1102. Each and every time Merrill & Ring is required to sort its logs in accordance with the *Coast Market End Use Sort Descriptions*, it is subject to “treatment”.

253. In the event this Tribunal agrees that requiring Merrill & Ring to sort its logs in a particular way *does* constitute “treatment”, Canada argues that this “treatment” is not in fact “less favorable”. Indeed, Canada goes so far as to argue that this “treatment” actually benefits Merrill & Ring, since, according to Canada, it ensures that Merrill & Ring obtains the best price possible for its logs. This is absurd. Merrill & Ring has been in the log production business for well over 100 years, and knows how to obtain the best prices for its logs. The best prices Merrill & Ring can obtain for its logs are on the world markets, not the BC market. Merrill & Ring’s export customers do not want their logs cut, sorted, and scaled in the way required by the Log Export Control Regime. This is why Merrill & Ring often has to re-scale and re-sort its logs incurring extra expense in the process if they end up passing the Surplus Testing Procedures and receiving export approval.<sup>238</sup>
254. Just like the Log Export Control Regime in general, the cutting, sorting, and scaling requirements Canada forces upon Merrill & Ring are not designed for Merrill & Ring’s benefit. They are created for the benefit of log *processors* not log *producers*. Canada inadvertently admits as much when it states that “[m]arket specific sorting practices accord the most favorable treatment available to processors in each market...”<sup>239</sup> The benefit such sorting requirements provide to log *processors* comes at the expense of log *producers* like Merrill & Ring.
255. Unlike Merrill & Ring, private forest landowners in Alberta and other provinces are free to cut, sort, or scale their logs any way they please, and can perfectly cater to the needs of

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<sup>237</sup> Kurucz Witness Statement, February 11, 2008 at para. 53.

<sup>238</sup> Schaaf Witness Statement, February 12, 2008 at para. 29.

<sup>239</sup> Canada’s Counter Memorial at para. 383.

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their customers.<sup>240</sup> Furthermore, log producers in the BC Interior, are not required to cut, sort, and scale their logs in accordance with the *Coast Domestic Market End Use Sort Descriptions*.<sup>241</sup> Coast log producers, who seek to export must comply with these mandatory rules. As a result, not only is there no question that the scaling and sorting requirements Canada imposes on Merrill & Ring constitute “treatment”, but there can be no doubt that this treatment is in fact “less favorable” than that accorded to log producers in Alberta and other provinces, as well as to log producers in the BC Interior.

*e. Merrill & Ring is Forced to Observe the So-Called “Remoteness Rule” Other Log Producers on the South-Coast Are Not*

256. Merrill & Ring has also argued that the fact that Canada has required it to observe the so-called “remoteness rule” with respect to its logs in Theodosia further constitutes “less favorable treatment”.<sup>242</sup> This is required by *Notice 102*, which specifies that logs in “remote” areas on the BC Coast must be advertised in volumes no less than 2,800 m<sup>3</sup>.<sup>243</sup>
257. In response, Canada argues that Merrill & Ring’s Theodosia lands are not actually considered “remote” the suggestion being that Merrill & Ring has never in fact been subject to the so-called “remoteness rule” of *Notice 102*.<sup>244</sup> Indeed, Canada goes so far as to say that *none* of Merrill & Ring’s lands are considered “remote”.<sup>245</sup> Canada suggests that, as a result, it has not accorded any “treatment” to Merrill & Ring in this respect.<sup>246</sup>
258. The fact is, however, that Canada *has* accorded Merrill & Ring “treatment” in this respect. As Mr. Kurucz has explained, a BCMOF employee and TEAC/FTEAC member,

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<sup>240</sup> Branter Witness Statement, December 9, 2008 at para. 5.

<sup>241</sup> Investor’s Memorial at para. 361(c).

<sup>242</sup> Investor’s Memorial at para. 361(b).

<sup>243</sup> *Notice 102*, section 1.4, Investor’s Schedule of Documents (Tab 22).

<sup>244</sup> Canada’s Counter Memorial at para. 368.

<sup>245</sup> Affidavit of John Cook at para. 81.

<sup>246</sup> Canada’s Counter Memorial at para. 371.

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Bruce Walders, assured him that Merrill & Ring's lands located in Theodosia are considered "remote", and logs from that area would have to be advertised in accordance with the minimum volume requirement as specified in *Notice 102*.<sup>247</sup> Since Mr. Walders was a representative of BCMOF and TEAC/FTEAC at the time, and acting in his capacity as such,<sup>248</sup> Canada is responsible under international law for his representation, regulated by FTEAC, even if the information were to be false.<sup>249</sup> Further, it is not just the disputed Theodosia properties at issue that are remote. There is no question that the following of Merrill & Ring's properties are also "remote": Charles Bay, East Thurlow, Hardwick Island, Kanish/Waiatt, Loughborough Inlet/Jackson Bay, Unwin Lake and Minstrel Island.<sup>250</sup>

259. Canada has cast aspersions upon Mr. Kurucz' sworn statement, stating that it is "unspecified" and "misleading".<sup>251</sup> C-1(b)(ii) [REDACTED], it is standard practice for BCMOF and TEAC/FTEAC not to put down in writing any representations they make.<sup>252</sup> This is consistent with the lack of transparency of the Log Export Control Regime in general.<sup>253</sup> In any event, it is not at all unreasonable for Merrill & Ring to have believed that its Theodosia lands are considered "remote". Not only is the term "remote" not defined anywhere, but, as Mr. Macpherson confirms, he considers Theodosia to be "remote" as well.<sup>254</sup>

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<sup>247</sup> Kurucz Reply Witness Statement, December 14, 2008 at paras. 5 & 8.

<sup>248</sup> Kurucz Reply Witness Statement, December 14, 2008 at para. 15.

<sup>249</sup> Article 7 of the *ILC Articles* makes clear that a person empowered to exercise elements of governmental authority shall be considered to be an act of the state under international law, even if the act exceeds his authority or instructions. In any event, as a FTEAC representative, Mr. Walders would be covered by *ILC Article 4* which creates direct state responsibility in this circumstance, Investor's Book of Authorities (Tab 130).

<sup>250</sup> Macpherson Expert Statement at para. 9.

<sup>251</sup> Canada's Counter Memorial at para. 535.

<sup>252</sup> C-1(b)(ii) [REDACTED]

<sup>253</sup> Please see our thorough review of the non transparent operation of the Log Export Control Regime in Section IV of this Reply Memorial.

<sup>254</sup> Macpherson Expert Statement, December 14, 2008 at paras. 6 10.



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260. In the case that Canada is deemed to have accorded Merrill & Ring “treatment” in this respect, Canada argues that the treatment it has accorded is not “less favorable”, since, according to Canada, it does not limit Merrill & Ring’s ability to export.<sup>255</sup> Again, Canada’s argument is plainly absurd. The minimum volume requirement clearly limits Merrill & Ring’s ability to export logs from its “remote” lands. Merrill & Ring is not even able to initiate the export process for these logs until it has been able to assemble a log sort of at least 2,800 m<sup>3</sup>. This is quite obviously a limitation on Merrill & Ring.
261. In any event, the question is not whether Merrill & Ring’s ability to export is limited. The question is simply whether Merrill & Ring receives “less favorable treatment”. For Merrill & Ring to be restricted in this way when its competitors are not, clearly constitutes “less favorable treatment” for Merrill & Ring. Canada even admits as much by recognizing that log producers may wish to circumvent the “remoteness” rule, in particular by towing their logs to “non-remote” areas for advertisement.<sup>256</sup> This is, in fact, what Merrill & Ring does. Yet contrary to what Canada suggests,<sup>257</sup> having to tow its logs to address the impacts of this requirement is a major burden on Merrill & Ring.<sup>258</sup> Not only is it a burden in terms of risk and effort, but it is a burden in terms of cost.<sup>259</sup>
262. For all these reasons, Canada has not only accorded Merrill & Ring “treatment” by representing to it that its Theodosia lands are “remote”, but this treatment is in fact clearly “less favorable” than that accorded to domestic investors with lands in “non-remote” areas.

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<sup>255</sup> Canada’s Counter Memorial at para. 372.

<sup>256</sup> Canada’s Counter Memorial at para. 372.

<sup>257</sup> Canada’s Counter Memorial at para. 372.

<sup>258</sup> Kurucz Reply Witness Statement, December 14, 2008 at para. 19.

<sup>259</sup> Kurucz Reply Witness Statement, December 14, 2008 at para. 24.

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*f. Merrill & Ring is Forbidden from Obtaining Standing Exemptions  
Log Producers on Provincial Lands Are Not*

263. In addition to treating it less favourably by forcing it to abide by *Notice 102*, Merrill & Ring has argued that Canada accords it “less favorable treatment” than provincial landholders by forbidding it from obtaining standing exemptions for its federal lands.<sup>260</sup>
264. Canada has responded by claiming that it has no constitutional authority to grant standing exemptions for federal lands. As a result, Canada asserts that it has not accorded Merrill & Ring any “treatment” in this respect.<sup>261</sup>
265. The issue here is very simple. Merrill & Ring is unable to obtain standing exemptions for its lands. There are two main reasons for this. First, Canada refuses to grant standing exemptions for federal lands, even though it grants standing exemptions for provincial lands. Second, Canada has apparently adopted a policy of not allowing standing exemptions even for provincial lands if those lands are located in the south-coastal region of BC, even though it grants standing exemptions in all other regions of BC.<sup>262</sup>
266. In the context of this international legal dispute, it is immaterial what Canada thinks it may or may not have the authority to do with respect to issuing standing exemptions. Although it is abundantly clear that Canada does in fact have the authority to grant standing exemptions for federal lands,<sup>263</sup> under international law which is the governing law of this dispute Canada is prohibited from invoking its internal laws as an excuse for violating its international obligations.<sup>264</sup> With respect to Canada’s policy of not allowing standing exemptions for provincial lands located in the south-coastal region of BC a policy that has absolutely nothing to do with its understanding of its constitutional authority this argument applies *a fortiori*.

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<sup>260</sup> Investor’s Memorial at para. 361(d).

<sup>261</sup> Canada’s Counter Memorial at para. 393.

<sup>262</sup> Letter from Lynn Sabatino to Richard Ringma (October 12, 2007), (Investor’s Schedule of Documents at Tab 74)

<sup>263</sup> Matkin Expert Opinion, December 11, 2008 at para. 6.

<sup>264</sup> As discussed earlier, this is set out in Article 27 of the *Vienna Convention* as well as in the *ILC Article 32*.

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267. In any event, R-1(b)(ii) [REDACTED]  
[REDACTED] .<sup>265</sup> This provides conclusive evidence that Canada has accorded Merrill & Ring less favourable treatment than its competitors on the BC South Coast. R-1(b)(ii) [REDACTED]  
[REDACTED]

268. Standing exemptions are of enormous value to log producers, since they represent an automatic bypassing of the Log Control Regime by allowing the guaranteed export of R-1(b)(ii) [REDACTED]

reasons for this:

- a) Since log producers with standing exemptions know ahead of time that they will be able to export their logs, they can enter into predictable supply contracts with their customers.
- b) Since standing exemptions allow logs to bypass the Surplus Testing Procedure, log producers that have them are immune from the ever-present threats of “blockmail” and special targeting.
- c) Since standing exemptions allow logs to bypass the Surplus Testing Procedure, exempted logs will not deteriorate from infestation and exposure to the elements as they wait for export approval.
- d) Since standing exemptions represent a guarantee to log producers that they will be able to export their logs, they know they will be able to receive the best market price for their logs, not the artificially suppressed BC market price.

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<sup>265</sup> R-1(b)(ii) [REDACTED]

<sup>266</sup> R-1(b)(ii) [REDACTED]

<sup>267</sup> R-1(b) [REDACTED]

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As a result, there can be no doubt that log producers that obtain standing exemptions are granted more favourable treatment than those who cannot obtain them.

269. This is a very straightforward matter. Canada forbids Merrill & Ring from obtaining standing exemptions for its lands. At the same time, Canada grants standing exemptions to Merrill & Ring's competitors. There is no question that standing exemptions are of tremendous value to log producers for several reasons. As a result, there can be no doubt that by denying Merrill & Ring even the possibility of obtaining standing exemptions, Canada accords Merrill & Ring "less favorable treatment" for the purposes of NAFTA Article 1102.

*g. Merrill & Ring is Forbidden from Advertising Standing Timber Log Producers in the BC Interior Are Not*

270. As Canada rightly points out, it allows some log producers to advertise their timber on the Bi-Weekly List before it has been cut into logs. This is what Canada refers to as "standing surplus applications" ("standing applications"). Canada notes that it only grants standing applications to log producers in the BC Interior, regardless of whether the associated timber is located on federal or provincial lands. By contrast Canada asserts that it does not allow standing applications for log producers on the BC Coast. As a result, Canada does not allow Merrill & Ring to advertise standing timber, even though it allows other log producers in BC to do so.

271. There is a significant difference for log producers between having a standing exemption, on the one hand, and, on the other, being able to advertise standing timber. A standing exemption is far more valuable, since it allows log producers to bypass the Surplus Testing Procedure and all the complications that come with that altogether.<sup>268</sup> By contrast, log producers with lands not covered by standing exemptions, but with timber they are able to advertise while it is still standing, enjoy a more modest benefit. Such log producers must still endure the risks and uncertainties of the Surplus Testing Procedure before being able to export their logs. However, the advantage they enjoy is that unlike log producers like Merrill & Ring they do not have to actually cut their trees before

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<sup>268</sup> C-1(b)(ii)

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being allowed to advertise their timber.<sup>269</sup> As a result, unlike log producers like Merrill & Ring, they can avoid many of the drawbacks of the Log Export Control Regime. Specifically, they can avoid having to cut, sort and scale their logs to the preferences of local mills.<sup>270</sup> They are also able to avoid blockmail and log blocking.<sup>271</sup> In addition, they are able to avoid having their logs deteriorate due to infestation and exposure to the elements while they wait to get through the Surplus Testing Procedure and obtain export approval. Finally, they can enter into reliable long-term supply contracts, obtaining much better prices than they could otherwise.<sup>272</sup>

272. Canada claims never to have allowed a standing application on the BC Coast in the past 15 years.<sup>273</sup> This is not the case. **R-1(b)(ii)**  
**[REDACTED]**.<sup>274</sup> Further, Canada *has* allowed standing applications in the BC Interior in recent years, and continues to do so on a regular basis.<sup>275</sup> This includes standing applications for timber located in the Wet Belt region of the BC Interior<sup>276</sup> a region with very similar growing conditions as those on the BC Coast.<sup>277</sup>
273. Just like the issue of standing exemptions, this is a rather simple matter. Canada does not allow Merrill & Ring to submit its timber to the Surplus Testing Procedure while it is still standing. At the same time, Canada *does* allow Merrill & Ring’s competitors to submit such standing applications. In light of all the aspects of the Log Export Control Regime standing applications allow a log producer to avoid, there can be no doubt that by denying

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<sup>269</sup> **C-1(b)(ii)** **[REDACTED]**

<sup>270</sup> **C-1(b)(ii)** **[REDACTED]**

<sup>271</sup> **C-1(b)(ii)** **[REDACTED]**

<sup>272</sup> **C-1(b)(ii)** **[REDACTED]**

<sup>273</sup> Canada’s Counter Memorial at para. 407

<sup>274</sup> **R-1(b)(ii)** **[REDACTED]**

<sup>275</sup> **C-1(b)(ii)** **[REDACTED]**

<sup>276</sup> **C-1(b)(ii)** **[REDACTED]**

<sup>277</sup> **C-1(b)(ii)** **[REDACTED]** Ruffle Report at para. 4.6.4.

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Merrill & Ring even the possibility of submitting standing applications, Canada accords Merrill & Ring “less favorable treatment” for the purposes of NAFTA Article 1102.

*h. Merrill & Ring is Required to Pay a Fee-in-Lieu to Export its Provincial Logs Federal Log Producers are Not*

274. Merrill & Ring is further required to pay a fee-in-lieu of manufacture to the BC government when it exports its provincial logs.<sup>278</sup> Exporters of federal logs do not have to pay any fee-in-lieu of manufacture upon export of their logs. There can be no doubt that this fee constitutes “less favorable treatment” to Merrill & Ring with respect to its provincial logs.

**6. The “Less Favourable Treatment” Received by Merrill & Ring is With Respect to the Management, Operation and Sale of its Investments**

275. Having established first that Merrill & Ring is in “like circumstances” to other log producers on the BC Coast, the BC Interior, and Alberta, and that Canada has accorded Merrill & Ring “less favorable treatment” than those other log producers, we shall now satisfy the requirements of the third step of NAFTA Article 1102 analysis, namely, that the treatment Canada has accorded Merrill & Ring is “with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.”

276. Merrill & Ring has argued that the Log Export Control Regime impedes the way it “manages” its investments, since it affects the way Merrill & Ring implements its harvest plans forcing it to behave in an economically illogical manner.<sup>279</sup> Merrill & Ring has also argued that the Log Export Control Regime “conducts” and “operates” its operations, since it prevents Merrill & Ring from entering into long-term supply contracts, and forces it to hire a log broker to help it navigate the many complexities of the Regime.<sup>280</sup> Finally,

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<sup>278</sup> Schaaf Reply Witness Statement, December 12, 2008 at para. 7.

<sup>279</sup> Investor’s Memorial at para. 362(a).

<sup>280</sup> Investor’s Memorial at para. 362(b).

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Merrill & Ring has further argued that the Log Export Control Regime affects the “sale” and “disposition” of its investments, since it forces Merrill & Ring to sell its logs to log processors in BC.<sup>281</sup>

277. Canada has not responded to any of these arguments. This is because it is simply incontrovertible that the “less favorable treatment” Canada accords Merrill & Ring does in fact impact Merrill & Ring’s investments in these ways. Without providing any argument to the contrary, Canada must be taken to admit that the “less favorable treatment” it accords Merrill & Ring is in fact “with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.” As a result, Merrill & Ring has satisfied the third and final step of national treatment analysis under NAFTA Article 1102.

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<sup>281</sup> Investor’s Memorial at para. 362(c).

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**IV. NAFTA ARTICLE 1105 – FAIR AND EQUITABLE TREATMENT**

278. Through the operation of the Log Export Control Regime, there can be no doubt that Canada has violated its obligation under NAFTA Article 1105(1) to accord Merrill & Ring “fair and equitable treatment”.<sup>282</sup>

**1. Overview**

279. Canada has advanced a meaning to the international law standard of treatment contains in NAFTA Article 1105 that is narrow and simply not in keeping with the text of the treaty. The meaning of the international standard is well known and has been well canvassed by many international tribunals, including other NAFTA tribunals. Canada argues for a threshold standard of breach that is inconsistent with the principles of state responsibility set out by the International Law Commission and by previous international investor-state tribunals. If Canada’s approach were to be followed, there would be no protection for rule of law and fundamental fairness issues within the NAFTA.

280. Canada has failed to meet its obligation to provide fair and equitable treatment to Merrill & Ring in a number of ways with respect to its administration of the Log Export Control Regime. In particular, Canada fails to meet its obligations to provide treatment in accordance with the international law standard of treatment set out in NAFTA Article 1105 under the Log Export Control Regime as Merrill & Ring is subjected to unfair and inequitable treatment including:

- a) The requirement to be subjected to the surplus testing prior to being granted an exemption to export their timber;
- b) Merrill & Ring’s ineligibility to obtain standing applications and/or obtain standing exemptions;
- c) The requirement to cut and sort timber from their federally regulated properties to artificial “normal market practices”;

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<sup>282</sup> The Investor continues to rely on the arguments made in the Investor’s Memorial, February 13, 2008 at paras. 189 254 and 352 358.



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- d) The requirement to follow the additional rules for Merrill & Ring properties located in the remote Coastal region;
  - e) The requirement to scale all timber rafts metrically even when such scaling is unnecessary; and,
  - f) The requirement to remit the fee-in-lieu on provincial rafts that are exported.
281. The Log Export Control Regime is administered in a highly secretive and non-transparent manner that flies in the face of the most fundamental aspects of the rule of law. The Surplus Testing Procedure administered by TEAC/FTEAC is completely shrouded in secrecy from beginning to end. Yet some of the most essential elements of Merrill & Ring's fundamental business operations are completely controlled by this non-transparent administration of the log export control regime. Furthermore, Canada is entirely aware of highly improper practices known as blockmailing which are taken by log processors to further extract concessions from log producers who are unfortunate to be covered by the terms of the Log Export Control Regime. Those log producers who are not covered by the Log Export Control Regime, because they receive more favourable treatment, are exempt from the application of these unethical practices which are enabled by Canada's administration fo the log export control regime.
282. Furthermore, there are serious questions about the natural justice and due process which occurs with respect to TEAC/FTEAC on account of its composition. No private log producers are permitted to sit on this body whereas log processors are always represented despite their obvious interest in maintaining artificial log prices and onerous conditions which benefit them at the cost of private producers like Merrill & Ring.
283. The onerous requirements under the Log Export Control Regime with respect to the mandatory cutting and storage of logs as they await export certification compounds the fundamental unfairness of the regime. Requirements to cut, sort and scale logs to the preferences of local mills prevent log producers from being able to enter into long term supply contracts with foreign customers. This results in highly impaired market operations and significant losses for domestic log producers who are federally regulated.

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284. The elements of unfairness inherent in the Log Export Control Regime are cumulative to each other. While each is individually unfortunate and harmful, when taken together these elements are designed to harm private landowners for the benefit of domestic British Columbia log producers.

**2. “Fair and Equitable Treatment” Is an Autonomous Standard**

285. NAFTA Article 1105(1) prescribes Canada’s duty to accord investments of foreign investors a “minimum standard of treatment.” This provides an absolute standard of treatment, regardless of how Canada treats investments of its own investors. NAFTA Article 1105(1) reads:

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.

Thus, the wording of NAFTA Article 1105(1) is clear: Canada must provide investments of foreign investors “treatment in accordance with international law.”

286. Article 38(1) of the *Statute of the International Court of Justice (“ICJ Statute”)* outlines the sources of international law. The sources of international law are as follows:

- a. international conventions;
- b. international custom, as evidence of a general practice accepted as law;
- c. general principles of law; and
- d. judicial decisions and the teachings of the most highly qualified publicists, as subsidiary means for the determination of rules of law.

Thus, the express wording of NAFTA Article 1105(1) makes clear that Canada must provide investments of foreign investors treatment in line with the rules and principles established by these four sources of international law.

287. NAFTA Article 1131 sets out the governing law of a NAFTA Chapter 11 dispute. NAFTA Article 1131(1) confirms that these sources of international law must be applied:

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A Tribunal established under this Section shall decide the issues in dispute with this Agreement and applicable rules of international law.

This merely confirms what every tribunal established pursuant to an international treaty does: interpret the obligations contained in the treaty by reference to all the sources of international law.

288. NAFTA Article 1131(2) further directs a tribunal to apply an interpretation of the Free Trade Commission to a dispute. As Canada has rightly pointed out,<sup>283</sup> on July 31, 2001, the Free Trade Commission issued Notes of Interpretation (“Notes”) with respect to NAFTA Article 1105(1). The Notes provide, in relevant part, as follows:

1. Article 1105(1) prescribes the customary international law standard of treatment of aliens as the minimum standard of treatment to be afforded to investments of investors of another Party.
2. The concepts of “fair and equitable treatment” and “full protection and security” do not require treatment in addition to or beyond that which is required by the customary international law minimum standard of treatment of aliens.

According to the wording of NAFTA Article 1131(2), the Notes may be seen to be binding on a tribunal.

289. Canada argues that the Notes restrict the meaning of NAFTA Article 1105(1) as requiring treatment only in accordance with customary international law.<sup>284</sup> Canada also argues that as a result of the Notes, this Tribunal may not apply the other normal sources of international law in interpreting Canada’s obligation to provide investments of foreign investors “fair and equitable treatment.”<sup>285</sup> Canada’s interpretation of NAFTA Article 1105(1) and the impact of the Notes is misguided.

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<sup>283</sup> Canada’s Counter Memorial at para. 445.

<sup>284</sup> Canada’s Counter Memorial at para. 449.

<sup>285</sup> Curiously, in support of this assertion, Canada quotes from *Mondev*, which does not at all support Canada’s position. As Canada highlighted, the *Mondev* Tribunal confirmed that “the standard of fair and equitable treatment and full protection and security, is to be found by reference to international law, i.e. by reference to the normal sources of international law...” See Canada’s Counter Memorial at para. 449. [emphasis added]

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290. This Tribunal is not only allowed to apply the normal sources of international law, but it is required to do so.
291. First, the Notes leave unaltered NAFTA Article 1131(1), which directs a tribunal to apply “applicable rules of international law” to NAFTA Chapter 11 disputes. These rules include all the sources enumerated in Article 38(1) of the *ICJ Statute* not just the rules of customary international law. The primary source of treaty interpretation is the wording of the treaty itself, and NAFTA Article 1131(1) is clear: a tribunal shall apply “applicable rules of international law.” A tribunal cannot, on the one hand, be directed to apply all the applicable rules of international law, and, on the other, be restricted to applying only the rules of customary international law. The Notes said nothing about discontinuing the applicability of NAFTA Article 1131(1) with respect to NAFTA Article 1105(1). As a result, NAFTA Article 1131(1) continues to apply to the entirety of NAFTA Chapter 11. This gives rise to an irresolvable conflict. In such a situation, the strict wording of the treaty itself necessarily trumps a loose interpretation thereof.
292. The second reason why Canada’s position on the Notes is not correct is that they run counter to the plain and ordinary meaning of NAFTA Article 1105(1). The general rule of treaty interpretation requires that a treaty be interpreted “in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in light of its object and purpose.”<sup>286</sup> NAFTA Article 1105(1) clearly states that Canada must “accord investments of investors of another Party treatment in accordance with *international law*” not *customary* international law. The ordinary meaning of “international law” refers to all sources of international law enumerated in Article 38(1) of the *ICJ Statute* not only customary international law. The drafters of the NAFTA were fluent in the language of international law, and were surely alert to the distinction.<sup>287</sup> Professor Schreuer puts it quite plainly:

As a matter of textual interpretation, it is inherently implausible that a treaty would use an expression such as “fair and equitable treatment” to denote a well known concept such as the

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<sup>286</sup> Article 31(1), *Vienna Convention on the Law of Treaties*, Investor’s Book of Authorities (Tab 41).

<sup>287</sup> In the *Anglo Iranian Oil Co. Case (United Kingdom v. Iran)*, Judgement, ICJ Reports 1952 at p. 105, the court accepted the principle that a legal text should be interpreted to give effect to every word in the text, Investor’s Book of Authorities (Tab 151)

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“minimum standard of treatment in customary international law.” If the parties to a treaty want to refer to customary international law, it must be presumed that they will refer to it as such rather than using a different expression.<sup>288</sup>

293. In their treatise on bilateral investment treaties, Dolzer and Stevens confirm the implausibility of the drafters of the NAFTA intending to confine the scope of the “fair and equitable treatment” standard only to customary international law:

[S]ome treaties [like the NAFTA] refer to international law in addition to the fair and equitable treatment, thus appearing to reaffirm that international law standards are consistent with, but complementary to, the provisions of the [treaty].<sup>289</sup>

294. UNCTAD provides yet another explanation about the implausibility of equating fair and equitable treatment with the international minimum standard:

Some items of State practice also support the view that the fair and equitable standard does not necessarily amount to the international minimum standard. In a number of BITs involving the United States, and in its model BIT, the fair and equitable standard is combined with full protection and security, and this combined standard is reinforced by the rule that each party to the agreement “shall in no case accord treatment less favorable than that required by international law” (Article II(3)(a)). At the same time, however, the United States has consistently maintained that customary international law assures the international minimum standard for all foreign investments. This approach – fair and equitable treatment with full protection and security on the one hand, and treatment no less favourable than that required by international law on the other – suggests that the two sets of standards are not necessarily the same.<sup>290</sup>

295. In the end, carrying the Notes through to their logical conclusion would deprive the words “fair and equitable treatment” in NAFTA Article 1105(1) of any meaning, thereby leading to an absurd or unreasonable result. This runs counter to one of the most basic tenets of

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<sup>288</sup> C. Schreuer, “Fair and Equitable Treatment in Arbitral Practice”, (June 2005), *J. World Invest. & Trade* 375 at 360, Respondent’s Book of Authorities (Tab 125); See also C. Schreuer, “Fair and Equitable Treatment (FET): Interactions with Other Standards, (2007) 4:5 *Transnat’l Disp. Mgmt.* 1 at 9-10, Respondent’s Book of Authorities (Tab 124).

<sup>289</sup> Dolzer and Stevens, “Bilateral Investment Treaties” at p. 60, Investor’s Book of Authorities (Tab 150).

<sup>290</sup> UNCTAD, “Fair and Equitable Treatment” (1999) at 39. Investor’s Book of Authorities (Tab 157).

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treaty interpretation, by which no words in a treaty are to be deprived of their meaning, or otherwise interpreted, so as to be rendered superfluous.

296. This Tribunal also must take into account the existence of over 2580 bilateral investment treaties, the vast majority of which contain fair and equitable treatment provisions. The overwhelming existence of this widespread acceptance of this obligation makes clear the widespread recognition and acceptance of this obligation by state parties.<sup>291</sup>
297. In short, it is simply impossible that the Notes accurately reflect the Parties' true intention at the time they drafted the NAFTA. Accordingly, this Tribunal should interpret NAFTA Article 1105(1) in accordance with its original wording. This means interpreting the words "fair and equitable treatment" according to their ordinary meaning. As UNCTAD aptly put it:

Where the fair and equitable standard is invoked, the central issue remains simply whether the actions in question are in all the circumstances fair and equitable or unfair and inequitable.<sup>292</sup>

298. Even if there were any lingering doubt about the appropriateness of the Notes in light of a textual analysis of the ordinary wording of NAFTA Article 1105(1), viewing NAFTA Article 1105(1) in light of the objects and purpose of the NAFTA adds further weight to the unlikelihood of the Parties having intended to restrict the meaning of NAFTA Article 1105(1) to just customary international law. NAFTA Article 102(1) sets out the objectives of the NAFTA. These include the following:

- a) Promoting transparency;
- b) Eliminating barriers to trade in, and facilitating the cross-border movement of, goods and services; and
- c) Promoting conditions of fair competition.

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<sup>291</sup> Publically available copies of bilateral investment treaties can be found on Westlaw's bilateral investment treaty service (ICA BITREATIES).

<sup>292</sup> UNCTAD, "Fair and Equitable Treatment" (1999) at 40, Investor's Book of Authorities (Tab 157).

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There is nothing about interpreting the protections of NAFTA Article 1105(1) to be limited to those recognized only by customary international law that serves to achieve these objectives.

299. Although it is clear on its face that NAFTA Article 1105(1) was never intended to be limited in this way, even in the event that any lingering uncertainty might justify recourse to the *travaux préparatoires* of the NAFTA, this supplementary means of treaty interpretation confirms that NAFTA Article 1105(1) was never intended to exclude general principles of law. Shortly after the Notes were issued, the *Pope & Talbot* Tribunal requested Canada to produce all drafting history materials supporting the intention of the Parties' to limit the reference to "international law" in NAFTA Article 1105(1) to "customary international law." In response, Canada produced some 1,500 pages of documents in 43 drafts of the NAFTA. In all those pages and drafts, the Tribunal was unable to detect a single intention by the Parties to restrict the meaning of "international law" in NAFTA Article 1105 to "customary international law."<sup>293</sup>
300. This gives rise to the third key reason why Canada's interpretation of the Notes is not binding on this Tribunal: they do not constitute a valid "interpretation" of NAFTA Article 1105, but, as Professor Chip Brower lays out clearly, are instead an "amendment".<sup>294</sup> A valid interpretation would have addressed the logical inconsistency left between NAFTA Articles 1131(1) and 1131(2) — namely, requiring international tribunals on the one hand to decide issues in accordance with "applicable rules of international law", and, on the other, requiring them to decide issues only in accordance with customary international law. A valid interpretation would also presumably be reflected in the ordinary meaning of the words of the treaty, and, failing that, at least be supportable by reference to its objects and purposes. At the very least, a valid interpretation would be supportable by reference to the *travaux préparatoires* of the treaty itself. Yet nowhere is any such support to be found for the Notes' interpretation of NAFTA Article 1105(1). It is for this

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<sup>293</sup> The public version of the negotiating history is available in Volume 3 of Barry Appleton, *NAFTA: Legal Text and Interpretive Materials*, (West Publishing: 2007).

<sup>294</sup> C.H. Brower II, "Why the FTC Notes of Interpretation Constitute a Partial Amendment of NAFTA Article 1105" *International Arbitration News*, Summer 2005, Investor's Book of Authorities (Tab 47).

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reason that after a detailed review of the drafting history of the NAFTA, the *Pope & Talbot* Tribunal concluded that the substance of the Notes does in fact amount to an “amendment” of the NAFTA, not an “interpretation”.<sup>295</sup>

301. This understanding of the Notes as an “amendment” as opposed to an “interpretation” is an important one. There is nothing indelible about the NAFTA; as NAFTA Article 2202 makes clear, the Parties may agree to amend any of its provisions at any time. An amendment is required where the Parties have reconsidered a fundamental aspect of their agreement, and would like to change it. This, however, requires that all Parties agree, and go through their respective processes to give legal effect to the amended agreement. By contrast, an “interpretation” is required not where a change to a fundamental aspect of an agreement is required, but rather where a mere clarification of, or elaboration upon the terms of that agreement is needed. Unlike a formal “amendment”, an “interpretation” is much easier to bring about; rather than requiring the Parties themselves to renegotiate the agreement a process which can be cumbersome and time-consuming an “interpretation” may be issued by a subsidiary body in this case the Free Trade Commission. If the Parties wanted to amend Article 1105(1) of the NAFTA, they were and indeed still are fully within their rights to do so. However, an amendment is a serious matter that requires the Parties to follow the proper procedures. In the case of the Notes, the Parties did not follow the proper procedures; rather, they sought to amend the NAFTA through a less cumbersome and more politically expedient channel. This was an improper attempt to circumvent the requirements of the NAFTA, and disguise an “amendment” in the garb of an “interpretation”. This amendment is therefore *ultra vires* the powers of the Free Trade Commission, and of no legal force or effect.
302. For all the above reasons, this Tribunal should consider itself at liberty to interpret the meaning of “fair and equitable treatment” as contained in NAFTA Article 1105(1) as an autonomous standard in accordance with all the normal and well-accepted sources of international law not just customary international law.

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<sup>295</sup> *Pope & Talbot*, Award in Respect of Damages at para. 47, Investor’s Book of Authorities (Tab 111).



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### 3. It is Customary to Interpret Treaties in Accordance with All Sources of International Law

303. Even if the Tribunal decides that the Notes are valid and binding or otherwise decides to demur on the matter it should still interpret the “fair and equitable treatment” standard contained in NAFTA Article 1105(1) with reference to all sources of international law. This is because the practice of deciding international legal disputes with reference to all the sources of international law is in-and-of-itself customary international legal practice.
304. As is well known, customary international law is comprised of two essential elements: consistent state practice, and *opinio juris*. That is, customary international law is formed by the consistent practice of states acting in the belief that their behaviour is legally required.<sup>296</sup> Absent either of these two elements, a practice will not obtain the status of customary international law.
305. International legal disputes are always resolved in accordance with all the rules and principles of international law. Respondent States always engage in these disputes knowing that they will be decided in accordance with the rules and principles of international law. They always do so in the belief that they are legally required to do so. If it were otherwise, States would not agree to submit their disputes to the International Court of Justice for resolution, since Article 38(1) of the *ICJ Statute* specifically states that disputes shall be interpreted with reference to all the sources of international law. As a result, the necessary elements of consistent state practice and *opinio juris* are both present in the practice of international legal dispute resolution. Resolving international legal disputes in accordance with all the rules and principles of international law is thus a part of customary international law.
306. Thus, even if the Notes are valid and binding, and the Tribunal is required only to interpret NAFTA Article 1105(1) in accordance with customary international law, it may nonetheless do so with reference to the full array of sources of international law, as is customary.

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<sup>296</sup> D.W. Greig, *International Law* at p. 26, Investor’s Book of Authorities (Tab 152).

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#### 4. The “Fair and Equitable Treatment” Standard May Be Inferred from International Jurisprudence

307. Since it is customary to resolve international legal disputes in accordance with all the rules and principles laid out in Article 38(1) of the *ICJ Statute*, this Tribunal is not as Canada argues<sup>297</sup> precluded from discerning the content of the fair and equitable treatment standard in light of the other international tribunal decisions.

308. While there can be no doubt that customary international law is comprised of state practice and *opinio juris*, nothing in international law suggests as Canada does that the decisions of international tribunals may not be used to ascertain what these elements are. As the ICJ famously proclaimed of the *North Sea Continental Shelf* cases:

That Judgment, while well known to have attributed more marked importance to the link between the legal institution of the continental shelf and the physical fact of the natural prolongation that has subsequently been given to it, is nonetheless the judicial decision which has made the greatest contribution to the *formation* of customary international law in this field.

Subsequently, the Court of Arbitration’s Decision of 30 June 1977 on the elimination of the continental shelf between France and the United Kingdom confirms on this point the Court’s conclusion in the *North Sea Continental Shelf* cases and *enunciates* as follows the general rule of customary international law on the matter: “failing agreement, the boundary between States abutting on the same continental shelf is to be determined on equitable principles.”<sup>298</sup>

From this we can see that, for the International Court of Justice at least, not only may international jurisprudence be referred to in order to “enunciate” customary international law, but it may even contribute to the actual “formation” of customary international law.

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<sup>297</sup> See, for example, Canada’s Counter Memorial at para. 454, where it argues that “the decisions of international tribunals dealing with good faith referred to by the Investor in its Memorial are...completely irrelevant...” Also at para. 474, where Canada further submits that “[d]ecisions rendered in the context of non NAFTA investor State arbitration are not relevant for this Tribunal in determining the content of NAFTA Article 1105.”

<sup>298</sup> *Gulf of Main Case* at paras. 91 & 92. [emphasis added], Investor’s Book of Authorities (Tab 135).

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309. The propriety of drawing from international jurisprudence to ascertain the scope of the “fair and equitable treatment” standard contained in NAFTA Article 1105(1) has also been affirmed by NAFTA Tribunals. As the Tribunal in *ADF* noted:

[A]ny general requirement to accord ‘fair and equitable treatment’ must be disciplined by being based upon State practice *and judicial or arbitral case law* or other sources of customary *or general international law*.<sup>299</sup>

For the Tribunal in *ADF*, then, it is clear that it is not only *permissible* to inform the meaning of the customary “fair and equitable treatment” in NAFTA Article 1105(1) with reference to international jurisprudence, but it is in fact *required*. Even more importantly, the *ADF* Tribunal also confirmed the requirement to interpret NAFTA Article 1105(1) in accordance with the other sources of international law contained in Article 38(1) of the *ICJ Statute*.

310. NAFTA Article 1105(1), like most investment protection treaties,<sup>300</sup> provides for “fair and equitable treatment”, which, as the very wording of NAFTA Article 1105(1) itself purports to make clear, is part of customary international law. This standard has been the subject of numerous disputes, and has been developed by a wide array of international tribunals in what has become a rich history of case law. Yet Canada would have this Tribunal turn a blind eye to this history, and branch out on its own in the misguided notion that the meaning of “fair and equitable treatment” in NAFTA Article 1105(1) is somehow different from the meaning of the same customary standard contained in thousands of other investment protection treaties.
311. By way of explanation, Canada argues that the “fair and equitable treatment” standard in the NAFTA context is somehow narrower than the standard contained in non-NAFTA

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<sup>299</sup> *ADF* at para. 184 [emphasis added], Respondent’s Book of Authorities (Tab 2).

<sup>300</sup> Christoph Schreuer, “Fair and Equitable Treatment in Arbitral Practice” at 1, Respondent’s Book of Authorities (Tab 125).; OECD, “Fair and Equitable Treatment Standard in International Investment Law”, September 2004 at 5, Respondent’s Book of Authorities (Tab 107).

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investment treaties.<sup>301</sup> Curiously, Canada is unable to specify in any concrete way how the standards might differ. Canada further suggests that, unlike the “fair and equitable treatment” standard contained in NAFTA Article 1105(1), the inexplicably different standard contained in non-NAFTA investment treaties has not yet “crystallized” into a rule of customary international law.<sup>302</sup> Canada is ostensibly only prepared to concede the relevance of the “fair and equitable treatment” standard contained in non-NAFTA investment treaties if Merrill & Ring is able to specifically prove that it has achieved the status of customary international law but only without referring to international jurisprudence. Canada offers no hint as to how this onus of proof might be satisfied.

312. Specifically proving that the “fair and equitable treatment” standard in non-NAFTA investment treaties has “crystallized” into a rule of customary international law without reference to international jurisprudence is not only nonsensical, but also highly impractical. To deny that there is any useful overlap between the two supposedly different standards is to engage in an act of willful blindness. To insist that it would be improper to admit any useful overlap between the two only after an investor has specifically proven the elements of consistent state practice and *opinio juris* without making reference to international jurisprudence is to accept a formalistic view of investor-state arbitration that would place an unduly onerous burden of proof upon any wronged investor. There is nothing fair or equitable about such an approach.
313. In any event, specifically proving that the “fair and equitable treatment” standard in non-NAFTA investment treaties has “crystallized” into a rule of customary international law is in fact not even necessary. There can be no doubt that the “fair and equitable treatment” standard and the principle of “good faith” it embodies at least qualifies as a general principle of law.<sup>303</sup> Since the resolution of international disputes in accordance with all the sources of international law including both general principles of law and

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<sup>301</sup> Canada’s Counter Memorial at para. 477.

<sup>302</sup> Canada’s Counter Memorial at para. 478.

<sup>303</sup> See OECD, “Fair and Equitable Treatment Standard in International Investment Law” at 2: “[The fair and equitable treatment standard] became established as a principle mainly through the increasing network of bilateral investment treaties.” Respondent’s Book of Authorities (Tab 107); See also P. Juillard, “L’évolution des sources du droit des investissements”, *Recueil des Cours*, Tome 250, 1994, from 132-134, Investor’s Book of Authorities (Tab 136).

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decisions of international tribunals is in-and-of-itself a rule of customary international law, there is nothing that precludes this Tribunal from drawing from this general principle as interpreted by international jurisprudence to inform the content of the “fair and equitable treatment” standard in the NAFTA context.

314. As a result, regardless of the relationship between the “fair and equitable treatment” standard in NAFTA Article 1105(1) and the “fair and equitable treatment” standard in other investment protection treaties, it is entirely permissible for this Tribunal to draw from international jurisprudence on the latter to inform the meaning and content of the former. In fact, it can do so without even having to determine the relationship between the two. This is a permissible, legally sound and practical approach.

#### **5. The Autonomous “Fair and Equitable Treatment” Standard and the International Law Standard Have Converged**

315. Even if the “fair and equitable treatment” standard is in fact part of customary international law, then it has greatly advanced the international law standard far beyond what Canada would have the Tribunal believe. Indeed, such has been the development of the “fair and equitable treatment” standard in recent years that the plain meaning approach, on the one hand, and, on the other, the minimum standard approach, have largely converged.
316. NAFTA Tribunals have determined that for the purposes of NAFTA Article 1105(1), to the extent that customary law is to be applied, it is to be applied as it stands today.<sup>304</sup> Recent jurisprudence on the “fair and equitable treatment” standard indicates that, while it is possible that there may still be some residual difference between the autonomous standard and customary law standard,<sup>305</sup> this difference is fast disappearing.

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<sup>304</sup> *ADF* at para. 179, Investor’s Book of Authorities (Tab 50); *Loewen*, Award, Respondent’s Book of Authorities (Tab 75).

<sup>305</sup> *Sempra* at para. 302, Respondent’s Book of Authorities (Tab 126) ; *Enron* at para. 258, Respondent’s Book of Authorities (Tab 44) .

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317. The *Azurix* Tribunal explained this convergence as follows:

... the minimum requirement to satisfy the [fair and equitable treatment] standard has evolved... and its content is substantially similar whether the terms are interpreted in their ordinary meaning... or in accordance with customary international law.<sup>306</sup>

... The question whether fair and equitable treatment is or is not additional to the minimum treatment required under international law is a question about the substantive content of fair and equitable treatment and, whichever side of the argument one takes, the answer to the question may in substance be the same.<sup>307</sup>

318. The Tribunal in *CMS Gas* took this one step further, and determined that there is in fact no difference between the autonomous “fair and equitable treatment” standard and the international minimum standard:

... the treaty standard of fair and equitable treatment... is not different from the international law minimum standard and its evolution under customary law.<sup>308</sup>

319. This view was further adopted by the Tribunal in the *Rumeli* case, which, after noting that there was agreement even between the parties that “fair and equitable” encompasses such concepts as transparency, arbitrary or discriminatory treatment, good faith, and procedural due process,<sup>309</sup> stated as follows:

The only aspect [of the fair and equitable treatment obligation] is that for Respondent, the concept does not raise the obligation on Respondent beyond the international minimum standard of protection. The Arbitral Tribunal considers that this precision is more theoretical than real. It shares the view of several ICSID tribunals that the treaty standard of fair and equitable treatment is not materially different from the minimum standard of treatment in customary international law.<sup>310</sup>

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<sup>306</sup> *Azurix* at para. 361, Respondent’s Book of Authorities (Tab 8).

<sup>307</sup> *Azurix* at para. 364, Respondent’s Book of Authorities (Tab 8).

<sup>308</sup> *CMS Gas* at para. 284, Respondent’s Book of Authorities (Tab 28).

<sup>309</sup> *Rumeli* at para. 609, Investor’s Book of Authorities (Tab 137).

<sup>310</sup> *Rumeli* at para. 611, Investor’s Book of Authorities (Tab 137).

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320. Since it is clear that customary international law may be inferred by international jurisprudence, and since that jurisprudence demonstrates that there is now a convergence between the “fair and equitable treatment” standard and the international law standard, the question about the impact of the FTC’s Notes is largely academic. Whether “fair and equitable treatment” is an autonomous standard to be interpreted in accordance with all the sources of international law, or whether it is to be understood as restricted to only customary international law, the end result appears to be the same: NAFTA Article 1105(1) requires Canada to accord foreign investors “fair and equitable treatment” in accordance with the plain and ordinary meaning of the term.

## 6. The Content and Scope of “Fair and Equitable Treatment”

321. Merrill & Ring has already thoroughly canvassed the scope and content of the “fair and equitable treatment” standard in its Memorial. The Investor’s Memorial set out the jurisprudence that *does* demonstrate that the standard of “fair and equitable treatment” in NAFTA Article 1105(1) is guided by the overarching principle of “good faith”, and requires that Canada do the following:

- Act in accordance with basic fairness and fundamental justice;<sup>311</sup>
- Act in a non-arbitrary and non-discriminatory manner;<sup>312</sup>
- Respect foreign investors’ legitimate expectations;<sup>313</sup>
- Deal with foreign investors according to basic principles of openness and transparency;<sup>314</sup>
- Ensure that it not abuse its rights in regulating foreign investors;<sup>315</sup> and
- Provide foreign investors with a basic level of security of the legal and business environment.<sup>316</sup>

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<sup>311</sup> Investor’s Memorial at para. 199.

<sup>312</sup> Investor’s Memorial at paras. 201 209.

<sup>313</sup> Investor’s Memorial at para. 221.

<sup>314</sup> Investor’s Memorial at paras. 228 234.

<sup>315</sup> Investor’s Memorial at para. 216.

<sup>316</sup> Investor’s Memorial at paras. 235 252.

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322. A recent UNCTAD study summarizes these elements by stating:

... the overall result of the arbitral decisions to date is that the fair and equitable treatment standard no longer prohibits solely egregious abuses of government power, or disguised uses of government powers for untoward purposes, but any open and deliberate use of government powers that fails to meet the requirements of good governance, such as transparency, protection of the investor's legitimate expectations, freedom from coercion and harassment, due process and procedural propriety, and good faith.<sup>317</sup>

323. Canada argues that none of these recognized elements of "fair and equitable treatment" are actually included in NAFTA Article 1105(1). That is, Canada denies that "fair and equitable treatment" in NAFTA Article 1105(1) provides foreign investors with any protection from arbitrary or discriminatory state conduct,<sup>318</sup> protects any expectations foreign investors may legitimately have,<sup>319</sup> requires Canada to abide by any standards of transparency in its dealings with foreign investors,<sup>320</sup> obliges Canada in any way to ensure that foreign investors are free to operate in a secure legal and business environment,<sup>321</sup> or otherwise prevents Canada from engaging in any sort of behavior that would be recognized as an abuse of rights.<sup>322</sup> Indeed, Canada even goes so far as to suggest that NAFTA Article 1105(1) does not require Canada to respect the overarching principle of "good faith".<sup>323</sup> Canada would have us believe that NAFTA Article 1105(1) is virtually devoid of any content at all.

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<sup>317</sup> UNCTAD, "Investor State Dispute Settlement and Impact on Investment Rulemaking" (2007) at 46, Respondent's Book of Authorities (Tab 142).

<sup>318</sup> Canada's Counter Memorial at paras. 492-506.

<sup>319</sup> Canada's Counter Memorial at paras. 507-527.

<sup>320</sup> Canada's Counter Memorial at paras. 528-535.

<sup>321</sup> Canada's Counter Memorial at paras. 536-547.

<sup>322</sup> Canada's Counter Memorial at paras. 507-527.

<sup>323</sup> Canada's Counter Memorial at para. 453.



*a. Canada Need Not Act in Bad Faith to Breach its Duty to Act in Good Faith*

324. Canada’s denial that “fair and equitable treatment” in NAFTA Article 1105(1) requires it to act in good faith is surprising. That “good faith” is an overarching principle of international law is so well settled that any suggestion to the contrary is simply not credible. As an overarching principle of international law, the principle of “good faith” finds expression in a number of international obligations.<sup>324</sup> One such obligation is the duty of a host State to provide foreign investors “fair and equitable treatment.” This connection between the principle of “good faith” and the “fair and equitable treatment” standard has been recognized by numerous Tribunals.<sup>325</sup>
325. Yet while the overarching duty of good faith may find expression in the “fair and equitable treatment” standard, it is not an essential element of it. This too has been affirmed by several Tribunals.<sup>326</sup> As a result, while bad faith may serve as an indication that there has been a breach of “fair and equitable treatment”, it is not necessary that a state act in bad faith to violate this obligation. Indeed, Canada even recognizes as such when it quotes from an UNCTAD study, which notes that “the content of the fair and equitable treatment standard no longer requires bad faith or “outrageous” behaviour on behalf of the host country.”<sup>327</sup>
326. Thus, even if Canada is found not to have acted in bad faith, it may nonetheless be said to have violated its obligation to provide Merrill & Ring with “fair and equitable treatment.”

*b. Breach of Any One of the Elements of “Fair and Equitable*

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<sup>324</sup> For example, under Article 26 of the *Vienna Convention*, Canada is required to perform its obligations under NAFTA in good faith.

<sup>325</sup> *S.D. Myers* at para. 134, Investor’s Book of Authorities (Tab 39); *Tecmed* at para. 153, Investor’s Book of Authorities (Tab 55); *Eureko* at para. 235, Investor’s Book of Authorities (Tab 56); *Siemens* at para. 308, Investor’s Book of Authorities (Tab 138); *Rumeli v. Kazakhstan* at para. 609, Investor’s Book of Authorities (Tab 137).

<sup>326</sup> *Enron* at para. 263, Respondent’s Book of Authorities (Tab 44); *Azurix* at para. 372, Respondent’s Book of Authorities (Tab 8); *Tecmed* at para. 153, Investor’s Book of Authorities (Tab 55). On this point, the position of the *Genin* Tribunal cited by Canada at para. 558 is to be seen as an outlier.

<sup>327</sup> Canada’s Counter Memorial at FN 484.

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*Treatment” is Sufficient but not Necessary for a Violation of  
NAFTA Article 1105(1)*

327. Although the “fair and equitable treatment standard” is comprised of all the above-noted elements, a violation of this standard does not require a breach of each of these elements. Rather, breach of any one of the elements may be sufficient but is not necessary to constitute a breach of the overall standard.
328. Canada, however, sees it differently. In defense of its highly implausible position that none of the obligations Merrill & Ring referred to in its Memorial are actually part of the “fair and equitable treatment” standard contained in NAFTA Article 1105(1), Canada reasons that none of these standards are “stand alone” obligations amounting to customary rules of international law in-and-of-themselves.<sup>328</sup>
329. Canada’s reasoning here is backwards. If the “fair and equitable treatment” standard has in fact attained the status of customary international law, then it is the “fair and equitable treatment” standard not its component parts that forms the customary international law rule. The failure to act in accordance with any one of the elements of “fair and equitable treatment” does not necessarily trigger a violation of NAFTA Article 1105(1) in-and-of-itself although it could. The triggering of NAFTA Article 1105(1) by conduct that can be categorized under a single constituent category, however, is not what is required. The various elements of the “fair and equitable treatment” standard are not independent silos; rather, they are mere indicia of what might be seen as treatment that is unfair and inequitable. Acting contrary to only one of these indicia may be sufficient though not necessary to constitute a breach of “fair and equitable treatment”.
330. In his Expert Legal Opinion, Professor Robert Howse has considered this issue. He concludes that many elements of unfair treatment such as vagueness, uncertainty and non-transparency can act together to form a violation of fair and equitable treatment. In the context of considering Prof. Reisman’s unusually restrictive concept of governmental measures, Prof. Howse opines:

47. A regulatory regime may be constructed in such a way as to leave considerable vagueness and uncertainty as to what a “routine and proper application” of the regime is. Indeed,

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<sup>328</sup> Canada’s Counter Memorial at para. 486.

under NAFTA and the customary international law of “fair and equitable treatment” vagueness, uncertainty and non transparency in a regulatory regime may individually or cumulatively contribute to a violation of “fair and equitable treatment” if they sufficiently impair the investor’s entitlement to a reasonably stable and predictable legal and regulatory environment in which to operate its investment.

48. But there may be some instances where the violation of fair and equitable treatment results from a combination of a vague, uncertain and non transparent regulatory scheme and the arbitrary and/or discriminatory individual exercises of discretion that such a scheme permits or indeed invites.
49. This is even clearer when interpreting a treaty like the NAFTA, the interpretative instructions of which direct this Tribunal to Article 102 to interpret NAFTA obligations through the principles and rules including national treatment, most favored nation treatment and transparency.
50. In such cases, under Professor Reisman’s test it is very hard to discern whether such instances of violation of fair and equitable treatment could be comprehended as a “routine and proper application” of a regulatory scheme that allows broad uncontrolled discretion, or whether the violation would have to be considered as in the application, which could then only be challenged as a *non* routine or *improper* application of the scheme. Thus, an investor would be faced with fundamental uncertainty as to when to bring its claim and how to state its claim.
51. But the standard rules of state responsibility do not pose this kind of uncertainty, as extended by the NAFTA to the challenge of statutory and regulatory schemes as such and including all along individual applications of such schemes, comprehend a full spectrum of state actions and omissions that can amount, individually and/or cumulatively, to treatment of the investor that falls below the standard of fair and equitable treatment, or indeed national treatment. Indeed, the very concept of treatment suggests that, with respect to NAFTA Articles 1102 and 1105, state responsibility must extend throughout such a spectrum.

331. Take, for example, the relationship between “arbitrariness” and the “fair and equitable treatment” standard. In discussing this relationship, the *LG&E* Tribunal noted:

...characterizing the measures as not arbitrary does not mean that such measures are characterized as fair and equitable... it was not arbitrary, though unfair and inequitable, not to restore the Gas

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Law or the other guarantees related to the gas distribution sector and to implement the contract renegotiation policy.<sup>329</sup>

332. The *Petrobart* Tribunal approached the “fair and equitable treatment” analysis in a similar vein. That case involved a claim advanced under Article 10(1) of the Energy Charter Treaty. Article 10(1) provides:

Each Contracting Party shall, in accordance with the provisions of this Treaty, encourage and create stable, equitable, favourable and transparent conditions for Investors of other Contracting Parties to make Investments in its Area. Such conditions shall include a commitment to accord at all times to Investments of Investors of other Contracting Parties fair and equitable treatment...<sup>330</sup>

333. Rather than scrutinize the Kyrgyz Republic’s actions under each obligation mentioned in Energy Charter Treaty Article 10(1) separately, the Tribunal amalgamated all of these elements under a single analysis of “fair and equitable treatment”:

The Arbitral Tribunal does not find it necessary to analyse the Kyrgyz Republic’s action in relation to the various specific elements in Article 10(1) of the Treaty but notes that this paragraph in its entirety is intended to ensure a fair and equitable treatment of investments.<sup>331</sup>

334. The Tribunal in *Noble Ventures v. Romania* also followed a similar approach. In determining whether Romania had violated the “fair and equitable treatment” provision of the Romania-US BIT, the Tribunal was careful to note that a violation of one or more of the standard’s constituent elements does not necessarily mean that the standard has not in fact been breached.<sup>332</sup>

335. Thus, should the Tribunal find that Canada has acted contrary to one of the indicia of “fair and equitable treatment”, it may legitimate conclude that Canada has breached its obligations under NAFTA Article 1105(1).

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<sup>329</sup> *LG&E* at paras. 162 163, Respondent’s Book of Authorities (Tab 71).

<sup>330</sup> *Energy Charter Treaty*, Article 10(1), Investor’s Book of Authorities (Tab 139).

<sup>331</sup> *Petrobart v. The Kyrgyz Republic*, Award, Arbitration Institution of the Stockholm Chamber of Commerce, (29 March 2005) at p. 76, Investor’s Book of Authorities (Tab 140).

<sup>332</sup> *Noble Ventures* at para. 182, Respondent’s Book of Authorities (Tab 99).

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*c. The Threshold for a Breach is Far Lower than Canada Contends*

336. Canada contends that the threshold for a breach under NAFTA Article 1105(1) is a high one.<sup>333</sup> However, the threshold for a breach of NAFTA Article 1105(1) is not as high as Canada claims.
337. Canada cites the International Court of Justice’s decision in *ELSI* to argue that to the extent that NAFTA Article 1105(1) does protect foreign investors from “arbitrary” State behavior the threshold for a breach requires that the impugned behaviour “displays a willful disregard of due process of law...which shocks, or at least surprises, a sense of judicial propriety.”<sup>334</sup> Canada then goes on to point out that a number of tribunals have adopted this standard in determining whether conduct was “arbitrary.” Though it does not say it, Canada’s argument seems to be that because tribunals have adopted the *ELSI* standard for “arbitrariness”, the standard for a breach of any of the other elements of “fair and equitable treatment” under NAFTA Article 1105(1) is also high.
338. In advancing this argument, Canada rightly points out that contrary to its assertion that “arbitrariness” is not covered by NAFTA Article 1105(1) NAFTA tribunals have decided that NAFTA Article 1105(1) does in fact preclude a State from engaging in arbitrary conduct.<sup>335</sup> Canada, however, offers an incorrect and incomplete account of the jurisprudence in its discussion.
339. For example, Canada suggests that the *Mondev* Tribunal expressly endorsed the *ELSI* threshold in its decision.<sup>336</sup> In fact, the *Mondev* Tribunal did just the opposite it used the *ELSI* case as a backdrop against which it adopted a much lower threshold. In this respect, the Tribunal stated the following:

The test is not whether a particular result is surprising, but whether the shock or surprise occasioned to an impartial tribunal leads, on reflection, to justified concerns as to the judicial

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<sup>333</sup> Canada’s Counter Memorial at para. 556.

<sup>334</sup> Canada’s Counter Memorial at para. 557.

<sup>335</sup> Canada’s Counter Memorial at para. 559.

<sup>336</sup> Canada’s Counter Memorial at para. 559.

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propriety of the outcome...In the end, the question is whether, at an international level and having regard to generally accepted standards of the administration of justice, a tribunal can conclude in the light of all the available facts that the impugned decision was clearly improper and discreditable, with the result that the investment has been subjected to unfair and inequitable treatment.<sup>337</sup>

Indeed, for the *Mondev* Tribunal, the threshold for a violation of “fair and equitable treatment” was not that high at all, and it rejected the suggestion that it requires a standard of conduct that is “outrageous” or even “egregious”.<sup>338</sup>

340. Canada glosses over the fact that many other Tribunals – NAFTA and non-NAFTA alike – have taken a similar approach, confirming that a violation of “fair and equitable treatment” need not be triggered by an act that can be characterized as “outrageous” or “egregious”.<sup>339</sup> Indeed, Canada outright ignores the fact that several tribunals have determined that a violation of “fair and equitable treatment” may be triggered by behaviour that is simply “unreasonable”.<sup>340</sup> Canada neglects to mention that in the context of its “fair and equitable treatment” analysis, the Tribunal in *Saluka* drew a close relationship between “reasonableness” and “fair and equitable treatment”:

The standard of “reasonableness” has no different meaning in this context than in the context of the “fair and equitable treatment” standard with which it is associated; and the same is true with regard to the standard of “non discrimination”. The standard of “reasonableness” therefore requires...a showing that the State’s conduct bears a reasonable relationship to some rational policy, whereas the standard of “non discrimination” requires a rational justification of any differential treatment of a foreign investor.”<sup>341</sup>

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<sup>337</sup> *Mondev* at para. 127, Respondent’s Book of Authorities (Tab 87); *Loewen*, Award on Jurisdiction at para. 131, Respondent’s Book of Authorities (Tab 75).

<sup>338</sup> *Mondev* at para. 116, Respondent’s Book of Authorities (Tab 87).

<sup>339</sup> *Pope & Talbot*, Investor’s Book of Authorities (Tab 48); *ADF Waste Management*, Investor’s Book of Authorities (Tab 50); *GAMI*, Investor’s Book of Authorities (Tab 59).

<sup>340</sup> *Iurri Bogdanov v. Moldova* at p. 10, Investor’s Book of Authorities (Tab 141); *Eureko* at para. 234, Investor’s Book of Authorities (Tab 56).

<sup>341</sup> *Saluka*, para. 460, Respondent’s Book of Authorities (Tab 123).

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341. The nexus between “fair and equitable treatment” and the duty to act “reasonably” was affirmed by the Tribunal in the Award in *Continental Casualty*, which stated:

...the fair and equitable standard is aimed at assuring that the normal law abiding conduct of the business activity by the foreign investor is not hampered without good reasons by the host government and other authorities.<sup>342</sup>

342. Canada also fails to point out that the Tribunals in *MTD Equity*, *Azurix*, and *Siemens* all affirmed that, in the context of “fair and equitable treatment” analysis, what is required is “treatment in an even-handed and just manner, conducive to fostering the promotion of foreign investment.”<sup>343</sup> Where the treatment in question is seen to be unjust or not even-handed, there may be a violation of “fair and equitable treatment.”

343. In light of the findings of recent Tribunals such as in *Azurix* and *CMS Gas* that there is a dwindling distinction between the treaty standard of “fair and equitable treatment” and the international minimum standard, the threshold for a breach of NAFTA Article 1105(1) is not as high as Canada would have us believe. Not only does the obligation to accord foreign investors “fair and equitable treatment” require Canada to act in a non-arbitrary and non-discriminatory manner, but it also requires Canada to act reasonably. Where there is no reasonable relationship between Canada’s actions and a rational policy, it fails to act reasonably, thereby violating its duty to provide “fair and equitable treatment”.

*d. The Test is a Flexible one to be Applied in All the Circumstances*

344. What amounts to a violation of the “fair and equitable treatment” standard is necessarily specific to each case. Admittedly, there is as of yet no general agreement on the precise content and scope of the customary standard of “fair and equitable treatment”. This stems from the inherently supple nature of the standard. There simply is no easy formula that

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<sup>342</sup> *Continental Casualty* at para. 254, Investor’s Book of Authorities (Tab 142).

<sup>343</sup> *MTD Equity* at para. 17, Investor’s Book of Authorities (Tab 124); *Azurix* at para. 360??, Investor’s Book of Authorities (Tab 67); and *Siemens* at para. 290??, Investor’s Book of Authorities (Tab 138).

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can apply to all cases. As the *Waste Management* Tribunal noted, “the standard is to some extent a flexible one which must be adapted to the circumstances of each case.”<sup>344</sup>

345. While this may lead to a certain level of uncertainty as to exactly what constitutes a violation of “fair and equitable treatment”, there is at least this much that *is* certain: the more grievous and numerous the violations of these various indicia, the more likely there is to be a violation of the duty to provide “fair and equitable treatment”. What is also certain is that the trend has for some time now been evolving towards a higher customary law standard of investment protection from State interference.<sup>345</sup>
346. Bearing all this in mind, all this Tribunal needs to ask itself is this: in light of all the circumstances of this case, with a view to all the sources of international law, and in the understanding that there has in recent years been a rapid convergence between the autonomous treaty standard of “fair and equitable treatment” and the customary international law standard, has Canada violated its obligation to accord Merrill & Ring the type of “fair and equitable treatment” guaranteed by NAFTA Article 1105(1)?
347. As straightforward as this question may seem, at this point in the discussion it still remains somewhat abstract. As the *Mondev* Tribunal pointed out:

A judgment of what is fair and equitable cannot be reached in the abstract; it must depend on the facts of the particular case.<sup>346</sup>

And as the Tribunal in *Rumeli* put it:

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<sup>344</sup> *Waste Management* at para. 99, Investor’s Book of Authorities (Tab 58).

<sup>345</sup> See, for example, C. Schreuer, “Fair and Equitable Treatment in Arbitral Practice” at 370, where he states that there is an “evolving trend towards a higher standard of protection against State interference.”, Respondent’s Book of Authorities (Tab 125).

<sup>346</sup> *Mondev*, Award at para. 118, Respondent’s Book of Authorities (Tab 87).



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The precise scope of the [fair and equitable treatment] standard is...left to the determination of the Tribunal which will have to decide whether in all the circumstances the conduct in issue is fair and equitable or unfair and inequitable.<sup>347</sup>

**6. Canada has Breached its Obligation to Provide Merrill & Ring “Fair and Equitable Treatment”**

*a. The Log Export Control Regime is Secretive and Opaque*

348. The Log Export Control Regime is administered in a “hush-hush” secretive manner that does not meet the standards of openness and transparency required by NAFTA Article 1105(1) and that does not enhance respect for the rule of law.
349. One of the most non-transparent aspects of the Log Export Control Regime surrounds the administration of the Surplus Testing Procedure by TEAC/FTEAC. This process is enshrouded in secrecy from beginning to end.<sup>348</sup> If Merrill & Ring wants to export its logs, it must first offer them for sale to domestic log processors on what is called the Bi-Weekly List. When inspecting the logs up for sale, log processors are able to tell which logs belong to which log producer. This enables them to target particular log producers by placing bids on logs offered up by only some companies, but not others. Merrill & Ring has been the subject of special targeting on many occasions.<sup>349</sup>
350. The ability to target log producers is crucial in enabling log processors to engage in the illicit practice of “blockmailing”; if it were not for their ability to see which logs belong to which producer, they would not be able to threaten log producers with “blocking” their logs from export. In essence, the lack of knowledge creates a lack of legal security for the log producers. Despite the fact that TEAC/FTEAC is aware of the practice of targeting, it has never adopted any procedures or protocols to address this problem.<sup>350</sup>

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<sup>347</sup> *Rumeli* at para. 610, Investor’s Book of Authorities (Tab 137).

<sup>348</sup> Kurucz Witness Statement, February 11, 2008 at para. 72.

<sup>349</sup> Kurucz Witness Statement, February 11, 2008 at para. 67.

<sup>350</sup> This is why Canada was unable to produce any responsive documents in response to Merrill & Ring’s Document Request #36, Investor’s Schedule of Documents (Tab 84), by which it requested that Canada produce all “[d]ocuments since April 1, 1998 evidencing the procedure or protocols TEAC/FTEAC has put in place regarding

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351. Once the bidding process comes to a close, the next step in the process is for TEAC/FTEAC to convene in order to determine whether the “block” offers placed on Merrill & Ring’s logs are at the so-called “fair market value” that is, the artificially suppressed domestic market value. These meetings are closed to the public, and Merrill & Ring is unable to attend to present its views about the propriety of any “block” offer it has received. Although Canada claims that Merrill & Ring can and does make submissions to TEAC/FTEAC on “block” offers it receives,<sup>351</sup> Canada is mistaken. Merrill & Ring has never been allowed to make oral submissions to TEAC/FTEAC. TEAC/FTEAC has never made public any guidelines about when guests may attend its meetings, nor has it otherwise ever made public any indication that log producers might be able to make oral submissions to it.<sup>352</sup>
352. Equally unclear is the basis upon which TEAC/FTEAC meetings may be cancelled. Canada states that TEAC/FTEAC meetings are cancelled “only when there are no offers to be discussed.”<sup>353</sup> Yet right after making this statement, Canada contradicts itself by admitting that a TEAC/FTEAC meeting *was* in fact cancelled in August 2006 where “block” offers were in fact to be considered.<sup>354</sup> Some of these “block” offers were on Merrill & Ring’s logs.<sup>355</sup> Canada does not deny this meeting was cancelled without consultation or prior notice. Such erratic behaviour has introduced uncertainty into the business environment, since log producers just do not know if and when TEAC/FTEAC meetings might be suddenly cancelled again.

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advertisers being subject to special targeting by purchasers.”

<sup>351</sup> Canada’s Counter Memorial at para. 607.

<sup>352</sup> This is why Canada was unable to produce any responsive documents in response to Merrill & Ring’s Document Request #41, Investor’s Schedule of Documents (Tab 85), by which it requested that Canada produce all “documents since April 1, 1998 evidencing the circumstances in which TEAC/FTEAC allows guests to attend their meetings, and private forest landowners to make personal presentations on matters of concern to them.” Canada produced only one document in response. This document, however, was not responsive to the document request.

<sup>353</sup> Canada’s Counter Memorial at para. 596.

<sup>354</sup> Canada’s Counter Memorial at FN 633.

<sup>355</sup> Stutesman Reply Witness Statement, December 12, 2008 at para. 5.

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353. In the event that a TEAC/FTEAC meeting *is* convened as scheduled, not only are log producers unable to attend to present their views, but they are also unable to ascertain in any detail the basis upon which TEAC/FTEAC makes its decisions. While it is understood that TEAC/FTEAC seeks to determine whether any given “block” offer is in line with the domestic market value of the logs, there is no way of knowing in any detail the basis upon which this determination is made. What is “fair” to TEAC/FTEAC is clearly different than what is “fair” to log producers like Merrill & Ring. The most striking example of this difference in perspective is the general guideline used by TEAC/FTEAC that as long as an offer is within 5% of the domestic market value of the logs, that offer is considered “fair”.<sup>356</sup> While 5% may not mean much to TEAC/FTEAC, it means a lot to private log producers operating in a very competitive market.<sup>357</sup> Even though Canada insists that these determinations are based on “objective” data,<sup>358</sup> they still come down to “subjective” judgments. In any event, regardless of the fairness of this approach, Canada has never documented or otherwise informed log producers about this ‘5% “fairness” rule’.<sup>359</sup> As a result, Canada’s unsupported assertion that the criteria by which TEAC/FTEAC decisions are made are “concrete, reasonable and well defined”<sup>360</sup> is simply untrue.
354. Concerns over the fairness of TEAC/FTEAC determinations are exacerbated by the secretive way in which TEAC/FTEAC members are appointed. Although Canada admits that it creates a shortlist of potential candidates, and forwards names to DFAIT for final

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<sup>356</sup> Canada’s Counter Memorial at para. 672.

<sup>357</sup> Stutesman Reply Witness Statement, December 12, 2008 at para. 13.

<sup>358</sup> Canada’s Counter Memorial at para. 585.

<sup>359</sup> This is why Canada was unable to produce any documents in response to Merrill & Ring’s Document Request #37, Investor’s Schedule of Documents (Tab 86), by which Merrill & Ring requested that Canada produce “[d]ocuments since April 1, 1998 evidencing the TEAC/FTEAC “rule” that an offer is considered fair if it within 5% of the current domestic market value of the logs.” Canada was unable to produce any documents in response.

<sup>360</sup> Canada’s Counter Memorial at para. 600.

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approval,<sup>361</sup> for some reason it was unable to produce any documents relating to the appointment process.<sup>362</sup>

355. In any event, there are simply no established criteria for the appointment of TEAC/FTEAC members. This is why the membership of TEAC/FTEAC is so slanted to favour the interests of log *processors*, as opposed to log *producers*. Prior to the initiation of this NAFTA claim, TEAC/FTEAC had never invited a private landowner to become a member.<sup>363</sup> The lack of criteria for selecting TEAC/FTEAC members is also the reason why no proposed member of TEAC/FTEAC has ever been excluded on the basis of conflict of interest,<sup>364</sup> and why TEAC/FTEAC has never so much as consulted with private landowners about the appointment of committee members.<sup>365</sup>
356. This is all the more concerning given the fact that TEAC/FTEAC has no guidelines on conflict of interest.<sup>366</sup> Yet despite this lack of guidelines, curiously the only potential candidate ever to be disqualified on this basis was the one private forest landowner

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<sup>361</sup> Canada's Counter Memorial at para. 84.

<sup>362</sup> Canada produced no documents in response to Merrill & Ring's Document Request #27, Investor's Schedule of Documents (Tab 87), which asked for "[d]ocuments related to the appointments for all members of TEAC or of FTEAC who have served on such bodies since December 26, 2003."

<sup>363</sup> This is why Canada was unable to produce any documents dated prior to the initiation of this claim in response to Merrill & Ring's Document Request #31, Investor's Schedule of Documents (Tab 88), which asked for "[d]ocuments evidencing invitations extended to private landowners to become members of TEAC or of FTEAC."

<sup>364</sup> This is why Canada was unable to produce any documents in response to Merrill & Ring's Document Request #30, Investor's Schedule of Documents (Tab 89), which asked for "[d]ocuments evidencing the fact that potential candidates for appointment to TEAC or to FTEAC were not considered on account of conflict of interest."

<sup>365</sup> This is why Canada was unable to produce any documents in response to Merrill & Ring's Document Request #32, Investor's Schedule of Documents (Tab 90), which asked for "[d]ocuments evidencing the existence of consultations between TEAC or FTEAC, or with agents or emissaries on behalf of these bodies, with private forest landowners about the appointment of committee members."

<sup>366</sup> This is why Canada was unable to produce any documents in response to Merrill & Ring's Document Request #33, Investor's Schedule of Documents (Tabs 91 92), which asked for "[d]ocuments since April 1, 19989 evidencing any TEAC/FTEAC guidelines addressing conflict of interest of members in any manner."

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Canada apparently invited after the initiation of this claim.<sup>367</sup> This complete lack of documentation stands in stark contrast to Canada's unsupported assertion that "TEAC/FTEAC has adopted procedural rules to deal effectively with potential conflict of interest."<sup>368</sup>

357. All this secrecy surrounding the TEAC/FTEAC membership and process is compounded by the fact that the Minutes of TEAC/FTEAC meetings are not made publically available.<sup>369</sup> As a result, there is no way to verify on what basis decisions are made. There is also no way to verify whether conflicted members actually excuse themselves from the meetings at the appropriate times. In short, there is simply no transparency, and therefore no accountability.
358. Once TEAC/FTEAC determines that an offer is "fair", its determination is almost invariably given final approval by DFAIT. While it is true that Merrill & Ring may take it upon itself to lobby the Minister of Foreign Affairs to disregard FTEAC determinations, in reality the Minister rarely does so.<sup>370</sup> While it is true that the Minister of Foreign Affairs has, on occasion, overturned FTEAC recommendations in the past, it is a gross exaggeration to suggest, as Canada does, that such occurrences are "not uncommon". On the contrary, they are quite rare. The reason for this is that it is clear that the only situations in which the Minister will overturn an FTEAC recommendation are when the recommendation is grossly and patently unfair, and where this can be positively proved.<sup>371</sup> These are the only circumstances where it makes any sense for

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<sup>367</sup> This is evident from the fact that Canada produced the same and only one document in response to both Merrill & Ring's Document Requests #30 and #31. Document Request #30 asked for "[d]ocuments evidencing the fact that potential candidates for appointment to TEAC or to FTEAC were not considered on account of conflict of interest." Investor's Schedule of Documents (Tab 89). Document Request #31 asked for "[d]ocuments evidencing invitations extended to private landowners to become members of TEAC or of FTEAC." Investor's Schedule of Documents (Tab 88).

<sup>368</sup> Canada's Counter Memorial at para. 591.

<sup>369</sup> See *Timberwest v. Canada*, Transcript of May 29, 2006, at p.606, lines 18-19, Investor's Schedule of Documents (Tab 93), where the Chairman of TEAC/FTEAC states that the Minutes of TEAC/FTEAC meetings are not made public.

<sup>370</sup> Stutesman Reply Witness Statement, December 12, 2008 at para. 9.

<sup>371</sup> Stutesman Reply Witness Statement, December 12, 2008 at Section III.

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Merrill & Ring to put in the effort and resources required to mount a challenge to an FTEAC determination.<sup>372</sup> This is not to say that it is only on rare occasions that FTEAC makes an unfair determination. Rather, it is to say that the situations where FTEAC determinations are so patently unfair as to be both impossible to ignore, on the one hand, and, on the other, possible to prove, that Merrill & Ring will challenge the decision.<sup>373</sup> Ultimately, the whole process is so opaque that it is only on rare occasions that Merrill & Ring will be able to mount any challenge to unfair FTEAC determinations that, under the circumstances, has a reasonable chance of success.<sup>374</sup>

359. Nonetheless, should Merrill & Ring in fact decide to challenge an FTEAC decision, it is true that DFAIT may examine what it calls “other relevant factors” that FTEAC does not consider. However, log producers do not know what these “other relevant factors” are.<sup>375</sup> Canada has never made any information public on this matter.<sup>376</sup> Instead, it baldly states that these “other relevant factors” are “well-known to participants in the log industry,”<sup>377</sup> and provides no evidence in support. Without knowing what these so-called “other relevant factors” are, should Merrill & Ring decide that it even has a chance at successfully challenging an FTEAC determination, it is simply unable to know for certain how to make its case.<sup>378</sup> Any challenge it mounts is necessarily based on experience and guesswork.<sup>379</sup>

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<sup>372</sup> Stutesman Reply Witness Statement, December 12, 2008 at para. 9.

<sup>373</sup> Stutesman Reply Witness Statement, December 12, 2008 at para. 12.

<sup>374</sup> Stutesman Reply Witness Statement, December 12, 2008 at para. 12.

<sup>375</sup> Kurucz Witness Statement, February 11, 2008 at para. 36.

<sup>376</sup> This is why Canada was unable to produce any documents that had been made public in response to Merrill & Ring’s Document Request #25, Investor’s Schedule of Documents (Tabs 94 99), which asked for “[d]ocuments evidencing the “other relevant factors” DFAIT is required to consider in addition to recommendations it receives from TEAC/FTEAC since April 1, 1998.” Every document Canada produced was an internal government document marked “Internal” or “Confidential”.

<sup>377</sup> Canada’s Memorial at para. 602.

<sup>378</sup> Stutesman Reply Witness Statement, December 12, 2008 at para. 10.

<sup>379</sup> Stutesman Reply Witness Statement, December 12, 2008 at para. 10.

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360. Such “long shot” challenges are not even available to address unfair “block” offers made on Merrill & Ring’s provincial logs; they are only available for challenging “block” offers approved by FTEAC, not TEAC.<sup>380</sup> Determinations made by TEAC on “block” offers on provincial logs are equally secretive as FTEAC decisions, but even more final.
361. Canada knows that the Log Export Control Regime affords log producers unfair opportunities to abuse the system. This is why TEAC/FTEAC may decide to take disciplinary action in the event a complaint is made. Yet even the disciplinary measures TEAC/FTEAC might take are befogged by secrecy, and there are no procedures or practices in place on the matter.<sup>381</sup> TEAC/FTEAC will not even let the victim of an abuse know if, when, or on what basis it might take corrective measures.<sup>382</sup> By way of explanation, Canada’s representative on FTEAC, Judy Korecky, says that making public some disciplinary actions taken against certain companies would be prejudicial to those companies.<sup>383</sup> As is clear from Merrill & Ring’s experience, however, not releasing the information is prejudicial to *it*.<sup>384</sup> Clearly, TEAC/FTEAC’s unwritten disciplinary policies err on the side of protecting offending log processors rather than victims of this unfair conduct.
362. Beyond the TEAC/FTEAC process, *Notice 102* and the *BC Export Procedures* themselves give rise to uncertain and opaque market conditions. For example, both *Notice 102* and the *BC Export Procedures* require Merrill & Ring to follow “normal market practices” in order for their logs to be able to qualify for export.<sup>385</sup> However, nowhere does either document provide any hint as to what “normal market practices”

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<sup>380</sup> Stutesman Reply Witness Statement, December 12, 2008 at para. 11.

<sup>381</sup> This is why Canada was unable to produce any documents in response to Merrill & Ring’s Document Request #22, Investor’s Schedule of Documents (Tabs 100 101), which asked for “[d]ocuments evidencing the procedures and practices, other than the Terms of Reference, that apply to TEAC or FTEAC.”

<sup>382</sup> Kurucz Witness Statement, February 11, 2008 at para. 69.

<sup>383</sup> Korecky Affidavit, May 10, 2008 at para. 106.

<sup>384</sup> Kurucz Witness Statement, February 11, 2008 at para. 69.

<sup>385</sup> *Notice 102*, section 1.5, Investor’s Schedule of Documents (Tab 22); *BC Export Procedures*, section 3.14, Investor’s Schedule of Documents (Tab 31).

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actually means. What is “normal” is left to the determination of BCMOF, which does not specify what it means either. Canada simply denies that there is any problem with this, and explains that “normal market practices” are specified in a document called the *Coast Domestic Market End Use Sort Descriptions*.<sup>386</sup> However, nowhere in this document does it state that its contents constitute “normal market practices” for the purposes of *Notice 102* and the *BC Export Procedures*. Instead of producing evidence that explains the meaning of “normal market practices” as it was asked to do<sup>387</sup> Canada flatly, and without support, simply claims that “Merrill & Ring knows exactly what “normal” market practices are.”<sup>388</sup>

363. This notion of Canada’s that market players somehow just ought to know what the rules of the Log Export Control Regime are can also be seen with respect to the so-called “remote” advertising rule.<sup>389</sup> This rule requires that log producers may not advertise logs in volumes of less than 2,800 m<sup>3</sup> in areas on the BC Coast that are considered “remote”.<sup>390</sup> Canada has never made any public announcement to industry players exactly what it considers “remote” to mean. Canada has been unable to produce any documents demonstrating otherwise.<sup>391</sup> All it is able to do is to plainly assert again without evidence or support that log exporters *do* know which areas are considered “remote”.<sup>392</sup> Canada can only cite an obscure policy document from 1986 that described what was considered “remote” at that time. What Canada underplays is the fact that this policy

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<sup>386</sup> Canada’s Counter Memorial at para. 639.

<sup>387</sup> Canada was unable to produce any responsive documents in response to Merrill & Ring’s Document Request #18, which asked for “[d]ocuments evidencing the meaning of “normal” market practices for the purposes of *Notice 102* since January 1, 1998.”

<sup>388</sup> Canada’s Counter Memorial at para. 639.

<sup>389</sup> *Notice 102*, section 1.4, Investor’s Schedule of Documents (Tab 22).

<sup>390</sup> Investor’s Memorial at para. 99.

<sup>391</sup> This can be seen from Canada’s inability to produce any documents in response to Merrill & Ring’s Document Request #17, Investor’s Schedule of Documents (Tab 103), which asked for “[d]ocuments evidencing the definition of the term “remote” as used in *Notice 102* having been communicated to private forest landowners in BC since January 1, 1998.”

<sup>392</sup> Canada’s Counter Memorial at para. 636.



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document was released under a previous Log Export Control Regime, some 12 years prior to *Notice 102* and 14 years prior to when the *BC Export Procedures* came into effect. Canada cannot and does not deny that it has never made any information public about what is considered “remote” under the current Log Export Control Regime.

364. Canada itself seems unsure about what it is that “remote” means. Judy Korecky describes it as describing “areas from which logs must be barged, rather than towed.”<sup>393</sup> This, however, is different than the definition offered by John Cook, who states that it “is roughly defined as any location requiring an inordinate amount of time or cost to access from the lower mainland log marketplace.”<sup>394</sup> Indeed, it is clear from the very documents Canada produced in response to Merrill & Ring’s request for evidence about this “rule”

R-1(b)(ii)

<sup>395</sup>

365. Still, Canada insists that log exporters somehow just know what is considered “remote” for the purposes of *Notice 102*, offering up yet another definition: “any location requiring excessive travelling time and cost to access from the lower mainland log marketplace.”<sup>396</sup> This is as clear as mud. Just how it is that log producers like Merrill & Ring are supposed to know what “excessive travelling time and cost” means remains unexplained.
366. Canada also insists that, in any event, its failure to let the industry know what “remote” means has had no impact on Merrill & Ring, since none of Merrill & Ring’s lands are considered “remote”. This runs counter to the testimony of Tony Kurucz, who has sworn that a BCMOF employee and TEAC/FTEAC member assured him that Merrill & Ring’s lands located in Theodosia *are* considered “remote”, and logs from that area would have to be advertised in accordance with the minimum volume requirement as specified in

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<sup>393</sup> Korecky Affidavit, May 10, 2008 at para. 85.

<sup>394</sup> Cook Affidavit, May 7, 2008 at para. 76.

<sup>395</sup> R-1(b)(ii)

<sup>396</sup> Canada’s Counter Memorial at para. 635.

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*Notice 102.*<sup>397</sup> Canada impugns Mr. Kurucz’ statement, pointing to the fact that there is no documentary evidence of this exchange. This contradicts Canada’s suggestion that this is all Merrill & Ring’s fault, since “any potential ambiguity can be clarified by a simple phone call.”<sup>398</sup> Mr. Kurucz *did* try to clear up this so-called “ambiguity” with a phone call and what he was told was that its Theodosia lands *are* considered “remote”. C-1(b)(ii) has attested that from the perspective of the market, and in light of the fact that Canada has never made any information available to the market about what is considered “remote”, it is entirely plausible that lands located in the Theodosia area would be considered “remote”.<sup>399</sup> In addition, Mr. McPherson has stated that he too considers Theodosia to be “remote”,<sup>400</sup> as well as the majority of Merrill & Ring’s other lands. If it is true that Theodosia is *not* considered “remote”, the blame for the damage this has caused should not fall on Merrill & Ring; this could have all been avoided if Canada had ever provided *any* information to the industry about just what it is that “remote” actually means.

367. Despite all these examples of secrecy and non-transparency, Canada is still somehow able to insist without offering any documentary evidence in support that “the regime is transparent.”<sup>401</sup> In the end, the facts speak for themselves.

*b. The Federal Government is Not Legally Limited from Granting Standing Exemptions It is a Political Choice*

368. The obscurity of the “rules” of the Log Export Control Regime is mirrored in the “shell game” of governmental authority that animates them. While the federal government has jurisdictional authority especially with respect to federal logs it simply refuses to

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<sup>397</sup> Kurucz Reply Witness Statement, December 14, 2008 at para. 6.

<sup>398</sup> Canada’s Counter Memorial, para. 636.

<sup>399</sup> C-1(b)(ii)

<sup>400</sup> Macpherson Expert Statement, December 14, 2008 at para. 9.

<sup>401</sup> Korecky Affidavit, May 10, 2008 at para. 155.

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assert its jurisdiction for political reasons.<sup>402</sup> Instead, it simply resiles from the exercise of the authority it rightfully has, deferring instead to the political sensitivities of the BC government.

369. As is clear from the very structure of the Log Export Control Regime, jurisdiction over BC logs is divided between the provincial government on the one hand, and the federal government on the other. This jurisdictional split is the result of the division of powers established by the Canadian Constitution.<sup>403</sup> Under the Canadian Constitution, the BC government has jurisdiction over forestry resources,<sup>404</sup> while the federal government has authority over all matters relating to trade and commerce, including international trade.<sup>405</sup> When it comes to regulating trade in logs, there is obviously significant overlap between the two levels of authority. Laws and regulations characterized by such overlap are said to have a “double aspect”.<sup>406</sup>
370. To determine whether either level of government has constitutional authority to exclusively regulate a forestry issue with a “double aspect”, the question is simply this: what is the essence or, in constitutional parlance, the “pith and substance” of the regulation in question? This requires scrutiny of the true character of the regulation by looking at two things: its legislative purpose; and its practical effect.<sup>407</sup> Where the analysis suggests that, on balance, the essential purpose and effect of the regulation relates to an area of provincial authority such as the regulation of forestry resources, then the regulation is said to properly fall within provincial jurisdiction. By contrast, where the analysis reveals that, on balance, the purpose and effect of the regulation instead

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<sup>402</sup> Matkin Witness Statement, December 11, 2008 at paras. 6 & 25.

<sup>403</sup> Matkin Witness Statement, December 11, 2008 at para. 11.

<sup>404</sup> Matkin Witness Statement, December 11, 2008 at para. 15.

<sup>405</sup> Matkin Witness Statement, December 11, 2008 at para. 13.

<sup>406</sup> Matkin Witness Statement, December 11, 2008 at para. 16.

<sup>407</sup> Matkin Witness Statement, December 11, 2008 at para. 12.

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relates to an area of federal authority such as the regulation of trade and commerce, then the regulation is said to fall within federal jurisdiction.<sup>408</sup>

371. Under the Log Export Control Regime, only the BC government grants standing exemptions to provincial timber. Canada insists that the federal government does not have constitutional authority to grant standing exemptions to federal timber.<sup>409</sup> Canada is clearly and unequivocally mistaken; it *does* have constitutional authority to grant standing exemptions to federal lands.<sup>410</sup> There can be no doubt that Canada knows this. Its refusal to grant standing exemptions is not the result of any legal limitation – it is simply a political decision.<sup>411</sup>
372. What standing exemptions essentially do is to exempt timber from having to go through the Surplus Testing Procedure prior to export. To the extent that this relates to the regulation of forestry resources, it is a matter of provincial jurisdiction. However, to the extent that it relates to the regulation of trade and commerce, it is a matter of federal jurisdiction. Clearly, this is one of those issues with a “double aspect”.
373. As a result, it is entirely misleading for Canada to say that the federal government simply does not have authority to grant standing exemptions. The argument could equally be made that the BC government lacks jurisdiction over the same matter. Since standing exemptions go directly to the issue of export, it seems to fit more squarely within a head of federal power. This is all the more so in light of the fact that the lands in question are under federal authority to begin with.<sup>412</sup> In truth, both levels of government may or may not have authority to grant standing exemptions. Whether a particular regulation is within or beyond the authority of the federal government is simply a question of what its essential “pith and substance” is.

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<sup>408</sup> Matkin Witness Statement, December 11, 2008 at para. 12.

<sup>409</sup> See, for example, Canada’s Statement of Defence at para. 34, and Canada’s Counter Memorial at paras. 400 & 574.

<sup>410</sup> Matkin Witness Statement, December 11, 2008 at paras. 6 & 25.

<sup>411</sup> Matkin Witness Statement, December 11, 2008 at paras. 6 & 25.

<sup>412</sup> Matkin Witness Statement, December 11, 2008 at para. 16.

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374. If the federal government were to enact a law or regulation with the essential purpose of regulating trade in- and export of logs, and with a corresponding practical effect, then that regulation would clearly fall within its sphere of constitutional authority. If motivated by the desire to assert its rightful jurisdiction over trade and commerce, there is absolutely nothing to prevent the federal government from passing legislation that would allow it to authorize standing exemptions for timber on federal lands in BC.<sup>413</sup>

*c. The Log Export Control Regime Discriminates Against Log Producers in Favour of Log Processors*

375. When Canada speaks of the “forest industry”, and its importance to the Canadian economy,<sup>414</sup> it is important to be clear about what exactly it is referring to. Canada rightly points out that this “industry” can be divided into different sectors.<sup>415</sup> These sectors can be roughly broken up into two categories: primary forest products; and secondary forest products. Primary forest products basically means “logs”. Secondary forest products essentially means products derived from logs, such as pulp, paper and lumber. Primary forest products are produced by logging companies like Merrill & Ring. Secondary forest products are produced by log processors, such as sawmills. Log processors like sawmills purchase the materials for their products from log producers like Merrill & Ring.

376. Canada points out that the value of BC secondary forest products exports is CDN \$32.6 Billion.<sup>416</sup> Canada also highlights the fact that BC log exports amount to a mere fraction of that number: CDN \$0.407 Billion.<sup>417</sup> The relative importance of these two sectors to the BC economy and, therefore, to the BC government is clear.

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<sup>413</sup> Matkin Witness Statement, December 11, 2008 at para. 18.

<sup>414</sup> Canada’s Counter Memorial at para. 32.

<sup>415</sup> See, for example, Canada’s Counter Memorial at para. 34.

<sup>416</sup> Canada’s Counter Memorial at para. 34.

<sup>417</sup> Canada’s Counter Memorial at para. 34.

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377. This is why the entire *raison d'être* of the Log Export Control Regime is to ensure log processors an adequate supply of low cost logs; simply put, the use of this coercive regime ensures that log producers keep running, and protects traditional Canadian jobs. This objective, however, is achieved at the direct expense of log producers, who are forced to sell their logs in the domestic market at artificially suppressed prices.<sup>418</sup> In essence, log producers are forced to subsidize the operations of log processors. The Log Export Control Regime is being used to indirectly subsidize inefficient mills by providing domestic mills with cheap, export quality logs.<sup>419</sup> Instead of subsidizing log processors directly from the public purse, Canada has opted to subsidize them indirectly from private pockets. Every time Merrill & Ring is forced to sell its logs in the domestic market at artificially low prices, their loss is a log processor's gain. For every Canadian job that is protected, there is a foreign investor that is paying for it. In short, the Log Export Control Regime is inherently discriminatory: it protects Canadian jobs at the expense of foreign investors. This is fundamentally unjust and unfair.
378. The discriminatory nature of the Log Export Control Regime manifests itself in all sorts of ways. For example, instead of being comprised of a membership from a rounded cross-section of the entire forest industry, TEAC/FTEAC excludes private forest landowners from membership. There has never been anyone on TEAC/FTEAC with any significant private federal landholdings.<sup>420</sup> In fact, prior to the initiation of this NAFTA claim, TEAC/FTEAC had never so much as invited a federal landowner to become a member.<sup>421</sup> Moreover, the only potential candidate ever to be disqualified from consideration from TEAC/FTEAC is the one private forest landowner Canada apparently invited after the initiation of this claim.<sup>422</sup>

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<sup>418</sup> Stutesman Witness Statement, February 8, 2008 at para. 31.

<sup>419</sup> C-1(b)(ii)

<sup>420</sup> Testimony of John McCutcheon, *TimberWest v. Canada*, June 5, 2006, at 783, Investor's Schedule of Documents (Tab 37).

<sup>421</sup> This is why Canada was unable to produce any documents dated prior to the initiation of this claim in response to Merrill & Ring's Document Request #31, Investor's Schedule of Documents (Tab 88), which asked for "[d]ocuments evidencing invitations extended to private landowners to become members of TEAC or of FTEAC."

<sup>422</sup> This is evident from the fact that Canada produced the same and only one document in response to both Merrill & Ring's Document Requests #30 and #31. Document Request #30 asked for "[d]ocuments evidencing the fact that potential candidates for appointment to TEAC or to FTEAC were not considered on account of conflict of

379. The only possible explanation for the exclusion of private forest landowners from TEAC/FTEAC is as a former Chair of TEAC has testified under oath that TEAC/FTEAC determines what is “fair” in the context of the overriding goal that log processors have an adequate supply of logs.<sup>423</sup> Clearly no log producer would ever view the unwritten TEAC/FTEAC rule that offers 5% below the already suppressed domestic market price as “fair”. That tacit rule is in-and-of-itself discriminatory and unfair. Canadian jobs are protected foreign investors pay.

380. The biased composition of TEAC/FTEAC may also explain why TEAC/FTEAC is so likely to reject export applications brought before it. Stuart Macpherson, the Executive Director of the Private Managed Land Forest Council, did an analytic review of TEAC/FTEAC minutes. As Mr. Macpherson’s research shows, of all the export applications it was required to scrutinize between April 1998 and May 2008,

R-1(b)(ii) of all applications put before it.<sup>424</sup> And compared to the R-1(b)(ii) failure rate for federal export applications, TEAC/FTEAC rejected an R-1(b)(i) of Merrill & Ring’s export applications for its federal logs.<sup>425</sup> In this period, TEAC/FTEAC repeatedly R-1(b)(ii) R-1(b)(ii)

381. TEAC/FTEAC’s concern for the interests of log processors at the expense of log producers can also be seen in the way it disciplines abusive practices. As we have seen, when it is clear that a log processor has blatantly abused the system, and the log producer

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interest.” Investor’s Schedule of Documents (Tab 89). Document Request #31 asked for “[d]ocuments evidencing invitations extended to private landowners to become members of TEAC or of FTEAC.” Investor’s Schedule of Documents (Tab 88).

<sup>423</sup> Kurucz Witness Statement, February 11, 2008 at para. 45.

<sup>424</sup> R-1(b)(ii)

<sup>425</sup> R-1(b)(i)

<sup>426</sup> R-1(b)(ii)

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has brought the matter to their attention, TEAC/FTEAC has to investigate the matter. Should it decide to take disciplinary action against the abuser, however, it will not even let the victim know if, when or on what basis it will take corrective measures. Judy Korecky explains that making public disciplinary actions taken against any particular log processor would be prejudicial to it.<sup>427</sup> As is clear from Merrill & Ring's experience, however, not releasing the information is prejudicial to it.<sup>428</sup> It is clear where TEAC/FTEAC's priorities lie: in protecting the interests of log processors at the expense of log producers. Again, Canadian jobs are protected foreign investors pay.

382. Another way in which the Log Export Control Regime is slanted to favour log processors over log producers can be seen in the sorting and scaling requirements imposed by the Regime. Cutting, sorting, and scaling requirements are laid out in *Notice 102* and the *BC Coast Domestic Market End Use Sort Descriptions*.<sup>429</sup> These dictate how Merrill & Ring must cut, sort and scale its logs, according to log species, grade, diameter and volume. These requirements force Merrill & Ring to cut and sort its logs to meet the preferences of BC log processors. However, Merrill & Ring's foreign customers prefer their logs to be sorted and scaled differently.<sup>430</sup> By having to sort and scale its logs in accordance with local requirements, Merrill & Ring is forced to incur extra time and cost to produce its logs.<sup>431</sup> Still, Canada expresses confusion over why Merrill & Ring is complaining about this. As Canada puts it, sorting and scaling requirements are, after all, "industry driven."<sup>432</sup> It is here, however, that we see clearly what Canada means when it talks about the "industry". As Canada states, "these "requirements" exist simply because sawmills located in BC prefer certain log dimensions..."<sup>433</sup> This is Merrill & Ring's point. Again,

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<sup>427</sup> Korecky Affidavit, May 10, 2008 at para. 106.

<sup>428</sup> Kurucz Witness Statement, February 11, 2008 at para. 69.

<sup>429</sup> Kurucz Witness Statement, February 11, 2008 at para. 53.

<sup>430</sup> Stutesman Witness Statement, February 8, 2008 at para. 25.

<sup>431</sup> Stutesman Witness Statement, February 8, 2008 at para. 26.

<sup>432</sup> Canada's Counter Memorial at para. 376.

<sup>433</sup> Canada's Counter Memorial at para. 640.



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Canada succeeds in clarifying for the Tribunal another way in which the Log Export Control Regime caters to the preferences of domestic log *processors* at the expense of foreign log *producers*.

383. Yet another way in which the Log Export Control Regime discriminates against log *producers* in favour of log *processors* can be seen in the so-called “remoteness” rule. According to this rule, logs located in “remote” areas may not be advertised for export in volumes less than 2,800 m<sup>3</sup>. Canada explains that the reason for this rule is to avoid so-called “abuse” by log producers who might otherwise advertise “remote” logs in volumes too small for prospective purchasers to want to bother inspecting them.<sup>434</sup> In any event, says Canada:

...log booms can easily be moved from such “remote” locations to other areas where the regime does not impose any minimum volume requirement. Thus, this minimum volume requirement is not really an obstacle for a company like Merrill & Ring.<sup>435</sup>

While it may be true that log booms can be towed from “remote” to “non-remote” areas to circumvent this unwritten rule, there is nothing “easy” about doing so. Indeed, it *does* in fact create all sorts of obstacles for Merrill & Ring.<sup>436</sup> First of all, if Merrill & Ring were to advertise “remote” logs, it would have to plan its operations so as to ensure that there is a minimum volume of 2,800 m<sup>3</sup>.<sup>437</sup> Otherwise, logs would deteriorate as they waited for other logs of a suitable sort to be cut. Second, in order to tow its logs, Merrill & Ring has to arrange for a suitable towing company to take its logs to a non-remote location. This takes time, effort, and money. Third, when towing the logs, Merrill & Ring faces the risk that the logs could break up and be lost.<sup>438</sup> This is a business risk that needs to be factored in to its decisions.

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<sup>434</sup> Cook Affidavit, May 7, 2008 at paras. 79-80.

<sup>435</sup> Cook Affidavit, May 7, 2008 at para. 82.

<sup>436</sup> Kurucz Reply Witness Statement, December 14, 2008 at Section IV.

<sup>437</sup> Kurucz Witness Statement, February 11, 2008 at para. 56.

<sup>438</sup> Kurucz Witness Statement, February 11, 2008 at para. 50.

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384. So that log processors can be spared the inconvenience and expense of inspecting logs forced up for sale from “remote” areas, Merrill & Ring is put to great inconvenience, risk and expense. Yet again, Merrill & Ring is penalized on a compulsory basis to enable Canada to provide benefits to preferred Canadian industries.

*d. The Log Export Control Regime Discriminates Against Federal and Coastal Log Producers in Favour of Provincial and Interior Log Producers*

385. In addition to discriminating against log producers in favour of log processors, the Log Export Control Regime also discriminates between different types of log producers themselves. Specifically, it discriminates against federal log producers in favour of provincial log producers. In addition, it also discriminates against log producers on the BC South Coast in favour of log producers in the BC Interior.

386. The discriminatory treatment between federal and provincial producers is evident in the rule relating to advertising remote logs. Prior to January 2007, logs from both remote provincial and federal lands could only be advertised after they had been towed to a non-remote region. However in January 2007 BCMOF changed the provincial policy to allow logs from remote provincial lands to be advertised while in transit to their destination provided the log producer could establish that it knew the destination to which the logs were being towed.<sup>439</sup> This decision only applied to provincial logs. The ability to advertise while towing is advantageous because it reduces the delay in the process and possibly reduces the period of time logs spend sitting in the water and being exposed to damage. This difference in treatment between provincial and federal logs is completely arbitrary.

387. This discriminatory treatment is also apparent in matters relating to standing timber exemptions. Since a log producer with lands covered by a standing exemption knows for certain that it will be able to export its logs, it is able to line up overseas purchasers ahead of time, before it even cuts its trees. As a result, the log producer can cut, sort, and scale its logs specifically to meet its customer’s needs. In addition, because the log are guaranteed to be exported, the log producer is not subjected to the harassment and intimidation of “blockmailers”. And finally, once cut the logs in question do not have to

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<sup>439</sup> Kurucz Reply Witness Statement, December 14, 2008 at para 23.

wait to pass the Surplus Testing Procedure, and, as such, are not forced to waste away in the elements as a result of needless delays.

388. Standing exemptions are only made available to log producers with provincial lands. Even though log producers with federal lands might be located immediately adjacent to provincial lands with standing exemptions, growing the exact same types of trees in the same circumstances, such exemptions are not made available to them. R-1(b)(i)

.<sup>440</sup> First Nation lands are categorized as federal lands. R-1(b)(ii)

389. This discriminatory treatment is also apparent in the issue of standing applications. In contrast to standing *exemptions*, standing *applications* do not exempt timber from the Surplus Testing Procedure. Instead, they simply allow a log producer to submit its logs to the Surplus Testing Procedure before they are actually cut. As a result, standing *applications* are not quite as valuable as standing *exemptions*. Nonetheless, they still allow log producers to avoid having to cut, sort and scale their logs to the preferences of local mills.<sup>441</sup> They allow log producers to avoid blockmail and log blocking.<sup>442</sup> Moreover, standing applications allow log producers to avoid having their logs deteriorate due to infestation and exposure to the elements while they wait to get through the Surplus Testing Procedure and obtain export approval. Finally, standing applications enable log producers to enter into reliable long-term supply contracts, obtaining much better prices than they could otherwise.<sup>443</sup>

390. While standing *exemptions* are only available to provincial landowners, standing *applications*, Canada asserts, are only available to log producers in the Interior. That is, standing applications are available to both federal and provincial timber, provided it is

<sup>440</sup> R-1(b)(ii)

<sup>441</sup> C-1(b)(ii)

<sup>442</sup> C-1(b)(ii)

<sup>443</sup> C-1(b)(ii)

located in the Interior, not on the Coast. The facts, demonstrate otherwise. R-1(b)(ii)

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391. Because Merrill & Ring is primarily a federal landholder with lands located exclusively on the BC South Coast, neither standing exemptions nor standing applications are available to it. This clearly demonstrates that the Log Export Control Regime discriminates against federal landholders on the BC south-coast such as Merrill & Ring in favour of provincial landholders elsewhere in the province.

*e. The Log Export Control Regime Discriminates Against Provincial Log Producers*

392. The Log Export Control Regime also discriminates against provincial log producers. Only exporters of provincial logs are required to pay a fee-in-lieu upon export of their logs, and only provincial log exporters are prohibited from exporting cedar and other high grade species. The only reason for the differential treatment is that the logs in question come from provincial timbermark lands.

*f. The Log Export Control Regime Fosters the Illicit Practice of “Blockmailing”*

393. Another way in which the Log Export Control Regime discriminates against log producers in favour of log processors is by encouraging and condoning the illicit practice of “blockmailing”.

394. In essence, “blockmail” occurs when a log processor approaches a log producer and threatens to “block” its log exports with a *non bona fide* offer unless the log producer enters into a side deal to sell it other logs at a discount price.<sup>445</sup> This extortive practice is so rampant that it is simply understood as accepted market practice, or, as a former Chair of TEAC put it, just “part of the game.”<sup>446</sup> Smaller log producers are particularly

<sup>444</sup> R-1(b)(ii)

<sup>445</sup> Kurucz Witness Statement, February 11, 2008 at para. 61.

<sup>446</sup> Testimony of John McCutcheon, *TimberWest v. Canada*, (June 5, 2006) at p.753, Investor’s Schedule of Documents (Tab 37).

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vulnerable to blockmailing because they do not have the clout necessary to fend off blockmailers.<sup>447</sup>

395. Canada denies that it is responsible for blockmail, claiming that it takes all necessary measures to prevent and discipline this illicit practice.<sup>448</sup> This is a blind denial of reality. Though it may be that Canada does not engage in the practice of blockmail itself, it is wrong to say that it is not in fact responsible for this practice; were it not for the Log Export Control Regime—a system that Canada cannot deny it is responsible for—blockmail would not be possible at all. That is, while Canada may not be the actual party that does the blockmail, it is directly responsible for enabling those who do. Canada’s denial is analogous to the claims of a mastermind claiming he is innocent, since he was not the one who actually carried out the crime.
396. Canada claims that its “policy is nevertheless to do all it can to prevent blockmailing.”<sup>449</sup> This is also false. Not only has Canada failed to produce any evidence of such a policy,<sup>450</sup> but there are also many basic things Canada could do to discourage blockmail, if that is truly what it wanted to do. There is no mechanism to ensure that anyone who blocks logs needs these logs nor even to ensure that these logs are used by the blockmailer.<sup>451</sup> This situation is made worse as blockmailers are not required to purchase the logs they have blocked, even after they have been custom cut to the blockmailers’ needs.<sup>452</sup> Another obvious way to discourage blockmail would be simply to impose fines upon

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<sup>447</sup>Kurucz Witness Statement, February 11, 2008 at para 70, C-1(b)(ii)

<sup>448</sup> Canada’s Counter Memorial at para. 646.

<sup>449</sup> Canada’s Counter Memorial at para. 651.

<sup>450</sup> This is why Canada was unable to produce any documents indicating its policy on blockmailing in response to Merrill & Ring’s Document Request #45, Investor’s Schedule of Documents (Tabs 107-117), which asked for “[d]ocuments since April 1, 1998 evidencing the practice of “log blocking,” “blockmailing” or *non bona fide* offers...including government responses...and government actions to address these practices.”

<sup>451</sup> C-1(b)(ii)

<sup>452</sup> Stutesman Witness Statement, December 12, 2008 at para 15.

blockmailers, yet Canada does not do so.<sup>453</sup> A further possibility would be for Canada to penalize blockmailers by preventing them from placing offers on export applications for a certain period of time again, Canada does not do so.<sup>454</sup> Other options abound; yet evidence that Canada does anything to prevent blockmailing is sparse.<sup>455</sup>

397. It is important to remember that the stated purpose of the Log Export Control Regime is “to ensure that there is an adequate supply of [logs] in Canada for defence or other needs.”<sup>456</sup> Yet there is not now, nor has there ever been, a shortage of supply of logs in Canada, let alone BC, with respect to either the needs of the military or of sawmills.<sup>457</sup> As such, there is no logical connection between the Log Export Control Regime and its stated purpose. The real and unstated purpose of the Regime is to ensure a *low cost* supply of logs for log processors in BC. In light of this disconnect, if Canada’s policy were truly to do all it can to prevent blockmail albeit within the confines of achieving its stated policy objectives it would simply abolish the Log Export Control Regime altogether. Instead, Canada allows this ineffective an outdated policy to carry on, in full knowledge that it is

R-1(b)(ii) [REDACTED] <sup>458</sup>

<sup>453</sup> C-1(b)(ii) [REDACTED]

<sup>454</sup> C-1(b)(ii) [REDACTED]

<sup>455</sup> The documents produced by Canada in response to Merrill & Ring’s Document Request #45, Investor’s Schedule of Documents (Tabs 107 117), which asked for documents evidencing the practise of “blockmailing” including government actions and responses to address these complaints, do not show that “blockmailers” were, in fact, penalized for “blockmailing”.

<sup>456</sup> Notice 102 at para. 1.2, Investor’s Schedule of Documents (Tab 22); *Export Import Permits Act* at s.3(e), Investor’s Schedule of Documents (Tab 19).

<sup>457</sup> This is why Canada was unable to produce any documents in response to Merrill & Ring’s Document Request #11, Investor’s Schedule of Documents (Tab 118). which asked for “[d]ocuments evidencing any shortage of logs anywhere in Canada related to (a) the needs of national defence; or (b) log supplies for domestic sawmills.”

R-1(b)(ii) [REDACTED]

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*g. The Log Export Control Regime Creates an Unstable Business Environment*

398. In light of all the foregoing, it is clear that the Log Export Control Regime creates an unstable business environment. Merrill & Ring has already presented its arguments in its Memorial as to why this is the case.<sup>459</sup> The BC Minister of Forests has also conceded that

R-1(b)(ii)

<sup>460</sup>

399. Apart from denying that it has any duty to uphold a stable business environment under NAFTA Article 1105(1), Canada's response is simply to deny that the business environment is unstable. Canada is unable to address the substance of Merrill & Ring's assertions because it has no effective way of doing so. Instead of addressing the issues, Canada tries to argue that Merrill & Ring is only minimally impacted by the Log Export Control Regime.<sup>461</sup>

400. Canada's argument is feeble and makes no sense. In the first place, Canada's assertion that Merrill & Ring is only minimally impacted by the Log Export Control Regime could not be farther from the truth. Canada misconstrues Merrill & Ring's claim by focusing only on the logs that are successfully blocked. This is but one aspect of the claim. Merrill & Ring has gone to great lengths to describe in detail how the Log Export Control Regime affects every single aspect of its operations, from planning to harvest to sales. This detailed description has clearly fallen on deaf ears with Canada.

401. In any event, the scale of the impact of the Log Export Control Regime on Merrill & Ring's operations is entirely immaterial. It would not matter if the Log Export Control Regime cost Merrill & Ring \$100 or \$100 Million. If Canada has failed to respect its obligations under NAFTA Article 1105(1), and Merrill & Ring has suffered damage as a result, Canada is required to compensate Merrill & Ring for that damage. Consequently,

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<sup>459</sup> Investor's Memorial at para. 355.

R-1(b)(ii)

<sup>461</sup> Canada's Counter Memorial at para. 659.

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we respectfully request that the Tribunal find that Canada has breached its obligations under NAFTA Article 1105(1).



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**V. NAFTA ARTICLE 1106: PERFORMANCE REQUIREMENTS**

402. The NAFTA contains specific and carefully drafted rules to prohibit the imposition of performance requirements upon foreign investors. Under NAFTA Article 1106, the NAFTA Parties agreed not only to prohibit these industrial policy measures against investors from each of the three NAFTA Parties, but they actually agreed to ban these performance requirements completely, against investors from any country in the world.<sup>462</sup>
403. The Log Control Export Regime fails to meet Canada's obligations under NAFTA Article 1106 as they impose:
- a) The requirement to cut and sort timber from their federally regulated properties to "normal market practices";
  - b) The requirement to scale all timber rafts metrically even when such scaling is unnecessary; and
  - c) The requirement to follow the additional rules for Merrill & Ring properties located in the remote Coastal region.
404. Canada has framed its arguments on NAFTA Article 1106(1) around the generally accepted principles of treaty interpretation laid out in Articles 31 and 32 of the *Vienna Convention*.<sup>463</sup> Merrill & Ring supports following this approach as well.<sup>464</sup>

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<sup>462</sup> The Investor continues to rely on the arguments made in the Investor's Memorial, February 13, 2008 at paras. 297 305 and 363 367

<sup>463</sup> Canada's Counter Memorial at para. 679.

<sup>464</sup> Of course, Merrill and Ring agrees with Prof. Howse who underscores that the interpretive approach taken by this Tribunal must also take into account the objectives, policies and rules of the NAFTA as set out in NAFTA Article 102. See the Legal Opinion of Prof. Robert Howse at paras. 5 11.

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**1. The Ordinary Meaning of NAFTA Article 1106(1) Supports Merrill & Ring's Claim**

405. The first step in treaty interpretation is to discern the “ordinary meaning to be given to the terms of the treaty”. The terms of NAFTA Article 1106(1) read, in relevant part, as follows:

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

- (a) to export a given level or percentage of goods or services;
- (c) to purchase, use or accord a preference to goods produced or services provided in its territory, or to purchase goods or services from persons in its territory;
- (e) to restrict sales of goods or services in its territory that such investment produces or provides by relating such sales in any way to the volume or value of its exports or foreign exchange earnings.

406. The most fundamental aspect of NAFTA Article 1106(1) is that Canada “impose or enforce” a “requirement” on Merrill & Ring. Canada states that the essential meaning here is one that “imports the notion of compulsion.”<sup>465</sup> Merrill & Ring agrees.

407. Canada further recognizes that consistent with the ordinary meaning of NAFTA Article 1106(1) the measures complained of must be “in connection with the establishment, acquisition, expansion, management, conduct or operation of an investment”.<sup>466</sup> Again, Merrill & Ring agrees.

408. Canada then goes on to claim that none of the measures at issue in this case meet these requirements.<sup>467</sup> In particular, Canada claims that log producers like Merrill & Ring are

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<sup>465</sup> Canada’s Counter Memorial at para. 688.

<sup>466</sup> Canada’s Counter Memorial at para. 689.

<sup>467</sup> Canada’s Counter Memorial at para. 691.

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“free to sell their logs on both the domestic and international market.”<sup>468</sup> This is where the disputing parties disagree. Canada seems to have a most unusual understanding of the word “freedom”. This can be clearly seen on the facts of this case, which provide a useful way to view the ordinary meanings of the terms contained in NAFTA Article 1106(1).

*a. Canada Compels Merrill & Ring to Export a Given Level of Goods*

409. Merrill & Ring argues that Canada compels it to export a given level of goods, in violation of NAFTA Article 1106(1)(a).<sup>469</sup> There are two key aspects to Merrill & Ring’s argument here. The first hinges on what it is that constitutes a “good”. The second turns on what it is that constitutes a “given level”.

410. The NAFTA defines what is meant by the term “goods” in its general definitions section in NAFTA Article 201. It defines a good as:

domestic products as these are understood in the *General Agreement on Tariffs and Trade* or such goods as the Parties may agree, and include originating goods of that Party.

411. The Expert Report of Darrell Pearson, submitted by Merrill & Ring with its Memorial, considered whether the harvesting of logs from trees constituted an originating good from Canada. Mr. Pearson, a Canadian customs law expert, concluded that:

7. Accordingly, live trees grown within the NAFTA territory, and in particular in this case in British Columbia and classifiable under the Canadian *Customs Tariff* Schedule Chapter 6 are considered to be NAFTA originating.

8. The live trees grown in Canada are harvested and converted / processed in Canada as you describe. Such growth, harvesting and processing constitutes “production” in accordance with the NAFTA Rules of Origin Regulations, Part I, Definition and Interpretation: “production”:

... means growing, mining, harvesting, fishing, trapping, hunting, manufacturing, processing or assembling a good; (*production*). (emphasis added).

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<sup>468</sup> Canada’s Counter Memorial at para. 704.

<sup>469</sup> Investor’s Memorial at para. 364.

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9. In summary, the live trees grown in Canada (and specifically in British Columbia) qualify as goods which originate in accordance with the NAFTA Rules of Origin. The application of the NAFTA Rules of Origin Regulations, Definitions and Interpretation, make clear that each of growing, or harvesting or conversion (ie. Processing ) of live trees into logs constitutes “production”. (The processed logs also “originate” in accordance with the NAFTA Rules of Origin.)<sup>470</sup>

Since the harvesting of trees is a production process and since the log (the result of the harvesting) is thus an originating good, then Merrill & Ring’s logs must constitute a good as defined by NAFTA Article 201.

412. Canada has not challenged Mr. Pearson’s reasoning and even admits that Merrill & Ring’s logs constitute “goods”.<sup>471</sup>
413. This understanding of what it is that constitutes a “good” is supported by the Oxford English Dictionary, which defines “goods” as “[s]aleable commodities, merchandise, wares...”<sup>472</sup> Since Merrill & Ring produces and exports all sorts of different log products all of which are saleable commodities it naturally follows that it also exports all sorts of different “goods”.
414. It is straightforward to see how Canada compels Merrill & Ring to export a “given level” of goods. As Merrill & Ring has pointed out, the “remoteness” rule requires it to advertise for export its logs in remote areas in minimum volumes of 2,800 m<sup>3</sup> and maximum volumes of 15,000 m<sup>3</sup>.<sup>473</sup> These minimum and maximum volumes clearly constitute “given levels” of these goods.
415. Canada has argued that this requirement does not have any impact on the level of goods exported, but rather only concerns the advertisement of logs.<sup>474</sup> Canada ignores the fact that these advertising volume requirements are a precondition for export approval. If

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<sup>470</sup> Expert Report of Darrell Pearson, February 4, 2008. See also Investor’s Memorial at para. 365(a).

<sup>471</sup> See Canada’s Counter Memorial at para. 707, where it refers to Merrill & Ring’s logs as “goods”.

<sup>472</sup> Oxford English Dictionary, 2<sup>nd</sup> Ed., Volume VI, at p.674.

<sup>473</sup> Investor’s Memorial at para. 364(a).

<sup>474</sup> Canada’s Counter Memorial at para. 707.

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Merrill & Ring advertises its goods in volumes outside of these given levels, it cannot export them. Moreover, if Merrill & Ring actually gains export approval for its remote logs, it cannot export any other volume than the given level for which it was compelled to advertise.

416. Canada further argues that this volume requirement does not limit Merrill & Ring’s “overall volume of exports from remote areas,” and that the requirement “has nothing to do with capacity to export.”<sup>475</sup> In so doing, Canada strays far wide of the wording of NAFTA Article 1106(1)(a), which does not speak to “overall volumes” or “capacity to export.” What NAFTA Article 1106(1)(a) *does* say is that it is impermissible for Canada to require Merrill & Ring to export a “given level” of “goods”. As the facts of this case demonstrate, this is exactly what the volume requirements in the “remoteness rule” do.

*b. Canada Compels Merrill & Ring to Accord a Preference to Goods Produced in Its Territory*

417. Canada compels Merrill & Ring to accord a preference to goods produced in Canada in violation of NAFTA Article 1106(1)(c).<sup>476</sup> Just as with NAFTA Article 1106(1)(a), there are two key aspects to this requirement. Again, just as with NAFTA Article 1106(1)(a), the first hinges on what it is that constitutes a “good”. The second, however, turns on what it is to “accord a preference”. Since the disputing parties already agree that Merrill & Ring produces “goods”, we only need to look here to see if Canada requires Merrill & Ring to “accord a preference” to “goods produced and services provided” in Canada.
418. Merrill & Ring argues that since it is required to cut, sort, and scale its logs in accordance with the specifications laid out in the *Coast Domestic Market End Use Sort Description*, it is required to produce certain types of goods.<sup>477</sup> Merrill & Ring further argues that the requirement to package its logs in accordance with the volume requirements of the “remoteness rule” also compel it to produce certain types of goods, since an inherent

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<sup>475</sup> Canada’s Counter Memorial at para. 707. Similar wording also appears at para. 711.

<sup>476</sup> Investor’s Memorial at para. 365.

<sup>477</sup> Investor’s Memorial at para. 365(a).

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aspect of the goods it produces involves raft size.<sup>478</sup> As a result, not only is Merrill & Ring required to accord a preference to such goods, but it is actually required to produce them.

419. Canada says that Merrill & Ring's claim here is "illogical",<sup>479</sup> and argues that absent the requirements to cut, sort and scale its logs in particular ways, Merrill & Ring would still be producing goods of the exact same nature.<sup>480</sup> From this statement, it is apparent that Canada views all logs as indistinguishable. This stands in stark contrast to Canada's strained efforts in the context of NAFTA Article 1102 to suggest that logs produced in the BC Interior are so different from logs produced on the BC Coast.<sup>481</sup>
420. It is clear that Canada has simply tried to ignore Merrill & Ring's position that logs of different lengths, grades, sorts and scales all constitute different goods. Canada has also ignored the fact that Merrill & Ring would be producing different types of goods if it were not required to conform to the *Coast Domestic Market End Use Sort Descriptions*. Instead of addressing Merrill & Ring's arguments head-on, Canada simply ignores them.

*c. Canada Compels Merrill & Ring to Accord a Preference to Services Provided in Its Territory*

421. Merrill & Ring is also required to accord a preference to services provided in Canada, in violation of NAFTA Article 1106(1)(c).<sup>482</sup> Specifically, Merrill & Ring points out that if it were not required to cut, sort, and scale its logs in particular ways before being able to export its logs, it would not have to hire the services in Canada of those who perform these tasks.<sup>483</sup> Merrill & Ring further argues that it is required to hire the services of those who retrieve their logs when they break up while awaiting the Surplus Testing

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<sup>478</sup> Investor's Memorial at para. 365(b).

<sup>479</sup> Canada's Counter Memorial at para. 715.

<sup>480</sup> Canada's Counter Memorial at para. 716.

<sup>481</sup> See, for example, Canada's Counter Memorial at paras. 42, 43, 46, 47, 328, 379, and 381.

<sup>482</sup> Investor's Memorial at para. 366.

<sup>483</sup> Investor's Memorial at para. 366(a).

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Procedure to run its course.<sup>484</sup> And, in light of the extra towing Merrill & Ring is required to do as a result of the “remoteness rule”,<sup>485</sup> it is also required to hire extra towing services.

422. Canada says that these arguments “border on the ridiculous”,<sup>486</sup> and denies that any of these are even requirements.<sup>487</sup> In making this denial, Canada ignores Merrill & Ring’s evidence about cutting, sorting and scaling. However, Canada does at least admit that “[l]og producers under the provincial regime must also hire the services of recovery providers”.<sup>488</sup> Yet Canada offers no explanation as to how this shows that there is no requirement. Indeed, by pointing out that Canada’s compulsory rules apply to both provincial and federal log producers, Canada seems to implicitly admit that they are requirements.
423. Canada states that it does not require Merrill & Ring to hire Canadian workers.<sup>489</sup> This is the centrepiece of Canada’s defence. With this argument, however, Canada again strays far from the express wording of the provision. NAFTA Article 1106(1)(c) forbids Canada from requiring Merrill & Ring to “accord a preference to...services provided in its territory.” It does not say that Canada is forbidden from requiring Merrill & Ring to “hire Canadian workers”. Thus, Canada is correct that it does not require Merrill & Ring to hire Canadian workers but this is irrelevant. What Canada does is require Merrill & Ring to “accord a preference...to services provided in its territory”, irrespective of the nationality of the service providers. The issue is not who provides the service, but rather where they provide it.
424. While Merrill & Ring must necessarily tow its logs to some extent in Canadian waters, there is nothing natural about the fact that it is required to hire the services of towing

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<sup>484</sup> Investor’s Memorial at para. 366(b).

<sup>485</sup> Kurucz Reply Witness Statement, December 14, 2008 at paras. 21-22.

<sup>486</sup> Canada’s Counter Memorial at para. 717.

<sup>487</sup> Canada’s Counter Memorial at para. 718.

<sup>488</sup> Canada’s Counter Memorial at para. 718.

<sup>489</sup> Canada’s Counter Memorial at paras. 717 & 718.

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contractors to a greater extent than it otherwise would. In a related way, while it is true that Merrill & Ring is naturally subject to the risk of having its booms break up in Canadian waters, there is nothing natural about being compelled to assume more risk than it needs to.

425. Finally, while it is undeniable that Merrill & Ring's trees must be cut *down* in Canada, there are no other natural limitations on where Merrill & Ring has to cut *up*, and otherwise sort and scale its logs. Yet because of the Log Export Control Regime, Canada *does* require Merrill & Ring to conduct all these activities in its territory. As a result, Canada not only requires Merrill & Ring to "accord a preference" to services provided in its territory, it actually requires Merrill & Ring to hire services that are provided in its territory full stop.

*d. Canada Compels Merrill & Ring to Restrict Sales in Its Territory by Relating Them to the Volume of Its Exports*

426. Merrill & Ring further argues that Canada requires it to restrict the sale of its logs by relating their sale to the volume of its exports, in violation of NAFTA Article 1106(1)(e).<sup>490</sup> Specifically, Merrill & Ring argues that because Canada requires it to advertise its "remote" logs in minimum volumes of 2,800 m<sup>3</sup> and maximum volumes of 15,000 m<sup>3</sup>, and because these volume requirements are a precondition for obtaining export approval, these volume restrictions are inextricably related to the volume of Merrill & Ring's exports.<sup>491</sup>
427. Canada has not developed any meaningful counter-argument on this point. Instead, Canada flatly asserts that these volume requirements do not restrict the sale of Merrill & Ring's logs in Canada.<sup>492</sup> Canada provides absolutely no reasoning to support this assertion it just says it.

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<sup>490</sup> Investor's Memorial at para. 367.

<sup>491</sup> Investor's Memorial at paras. 367(a) & 367(b).

<sup>492</sup> Canada's Counter Memorial at paras. 710 & 712.



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428. It is difficult to understand how it is Canada thinks that the volume restrictions on advertisements from “remote” lands do not restrict the sale of logs in Canada. If Merrill & Ring wants to export these logs, it is required to advertise them in packages no smaller than 2,800 m<sup>3</sup> and no larger than 15,000 m<sup>3</sup>. If a log processor blocks these logs Merrill & Ring is required to sell them on the domestic market. Because in such a situation the logs are already packaged according to the volume restrictions of the “remoteness rule”, the terms of this sale of logs in Canada are restricted. And since this volume restriction is imposed only for logs that are advertised for export, it is necessarily related to the volume of exports. These requirements are inconsistent with Canada’s NAFTA obligation in NAFTA Article 1106(1)(e).

*e. Canada’s Measures Are in Connection with the Management of Merrill & Ring’s Investment in Canada*

429. Canada has already agreed that Merrill & Ring’s timber and logs constitute “investments” for the purposes of NAFTA Article 1139(g).<sup>493</sup> All the foregoing requirements impact the way Merrill & Ring either cuts, sorts, scales, tows, recovers, and advertises its logs. In short, they all impact the way Merrill & Ring manages its investments in Canada. As such, there can be no doubt that all these requirements meet the condition of any NAFTA Article 1106(1) claim that the requirement be “in connection with the establishment, acquisition, expansion, management, conduct or operation of an investment.”

**2. The Context of NAFTA Article 1106(1) Supports Merrill & Ring’s Claim**

430. Although it is clear that Merrill & Ring’s arguments satisfy the ordinary meaning of the words contained in NAFTA Articles 1106(1)(a), 1106(1)(c), and 1106(1)(e) on their face, it is equally clear that these arguments also match the meaning of these terms in their context.

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<sup>493</sup> Canada’s Counter Memorial at para. 264.

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431. Canada places heavy reliance on NAFTA Article 1106(5) to suggest that Article 1106(1) must be read narrowly.<sup>494</sup> NAFTA Article 1106(5) reads as follows:

Paragraphs 1 and 3 do not apply to any requirement other than the requirements set out in those paragraphs.

432. From this it is apparent that NAFTA Article 1106(5) does not say anything to the effect that NAFTA Article 1106(1) must be interpreted narrowly. Rather, it merely emphasizes that the list of requirements enumerated under NAFTA Article 1106(1) is closed, not open ended.
433. Merrill & Ring is not advancing any argument that expands the list of requirements contained in NAFTA Article 1106(1). Rather, Merrill & Ring is only advancing arguments under NAFTA Article 1106(1)(a), 1106(1)(c), and 1106(1)(e). Moreover, there is nothing expansive about the arguments Merrill & Ring is advancing; they all fit squarely within the wording of each of these provisions. The overall context of NAFTA Article 1106 does nothing to alter this.

### **3. The Object and Purpose of the NAFTA Supports Merrill & Ring's Claim**

434. Canada also points out that “the objective of prohibiting performance requirements is to prevent NAFTA countries from distorting investment decisions in their favour.”<sup>495</sup> Merrill & Ring agrees. Everything about the Log Export Control Regime is designed to encourage the domestic manufacturing of logs something that clearly distorts Merrill & Ring's decisions in Canada's favour.
435. Despite this admission, Canada suggests that the object and purpose of NAFTA Article 1106(1) does not fit with the arguments advanced by Merrill & Ring.<sup>496</sup> Although it is the

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<sup>494</sup> Canada's Counter Memorial at para. 692.

<sup>495</sup> Canada's Counter Memorial at para. 696.

<sup>496</sup> Canada's Counter Memorial paras. 694 701.

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only disputing party with full access to the *travaux préparatoires* of the NAFTA, Canada offers no evidence in support of its assertion.

436. Canada appears to further its arguments in line with the principles of treaty interpretation contained in Articles 31 of the *Vienna Convention*. Canada, however, misunderstands Article 31.

437. Article 31(1) of the *Vienna Convention* reads as follows:

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

438. As is evident from the express wording of this provision, NAFTA Article 1106(1) is not to be read in light of *its own* object and purpose; rather, NAFTA Article 1106(1) is to be read in light of the object and purpose of *the treaty*. This is confirmed by the mandatory interpretive instructions set out in NAFTA Article 102.

439. The objectives of the NAFTA are set out in Article 102. One of these objectives is to “eliminate barriers to trade in, and facilitate the cross-border movement, of goods and services between the territories of the parties.”<sup>497</sup> As NAFTA Article 102(2) makes clear, NAFTA Article 1106(1) is to be interpreted and applied in light of this objective. There is nothing about the performance requirements Canada imposes upon Merrill & Ring that furthers this objective. Accordingly, the objects and purposes of the NAFTA add further support to Merrill & Ring’s arguments based on the ordinary meaning of NAFTA Articles 1106(1)(a), 1106(1)(c), and 1106(1)(e).

**4. Interpreting NAFTA Article 1106(1) In Accordance with its Plain and Ordinary Meaning as well as Its Object and Purpose Does Not Lead to an Absurd Result**

440. Canada finally suggests that the arguments advanced by Merrill & Ring give rise to an absurd result. According to Canada, if the Tribunal were to endorse Merrill & Ring’s arguments then any border measure or export restriction would result in a violation of

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<sup>497</sup> NAFTA Article 102(1)(a).

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NAFTA Article 1106(1).<sup>498</sup> Canada does not and cannot develop any reasoned argumentation to support this assertion, which is simply untrue.

441. Just as with NAFTA Article 1102, the NAFTA Parties made a number of reservations and exceptions to the application of NAFTA Article 1106 under Article 1108 and its associated Annexes. And just as with NAFTA Article 1102, under Article 1108(3) the NAFTA Parties each listed a number of economic sectors that are exempt from the application of NAFTA Article 1106 in their respective Schedules to Annex II. Accordingly, any border measure or export restriction Canada might take that is expressly exempted by NAFTA Article 1108, or otherwise applied to an economic sector listed in Canada's Schedule to Annex II, would not lead to a violation of NAFTA Article 1106.
442. Although Canada *did* list a large number of economic sectors that were to be exempt from NAFTA Article 1106 in its Schedule to Annex II, it did not exempt the forestry or lumber processing sectors. Consequently, Canada agreed when signing the NAFTA that NAFTA Article 1106 would apply to these sectors.
443. It is clear that there are a large number of situations in which Canadian border measures could not constitute violations of NAFTA Article 1106. Accepting Merrill & Ring's arguments in this claim does nothing to alter Canada's existing authority to address border measures.

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<sup>498</sup> Canada's Counter Memorial at paras. 679 & 699.

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**VI. NAFTA ARTICLE 1110: EXPROPRIATION****1. Overview**

444. The question as to whether Canada has violated its obligations to provide compensation on the taking of acts tantamount to expropriation under NAFTA Article 1110 is really very simple. While there is a substantial body of law on this issue of expropriation and regulatory takings, on the facts of this case, most of this law is in fact rather more distracting than instructive.
445. Simply put, on the facts of this case, it is obvious that Canada has violated its obligations under NAFTA Article 1110.<sup>499</sup>
446. Canada agrees with Merrill & Ring on the analytical steps necessary to find expropriation. Since in the context of expropriation, the only investment at issue is Merrill & Ring's interest in selling its logs at fair value on the international market, the first step is to simply ask whether Merrill & Ring has such an interest.
447. Canada applies an outdated conception of property rights by denying that this Tribunal has jurisdiction over Merrill & Ring's intangible investments. This argument is contrary to the plain meaning of the NAFTA, previous NAFTA decisions and good sense. It is clear that the intangible rights at issue in this claim are part and parcel of the tangible rights. This Tribunal should therefore reject these arguments. It has authority to rule on the tangible and intangible elements of Merrill & Ring's investment.
448. Canada has taken acts tantamount to the expropriation of property interests owned by Merrill & Ring, but Canada has not provided Merrill & Ring with fair market value compensation. The Log Export Control Regime substantially interferes with Merrill & Ring's ability to sell its log at fair value on the international market. Canada takes away value from Merrill & Ring and redistributes it to other private interests in a manner contrary to the obligations of NAFTA Article 1105.

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<sup>499</sup> The Investor continues to rely on the arguments made in the Investor's Memorial, February 13, 2008 at paras. 306 350 and 368 389.

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449. In particular, the Log Export Control Regime is inconsistent with Canada's obligation to provide fair market value compensation upon an act tantamount to expropriation due to:

- a) The requirement to be subjected to the surplus testing prior to being granted an exemption to export their timber;
- b) The requirement to cut and sort timber from their federally regulated properties to "normal market practices".
- c) The requirement to scale all timber rafts metrically even when such scaling is unnecessary;
- d) The ineligibility to submit standing applications and/or obtain standing exemptions; and,
- e) The requirement to remit the fee-in-lieu on provincial rafts that are exported.

**2. The Law of Expropriation: The Analytical Steps**

450. NAFTA Article 1110(1) lays out the conditions a NAFTA Party must adhere to in the event it takes an expropriatory measure against a foreign investor. It sets out the general rule as follows:

No Party may directly or indirectly nationalize or expropriate an investment of an investor of another Party in its territory or take a measure tantamount to nationalization or expropriation of such an investment ("expropriation") except:

- (a) for a public purpose;
- (b) on a non discriminatory basis;
- (c) in accordance with due process of law and Article 1105(1); and
- (d) on payment of compensation in accordance with subparagraphs 2 through 6.

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Where a Party takes an expropriatory measure that is inconsistent with any one of these four conditions, that Party is in violation of its obligations under NAFTA Article 1110.

451. Merrill & Ring has argued that there are three key determinations this Tribunal must make to reach a finding that Canada has breached its obligations under NAFTA Article 1110. These determinations are as follows:

- i) Merrill & Ring has an investment in Canada as defined by NAFTA Article 1139;
- ii) Merrill & Ring's investment has been expropriated by Canada; and
- iii) Merrill & Ring has not received any compensation for this expropriation.<sup>500</sup>

452. Canada has also argued that there are three key determinations required to find that it has breached its obligations under NAFTA Article 1110.

- i) Merrill & Ring has an interest capable of being expropriated;
- ii) Canada has expropriated that interest; and
- iii) The expropriation was unlawful under NAFTA Articles 1110 (1)(a) to (d).<sup>501</sup>

453. While the disputing parties approaches to NAFTA Article 1110 analysis may at first blush seem quite different, in the context of this case they are in fact strikingly similar. The reasons for this are laid out in sequence as follows:

- i) In the context of NAFTA Article 1110, the only investment at issue in this case is Merrill & Ring's interest in realizing fair market value on the

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<sup>500</sup> Investor's Memorial at para. 351.

<sup>501</sup> Investor's Memorial at para. 723.

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international market. As Merrill & Ring has already demonstrated,<sup>502</sup> this interest *is* recognized as an investment under NAFTA Article 1139(h). While Canada may dispute this fact, it does at least admit that if this interest *is* recognized as an investment under NAFTA Article 1139, then it must also be capable of being expropriated.<sup>503</sup> As such, the disputing parties actually agree that the real question at this first step is simply whether Merrill & Ring's interest in realizing fair market value on the international market is a recognized investment under NAFTA Article 1139(h).

- ii) Both Merrill & Ring and Canada agree that the second step of the analysis is to determine whether Canada has expropriated Merrill & Ring's interest in realizing fair market value for its logs on the international market.
- iii) Both Merrill & Ring and Canada agree that the third step of the analysis requires the Tribunal to determine whether Canada has provided Merrill & Ring compensation for the expropriation which is required to by NAFTA Article 1110(1)(d). Canada, however, would also have the Tribunal examine NAFTA Articles 1110(1)(a) to (c). Since inconsistency with any *one* of the requirements listed in NAFTA Articles 1110(1)(a) to (d) is fatal to Canada's defence, the failure by Canada to pay Merrill & Ring compensation under NAFTA Article 1110(d) is determinative. Merrill & Ring is prepared to restrict the inquiry to this single ground. Since it is a required element of the inquiry in any event, Canada could not possibly object. This simply makes the analysis simpler and less burdensome for both the disputing parties, as well as the Tribunal.

454. To the extent that Canada wishes to consider issues of due process and consistency with the international law standard of treatment contained in NAFTA Article 1105, the Investor incorporates its arguments set out in Section IV of this Reply.

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<sup>502</sup> See *Supra*, Section II.2.b.

<sup>503</sup> See Canada's Counter Memorial at para. 727, where it states: "...when an investor demonstrates that it possesses interests within the meaning of the definition of "investment" in NAFTA Article 1139...the Tribunal can proceed to the second step of determining whether such "investments" have been expropriated."



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455. Since the analytical approaches advanced by Merrill & Ring and Canada are essentially the same, we shall now proceed to follow this framework to demonstrate that Canada has indeed violated its obligations under NAFTA Article 1110.

**3. Merrill & Ring's Investment Includes an Interest in Realizing Fair Market Value for its logs on the International Market**

456. At the heart of the arguments made so far by either disputing party on NAFTA Article 1110 lies one simple threshold question: is Merrill & Ring's interest in realizing fair market value for its logs on the international market recognized as an investment under NAFTA Article 1139(h)?

457. To help it answer this question, we refer the Tribunal back to our arguments on why it *does* have jurisdiction *ratione materiae*.<sup>504</sup> In reviewing that section, the Tribunal shall clearly see that Merrill & Ring's interest in realizing fair value for its logs on the international market *is* in fact an investment covered by NAFTA Article 1139(h). Not only is this interpretation consistent with the plain and ordinary meaning of NAFTA Article 1139(h), but it is also supported by the objects and purposes of the NAFTA.

458. This is why NAFTA jurisprudence supports the notion that Merrill & Ring's interest in realizing fair value for its logs on the international market *does* constitute an investment under NAFTA Article 1139(h). As the Tribunal in *Pope & Talbot* the only other Chapter 11 Tribunal presiding over a dispute involving the regulatory regime of the BC lumber industry clearly stated:

...the Investment's access to the US market *is* a property interest subject to protection under Article 1110.<sup>505</sup>

459. Should the Tribunal decide this threshold question in Merrill & Ring's favor, the conclusion that Canada has violated its obligations under NAFTA Article 1110 follows quite naturally.

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<sup>504</sup> See *Supra*, Section II.2.b.

<sup>505</sup> *Pope & Talbot*, Interim Award at para. 96 [emphasis added], Investor's Book of Authorities (Tab 72).

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#### 4. Canada Has Completely Expropriated Merrill & Ring's Investment

460. The reason for this is that, once it has been identified that one of Merrill & Ring's investments does in fact include its interest to realize fair value for its logs on the international market, then there can be no doubt that Canada has expropriated that investment. Once the investment at issue in NAFTA Article 1110 has been so defined, then the question about the extent of interference with that investment fades away. Canada has not merely interfered with this investment in some partial or ephemeral way; Canada has completely taken this investment away from Merrill & Ring. This is not just a partial taking it is a complete taking.
461. Since the investment in question is intangible, there can be no issue here about whether Canada has taken physical possession of Merrill & Ring's property, or otherwise stormed its offices. These aspects of a traditional claim of expropriation of physical property simply do not fit with an expropriation of the type of investment at issue here.
462. Strictly speaking, the only investment at issue in NAFTA Article 1110 is Merrill & Ring's NAFTA Article 1139(h) interest in realizing fair value for its logs on the international market. It is important to note that this interest is not simply reflected in the price Merrill & Ring ultimately receives for its logs; rather it is also reflected in the costs Merrill & Ring incurs to produce its logs. This is because the *value* of Merrill & Ring's logs is affected by both the cost and return sides of the equation.
463. As we have seen, the Log Export Control Regime forces Merrill & Ring to incur extra costs at every step of the production process. By consequence, in addition to the suppressed prices Merrill & Ring receives for selling its logs on the domestic market, the extra costs Merrill & Ring incurs as a result of the Log Export Control Regime must also be factored into its interest in receiving fair *value* for its logs on the international markets. As a result, it is not only those logs that Merrill & Ring was forced to sell on the domestic market that need to be included as part of its interest covered by NAFTA Article 1110; it is all the logs that Merrill & Ring produces, regardless of whether they are ultimately sold on the export market or not.
464. In summary, Merrill & Ring's interest in selling its logs for fair value on the international markets that should be the only investment the Tribunal considers in the course of its

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deliberations on NAFTA Article 1110. This interest includes both the reduced revenues realized the logs, as well as the increased costs of producing them.

**5. Canada Has Not Paid Merrill & Ring Any Compensation**

465. Not only has Canada completely not just partially interfered with Merrill & Ring's interest in realizing fair value for its logs on the international markets, but Canada has also completely neglected to pay Merrill & Ring any compensation and it has taken measures in a manner that is inconsistent with NAFTA Article 1105 and due process. Consequently, Canada has not met its obligations enumerated under NAFTA Article 1110(1).

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## VII. DAMAGES

### 1. Overview

466. Canada and the Investor seem to be in general agreement on the fundamentals of the law of damages that apply in this claim.<sup>506</sup> The differences appear to occur with respect to the quantification of damages.
467. Canada completely not just partially interfered with Merrill & Ring's interest in realizing fair value for its logs on the international markets. Canada is required under NAFTA Article 1110 to compensate the Investor but it has failed to do so. Additionally, Canada has taken measures in a manner that is inconsistent with NAFTA Article 1105 and due process. Consequently, Canada has not met its obligations enumerated under NAFTA Article 1110.
468. Douglas Ruffle is a Registered Professional Forester in British Columbia who reviewed Merrill & Ring's Harvest Plan. He has produced a revised harvest plan upon which the Low Report has relied in its calculation of the damages in this claim.<sup>507</sup>
469. As a result of the filing of the Low Report, it would appear likely that the disputing parties can find more consensus on the quantum of the loss that Merrill & Ring has, and will continue to incur as a result of Canada's inconsistency with its NAFTA obligations under the Log Export Control Regime due to the use of independent, non-speculative data by low.

### 2. Merrill & Ring Harvest Volumes

470. R-1(b)(i)
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<sup>506</sup> See Canada's Counter Memorial at para. 803.

<sup>507</sup> The Investor continues to rely on its damages law set out in the Investor's Memorial, February 13, 2008 at paras. 390-431.

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R-1(b)(i) [Redacted] 508

471. R-1(b)(i) [Redacted]

472. R-1(b)(i) [Redacted]

473. R-1(b)(i) [Redacted]

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<sup>508</sup> R-1(b)(i) [Redacted]

<sup>509</sup> R-1(b)(i) [Redacted]

<sup>510</sup> R-1(b)(i) [Redacted]

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R-1(b)(i) [Redacted]

474. R-1(b)(i) [Redacted] 514

475. R-1(b)(i) [Redacted]

[Redacted]

[Redacted]

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<sup>511</sup> R-1(b)(i) [Redacted]

<sup>512</sup> R-1(b)(i) [Redacted]

<sup>513</sup> R-1(b)(i) [Redacted]

<sup>514</sup> R-1(b)(i) [Redacted]

<sup>515</sup> R-1(b)(i) [Redacted]

<sup>516</sup> R-1(b)(i) [Redacted]

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R-1(b)(i) [Redacted]

517

c) R-1(b)(i) [Redacted]

d) R-1(b)(i) [Redacted]

519

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<sup>517</sup> R-1(b)(i) [Redacted]


<sup>518</sup> R-1(b)(i) [Redacted]

<sup>519</sup> R-1(b)(i) [Redacted]

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R-1(b)(i)




476. R-1(b)(i)




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<sup>520</sup> R-1(b)(i)



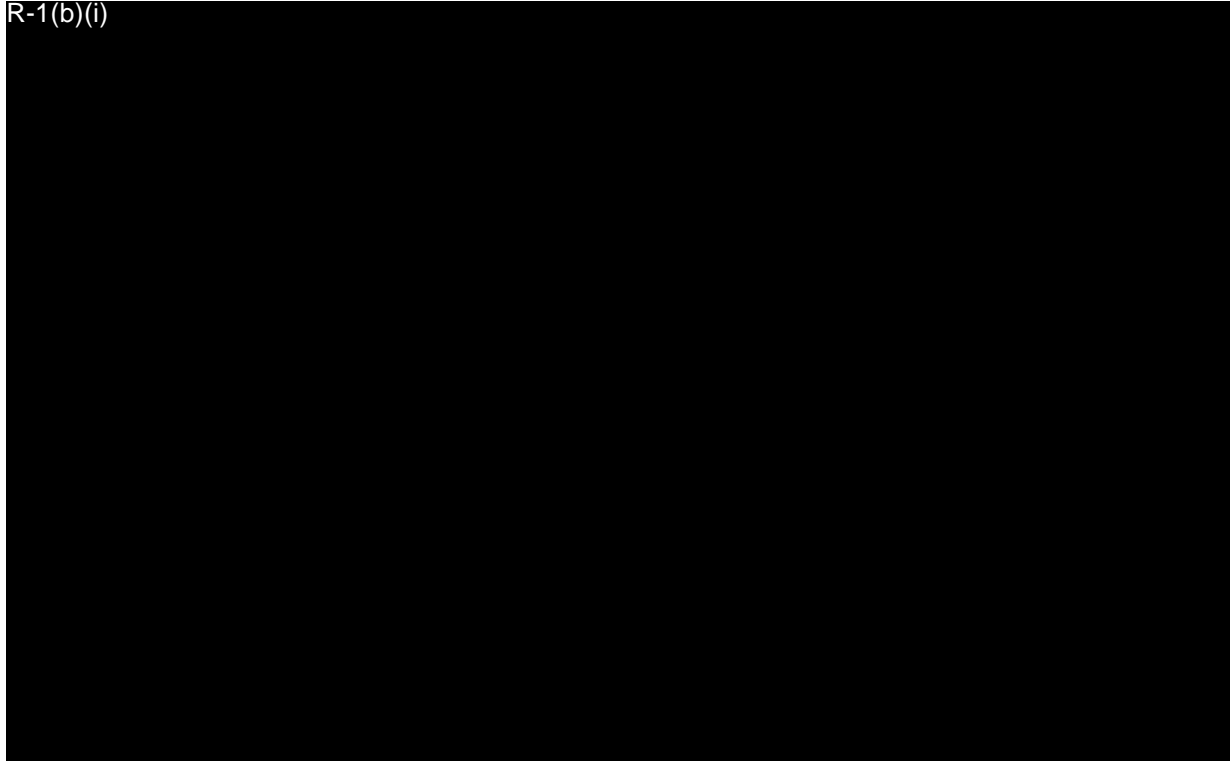
<sup>521</sup> R-1(b)(i)





477.

R-1(b)(i)



**3. Damages Suffered by Merrill & Ring**

478. The Low Report calculates total damages. These flow from three categories of losses:

- a) R-1(b)(i) [redacted]
- b) R-1(b)(i) [redacted] d
- c) R-1(b)(i) [redacted] 524

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<sup>522</sup> R-1(b)(i) [redacted]

<sup>523</sup> R-1(b)(i) [redacted]

<sup>524</sup> R-1(b)(i) [redacted]

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479. R-1(b)(i) [Redacted]

480. R-1(b)(i) [Redacted]

481. R-1(b)(i) [Redacted]

<sup>52</sup>R-1(b)(i) [Redacted]


<sup>526</sup>R-1(b)(i) [Redacted]

<sup>527</sup>R-1(b)(i) [Redacted]

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R-1(b)(i)

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*a. Losses by Category*


482. R-1(b)(i)

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R-1(b)(i)

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483. R-1(b)(i)

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*b. Losses By NAFTA Provision*

484. R-1(b)(i)

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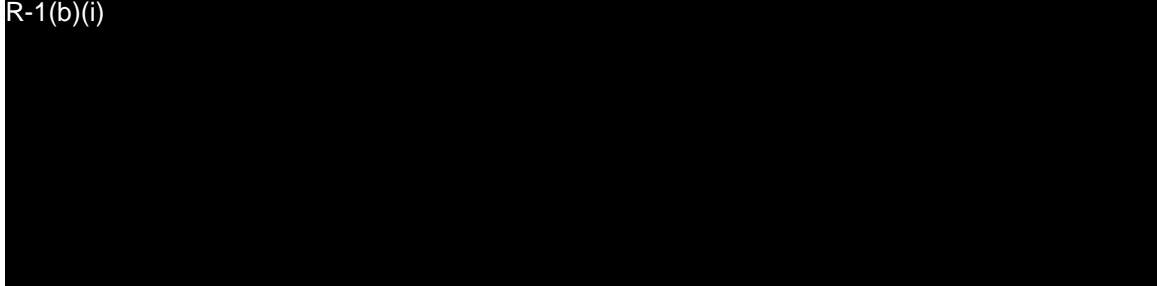
<sup>528</sup> R-1(b)(i)

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R-1(b)(i)



Based on these four categories, Deloitte calculates Merrill & Ring's losses due to the breach of NAFTA Article 1102 as \$16,804,068.<sup>529</sup>

485. R-1(b)(i)




Based on the above, Mr. Low calculates Merrill & Ring's losses due to the breach of NAFTA Article 1105 as \$16,804,068.<sup>530</sup>

486. R-1(b)(i)




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<sup>529</sup> R-1(b)(i)



<sup>530</sup> R-1(b)(i)

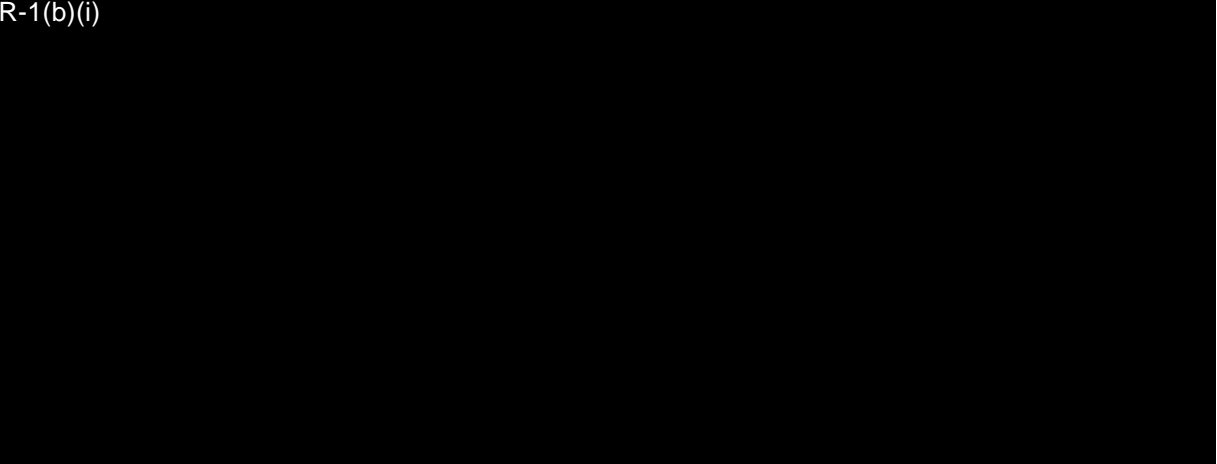


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R-1(b)(i)". Based on this Deloitte calculates Merrill & Ring's losses due to the breach of NAFTA Article 1106 as \$16,756,272.<sup>531</sup>

487. R-1(b)(i)



Based on the above, Mr. Low calculates Merrill & Ring's losses due to the breach of NAFTA Article 1110 as \$18,682,368, inclusive of interest to May 31, 2009.<sup>532</sup>

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<sup>531</sup> R-1(b)(i)

<sup>532</sup> R-1(b)(i)

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**VIII. RELIEF REQUESTED**

483. In view of the facts and arguments set out in this Reply Memorial, Merrill & Ring respectfully requests that the Tribunal grant the following relief:

1. A Declaration that Canada has acted in a manner inconsistent with its NAFTA obligations under Articles 1102, 1105, 1106 and 1110.
2. Damages with respect to the breach of Canada's obligations under NAFTA Articles 1102 or 1105 in the amount of CND\$ 16,804,068; and/or
- c. Damages with respect to the breach of Canada's obligations under NAFTA Articles 1106 in the amount of CND\$ 16,756,272; and/or
- d. In conjunction with the findings made under paragraphs (b) and/or (c), Merrill & Ring seeks damages with respect to the breach of Canada's obligations under NAFTA Article 1110 in the amount of CND\$ 18,682,368 plus interest from May 31, 2009 at a rate set by the Tribunal.
- e. An award in favour of Merrill & Ring for its costs, disbursements and expenses incurred in the liability phase of the arbitration for legal representation and assistance, plus interest and for the costs of the Tribunal.

ALL OF WHICH IS RESPECTFULLY SUBMITTED



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Appleton & Associates International Lawyers

Date: December 15, 2008