

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

**BETWEEN**

**POPE & TALBOT INC**

**and**

**THE GOVERNMENT OF CANADA**

**AWARD ON THE MERITS OF PHASE 2**

**BY**

**ARBITRAL TRIBUNAL**

**The Hon. Lord Dervaird  
(Presiding Arbitrator)**

**The Hon. Benjamin J. Greenberg, Q.C.**

**Mr. Murray J. Belman**

*Confidential business information  
has been redacted from this version of  
the award by agreement of the parties.*

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## INTRODUCTION

### A. Procedural History

1. The Tribunal issued its Interim Award on June 26, 2000. As a result of that Award it was necessary for the parties to proceed to a further stage wherein the questions under consideration were a further examination of the claim under Article 1102 in light of the additional material called for by the Tribunal in the appendix to the Interim Award and an examination of the claim under Article 1105. This stage is generally referred to as Phase 2 of the arbitration.
2. A procedural issue which had been foreshadowed was the extent to which conduct by Canada subsequent to the Investor's Statement of Claim should be subject to the jurisdiction of the Tribunal. Specifically, that matter arose in connection with the Super Fee Base levy (discussed in detail elsewhere in this Award) which arose in the latter part of 1999.
3. In the course of a conference call with the parties on July 6, 2000 the Tribunal ordered that if Canada wished to have a determination of the issue whether the Super Fee Base levy should be excluded from the scope of the present claim it should make a written submission by July 13 and the Investor respond by July 20. The parties duly did so, and the Tribunal ruled on August 7, 2000 that the Super Fee Base levy issue did fall within the scope of the present claim.

4. In the course of the document discovery process between the parties Canada declined to produce certain documents upon the basis that these constituted Cabinet confidences within the meaning of the Canada Evidence Act s.39.
5. The Tribunal upon consideration of the parties' submissions on the matter held that the Canada Evidence Act did not apply to a NAFTA Chapter 11 Tribunal and requested Canada to provide justification for its refusal to produce the documents in question. Canada declined to so do, and also declined to produce or further identify those documents.<sup>1</sup> By reason of circumstances surrounding the dispute about the non-production of the documents by Canada, the Tribunal found the Investor liable to Canada for costs related to this particular matter.
6. The Investor submitted a Memorial in relation to the Second Phase on September 5, 2000, and Canada a Counter Memorial on October 10, 2000. The Investor submitted a Supplemental Memorial on October 25, 2000 and Canada a Supplemental Counter Memorial on November 7, 2000.
7. Each party filed prior to the hearing documents and authorities and lodged affidavits of witnesses on whose evidence it sought to rely.
8. Mexico and the United States each exercised its right under Article 1128 to make written submissions to the Tribunal on questions of interpretation of NAFTA and the Investor responded thereto on November 10, 2000.
9. The hearing on the Phase 2 issues took place in Montreal between November 13 and November 17, 2000.

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<sup>1</sup> See ¶ 193 below.

10. The Investor was represented by Mr. Barry Appleton and Mr. Keith Mitchell. Canada was represented by Mr. Brian Evernden, Ms. Meg Kinnear and Professor Don McRae.
11. The Investor submitted an affidavit by Howard Rosen who was cross examined on behalf of Canada.
12. Canada submitted affidavits by Mr. Douglas George and Mr. Claudio Valle and they were cross examined on behalf of the Investor. In addition, Mr. George was recalled by the Tribunal for further questioning.
13. The Tribunal had indicated that it would wish to call Mr. Tom MacDonald and a Canada statistics witness if the Investor did not do so. In the event, the Tribunal questioned Mr. MacDonald but decided that it did not require to question a statistics witness.
14. Representatives of Mexico and the United States attended the hearing throughout.
15. The disputing parties made oral submissions at the conclusion of the hearing.
16. Mexico and the United States each made post-hearing submissions in relation to Articles 1102 and 1105 on December 1, 2000. The Investor and Canada both responded thereto on December 15, 2000.
17. On February 20, 2001 Canada applied to the Tribunal to release it from its obligation of confidentiality in relation to the Article 1128 submission filed by the United States in the case (in relation to Article 1105), in order that it might use the same in an intervention it had been allowed to make in a statutory review of another NAFTA award before a Court in British Columbia. The

Investor objected to such release and on February 21, 2001 the Tribunal refused the application.

**B. Factual Background**

18. On May 29, 1996 Canada and the United States signed the Softwood Lumber Agreement (hereinafter "SLA").

- In terms of Article 1 the United States undertook not to take certain specified actions under the laws of the United States with respect of imports of softwood lumber from Canada.
- In terms of Article 2.1 Canada was required to place softwood lumber on the Export Control List under the Export and Import Permits Act and to require a Federal export permit for each exportation to the United States of softwood lumber first manufactured in the covered provinces.
- By Article 2.2 Canada was bound to collect a fee on issuance of a permit for export to the United States of softwood lumber first manufactured in the covered provinces for quantities above the established base in a given year. The Established Base ("EB") was 14.7 billion board feet, and up to that level the export was free of charge. Between 14.7 and 15.35 billion board feet could be exported to the United States at the Lower Fee Base ("LFB") of \$50 per thousand board feet.<sup>2</sup> For exports in excess of 15.35 billion board feet, the Upper Fee Base ("UFB") of \$100 per thousand board feet applied. Those

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<sup>2</sup> Unless otherwise indicated, all dollar amounts are in U.S. currency.

fees were subject to adjustment for inflation on April 1 of each year beginning April 1997.

- By Article 2.4 Canada was to allocate the EB and the LFB for each year prior to its beginning among Canadian softwood lumber exporters.
  - By Articles 2.5 and 2.6 Canada was obliged in effect to collect fees under the LFB or the UFB from each exporter of softwood lumber first manufactured in the covered provinces whose exports to the United States in that quarter exceeded 28.75% of the exporters' yearly allocation of the EB (the "speed bump" provision).
  - By Article 2.9 Canada was not required to collect a fee under 2.5 or 2.6 from an exporter whose production of softwood lumber in the previous calendar year was less than 10 million board feet.
  - By Article 3 for each calendar quarter in which the average price in the United States for specified lumber exceeded the trigger price as defined, a further 92,000,000 board feet of softwood lumber first manufactured in the covered provinces could be exported to the United States, fee free, during the following four quarters ("trigger price bonus").
19. The SLA was retroactive to April 1, 1996. Canada added Softwood Lumber Products (where the province of first manufacture was any of the covered provinces) to the Export Control List until March 31, 2001.
20. By Notice to Exporters No. 90 issued on March 25, 1996, Canada informed exporters that, as of April 1, 1996, softwood lumber products would be placed on

the Export Control List and as of that date, where the province of first Manufacture was British Columbia ("B.C."), Alberta, Manitoba or Quebec, all exports to the United States would require an export permit. As to Ontario, the Notice stated that the application of an export permit remained under discussion and would be decided shortly.

21. By Notice to Exporters No. 92 issued on June 19, 1996 Canada amended the information in Notice to Exporters No. 90 (*inter alia*, by deleting Manitoba from the list of provinces and substituting Ontario). It also requested softwood lumber stakeholders from the covered provinces to complete a questionnaire on production and exports of softwood lumber for the years 1994 and 1995 and the period January 1 to March 31, 1996 and invited views from softwood lumber stakeholders as to methods of allocation.
22. On June 21, 1996 Canada issued Softwood Lumber Products Export Permit Fees Regulations, which introduced an administrative fee to be paid by an exporter for the issuance of a permit in respect of exports of softwood lumber products in the EB, and for export fees to be paid for permits in the LFB of \$50 and in the UFB of \$100 per thousand board feet.
23. On the same date Canada issued Export Permit Regulations (Softwood Lumber Products) setting out the requirements of and procedure for issuing a permit to export softwood lumber to the United States. The Regulations limited issuance of permits in respect of exports in the EB or the LFB to exporters that had been assigned an export level, *i.e.*, a share of the EB or the LFB totals.



24. By Notice to Exporters No. 94 dated October 31, 1996 Canada set out the method of allocation, and also updated the matters contained in Notices to Exporters Nos. 90 and 92.
25. In terms of Article 6.2 of Notice to Exporters No. 92, until a system of allocation was designed and implemented (for which the due date was September 30, 1996), softwood lumber export controls were administered on a "first-come, first-served" basis. Limits were set for each of the first two quarters at 4,226,250,000 board feet (28.75% of the annual EB). Once that total had been reached in each quarter, exporters faced a fee of \$50 per thousand board feet for the next 186,875,000 board feet (28.75% of the annual LFB) and \$100 per thousand board feet beyond that level. This was changed to an allocation regime under Notice to Exporters No. 94.
26. According to Notice to Exporters No. 94 the allocation is a national corporate – based system, under which EB levels (attracting no fee) and LFB levels (with a fee of \$50 per thousand board feet) were allocated to primary producers and remanufacturers, including new entrants. Exports to the United States above the EB and LFB levels fell into the UFB and attracted a fee of \$100 per thousand board fee. The allocation was based on recent export shipments, and on special criteria in the case of new entrants. The system was to be reviewed annually, with adjustments to allocations then being made. Allocations were normally to be valid for one year at a time, and unused amounts at the end of a year did not carry forward. The policy of Canada was stated to be that the allocation system be a flexible and responsive one. One of the four important elements of market

responsiveness was stated to be a growth mechanism for companies whose sales exceeded their EB level, and another an under-utilization provision allowing the reallocation of quantities away from those unable to ship their allocated levels.

27. In order to allocate the EB in the first year, Canada appears to have proceeded as follows:

- The 14.7 billion board feet EB referred to in the SLA was reduced by 2% i.e. 294,000,000 board feet as provision for new entrants.
- Other deductions, namely a one-time transitional adjustment of 170,000,000 board feet and a ministerial reserve of 50,000,000 board feet, were reserved from the EB figure.
- The balance, 14,186,000,000 board feet, was allocated to companies, either primary mills or remanufacturing facilities in the four covered provinces. As a consequence, firms based in B.C. received 59% of the EB available, in Alberta 7.7%, in Ontario 10.3% and in Quebec 23%. (Some remanufacturers located outside the covered provinces that used lumber originating in a covered province had quota assigned to them out of the quota allocated to the covered province.)
- In arriving at the EB allocation, Canada applied different methods in different provinces for the calculation of the base. In relation to B.C., the base for remanufacturing concerns was the better of 1994 or 1995 calendar year direct exports to the United States. For B.C. primary mills, the base was the average of direct exports in each of 1994 and 1995, with a saving for cases where the average showed a diminution over 1995 alone in excess of 35%, in which case the 1995 figure was used. In all the other covered

provinces the base was taken as the best of 1994, 1995 or a constructed figure consisting of the last half of 1995 and two times the first quarter of 1996.

28. The original amount of LFB notionally available for allocation was 650,000,000 board feet. That figure was reduced by 150,000,000 board feet for new entrants and by a further 50,000,000 board feet for a one-time transitional adjustment.
29. Like all primary producers and remanufacturers of softwood lumber in B.C., the Investment completed and submitted its initial Questionnaire responses.<sup>3</sup> Thereafter, the Investment received its share of quota allocations based upon those responses.

### THE CLAIM UNDER ARTICLE 1102

#### A. Introduction

30. The Investor claims that its Investment has been denied treatment guaranteed by NAFTA Article 1102, particularly paragraph 2 of that Article, which provides:

Each Party shall accord to investments of investors of another Party treatment no less favorable than 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.

31. There is no dispute that the implementation of the SLA does relate at least to the "expansion, management, conduct [and] operation" of the Investment. The contentions of the Parties concerning Article 1102(2) relate to three other

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<sup>3</sup> See Responses dated July 29, 1996, Joint Book of Documents submitted by the parties for the November 2000 hearing, Tab 39. These documents are hereinafter referred to as "Tab \_\_\_."

issues: First, how should the terms “investments of investors” and “treatment no less favorable” in Article 1102(2) be interpreted? Secondly, what standards should be employed in determining whether the Investment has been denied “treatment no less favorable” than that received by investments of Canadian investors? Finally, in applying Article 1102(2), to which Canadian-owned investments should the Investment be compared, *i.e.*, which of those Canadian-owned investments are “in like circumstances” to the Investment?

32. These questions require an interpretation of the language and substance of Article 1102 and consideration of the facts of this case within that legal context.

**B. Legal Analysis**

**1. The Semantics of Article 1102.**

**a. Use of the plural form.**

33. What began as an apparently offhand comment during the May 2000 hearing on the initial phase of this case developed into a significant element of Canada’s argumentation on Article 1102(2). At the May 4, 2000 hearing, counsel for Canada advanced the suggestion that, since Article 1102(2) uses the plural form – “investments of investors” – NAFTA may require that more than one investor be disadvantaged before the national treatment provisions would apply.<sup>4</sup>

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<sup>4</sup> Canada’s counsel stated:

Might I add one comment. On the national treatment point, it’s not “find an investor.” The language is “investors in like circumstances.” We might ...

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34. This use of the plural form was not directly addressed in Canada's Phase 2 Counter Memorial, other than in an oblique reference to the requirements Canada believed necessary to establish *de facto* discrimination.<sup>5</sup> However, Canada's Phase 2 Supplemental Counter Memorial developed the argument, this time adding the suggestion that it might be necessary to consider more than one *domestically* owned investment in determining whether national treatment has been accorded to the foreign owned investment:

Article 1102 would have been worded differently had it intended that only the circumstances of the disputing investment were the relevant comparator. If the Investor were correct, Article 1102(2) would require comparison of the treatment accorded to a disputing investment with the treatment accorded to domestic investments, even to a single domestic investment. Article 1102(2) does not provide for this nor is it reflected in WTO or GATT jurisprudence on national treatment.

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Where the issue is *de facto* discrimination, the adjudicator must look at the effect of the measure. In all such cases, discrimination has been found only where the measure wholly or disproportionately discriminates<sup>6</sup> against the foreign origin goods or services. No case has found discrimination based on a lesser record of discrimination, much less discrimination against a single entity.<sup>7</sup>

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We have to find more than one, but I think it's a ... class because it relates to the treatment that is afforded to those investors, and that's the important consideration. That's what the language says. It's not my invention.

May 2000 Tr. Vol. VII, pp 204:4-18.

<sup>5</sup> See Phase 2 Counter Memorial at ¶490.

<sup>6</sup> In its various submissions, Canada has used the terms "disproportionate discrimination" against foreign investments, "disproportionate disadvantage" to foreign investments and "disproportionate favour" to domestic investments. The Tribunal views these terms as meaning the same and will use "disproportionate disadvantage" in this decision.

<sup>7</sup> Phase 2 Supplemental Counter Memorial at ¶¶ 100-102. In its submission dated December 1, 2000, Mexico subscribed to this interpretation: "It is noted that Article 1102

35. During the Phase 2 hearings in November, 2000, Canada continued to stress the use of the plural form in Article 1102(2) as a reason to deny relief to a single investment, but acknowledged that a single investment could be considered a "class" of one.<sup>8</sup> However, to achieve that status, the investor would have to prove that there were no other investments in "like circumstances" that were also owned by U.S. or Mexican investors.<sup>9</sup>
36. The Tribunal rejects Canada's argument that the plural form of the *language* of Article 1102(2) places a single investment outside the Article's coverage or requires a claimant on behalf of that investment to demonstrate whether there are other similarly situated foreign owned investments. The Tribunal also rejects the contention that that plural form requires, as a matter of semantics, comparison of the treatment provided to the foreign investor with that accorded to more than one domestically owned investment.
37. As a general principle of interpretation, use of the plural form does not, without more, prevent application of statutory or treaty language to an individual case.<sup>10</sup>

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requires the Tribunal to compare the treatment of investors of another Party to the treatment of domestic investors, not a domestic investor (in the singular)." Canada expressly agreed with this formulation in its Response dated December 15, 2000 (at ¶ 10).

<sup>8</sup> Nov. 2000 Tr., Vol XIII, at 23:9-24. However, shortly thereafter, counsel for Canada again urged that the plural form was determinative. *Id.* at 26:12 – 27:24.

<sup>9</sup> Nov. 2000 Tr., Vol. XIII, at 21:8 – 27: 24. During those hearings, Canada also refined its arguments on the need for disproportionate disadvantage as a predicate for a violation of Article 1102(2). The Tribunal addresses those arguments below.

<sup>10</sup> *See, e.g.,* Sutherland, *Statutory Construction*, 6<sup>th</sup> Ed. 2000 at § 47.34:

Laws outlawing discrimination against "women" or setting labour standards for "children" could not reasonably be interpreted to prevent their application to a woman or a child. NAFTA Article 1102 requires the Parties to accord national treatment under specified circumstances, and there is no evidence of any intention that more than one investor need be aggrieved before that requirement comes into play. Indeed, Article 1102(4), in order to create "greater certainty," prohibits Parties from imposing "on an investor" specified requirements or requiring "an investor" to take specified actions. Finally, Article 1105 uses the very same plural form as Article 1102(2), and Canada has never suggested that more than one investment must be affected before the provisions of that Article apply.<sup>11</sup> In short, the text of Chapter 11 simply does not support Canada's interpretation.

38. Moreover, the contemplation of the drafters must have been that Chapter 11 cases would most often involve claims by *individual* investors that they or their investments were being denied national treatment. In that context, the Tribunal sees no special justification for departing from the normal and common sense

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Common usage in the English language does not scrupulously observe a difference between singular and plural word forms. This is especially true when speaking in the abstract, as in legislation prescribing a general rule for future application. In recognition of this, it is well established, by statute and by judicial decision, that the legislative terms which are singular in form may apply to multiple subjects or objects. Those that are plural in form may apply to single subjects or objects if that is the intended or reasonably understood meaning and effect. [Citations omitted.]

<sup>11</sup> Indeed, Canada made specific reference to "investment" in the singular in its discussion of Article 1105, thus demonstrating its awareness that the plural form may encompass the singular. See Canada's Response dated December 15, 2000 to Post Hearing Submissions of Mexico and the United States at ¶ 4.

interpretation of the plural form in Article 1102(2), which would include individual investors and investments. For these reasons, the Tribunal determines that the *language* of Article 1102(2) permits individual investors and investments to maintain claims of denial of national treatment based upon a comparison of the treatment they receive with the treatment received by host country investors and investments.<sup>12</sup> This conclusion also entails rejection of Canada's contention that the language of Article 1102(2) requires claimants to show whether and how many other foreign owned investments may fall within the "like circumstances" as themselves.

b. "Most favorable," "no less favorable," and "best."

39. In another textual argument, Canada sought to draw a substantive distinction between the rights accorded an investment under Article 1102(2) (to "no less favorable" treatment) and those accorded under Article 1102(3) (to "no less favorable than the most favorable" treatment).<sup>13</sup> The former provision applies to the national government and the latter to states and provinces,<sup>14</sup> and Canada suggested that NAFTA treats the two levels of government differently. Canada's

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<sup>12</sup> As noted, this ruling on the language of Article 1102 does not address Canada's contention that precedent requires a showing of disproportionate disadvantage for foreign investors and investments.

<sup>13</sup> Nov. 2000 Tr., Vol. III, at 35:3 – 35:14.

<sup>14</sup> Article 1102(3) reads as follows:

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



semantic argument is that, since Article 1102(2) does not employ the modifier "than the most favorable," it permits national governments to provide foreign investments something less than the most favourable treatment. However, the structure of Article 1102 strongly suggests that Canada's semantic construct is flawed.

40. Article 1102(3) expressly states that it is defining the meaning of the requirements of Article 1102(1) and 1102(2) when those provisions are applied to states and provinces. Therefore, to adopt Canada's semantics would require the Tribunal to conclude that the supposedly narrower requirements of 1102(1) and (2) are somehow broadened to restrain states and provinces more vigorously than the NAFTA Parties themselves.
41. Canada has suggested no reason why the NAFTA parties would have undertaken such an approach or any evidence of an intention to do so, and the Tribunal can see none. Instead, the Tribunal believes that the language of Article 1102(3) was intended simply to make clear that the obligation of a state or province was to provide investments of foreign investors with the best treatment it accords *any* investment of its country, not just the best treatment it accords to investments of *its* investors.<sup>15</sup> Since, as noted, the treatment of states

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<sup>15</sup> Article II (7) of the U.S. Model Bilateral Investment Treaty contains language suggesting that the obligations of a state (or province) under its national treatment requirements are less broad than under NAFTA, *i.e.*, limited to the treatment it accords to companies of other states:

The treatment accorded by the United States of America to investments and associated activities under the provisions of this Article shall in any State, Territory or possession of the United States of America be the treatment

and provinces in Article 1102(3) is expressly an elucidation of the requirement placed on the NAFTA Parties by Articles 1102(1) and (2), that interpretation lends support to the conclusion that, like states and provinces, national governments cannot comply with NAFTA by according foreign investments less than the most favorable treatment they accord their own investments.<sup>16</sup>

42. In summary, the Tribunal is unable to accept that these different wordings carry any substantive difference in the conduct owed investors and investments under Article 1102. Accordingly, the Tribunal interprets the treatment required by Articles 1102(1) and 1102(2), on the one hand, and 1102(3) on the other, to be identical, save for the limitations to states and provinces. The Tribunal also interprets both standards to mean the right to treatment equivalent to the "best" treatment accorded to domestic investors or investments in like circumstances. The Tribunal thus concludes that "no less favorable" means equivalent to, not better or worse than, the best treatment accorded to the comparator.

## 2. The substance of Article 1102

43. The parties agree that Article 1102 can apply to measures that do not facially discriminate against the investors or investments of other NAFTA parties, and that the implementation of the SLA would be such a measure, since it in no way singles out foreign owned lumber producers for special treatment. Canada

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accorded therein to companies legally constituted under the laws and regulations of other States, Territories or possessions of the United States of America.

<sup>16</sup> Canada also contended that the language used in Article 1102 is not equivalent to "best" treatment. Nov. 2000 Tr., Vol. III at 78:1 – 82:13.

argues that, in such *de facto* cases, a violation of national treatment obligations can be found only if the measure in question disproportionately disadvantages the foreign owned investments or investors.<sup>17</sup>

44. Canada asserts that, to apply the disproportionate disadvantage test in this case, the Tribunal must determine whether there are any Canadian owned investments<sup>18</sup> that are accorded the same treatment as the Investor. Then, the size of that group of Canadian investments must be compared to the size of the group of Canadian investments receiving more favorable treatment than the Investment. Unless the disadvantaged *Canadian* group (receiving the same treatment as the Investor) is smaller<sup>19</sup> than the advantaged group, no discrimination cognizable under Article 1102 would exist.<sup>20</sup>

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<sup>17</sup> Canada does accept that the disproportionate disadvantage test is not applicable to cases of *de jure* discrimination. *See, e.g.*, Nov. 2000 Tr. Vol. III at 67:18 – 68:15.

<sup>18</sup> In this discussion, it is assumed, solely for clarity of analysis, that the Canadian owned investments and the Investor's Investment are in "like circumstances."

<sup>19</sup> How much smaller is unknown (Canada has offered no guidance on this point), but the difference would have to be enough to justify a conclusion that the size of the advantaged Canadian owned group is "disproportionate" to the disadvantaged Canadian (and foreign) group.

<sup>20</sup> Canada advocated a stricter test at one point: "[T]he Investor must establish that 'virtually all' \*\*\* or 'most' of the investments in the covered provinces (particularly British Columbia), who receive the less favourable treatment, are of U.S. origin and that 'virtually all' or 'most' of the investments in the non-covered provinces, who receive the more favourable treatment, are of domestic origin." Phase 2 Counter Memorial at ¶ 490. This position was modified at the hearing to the formulation in the text. *See* Nov. 2000 Tr., Vol. III at 54:12 – 59:12.

45. Canada acknowledges that the disproportionate disadvantage test does not appear in the text of NAFTA; it finds these requirements in GATT and WTO precedents.<sup>21</sup> The Tribunal addresses those precedents below.

a. *European Communities - Regime for the Importation, Sale and Distribution of Bananas.*<sup>22</sup>

46. The “*Bananas*” dispute involved an elaborate program governing the importation of bananas into the European Union.<sup>23</sup> That program treated various sources of imports differently:

- Traditional African, Caribbean and Pacific suppliers parties to the Lome Convention (ACP) were provided a fixed level of duty-free imports.
- A fixed level of imports dutied at 75 ECU per tonne was allocated (i) 49.4% to parties to the Framework Agreement on Bananas (BFA), (ii) a fixed tonnage level to ACP countries for their non-traditional supply to EC countries, and (iii) the remainder to other banana exporters.
- Imports in excess of those amounts were subject to a high duty (in 1995, 722 ECU per tonne for ACP countries, 822 ECU for others).
- Bananas from EC territories could be sold without restriction.

47. To implement these measures, the EC established licensing procedures and rules categorizing the “operators” that distributed bananas:

- Category A – Those who had, during a previous three-year period, marketed third country and non-traditional ACP bananas.

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<sup>21</sup> See Nov. 2000 Tr., Vol. III at 45:22-25.

<sup>22</sup> WT/DS27/R/USA22, May 1997.

<sup>23</sup> The WTO panel referred to the European Union as the “EC,” and the Tribunal will follow that nomenclature.

- Category B – Those who had, during a previous three-year period, marketed EC and traditional ACP bananas.
- Category C – New entrants who begin marketing third country and non-traditional ACP bananas.

In practice, some operators could meet the requirements for both A and B categories and could thus qualify as both

48. The EC regulations earmarked for Category A operators 65% of the licenses for the reduced duty imports of third-country and non-traditional ACP bananas. Category B operators were reserved 30% of those licenses, and Category C, 3.5%.
49. The panel first found that reserving 30% of the third-country and non-traditional ACP licenses for Category B operators encouraged operators to increase purchases of EC and traditional ACP bananas. The provision thus violated Article III:4 of the GATT, which requires members to accord products of other member countries treatment “no less favourable” than that accorded to their own like products with respect to laws, regulations and requirements affecting their internal sale, etc. In reaching this conclusion, the panel performed no analysis whether imported products were subjected to disproportionate disadvantage. Indeed, it rejected the EC’s argument that third-country and non-traditional ACP bananas received a benefit from other provisions of the regime, refusing to consider whether the relative effects of the various operator regulations might benefit imported products:

The Panel was of the view that, *regardless of the trade effects*, the apportioning of 66.5 per cent of the tariff quota to operators who had marketed third-country or non-traditional ACP bananas could not offset

or legally justify the inconsistencies of the licensing system with Articles III:4 and I:1.<sup>24</sup>

50. The finding by the Bananas panel that GATT Article III:4 was breached made it unnecessary for the panel to consider whether the operator rules also violated the WTO Trade Related Investment Measures (TRIMs) Agreement:

[T]he TRIMs Agreement essentially interprets and clarifies the provisions of [GATT] Article III (and also Article XI) where trade-related investment measures are concerned. Thus the TRIMs Agreement does not add to or subtract from those GATT obligations, although it clarifies that Article III:4 may cover investment related matters.<sup>25</sup>

This language suggests that the *Bananas* panel would have applied its analysis of GATT Article III:4 to an investment issue under the TRIMs Agreement, and would have refused to consider whether the treatment of foreign products (and, therefore, under TRIMs, of foreign investors as well) was or was not disproportionately unfavourable.

51. The *Bananas* panel also considered whether the EC regime violated the WTO General Agreement on Trade in Services (GATS). Canada principally relies on that discussion in urging the Tribunal to adopt the disproportionate disadvantage standard.<sup>26</sup>

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<sup>24</sup> WT/DS27/R/USA22 at ¶ 7.179, emphasis supplied. The quoted language is actually from an earlier GATT panel decision, which the 1997 panel adopted "as our own findings." WT/DS27/R/USA22 at ¶ 7.180.

<sup>25</sup> WT/DS27/R/USA22 at ¶ 7.185.

<sup>26</sup> See undated submission by Canada during the November, 2000 hearings, *Response to request from Tribunal Member Murray J. Belman* ("Response") at 2-5. Canada also relies on other elements of the panel's decision on the EC bananas regime: "activity functions" and "hurricane licenses." *Id.* at 2-4.

52. The GATS contains a national treatment provision identical to NAFTA Article 1102(2). That is, the Agreement entitles covered services and service suppliers to "treatment no less favourable" than that accorded by a host country to its own services and service suppliers.<sup>27</sup> Unlike NAFTA, however, the GATS specifies an important exception to the general rule:

A Member may meet the requirement of paragraph 1 by according to services and service suppliers of any other Member, either formally identical treatment or formally different treatment to that it accords to its own like services and service suppliers.<sup>28</sup>

This exception is in turn limited by the following:

Formally identical or formally different treatment shall be considered to be less favorable if it modifies the conditions of competition in favour of services or service suppliers of the Member compared to like services or service suppliers of any other Member.<sup>29</sup>

Thus, the GATS permits formally different treatment of foreign entities, provided that that treatment does not result in a modification of the conditions of competition to the detriment of those entities.<sup>30</sup>

53. In the event, the *Bananas* panel found that the EC's operator category rules were formally identical, in that both EC origin and non-EC origin suppliers could qualify for Category A and Category B treatment. The panel therefore addressed

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<sup>27</sup> GATS Article XVII.1.

<sup>28</sup> GATS Article XVII.2.

<sup>29</sup> GATS Article XVII.3.

<sup>30</sup> This, of course, is an important difference, since, as conceded by Canada (*see fn. 17 above*) *de jure* discrimination of the kind countenanced by GATS would violate NAFTA (and, as the *Bananas* panel found, the GATT) without any showing of disproportionality.

the question whether, applying the test of GATS Article XVII.3,<sup>31</sup> those rules nonetheless modified the “conditions of competition” to the detriment of the foreign origin suppliers. It was in this context that the panel considered whether, despite their facial neutrality, the operator categories in fact functioned neutrally. In finding that they did not, the panel ascertained that most non-EC origin suppliers fell within Category A and most EC origin suppliers fell within the favoured Category B. In other words, the natural affinity that one would expect between the country of origin of the bananas and the country of origin of wholesalers of those bananas was confirmed by the evidence.

54. It was for this reason that the panel found that non-EC origin suppliers received less favourable conditions of competition.<sup>32</sup> In reaching this conclusion, the panel made no analysis whether the effect the regime was disproportionately unfavourable to one group or the other,<sup>33</sup> but found, in essence, that Category A could be fairly described as “mostly non-EC wholesalers” and Category B as “mostly EC wholesalers.”<sup>34</sup>
55. Recall that Canada urges that no denial of national treatment may be found in a *de facto* case, unless the measures in question disproportionately disadvantage

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<sup>31</sup> *Bananas* ¶ 7.332.

<sup>32</sup> *Bananas* ¶ 7.336.

<sup>33</sup> Indeed, the word “disproportionate” or any of its forms appears only once in the *Bananas* decision and then in a context (use of private attorneys before WTO panels) wholly unconnected with the national treatment issues we address here. See *Bananas* at ¶ 7.12(e).

<sup>34</sup> The panel added that its conclusions were supported by the fact that the EC intended its marketing system to “cross subsidize” and otherwise benefit operators that previously marketed traditional ACP and EC bananas. See *Bananas* ¶7.352.



foreign investors. The *Bananas* panel's analysis does not support that theory. While the panel found that "most" Category A operators were of third country origin and "most" Category B were of EC origin, that exercise was aimed at determining whether, behind facially neutral labels, stood groups predominantly composed of foreign owned or domestically owned operators.<sup>35</sup> That exercise was a matter of *identification*, not *quantification*, and does not equate to the panel's establishing that the national treatment to which a foreign entity is entitled is that treatment accorded to the largest group, the arithmetic average, the arithmetic mean, or some other proportion of domestic like entities.

56. Another factor makes a case under Article 1102 of NAFTA quite different from *Bananas*. NAFTA plainly contemplates a single investor invoking the national treatment requirements to obtain damages from a Party, where particular governmental measures have accorded its investment less favourable treatment. As Canada admits, if that measure is *de jure* discriminatory, it will violate Article 1102. If the measure is facially neutral, the question becomes whether, behind that neutrality, the measure disadvantages the foreign owned investment. In addressing that question, there is no need to identify the foreign owned investment – it is right there urging its rights.

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<sup>35</sup> As mentioned above, Canada raises two other aspects of the EC's *Bananas* regime: allocations of licenses based on activity functions and allocations to alleviate consequences of hurricanes. As in the analysis of operator status, the panel concluded that categories labeled neutrally were, in fact, composed principally of EC or non-EC entities. See *Bananas* at ¶¶ 7.354 – 7.368, 7.386 – 7.393.

57. As *Bananas* shows, the same is not true under GATS. There, the vindication of rights is left to the national government of those companies allegedly disadvantaged, and the analysis of the challenged measures is, perforce, made on a sector basis ("services or service providers"). Finally, at bottom, the prohibited activity is, unlike in NAFTA, a modification in the conditions of competition, a standard that may under certain circumstances require comparative analysis of how the various competitors are being treated. For these reasons, the Tribunal finds that *Bananas* does not support Canada's theory of disproportionate disadvantage as applied to NAFTA.

b. *European Communities – Measures Concerning Asbestos and Asbestos Containing Products.*<sup>36</sup>

58. The "Asbestos" proceeding considered a French law prohibiting the import, production and sale of asbestos and asbestos-containing products.<sup>37</sup> Canada challenged the law under, among other things, the national treatment provisions found in Article III:4 of the GATT.

59. The GATT provision in issue required member states to accord products of other members treatment "no less favorable" than that accorded its own like products. Since, as a result of the law in dispute, no asbestos or asbestos-containing products were made or sold in France,<sup>38</sup> the panel had to determine whether a like product to asbestos existed in France. After considering the

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<sup>36</sup> WT/DS135/R, September 18, 2000.

<sup>37</sup> Decree No. 96-1133, December 24, 1996.

<sup>38</sup> *Asbestos* ¶ 8.91.

physical characteristics, end uses, customer expectations and the like, the panel concluded that certain "PVA," glass and cellulose fibers were "like" asbestos fibers and that fibro-cement products were "like" asbestos fiber products.<sup>39</sup>

Having found the existence of domestic like products not similarly banned, the panel concluded that the French law was a *de jure* violation of Article III:4,<sup>40</sup> adding that it was consequently unnecessary "to determine whether there is any *de facto* discrimination between these products."<sup>41</sup>

60. Canada reads this run of the mill analysis as supporting its disproportionate disadvantage standard.<sup>42</sup> In order to do so, Canada first recharacterizes the French law as a *de facto* violation of national treatment, presumably since it did not mention any other products or refer to Canada, the world's primary source of asbestos fibre.<sup>43</sup> Then Canada argues that the effect of the prohibition on asbestos disproportionately disadvantaged the foreign product, since, while France produced a substitute, it did not mine asbestos or make asbestos

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<sup>39</sup> *Asbestos* ¶¶ 8.112 – 8.150; those findings of "likeness" were reportedly reversed on appeal. See *Financial Times* March 12, 2001.

<sup>40</sup> *Asbestos* ¶¶ 8.154 – 8.157.

<sup>41</sup> *Asbestos* ¶ 8.156 (see also ¶ 8.155). Nonetheless, the panel found that the ban of asbestos from France was justified as a public health measure under paragraph (B) and the introductory clause of Article XX of the GATT 1994.

<sup>42</sup> Response at 4-5.

<sup>43</sup> The panel's finding of *de jure* discrimination seems to have been based on the fact that the law specifically addressed asbestos, the allegedly injured product. See *Asbestos* at ¶ 8.155. The very uncertainty about whether some measures would be *de facto* or *de jure* violations must at least raise doubts about the efficacy of the proposed disproportionate disadvantage standard, which, Canada has stated, would only apply in *de facto* cases.

products.<sup>44</sup> That statement is true, but there is nothing in the panel's report that suggests any reliance whatsoever on that disproportionality as an element of its analysis of the requirements of national treatment. Once the panel found domestic like products to asbestos, the imports from Canada could lay claim to treatment accorded those products.

c. *United States – Measures Affecting Alcoholic and Malt Beverages (“Beer”).*<sup>45</sup>

61. The “*Beer*” matter involved the regulation of sales of beer, wine and cider by the states of the United States<sup>46</sup> Canada refers to the panel's analysis of one of those state laws, Alaska's licensing fees for beer and wine, which were applicable only to sales through wholesalers. Domestic breweries could avoid those fees by selling directly to retailers, although the only two domestic Alaskan brewers did use wholesalers and paid the fee.<sup>47</sup>
62. The panel found that Alaska's requirement that imported beer and wine be sold through wholesalers violated GATT Article III:4.<sup>48</sup> The fact that in-state brewers *could* avoid the fee, even if they chose not to do so, made the mandatory use of wholesalers by foreign suppliers a discriminatory denial of national

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<sup>44</sup> Phase 2 Supplemental Counter Memorial, at ¶ 97.

<sup>45</sup> DS23/R – 39S/206 March 16, 1992.

<sup>46</sup> Under the 21<sup>st</sup> Amendment to the U.S. Constitution, states are given authority to regulate importation and possession for sale of alcoholic beverages.

<sup>47</sup> *Beer* ¶¶ 5.53 – 5.54.

<sup>48</sup> *Beer* ¶ 5.54.

treatment. Since the discrimination was on the face of the measure, it may fairly be said to represent a case of *de jure* denial of national treatment.<sup>49</sup>

63. Far from supporting Canada's theory of disproportionate disadvantage, the *Beer* panel's decision found a denial of national treatment despite the fact that both of the Alaskan brewers were in precisely the same position, *i.e.*, using wholesalers and paying the fee, as the foreign brewers. To arrive at its holding, the panel compared the treatment accorded imported beer with a *hypothetical* Alaskan brewer taking advantage of its right not to use a wholesaler. It is hard to think of a case more appropriate for applying the theory Canada asserts, which, after all, is posited on an alleged requirement that actual disadvantage be measured before a denial of national treatment can be found.<sup>50</sup> The *Beer* panel did not do so.

d. *S. D. Myers v. Canada.*

64. Canada also relies on the recent NAFTA Chapter 11 decision in *S. D. Myers v. Canada*<sup>51</sup> to support its position on national treatment. That case involved Canadian measures prohibiting export of PCBs and PCB wastes.<sup>52</sup> The investor, a corporation organized in the United States claimed, among other things, that

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<sup>49</sup> The Tribunal notes, however, that Canada considers the measure to be "facially neutral" and the case to be one of *de facto* discrimination. See Response at 5. This stance shows again that there can be uncertainty in discerning into what camp borderline cases may fall.

<sup>50</sup> See, e.g. Phase 2 Counter Memorial at ¶ 441; Phase 2 Supplemental Counter Memorial at ¶ 105.

<sup>51</sup> "Partial Award" dated November 13, 2000 ("*Myers*").

<sup>52</sup> *Myers* ¶ 126.

the Canadian export restrictions violated the national treatment provisions of Article 1102. The claimant asserted that the export ban effectively barred it from competing for PCB waste disposal business in Canada, while Canadian companies, which had access to processing facilities located in Canada, were not similarly restrained.<sup>53</sup> The tribunal agreed.<sup>54</sup>

65. Canada places reliance on the *Myers* tribunal's statement that –

in assessing whether a measure is contrary to a national treatment norm, the following factors should be taken into account:

- whether the practical effect of the measure is to create a disproportionate benefit for nationals over non nationals;

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Specifically, Canada asserts that the tribunal's finding of *de facto* discrimination "clearly" was based on the disproportionate effect of the export ban, which applied only to non-nationals.<sup>56</sup>

66. The Tribunal disagrees. Once the *Myers* tribunal found that the claimant and its Canadian competitors were in "like circumstances,"<sup>57</sup> the finding of a denial of national treatment was a foregone conclusion. That is, the situation at that point was that two Canadian companies were free to operate, while their

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<sup>53</sup> *Myers* ¶ 131.

<sup>54</sup> *Myers* ¶ 256.

<sup>55</sup> *Myers* ¶ 252.

<sup>56</sup> Response at 1.

<sup>57</sup> *Myers* ¶¶ 243 – 251.

American competitor was effectively out of business.<sup>58</sup> Weighing of proportionate advantages and disadvantages was not required, and in the context of the *Myers* fact situation, the word "disproportionate" in the passage quoted above was wholly unnecessary.<sup>59</sup> Whatever the meaning of the phrase as used by the *Myers* tribunal, there is nothing in that case to support the contention of Canada that, where domestic companies are receiving varying treatment from the host government, foreign companies (of NAFTA origin) are entitled only to the treatment accorded the preponderance of those domestic companies.

67. Accordingly, the Tribunal rejects Canada's assertion that WTO/GATT and NAFTA precedents support its position on disproportionate disadvantage.

e. **Other precedents**

68. Indeed, precedents exist for the contrary position. For example, in *United States – Section 337 of the Tariff Act of 1930*,<sup>60</sup> the United States argued that the law under dispute contained elements that might, in practice, provide advantages to imported products that were not available to domestically produced competitive products. The panel rejected that approach, stating:

The Panel therefore considered that, in order to establish whether the "no less favourable treatment standard of Article III:4 is met, it had to assess whether or not Section 337 in itself may lead to the application to imported products of treatment less favourable than that accorded to

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<sup>58</sup> The tribunal was confronted with arguments that the discrimination was justified (*Myers* ¶¶ 152-153, 255), but these issues had no bearing on whether Canada had denied the claimant national treatment.

<sup>59</sup> That is, once the tribunal found any kind of significant benefit for nationals over non-nationals, the predicate for a violation of Article 1102 was satisfied.

<sup>60</sup> L/6439 – 36S/345, January 1989.

products of United States origin. It noted that this approach is in accordance with previous practice of the CONTRACTING PARTIES in applying Article III, which has been to base their decisions on the distinctions made by the laws, regulations or requirements themselves and on the potential impact, rather than on the actual consequences for specific imported products.

The Panel further found that the "no less favorable" treatment requirement of Article II:4 has to be understood as applicable to *each individual case* of imported products. The Panel rejected any notion of balancing more favourable treatment of some imported products against less favourable treatment of other imported products. If this notion were accepted, it would entitle a contracting party to derogate from the no less favourable treatment obligation in one case, or indeed in respect of one contracting party, on the ground that it accords more favourable treatment in some other case, or to another contracting party. Such an interpretation would lead to great uncertainty about the conditions of competition between imported and domestic products and thus defeat the purposes of Article III.<sup>61</sup>

69. The *Beer* case ruled on matters beyond the state distribution laws to which Canada has drawn attention. One such ruling related to the U.S. federal excise tax on beer, which provided a lower rate for the first 60,000 barrels produced by brewers making less than 2,000,000 barrels per year. The lower rate was not available to imported beer. In defense of this treatment, the United States pointed out that the lower tax rate applied to a very small portion of domestic beer production. The panel stated –

[T]he fact that only approximately 1.5 per cent of domestic beer in the United States is eligible for the lower tax rate does not immunize this United States measure from the national treatment obligations of [GATT] Article III.<sup>62</sup>

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<sup>61</sup> Section 337 ¶¶ 5.13-5.14, emphasis added. *Accord, Canada – Term of Patent Protection*, where the panel rejected Canada's contention that, because its law complied with the WTO rules *on the average*, there was no violation of TRIPS Agreement requirements. WT/DS170/R May 5, 2000, ¶¶ 6.99 – 6.100.

<sup>62</sup> *Beer* at ¶ 5.6.



Canada's disproportionate disadvantage theory would have required a different result. The panel would have been obligated to find that the predominate treatment accorded to U.S. brewers called for the higher tax and that the Canadian imports would thus have no right to any better treatment.

70. Canada contends that these cases are distinguishable because they involve *de jure*, rather than *de facto*, discrimination. We have already seen that it is not always clear whether a measure is a *de jure* or *de facto* case,<sup>63</sup> but even if it were, Canada has presented no reasons to justify treating the two forms of disadvantage differently. Indeed, the recognition that national treatment can be denied through *de facto* measures has always been based on an unwillingness to allow circumvention of that right by skillful or evasive drafting. Applying Canada's proposed more onerous rules to *de facto* cases could quickly undermine that principle. That result would be inconsistent with the investment objectives of NAFTA, in particular Article 102(1)(b) and (c), to promote conditions of fair competition and to increase substantially investment opportunities.
71. These views are strengthened by consideration of the practical implications of Canada's position. In this case, Canada's disproportionate disadvantage approach would require the Investor to ascertain whether there are any other American owned lumber producing companies among the more than 500 softwood lumber quota holders operating in Canada. If so, the treatment

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<sup>63</sup> See text at fn. 43 and fn. 49 above.

accorded those companies as a whole would have to be measured and then weighed against the predominant treatment, whatever that might mean, accorded Canadian companies operating in like circumstances. A violation of Article 1102 could then only be found if the differing treatment between the class of American investments and their Canadian competitors in like circumstances is "disproportionately" in favour of the domestic investments, whatever that might mean.

72. Simply to state this approach is to show how unwieldy it would be and how it would hamstring foreign owned investments seeking to vindicate their Article 1102 rights. Only in the simplest and most obvious cases of denial of national treatment could the complainant hope to make a case for recovery. The Tribunal is unwilling to take a step that would so weaken the provisions and objectives of NAFTA and, for the reasons stated, rejects Canada's disproportionate disadvantage test.

**3. Determination of "in like circumstances."**

**a. Introduction**

73. As noted, NAFTA Article 1102(1) and (2) require a Party to accord another Party's investors and investments treatment no less favourable than it accords its own investors and investments that are "in like circumstances." Thus, in determining whether Canada has violated Article 1102, it is necessary to identify the domestic entities whose treatment should be compared with that accorded the Investor and the Investment.

74. The measures under consideration in this case limit, in one way or another, the Investment's ability to export and sell softwood lumber to the United States.<sup>64</sup> Some Canadian sellers of the product are similarly limited. Not surprisingly, it is those entities that Canada argues are in like circumstances to the Investment. The Investor, also not surprisingly, argues that any Canadian softwood lumber producers not limited or less restrictively limited than the Investment should be considered in like circumstances.<sup>65</sup>
75. The Tribunal must resolve this dispute by defining the meaning of "like circumstances." It goes without saying that the meaning of the term will vary according to the facts of a given case.<sup>66</sup> By their very nature, "circumstances" are context dependent and have no unalterable meaning across the spectrum of fact situations.<sup>67</sup> And the concept of "like" can have a range of meanings, from "similar" all the way to "identical."<sup>68</sup> In other words, the application of the like

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<sup>64</sup> We address below the details of these limitations.

<sup>65</sup> Initial Phase Memorial, at ¶¶ 78 - 79.

<sup>66</sup> Both the Investor and Canada agree that the "circumstances" pertinent to Article 1102 must be determined in light of the surrounding facts. *See, e.g.,* Initial Phase Memorial at ¶ 66; Initial Phase Counter Memorial at ¶ 189; Initial Phase Supplemental Memorial at ¶ 57.

<sup>67</sup> Webster defines "circumstance" to include: "a specific part, phase, or attribute of the surroundings or background of an event, fact or thing or of the prevailing conditions in which it exists or takes place," and "the total complex of essential attributes and attendant adjuncts of a fact or action." *Webster's Third New International Dictionary* (1986).

<sup>68</sup> *Id.* These definitions must, of course, be considered in the light of the *Vienna Convention*, particularly Article 31(1), which provides that "the ordinary meaning [is] to be given to the terms of the treaty in their context and in the light of its object and purpose." Accordingly, the analysis and interpretation of Article 1102 of NAFTA is initially informed by the ordinary meaning of its terms. As the Appellate Body of the World Trade Organization expressed it: "... interpretation must be based above all on the text of the treaty".<sup>68</sup> *Japan -*

circumstances standard will require evaluation of the entire fact setting surrounding, in this case, the genesis and application of the Regime.<sup>69</sup>

76. An important element of the surrounding facts will be the character of the measures under challenge. In this respect, the Tribunal agrees with the NAFTA Chapter 11 tribunal in *Myers v. Canada*, which stated: "In considering the meaning of 'like circumstances' under Article 1102 of the NAFTA, it is similarly necessary to keep in mind the overall legal context in which the phrase appears."<sup>70</sup> The Tribunal addresses that legal context first and then turns to the other facts of this case.

**b. The legal context of "like circumstances."**

77. The Investor submits that the legal context of Article 1102 includes "the trade and investment-liberalizing objectives of the NAFTA."<sup>71</sup> The Tribunal agrees. Canada argues that the legal context also includes the entire background of its

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*Taxes on Alcoholic Beverages*, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, October 4, 1996, at 12.

<sup>69</sup> The SLA itself is not the object of the claim here. The Investor cannot and does not challenge the SLA; it is a treaty between two of the NAFTA Parties and not a "measure" covered by Chapter 11 of NAFTA. The Investor's attack is directed at and limited to Canada's implementation of the SLA via the Regime, its planning, design, development, content, preparation, implementation and administration. As discussed below, the Tribunal does not reach the question whether amendment of the SLA could properly be considered to be a measure under the Regime.

<sup>70</sup> Partial Award dated November 13, 2000 at ¶ 245.

<sup>71</sup> Initial Phase Memorial, at ¶ 64.

disputes with the United States concerning softwood lumber trade between the two countries.<sup>72</sup> Again, the Tribunal agrees.

78. In evaluating the implications of the legal context, the Tribunal believes that, as a first step, the treatment accorded a foreign owned investment protected by Article 1102(2) should be compared with that accorded domestic investments in the same business or economic sector.<sup>73</sup> However, that first step is not the last one. Differences in treatment will presumptively violate Article 1102(2), unless they have a reasonable nexus to rational government policies that (1) do not distinguish, on their face or *de facto*, between foreign-owned and domestic

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<sup>72</sup> See, e.g., Phase 2 Counter Memorial at ¶¶ 498-514.

<sup>73</sup> The OECD's analysis, *National Treatment for Foreign-Controlled Enterprises*, declared in considering language similar to Article 1102(2):

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

Organization for Economic Co-operation and Development (1993; OECD, Paris) at 22. This is not to say, however, that the economic sector will be determinative. The OECD declaration went on to state:

More general considerations, such as the policy objectives of Member countries, could be taken into account to define the circumstances in which comparison between foreign-controlled and domestic enterprises is permissible inasmuch as those objectives are not contrary to the principle of National Treatment. In any case, the key to determining whether a discriminatory measure applied to foreign-controlled enterprises constitutes an exception to National Treatment is to ascertain whether the discrimination is motivated, at least in part, by the fact that the enterprises concerned are under foreign control.

*Id.*

companies, and (2) do not otherwise unduly undermine the investment liberalizing objectives of NAFTA.<sup>74</sup>

79. In one respect, this approach echoes the suggestion by Canada that Article 1102 prohibits treatment that discriminates on the basis of the foreign investment's nationality.<sup>75</sup> The other NAFTA Parties have taken the same position.<sup>76</sup> However, the Tribunal believes that the approach proposed by the NAFTA Parties would tend to excuse discrimination that is not facially directed at foreign owned investments. A formulation focusing on the like circumstances question, on the other hand, will require addressing *any* difference in treatment, demanding that it be justified by showing that it bears a reasonable relationship to rational policies not motivated by preference of domestic over foreign owned investments. That is, once a difference in treatment between a domestic and a foreign-owned investment is discerned, the question becomes, are they in like circumstances? It is in answering that question that the issue of discrimination may arise.

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<sup>74</sup> The Tribunal believes that the latter test will rarely apply and does not think it useful now to speculate on the kind of fact situations that would bring it into play. Nonetheless, it is important to recognize that the fundamental purposes of NAFTA, as expressed in its Article 102, may need to supplement the former test.

<sup>75</sup> Initial Phase Counter-Memorial, at ¶ 8; Canada's Submission of June 1, 2000, at ¶¶ 6, 8, 9 & 10; Phase 2 Counter-Memorial at ¶¶ 440, 462, 466; Phase 2 Supplemental Counter-Memorial, at ¶¶ 94, 98.

<sup>76</sup> United States First Article 1128 Submission, April 7, 2000, at ¶ 3; United States Second Article 1128 Submission, May 25, 2000, at ¶ 3; Mexico's Supplemental Article 1128 Submission, May 25, 2000, at Section A.1, pp. 2 and 3 of 11.

80. For its part, the Investor raises another important question relating to the legal context of the measures to be evaluated:

If the measure is applied in a manner that has the effect of providing a less satisfactory competitive position to a foreign company, can the state applying the measure use the very same elements of the measure that leads to the discriminatory treatment in question to justify why the competitors are actually not in "like circumstances"? The answer must be no. Otherwise a state could merely manipulate the definition of what is a "like investment" through the design of the measure itself. National treatment would be rendered meaningless as a principle.<sup>77</sup>

81. In other words, does NAFTA permit the Parties to reach an agreement that is not a "measure" under Chapter 11, and then permit one of those Parties to use the substance of that agreement to create an unchallengeable basis for discrimination? The Tribunal believes that if the situation were to arise, it could be evaluated as stated above, i.e., whether there is a reasonable nexus between the measure and a rational, non-discriminatory government policy, whether those policies are embodied in statute, regulation or international agreement.

82. With this analysis of legal context in mind, the Tribunal will now address the facts of this matter pertinent to the like circumstances issue.

**c. Factual determinations.**

83. The history of the softwood lumber dispute between the United States and Canada prior to the SLA and the evolution of the softwood lumber Export Control Regime under the SLA are described elsewhere in this Award and in the Tribunal's Interim Award in this case dated June 26, 2000. What follows is an

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<sup>77</sup> Initial Phase Supplemental Memorial, at ¶ 56.

analysis of the cases where the Investment was accorded treatment different from that of other softwood lumber producers in Canada.

**1) Treatment of softwood lumber producers in the non-covered provinces**

84. The softwood lumber Export Control Regime did not apply in the non-covered provinces, that is all the provinces other than B.C., Alberta, Ontario and Quebec. Under the SLA, producers in those non-covered provinces could freely export softwood lumber to the United States in unlimited quantities, without the payment of any export fees. That was the case for all softwood lumber producers in those non-covered provinces, Canadian and foreign-owned alike.
85. Consequently, all softwood lumber producers in the non-covered provinces were afforded more favourable treatment than producers in the covered provinces, including the Investment.
86. Canada argues that in negotiating the SLA, both parties determined which were to be the covered provinces and that that determination was reasonably based upon the approximately twenty-year ongoing softwood lumber trade dispute between Canada and the United States. Specifically, at the time the SLA was negotiated, B.C., Alberta, Ontario and Quebec accounted for 95% of Canada's softwood lumber exports to the United States, and only those provinces faced a real threat of countervailing duty ("CVD") actions by the U.S. Department of Commerce.
87. The Investor asserts that all Canadian softwood lumber producers faced such a threat, but the evidence shows that, although a number of CVD cases addressed



Canadian softwood lumber imports, the United States never made a final determination against producers in the non-covered provinces. Consequently, the Tribunal finds that the decision to implement the SLA through a regime effecting controls only against exports to the United States from covered provinces was reasonably related to the rational policy of removing the threat of CVD actions. Since the decision affects over 500 Canadian owned producers precisely as it affects the Investor, it cannot reasonably be said to be motivated by discrimination outlawed by Article 1102.

88. Based on that analysis, the producers in the non-covered provinces were not in like circumstances with those in the covered provinces. Accordingly, the Tribunal finds no breach by Canada of its national treatment obligations by virtue of its treatment of producers in the non-covered provinces.<sup>78</sup>

**2) Treatment of softwood lumber producers in the covered provinces**

89. The Investor argued that, since the advent of the SLA, B.C.'s relative proportion of total Canadian softwood lumber production and total exports of softwood

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<sup>78</sup> Prior to the signature of the SLA, in addition to the four covered provinces, Canada had placed lumber produced in Manitoba on the Export Control List. According to McDonald, that measure reflected discussions between Canada and representatives of Manitoba and Saskatchewan about whether it might be desirable to issue export permits for softwood lumber originating from those provinces for monitoring purposes only. There had never been any question of those two provinces being included in the Softwood Lumber Quota Regime as such, since the forest management programs of those two provinces had never been determined by the U.S. Department of Commerce to confer countervailable subsidies. Monitoring exports from Manitoba and Saskatchewan was viewed as a way to address possible circumvention of the SLA by softwood lumber producers in the covered provinces. While Manitoba was willing to opt into the export permit system, it wished to remain in tandem with Saskatchewan in that regard, and when Saskatchewan decided not to be included in the export permit system, Manitoba also withdrew. Consequently, Manitoba was never a covered province and was never included in the Softwood Lumber Export Permit System. McDonald Affidavit, March 24, 2000, at ¶¶ 37-38.

lumber to the United States has steadily declined. In contrast, the Investor notes, Quebec's shares of that production and of those exports have steadily increased. There have also been substantial percentage increases, albeit far smaller quantitatively, in the shares of the other covered provinces, Alberta and Ontario.

90. Canada has submitted that those decreases and increases were but a continuation of trends already in place prior to the SLA. The witnesses Waverman (called by the Investor) and Vertinsky (called by Canada), each one using different starting points, produced analyses showing trend lines, each rising or descending at different degrees, depending upon which year was used as the point of commencement. The Tribunal cannot reach any reasoned conclusions based upon those analyses.
91. Notwithstanding that determination, it is true that, prior to the SLA, more investments in new mills and to increase existing mills' capacity were being made in Quebec than in B.C. Market conditions, including the availability of mature forests for cutting and production and return on investment, were factors that had caused and encouraged those pre-SLA trends.
92. These economic circumstances of the softwood lumber industries in the covered provinces did have an important effect on one aspect of the Regime, the assignment of quotas to new entrants. Like many quota programs restricting production and sales, the Regime made a provision for new entrants, particularly

where investments had already been made.<sup>79</sup> The Investor does not dispute that accommodation for new entrants was necessary and reasonable.<sup>80</sup>

93. The Tribunal does not accept the Investor's argument that new entrant quota allocations should have followed the same percentage distribution among the four covered provinces as did the EB and LFB allocations. The special nature and character of new entrant provisions required that allocations be made based upon where the qualified new entrants were located, and their locations were necessarily inconsistent with a tidy percentage distribution among the covered provinces. The effects of the decision to set aside quota for new entrants were shaped by those economic factors, but the Regime did not create them. Consequently, it cannot be fairly asserted that the Regime accentuated or otherwise enhanced the underlying effects of the economic changes. It was the underlying economics of the softwood lumber industry in Canada that placed the Investment and other producers in B.C. in unlike circumstances to those in the other covered provinces. For those reasons, the Tribunal concludes that the new entrants' allocation choice by Canada had a reasonable nexus with the rational policy of providing for new entrants and it had no elements of discrimination against foreign-owned producers.

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<sup>79</sup> Canada treated all applications for new entrant allocations of quota on the basis of an established and known list of criteria that were objectively applied to all applicants, without regard to whether they were Canadian or foreign-owned. The Investment did not qualify as a new entrant and made no request for new entrant quota. See discussion at ¶¶ 120-121 below.

<sup>80</sup> See, e.g. Nov. 2000 Tr., Vol. XII at 57:20 – 58:8.

94. For the same reasons, the Tribunal cannot determine that B.C.'s decreasing shares of total Canadian production and exports to the United States (as well as Quebec's increased shares of both) can be laid at the doorstep of the Regime, nor can those facts constitute a breach by Canada of its national treatment obligations under Article 1102(2).
95. Similarly, the Tribunal concludes that there is no violation of Article 1102 arising from Canada's other allocations for new entrants or measures it took to address errors and omissions or hardship cases. The Investment was not in like circumstances to the new entrants, and it never made application for consideration under the Regime of any alleged errors, omissions or hardships affecting its interests.<sup>81</sup>

**3) Treatment of softwood lumber producers in British Columbia.**

96. The Investment's three lumber mills, situated at Castlegar, Grand Forks and Midway, are all located in B.C., within what is commonly referred to as the "interior" of that province. Softwood lumber producers in the province are also located in the "coastal" region.
97. Based upon evidence produced by the parties, the Tribunal firstly concludes that, at least until the advent of the stumpage reductions discussed below, the Investment received treatment no less favorable than that accorded Canadian-owned producers throughout B.C. Indeed, the Investor has not contended

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<sup>81</sup> These aspects of the Regime are further addressed in the discussion of Article 1105, below.

otherwise, apart from its allegations of discrimination allegedly inherent in the Regime, which the Tribunal addressed above.

98. The Super Fee was introduced to settle a dispute between Canada and the United States concerning reductions in stumpage fees charged by B.C., which were instituted on June 1, 1998. For coastal producers, the reduction was Can \$8.10 per cubic metre; for interior producers it was Can \$3.50.
99. The difference in the stumpage reductions for interior and coastal producers arose from the decision of the BC government to divide the total dollar amount budgeted for stumpage reduction evenly between the two regions. (That decision was apparently made upon the recommendation of the B.C. industry.) Since there was more timber harvested from Crown lands in the interior, the reduction per cubic metre was smaller in that region.<sup>82</sup> At that point, one might have questioned whether the Investment, being in the interior, was being treated less favourably than lumber producers in the coastal area. But that question would relate to a measure taken by the B.C. government, a matter that is not before this Tribunal.
100. In the event, the B.C. stumpage reductions provoked a complaint and then a request for arbitration by the United States. Those proceedings in turn led to a negotiated settlement, which provided for increased fees on some B.C. exports as described above.<sup>83</sup> That settlement arguably disadvantaged the Investment in

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<sup>82</sup> See George 3<sup>rd</sup> Affidavit, October 4, 2000 at ¶ 124.

<sup>83</sup> See discussion at ¶¶ 129-155 below.

two respects: (1) it (like other producers in the interior region) continued to receive a lower benefit per cubic metre from the stumpage reductions than producers in the coastal region and (2) its exports were subject to higher fees than those of producers not using the UFB and LFB quotas to the same degree. The Tribunal considers that neither of these putative disadvantages would entitle the Investment to relief under Article 1102(2).

101. It is true that the settlement with the United States that led to the imposition of the Super Fee did not differentiate between exports from the two regions of B.C. That is, the settlement did nothing to rectify the imbalance, if there was one,<sup>84</sup> between the treatment of coastal and interior producers under the stumpage reductions. However, the discrepancy was not due to any action by Canada; it was entirely the result of actions by the B.C. government.<sup>85</sup> Because the settlement was struck against this status quo of arguably different treatment between coastal and interior producers, those producers cannot be said to have been in "like circumstances" at the time of the settlement. Instead, the Investment was in the arguably disadvantaged class that existed before anything Canada did under the settlement or its implementation. As noted, a claim based on that possible disadvantage is not before this Tribunal.

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<sup>84</sup> It is not entirely clear that a lower stumpage rate equates to an advantage over producers in other areas who must pay a higher rate. There are other factors, like ease of access and quality of timber, that will make timber for which the stumpage rate is higher still cheaper in the long run to the producer. *See* Campbell testimony, May 2000 Tr., Vol. III 72:12 – 74:5.

<sup>85</sup> Prior to 1998 different stumpage rates had been struck by B.C. between the two regions.

102. The second basis for possibly considering the Investment to be disadvantaged is the settlement's more onerous effects on producers, like the Investment, that used LFB and UFB extensively. In effect, Canada chose to settle the dispute with the United States by burdening only users of LFB and UFB, rather than the entirety of those producers benefiting from the B.C. stumpage reductions. Applying the legal considerations discussed above, the Tribunal finds that the choice made by Canada to resolve the B.C. stumpage fee controversy in this manner bears a reasonable relationship to a rational choice of remedies aimed at avoiding a threat to the SLA.
103. The settlement undoubtedly had a greater adverse effect on some B.C. producers than others, but there is no convincing evidence that it was based on any distinction between foreign-owned and Canadian owned companies. Indeed, there were some 132 B.C. companies using LFB quotas, each of which was affected by the settlement and only one of which (as far as the Tribunal knows) is owned by NAFTA investors. When it is recalled that this proceeding is to evaluate measures to *implement* the SLA (and any amendment thereto) rather than the SLA itself, the Tribunal cannot say that placing the burden exclusively on users of LFB and UFB was not a rational choice of solution.<sup>86</sup>

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<sup>86</sup> The Tribunal does not suggest that there are no cases where the requirements of NAFTA Chapter 11 would circumscribe the freedom of NAFTA parties to enter agreements that would impinge on those requirements. Certainly, in construing such agreements, it would be proper to give as much life to the Chapter 11 requirements as the language would permit. But, this is not such a case, since there is no hint that the decision to place the burden on the many users of LFB and UFB was motivated by the nationality of one of those users, the Investment.

104. Consequently, the Tribunal determines that implementation of the Super Fee settlement did not deny the Investment national treatment in contravention of Article 1102.

### THE CLAIM UNDER ARTICLE 1105

#### A. Interpretation of Article 1105

105. The Investor claims that Canada's implementation of the SLA violated NAFTA Article 1105(1), which provides:

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.

106. The Investor and Canada agree that this provision establishes a minimum standard of treatment that applies apart from the treatment a NAFTA party may accord to its own or to other countries' investors and investments.<sup>87</sup> They do not agree, however, on the content of that minimum standard.
107. For its part, Investor asserts that the "international law" requirements of Article 1105 include (1) all the sources of international law found in Article 38 of Statute of the International Court of Justice,<sup>88</sup> (2) the concept of "good faith" (including *pacta sunt servanda*),<sup>89</sup> (3) the World Bank's guidelines on foreign direct investment,<sup>90</sup> (4) the NAFTA Parties' other treaty obligations,<sup>91</sup> and (5)

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<sup>87</sup> See, e.g., November 2000 Tr., Vol. I at 33:3-8 (Investor) and Vol. II at 20:7-15 (Canada).

<sup>88</sup> See, e.g., Phase 2 Memorial at ¶ 103; November 2000 Tr., Vol. I at 25:24 – 27:11. Article 38 of the Statute identifies treaties, custom, general principles, decisions and teachings of the most highly qualified publicists of the various nations as sources of international law.

<sup>89</sup> See, e.g., Phase 2 Memorial at ¶¶ 109 – 125.

<sup>90</sup> See, e.g., November 2000 Tr., Vol. I at 29:10 – 30:8.



the body of domestic law of each NAFTA Party that addresses the exercise of domestic regulatory authority.<sup>92</sup>

108. Canada disputes the suggestion that Article 1105 imports this broad range of standards and argues that, before a violation of international law can properly be found, the conduct in question must be "egregious."<sup>93</sup> That word is not used in NAFTA or, indeed, in the precedents on which Canada relies; Canada believes the word "encapsulates" what it sees as an element recurring in those precedents.<sup>94</sup>
109. The precedents relied on by Canada addressed the content of the requirements of international law, rather than the other factors referred to in Article 1105, namely, "fair and equitable treatment and full protection and security."<sup>95</sup> The language of Article 1105 suggests that those elements are *included* in the requirements of international law, and both the Investor and Canada subscribe to that reading,<sup>96</sup> albeit with vastly different views of the implications of that reading. Canada sees its concept of the international law requirement (only "egregious" misconduct covered) being applicable to the fairness elements, so

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<sup>91</sup> See, e.g., November 2000 Tr., Vol. I at 42:18-23.

<sup>92</sup> See, e.g., November 2000 Tr., Vol. I at 42:24 – 43:3.

<sup>93</sup> See, e.g., Phase 2 Counter Memorial at ¶ 309, where the threshold is described as requiring "gross misconduct, manifest injustice or \*\*\* an outrage, bad faith or the wilful neglect of duty." The use of "egregious" came at the November 2000 Hearing. See, e.g., Vol. II at 40:06 – 41:13, 49:16-23, and 54:01-04; Vol. XIII at 59:01-17.

<sup>94</sup> See November 2000 Tr., Vol. II at 54:01-04 and 58:8-20. In another instance, Canada described the standard as getting to "the level where you are shocked by the actions, that when you're dealing with reprehensible conduct \*\*\*". *Id.*, Vol. XIII at 116:15-20.

<sup>95</sup> For the sake of brevity, these elements collectively are called the "fairness elements."

that, for example, a denial of fairness would have to be shocking to be a violation of Article 1105.<sup>97</sup> The Investor sees the incorporation of the fairness elements into international law as support for its view that international law standards have progressed and have liberalized the “egregious” conduct threshold that Canada finds in the older cases.<sup>98</sup>

110. Another possible interpretation of the presence of the fairness elements in Article 1105 is that they are *additive* to the requirements of international law. That is, investors under NAFTA are entitled to the international law minimum, *plus* the fairness elements. It is true that the language of Article 1105 suggests otherwise, since it states that the fairness elements are included within international law.<sup>99</sup> But that interpretation is clouded by the fact, as all parties

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<sup>96</sup> See, e.g., Phase 2 Memorial at ¶ 102; Phase 2 Counter Memorial at ¶¶ 221, 224.

<sup>97</sup> See, e.g., November 2000 Tr., Vol. XIII at 116:10-20.

<sup>98</sup> See, e.g., November 2000 Tr., Vol. XII at 51:13-25, 53:7 – 56:26.

<sup>99</sup> This facially sound approach appears to be the basis for the comments of the NAFTA Chapter 11 tribunal in *Myers* rendered in its Partial Award dated November 13, 2000. It stated:

The phrases ... *fair and equitable treatment*... and ...*full protection and security*... cannot be read in isolation. They must be read in conjunction with the introductory phrase ...*treatment in accordance with international law*.

The Tribunal considers that a breach of Article 1105 occurs only when it is shown that an investor has been treated in such an unjust or arbitrary manner that the treatment rises to the level that is unacceptable from the international perspective.

*Myers* at ¶¶ 262-263. As the majority in *Myers* found that Canada violated Article 1105 because it violated Article 1102, the tribunal’s quoted observations on the interpretation of Article 1105 must be viewed as *dicta*. See *id.* at ¶¶ 256, 266, 268. In any case, for the reasons set out below, this Tribunal adopts a different interpretation.

agree,<sup>100</sup> that the language of Article 1105 grew out of the provisions of bilateral commercial treaties negotiated by the United States and other industrialized countries. As Canada points out, these treaties are a “principal source” of the general obligations of states with respect to their treatment of foreign investment.<sup>101</sup>

111. These treaties evolved over the years into their present form, which is embodied in the Model Bilateral Investment Treaty of 1987.<sup>102</sup> Canada, the UK, Belgium, Luxembourg, France and Switzerland have followed the Model.<sup>103</sup> It provides as follows:

Investment shall at all times be accorded fair and equitable treatment, shall enjoy full protection and security and shall in no case be accorded treatment less than that required by international law.<sup>104</sup>

The Tribunal interprets that formulation as expressly adopting the additive character of the fairness elements. Investors are entitled to those elements, no

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The Tribunal also considered the decision rendered by the Chapter 11 tribunal in *Metalclad Corp. v. Mexico* dated August 25, 2000. That tribunal determined that Mexico had failed to accord the claimant fair and equitable treatment in accordance with international law, but did not make any finding that the conduct in question had to meet any threshold standard of egregiousness, outrageousness or the like.

The Tribunal also reviewed the Chapter 11 tribunal’s recent interim decision in *Loewen v. U.S.* dated January 5, 2001. That decision did not address the issues before us.

The Tribunal understands that the *Myers* and *Metalclad* cases are under judicial review.

<sup>100</sup> See, e.g., Phase 2 Memorial at ¶ 127; Phase 2 Counter Memorial at ¶¶ 252-254.

<sup>101</sup> Phase 2 Counter Memorial ¶ 246.

<sup>102</sup> Reprinted in J.J. Vandenvelde, *United States Investment Treaties: Policy and Practice*.

<sup>103</sup> R. Dolzer & M. Stevens, *Bilateral Investment Treaties* at 58.

<sup>104</sup> Article II.2.

matter what else their entitlement under international law. A logical corollary to this language is that compliance with the fairness elements must be ascertained free of any threshold that might be applicable to the evaluation of measures under the minimum standard of international law.<sup>105</sup>

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<sup>105</sup> Accord, F. A. Mann, *British Treaties for the Promotion and Protection of Investments*, 52 *The British Year Book of International Law* (1981), 241, 244:

The terms "fair and equitable treatment" envisage conduct which goes far beyond the minimum standard and afford protection to a greater extent and according to a much more objective standard than any previously employed form of words. A tribunal would not be concerned with a minimum, maximum or average standard. It will have to decide whether in all the circumstances the conduct in issue is fair and equitable or unfair and inequitable. No standard defined by other words is likely to be material. The terms are to be understood and applied independently and autonomously.

Also accord, UNCTAD, *Fair and Equitable Treatment* (1999) at 39-40 (citations omitted and emphasis supplied):

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. To be sure, the reference to treatment no less favourable than that required by international law could possibly be made *ex abundante cautela*, but its presence in most bilateral treaties involving the United States suggest that it is not perceived as verbiage.

Generally, therefore, the law on this point is characterized by some degree of contradiction and uncertainty. If the fair and equitable standard is the same as the international minimum standard which is traditionally supported by capital-exporting countries, then reference to fair and equitable treatment in investment instruments will incorporate by reference an established body of case law on the minimum standard for foreigners: States would fail to meet the minimum standard, and, by this reasoning, the fair and equitable standard, if their acts amounted to bad faith, wilful neglect, clear instances of unreasonableness or lack of due diligence. [Citing *Neer*.] On the other hand, the instances in which States have indicated or implied an equivalence between the fair and equitable standard and the international minimum standard are sparse. Also, as noted above, bearing in mind that the international minimum standard has itself been an issue of controversy between developed and developing States for a considerable period, it is unlikely that all States would have accepted the idea that this standard is fully reflected in the fair and equitable standard without clear discussion.

112. The Fourth Submission of the United States to this Tribunal, November 1, 2000, discusses the use of the fairness elements in the BITs. The United States suggests that the term arose out of the OECD Draft Convention on the Protection of Foreign Property proposed in 1963 and revised in 1967. The commentary to that document stated that –

The phrase “fair and equitable treatment” \*\*\* indicates the standard set by international law for the treatment due by each State with regard to the property of foreign nations. \*\*\* The standard required conforms in effect to the “minimum standard” which forms part of customary international law.<sup>106</sup>

It should be noted that the OECD Draft did not contain any reference to treatment required by “international law.” Thus, the question how to interpret the fairness elements where, as in the BITs and NAFTA, both concepts are expressly included, was not an issue before the drafters of the OECD Draft.

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These considerations point ultimately towards fair and equitable treatment not being synonymous with the international minimum standard. Both standards may overlap significantly with respect to issues such as arbitrary treatment, discrimination and unreasonableness, but the presence of a provision assuring fair and equitable treatment in an investment instrument does not automatically incorporate the international minimum standard for foreign investors. *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.*

Also accord, Dolzer & Stevens, *supra*, at 60:

It is submitted here that the fact that parties to BITs have considered it necessary to stipulate this [fair and equitable treatment] standard as an express obligation rather than relied on a reference to international law and thereby invoked a relatively vague concept such as the minimum standard, is probably evidence of a self-contained standard. Further, some treaties 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 BIT.

<sup>106</sup> OECD 1967 *Draft Convention of the Protection of Foreign Property*, reprinted 7 Int'l L. Materials 117, 120 (1968).

113. The United States acknowledged that “a few scholars” have concluded that the fairness elements in the BITs are distinct from customary international law standards.<sup>107</sup> The Tribunal considers that those scholars and other authorities are correct and that the language and evident intention of the BITs makes the discrete (*i.e.*, additive) standards interpretation the proper one. A contrary reading would do violence to the BIT language.<sup>108</sup>
114. The United States asserts that, whatever the meaning of the BITs, the drafters of NAFTA Chapter 11 “excluded any possible conclusion that the parties were diverging from the customary international law concept of fair and equitable treatment.”<sup>109</sup> The United States supports this contention solely by pointing to the language of Article 1105; it offered no other evidence to the Tribunal that the NAFTA parties intended to reject the additive character of the BITs.<sup>110</sup> Consequently, the suggestions of the United States on this matter do not enjoy the kind of deference that might otherwise be accorded to representations by

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<sup>107</sup> United States Fourth Submission at ¶ 6. In fact, there seems to be at least as much authority for the “distinct concept” interpretation as for the contrary.

<sup>108</sup> While the tribunal in the *Myers* case recognized that there is a relationship between Article 1105 and the BITs, it apparently interpreted the BITs as simply establishing a minimum standard of conduct. *See Myers* at ¶ 259. By not appreciating the plain language of the BITs, the *Myers* tribunal did not address the implications of that language on the proper interpretation of Article 1105. For that reason, this Tribunal does not consider the *Myers* Partial Award to be a persuasive precedent on this matter and will not be bound by it.

<sup>109</sup> United States Fourth Submission at ¶ 7. Neither Mexico nor Canada has subscribed to the version of the intent of the drafters put forward by the United States

<sup>110</sup> The Tribunal requested Canada and the other NAFTA parties to produce any evidence to support the contention of the United States. *See* November 2000 Tr., Vol. III at 4:16 – 5:1 and Vol. V at 2:3 – 4:20. None was provided. *See id.* Vol III at 4:16-23. Both Mexico and the United States made post-hearing submissions to the Tribunal; both were silent on this issue.

parties to an international agreement as to the intentions of the drafters with respect to particular provisions in that agreement.

115. Indeed, notwithstanding the position espoused by the United States, there are very strong reasons for interpreting the language of Article 1105 consistently with the language in the BITs. First, there is the basic unlikelihood that the Parties to NAFTA would have intended to curb the scope of Article 1105 *vis a vis* one another when they (at least Canada and the United States) had granted broader rights to other countries that cannot be considered to share the close relationships with the NAFTA parties that those Parties share with one another. NAFTA begins by stressing "the special bonds of friendship and cooperation among their nations."<sup>111</sup> Article 103(2) expressly provides that, in the event of a conflict, NAFTA prevails over GATT and "other agreements to which [the NAFTA] Parties are party."<sup>112</sup> Thus, on general principles of interpretation, it would be difficult to ascribe to the NAFTA Parties an intent to provide each other's investments more limited protections than those granted to other countries not involved jointly in a continent-wide endeavor aimed, among other things, at "increas[ing] substantially investment opportunities in the territories of the Parties."<sup>113</sup> The Tribunal views these factors to be relevant to the

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<sup>111</sup> NAFTA Preamble, clause 1.

<sup>112</sup> The quoted language appears in Article 103(1). It can be admitted that, under ordinary principles of treaty interpretation, the provisions of a later concluded agreement would prevail over earlier ones. *See Vienna Convention on the Law of Treaties*, Article 30(3). Nonetheless, by including Article 103, the Parties were emphasizing the special importance to themselves of the NAFTA undertakings.

<sup>113</sup> NAFTA Article 102 (1) (c).

interpretation of NAFTA as describing its "context, object and purpose." Those factors are, of course, pertinent to definition of the "ordinary meaning" of Article 1105,<sup>114</sup> and Article 102(2) of NAFTA itself requires the Parties "to interpret and apply the provisions of this Agreement in the light of the objectives set out in paragraph 1" thereof, which include "increas[ing] substantially investment opportunities."

116. It is doubtful that the NAFTA parties would want to present to potential investors and investments from other NAFTA countries the possibility that they would have no recourse to protection against anything but egregiously unfair conduct. The aim of NAFTA seems to be quite the opposite, that is, to present to investors the kind of hospitable climate that would insulate them from political risks or incidents of unfair treatment. Yet Canada's reading of Article 1105 would raise just those concerns – it would permit a NAFTA Party to take measures against investors and investments from other NAFTA countries that its domestic law would prevent it from taking against its own investors and investments and that BITs would preclude taking against investors and investments from a number of other countries. It is difficult to believe that the drafters of NAFTA consciously intended such a result, and, as noted, Canada, Mexico and the United States have provided no evidence whatsoever that they did.

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<sup>114</sup> See *Vienna Convention* Article 31 (3). Canada agreed with the importance of context in the interpretation of NAFTA. See *e.g.*, November 2000 Tr., Vol. II at 19:17 – 20:5.



117. In addition to the context, object and purpose of NAFTA, there is a practical reason for adopting the additive interpretation to Article 1105. As noted, the contrary view of that provision would provide to NAFTA investors a more limited right to object to laws, regulation and administration than accorded to host country investors and investments as well as to those from countries that have concluded BITs with a NAFTA party. This state of affairs would surely run afoul of Articles 1102 and 1103, which give every NAFTA investor and investment the right to national and most favoured nation treatment. NAFTA investors and investments that would be denied access to the fairness elements untrammelled by the "egregious" conduct threshold that Canada would graft onto Article 1105 would simply turn to Articles 1102 and 1103 for relief.
118. The Tribunal is unwilling to attribute to the NAFTA Parties an intention that would lead to such a patently absurd result.<sup>115</sup> Accordingly, the Tribunal interprets Article 1105 to require that covered investors and investments receive the benefits of the fairness elements under ordinary standards applied in the NAFTA countries, without any threshold limitation that the conduct complained of be "egregious," "outrageous" or "shocking," or otherwise extraordinary.<sup>116</sup> For this reason, the Tribunal will test Canadian

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<sup>115</sup> See *Vienna Convention* Article 32.

<sup>116</sup> Of course, the minimum standards reach of Article 1105 would protect NAFTA investors and investments against such conduct, even in the unlikely event it was ordinary within a NAFTA Party.

implementation of the SLA against the fairness elements without applying that kind of threshold.<sup>117</sup>

**B. Application of Article 1105**

119. The Investor challenges several elements of the Regime under Article 1105:

**1. New Entrants**

120. As noted above, an important part of the implementation of the SLA was provision for new entrants.<sup>118</sup> In October 1996 Canada issued a new entrant questionnaire to more than 2,000 primary producers and remanufacturers in the covered provinces; 218 of those companies made application for new entrant status. Those applicants requested approximately 8.3 billion board feet in quota, which far exceeded the reserve of 628 million board feet that had been set aside for new entrants by the minister, after consultation with the provincial governments and the softwood lumber industry as a whole. Because of the extreme disparity between the reserve and total allocations requested by new entrant applicants, very rigorous qualifications for eligibility were established. The Investor did not apply for new entrant status and consequently received no new entrant quota.

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<sup>117</sup> Under the circumstances of this case, the Tribunal's determination makes it unnecessary to review the many precedents stretching back into the early days of the Twentieth Century to divine the current content of the international minimum standard. It is also unnecessary to consider separately the claims advanced by the Investor (described in paragraph 107 above) as to the contents of that standard.

<sup>118</sup> This provision came from a set-aside of a portion of the year 1 EB and LFB quotas and from trigger price bonuses subsequently earned.

121. The Investor complains that the result of the allocation of new entrant quota was to move quota away from B.C. and in particular to remove it to Quebec. It is correct that the higher share of new entrant allocations went to Quebec. But as the Tribunal notes above,<sup>119</sup> this was the result of the fact that, when the SLA came into effect, various economic factors had been causing greater investment in new manufacturing capacity in Quebec than in B.C. Accordingly, the grant of new entrant quota allocations reflected the pattern of where the new capacity had been created. To have restricted the grant of quota according to historically agreed patterns for existing production would have prevented many new entrants from receiving an appropriate share of what was a relatively small quota. The Tribunal does not consider that, by acting in this way, Canada behaved unfairly or inequitably to the Investment.

## **2. Transitional Adjustment**

122. The one-time transitional adjustment quota was devised in order to deal with the problem created by the fact that, while the SLA came into effect on April 1, 1996, quotas were not allocated until October of that year. As a result, some companies had almost fully used their quota allocations in the first part of the year. The transitional adjustment enabled a company to borrow against its year 2 quota, effectively using more quota in year 1 and suffering a reduction in year 2. This was a once only adjustment, and the quota allocated in this manner was returned to the pool for distribution in year 2 amongst companies that had

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<sup>119</sup> See ¶¶ 89 – 93 above.

not borrowed in this way. The Investor did not request or receive any allocation of transitional quota in year 1. It did receive its share of the returned quota in year 2.

123. The Investor complains that these transitional provisions benefited companies that "rushed the border" during the early months of the SLA and thereby reduced the year 1 quota for companies, like itself, that exercised restraint. The Tribunal considers that Canada's operation of the transitional adjustment to the quota system was a reasonable response to the circumstances described above and did not deny the Investment fair and equitable treatment.

### 3. Wholesaler Issue

124. The Investor also alleges that Canada acted in an unfair and arbitrary manner with respect to allocation of quota to the Investment by reason of its dealing with the wholesaler issue. The matter arises in this way. When Canada decided not to assign quota allocations directly to wholesalers, it had to devise a method to ensure that exports by wholesalers were properly allocated to primary producers and remanufacturers. Primary producers and remanufacturers could and did report sales to Canadian wholesalers on their questionnaires; they could not, however, know how much of their lumber Canadian wholesalers actually exported to the United States. Canada relied on the questionnaires of wholesalers for that information and developed a system of allocating those sales to the various supplying primary producers and remanufacturers.<sup>120</sup>

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<sup>120</sup> Valle 2<sup>nd</sup> Affidavit, October 6, 2000 at ¶¶75-77.

125. The Investor complains that Canada's approach did not achieve accurate numbers for wholesaler exports and that, in applying the wholesaler data to modify quotas held by primary producers and remanufacturers, Canada took the lower of the amounts reported by the wholesalers and the producers. The Tribunal notes that, in the case of the Investment, neither alleged defect in the program had any adverse effect, since the Investment had reported on its questionnaire responses all exports, directly or through wholesalers, as direct exports.<sup>121</sup> In any event, the Tribunal finds that the approach taken by Canada was a reasonable response to the difficulty with which it had to deal and cannot be characterized as unfair or inequitable.

#### 4. B.C. Adjustment

126. In 1997, the Minister approved a special reallocation for 13 B.C. companies, which was taken from the EB quota of other B.C. producers, including the Investment. The reallocation was to offset certain errors and omissions, which the B.C. Softwood Lumber Advisory Committee characterized as principally due to wholesaler error and the Canadian government officials considered to be largely related to the application of the B.C. averaging criteria. It appears to the Tribunal that what gave rise to the need to adjust was a variety of errors and other factors applicable to the individual companies involved.

127. The Investor complained that the adjustments meant a reduction in the Investment's EB quota of some % for year and that that reduction was not

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<sup>121</sup> See Tab 39.

justified by the alleged errors, omissions and hardships. The Investor also asserts that the effects of those adjustments should have applied to all producers in the covered provinces, not just to those in B.C.<sup>122</sup>

128. The Tribunal concludes that the adjustments were a reasonable response to perceived errors, omissions and hardships, and cannot be said to violate principles of fairness and equitable treatment. The application of the effects of those adjustments to B.C. producers only was also reasonable, given the view that at least a significant element of the justification was considered to be the B.C. averaging criteria (which were not applicable in other provinces) and that, to confine those effects to B.C. producers, was what the B.C. Committee had recommended.<sup>123</sup> For these reasons, the Tribunal does not consider that Canada acted in an unfair and inequitable manner in making the B.C. adjustments.

##### 5. Super Fee

129. The background is that in each province charges, known as stumpage fees, are made for timber cut on Crown lands. The rates were fixed by the provincial

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<sup>122</sup> The Investor also suggests that the Investment should have been accorded treatment no less favorable than that given to the beneficiaries of the adjustments. The Tribunal finds that, since the Investment never argued that it was the victim of any error, omission or hardship, it is not in like circumstances to those beneficiaries.

<sup>123</sup> The Tribunal notes that the application of the B.C. averaging formula to the Investment was in fact to its advantage since it, unlike others who were involved in the adjustment exercise, had not suffered a significant drop in exports to the United States between 1994 and 1995.

governments and varied considerably. In B.C. different stumpage rates were fixed for the coastal region and the interior.<sup>124</sup>

130. It will be recalled that the Regime operated initially on the basis that softwood lumber producers in the four covered provinces were entitled to export lumber to the United States at three levels.<sup>125</sup> First at EB in which case no fee was charged. Above that was the LFB in which category a fee of \$50 per thousand board feet was charged. Beyond that, at UFB a fee of \$100 per thousand board feet was payable. Both fee levels were subject to change to take account of inflation. Relevant producers were assigned EB and LFB quota, but there was no limit on UFB exports. Further quota allocations were made to the relevant companies in respect of returned allocations and also for Trigger Price Bonuses, when the price of lumber in the United States exceeded specified levels.<sup>126</sup> Producers in the covered provinces that produced less than 10,000,000 board feet annually were not exempt from paying LFB and UFB fees but were not subject to the "speed bump" provisions designed to even out exports.<sup>127</sup>
131. Overall, the SLA permitted annual exports of 14.7 billion board feet of softwood lumber at EB level from the covered provinces, not including any trigger price bonuses. The LFB level applied to the next 650 million board feet. In the event,

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<sup>124</sup> Smyth, *Impact of U.S. and Japanese Consumption and North American Supplies on Softwood Lumber Price 1991 to 2001*, Tab 293, Table 81.

<sup>125</sup> George 2nd Affidavit March 27, 2000 ¶¶ 10-16; McDonald Affidavit March 24, 2000 ¶ 53. *See also* Notice to Exporters 94 October 31, 1996, Tab 227.

<sup>126</sup> George 2nd Affidavit ¶¶ 66-69.

<sup>127</sup> George 2<sup>nd</sup> Affidavit ¶¶ 45-48.

EB was reduced to 14,186,000,000 board feet after making deductions for new entrants' reserve, transitional adjustment and ministerial reserve, and LFB was similarly reduced to 490,000,000 board feet.<sup>128</sup> B.C. was allocated a 59% share of the adjusted totals at each level.<sup>129</sup>

132. On June 1, 1998 the BC government reduced stumpage fees for timber cut on Crown lands both on the coast and the interior. The U.S. government invoked the dispute resolution provisions of the SLA, making the claim that this reduction had the effect of subsidizing the production and export of lumber from BC and was thus inconsistent with the SLA. Canada disputed this and claimed that changes in forest management practices were not covered by the SLA.<sup>130</sup> The dispute was taken before an arbitration panel, which conducted an oral hearing in March 1999.
133. On August 26, 1999, just prior to the panel's scheduled decision, Canada and the United States reached an agreement to end the dispute by amending the SLA to (a) reprice 90 million board feet of B.C. lumber from the LFB rate of \$52.93 per 1000 board feet to the UFB rate of \$105.86; (b) limit B.C. export of UFB (including the repriced LFB) to 110 million board feet and (c) create a new Super

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<sup>128</sup> Ministerial Announcement of September 10, 1996, Tab 52; Valle 2<sup>nd</sup> Affidavit October 6, 2000 at ¶ 96; Smyth, *op. cit.*, at 232 and Table 56.

<sup>129</sup> See Valle 1<sup>st</sup> Affidavit, March 27, 2000 at ¶ 107.

<sup>130</sup> Submission of United States before SLA Arbitral Panel, Tab 261 at ¶¶ 21-22; Counter Submission of Canada, Tab 262 at ¶¶ 30-33.



Fee Base for all additional exports by B.C. companies at the level of \$146.25 per 1,000 board feet.<sup>131</sup>

134. On October 21, 1999 the Governor General of Canada in Council promulgated an Order in Council issuing Regulations amending the Softwood Lumber Products Export Permit Fees Regulations.<sup>132</sup> The effect of the amendment was that, with respect to softwood lumber products first manufactured in B.C. and exported on or before March 31, 2000, the fees to be paid by the exporter for a permit were:

- (a) for LFB exports of 90,000,000 board feet, at a rate equivalent to UFB ;
- and
- (b) for UFB exports in excess of 110,000,000 board feet, \$146.25 per 1,000 board feet.

135. In relation to softwood lumber products first manufactured in B.C. and exported during the year beginning April 1, 2000 the fee to be paid for a permit was:

- (a) at a rate equivalent to the UFB for the greater of:
  - (i) LFB exports of 90,000,000 board feet or
  - (ii) LFB exports that exceed 272,000,000 board feet.
- (b) for UFB exports in excess of 110,000,000 board feet, the sum of the UFB and \$40.39 per 1,000 board feet.

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<sup>131</sup> Exchange of letters Canada - United States dated August 26, 1999, Tab 179.

<sup>132</sup> Regulations amending the Softwood Lumber Products Export Permit Fees Regulations October 21, 1999, Tab 191.

136. The result of the amendment made in October 1999 can be summarized as follows:

- (a) EB levels were unaffected by the amendment.
- (b) LFB quota was divided. Approximately 75% was treated as LFB at the previously fixed rate.
- (c) As to the remainder, LFB quota up to the level of 90,000,000 board feet was repriced at what had been the UFB level ("RLFB").
- (d) For exports between that figure and 110,000,000 board feet (available on a first-come, first-served basis except for a small reserve) the UFB level remained as before.
- (e) Above that level a new super fee price was imposed amounting to \$146.25 per 1000 board feet.<sup>133</sup>

These arrangements applied only to softwood lumber first manufactured in B.C.

137. The allocations actually made to the Investment (taking into account the modifications introduced by the Super Fee Regime) were as follows (Year 1 is the period from April 1, 1996 to March 31, 1997).<sup>134</sup>

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<sup>133</sup> Notice to Exporters No. 120 September 3, 1999 Tab 233.

<sup>134</sup> George 3rd Affidavit, October 4, 2000, Annex A.

	Year 1	Year 2	Year 3	Year 4	Year 5
EB					
LFB					
RLFB	-	-	-		
Returned Allocation	-		-	-	
Trigger Price Bonus	-		-		

138. Over that period the actual fee payable in respect of each category was raised so that it had reached \$52.93 per thousand board feet for LFB and \$105.86 per thousand board feet for UFB by Year 4.<sup>135</sup>

139. In year 4, the Super Fee regime reduced the Investment's LFB allocation by [redacted] board feet. The remaining [redacted] board feet became repriced LFB (or RLFB). Those allocations remained the same for year 5. The financial consequence for year 4 was to impose a further fee of some [redacted] on the Investment if it exported lumber up to the level of its year 3 LFB allocation of [redacted] board feet.

140. The Press Release issued by the Government of Canada headed "B.C. Stumpage Fees: Canada - U.S. Settlement" dated August 30, 1999 stated "At current volumes these changes will affect about 1 per cent of B.C.'s total lumber exports to the United States."<sup>136</sup>

<sup>135</sup> Press release by Canada August 30, 1999, Tab 249.

<sup>136</sup> Tab 249.

141. B.C.'s changes made to its stumpage fees that took effect from June 1, 1998 reduced the rate payable at the coast by an average of Can \$8.10 per cubic metre and in the interior by Can \$3.50 per cubic metre.<sup>137</sup> As at the first quarter 2000 the average stumpage rate for softwood sawtimber was at the coast Can \$26.67 and in the interior Can \$31.12.<sup>138</sup> The Investment was an interior producer.

142. In its answer to the questions posed by the Tribunal in relation to Super Fee, Canada stated:

Neither Canada nor the BC government contemplated allocating the super fee based [on] the relative reduction in stumpage charges between coastal and interior producers. The super fee base, like the LFB and UFB, was intended to act as an export restraint for all exporters of softwood lumber first manufactured in BC - not as a direct offset to stumpage decreases. None of these fees differentiates between coastal and interior BC producers.<sup>139</sup>

143. In each of the first three years of the SLA the Investment fully used its allocation of EB and LFB quota. In year 1 it exported                      board feet at UFB rates. In year 3 it exported                      at UFB rates.<sup>140</sup> In that year the total exports from B.C. at UFB levels amounted to                      board feet. The Investment thus exported approximately                      of all UFB exports from

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<sup>137</sup> George 3<sup>rd</sup> Affidavit ¶ 124.

<sup>138</sup> Smyth, Tab 293, Table 81.

<sup>139</sup> Canada's submission of documents responding to the Tribunal's Document Requests made on June 26, 2000, at 16.

<sup>140</sup> See George 3<sup>rd</sup> Affidavit, Annex A.

- B.C. in that year. One other company, \_\_\_\_\_ exported at a higher level. It was a producer on the coast and was Canadian owned.<sup>141</sup>
144. In August 1999 Canada was aware that the repriced LFB was set at a level at which it was uneconomic for many B.C. companies to ship lumber. To address this problem in year 4 producers were allowed to return up to 25% of their LFB quota in order to bring their entire LFB shipments within 75% of their original LFB quota, thus enabling them to avoid paying for any lumber exported at the RLFB level.<sup>142</sup> The Investment did not return any quota at any stage.<sup>143</sup> In year 4 it exported \_\_\_\_\_ board feet. It received an allocation of \_\_\_\_\_ board feet as its share of trigger price bonus. In addition it exported \_\_\_\_\_ board feet at Super Fee Level.<sup>144</sup>
145. Canada estimated that the overall effect of B.C.'s stumpage reduction, across coastal and interior producers combined, amounted to a reduction of \$14.44 per thousand board feet. The negotiated increase in relation to the Super Fee was of the order of \$40.00 per thousand board feet.<sup>145</sup>

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<sup>141</sup> George testimony Nov. 2000 Tr., Vol. VI 22:2-15; Vol VII 50:14-25.

<sup>142</sup> See George 2<sup>nd</sup> Affidavit ¶ 121. In prior years the limit was set at 10%.

<sup>143</sup> George 2<sup>nd</sup> Affidavit ¶111.

<sup>144</sup> George 3<sup>rd</sup> Affidavit Annex A.

<sup>145</sup> George testimony Nov. 2000 Tr., Vol. VI 40:4-15; see also Canada's Submission of Documents Requested by the Tribunal Tab 72.

146. Canada was aware of the concerns of non-quota holders in B.C. who had always been required to export lumber at the UFB level and were now faced with fees of \$146.25 if required to export at the Super Fee Base. Accordingly, in respect of year 4, out of the 20,000,000 board feet permitted to be exported at UFB level (being the difference between 90,000,000 repriced LFB and the maximum UFB of 110,000,000 board feet), 2,000,000 board feet were reserved for those who had no quota.<sup>146</sup>
147. Canada was also aware that the Investment's UFB shipments in year 3 were over \_\_\_\_\_ of the B.C. total and that, therefore, the methodology adopted would have a particularly adverse effect upon it should it continue to make UFB shipments at those levels. The other large shipper at UFB levels in year 3, \_\_\_\_\_ being a coastal producer benefited from the greater reduction in stumpage rates applicable to its timber. Canada consulted neither company about the imposition of the Super Fee; although Canada did consult with the industry associations of which they were members.<sup>147</sup>
148. Canada did consider whether certain types of companies should be exempted from the operation of the Super Fee altogether, including the Investment, but decided not to do so.<sup>148</sup>

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<sup>146</sup> George testimony Nov. 2000 Tr., Vol. VI 42:1-3, 49:20 – 50:2 and 52:6-25.

<sup>147</sup> George testimony Nov. 2000 Tr., at Vol. VI 22-31, 37.

<sup>148</sup> George testimony Nov. 2000 Tr., at Vol. VI 42 - 45.

149. In briefing the Minister in relation to the settlement of the stumpage fee dispute between Canada and the United States, Canada's officials drew the his attention to the existing Chapter 11 arbitration between the Investor and Canada and suggested that the Investor might seek to include the Super Fee issue. It was there stated that if so, Canada's defense would be based on the fact that the Investment was being treated on the same basis as other B.C. companies.<sup>149</sup> In the November 2000 hearing Canada stressed that point.<sup>150</sup> Canada also pointed out that the settlement was supported by B.C.'s softwood lumber industry.<sup>151</sup>

150. The Investor, on the other hand, argues that the effect of the Super Fee measures was to act as an export restraint in a manner that was unfair and inequitable. It was directed against a small proportion only (1% on Canada's estimate) of the B.C. softwood lumber industry's exports to the United States. It had no effect at all on those who confined their export of lumber within the EB base and the 75% of the LFB base that was not repriced. Companies in that category remained able to export at the fixed fees previously set and with the advantage of the reduction in their costs due to the stumpage reduction.

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<sup>149</sup> Action Memorandum for the Minister for International Trade, August 18, 1999, Tab 255 at ¶ 12.

<sup>150</sup> Phase 2 Counter-Memorial ¶¶ 164-165.

<sup>151</sup> Phase 2 Counter-Memorial ¶ 172.

151. The Investor also argued that the Investment was one of 132 B.C. companies liable to be affected by the repricing of a portion of the LFB quota. In the whole of Canada it ranked in terms of the size of its quota allocation.<sup>152</sup> It held approximately % of the B.C. LFB quota allocation. In year 3 it was much the largest exporter at UFB level from the interior region. In year 3, the Investment was responsible for over % of exports from B.C. for which a fee was exigible, *i.e.*, both LFB and UFB rates. Against this background the Tribunal believes that Canada must have been aware of the special significance to the Investment of the choices it made to settle the B.C. stumpage dispute with the United States

152. Canada's further response to the Investor's argument was in the first place that the Investment's history of UFB exports showed no consistency. It was in any event for a particular company to choose whether to export and pay the relevant fee or not to do so. Further, the level of fee was fixed as part of the U.S.-Canada agreement to settle the stumpage dispute between them and it was not for Canada to vary that agreement. That last argument however does not accord with the evidence of George<sup>153</sup> that Canada did consider exempting certain classes of exporter, including the Investor, but decided not to do so, except to a limited extent in relation to those who had no quota.

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<sup>152</sup> Vertinsky Affidavit ¶ 9.

<sup>153</sup> George testimony, Nov. 2000 Tr., Vol. VI at 42:11 - 46:20.



153. The question is whether the treatment accorded to the Investment in relation to the Super Fee was fair and equitable. All softwood lumber producers in B.C. benefited to some extent from the reduction of stumpage rates in the province, but the only producers who were to a degree penalized were those who had been allocated quota at LFB rates or who for whatever reason exported in excess of quota, amounting in all to some 1% of B.C. lumber exports.
154. The fact that only a very small percentage of the exports would attract the new Super Fee level is not an argument for disregarding those exporting at that fee level. Quite to the contrary. Similarly, the fact that the B.C. lumber industry as a whole supported the settlement should carry little weight, since only 1% of exports was to be affected.
155. The choice made to resolve the B.C. stumpage dispute through the Super Fee undoubtedly required certain exporters to pay a price for a benefit accorded by B.C. to all producers in that province.<sup>154</sup> Therefore, Canada might have chosen another approach to settlement, one that shared the burden more equitably across the range of B.C. producers that received the benefits of the stumpage reductions. However, it is not the place of this Tribunal to substitute its judgment on the choice of solutions for Canada's, unless that

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<sup>154</sup> Some 40% of all the producers in B.C. fell into the category of users of LFB; the Super Fee settlement required them to pay a fee of approximately double on 25% of their LFB exports. Two producers, of which the Investment was one, accounted for about 1% of UFB shipments in year 3, and they would be required by the Super Fee settlement to pay in year 4 an additional \$40 per thousand board feet to make those shipments if they wanted to do so.

choice can be found to be a denial of fair and equitable treatment. Given the large number of B.C. producers affected by the settlement as well as the hierarchical treatment of shipment levels under the SLA itself, the Tribunal cannot conclude that Canada's decision to apportion the costs as it did was a denial of fair and equitable treatment to the Investment.<sup>155</sup>

## 6. Verification Review Episode

156. On December 24, 1998, the Investor served upon Canada a Notice of Intent to Submit a Claim to Arbitration under Article 1119 of NAFTA. That filing triggered a review by Canada's Softwood Lumber Division ("SLD")<sup>156</sup> of the Investor's claim that its Investment had not received the quota allocation to which it was entitled.<sup>157</sup> That review discerned that the Investment's questionnaire responses (submitted as required by the Regime) stated that it had sold about 10% more lumber than it produced for the years 1994 and

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<sup>155</sup> Because the Tribunal reaches this conclusion, it is unnecessary to address the question whether, in the case of the Super Fee settlement, the Investor's challenge is to the implementation of the SLA or to the SLA itself.

<sup>156</sup> The SLD is a division of the Export and Import Controls Bureau within Canada's Department of Foreign Affairs and International Trade. The SLD assists in the administration of the Softwood Lumber Export Restraint Program, which is the implementation for Canada of the Softwood Lumber Agreement with the United States; that implementation is known as the Softwood Lumber Regime (the "Regime"). See Affidavit of Douglas George dated November 26, 1999 ("George 1") at ¶¶ 1-2.

<sup>157</sup> *Id.* at ¶ 44. While George refers to the filing of the "Statement of Claim," that document was not filed until March 25, 1999. Since he acknowledges that his earliest letters on the issue (sent in January and February, 1999) were triggered by his awareness of the Investor's Claim, he must be referring to the December 24, 1998 notice of intent. See George testimony, Nov. 2000 Tr. Vol. VI 95:22 – 98:25. Indeed, he said he was first made aware of the Investor's "NAFTA complaint" around Christmas 1998. See *id.*, Vol. VIII at 9:25 – 10:8.

1995.<sup>158</sup> That difference was viewed as a discrepancy by the SLD, and, by letter dated January 26, 1999, it asked the Investment for an explanation.<sup>159</sup>

157. That letter was, in fact, the second inquiry the Investment had received from the SLD concerning the production/sales imbalance. Well before the December 24, 1998 Notice of Intent, the SLD had raised the matter by telephone with the Investment, which, in response, explained that the imbalance was due to invasions of inventory. The then Director of the SLD took the "explanation at good faith and did nothing further."<sup>160</sup>

Consequently, it is not surprising that the Investment's response to the January 26, 1999 letter was to reiterate its earlier explanation that "inventories were significantly reduced during the periods covered in the questionnaire." The response also pointed out that Arthur Andersen had audited the company's sales and production data.<sup>161</sup>

158. The next communication from the SLD could hardly have been more different from the earlier telephonic exchange, when the Investment's assurances were taken in good faith. By letter dated February 25, 1999, the

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<sup>158</sup> *Id.* at ¶ 45.

<sup>159</sup> *Id.* at ¶ 48. At that time, the perceived discrepancy between production and sales was the sole question in the minds of the SLD officials in reviewing the Investment's questionnaire responses. *See* George testimony Nov. 2000 Tr., Vol. VIII at 13:12-23.

<sup>160</sup> *See* Valle testimony Nov. 2000 Tr., Vol. IX at 115:17 – 117:6.

<sup>161</sup> Letter from McGrath to George, dated February 5, 1999. This letter and the others cited in this section of the Tribunal's decision were submitted as exhibits to the Affidavit of Douglas George dated November 26, 1999, which, in turn, was attached to Canada's Reply to Claimant's Motion for Interim Measures, dated the same day.

SLD stated that the February 5 reply did not provide sufficient information to address the government's "concerns" and reminded the Investment that its data could be subject to verification and access by government officials to company information. It requested responses to a series of questions, including shipments made through wholesalers, information not strictly pertinent to the production/sales discrepancy. The letter requested a two-week turnaround, as the SLD was "preparing allocations for Year 4."<sup>162</sup>

159. The Investment replied by fax on March 12, 1999, providing answers to each of the questions posed by the SLD. The response also volunteered that total shipments had been overstated (by less than % for each of 1994 and 1995) in the company's questionnaire responses, due to the inclusion of intra-mill transfers. On the other hand, shipments to the United States had been understated, based upon the Investment's refinement of its allocation of shipments to wholesalers based upon historical performance. Overall, these two "oversights" yielded a small understatement of shipments for both 1994 and 1995 in the questionnaire responses, *i.e.*, to the Investment's disadvantage. The letter stated that the company had "reams and reams of voluminous sales reports which you are welcome to review," and it closed by reiterating, "if you need access to the above reference (sic) sales reports please do not hesitate to call."<sup>163</sup> The Investment's response did not change its

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<sup>162</sup> Letter from George to McGrath, dated February 25, 1999.

<sup>163</sup> Letter from McGrath to George, dated March 12, 1999.

explanation of the production/sales discrepancy that had triggered SLD's inquiry, *i.e.*, that it was due to invasion of inventory.

160. Despite the purported urgency of the matter, the SLD did not respond for almost a month. On April 7, 1999, it faxed a letter to the Investment, notifying it of the decision to institute a "verification review" with respect to the questionnaire responses. The verification was scheduled for April 28-30 and was to include a review of the responses, related systems, procedures, supporting documentation and quota transfers.<sup>164</sup> On April 12, the Investor responded by inviting the verification team to its head office in Portland Oregon, where the records to be reviewed were located, thereby implicitly confirming the verification dates.<sup>165</sup>
161. At that juncture, one could not reasonably conclude that the Investment had been anything less than fully cooperative with the SLD. It made no complaints that the production/sales issue had been resolved previously, it promptly responded to broad inquiries going beyond that issue, it volunteered minor corrections to its questionnaire responses and it willingly accepted a very extensive verification exercise.<sup>166</sup> Unfortunately, matters thereafter took a substantial turn for the worse.

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<sup>164</sup> Letter from George to McGrath, dated April 7, 1999.

<sup>165</sup> Letter from Gray to George, dated April 12, 1999.

<sup>166</sup> The head of the SLD acknowledged that, at that time, the Investor was unaware of any policy that verification had to take place in Canada and that the Investor's April 12 letter was just pointing the SLD to the location of the documents. *See* George testimony Nov. 2000 Tr., Vol. VI at 105:25 - 106:9.

162. On April 13, 1999, the SLD wrote the Investment stating that "we require this information to be made available in Canada." Further, the requested information expanded to include bank statements and accountants' working papers.<sup>167</sup> At that point, the Investment turned the matter over to its lawyer in this NAFTA Chapter 11 proceeding and asked that further discussion of verification be through him.<sup>168</sup> The SLD responded that there was no linkage between verification and the NAFTA claim and requested confirmation by April 23, 1999 that the requested documents would be on hand in Grand Forks, B.C. on the appointed date of April 28, 1999.<sup>169</sup> The following day, the Investment's lawyer wrote to the SLD questioning the agency's authority to conduct a verification review or to require records to be made available in Canada. He stated that "[n]onetheless, we are prepared to deal with your request through a NAFTA Article 1118 consultation."<sup>170</sup>
163. SLD rejected every element of the proposals by the Investment's counsel. It again denied any relationship between the NAFTA claim and verification, it rejected the request to discuss verification through the Investment's counsel, it rejected the proposed Article 1118 consultation, and it reasserted its demand that the documents be produced in Canada. It strongly suggested

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<sup>167</sup> Letter from George to McGrath, dated April 13, 1999.

<sup>168</sup> Letter from Gray to George, dated April 20, 1999.

<sup>169</sup> Letter from George to Gray, dated April 21, 1999.

<sup>170</sup> Letter from Appleton to George, dated April 22, 1999.

that failure to cooperate could be disastrous for the Investment: "Otherwise, the Minister could either determine a new quota allocation \*\*\* or, because it [sic] cannot verify the answers in the questionnaire, and the correctness of the allocation based upon them, it is possible that the Minister may not be able to award any additional quota to the company" when allocations were made for Year 4 of the program.<sup>171</sup>

164. What followed during the remainder of April, 1999, was a flurry of correspondence between the Investor's counsel and elements of the Canadian government, including the SLD. For present purposes, only two points from these letters is material. First, counsel for the Investor stated:

At no time have we or our clients refused your Ministry's request for a review of Pope & Talbot's relevant records. Rather, we have attempted to find a solution that satisfies your Ministry's request in an expeditious manner that is also fair and reasonable to our clients.<sup>172</sup>

165. For its part, the SLD stated that that comment and other points would be brought to the attention of the Minister, as would any further comments submitted by May 4, 1999.<sup>173</sup> The Investor's counsel accepted that offer and submitted a letter protesting the requirement that the records be shipped to Canada and the use of a threat to deny the company any quota for Year 4. He also asked for a copy of the "policy and regulations under the [Softwood

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<sup>171</sup> Letter from George to Appleton, dated April 23, 1999.

<sup>172</sup> Letter from Appleton to de Pencier, dated April 29, 1999.

<sup>173</sup> Letter from George to Appleton, dated April 30, 1999.

Lumber] Agreement" that the SLD asserted as justification for its verification demands.<sup>174</sup>

166. After further extensive correspondence on modalities and parameters, verification took place in Vancouver on July 13-16, 1999. One of the agreed bases for agreement on verification was the willingness of Canada to provide an explanation of the allocation system since 1996. Both sides agreed that the verification team did not include someone knowledgeable on that matter, and attempts were made to schedule a meeting to that end.<sup>175</sup> On October 6, 1999, almost 12 weeks after the verification review, the SLD wrote the Investment, advising that the verification "revealed a number of systemic errors" and "discrepancies between amounts shown on invoices and the amounts reported on your questionnaire as well as a possibility that there may have been double counting." These problems necessitated that the Investment submit a revised questionnaire.<sup>176</sup>
167. The Investor protested, noting its expectation that the SLD would have provided preliminary findings from the review before taking action. The Investor asked to know the exact nature and magnitude of any errors and requested copies of the various reports and working papers that supported the conclusions summarized in the communication requiring a new

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<sup>174</sup> Letter from Appleton to George, dated May 3, 1999.

<sup>175</sup> See letter from George to McGrath, dated August 5, 1999.

<sup>176</sup> Letter from George to McGrath, dated October 6, 1999.



questionnaire response.<sup>177</sup> The SLD replied by offering to make further explanation by telephone, but stating that, unless the revised questionnaire was received by November 8, 1999, the matter would be referred to the Minister for International Trade.<sup>178</sup>

168. The Investor replied by asserting that it had not refused to submit a revised questionnaire, but was only seeking the information that had been promised. It asked for a meeting with the Minister to discuss the matter.<sup>179</sup> The SLD replied by advising that they would recommend that the Minister revise quota allocations with or without the Investment's new questionnaire, that a new questionnaire would have to be filed by end of business on November 15, 1999 and that the Minister would be informed of the request for a meeting.<sup>180</sup>
169. On November 11, 1999, the Investor filed a Motion for Interim Measures to this Tribunal asking for a standstill order preventing any changes to the Investment's quota allocation until the final determination of all matters in this arbitration.
170. After extensive submissions by the parties and testimony received at a hearing on January 6-7, 2000, the Tribunal concluded that the interim

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<sup>177</sup> Letter from Appleton to George, dated October 25, 1999.

<sup>178</sup> Letter from George to Appleton, dated November 3, 1999.

<sup>179</sup> Letter from Appleton to George, dated November 5, 1999.

<sup>180</sup> Letter from George to Appleton, dated November 9, 1999.

measures requested were beyond its jurisdiction. The Tribunal went on to observe, however, that “the verification review and the report thereon were seriously flawed and are not a reliable basis for further action [by Canada].”<sup>181</sup> As far as the Tribunal is aware, the SLD has taken no action based upon the verification.

171. The Investor contends that Canada’s conduct during this “verification episode” was a denial of fair and equitable treatment in violation of Article 1105.<sup>182</sup> For the following reasons, the Tribunal agrees.

172. A major sticking point on verification was the unwillingness of the SLD to conduct its review at the place where the documents were located. As both sides agree, the volume of the requested documents was large, a number of truckloads; moving them would be a substantial and disruptive burden. The SLD simply advised the Investment that the proposal to conduct verification in Portland was “not acceptable,” but gave no reasons why.<sup>183</sup> During the November 2000 hearing the head of the SLD during 1999 stated that he had no authority to conduct verification outside Canada, but he could point to no regulation, written policy or other credible basis for that proposition.<sup>184</sup>

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<sup>181</sup> Ruling on Claimant’s Motion for Interim Measures, dated January 7, 2000.

<sup>182</sup> See Phase 2 Memorial of the Investor at ¶ 220.

<sup>183</sup> See letter from George to Appleton, dated May 4, 1999.

<sup>184</sup> See George testimony Nov. 2000 Tr., Vol. VI at 105:5 – 116:24.

Indeed, the former head of the SLD saw no legal reason preventing verification outside Canada.<sup>185</sup>

173. The Tribunal finds that the SLD's position on this issue cannot be explained by reasonable legal concerns and that, even if there were legitimate concerns about its authority to conduct a review outside Canada, the SLD made no effort to deal with the problem with an intent to alleviate the admitted burden that verification in Canada would cause the Investment. What comes through the communications is, instead, the SLD's imperious insistence on having its way.

174. As noted, the Investment was initially willing to undergo a verification review in Portland; however, in correspondence after the SLD rejected that approach, the Investment began to ask whether the SLD had the authority to require verifications in the first place.<sup>186</sup> The SLD refused to provide any kind of legal justification, relying instead on naked assertions of authority<sup>187</sup> and on threats that the Investment's allocation could be canceled, reduced or suspended for failure to accept verification.<sup>188</sup>

175. However, on the very day the SLD was telling the Investment that the "Government acts under lawful authority" in requiring verification

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<sup>185</sup> See Valle testimony Nov. 2000 Tr., Vol. IX at 120:2 – 121:20.

<sup>186</sup> See, e.g., letter from Appleton to George, dated April 22, 1999.

<sup>187</sup> See letter from George to Appleton, dated June 2, 1999.

<sup>188</sup> See, e.g., letter from George to Appleton, dated April 29, 1999.

reviews,<sup>189</sup> it was telling the Minister: "As neither the EIPA nor the EIPA regulations authorize verifications specifically, the Department of Justice is preparing a legal opinion on the question."<sup>190</sup> While good faith reliance on the SLD's legal authority was not improper, it appears to the Tribunal that, before seeking to bludgeon the Investment into compliance, the SLD should have resolved any doubts on the issue and should have advised the Investment of the legal bases for its actions.

176. The SLD told the Investment that verification was intended "to develop a clear understanding of the type and scope of the errors in the original questionnaire, in order that a revised and corrected questionnaire can be submitted as soon as possible."<sup>191</sup> Shortly before verification took place, the Investment sought to confirm that purpose,<sup>192</sup> and the SLD made no change to its earlier formulation. After verification was completed on July 16, the SLD did nothing for 12 weeks to apprise the Investment of its findings concerning the results of the review. Even then, instead of informing the Investment of specific problems that arose in the review, the SLD gave only

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<sup>189</sup> Letter from George to Appleton, dated June 2, 1999.

<sup>190</sup> Memorandum from SLD to Minister, dated June 2, 1999, at ¶ 19. The Tribunal and the Investor received this document and a later one (November 25, 1999) on the same subject only on November 16, 2000, well into the Phase 2 hearings. Canada offered no explanation why they had not been produced earlier, particularly prior to the hearing on interim relief in January 2000, where they were extremely material. The head of the SLD admitted that he was aware of the document at that time. George testimony Nov. 2000 Tr., Vol. X at 17:9-18.

<sup>191</sup> Letter from George to Laird, dated May 13, 1999.

<sup>192</sup> See letter from Appleton to George, dated July 2, 1999.

general comments, like the conclusion that the verification "revealed a number of systemic errors," and that the "verification team discovered discrepancies between amounts shown on invoices and the amounts reported on your questionnaire."<sup>193</sup> The only specific comments were directed towards intra-mill transfers, which the Investment had detected and voluntarily reported eight months before.<sup>194</sup>

177. In appraising the fairness of the SLD's position on verification, the Tribunal is also troubled by the tenor and lack of forthrightness of its internal communications with the Minister. For example, at a critical juncture in the verification controversy, the SLD recommended to the Minister that he reduce the Investment's quota on the ground that it "continues to refuse to cooperate in providing original documentation necessary to conduct a verification visit."<sup>195</sup>

178. In the view of the Tribunal, that memorandum to the Minister contained a number of questionable statements:

- Concerning the Investment's explanation of the production/sales discrepancy, the SLD told the Minister: "The company's first written reply to our January 26, 1999 request for clarification gave no

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<sup>193</sup> Letter from George to McGrath, dated October 6, 1999.

<sup>194</sup> Letter from McGrath to George, dated March 12, 1999.

<sup>195</sup> Memorandum from SLD to Minister, dated June 2, 1999, at opening ¶¶ 1-4, "Recommendation."

explanation of the discrepancy.”<sup>196</sup> In fact, that reply dated February 5, 1999 (which was not included in the 18 letters attached to the memorandum to the Minister), gave the same explanation that had been accepted, without more, by the former head of the SLD and the same explanation that was found to be correct during verification.

- In another passage, the SLD informed the Minister that the Investment had “refus[ed] to divulge information.”<sup>197</sup> In fact, there had been no such refusal, and the basis for the allegation was that the Investment had (at that time) asserted its request that verification take place where the documents were located.<sup>198</sup>
- The memorandum suggested that verification could provide justification for a customs investigation into whether the Investment had willingly provided false or misleading information.<sup>199</sup> The Tribunal finds this hint of possible criminal misconduct was wholly unjustified, particularly since the Investment had, in fact, volunteered the specific errors it had discovered in its questionnaire responses.<sup>200</sup>

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<sup>196</sup> *Id.*, at ¶ 7.

<sup>197</sup> *Id.*, at ¶ 20.

<sup>198</sup> See George testimony, Nov. 2000 Tr., Vol. X 34:7 – 35:25.

<sup>199</sup> Memorandum from SLD to Minister, dated June 2, 1999, at ¶ 20.

<sup>200</sup> See George testimony, Nov. 2000 Tr., Vol. X 36:19 – 38:16.

These were not trivial matters. As noted, in this same memorandum to the Minister, the SLD recommended that the Investment's allocation be reduced,<sup>201</sup> and the Minister's reaction could be expected to be coloured by the several misleading statements made about the Investment's behaviour.

179. Again in November, 1999, the SLD referred matters to the Minister, and, again, its memorandum contained serious misstatements and omissions:

- The background provided the Minister suggested that the production/sales discrepancy was "serious," that the Investment "gave no satisfactory explanation," and that verification "clearly demonstrated" "a number of systemic errors." The Minister was not informed that verification had cleared up the production/sales discrepancy by accepting the Investment's original explanation.<sup>202</sup>
- Contrary to assurances given the Investment, the memorandum did not include documents it had submitted or otherwise fairly represent the positions it was taking. Instead, the Investment is said to have "refused" to make information available, has "repeatedly tried to delay" verification, and is "not complying with requests to provide revised data."
- The memorandum does mention the Investment's request to know the details of the verification review but dismisses that request with the

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<sup>201</sup> Memorandum from SLD to Minister, dated June 2, 1999, Recommendation in ¶ 1. Discussion of the recommendation did, however, accept the possibility that later review could result in an increase or decrease of the quota. *See id.*, at ¶¶ 22(b) and 23.

<sup>202</sup> Nor was the Minister advised that the matter had been addressed to the satisfaction of the SLD long before the Investor filed notice to institute this proceeding.

statement that granting it “would undermine the purpose of the review, i.e., for the EICB to have its own data as a benchmark against which to evaluate the validity of revised data provided by the company.” The Minister was not told that the purpose of verification, as the SLD earlier espoused to the Investment, was “to develop a clear understanding of the type and scope of the errors in the original questionnaire, in order that a revised and corrected questionnaire can be submitted as soon as possible.”

It is difficult for the Tribunal to perceive how the verification report would assist in creating a clear understanding of the errors if it was never to be shown to the Investment. Nor does the Tribunal comprehend why the SLD would seek to act without getting the comments of the regulated company on its findings or to use its report solely to check on the validity of the Investment’s later submissions,<sup>203</sup> unless the SLD was more devoted to catching the Investment in further errors than to its professed aim of assuring that accurate data be used by the SLD in administering the Regime.

180. Implementation of the Regime was a complicated matter, involving complex quota allocations to over 500 softwood lumber producers in the covered provinces, acquiring information from numerous sources and providing direction and guidance to governmental and private entities. Even in the face of

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<sup>203</sup> As noted, the verification review and report were “seriously flawed;” permitting the Investment to comment on the findings might have mitigated this result.



these difficulties, the program apparently was administered, in most instances, in an open and cooperative spirit.<sup>204</sup>

181. Against that background, within the context of the verification review process, the treatment of the Investment stands in stark contrast. The relations between the SLD and the Investment during 1999 were more like combat than cooperative regulation, and the Tribunal finds that the SLD bears the overwhelming responsibility for this state of affairs. It is not for the Tribunal to discern the motivations behind the attitude of the SLD; however, the end result for the Investment was being subjected to threats, denied its reasonable requests for pertinent information, required to incur unnecessary expense and disruption in meeting SLD's requests for information, forced to expend legal fees and probably suffer a loss of reputation in government circles. While

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<sup>204</sup> This approach was effectively described by the head of the SLD during the initial phases of the Regime:

I called hundreds of people, anybody who was concerned about some aspects, who wanted to speak to me. I made myself available. And we extended the hours of the division to be accessible to everybody. We did not want to be seen not to be accessible.

\*\*\*[I]t's common administrative practice. Somebody raises a problem or asks a question, you get back to him as quickly as you can and see what the concern is.

Valle testimony, Nov. 2000 Tr., Vol. IX at 7:20 – 8:8. This passage is a typical description of the work of the SLD under Mr. Valle, and the Tribunal has seen no evidence, apart from the treatment of the Investment in respect of the verification review process, that it changed under his successors.

administration, like legislation, can be likened to sausage making, this episode goes well beyond the glitches and innocent mistakes that may typify the process.

In its totality, the SLD's treatment of the Investment during 1999 in relation to the verification review process is nothing less than a denial of the fair treatment required by NAFTA Article 1105, and the Tribunal finds Canada liable to the Investor for the resultant damages.

#### 7. Administrative fairness

182. The Investor also complains that in its general operation of the Regime, Canada breached its Article 1105 obligation of administrative fairness. It points out that there was no internal appeal mechanism against decisions on such matters as allocation of quota. Furthermore, it asserts that those with best access to the Minister or his officials had the best chance of having their concerns addressed.
183. The Export and Imports Controls Bureau of the Department of Foreign Affairs and International Trade of Canada ("the Bureau") is responsible for the administration of the Export and Import Permits Act 1985. It carried out extensive consultations about the softwood lumber export permit system and the allocation of quota which the operation of the SLA required. In relation to B.C., the Bureau consulted trade organizations in the B.C. softwood lumber industry, B.C. government officials and many others.<sup>205</sup> It sent out questionnaires and collated responses in order to devise a quota allocation

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<sup>205</sup> Valle 1<sup>st</sup> Affidavit, March 27, 2000 ¶¶ 46-69; George 3<sup>rd</sup> Affidavit, October 4, 2000, ¶¶ 14-38.

system that operated fairly among the various quota holders.<sup>206</sup> The Tribunal has seen no evidence that the quota allocation system operated at any stage on the basis of the nationality of the parties. While there was no internal appellate system, the Investment, like any other softwood lumber producer in the covered provinces, was able to resort to judicial review if it chose. Several producers did seek judicial review in the courts of Canada.<sup>207</sup>

184. The Bureau sought to explain the operation of the Regime to all softwood lumber producers in the covered provinces affected by it. Quota allocation letters contained a special telephone number for those with questions about quota. The Bureau answered all requests made to it whether by telephone or in meetings. If the circumstances justified it, the Bureau recommended some form of redress to the Minister. Discretionary reserves were used to give redress to some of those who sought it, without regard to political connections.<sup>208</sup>
185. The Tribunal considers that in administering its responsibilities as it did, the Bureau (and, therefore, Canada) did not breach any obligation under NAFTA Article 1105 in respect of administrative fairness, save in the case of the verification review episode discussed above.

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<sup>206</sup> Valle 1<sup>st</sup> Affidavit ¶¶ 70-77.

<sup>207</sup> Valle 2<sup>nd</sup> Affidavit October 6, 2000 ¶¶ 186-195.

<sup>208</sup> Valle 2<sup>nd</sup> Affidavit ¶¶ 199-212.

## FINAL MATTERS

186. In a Preliminary Motion dated November 12, 1999, Canada requested that the Tribunal strike from the record paragraphs 34 and 103 of the Statement of Claim. Those two paragraphs alleged damages sustained by the Investor arising from its ownership interest in Harmac Pacific Inc. ("Harmac").<sup>209</sup>
187. At the time the Statement of Claim was filed, in addition to the three lumber mills operated in B.C. by the Investment, the Investor controlled Harmac, a publicly traded pulp and paper company operating a facility at Nanaimo, B.C.
188. With effect from December 31, 1999, the Investment and Harmac effected an amalgamation, approved by the Supreme Court of B.C. on December 15, 1999, whereby the two companies were merged into one. The new company, which was continued under the name Pope & Talbot, Ltd., took over the entire assets and liabilities of both former companies.
189. The issue of the then absence of a waiver under Article 1121(1)(b) in respect of the claim concerning Harmac was raised by the Tribunal, addressed by the parties and resolved to the Tribunal's satisfaction by the filing of a waiver by the amalgamated entity on January 10, 2000.

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<sup>209</sup> Paragraph 103 of the Statement of Claim declared: "The decreasing supply of wood chips due to lost production on the British Columbia coast has resulted in economic loss for Investor's Investment (sic) in Harmac Pacific Inc., which must purchase increasingly expensive wood chips for its pulp and paper operation."

190. Based on the foregoing, the Tribunal dismissed Canada's motion on February 24, 2000. Consequently, the Investor's claim in regard to Harmac has remained before the Tribunal.
191. Since, except for the verification review episode, the Tribunal has not found any liability on Canada's part arising from Articles 1102 and 1105, it need say nothing further regarding the Investor's claim relating to Harmac.
192. For the same reason, the Investor's argument that multiple violations of Article 1105 might have cumulative consequences greater than the individual components<sup>210</sup> becomes moot.
193. As noted,<sup>211</sup> during the course of discovery in this proceeding, Canada objected to producing certain items on the ground that, as Privy Council documents, their disclosure was prohibited by the Canada Evidence Act. The Tribunal ruled that that Act by its terms did not apply to a Chapter 11 tribunal, and Canada did not contest that ruling. However, it nonetheless refused to produce or even identify the documents in order to permit the Tribunal to make a reasoned judgment as to their relevance and materiality.<sup>212</sup> In the result, this refusal did not appear prejudicial to the Investor, and the Tribunal proceeded upon the basis of the materials actually before it. However, the Tribunal deplores the decision of Canada in this matter. As the Tribunal noted in its decision on this

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<sup>210</sup> See Nov. 2000 Tr., Vol. II 6:17 -- 9:3.

<sup>211</sup> See ¶¶ 4-5 above.

<sup>212</sup> See Letter to the Tribunal from M. Kinnear, dated September 27, 2000.

matter dated September 6, 2000, Canada's position could well be a derogation from the "overriding principle" found in Article 15 of the UNCITRAL Arbitration Rules, under which these proceedings have been conducted, that all Parties should be treated with equality. Moreover, Article 1115 of NAFTA declares that there shall be "equal treatment among investors of the Parties." As Canada's refusal to disclose or identify documents in these circumstances is at variance with the practice of other NAFTA Parties, at least of the United States, that refusal could well result in a denial of equality of treatment of investors and investments of the Parties bringing claims under Chapter 11.

#### CONCLUSIONS

194. For the reasons given above, the Tribunal determines that Canada has not been in breach of its obligation to the Investor under Article 1102 of NAFTA.
195. For the reasons given above, the Tribunal determines that Canada has breached its obligation to the Investor under Article 1105 of NAFTA in relation to the Verification Review Episode. In all other respects, it determines that Canada has not been in breach of its obligations to the Investor under Article 1105.
196. The Tribunal will be inviting the disputing parties to make submissions on the quantum of damages to be awarded, as well as with regard to the questions of interest on that quantum and assessment of the costs of the Arbitration. Shortly after issuing the present Award, the Tribunal will organize a telephone conference with counsel to schedule such submissions, as well as any further hearing that may be required.

*The Honourable Lord Doherty*

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The Honourable Lord Doherty, Presiding Arbitrator

*Benjamin J. Greenberg*

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The Honourable Benjamin J. Greenberg, Q.C., Arbitrator

*Murray J. Belman*

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Murray J. Belman, Arbitrator

Dated: April 10, 2001