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

BETWEEN:

POPE & TALBOT, INC.

Claimant / Investor

and

THE GOVERNMENT OF CANADA

Respondent / Party

GOVERNMENT OF CANADA

STATEMENT OF DEFENCE

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STATEMENT OF DEFENCE

I. Introduction

The Government of Canada ("Canada"), in answer to the Notice of Intent to submit a Claim to Arbitration ("Notice of Intent") delivered by Pope and Talbot, Inc. (the "Claimant") on December 24, 1998 and to the Statement of Claim (the "Claim") delivered by the Claimant on March 25, 1999, says as follows:

1. Canada has acted in a manner fully consistent with its obligations under Chapter 11 of the *North American Free Trade Agreement*[1] ("*NAFTA*") and, in any event, the Claimant is not entitled to recover damages under the heads of damage or in the amounts claimed. As a general response to the Claim, Canada says that:

2. The Claimant has failed to meet its burden to provide adequate particulars of the facts supporting its Claim, as required by Article 18 of the *United Nations Commission on International Trade Law Arbitration Rules*[2] ("*UNCITRAL* Rules"). Since the statement of facts is inadequate, the Claimant will not be able to meet its burden of proof as required by Article 24(1) of the *UNCITRAL* Rules. Therefore, its Claim must be dismissed.

3. The Claimant's request for an interim order is unwarranted on the facts and at law and, therefore, must be rejected.

4. The Claim falls outside the scope of *NAFTA* Chapter 11 because it does not raise measures relating to investments and to investments of investors and therefore its Claim must be dismissed.

The Tribunal must strike the allegations and alleged damages relating to Harmac Pacific c. ("Harmac") because the Claimant has failed to satisfy the requirements of *NAFTA* Articles 1119 - 1121.

6. The Tribunal must strike the allegation of a breach by Canada of its *NAFTA* Article 1103 most favoured nation treatment obligations. If it does not strike this allegation, Canada says that it complied with its *NAFTA* Article 1103 most favoured nation treatment obligations by according the Claimant and its investment treatment no less favourable than the treatment it accorded to investors and investments of investors of a Party or of a non-*NAFTA* Party in like circumstances with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.

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1 *North American Free Trade Agreement between the Government of Canada, the Government of Mexico and the Government of the United States*, December 17 1992, Can, T.S. 1994 No. 2 (entered into force January 1, 1994) **Tab L-1**.

2 *United Nations Commission on International Trade Law Arbitration Rules (1976)*, General Assembly Resolution 31/98, **Tab L-3**.

7. The Claimant acquiesced in the implementation of the Canada-United States Softwood Lumber Agreement[3], signed May 29, 1996 (the "*SLA*"), and is therefore estopped from bringing its Claim.

8. Canada complied with its *NAFTA* obligations. Specifically:

a. Canada complied with its *NAFTA* Article 1102 national treatment obligations by according the Claimant and its investment treatment no less favourable than the treatment it accorded, in like circumstances, to Canadian investors and investments with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments;

b. Canada accorded the Claimant's investment treatment in accordance with international law, including fair and equitable treatment, thereby complying with its *NAFTA* Article 1105 (Minimum Standard of Treatment) obligations;

c. Canada complied with its *NAFTA* Article 1106 (1) (Performance requirements) obligations by not imposing or enforcing any proscribed requirements, commitment or undertaking in connection with the establishment, acquisition, expansion, management, conduct, or operation of the investment of the Claimant;

d. Canada complied with its *NAFTA* Article 1106 (3) (Performance requirements) obligations by not conditioning the receipt or the continued receipt of an advantage, in connection with an investment in its territory, on compliance with proscribed requirements;

e. Canada complied with its *NAFTA* Article 1110 obligations by not directly or indirectly expropriating an investment of the Claimant in Canada, or by not taking measures tantamount to an expropriation of an investment of the Claimant in Canada.

9. If Canada is found not to have complied with one or more of the aforementioned *NAFTA* obligations, which is not conceded, Canada says that it entered into the *SLA* fully intending to be bound by its provisions and with full knowledge of its pre-existing *NAFTA* obligations. Canada says that if compliance with its *SLA* obligations puts it in violation of its *NAFTA* Chapter 11 obligations, which is not conceded, then the *SLA* must prevail to the extent of any inconsistency as an international agreement later in time.

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[3] *Softwood Lumber Agreement between the Government of Canada and the Government of the United States*, May 29, 1996, Can. T.S. 1996 No. 16 (entered into force April 1, 1996), **Tab L-6.**

10. The Claimant is not entitled to the compensation or damages claimed, or to any compensation or damages.

11. Canada claims all costs, disbursements and expenses incurred by Canada in the defence of this Claim including, but not restricted to, legal, consulting, and witness fees and expenses, and travel and administrative expenses, as well as the costs of the Tribunal.

II. The Claim is not Arbitrable

12. For the reasons set out in paragraphs 13 to 33, this Claim is not arbitrable by this Tribunal.

A. The Claim falls outside of the scope of *NAFTA* Chapter 11

13. The Claim falls outside the scope of *NAFTA* Chapter 11 because it does not relate to investment measures and therefore does not meet the requirements of *NAFTA* Articles 1116 and 1101.

14. The Claim takes issue with the *SLA* and its implementation. The *SLA* and *SLA* implementation are not investment measures.

15. *NAFTA* Article 1116 stipulates that "[a]n investor of a Party may submit to arbitration under this Section a claim that another Party has breached an obligation under:

(a) Section A [of Chapter 11] ... ."[4]

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[4] *North American Free Trade Agreement between the Government of Canada, the Government of Mexico and the Government of the United States*, December 17 1992, Can, T.S. 1994 No. 2, Article 1116, **Tab L-1**.

16. *NAFTA* Article 1101 stipulates that "[t]his Chapter applies to measures adopted or maintained by a Party relating to:

(a) investors of another Party;

(b) investments of investors of another Party in the territory of the Party; and

(c) with respect to Articles 1106 and 1114, all investments in the territory of the Party."[5] (emphasis added).

17. The measures Canada adopted or maintained to implement the *SLA* relate exclusively to trade in softwood lumber. They are not measures that relate to investors or investments of investors of the other *NAFTA* Parties within the meaning of Article 1101(1). Consequently, the Claim is invalid and not arbitrable under *NAFTA* Chapter 11.

B. The Claimant cannot claim damages suffered by Harmac

18. No claim on behalf of Harmac is arbitrable in these proceedings. The Tribunal must strike the allegations and alleged damages relating to Harmac for three reasons:

a) Harmac was never mentioned as an investment of the Claimant in either the Notice of Intent or the Notice of Arbitration and therefore the Claimant has not met its obligations set out in *NAFTA* Articles 1119 and 1120;

b) The conditions precedent to submission of a claim under *NAFTA* Chapter 11 in respect of Harmac have not been satisfied: specifically, Harmac failed to provide the waiver required by Article 1121; and

c) it is prejudicial to Canada to permit the claim on behalf of Harmac to be adjudicated.

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5 *North American Free Trade Agreement between the Government of Canada, the Government of Mexico and the Government of the United States*, December 17 1992, Can, T.S. 1994 No. 2, Article 1101, **Tab L-1**.

C. The allegation regarding most favoured nation treatment must be dismissed

19. The Tribunal must strike the allegation that Canada breached its *NAFTA* Article 1103 obligations.

20. In accordance with Article 18(2) of the *UNCITRAL* Rules[6], a statement of claim must include particulars of the facts supporting the claim and the points at issue. The Claim does not satisfy this requirement.

21. The Claimant does not allege facts to support any of the allegations that Canada has breached its *NAFTA* Article 1103 obligations.

22. The Claimant cannot reserve its right to make a claim that Canada has breached its *NAFTA* Article 1103 obligations at a later date. Such a reservation violates Article 18(2) of the *UNCITRAL* Rules and violates the principle of procedural fairness whereby an opposing party has the right to know the case it must meet.

23. The Tribunal must strike this allegation and the related claim for damages for one hundred and twenty five million, six hundred and fifty seven thousand, nine hundred U.S dollars ($125,657,900).

24. In the alternative, if the Tribunal does not strike this allegation, Canada says that it acted in conformity with its *NAFTA* Article 1103 obligations.

25. *NAFTA* Article 1103 states:

> 1. Each Party shall accord to investors of another Party treatment no less favourable than it accords, in like circumstances, to investors of any other Party or of a non-Party with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.
>
> 2. Each Party shall accord to investments of investors of another Party treatment no less favourable than that it accords, in like circumstances, to investments of investors of any other Party or of a non-Party with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.

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[6] *United Nations Commission on International Trade Law Arbitration Rules (1976)*, General Assembly Resolution 31/98, Article 18, **Tab L-3**.

26. The phrase "in like circumstances" in *NAFTA* Article 1103 establishes a basis for comparison between, on the one hand, domestic investors and investments, and on the other hand, investors and investments of other *NAFTA* Parties of non-Parties.

D. The Claimant is estopped from bringing its Claim

27. Estoppel (common law) and préclusion (civil law) are applied by courts and tribunals, both domestically and internationally. The elements of estoppel are:

a) Representation: a party represents to another that it will act in a particular way or its conduct indicates an intention to do so;

b) Reliance: the party to whom the representations were made relies on the representations;

c) Inconsistent behaviour: the party making the representations subsequently denies the truth of its representations or acts contrary to them; and

d) Benefit/Disadvantage: there is reliance upon the inconsistent behaviour either to the detriment of the party relying on it, or to the advantage of the party exhibiting inconsistent behaviour.

28. The conduct of the Claimant, as evidenced by its letter which is included in Annex 1 of the *SLA*[7], as well as the conduct of the Claimant's investment, as evidenced through its participation in consultations and acquiescence in its *SLA* implementation, indicated their intention to abide by the *SLA* and the *SLA* implementation. Expressions of support for the *SLA*, conduct during consultations on *SLA* implementation and conduct during *SLA* implementation demonstrate that the Claimant and its investment supported the *SLA* and *SLA* implementation.

29. Canada relied on the conduct and representations of both the Claimant and its investment to conclude the *SLA* and implement it. Without the letters from U.S. softwood lumber producers at Annex 1 of the *SLA*, the U.S. would not have been able to provide credible assurance to Canada that companies accounting for "more than 60 per cent of the total U.S. production of softwood lumber" (Article I of the *SLA*) would oppose petitioning for trade actions and initiating countervailing duty ("CVD") investigations.

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[7] *Softwood Lumber Agreement between the Government of Canada and the Government of the United States*, May 29, 1996, Can. T.S. 1996 No. 16 (entered into force April 1, 1996), **Tab L-6**.

30. In addition, during consultations on *SLA* implementation, Canada solicited comments from all softwood lumber exporters, including the Claimant's investment. The Claimant's investment was silent, thereby conveying its acquiescence in the implementation of the *SLA*.

31. The Claimant's initiation of its Claim and its position in the Claim are inconsistent with its and its investment's representations of support for the *SLA* and *SLA* implementation on which Canada relied.

32. Moreover, the Claimant has taken advantage of the benefits offered by the *SLA* for 3 years.

33. Consequently, the Claimant is estopped from bringing its Claim.

III. The Claim

34. If the Claim is arbitrable, which is not conceded, Canada denies all those facts alleged in the Claim that are not expressly admitted below and puts the Claimant to the strict proof thereof.

35. Canada admits the facts alleged in paragraphs 1 - 3, and the first sentence of paragraph 47, paragraphs 48 and 49 of the Claim.

36. With respect to paragraph 4 of the Claim, Canada has not waived any right to call for further or subsequent discussions. To the contrary, Canada has offered consultations to the Claimant who refuses to participate.

37. Paragraphs 5 and 6 of the Claim are irrelevant.

38. Canada refers the Tribunal to the text of *NAFTA* for the ordinary meaning of *NAFTA* Articles 1102, 1103, 1105, 1106, 1110 and 201 which are stated inaccurately in paragraphs 10 and 12 of the Claim and throughout the Claim.

39. Except as expressly admitted below, Canada denies the facts alleged in the Introduction on page 1 of the Claim, paragraphs 4, 7, 8, 11, 13 - 33, 40 - 46, and 50 - 105.

40. Except as expressly admitted below, Canada has no knowledge of the facts alleged in paragraph 9, paragraphs 34 - 39, and the second sentence of paragraph 47 of the Claim.

41. Canada does not accept the legal interpretations or conclusions of law pleaded in the Claim.

A. Governing law

42. *NAFTA* Article 1131 stipulates that, "[a] Tribunal established under this Section shall decide the issues in dispute in accordance with this Agreement and applicable rules of international law."[8]

43. The applicable rules of international law include the *Vienna Convention on the Law of Treaties*[9] ("*Vienna Convention*") which is generally accepted as reflecting customary international law.

44. The first general rule of interpretation in the *Vienna Convention* states:

> Article 31: General rule of interpretation
>
> 1. A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.

45. The Tribunal is required to look first to the ordinary meaning of the words used in the agreement and must consider the meaning actually to be attributed to words and phrases looking at the text as a whole and examining the context in which the words appear.[10]

B. The burden of proof

46. At law, the party asserting a claim has the burden of proving that Claim.[11]

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8 *North American Free Trade Agreement between the Government of Canada, the Government of Mexico and the Government of the United States*, December 17 1992, Can, T.S. 1994 No. 2 (entered into force January 1, 1994), Article 1131(1), **Tab L-1**.

9 *Vienna Convention on the Law of Treaties*, May 23, 1969, 1155 U.N.T.S. 331 (entered into force January 27, 1980), **Tab L-7**.

10 *In the Matter of Tariffs Applied by Canada to Certain U.S. - Origin Agricultural Products* (*United States* v. *Canada*), CDA-95-2008-01, 1 T.T.R. (2d) 975 (Ch. 20 Panel), at paragraph 19, **Tab L-8**.

11 M. Kazazi, *Burden of Proof and Related Issues: A Study on Evidence Before International* Tribunals (Kluwer Law International, 1996), p. 116 and 117, **Tab L-9**.

47. Article 18(2)(b) of the *UNCITRAL* Rules stipulates that the Claimant has the duty to provide a Statement of Claim which includes a statement of the facts supporting the claim that Canada has breached its *NAFTA* obligations.

48. Article 24 of the *UNCITRAL* Rules stipulates that the Claimant has the burden of proving the facts relied on to support [its] claim that Canada has breached its *NAFTA* obligations.

49. The Claim alleges no facts supporting any allegation that Canada has breached its *NAFTA* obligations. The Claimant has not discharged its obligation to provide adequate particulars, nor can it, with respect to any of the allegations made. It will not, therefore, be able to meet its burden of proof. The Claim must be dismissed.

C. Background

a) The Canadian softwood lumber industry

50. Nearly half of Canada's land mass is forested, with 67 per cent of forests classified as softwood (spruce, pine, fir, cedar, etc.). Canadian forests are largely publicly owned, with 71 per cent under provincial jurisdiction, 23 percent under federal jurisdiction and 6 per cent owned by an estimated 425,000 private landowners. In 1998, approximately 877,000 Canadians were employed directly or indirectly in the wood and paper industries.

51. The three major softwood lumber industry sectors are:

a) primary manufacturers, which produce lumber from logs;

b) remanufacturers, which perform "value added" operations on lumber; and

c) wholesalers, which sell various products.

52. Canada supplies approximately one-third of the U.S. softwood lumber market.

53. Over the years, the disputes relating to U.S. - Canada softwood lumber trade have created uncertainty for producers and exporters of Canadian softwood lumber.

54. Under Canada's Constitution, which divides jurisdiction between the federal government and the provincial governments, forest management is a provincial responsibility, while international trade is a federal responsibility. Forest management practices do vary among the different provinces. Consequently, the formulation of trade policy for softwood lumber involves federal-provincial consultation as well as the support and involvement of the lumber industry.

b) Canada-United States trade relations in the softwood lumber sector

55. Since 1982, there have been three disputes and two international agreements relating to U.S. - Canada trade in softwood lumber.

56. For more than seventeen years, a group of U.S. softwood lumber producers sought action by the U.S. Government either to force Canadian provinces to change their forest management practices or to restrict trade in Canadian lumber on the theory that the forest management practices of British Columbia, Quebec, Alberta and Ontario constituted countervailable subsidies, and that imports of such "subsidized" lumber from Canada were a cause of material injury to the U.S. industry. Canada has always rejected claims that provincial forest management practices constitute subsidies.

57. Each of the U.S. Department of Commerce ("Commerce") investigations of Canadian softwood lumber imports under the U.S. CVD law found countervailable subsidies only respecting British Columbia, Quebec, Ontario and Alberta (these four provinces are the ones covered by the *SLA* and are referred to as the "four covered provinces" or the "covered provinces"):

a) Ontario and Quebec in the first U.S. industry petition (October 7, 1982)[12];

b) the four covered provinces in the second U.S. industry petition (May 19,1986)[13]; and

c) the four covered provinces in the determination (May 28, 1992) respecting the third investigation.[14] In its third investigation, Commerce restricted its investigation to the four covered provinces.

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12 *Certain Softwood Products from Canada*, 48 Fed. Reg. 24,159 (Final Negative Countervailing Duty Determination) (May 31, 1983) ("*Lumber I*"). Under U.S. law no final injury determination is undertaken if the final subsidy determination is negative.

13 *Certain Softwood Products from Canada*, 51 Fed. Reg. 37,453 (Preliminary Affirmative Countervailing Duty Determination) (1986) ("*Lumber II*").

14 Certain Softwood Lumber Products from Canada, 57 Fed. Reg. 22,570 (Final Affirmative Countervailing Duty Determination) (1992) ("*Lumber III*").

58. Canada and the U.S. entered into a Memorandum of Understanding ("MOU") on December 30, 1986[15] to resolve the second dispute. Canada agreed in the MOU to impose and collect export taxes respecting softwood lumber.

59. Canada exercised its right to terminate the MOU on September 4, 1991.[16] The MOU terminated on October 4, 1991, following the 30 day notification period.

60. The U.S. industry reacted to Canada's decision by pressuring the U.S. Government to take retaliatory action.

61. The final determinations on subsidy and injury made in the third investigation were referred by Canada to a binational panel under Chapter 19 of the *Canada-United States Free Trade Agreement* ("*FTA*"). On remand, Commerce accepted the finding that provincial forest management practices were not countervailable subsidies and terminated the CVD order.[17]

62. The U.S. CVD law was amended, subsequent to the *NAFTA* Chapter 19 rulings, in a manner that could make it more difficult for Canada to prevail on the same basis as in 1994 in the event of a future U.S. CVD investigation.

63. Canada and the Canadian industry remained concerned that costly litigation and marketplace uncertainty would continue.

64. Canada agreed to consultations with the U.S in December 1994 to canvass issues including current and future policies and practices, barriers that affect trade in softwood lumber and related forestry issues, and challenges facing the industry.

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15 Memorandum of Understanding concerning trade in certain softwood lumber products, December 30, 1986 [unpublished].

16 Article 9 of the *Memorandum of Understanding*: "Either government may terminate this understanding at any time upon thirty (30) days written notice."

17 *Certain Softwood Lumber Products from Canada* (U.S. Determination on Remand), USA-92-1904-01, January 6, 1994, affirmed by the Panel at *Certain Softwood Lumber Products from Canada* (Order), USA-92-1904-01, February 23, 1994 (Ch. 19 Panel). *Certain Softwood Lumber Products from Canada*, 59 Fed. Reg. 12,584 (Court Decision and Suspension of Liquidation) (March 17, 1994).

c) The negotiation of a volume restraint agreement

65. After three rounds of consultations, the U.S., in the fall of 1995, pressed Canada and the provinces historically targeted by CVD investigations (British Columbia, Quebec, Ontario and Alberta) to engage in negotiations that focussed on provincial forestry practices.

66. Canada consulted extensively with the governments of the covered provinces, and softwood lumber industry associations and producers and exporters.

67. The negotiators had been developing an umbrella lumber agreement with distinct annexes for Quebec, Ontario and Alberta based on their respective interests and the degree to which each was willing to make commitments regarding its respective forest management systems. With respect to British Columbia, discussions concerned a proposal to restrain exports through an export tax, with no comments regarding B.C. forest management practices. By late March 1996, the idea of an umbrella agreement with distinct annexes yielded to an agreement regarding an overall voluntary restraint arrangement. This became the basis for the *SLA*.

68. The *SLA* was signed on May 29, 1996, effective April 1,1996. It expires on March 31, 2001.[18]

d) The purpose of the Softwood Lumber Agreement

69. The purpose of the *SLA* is to provide for the regulation of Canada - U.S. trade in softwood lumber. The *SLA* brought relative certainty and predictability to U.S.-bound exports of Canadian softwood lumber by precluding further U.S. trade actions for the period of the *SLA*.[19]

e) The Softwood Lumber Agreement

70. Under the *SLA*, the U.S. agreed in Article I to refrain from initiating trade actions respecting exports of softwood lumber first manufactured in the covered provinces for the life of the *SLA*.

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[18] *Softwood Lumber Agreement between the Government of Canada and the Government of the United States*, May 29, 1996, Can. T.S. 1996 No. 16 (entered into force April 1, 1996), Article X, **Tab L-6**.

[19] *Softwood Lumber Agreement between the Government of Canada and the Government of the United States*, May 29, 1996, Can. T.S. 1996 No. 16 (entered into force April 1, 1996), Article I (1), **Tab L-6**.

71. In return, Canada agreed to impose export fees on annual exports of softwood lumber first manufactured in the covered provinces in excess of 14.7 billion board feet. Article II(2) of the *SLA* provides that exports over 14.7 billion board feet and up to 15.35 billion board feet (the lower fee base or "LFB") are to be subject to an export fee of US$50.00 per thousand board feet, while exports over 15.35 billion board feet are subject to an export fee of US$100 (the upper fee base or "UFB"). Export fees are adjusted to account for inflation.[20]

72. Article II (4) of the *SLA* requires Canada to allocate, prior to the beginning of each year, the fee-free established base (or "EB"meaning the quantity that can be exported fee-free) and LFB for that year among Canadian exporters of softwood lumber first manufactured in the covered provinces.

73. Under Article II(6) and (7) of the *SLA*, Canada is required to collect fees from companies that produce more than 10 million board feet of lumber per year, not only where annual levels are exceeded, but also if an individual exporter's shipments to the United States exceed 28.75% of the EB in a given quarter. Such companies may export a maximum of 28.75% of their EB allocations in any one quarter, after which LFB quota[21] is used and, if LFB is exhausted, UFB.

74. The *SLA* placed no limit on the quantity of softwood lumber first manufactured in the covered provinces that may be exported at the UFB rate.

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20 *Softwood Lumber Agreement between the Government of Canada and the Government of the United States*, May 29, 1996, Can. T.S. 1996 No. 16 (entered into force April 1, 1996), Article II (3), **Tab L-6.**

21 Several words and phrases are used in the present text to refer to export quantities agreed by the SLA Parties and shares of such export quantities. "Export level" is allocated and *Export and Import Permits Act* ("EIPA") export permits are issued with respect to exportation of softwood lumber products first manufactured in the SLA-covered provinces.. "Export level" is defined in the *Export Permit Regulations (Softwood Lumber Products)*, as follows:

> "export level" in respect of any year, means a share of the established base or the lower fee base assigned to an exporter".

Often, "export level" is referred to as "quota" or "an allocation". The terms "established base", "lower fee base" and "upper fee base"are defined, in the *Softwood Lumber Products Export Permit Fees Regulations*, in terms of SLA-agreed quantities of softwood lumber exports; the regulations prescribe export fees payable for each quantity. Qualified exporters are allocated "export level" shares of the "established base" and "lower fee base" quantities.

75. Article III of the *SLA* permits Canada to export, without a fee, an additional 92 million board feet of lumber for each calendar quarter where the price per thousand board feet equals or exceeds the "trigger price"of US $410 (US$ 405 in the first two years of the *SLA*). This trigger price bonus is designed to permit exports above the fee-free base to enter the U.S. market without a fee during periods of high market price and strong demand.

76. The trigger price bonus was earned in the first six quarters of the *SLA* and again in the quarters ending March 31, June 30 and September 30, 1999.

77. In order to implement Article 1 of the *SLA*, Canada insisted that letters signed by U.S. domestic producers be attached as Annex 1 of the *SLA* and constitute an integral part of the *SLA*. The U.S., on the strength of these letters, committed to dismiss any petition filed requesting that a trade investigation or action be initiated during the five years the *SLA* is in effect. The letters, from producers accounting for more than 60 percent of the total U.S. production of softwood lumber, provide, in relevant part, that:

> ... the Agreement removes any alleged material injury or threat of material injury, within the meaning of 19 U.S.C. § 1677(7), to the U.S. softwood lumber industry from imports of softwood lumber from Canada.[22]

78. The *SLA* applies to softwood lumber first manufactured in the covered provinces, irrespective of whether the exporter is located in a covered or non-covered province. The *SLA* applies to any exporter wishing to export softwood lumber first manufactured in the covered provinces no matter where in Canada the business is located. It does not differentiate between Canadian and foreign-owned exporters.

f) The implementation of the Softwood Lumber Agreement

79. Canada implemented the *SLA* after open and extensive consultations which afforded exporters of Canadian softwood lumber first manufactured in the covered provinces an opportunity to participate in the development of a method of quota allocation. The Claimant's investment participated in these consultations and acquiesced in the *SLA* implementation.

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[22] *Softwood Lumber Agreement between the Government of Canada and the Government of the United States*, May 29, 1996, Can. T.S. 1996 No. 16 (entered into force April 1, 1996), Article I(1) and Annex 1, **Tab L-6.**

80. The *SLA* requires Canada to allocate fee-free EB and fee-incurring LFB quota to softwood lumber exporters on an annual basis.[23]

81. In March 1996, the federal government began consultations with industry stakeholders and with the governments of the covered provinces on a method for allocating the quota under the *SLA*. Consultations were inclusive, extensive and complex, as they needed to address the varying needs and priorities of more than 500 stakeholders. In addition to the governments of the covered provinces, representatives of primary mills, remanufacturers and wholesalers were involved in meetings, conference calls and written communications with the federal government.

82. A number of national and provincial associations were also involved, including British Columbia's Council of Forest Industries ("COFI"). The Interior Lumber Manufacturers Association ("ILMA)", of which the Claimant's investment was and continues to be a member, is affiliated with COFI. Individual companies were free to, and did, make representations.

83. On March 25, 1996, officials from the Department of Foreign Affairs and International Trade ("DFAIT") convened a meeting in Vancouver with British Columbia ("B.C.") industry stakeholders, including industry representatives and officials from the B.C. Ministry of Forests, to examine an allocation method for B.C. softwood lumber. ILMA attended. It provided DFAIT a list of its representative which included Mr. Abe Friesen, Group Vice President, Wood Products of the Claimant's investment.[24]

84. In May 1996, DFAIT officials began developing a questionnaire with the advice of the Canadian Institute of Chartered Accountants, designed to ascertain the nature of the activities of all industry sectors, including primary mills, remanufacturers, distributors and wholesalers. A draft questionnaire was submitted for review and comment to the industry associations, including COFI, on May 14, 1996.

85. Numerous communications on the draft questionnaire were received from stakeholders from all sectors of the industry. COFI submitted its comments on June 5, 1996. After reviewing the comments received, DFAIT officials made substantial changes to the draft to take account of the views expressed in the various communications.

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23 *Softwood Lumber Agreement between the Government of Canada and the Government of the United States*, May 29, 1996, Can. T.S. 1996 No. 16 (entered into force April 1, 1996), Article II, **Tab L-6**.

24 Letter from the Interior Lumber Manufacturers Association, re: list of ILMA representatives which included Mr. Abe Friesen, from Pope & Talbot (March 22, 1996), **Tab A-15**.

86. Following this, the questionnaire was sent to industry stakeholders under Notice to Exporters No. 92 of June 19, 1996.[25] This Notice invited industry participants to complete the questionnaire and return it by July 31, 1996. The Notice also invited stakeholders to submit their views on methods of allocation, preferably before July 31, 1996.

87. A coalition of industry associations from British Columbia, Alberta and Quebec made a joint submission to DFAIT, which set out an agreed position on allocation of quota.[26]

88. From June 19, 1996 to July 31, 1996, extensive consultations were held between DFAIT and representatives of industry, provincial governments and industry associations on how the allocation should be made.

89. Throughout this period, officials of DFAIT responded to numerous requests from industry stakeholders for assistance in completing the questionnaire. DFAIT received more than 600 completed questionnaires from which it built a computer database. The Claimant's investment's questionnaire was submitted on July 19, 1996.[27]

90. On August 9, the Quebec association, l'Association des manufacturiers de bois de sciage du Québec ("AMBSQ") submitted a position paper[28] setting out a position different from that set out in the joint submission made in June. The AMBSQ's new position was closer to that of the Ontario industry, in that it, too, supported allocations based on each company's export history (i.e., no provincial shares, but rather company shares), with provision for allocations to shift from companies underutilizing their quotas to those that fully utilise their quotas. The Quebec industry also supported more generous treatment of new entrants.

91. Consistent with DFAIT's usual practice, an *ad hoc* Consultative Committee on Softwood Lumber was created to assist the Minister of International Trade with allocations of quota.

92. Industry associations and provincial representatives were invited to attend a meeting of the *ad hoc* Consultative Committee on Softwood Lumber held in Ottawa on August 19 and 20, 1996. Industry associations were free to select their representatives. The B.C. representation included COFI, with which the ILMA, the Claimant's investment's association, is affiliated.

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25 *Notice to Exporters*, No. 92, "Item 5104: Softwood Lumber Products" (June 19, 1996), **Tab A-15**.

26 See Statement of Claim, paragraph 48.

27 Pope & Talbot Ltd. Questionnaire (July 29, 1996), **Tab A-1**.

28 Position Paper of the Association des manufacturiers de bois de sciage du Québec (August 9, 1996), **Tab A-28.**

Following two days of discussion on the allocation method and its various elements, including the base year for the establishment of provincial corporate shares, a general consensus began to emerge. Afterwards, DFAIT circulated to all participants a summary of this consensus regarding the principal elements of an allocation method.

93. On September 10, 1996, the Minister announced the Softwood Lumber Plan, together with the Softwood Lumber Allocation Principal Elements, which provided:

a) initial quota allocations to exporters would be based on proportional provincial corporate shares that;

b) allocations would be subject to annual review and adjustment based on utilisation;

c) allocations would be made to new entrants;[29] and

d) no allocations would be made to wholesalers.

94. Following extensive consultations on allocating the wholesale portion of the quota, on September 30, 1996, DFAIT sent letters to companies advising them that they would be receiving an allocation. Allocations were communicated to companies on October 31, 1996.

g) Quota allocation pursuant to the Softwood Lumber Agreement

95. On April 1, 1996, Canada added softwood lumber to the *Export Control List*[30] by amending the *Export Control List* and later specified softwood lumber from the provinces covered by the *SLA*.

96. Quota is allocated on a non-discriminatory basis, with no distinction between foreign-owned and Canadian exporters of softwood lumber first manufactured in the covered provinces.

97. Companies which exported softwood lumber accessed EB and LFB quota on a "first-come first-served" basis for the first seven months of the *SLA*. Exports were tracked through the issuance of permits and were counted as utilized quota when allocations were communicated on October 31, 1996.

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29 "new entrants" are companies that lacked the export history required of other applicants because they had begun production or construction in 1995 or 1996 or had made investments in new mills or major capacity increases.

30 *Export Control List*, S.O.R. / 89-202, as amended, **Tab L-11**.

98. On June 21, 1996, regulations were adopted to give legal effect to the fees set out in Article II of the *SLA* for the LFB and the UFB. These regulations are the *Export Permits Regulations (Softwood Lumber Products)*[31] and the *Softwood Lumber Products Export Permits Fees Regulations*.[32]

99. Once a method of quota allocation had been determined, calculations of quota were based on historical exports to the U.S. Each applicant provided DFAIT with historical data on its exports in its completed questionnaire.[33]

100. Fee-free EB quota was divided initially according to provincial corporate shares based on the data collected in the company questionnaires (i.e., history of exports to the U.S.). Prior to this division, certain amounts were deducted from the total 14.7 billion board feet of EB as follows:

a) 294 million board feet (2%) was withheld for allocations to new entrants;

b) 50 million board feet (0.34%) was set aside for the Minister's reserve to address special circumstances; and

c) 170 million board feet (1.16%) was set aside as a one-time "transitional reserve" to account for shipments during the "first-come first-served" period that could not be allocated to specific companies, or exports that were beyond a specific company's annual allocation.

101. The remaining EB quota of 14.186 billion board feet was allocated to qualified companies. The provincial corporate shares (i.e., the ratio of historical exports of all companies in a given covered province to the total of historical exports from the four covered provinces expressed in percentage terms) of the remaining quota were as follows: B.C. exporters accounted for 59 per cent of total exports from the covered provinces; Quebec exporters accounted for 23 per cent; Ontario exporters for 10.3 per cent; and Alberta exporters for 7.7 per cent.

102. The Softwood Lumber advisory groups in each of the four covered provinces recommended the basis for calculating year 1 allocations for companies operating in their respective provinces. Using data collected through completed questionnaires, three provinces

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31 *Export Permits Regulation (Softwood Lumber Products)*, S.O.R. / 96-319, as amended, **Tab L-14.**

32 *Softwood Lumber Products Export Permit Fees Regulation*, S.O.R. / 96-317, as amended, **Tab L-13.**

33 Pope & Talbot Ltd. Questionnaire (July 29, 1996), **Tab A-1.**

chose to use a "best year" approach[34] while B.C. chose an average of 1994 and 1995 figures as its basis for primary mills. However, if 1995 exports were more than 35 per cent greater than the average, the 1995 level was used instead. For remanufacturers, B.C. used a "best year" approach.

103. The quota allocation methodology was explained to the Claimant's investment in Notice to Exporters No. 94[35] and in a letter from DFAIT dated November 7, 1996. The Claimant did not contact DFAIT to express concern respecting the quota allocation methodology.

104. A quantity of 628 million board feet[36] of quota was set aside for allocation to new entrants during the first 18 months of the *SLA*.

105. In letters to companies receiving bonus quota under the "new entrants" program, DFAIT officials indicated that bonus utilisation would be factored into the calculation of their next year's EB allocation.[37]

106. New entrant questionnaires, developed in consultation with the provinces and industry, collected data on investment, timber supply and projected production and exports. Applications far exceeded the amount set aside, with 218 companies requesting nearly 8.3 billion board feet of quota. Only 7.5 per cent of the quantity requested could be accommodated. Given those circumstances, each application, without regard to the province in which the applicant operated, was subjected to rigorous review according to national criteria.

107. Any company exporting softwood lumber first manufactured in the covered provinces which found itself out of quota, or nearly out of quota, half way through year 1 was given the option of borrowing against its year 2 allocations.[38]

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34 The basis for calculation in the "best year" approach is the higher of U.S. sales volumes for either (a)1994, (b)1995 or (c) the last half of 1995 plus two times the first quarter of 1996.

35 *Notice to Exporters*, No. 94, "Item 5104: Softwood Lumber Products: The Assignment of Export Levels" (October 31, 1996), **Tab A-16**.

36 628 = 294 million board feet of fee-free EB quota (two per cent of the national total) + 150 million board feet of LFB quota + 184 million board feet fee-free (the first two trigger price bonuses of 92 million board feet).

37 Letter to New Entrants, re: New Entrants Applications (October 31, 1996), **Tab A-5**.

38 *Notice to Exporters*, No. 94, "Item 5104: Softwood Lumber Products: The Assignment of Export Levels" (October 31, 1996), at 10.2., **Tab A-16**.

108. The effect, in years 2 and 3, of borrowing forward in year 1 was as follows:

a) In year 2, the companies that had borrowed in year 1 received reduced allocations to make up for the amount borrowed. The other quota holders, including the Claimant's investment, received slightly higher levels, each receiving its proportional share of total amounts borrowed by others.

b) In year 3, the quota holders that had borrowed forward in year 1 received "normal"[39] allocations. It follows that the other quota holders who had benefited from slightly higher levels in year 2 had their quota allocations adjusted downward, back to normal levels.

109. After year 1, the quota allocation methodology was no longer based on historical exports of softwood lumber first manufactured in the covered provinces. A common allocation methodology applied nationally, with company allocations based on company quota utilisation respecting the previous year ("use it or lose it").[40] The common allocation methodology based on quota utilisation enables shifts in quota from companies that underutilize their allocations to those that fully utilise their allocations (the "growth mechanism").

110. Smaller quota holders (allocations of 10 million board feet or less) were offered the opportunity to "opt out" of the growth mechanism.[41] In return for relinquishing their LFB allocations, these companies had their EB quotas protected from the effects of the growth mechanism. Normally, quota allocations do not decrease as long as the quota is fully utilized during the previous year.

i) Allocation methodology following year 1

111. The following methodology, for allocating quota to companies from year 2 onward (with the exception of companies that had opted-out), was adopted after consultation with stakeholders from across Canada, including British Columbia, and the Minister's National Advisory Committee:

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39 "normal": as if they had never borrowed forward.

40 *Notice to Exporters*, No. 94, "Item 5104: Softwood Lumber Products: The Assignment of Export Levels" (October 31, 1996), **Tab A-16** and *Notice to Exporters*, No. 98, "Softwood Lumber: Transferability" (March 24, 1997), **Tab A-18.**

41 *Notice to Exporters*, No. 94, "Item 5104: Softwood Lumber Products: The Assignment of Export Levels" (October 31, 1996), **Tab A-16** and *Notice to Exporters*, No. 107, "Softwood Lumber: Growth Mechanism" (March 10, 1998), **Tab A-22.**

Established Base (EB)

a) EB quotas are calculated based on the total utilisation by all companies of their EB and LFB quotas as well as any trigger price bonus quota that was granted on a "permanent" basis, such as the bonus referred to in paragraphs 75 and 76.

b) To the extent that this total exceeds the allowable national EB level (14.7 billion board feet minus 40 million board feet kept for the Minister's reserve), each quota holder's EB level is then adjusted to "fit" into the allowable total.

c) Companies that fail to fully utilise their EB and LFB allocations experience decreases in their EB in the next year.

d) Companies that failed to fully utilise their LFB allocations in previous years also experience decreases because their EB/LFB total is proportionately less than the totals of companies that consistently used their full quotas.

Lower Fee Base (LFB)

While there was provision, in the first year of the *SLA*, for companies to lose no more than 20 per cent of their LFB (US$50) quotas through underutilization, in subsequent years the "use it or lose it" approach applies, with quotas being reduced by the amount of underutilization.[42]

ii) Factors affecting allocations going into year 2

112. At the end of year 1, the B.C. Softwood Lumber Advisory Committee recommended that the Minister adjust the quota allocated to certain B.C. companies. The Minister gave effect to this B.C.-specific recommendation, resulting in increased allocations to some companies and decreases in the order of 3 per cent to most companies.

113. Quota holders across Canada experienced a quota decrease in year 2, as new entrants' trigger price bonus was converted to EB quota and allocations from the Minister's reserve were factored into calculations. This decrease amounted to 0.14 per cent. When bonus quota was

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[42] For a more detailed description, see Letter to Pope & Talbot Ltd., re: 1997/98 Final Allocations (June 5, 1997), **Tab A-8**.

made "permanent"[43], the total EB did not get bigger; rather, the specific allocations to quota holders were decreased equally to make room for quota allocated to new entrants.

114. Hence, British Columbia quota holders that fully utilized their EB and LFB allocations and had no other extraordinary circumstances attached to their allocations experienced decreases of 3.14 per cent in their EB levels going into year 2 due to the need to accommodate the circumstances listed above (e.g. 3% + 0.14% as described in paragraphs 112 and 113). This "squeezing" to accommodate all requirements is called the "fit factor".

iii) Factors affecting allocations going into years 3 and 4

115. The general methodology outlined in paragraph 111 continued to apply, with the following "fit factors" affecting allocations in all four covered provinces going into year 3:

a) quota that was returned to the companies that borrowed forward in year 1;

b) "permanent" trigger price bonus allocations that had been utilised in year 2; and

c) allocations from the Minister's reserve.

116. Companies in the four covered provinces that had fully utilized their EB and LFB levels consistently since the beginning of the *SLA* generally experienced decreases of approximately 3.3 per cent due to the "fit factor" circumstances listed above going into year 3.

117. Beginning in year 4, the quota allocation system had absorbed the effects of new entrants and quota that had been borrowed forward.

118. Throughout the stages of negotiation of the *SLA* and of planning for *SLA* implementation, and continuing for the duration of the *SLA*, Canada has provided and continues to provide ample opportunity for consultations. Canada provided explanations respecting *SLA* implementation to exporters affected by the *SLA* through letters, background notes and notices to exporters[44] ("information"). An exporter could write DFAIT officials if it required an explanation regarding any aspect of the information it did not understand. Prior to 1998, the Claimant's investment did not write DFAIT officials respecting any information DFAIT sent to it. The Claimant's investment did not seek, respecting its quota allocation, administrative review or judicial review before the Federal Court of Canada. (See paragraph 139)

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[43] "permanent": in law and in practice the Minister's allocation decisions remain unfettered by quota allocation methodology.

[44] Letters and Background notes, **Tab A-2 to A-11** and Notices to exporters, **Tab A-14 to A-26.**

IV. Points in Issue

A. Request for interim order

119. The Claimant's request for an interim order is unwarranted on the facts and at law and therefore, the Tribunal should reject such request.

120. *NAFTA* Article 1134 limits the circumstances in which the Tribunal may grant an interim order. *NAFTA* Article 1134 states:

> A Tribunal may order an interim measure of protection to preserve the rights of a disputing party, or to ensure that the Tribunal's jurisdiction is made fully effective, including an order to preserve evidence in the possession or control of a disputing party or to protect the Tribunal's jurisdiction. A Tribunal may not order attachment or enjoin the application of the measure alleged to constitute a breach referred to in Article 1116 or 1117. For purposes of this paragraph, an order includes a recommendation.[45] (emphasis added).

121. If the Tribunal granted an interim order in this case, it would be enjoining the very measure that is being impugned. The Tribunal has no authority to grant an interim order that specifies how the *SLA* regime ought to apply to the Claimant's investment.

122. The interim order requested by the Claimant would result in prejudice to Canada and to all other quota holders. Its effect would be equivalent to a final determination in favour of the Claimant. It would take the Claimant out of the *SLA* regime and would create new rights, as opposed to preserving rights. It would potentially require Canada to reduce the quota allocations of other exporters to adjust for shipments by the Claimant's investment, or to breach its *SLA* obligations towards the U.S.

123. There are no circumstance in this case which indicate an interim order is required to preserve evidence. Nor has the Claimant otherwise made a case for an interim measure within the meaning of NAFTA Article 1134.

124. The Claimant has not proved, nor can it, that it is in need of an interim order. It has not alleged any facts which demonstrate a need to preserve evidence.

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[45] *North American Free Trade Agreement between the Government of Canada, the Government of Mexico and the Government of the United States*, December 17 1992, Can, T.S. 1994 No. 2 (entered into force January 1, 1994), Article 1134, **Tab L-1**.

B. In the event the Claim is Arbitrable

125. If the Tribunal rejects Canada's contention that this Claim is not arbitrable and that the *SLA* is an investment measure, which is not conceded, the following addresses the allegations raised with respect to breaches by Canada of its *NAFTA* Chapter 11 obligations.

C. *NAFTA* Chapter 11

126. Canada has complied with its *NAFTA* Chapter 11 obligations.

a) Canada provided national treatment as required by *NAFTA* Article 1102

127. The Claimant alleges Canada breached its *NAFTA* Article 1102 obligations by failing to provide to the Claimant and its investment the best treatment Canada accords, with respect to the export fees imposed on the export of softwood lumber, to:

> a) other investors and investments of investors which produce softwood lumber in Canada;[46] and
>
> b) other investors and investments of investors which produce softwood lumber in the covered provinces excepting British Columbia.[47]

128. Canada denies any breach and asserts that it has provided the Claimant and its investment the treatment required under *NAFTA* Article 1102.

129. *NAFTA* Article 1102 states:

> 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 investments of its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.

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46 Paragraph 76 of the Statement of Claim.

47 Paragraph 77 of the Statement of Claim.

3. 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.

4. For greater certainty, no Party may:

a) impose on an investor of another Party a requirement that a minimum level of equity in an enterprise in the territory of the Party be held by its nationals, other than nominal qualifying shares for directors or incorporators of corporations; or

b) require an investor of another Party, by reason of its nationality, to sell or otherwise dispose of an investment in the territory of the Party.[48]

130. The phrase "in like circumstances" in *NAFTA* Article 1102 establishes a basis for comparison between, on the one hand, domestic investors and investments, and on the other hand, investors and investments of other *NAFTA* Parties.

131. The Claimant misconstrues the obligations in *NAFTA* Article 1102 by ignoring the requirement to compare investors and investments that are in like circumstances.

132. The Claimant makes allegations that by implementing the *SLA*, Canada breached its *NAFTA* Article 1102 obligations. Canada categorically denies these allegations. The Claimant's interpretation of the treatment required under *NAFTA* Article 1102 contradicts an ordinary reading of the provision as required by the fundamental principle of treaty interpretation found in Article 31 of the *Vienna Convention*.[49]

133. Under the *SLA* and the *SLA* implementation, Canada accords to investors and investments of other *NAFTA* Parties treatment no less favourable than that accorded to domestic investors and investments, in like circumstances, with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments. The Tribunal must conclude that Canada has not breached its *NAFTA* Article 1102 obligations.

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48 *North American Free Trade Agreement between the Government of Canada, the Government of Mexico and the Government of the United States*, December 17 1992, Can, T.S. 1994 No. 2 (entered into force January 1, 1994), article 1102, **Tab L-1**.

49 *Vienna Convention on the Law of Treaties*, May 23, 1969, 1155 U.N.T.S. 331 (entered into force January 27, 1980), **Tab L-7**.

b) Canada exceeded the minimum standard of treatment required by *NAFTA* Article 1105

134. The Claimant alleges Canada breached its minimum standard of treatment obligations of *NAFTA* Article 1105. Canada categorically denies this allegation.

135. *NAFTA* Article 1105 states in relevant part:

> 1. 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.[50]

136. Canada acted in conformity with its *NAFTA* Article 1105 obligations and in fact exceeded them. The *SLA* implementation was conducted in a fair and equitable manner. Canada refers the Tribunal to, and relies on, paragraphs 65, 66, 79, 81 - 92, 94, 102 - 103, 105, 106, 111, 118 above, which describe the consultations surrounding *SLA* and the manner in which the *SLA* was implemented.

137. *NAFTA* Article 1105 refers to the "minimum" standard of treatment at international law. Canada met or exceeded this standard.

138. In particular, Canada says that it far exceeded the requirements of *NAFTA* Article 1105 with respect to the Claimant's investment by, *inter alia,*:

> a) according fair and equitable treatment to exporters regarding the allocation of quota; prior to the allocation of quota, consultations occurred through the completion of a questionnaire; this required no hearing as the allocation of quota is effected by an objective mathematical exercise based on information provided by softwood lumber producers;
>
> b) sending notices, letters and background[51] notes informing exporters affected by the *SLA* of the process governing *SLA* implementation and quota allocation; and

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50 *North American Free Trade Agreement between the Government of Canada, the Government of Mexico and the Government of the United States*, December 17 1992, Can, T.S. 1994 No. 2 (entered into force January 1, 1994), Article 1105, **Tab L-1.**

51 Letters and Background notes, **Tab A-2 to A-11** and Notices to exporters, **Tab A-14 to A-26.**

c) providing, within days of the letters announcing allocations, Notice No. 94 (October 31, 1996) and correspondence dated November 7, 1996 informing exporters of the reasons for, and factors determining, allocations. In subsequent years, background notes were attached to annual allocation letters.

139. A procedure to review Canada's quota allocation decisions is not required under the standard of treatment required by *NAFTA* Article 1105. Even though one is not required, Canada denies that one was unavailable to the Claimant's investment. At any time, the Claimant's investment could have called, and did call in June 1998, upon DFAIT officials for explanations and information. In the event that it was not satisfied, the Claimant's investment could have applied to the Federal Court of Canada for judicial review of softwood lumber export quota allocation decisions. The Claimant's investment has not applied for judicial review of any of Canada's quota allocation decisions that have affected it.

140. The Claimant's investment chose not to avail itself of these review procedures with respect to its allocations in year 1 and year 2 in spite of its awareness of them.[52]

141. The Claimant's investment did request an explanation of its year 3 allocation.[53] DFAIT promptly provided information in response to this request.[54] The Claimant's investment did not communicate further with DFAIT with respect to its year 3 allocation.

c) Canada did not impose performance requirements as proscribed by *NAFTA* Article 1106(1)(a)(e) and (3)(d)

142. The Claimant alleges Canada has breached its *NAFTA* Article 1106(1)(a)(e) and 1106(3)(d) obligations. Canada categorically denies this allegation and asserts that it did not impose any performance requirement contrary to *NAFTA* Article 1106(1)(a)(e) and 1106(3)(d).

143. The interpretation which the Claimant seeks to give to *NAFTA* Article 1106(1)(a)(e) and 1106(3)(d) flies in the face of the ordinary meaning of the provision as required by the fundamental principle of treaty interpretation found in Article 31 of the *Vienna Convention*.[55]

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52 See reference to an affidavit filed by Canada in footnote 39 at page 13 of Claim.

53 Letter from Pope & Talbot Ltd., re: Allocation for Year 3 (1998-1999) (June 3, 1998), **Tab A-12**.

54 Letter to Pope & Talbot Ltd., re: Allocation for Year 3 (1998-1999) (June 12, 1998), **Tab A-13**.

55 *Vienna Convention on the Law of Treaties*, May 23, 1969, 1155 U.N.T.S. 331 (entered into force January 27, 1980), **Tab L-7**.

144. *NAFTA* Article 1106(1) states in relevant part:

> 1. No Party may impose or enforce any of the following requirements, or enforce any commitment or undertaking, in connection with the establishment, acquisition, expansion, management, conduct or operation of an 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; ...
> >
> > 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;[56]

145. For there to be a violation of *NAFTA* Article 1106(1), several elements must be satisfied:

a) there must be a "requirement", "commitment" or "undertaking";

b) this requirement, commitment or undertaking must be "in connection with" the establishment, acquisition, expansion, management, conduct or operation of an investment of an investor; and

c) this requirement, commitment or undertaking must be "impose[d] or enforce[d]" by a *NAFTA* Party.

146. Canada did not violate *NAFTA* Article 1106(1)(a) and *NAFTA* Article 1106(1)(e) for the following reasons:

a) Neither the *SLA* nor *SLA* implementation require the Claimant's investment to export a given quantity of goods or service. It does not, therefore, contravene *NAFTA* Article1106(1)(a).

b) Neither the *SLA* nor *SLA* implementation restrict the Claimant's investment's domestic sales of goods in Canada. All investments and investors which produce softwood lumber, including the Claimant's investment, are free to sell as much lumber as they want in Canada. It does not, therefore, contravene *NAFTA* Article 1106(1)(e).

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[56] *North American Free Trade Agreement between the Government of Canada, the Government of Mexico and the Government of the United States*, December 17 1992, Can, T.S. 1994 No. 2 (entered into force January 1, 1994), Article 1106, **Tab L-1**.

147. *NAFTA* Article 1106(3) states in relevant part:

> 3. No Party may condition the receipt or continued receipt of an advantage, in connection with an investment in its territory of an investor of a Party or of a non-Party, on compliance with any of the following requirements:
>
> > d) 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. (emphasis added).

148. For there to be a violation of *NAFTA* Article 1106(3), several elements must be satisfied:

a) there must be an "advantage";

b) there must be an "investment in its territory of an investor of a Party or of a non-Party"

c) this advantage must be "in connection with" the investment in the Party's territory of an investor; and

d) the receipt or continued receipt of this advantage has to be "condition[ed] ... on compliance" with a prescribed performance requirement in *NAFTA* Article 1106(3).

149. Canada did not condition the receipt of any advantage on compliance with any requirement relating to restriction of sales of goods in its territory. Neither the *SLA* nor *SLA* implementation restricts the Claimant's investment's domestic sales of goods *in Canada.* All investors and investments of investors which produce softwood lumber, including the Claimant's investment, are free to sell as much lumber as they want in Canada.

150. Moreover, in respect of *NAFTA* Article 1106(1) and 1106(3), *NAFTA* Article 1106(5) further limits their scope by specifying that the prohibition on performance requirements does "not apply to any requirement other than the requirements set out in...paragraphs [1106(1) and (3)]."

d) Canada has not expropriated the Claimant's investment contrary to *NAFTA* Article 1110

151. The Claimant alleges Canada breached its *NAFTA* Article 1110 obligations. Canada categorically denies this allegation.

152. *NAFTA* Article 1110 states in relevant part:

> 1. No Party may directly or indirectly nationalize or expropriate an investment of an investor of another Party in its territory or take a measure tantamount to nationalization or expropriation of such an investment ("expropriation"), except:
>
> a) for a public purpose;
>
> b) on a non-discriminatory basis;
>
> c) in accordance with due process of law and *NAFTA* Article 1105(1); and
>
> d) on payment of compensation in accordance with paragraphs 2 through 6.[57]

153. Canada has not directly or indirectly expropriated the Claimant's investment or taken a measure tantamount to expropriation of the Claimant's investment. The Claimant's investment remains a going concern that continues to export softwood lumber to the U.S. to this day.

154. The Tribunal must have regard to the definitions of "investment" and of "investment of an investor of a Party" in *NAFTA* Article 1139 as only the expropriation of such an investment of an investor of another *NAFTA* Party is proscribed by operation of *NAFTA* Article 1110.

i) There is no property that can be subject to expropriation

155. The property which the Claimant alleges was expropriated is not an "investment of an investor of another Party" as required by *NAFTA* Article 1110. (See paragraph 158)

156. The Claimant at paragraph 93 of its Claim contends that the property which has been expropriated is "its ordinary ability to alienate its product to [the U.S.] market." At law, access to the U.S. market is not a property right and, therefore, there is no property capable of being expropriated.

157. The *SLA* and *SLA* implementation provide for export regulations which, at international law, do not constitute expropriation.

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[57] *North American Free Trade Agreement between the Government of Canada, the Government of Mexico and the Government of the United States*, December 17 1992, Can, T.S. 1994 No. 2 (entered into force January 1, 1994), Article 1110, **Tab L-1**.

158. In response to the Claimant's allegation at paragraph 95 of its Claim that Canada has breached its *NAFTA* Article 1110 obligations by "depriving the Investor of its ability to carry out its otherwise legal business operations"(emphasis added), Canada says:

> a) *NAFTA* Article 1110 does not apply to "investors", it applies to "investment[s] of an investor of another Party"; and
>
> b) the definition of "investment" in *NAFTA* Article 1139 does not include "the ability to carry out legal business operations" or the "ability to alienate ... product to [the U.S.] market."

ii) There has been no interference with property that would amount to expropriation

159. If the Tribunal determines that there is property that can be subject to expropriation, and that the export regulations constitute interference with that property, neither of which is conceded, it must have regard to the effects of the *SLA* and *SLA* implementation on the Claimant and its investment in order to find expropriation within the meaning of *NAFTA* Article 1102.

160. The effects of the *SLA* and *SLA* implementation are not such as to deprive the Claimant of its investment. In fact, there can be no finding of expropriation within the meaning of *NAFTA* Article 1102 as the Claimant's investment has exported softwood lumber to the U.S. since the inception of the *SLA* and it continues to export softwood lumber to the U.S. to this day.

iii) There has been no creeping expropriation

161. For the reasons noted above in paragraphs 151 -160, Canada denies that either the *SLA* or *SLA* implementation resulted in a "creeping expropriation" of the Claimant's investment. Neither the *SLA* nor the *SLA* implementation amount to a measure tantamount to expropriation of the Claimant's investment.

162. As the Claimant's investment has not been expropriated, it is not entitled to compensation under *NAFTA* Article 1110.

163. If the Tribunal determines that there has been an expropriation or indirect expropriation or that a measure has been taken tantamount to expropriation of the Claimant's investment, which is not conceded, Canada refers the Tribunal to, and relies on, paragraphs 171 -174 in the section on Damages below.

D. To find Canada in breach of its *NAFTA* Chapter 11 obligations would place Canada in a position of having unintended conflicting international obligations

164. For the reasons stated above, Canada says that the Claimant has failed to prove that the Claim is arbitrable under *NAFTA* Chapter 11 B and it has failed to prove that Canada has breached its *NAFTA* Chapter 11 obligations.

165. In the alternative, were the Tribunal to find that Canada has breached *NAFTA* Chapter 11, it would place Canada in an untenable position vis-à-vis its international obligations under *NAFTA* and the *SLA*. Such a conclusion would be at odds with the presumption of Canada's compliance with international agreements to which it is a Party and the principle of *pacta sunt servanda*.[58]

166. Canada and the U.S. entered into the *SLA* fully intending to be bound by its provisions and with full knowledge of their pre-existing *NAFTA* obligations.

167. *NAFTA* does not restrict the *NAFTA* Parties' respective abilities to enter into international agreements.

168. The Tribunal must reject the Claimant's ill-founded attempt, by way of its Claim under *NAFTA* Chapter 11, to seek to challenge Canada's obligations under the *SLA*.

169. The Claimant is not a Party to the *SLA*. The Claim, at paragraphs 76, 86, 87 and 93, attacks *SLA* measures expressly prescribed by the *SLA* itself (i.e., coverage of exports of lumber first manufactured in the provinces covered by the *SLA*; collection of export permit fees; restrictions on exports to the U.S. market). The claimant does not have standing to challenge the *SLA* as it purports to do so by way of its *NAFTA* Chapter 11 claim. Canada and the U.S provided for the resolution of disputes regarding breaches of the *SLA* in Article V of the *SLA*. Only the Parties to the *SLA* have recourse to dispute settlement with respect to matters falling under the *SLA*. Moreover, this Tribunal has no jurisdiction to arbitrate disputes properly the subject of dispute resolution under the *SLA*.

170. If Canada is found not to have complied with one or more of the aforementioned *NAFTA* obligations, and if Canada's compliance with its *SLA* obligations puts it in violation of its *NAFTA* Chapter 11 obligations, neither of which is conceded, then the *SLA* must prevail to the extent of any inconsistency as an international agreement later in time.

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58 *Vienna Convention on the Law of Treaties*, May 23, 1969, 1155 U.N.T.S. 331 (entered into force January 27, 1980), Article 26, **Tab L-7**.

E. Damages

171. Canada submits that the Claimant has not incurred any compensable loss or damage by reason of, or arising out of, breach of Canada's *NAFTA* Chapter 11 obligations towards the other *NAFTA* Parties, nor has it proved that it has incurred such loss or damage.

172. In the alternative, if the Claimant is found to have incurred any compensable loss or damage by reason of, or arising out of, any breach of Canada's *NAFTA* Chapter 11 obligations towards the other *NAFTA* Parties that is recoverable under *NAFTA* Chapter 11, which is not conceded, the amount claimed is grossly exaggerated, excessive, unreasonable and too remote to be recovered.

173. In the further alternative, if the Claimant has sustained any compensable loss or damage incurred by reason of, or arising out of, any breach of Canada's *NAFTA* Chapter 11 obligations towards the other *NAFTA* Parties that is recoverable under *NAFTA* Chapter 11, which is not conceded, the Claimant should be barred from recovering damages.

174. The Claimant has failed to mitigate its damages.

IV. Relief Claimed

175. Canada respectfully requests that this honourable Tribunal

a) reject the Claimant's request for an interim order;

b) dismiss this Claim for all of the reasons set out above; and

c) order the Claimant to pay all costs, disbursements and expenses incurred by Canada in the defence of this Claim including, but not restricted to, legal, consulting, and witness fees and expenses, and travel and administrative expenses, as well as the costs of the Tribunal.

Submitted this 8th day of October, 1999 at Ottawa, Ontario, Canada.

of Counsel for the Government of Canada

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TO: The Tribunal

AND TO: Barry Appleton, Counsel for Pope and Talbot, Inc.