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UNDER THE UNCITRAL ARBITRATION RULES AND THE NORTH AMERICAN FREE TRADE AGREEMENT

MEMORIAL OF THE INVESTOR (SECOND PHASE)

BETWEEN:

POPE & TALBOT, INC.

Claimant / Investor

- and -

GOVERNMENT OF CANADA

Respondent / Party

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INVESTOR'S MEMORIAL
(SECOND PHASE)

SECTION ONE: GENERAL INTRODUCTION

This is a Claim detailing how the Government of Canada ("Canada") implemented a measure, described as the Export Control Regime, in a manner that was inconsistent with its obligations arising under Section A of Chapter 11 of the North American Free Trade Agreement ("NAFTA").

The NAFTA is designed to facilitate the process of economic integration between its three Parties. Chapter 11 of the NAFTA carries out the NAFTA objective of increasing substantially investment opportunities in the territories of all NAFTA Parties. To encourage investment from all three partner countries, NAFTA Parties have obliged themselves to provide investors from other NAFTA Parties and their investments with legal security including: national treatment and treatment in accordance with international law. Fundamentally such security means that investors will be free from the risk of arbitrary or discriminatory conduct in any government measure.

This phase of the NAFTA claim concerns Canada's fundamental failure to provide legal security to the Investor and its Investment as well as dealing with certain issues relating to Canada's failure to provide national treatment to the Investor and Investment by its Export Control Regime. The Investor makes the following arguments, which are detailed within this Memorial:

NAFTA Article 1105 protects NAFTA investors making an investment in the territory of another NAFTA Party by creating "legal security". This enhanced security means that an investor should expect other NAFTA governments to behave in good faith and in a transparent manner so that the investor can always assess the status of its rights. Legal security also means that the government should not behave capriciously so as to abuse the rights of the investor, nor obstruct the rights of the investor to have an independent review process in cases where its rights may be infringed.

Canada has breached its obligations to meet international law standards as set out in NAFTA Article 1105. The Investor submits that international law establishes a level of treatment founded upon the principle of good faith. This level of treatment includes, but is not limited to, the observance of:

(a) *Pacta Sunt Servanda*;
(b) Fair and Equitable Treatment;
(c) Transparency;
(d) Protection Against Abuse of Rights;

(e) National Treatment; and
(f) International Economic Rights.

Canada has failed to provide this level of treatment by, among other things:

(a) Failing to provide fair and equitable treatment to the Investment by providing worse treatment to it than was provided to other softwood lumber manufacturers operating in Canada that were exporting softwood lumber to the United States;

(b) Neither fairly nor equitably allocating quota to the Investor's Investment initially and then continuing this behaviour in the making of quota allocations under the Export Control Regime in subsequent years;

(c) Failing to meet its international treaty law obligations under other international treaties to which the three NAFTA Parties are parties, including the WTO Agreement;

(d) Engaging in intentionally harmful conduct through the actions of Canadian officials administering the Investment's quota allocation; and

(e) Engaging in an abuse of discretion and other breaches of international law in the design and implementation of the Super Fee Base Levy in 1999, which specifically and significantly harmed the Investor and its Investment.

Each of these failures by Canada to fulfill its good faith obligations has caused harm to the Investor and its Investment.

Canada's obligation to provide national treatment to the Investor and its investments (pursuant to NAFTA Article 1102) must be applied in strict good faith by Canada under international law (pursuant to NAFTA Article 1105). A measure that fails to provide the best available treatment to investments of NAFTA investors which are similarly situated to domestic investments, because of a lack of transparency or through arbitrariness in its application, is a measure that is capable of breaching a Party's obligations under both NAFTA Articles 1102 and 1105.

Canada has breached its obligation to provide national treatment to the Investor and the Investment by, among other things:

(a) Failing to extend to the Investment the best level of treatment accorded to other softwood manufacturers in Canada (including Non-Listed Provinces) that are operating under the same risk of *bona fide* countervailing duty determinations as the Investor;

(b) Removing a significant amount of the Investor's quota in 1997 to deal with hardship cases caused in British Columbia as a result of the operation of the Export Control Regime without ameliorating the harm caused to the Investor through the operation of the Export Control Regime; and

(c) Imposing the Export Control Regime's Super Fee Base Levy in 1999.

SECTION TWO: THE FACTS

I. GENERAL OVERVIEW

1. The Investor adopts and maintains the facts set out at paragraphs 1 to 45 of its Memorial (Initial Phase) and at pages 4 to 5 of its Supplemental Memorial (Initial Phase).[1] In its Interim Award (dated June 26, 2000), the Tribunal made the findings of fact with respect to the operation of Canada's Export Control Regime in paragraphs 30 - 40. The Investor sees no need to make further comment upon these findings within this Memorial.

2. Canada implemented its Export Control Regime in a capricious manner that ignored those basic fairness obligations that it owed to quota holders (under international law and NAFTA Article 1105) in favour of reducing the administrative workload for government officials. For example:

   a) Despite the fact officials knew that the data upon which they were basing the Export Control Regime was incorrect, these officials based the five year operation of the Export Control Regime on this unreliable data rather than to take steps to obtain correct information.

   b) When specifically ordered by the Executive Assistant to the International Trade Minister to address the lack of any independent quota appeal mechanism, the most senior officials in the department reported that they did not favour the creation of an appeal mechanism as it could attract more work for their department that they did not want, irrespective of the reasonableness of the quota holder's situation. Indeed, no independent appeal mechanism was ever put into place.

3. The Export Control Regime prevented quota holders from being able to understand their legal position due to the remarkable lack of transparency endemic in this system. The process of secretive and arbitrary ministerial quota allocations further compounded the problems caused by the lack of transparency in the Export Control Regime.

4. The process whereby softwood lumber quota allocations were made to primary producers to reflect sales made by wholesalers was entirely inconsistent with Canada's obligations to act fairly and equitably. Not only was the data upon which the wholesaler allocation was made unreliable, but some primary producers secretly received different (and better) treatment about their wholesaler sales than the majority of primary producers (including the Investment).

[1] In addition, the Investor maintains all legal arguments that it has made to this Tribunal up to the submission of this Memorial.

5. Canada has engaged in activities which demonstrate a lack of administrative fairness and an absence of good faith. For example, when the Investor asserted its legitimate legal rights by launching this NAFTA Chapter 11 claim, Canada subjected it to the verification review. Despite repeated requests from the Investor, Canada never produced any proof of its lawful authority to conduct its verification review. This absence of legal authority did not moderate Canada's repeated threats to the Investment that Canada would revoke the Investment's entire softwood lumber quota allocation unless the verification review took place.

6. When the Investment agreed to participate in the verification review, it did so on the basis of specific terms. While the Investment complied strictly with the terms of the agreement, Canada ensured that its personnel could not meet the terms of the agreement during the verification review and it never completed its undertakings to the Investment and Investor in this respect following the audit.

7. At the conclusion of Canada's audit, it was clear that Canada relied upon data that it knew to be unreliable to condemn the propriety of the Investment's quota allocation. Only the independent review by this NAFTA Tribunal during the course of the Investor's motion for interim measures ensured that Canada did not rely upon this faulty verification review report. The Tribunal's review also ensured that for the first time, the Investment was aware of the evidence (which was initially kept from the Investor) which supported Canada's purported case for the downward revision of the Investment's softwood lumber quota allocation.

8. Finally, Canada imposed a new levy only against softwood lumber exports from British Columbia. This SBF levy was intended to make exports of softwood lumber uneconomic. When developing the implementation of this SBF levy in 1999, Canada knew that by selecting this specific SBF levy mechanism that it would effectively reduce Pope & Talbot's softwood lumber export quota in a material respect. Furthermore, while Canada had a number of options available to it in allocating the SBF quota, it specifically selected a procedure that would most seriously harm the largest shippers of high-levy wood from British Columbia, which happened to include the Investment, Pope & Talbot Ltd.

II. HISTORIC PERFORMANCE UNDER THE EXPORT CONTROL REGIME

9. In his year 2000 report on softwood lumber in Canada ("the Smyth Report"), Doug Smyth, the research director for the Industrial, Wood and Allied Workers of Canada ("I.W.A. Canada"), reports that the market for softwood lumber in the United States ("US") hit unprecedented levels between 1996 to 1999. He states:

Table 1 in Chapter 2 shows that between 1996 and 1999 the United States enjoyed an unprecedented boom in softwood lumber consumption. The table reveals that during 1999 the US market consumed a super record-high 55.0 billion board feet (BBF) – 5.4 BBF more than the 49.6 BBF used in 1996, which until that time was also a record.[2] (Emphasis in original)

Table 94 summarizes the changes in softwood lumber imports from Canada between calender years 1996 and 1999. It is based on the statistics contained in **Appendix E.** The table shows that over the full 3-year period [1996 - 1999] shipments of quota items to the United States from the 4 provinces covered by the US - Canada agreement plummeted by one billion board feet.

By way of contrast, exports to the United States from the non-covered provinces shot up by a whopping 1.44 BBF. Of that, 1.1 BBF came from the east coast Maritime provinces of New Brunswick and Nova Scotia.

Altogether, all Canadian provinces increased US destination shipments by a net 858 MMBF during the 3-year focus period. **But there clearly was a dramatic trade-off between the -583 MMBF decrease for the covered provinces and the 1.44 BBF jump for the Maritimes, Saskatchewan and Manitoba.**[3] (Emphasis in original)

10. The Smyth Report sets out the changes in softwood lumber imports in Table 94 which provides:

Table 94
Changes in Imports of Canadian Softwood Lumber into the United States, Calender Years 1996 - 1999
(Millions of board feet)

Covered Provinces[1]	1996-1997	1997-1998	1998-1999	Total change 1996-1999
Quota items	-924	117	-196	-1,003
Non-quota items	370	100	-50	420
Total covered provinces	**-554**	**217**	**-246**	**-583**
Non-covered provinces[2]	-550	495	396	1,441
All provinces	**-4**	**712**	**150**	**858**

[1] British Columbia, Alberta, Ontario and Quebec.
[2] New Brunswick, Nova Scotia, Saskatchewan and Manitoba.
Source: Statistics Canada; Export-Import Control Bureau of Canada; U.S. Commerce Dept.; I.W.A. Canada.

[2] See Schedule 49, Doug Smyth, *The Impact of US and Japanese Consumption and North American Timber Supplies on Softwood Lumber Prices, 1996 - 2001* (I.W.A. Canada, Vancouver, BC, 2000) at 275. It should be noted that 1996 was the first year of the operation of the Export Control Regime, however, the Export Control Regime was not based on these 1996 results, but upon earlier years.

[3] See Schedule 49, Smyth Report at 280.

The Smyth Report comments on Table 94 by stating:

> **Table 94 shows that between 1996 and 1999 softwood lumber imports into the United States from the 4 exempt provinces under the US - Canada quota agreement surged by 1.44 BBF. The 2 Maritime provinces of New Brunswick and Nova Scotia accounted for a whopping 1.1 BBF of that increase, while the two prairie provinces of Saskatchewan and Manitoba stepped up US-destination shipments by 349 MMBF.**[4] (Emphasis in original)

11. The Smyth Report also provides commentary on softwood lumber exports from the four Listed Provinces. It states:

> **However, between calender years 1996 and 1999 total exports to the United States of quota and non quota items from the 4 covered provinces – British Columbia, Alberta, Ontario and Quebec – fell by -583 MMBF. But given the fact that by the Summer of 1999 the US Customs Service had reclassified almost all of the former non-quota items into tariff categories that are included under the coverage of the lumber agreement, the actual total decrease in US-destination shipments in 2000 was closer to -1.0 BBF. The list of reclassified items includes predrilled and notched studs, and rougher-header fascia.**
>
> **The production record of the 4 covered provinces is mixed. During 1999 British Columbia output remained -355 MMBF below the 1996 level. However that decrease represented a substantial improvement over the 1.0 BBF loss between 1996 and 1998.**
>
> In **Alberta** output rose by a healthy 228 MMBF during the 1996 - 1999 period.
>
> **However, in spite of the restrictions which were imposed on Ontario and Quebec by the quota agreement, combined production in those 2 provinces skyrocketed by 1.4 BBF over the 3 focus years. A whopping 1.0 BBF, or almost three-fourths of that increase, was manufactured in Quebec.**
>
> **When all of the changes are added up over the 1996 - 1999 period, total production in the 4 covered provinces rose by 1.3 BBF, while total exports to the Untied States fell by -583 MMBF after the non-quota items are excluded. However, it is clear that the brunt of the reduction in covered-province shipments to the United States fell on British Columbia. B.C. exports plummeted by -596 MMBF, while the other 3 increased theirs by a combined 13 MMBF from the 1996 level.**[5]

[4] See Schedule 49, Smyth Report at 304.

[5] See Schedule 49, Smyth Report at 304-305. (Emphasis in original).

A. The Imposition of the Export Control Regime

12. The Export Control Regime was intended to limit softwood lumber exports from Canada. As a function of the vagaries of the negotiations that took place between Canada and the US, which led to Canada's imposition of the Export Control Regime, Canada agreed to limit its fee-free exports to 14.7 MBBF (subject to quarterly bonuses). Canada was entitled to implement this Agreement in any way it so chose – so long as exports from the four largest provinces were included under this restraint mechanism.

13. Softwood lumber producers in the US, who were primarily responsible for the political and domestic legal pressures that led the US and Canada to enter into a voluntary export restraint agreement imposed by way of the Export Control Regime, were fundamentally interested in ensuring that softwood lumber exports would be limited. There is no evidence that their interest was limited particularly to softwood lumber produced in the four Listed Provinces, except in so much as they realized that restricting imports from the four largest provinces in Canada would substantially limit overall exports from Canada.

14. The risk remains that producers in the US will continue to attack the forest practices of many Canadian provinces, including Saskatchewan, Manitoba and the Maritimes, so long as their exports remain sufficiently high. It is clear that, unless Canada agrees to impose a new export restraint mechanism on its lumber producers, US producers will make use of US trade remedy law against unfair subsidization to have countervailing duties imposed on as much of Canada's softwood lumber imports as possible. It is unclear to what extent Canada would have to restrict exports from the larger provinces to continue allowing fee-free exports from the provinces of Saskatchewan, Manitoba or the Maritimes provinces.

15. Canada now appears confident, however, that the same US trade remedy laws that allegedly forced it into agreeing to limit softwood lumber exports in 1996 are actually illegal under the WTO Agreement.[6] In other words, Canada now admits that its voluntary imposition of export controls on softwood lumber shipments in 1996 was not to protect subsidized exports from potential countervailing duties, but to simply restrict exports from its territory, in order to manage the softwood lumber trade within its borders.

1. Lack of Administrative Fairness

16. Canada's implementation of the Export Control Regime was designed to operate in the absence of any independent review mechanism. The only avenue available to softwood lumber producers who felt their allocation was not fair was therefore to write a letter to

[6] See Schedule 25.

the Minister outlining their concerns, or to hire a lobbyist. Ultimately, the Minister had complete and total discretion to dismiss any complaints without the need to provide any consideration or any reasons for the decision.

17. In a memo of A. Kaufman to Claudio Valle, dated September 11, 1996, Mr. Kaufman, the Executive Assistant to the Minister of International Trade, noted that the Minister's office anticipated receiving "many more appeals than your branch is accustomed to". In particular, Mr. Kaufman anticipated problems with the wholesaler component, such as the inadequacy of the wholesaler reported data and the problems with the fact primary producers could not view the wholesaler reports. Mr. Kaufman requested that Mr. Valle "provide the Minister for his approval the procedure you intend to utilize on the (anticipated) appeals, before the quota is issued."[7] Mr. Kaufman noted that officials had already decided not to grant requests from primary producers to see the audited wholesaler questionnaires on the grounds that "such requests would overload the system."[8] This is contradictory to the standard explanation of Canada that this information could not be released on grounds of confidentiality. The real reason was the it would be too difficult from an administrative point of view. Thus, one can conclude that the primary goal of Canadian officials was to limit review or appeal in order to conserve departmental resources, rather than design a fair and equitable system

18. Mr. Valle responded to Mr. Kaufman in a memo dated September 19, 1996 with respect to the appeal procedure by advising the Minister not to put such as mechanism in place. Mr. Valle stated as follows:

> Appeals (Setting aside 80 million from the EB)
> There will invariably be firms that will want to contest the allocation entitlement. There is no formal appeal body under the Export and Import Permits Act. The Minister retains the ultimate discretion to review and deal with them in an even-handed way. Moreover, **we do not favour the establishment of a formal appeal process as it becomes the magnet attracting both reasonable and unreasonable requests.** The formula approach in the allocation system ensures generic unpreferential treatment. As long as everyone is equally satisfied (or unsatisfied), there will be a few special cries for reviews.[9] (Emphasis added)

19. The lack of any appeal mechanism under the Export Control Regime inevitably led to the result that investments with the best access to the Minister to lobby their case were able to

[7] See Schedule 6, Memo of A. Kaufman to C. Valle, September 11, 1996 at 1.

[8] See Schedule 6, Memo of A. Kaufman to C. Valle, September 11, 1996 at 1.

[9] See Schedule 6, Action Memorandum for Minister from C. Valle, September 19, 1996 at 2-3. The memorandum also draws attention, at 3, to the concerns of officials to avoid arbitrariness with respect to the remanufacturer issue in Quebec, but did not have the same concerns with respect to appeals.

.. have their concerns addressed through ministerial discretion. This caused some investments, such as Pope & Talbot Ltd., to receive a reduced opportunity to obtain a correct, fair and equitable quota allocation while others received more than their fair share. For example, as discussed below with respect to the 1997/ 98 special re-allocation of British Columbia quota, only nine companies who experienced problems regarding "quota attributable to exports via wholesalers" received compensation for the faulty wholesaler component of the Export Control Regime. Canada did not provide an open and systemic solution to a system-wide problem.

20. Ministerial briefing memoranda indicate that those officials charged with implementing the Export Control Regime were aware of the detrimental effect that would result from the absence of any review process. These officials indicated their belief that **the existence of an appeal mechanism would be too burdensome by attracting "too many reasonable and unreasonable requests,"** which would interfere with the Minister's ultimate discretion to review cases.[10]

2. ***Misallocation of Discretionary Reserves***

21. As described in paragraphs 33 and 34 of the Memorial (Initial Phase), Canada created three discretionary reserves - the Transitional Reserve, the New Entrants Reserve, and the Ministerial Reserve - from the overall established base ("EB") and lower fee base ("LFB") established under the Export Control Regime. In addition, the Minister had within his discretion a number of other pools of quota on which he could draw, for example, the Trigger Price Bonus allocation. Unlike a "formula approach in the allocation system", which "ensures generic unpreferential treatment" as stated by Mr. Valle to the Minister,[11] these sources of quota allocation were entirely within the Minister's discretion and not subject to review or appeal.

22. In August 1996, it was understood by stakeholders that Canada would make these discretionary allocations in a manner that reflected the consensus achieved among provincial government representatives and members of the softwood lumber industry. While the shares ultimately decided upon were consistent with historic export patterns over the 1994-1995 period, the shares actually allocated were the subject of significant negotiation and discussion between Canada and the stakeholders. As stated by Claudio

[10] See Schedule 6, Action Memorandum from Claudio Valle to Minister Eggleton dated September 19, 1996 at 2.

[11] See Schedule 6, Action Memorandum from Claudio Valle to Minister Eggleton, September 19, 1996 at 2.

Valle in his Affidavit appended to Canada's Counter-Memorial (Initial Phase) at paragraph 92:

> The percentage shares identified for lumber manufactured in each province was not based on precise historical export level, but rather represented the consensus achieved by industry stakeholders with respect to what the starting points for allocating the corporate share would be.

Mr. Valle also stated that the "consensus" reached included the agreement that provincial corporate shares would be a certain percentage - British Columbia 59%, Alberta 7.7%, Ontario 10.3% and Quebec 23%.[12]

23. Only 11 days prior to the Ad-Hoc Committee Meeting of August 19, 1996, the Premier of British Columbia wrote to the Prime Minister of Canada to re-iterate British Columbia's understanding that the determination of quota allocation would be determined on a provincial basis. Premier Clark stated:

> It was always understood that the allocation of the quota to the provinces will be based on the historical pattern of shipments from mills in the provinces, and that the exact determination of the allocation will be worked out with the provinces on this basis...I am writing to you today out of a concern that the Federal Government may not be maintaining the same commitment to this agreed industry-federal government provincial government process.[13]

24. Although, as Mr. Valle noted at paragraphs 65-68 of his Affidavit, a federally administered quota system could not be based on fixed provincial allocations or administered on a provincial basis, the provinces no longer sought an entirely provincially run quota by the time of the August 19-20 Ad Hoc Committee Meeting.[14] Stakeholder consensus supported a system based on federal allocation, but Quebec and Ontario did not agree that the federal allocation should be "on the basis of corporate provincial allocation" and sought a single national system of quota allocation.[15] Nevertheless, corporate provincial shares were created and agreed upon as part of the "consensus".

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[12] Affidavit of Claudio Valle at para. 91. Also see Schedule 44, Memo, "Provincial Corporate Share Calculation", September 8, 1996.

[13] See Schedule 46, Letter of Premier Glen Clark to Prime Minister Jean Chretien, August 8, 1996.

[14] Affidavit of Claudio Valle at para. 78.

[15] See Exhibits L, M, N, and O to Affidavit of Claudio Valle to Canada's Counter-Memorial detailing the provincial stakeholder's responses to Canada's "Softwood Lumber Allocation - Draft Principal Elements", which resulted from the stakeholder meetings of August 19-20, 1996. British Columbia and Alberta agreed to corporate provincial allocations; Ontario and Quebec did not agree with corporate provincial allocations.

25. Mr. Valle states in his Affidavit that there was a consensus of provincial and industry stakeholders that the discretionary allocations (Transitional Reserve, New Entrants and Ministerial Reserve) would be deducted from the national EB quota allocation of 14.7 billion board feet prior to the allocation of EB and LFB shares based on provincial corporate shares.[16] The submissions of the provincial stakeholders provided in support of his Affidavit contradict Mr. Valle's statements. The stakeholder submissions show that there was no understanding or agreement that discretionary allocations would be deducted prior to the allocation of the provincial corporate shares. There was in fact no discussion on this point, nor was this point addressed in Mr. Valle's "Softwood Lumber - Draft Principal Elements" derived from the August 19-20 stakeholder consultations[17] nor in a Memo dated September 8, 1996 setting out the allocation process with respect to provincial corporate shares.[18]

26. Similar to the position of British Columbia, the Alberta government suggested in a letter dated August 27, 1996, that discretionary allocations, such as the new entrants quota, be "allocated to the provinces in the same manner as the initial provincial corporate allocations from the established base".[19]

27. The letter received by Pope & Talbot from the Minister dated September 30, 1996 outlines the Minister's September 10, 1996 announcement of the corporate provincial allocations.[20] In the letter, Canada stated that the amount allocated to British Columbia would be 8,673 million board feet, or 59% of 14.7 billion board feet. This is not the amount noted in Mr. Valle's affidavit, at paragraph 107, or as provided to the Investor at the time of its initial allocation on October 31, 1996 which stated that British Columbia's "59%" share of the national EB quota was 8,369 million board feet.[21] As of September 30, 1996, there is no evidence of any kind of consensus that discretionary allocations

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[16] Affidavit of Claudio Valle to Canada's Counter-Memorial at para's. 91, 102, 105 - 107.

[17] See Exhibits L, M, N, and O to Affidavit of Claudio Valle to Canada's Counter-Memorial.

[18] Also see Schedule 44, Memo, "Provincial Corporate Share Calculation", September 8, 1996. This Memo was prepared immediately prior to the September 10, 1996 press release by Minister Eggleton setting out the allocation criteria.

[19] See Schedule 47, Letter from Helmut Mach, Alberta Ministry of Foreign and International Affairs, August 27, 1996 at 2.

[20] Exhibit S to Affidavit of Claudio Valle to Canada's Counter-Memorial.

[21] Schedule 41, "Canada-US *Softwood Lumber Agreement* - Provincial Corporate Base Allocations - Primary Mills and Remanufacturers", also see Schedule 23 of the Investor's Memorial (Initial Phase).

would be first deducted from the national EB quota allocation of 14.7 billion board feet before the provincial corporate shares. In fact, the opposite was the case.

28. Doug Smyth notes the effect of the New Entrants Reserve on the initial quota allocation in his most recent report. He debunks what he terms is the first "myth" of the Export Control Regime, reflecting the fact that it was a widely held misconception among producers that they were receiving their agreed upon share of available quota: "That the total volume of fee-free quota allocated was 14.7 BBF". Smyth confirms that as a result of the New Entrants Reserve, British Columbia's real allocation amounted to less than 57% of the 14.7 billion board feet allocation. He concludes:

> B.C. did not receive its full 59.0 percent share of the total 1994-1995 average exports to the U.S. by the 4 covered provinces. Instead, the province's initial allocation cost the B.C. industry 1.28 BBF of its base year volume. (Table 76.) **That in turn caused its portion of the initial theoretical total allocation of 14.7 BBF to fall to 56.9 percent from its calculated base year share of 59.0%, even before the program was off the ground!**[22] (Emphasis in original)

29. Later meetings of stakeholders concerning the Export Control Regime confirm that the Alberta and British Columbia stakeholders believed that the provincial corporate share was being maintained and that it should continue to be maintained. They also believed that further allocations should be made within provincial corporate share. This is evidenced in a report from the February 10, 1997 meeting of the National Advisory Committee on Softwood Lumber. It was also evident at the meeting that the Western provinces would see their provincial corporate shares decline in 1997/ 98. The report notes that Quebec embraced proposals

> ...which are designed to accelerate the eastward shift of allocations **already occurring under the current system.** While BC and Alberta, as also expected, opposed these proposals, the discussion reflected the usual east-west differences over maintaining the existing provincial allocations, as opposed to any major east-west split over the basic structure of the allocation system. **The BC and Alberta industries and provincial governments continued to contend that the 1997/ 98 allocation to companies should be made within the existing provincial shares,** with Alberta going one step farther and asserting its provincial share should be increased. They appeared, however, to accept tacitly that their provincial shares will fall in 1997/ 98.[23] (Emphasis added)

30. Between the announcement of the corporate provincial allocations in September and the company quota allocations on October 31, 1996, Canada unilaterally decided, without consultation or announcement, to first deduct the discretionary allocations from the national allocation and not maintain the integrity of the provincial corporate shares. In a

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[22] See Schedule 49, Smyth Report at 232.

[23] Schedule 4 - Memorandum to Minister from A. R. Moroz dated February 27, 1997.

briefing memorandum titled "Issues Checklist", dated October 6, 1996, prepared for a meeting of senior DFAIT officials on softwood lumber allocation, the question of how the new entrants allocation would relate to corporate provincial shares was addressed briefly as follows:

> New Entrants
>
> - a number of issues will arise:...
>
> (4) How should the allocation be approached?
>
> - The choice will be between many qualifiers/ tiny allocations or few qualifiers/ sizeable allocations. **The issue of provincial distribution will also be sensitive, although this quota is not intended to be subject to any constraints related to provincial shares.** [24] (Emphasis added)

31. Accordingly, discretionary allocations did not reflect the "consensus" amongst stakeholders as claimed by Mr. Valle.[25] Based on the statements of Canada in September, it is reasonable to conclude British Columbia stakeholders, including Pope & Talbot, had an expectation that the provincial corporate share would be 59% of 14.7 billion board feet, not 59% of 14.7 billion less discretionary allocations.

32. It appears that Canadian officials became aware, while they finalized the design of the quota allocation process in October 1996, that the discretionary allocations could be predominantly allocated to the East - Quebec and Ontario - which would provide a facially neutral means to redistribute quota from British Columbia producers to producers in the East. These discretionary allocations took on the character of permanent EB and LFB allocations, which were subject to the corporate provincial share, when they were included in the "growth mechanism" described at paragraphs 38 to 40 of the Memorial (Initial Phase). As noted at the February 1997 National Advisory Committee Meeting, the growth mechanism contributed to the eastward shift of quota away from British Columbia:

> Quota is already moving east due to the higher share of New Entrant allocations and hardship adjustment allocations going to eastern producers. **The eastward shift will continue under the current system since exports in these allocations would be included for purposes of determining the 1997/ 98 allocations to the companies on the basis of their 1996/ 97 annual utilization of fee-free and lower-fee export levels.** [26]

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[24] Schedule 43, Softwood Lumber Export Quota Allocation, Meeting Monday October 7, 9:30 and Issues Checklist at 5.

[25] Affidavit of Claudio Valle to Canada's Counter-Memorial at para. 91, 102, 105-107.

[26] Schedule 4 - Memorandum to Minister from A. R. Moroz dated February 27, 1997 at 2.

33. Canadian officials later made use of the fact that the discretionary allocations favoured the Eastern Listed Provinces to justify and defend the Export Control Regime to members of the Quebec and Ontario softwood lumber industry. Canadian officials were always extra-sensitive to the effects that the measure would have on softwood lumber manufacturers in Quebec. In the report of the February 1997 meeting of the National Advisory Committee, it was noted that:

> The Quebec front, however, will continue to require careful management...We will therefore continue our efforts to increase awareness of the Quebec mills that quota is already moving east under the current system, as well as explore further alternative solutions to address their concerns, such as the Quebec formula.[27]

34. In a memorandum from Wallace Dowswell, Director of the Softwood Lumber Division, dated from July 1997, the benefits of the Export Control Regime allocation system for Quebec are set out. The Memo confirms that:

> Quebec mills benefited significantly from the new entrants provisions.
>
> In addition, a number of companies, including from Quebec, benefited from a number of provisions put into place by the federal government to assist companies in adjusting to their specific allocations from the first come first served export regime in the first six months of 1996-1997.[28]

35. By not applying the provincial corporate shares to the discretionary allocations, Canada could indirectly favour certain softwood lumber producers operating in certain regions of Canada. In the absence of a formal review or appeal process, transparent criteria for discretionary allocations or the identification of producers who would ultimately benefit from such allocations, discretionary allocations provided an opportunity for Canada to do indirectly what could not be undertaken publically. The demands of the West for its corporate provincial share of the quota could be facially met while the East's demand for an increasing amount of quota over the term of the Export Control Regime would also be satisfied.

a) ***Transitional Reserve***

36. Canada established the Transitional Reserve ostensibly to address any necessary adjustments that could smooth the transition from a free market for softwood lumber to a

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[27] Schedule 4 at 4.

[28] Schedule 12 - Memorandum from Wallace H. Dowswell, Director of Softwood Lumber Division to Louis Gionet (EPMT) entitled "Quebec's interests in the Softwood Lumber Agreement", dated July 15, 1995 *(sic)* in error. The document appears to date from July 1997.

managed one. Under the Export Control Regime, Canada had implemented a permit system that was supposed to allow it to track exactly from what mill any particular export shipment of lumber had originated. This system was supposed to allow Canada to ensure that exports made during the first six months of the application of the Export Control Regime would ultimately result in an equitable allocation of quota once it was determined who was entitled to what quota allocation over the first year (i.e. including exports made during the first six months).

37. As a result of information collected under the permit system, Canada was completely aware that primary mills from Central Canada, particularly from Quebec, had "rushed" the border with significantly higher volumes of exports than had previously been shipped. Some of these producers apparently exported more lumber in the first six months than that to which they would actually be entitled for the entire year. It was surmised that the explanation for this border rush was to influence any calculation of quota allocation that included export performance in 1996 (which had been advocated by producers' lobby groups in both Ontario and Quebec).

38. Mr. Valle confirmed the "rush to the border" was an issue with respect to the allocation as stated in his memo of September 19, 1996, as follows:

> *The consensus at the August 19-20 stakeholders meeting was that no April/June 96 data be utilized as the basis of computing the allocation, as it was widely held that several prominent eastern Canadian companies had rushed to the border in that period. . . . Backtracking [on methodology], if only for Ontario, would be difficult as there would be great resistence toward rewarding those perceived as having raced to the border.*[29]

39. Ultimately, Canada decided, following advice from and provincial government representatives and selected industry representatives at the Ad-Hoc Committee Meeting, that export performance in 1996 could not be used to determine the appropriate historical share that should be allocated to producers by province (the "provincial corporate share"). However, the Quebec and Ontario producers who rushed the border did not suffer from their decision to export more lumber fee-free (or at a reduced fee) than that to which they were actually entitled. Instead, Canada used the Transitional Reserve to provide them with an extra quota allocation separate from and in addition to their Year 1 allocation.

40. Moreover, despite having put into place a permit system that permitted Canada to know exactly which primary mills were rushing the border, Canada apparently could not trace all lumber shipped by wholesalers and remanufacturers during the first six months back to the originating primary mill. It is submitted that either the permit system was completely

[29] See Schedule 6 at 1.

inadequate (which seems unlikely, given that it is still in place today), or that the people responsible for exports over the first six months did not keep the proper records required under the system to ensure that shipments could be traced. Rather than force these exporters to pay fees equivalent to the lumber exports that could not be traced, Canada apparently allocated quota from the Transitional Reserve instead.

41. The manner in which Canada established and allocated the Transitional Reserve harmed every primary mill that could have received more quota if not for the existence of the Reserve. The Transitional Reserve was developed by Canada after it was known that producers from Quebec and Ontario were rushing the border, although notice of the existence of the Transitional Reserve was provided only after the border rush was over. Accordingly, the criteria for effective participation in an allocation of the Transitional Reserve were never made public. Producers were simply notified that such a Reserve was established and that it had been allocated. Canada has never published information identifying exactly who had benefited from an allocation under the Transitional Reserve, or why.

b) *New Entrants Reserve*

42. Canada allegedly established a reserve of quota to be allocated to "new entrants" in order to address the hardship of firms that would not receive an allocation of quota based on historical performance over the first two years of the Expert Control Regime. This New Entrants Reserve was ostensibly supposed to ameliorate the punitive effects of the imposition of the Export Control Regime on producers who would otherwise be forced to close their facilities, causing job losses. For some reason, however, this New Entrants Reserve was not made available to producers in coastal regions of British Columbia who, as a result of the collapse of the Japanese lumber market, were looking to invest in retooling their mills in order to enter the US export market (thereby hoping to forestall mill closures and avert substantial job losses). Instead, the New Entrants Reserve was limited to firms with:

A. new facilities that began operation in 1995 or 1996;
B. new facilities under construction by April 1, 1996;
C. verifiable Investment commitments to construct new facilities by April 1, 1996; and
D. major capital investments in new production capacity (i.e. expansions of existing facilities) since January 1, 1995.

43. Through negotiations with selected members of the industry and provincial government officials, Canada determined that 2% of fee-free quota and 184 million additional board feet of fee-free quota generated under the Trigger Price Bonus mechanism would be set aside for new entrants. Producers in British Columbia, including Pope & Talbot, were

led to assume that this New Entrants Reserve would be allocated in accordance with the export patterns agreed to in establishing the provincial corporate share.

44. Canada was aware that Quebec and Ontario would receive a greater share of the new entrant allocation,[30] and accordingly, Quebec and Ontario were very desirous of a larger reserve for new entrants. Canada appears to have been under the mistaken impression that it was primarily, if not almost exclusively, producers from Quebec and Ontario who were in a position to benefit from the New Entrants Reserve. Apparently motivated by a desire to provide further assistance to these central Canadian producers, and in spite of the consensus achieved concerning the size of the New Entrants Reserve, Canada expanded the New Entrants Reserve to include an additional 150 million board feet of lower fee base ("LFB") quota.

45. After 218 firms applied for new entrant quota, including 82 from Quebec and 28 from Ontario, Canada appears to have decided to increase the New Entrants Reserve yet again – to include an additional 184 million board feet of fee-free quota. Canada also appears to have decided to exempt new entrants quota holders from the "speed bump" provisions of its measure. Combined with the inclusion of all new entrants quota in the "growth mechanism", holders of quota allocated from the New Entrants Reserve were to be entitled to significant advantages *vis-a-vis* established producers.

46. Because there were far more requests for New Entrants Reserve allocations than there was quota available, Canada developed criteria for weeding out "ineligible" applicants.[31] The criteria employed were never made subject to public scrutiny, or even provided to any of the applicants, apparently on the basis that it was necessary to secure the confidentiality of the companies involved. Canada has never provided any real reason why the actual criteria for qualification or the process for application was not transparent.

47. After this process of identifying and removing ineligible applicants from contention was completed, 83 applicants remained. There was no appeal or review process for those who were determined to be ineligible. Of these 83 applicants, 23 were from British Columbia. The 798,206,000 board feet of quota requested by these applicants was far more than the 173,460,000 board feet of New Entrants Reserve quota that would have reflected the 59% share that could have been allocated to new entrants in British Columbia.

48. Rather than provide these British Columbia applicants with their *pro rata* share of the 59% New Entrants Reserve that should have been made available to producers from

[30] See Affidavit of Claudio Valle to Canada's Counter-Memorial, March 27, 2000, at para. 138.

[31] See Schedule 48, "Methodology for New Entrant Quota Allocations".

British Columbia, Canada secretly developed another set of unpublished criteria for further reducing the amount of quota allocated to eligible applicants. Applicants were not informed of this criteria or provided with an opportunity to either comment upon its usefulness or about its application to their particular circumstances. There were no provisions for review or appeal.

49. Even after this second culling process had taken place, the 23 applicants from British Columbia would have still been entitled to 205,125,900 board feet of quota (or 69.8% of the total quota available under the Reserve). Rather than allocate the New Entrants Reserve to reflect the tacit agreement among "stakeholders" to generally make allocations based along the "historical" provincial shares, Canada pro-rated its allocation on a national basis, significantly benefiting the larger number of applicants from Quebec and Ontario as a result.

50. Moreover, Canada even went so far as to exempt applicants in "Category C" (i.e. those who had nothing more than verifiable Investment commitments by April 31, 1996 – rather than those who had actually commenced or completed expansions or new facilities) from this final pro-rating exercise. Of the 20 applicants in Category C, 12 were from Quebec and Ontario, while only six were from British Columbia. By virtue of merely demonstrating that they would be investing in the lumber business, these firms were provided with a non-pro rated allocation from the New Entrants Reserve, inclusion in the "growth formula" for future allocations, and exemption from the "speed bump" provisions.

51. There is no evidence that Canada made this *pro rata* exemption, or the process of its development in the light of public scrutiny – much less public consultation. The identities of the beneficiaries of this secretive private allocation process were never made available for public examination, nor were statistics on whether the allocation was made fairly, in relation to established provincial shares.

52. The results of Canada's new entrants scheme are clear. In his recent report on export performance under the *Softwood Lumber Agreement*, Doug Smyth concluded:

> Quebec wound up with most of the 514 MMBF in new entrants' quota that the E.I.C.B. subtracted from the four-province total allocation of 14.7 BBF even before the program began. That left British Columbia with just 56.9 percent of the initial allocation, not the 59.0 percent it should have received based on the province's 1994-1995, average base year exports to the U.S.A. Since most of the new entrants group was in Quebec, where several new sawmills had been under construction on April 1, 1996, the province received the lion's share of the reserve.[32]

[32] See Schedule 49, Smyth Report at 243.

c) ***Ministerial Reserve*** –

53. In all years of the application of the Export Control Regime, Canada reserved an amount of quota for the Minister to allocate at his complete discretion. This "Ministerial Reserve" was mentioned by Canada in its notices to the industry as the mechanism available to dissatisfied producers instead of some form of administrative review or appeal. Canada was apparently implying that, even though there was no way to seek an impartial or individualized review of any particular allocation to a producer, there was at least the opportunity to petition the Minister for a small allocation to address unspecified hardships.

54. The criteria for allocations made under the Ministerial Reserve were never published, nor was any formal mechanism put into place to enable petitions to be heard and treated equally.[33] Rather, it would seem to have allowed less well-connected producers to access the Ministerial Reserve by way of complaints to bureaucrats or by writing letters to the Minister. More well-connected producers appear to have been able to take complaints directly to the Minister or his staff, in addition to the bureaucrats.

55. Documentary evidence demonstrates that, although Canada may now say that "province of origin" was of no consequence to the determination of who would receive an allocation from the Ministerial Reserve[34], in truth the province of origin of the would-be quota recipient was always taken into consideration. In consideration of how to placate the increasing demands from Quebec producers for revised provincial allocations in subsequent years of the Export Control Regime, Canadian officials were careful to note how the manner in which discretionary reserves had been allocated had resulted in the most significant net benefits for Quebec producers.[35]

56. This significant advantage for Quebec producers was multiplied by the inclusion of all allocations of the Ministerial Reserve in the "growth formula". Accordingly, these preferential allocations were not one-time gifts. Quota recipients under the Ministerial Reserve would be the beneficiaries of relative increases in the general allocation of EB and LFB quota, so long as they fully utilized their gifts from the Minister in the time permitted.

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[33] May 2000 Merits Hearing Transcripts, Vol. 6., at 65-67. Douglas George confirms, at 67:3-67:8, in response to questions from Arbitrator Belman about whether Ministerial allocations were publically announced: "I don't think we publish beyond announcing that there are errors and omissions, and companies with concerns can write the Minister".

[34] For example, see Canada's Response to Questions of Tribunal, August 8, 2000, Question #5 at 2.

[35] See Schedule 12.

57. Under the guise of the protection of producer "confidentiality", Canada never made its individual decisions about quota allocations, or the Minister's reasons for decision, public. Given that there was no standardized application process, it naturally follows that there was no process for review or appeal. The Minister allocated his Ministerial Reserve at his complete discretion. It is clear, however, that the Minister did not make allocations with the equalization of benefits to producers from each province in mind. In other words, it did not concern the Minister that producers in British Columbia or Alberta were not proportionately represented among Ministerial Reserve quota recipients, but his staff was quick to point out to producers from Quebec exactly how well they fared under the very same system.[36]

d) ***Trigger Price Bonus***

58. The Trigger Price Bonus mechanism is a further example of the discretionary power of the Minister to allocate quota in a manner that specifically disadvantaged British Columbia, and British Columbia producers such as Pope & Talbot, while giving advantage to Ontario and Quebec producers.

59. Doug Smyth confirms in his recent report that one of the main reasons for the shift of quota from British Columbia to Quebec was the result of the Trigger Price Bonus generated during the first six quarters being made a permanent part of the new entrant group's allocations. As Smyth stated:

> The provision was triggered during the first 6 quarters of the agreement, for a total of 552 MMBF. Instead of dividing that volume among the 4 covered provinces according to their initial relative shares of fee-free quota, however, the E.I.C.B. retained the bonus in order to provide quota to the new entrants pool companies during the second agreement year. **Unfortunately, when the U.S. lumber prices plunged during the second half of 1997 and throughout 1998 to levels below the trigger point, the bureau no longer received any additional quota to sustain the new sawmills. As a result, at the beginning of the third agreement year on April 1, 1998, the E.I.C.B. was forced to require all non-new entrant companies in all 4 covered provinces to absorb a 3.14 percent reduction in fee-free or established base quota.**[37] (Emphasis in original)

One possible reason for Pope & Talbot to have lost EB quota in Year 3 of the Export Control Regime was that, like all non-new entrant producers, it lost EB quota because Canada had made the Trigger Price Bonus allocations to new entrants in Years 1 and 2 permanent.

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[36] See Schedule 34 - Memorandum from Keith L. Aird to the Minister dated March 31, 1997 at 6.

[37] See Schedule 49, Smyth Report at 235.

60. The Smyth Report summarizes the quota allocations made between 1996 and 1999 to new entrants, in Table 78 which demonstrates that as most of the new entrants groups were located in Quebec that:

> ... exactly half of the 488 MMBF that was used during the first and second agreement years - that is, 1996-1998 - was consumed in that province. British Columbia, on the other hand, accounted for just over a fourth of that volume, even though total shipments of B.C. softwood lumber to the United States well exceeded the Quebec total.[38] (Emphasis in original)

Table 78
Usage of Triggered Bonus Provision,
By Province, by Agreement Years 1996-1999
(Million of Board Feet)

	B.C.	Alberta	Ontario	Quebec	Total
1st agreement year	27	19	19	104	168
Percent	16.1	11.3	11.3	61.9	100.6
2nd agreement year	107	23	48	142	320
Percent	33.4	7.2	14.7	44.4	99.7
3rd agreement year	23	4	3	8	38
Percent	60.5	10.5	7.9	21.1	100
4th agreement year	100	15	23	37	175
Percent	57.1	8.6	13.1	21.1	99.9
Total, 1st 3 agreement years	**157**	**46**	**70**	**254**	**526**
Percent	**29.8**	**8.7**	**13.3**	**48.3**	**100.1**
Quebec exceeds B.C.				**97**	
Percent			**18.52**		
Total, 1st 4 agreement years	**257**	**61**	**93**	**291**	**7011**
Percent	**36.7**	**8.7**	**13.3**	**41.5**	**100.2**
Quebec exceeds B.C.				**34**	
Percent			**4.82**		

[1] Total allocation to date was 92 MMBF x 10 quarters = 920 MMBF. As of March 31, 2000, a total of 219 MMBF of triggered quota remained unused.

[2] Basis points

Source: Export-Import Control Bureau; I.W.A.

[38] See Schedule 49, Smyth Report at 235.

61. The first two Trigger Price Bonus allocations, earned in the first and second quarters of Year 1 of the Export Control Regime, were allocated to new entrants solely. In addition, new entrants received quota derived from the Trigger Price Bonus allocation in the third and fourth quarters of Year 1 of the Export Control Regime. Canada has admitted that the Trigger Price Bonus allocations for the third quarter was allocated to only 37 specific new entrant companies out of the total of 83 companies that originally received new entrants quota allocations. Of the 37 companies receiving the Year 1 third quarter Trigger Price Bonus allocations, 12 were to Quebec companies, eight were to Ontario, three were to Alberta and only 13 allocations were to British Columbia new entrants.[39]

62. In the Ministerial memorandum on which the allocation was approved, it is indicated that 36 of the 38 new entrant companies were category A mills (new mills) and category D+ mills (mills with more than 100% expansion, such as completely rebuilt mills) and they received quota "in proportion to their initial new entrant allocations."[40] In other words, the more the new entrant received in the original new entrants allocation, the more a company would receive in this special Trigger Price Bonus allocation.

63. It should be noted that, of the 14 primary manufacturers who received category A quota allocations, three companies were from British Columbia (accounting for only 11,180,000 of 198,216,000 board feet allocated to category A new entrants) and the remaining 11 category A primary producer recipients were from Ontario and Quebec (accounting for the remainder of the allocation).[41]

64. In addition, concerning D+ category primary producer new entrants, no British Columbia company received an allocation from this category allocation of 171,607,000 board feet. Five of the six primary producers receiving the D+ new entrant allocations were from Quebec and Ontario (an Alberta company accounted for the balance of 29,152,000 board feet).[42]

65. In summary, because the third quarter trigger price bonus allocation was restricted to primary producer new entrants under categories A and D+, and these new entrants received quota "in proportion to their initial new entrant allocations", British Columbia

[39] See Schedule 34 at 2.

[40] See Schedule 21 at 2.

[41] See Schedule 31, Tab 20 of the Canada Documents provided to the Tribunal relating to new entrants allocations charts by category.

[42] See Schedule 31.

primary producer new entrants were almost entirely ignored by Canada in the allocation of this special discretionary quota allocation.[43] More particularly, Quebec and Ontario companies received 88% of the special Trigger Price Bonus allocation made to primary manufacturers while British Columbia received only 3%. As with all of the first four bonuses, this allocation was made on a permanent basis and, accordingly, the inequitable nature of this allocation was exacerbated through the "growth mechanism".

66. This process of allocation for the third quarter trigger price bonus was made without public consultation nor were the beneficiaries of this entirely secretive allocation process ever made open to public scrutiny. In particular, information and statistics on whether the allocation was made fairly, in relation to provincial corporate shares, were never made public. Pope & Talbot and other softwood lumber producers did not have an opportunity to be apprised of this allocation other than being advised in their 1997/ 98 allocation letter that a Trigger Price Bonus allocation had been made.[44]

3. Wholesaler Problem

67. While Canada was designing its implementation of the Export Control Regime, officials knew that there were irregularities in the collection of accurate data from softwood lumber wholesalers. Indeed, officials commented that this lack of precise information would make the creation of a softwood lumber export quota regime "very hazardous" without proper preparation.[45] In February 1997, after the initial implementation of the Export Control Regime, a briefing memo stated succinctly:

> On the cause of error in calculation (of the wholesaler allocation) - there are no errors in calculations. **It's a consequence of faulty data!** Industry associations had been advised about data shortcomings.[46] (Emphasis added)

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[43] Out of the initial total allocation of 369,826,000 board feet to category A and D+ new entrants, new entrants in the Listed Provinces received, as follows: British Columbia received only 11,180,000 board feet (3%), Alberta received 29,152,000 board feet (8%), Ontario received 85,844,000 board feet (23%), and Quebec received 243,650,000 board feet (65%).

[44] See Schedule 26, letter to Pope & Talbot from Department of Foreign Affairs and International trade re: 1997/98 Final Allocation.

[45] See Schedule 1 - Memorandum from Claudio Valle to the Minister for International Trade dated April 24, 1996 at 5.

[46] See Schedule 45, Memo, "Softwood Lumber Quota Allocation System", February 11, 1997, at 8. This document was prepared in response to comments from industry in light of the February 1997 National Advisory Committee Meeting.

Despite these indications that the wholesaler data was erroneous, these same officials imposed the Export Control Regime on investments like Pope & Talbot Ltd. without taking steps to correct the obvious flaws in the Export Control Regime. At the same time, Canadian officials kept this discussion out of the public realm.

68. In the "Action Memorandum to the Minister" regarding the 1997/ 1998 Final Allocation, dated May 27, 1997, it was recommended by officials, and the Minister approved, that 13 British Columbia softwood lumber producers receive a special re-allocation from the EB quota of other British Columbia producers, including Pope & Talbot, in relation to problems with the British Columbia wholesaler allocation component. The ministerial document stated as follows:

> The B.C. Committee has provided us with a list of companies that it proposes should have their allocations adjusted upward to address problems related to the distribution of the B.C. wholesaler component, although our analysis suggests that part of the proposed adjustments relate to problems stemming from the application of the B.C. averaging criteria. We have reviewed the companies on this list and we recommend that the allocations to the B.C. companies identified in Annex C should be adjusted upwards by a total of 209.5 million board feet, with a corresponding reduction in the quotas for the other B.C. companies to fit these adjustments back into B.C.'s original provincial corporate share.[47]

69. The British Columbia Softwood Lumber Advisory Committee made its recommendation by letter to Canada dated April 17, 1997. All 12 companies recommended by the Advisory Committee were accepted by the Minister in the re-allocation. With the exception of one company, the amounts accepted by the Minister were as recommended by the Advisory Committee.[48] Of the 12 companies, one company was provided quota because it failed to file a questionnaire, two companies were provided quota based on the reason of *force majeure*, and nine were given quota regarding "quota attributable to exports via wholesalers.

[47] See Schedule 20, Memorandum to Minister of Trade from Wallace H. Dowswell and Robert G. Wright, "1997/ 98 Final Allocations for Softwood Lumber Exports to the USA", May 27, 1997 at 7. See Schedule 22, Comparison of Pope & Talbot, Ltd.'s Year 1 Allocation, Tab 96 - Canada Documents Requested from Tribunal. It should be noted that with respect to Pope & Talbot it was not a question of the averaging criteria versus best year problem under the British Columbia provincial formula. The averaging criteria worked in Pope & Talbot's favour.

[48] See Schedule 21, Letter from John Allan, BC Softwood Lumber Advisory Committee, to Minister Eggleton, April 17, 1997. Compare with Annex "C" from Schedule 20. The only company added by Canada was [redacted], which was a company that had applied for a new entrant's allocation but was turned down by Canada (compare list of applicants at Tab 33 of Canada's Documents Requested by Canada).

70. In its letter the British Columbia Advisory Committee set out the "principles and guidelines" for these recommended adjustments. The Advisory Committee described the "wholesaler problem" as follows:

> "Wholesaler problem" - the amount of quota attributed to US exports of a producer's lumber through wholesale reloads and distribution yards was low. The problem arises because of the lack of relevant information required by the federal questionnaire, and the use of a formula to estimate quota in respect of producers' lumber sold into wholesalers' inventory, and then exported.
>
> Adjustment calculation requires a solid estimate of the lumber sold to a wholesaler as his inventory (usually to a reload or distribution yard), which was then exported to the US. This estimate is added to the producers direct exports to determine total US exports; total US exports are multiplied by 84% to determine "adjusted quota"; adjusted quota is compared to the actual quota.[49]

71. Attached to the Advisory Committee's letter to the Minister are detailed charts for each company showing how the re-allocation was calculated. In effect, the solution provided to these companies for their deficiency in wholesaler quota allocation was solved by ignoring the complicated wholesaler formula applied to all other producers (such as Pope & Talbot) and calculating the wholesaler sales in the same manner that direct sales were calculated.[50]

72. In its 1997/ 98 Final Allocation letter, Pope & Talbot was only advised by Canada that its reduction in quota incorporated "the modifications of the provincial formulae (e.g. adjustments to the distribution of the wholesaler component)."[51] Following-up on the final allocations, the British Columbia Softwood Lumber Advisory Committee confirmed to the Investment by way of a memo that was circulated to the industry that the net effect of the 1997/ 98 re-allocations was a decrease of 3.1% to the vast majority of producers in British Columbia. The Investment was advised that this re-allocation was done as a result of "data problems (for example, companies which received only partial credit for lumber sold to wholesalers, which ultimately was exported to the US in 1994 and 1995...)"[52] Neither the Advisory Committee, nor Canada, advised Pope & Talbot that the problem for which these companies received lower quota allocations as a result of "data problems" was the same problem that any company in British Columbia with wholesaler quota allocation would have unknowingly experienced.

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[49] See Schedule 21 at 3.

[50] See example of this calculation at Schedule 22.

[51] See Schedule 26, Letter from Canada to Pope & Talbot, 1997/ 98 Final Allocations, June 5, 1997 at 2.

[52] See Schedule 24, BC Softwood Lumber Advisory Committee, 1997/ 98 Softwood Lumber Quota Allocations, June 24, 1997 at 2.

73. The phrase "made in BC adjustments" was written into the margin of Annex C to the Ministers Memorandum detailing the 1997/ 98 quota allocation to reflect that only British Columbian producers who complained were going to receive compensation for what were widespread problems with the wholesaler quota allocation.[53] The BC Advisory Committee concluded that Canada's wholesaler mechanism was at fault for the problems in the allocation, in particular because of (1) "data problems" related to "a lack of relevant information" required by the federal questionnaire, and (2) the use of what was a questionable formula to estimate quota in respect of producers' lumber sold into wholesalers' inventory, and then exported.[54]

74. For example, in a comparison of Schedule IIb from Pope & Talbot's Questionnaire, and the list of wholesalers provided by Canada used to determine Pope & Talbot's wholesaler allocation,[55] the difference between what Pope & Talbot submitted to Canada and what wholesalers submitted to Canada is a dramatic and egregious demonstration of the flaws in the wholesaler component of the quota allocation. Over the period at issue under the Questionnaire, 1994 to Q1 of 1996, Pope & Talbot reported over [redacted] of sales to wholesalers more than wholesalers reported purchases from Pope & Talbot.[56]

75. Pope & Talbot's Year 1 EB allocation was [redacted] and its Year 2 EB allocation was [redacted] - a decrease of 3.1%.[57] If Pope & Talbot had not received the [redacted] from Years 1 to 2, approximately [redacted], its base EB allocation would have remained at [redacted] in Year 2 EB quota.

4. The Verification Review Exercise

76. On January 7, 2000 this Tribunal made a factual ruling concerning the conduct of Canada with respect to the Export Control Regime. In dismissing the Investor's Motion for Interim Measures, this Tribunal confirmed that the verification review process was an

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[53] See Schedule 20 at Annex C.

[54] See Schedule 24.

[55] See Schedule 32, Information Submitted by Wholesalers Used to Determine the Allocation of Pope & Talbot Ltd., as provided to the Investor in its Request for Documents. This document refers to wholesaler questionnaire responses to lines 9(a) and (b) as submitted in wholesaler schedule IVc indicating the amount of softwood lumber sales to the United States.

[56] See Schedule 33, Witness Statement of Howard Rosen.

[57] See Schedule 2, Letter of Abe Friesen to Canada, June 3, 1998.

"application of the measure which is the quota regime and its implementation" and accordingly it did not have power to grant the relief sought by the Investor.

77. On the basis that the verification review process is part of the Export Control Regime, the Investor relies on the factual findings of the Tribunal in the Award on Interim Measures for this memorial. The Tribunal stated in its ruling as follows:

> ... the Tribunal feels compelled to state that the verification review and the report thereon were seriously flawed and are not a reliable basis for further action. Nevertheless there were also admitted errors by Pope & Talbot, Inc. But the Tribunal finds these to be immaterial in the context of Pope & Talbot's total quota and past action by Canada in implementing the measure.
>
> The Tribunal wishes it to be understood that it will be mindful of the views just expressed should these matters become material in the future.[58]

a) ***Wholesaler allocation data was flawed***

78. Canada's verification review was flawed in particular with respect to the wholesaler allocation data and audit process.[59] These flaws were made worse due to the lack of transparency maintained by Canada. In particular, the Investor would not have become aware of the flaws relating to its wholesaler allocation, and the problems inherent in the Export Control Regime's wholesaler allocation,[60] if not for the verification review and the documents produced for the Interim Measures Motion. Some of the wholesaler data used in support of Mr. Lund's Report was only provided to the Investor's counsel, on the basis of Third Party Confidentiality under the Tribunal's Confidentiality Order, on July 26, 2000 in response to the Investor's Request for Documents.

79. The Investor requested all information regarding the verification review from Canada on the last day of the verification review process in July 1999. Pope & Talbot requested at that time that it would "need a detailed list of the 'errors' identified by Mr. Lund and his team during the audit so that we [Pope & Talbot] could review them" against our

[58] *Pope & Talbot and Canada*, Ruling by the Tribunal on Claimant's Motion for Interim Measures, January 7, 2000.

[59] As claimed in the Investor's Reply to the Response of Canada, Motion for Interim Measures, December 7, 1999 at para's. 1- 3.

[60] Testimony of Kyle Gray, January 6, 2000 Transcripts at 143:21 to 144:5 where it is noted that at the verification review Mr. Lund admitted to Mr. Gray that the allocation and questionnaire process with respect to wholesalers was flawed.

records.[61] Mr. George continually refused to provide Pope & Talbot with this information and, as the Tribunal may recall, did not even provide a full copy of the Lund Report setting out the numerical calculations until a week before the Interim Measures Motion hearing.

80. It appears very unlikely that the Investor would never have been permitted access to the information about its own quota supporting Canada's administrative action with respect to the verification review if not for the bringing of the Investor's Interim Measures Motion and the intervention of this Tribunal. In particular, Pope & Talbot would not have received specific data with respect to Canada's wholesaler allocation in the absence of the Investor's Request for Documents made in this NAFTA Chapter 11 Claim.

81. In response to the Investor's February 2000 Request for Documents, Canada produced a document titled "Information Submitted by Wholesalers Used to Determine the Allocation of Pope & Talbot Ltd."[62] This document was produced over a full year after the verification review and it required the procedural tools of this international arbitration to bring this evidence out. In a comparison of the data submitted by wholesalers with respect to purchases from Pope & Talbot exported to the US and of the sales to wholesalers reported by Pope & Talbot (at line 9(c)(ii) and in Schedule IIb of the 1996 Questionnaire), it is clear that there was a dramatic difference in reporting.

82. For example, in 41 of the 62 cases in which Pope & Talbot sold softwood lumber to wholesalers, Pope & Talbot reported sales to wholesalers that were not in turn reported by those very wholesalers at all. Ten wholesalers reported only fractions of what Pope & Talbot reported, and eight of the 62 wholesalers actually reported that they exported more lumber to the US than Pope & Talbot sold to them. In total, over the period at issue under the Questionnaire (1994 to the first quarter of 1996), [redacted] to wholesalers more than wholesalers reported purchases from Pope & Talbot.[63] This reinforces the evidence produced at the Interim Measures Motion hearings showing that the wholesaler allocation process and the wholesaler formula were deeply flawed.

[61] See Schedule 36.

[62] See Schedule 32.

[63] See Schedule 33.

b) ***Audit process was flawed***

83. The Investor continues to maintain that the audit process was flawed as it was not conducted in accordance with accepted auditing principles.[64] Counsel for the Investor and the external expert retained by the Investor, Howard Rosen, pointed out the flaws in the system used by Canada both before and during the audit[65] and then at the Interim Measures Motion hearing.[66] These flaws included fundamental issues such as the methodology used by Canada in its audit, which did not follow accepted statistical sampling procedures in Mr. Rosen's expert opinion. On the basis of this flawed process, it was impossible for the Investor, or for the Tribunal, to verify the fairness or accuracy of the auditing conclusions arrived at by Canada.

c) ***Lawful authority not provided***

84. Canada refused, despite repeated requests by the Investor, to provide any evidence to the Investor of lawful authority for the audit at any time during the verification process or up to the time of the hearing. The verification review was held on a consensual basis, albeit under the threat of the total revocation of the Investment's softwood lumber quota by Canada. The Investor has never received evidence of Canada's legal authority to hold such an audit.

d) ***Terms of the audit agreement not honoured***

85. The terms of the Agreement on which the verification audit was held included that:[67]

i. Canada would provide Pope & Talbot with a question and answer session concurrently with the audit where it would explain the process through which the initial allocation was made and then allocated for each additional year; and that

ii. Canada would provide the company with the results obtained from the audit so that the company could have a "clear understanding of the type and scope of errors" so as to take such results into account if it were to revise a new questionnaire.

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[64] This allegation was also made by the Investor in its reply to Canada's reply to the Interim Measures Motion at para. 4.

[65] Statement of Howard Rosen, December 7, 1999 at para's. 3-4.

[66] *Interim Measures Motion Transcripts Vol. I*, January 6, 2000 at 9 - 82.

[67] See Schedule 36, Letter to Douglas George from Investor dated October 25, 1999.

86. Canada did not comply with the terms of the Agreement, as follows: –

i. Canada did not provide a question and answer session with Pope & Talbot on the allocation of the quota after the initial year at Vancouver, BC; and

ii. Canada failed to provide any information to Pope & Talbot about any possible errors in its softwood lumber quota questionnaire until the Interim Measures Motion was brought by the Investor in October 1999.

Indeed, Canada sent no person to the verification review who had any knowledge of the operations of the Export Control Regime after its initial year, making compliance with this part of the "verification review agreement" impossible.

e) ***Conduct of Canada***

87. As stated in the Investor's Motion for Interim Measures, dated November 11, 1999, Canada threatened to cancel Pope & Talbot's quota allocation on five occasions.[68] The final threat occurred on the day before the Investor's Motion was due to be submitted. On November 10, 1999, Canada wrote to the Investor threatening to revoke the Investor's quota.[69] Mr. George stated in the letter that Canadian officials were then prepared to propose to the Minister a unilateral revision of the Investment's quota allocation. This threat was made without Canada responding to the Investment's concerns or providing the Investment with a reasonable opportunity to know the basis of that recommendation to be made to the Minister. Canada's letter stated:

> ... officials propose to recommend that the Minister proceed with revisions of quota allocations to Pope & Talbot Ltd., whether or not your client supplies additional information. If you wish to provide a new questionnaire or other information relevant to the proposed revisions of quota allocations, please do so by the end of business on November 15, 1999.

5. The Super Fee Base Levy

88. As stated in the Investor's Memorial (Initial Phase) at paragraph 89, on September 3, 1999 Canada introduced a measure establishing an "extra fee level" solely applicable to exports of softwood lumber from British Columbia mills (the "SFB Levy").[70] This

[68] Investor's Motion on Interim Measures at para's. 6 - 20.

[69] This letter was set out as Schedule "B" of the Investor's Motion on Interim Measures.

[70] *Notice to Exporters No. 120.*

measure involved the repricing of LFB and UFB for all British Columbia softwood lumber producers and had a particularly adverse effect on the Investor and its Investment.

89. Canada's measure had the immediate impact of depriving the Investment of over 25% of its LFB quota, which was repriced from US$53.00 per thousand board feet to what was formerly the UFB fee level of US$105.86 per thousand board feet ("repriced LFB" or "R-LFB").[71] In addition, what was formerly the unlimited UFB of US$105.86 per thousand board feet greater than 110 million board feet in each of Years 4 and 5 of the Export Control Regime was increased by Canada to US$146.25 per thousand board feet (SFB Levy).[72]

90. In Pope & Talbot's Year 5 (2000-2001) quota allocation, [redacted] of the LFB level softwood lumber was repriced at the R-LFB level.[73] In Year 3 of the Export Control Regime, [redacted] of UFB level softwood lumber was exported by softwood lumber producers in British Columbia.[74] In Year 3 of the Export Control Regime, Pope & Talbot exported [redacted] of softwood lumber at the UFB level.[75] This represents [redacted] of total UFB level exports from British Columbia in 1998-1999.

91. In a briefing memorandum by Douglas George to the Deputy Minister of International Trade, it is clear that Canada knew that the imposition of the SFB levy would be economically punitive to softwood lumber companies in British Columbia, in particular those companies that were heavy exporters of UFB level softwood lumber. More specifically, Douglas George stated in this memo that:

> **The implementation of the BC Stumpage settlement required that DFAIT to re-price 25% of each BC-based company's LFB allocation from US$53 per thousand board feet to US$106. This has made it uneconomic for many companies to ship this re-priced LFB. Under the current policy, even if these companies return the full 10% , they would be faced with the choice**

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[71] *Notice to Exporters No. 120* at para. 4.1.

[72] *Notice to Exporters No. 120* at para. 4.3(c).

[73] See Schedule 18, Letter from Canada to Pope & Talbot, 2000-2001 Final Allocation, May 29, 2000. Also see Schedule 29, Pope & Talbot Export History as at March 24, 2000, attached as Annex A to Affidavit of Douglas George, March 27, 2000.

[74] See Schedule 30, Department of Foreign Affairs and International Trade, EICB, Softwood Lumber Exports to the U.S.A., April 1, 1998 - March 31, 1999.

[75] See Schedule 29.

> *of either shipping at uneconomic prices, or facing lower overall quotas next year due to underutilization penalties.*[76] [emphasis added]

92. Doug Smyth confirms the punitive nature of the SFB levy to previous exporters of UFB levy softwood lumber when he states:

> As a result, the penalty fee for most over-quota shipments has now become prohibitive for most B.C. companies. Even at the high lumber prices which were in effect during the Summer of 1999, most B.C. companies had difficulty overcoming that hurdle.
>
> Given those restrictions, the volumes of upper fee base lumber shipped from British Columbia at the fifth agreement year super upper fee base rate of $148.27 (U.S.) is likely to shrink dramatically from the 1999-2000 level of 133 MMBF.[77]

93. The Investment was one of the largest single exporters of UFB levy softwood lumber in British Columbia (exporting [redacted] of the province's total exports under the UFB fee level). Accordingly, Canada would have been in a position to know that Pope & Talbot would experience one of the most adverse impacts of any softwood lumber manufacturer in British Columbia, as a result of its imposition of the SFB levy.

94. In the "Decision Memorandum" of the Minister providing his authority to implement the SFB levy, prepared by Douglas George and signed off by Deputy Minister Robert Wright, Canada specifically adverted to the effect of the new measure upon Pope & Talbot. This memo also contemplated the possibility that Pope & Talbot might "amend" its NAFTA Claim to recoup additional damages caused by imposition of the measure.[78] Pope & Talbot was the only softwood lumber company discussed in this ministerial document.

95. The SFB levy measure was implemented by Canada as part of its negotiated settlement agreement with the US Government concerning a dispute about the lowering of the British Columbia stumpage rate in 1998. On May 28, 1998 stumpage rates in British Columbia were lowered by an average of CAD$8.10 per cubic metre, or 24%, with respect to coastal producers, and by an average of CAD$3.50 per cubic metre, or 14%,

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[76] See Schedule 7 Memorandum to Deputy Minister's Office from EPS dated October 25, 1999 at 2.

[77] See Schedule 49, Smyth Report at 240.

[78] See Schedule 8 Memorandum to MINT from EPS dated August 18, 1999 at para. 12.

with respect to interior producers.[79] Even after the reduction, B.C. stumpage rates remained the highest in Canada.[80]

96. The settlement of the *BC Stumpage Case* did not reflect the relative reductions of the stumpage rates on the coast and interior that was put at issue by the US. The settlement was, as described above, equally applied to all British Columbia softwood lumber manufacturers, coast or interior, in a uniform manner regardless of the stumpage reductions received. Canada has admitted that neither Canada nor the British Columbia Government "contemplated allocating the super fee based on the relative reduction in stumpage charges between coastal and interior producers".[81] The SFB levy measure was intended to act as a general "export restraint" on all British Columbia producers exporting into the US even though the coastal producers, who received the lions' share of the stumpage rate reductions, were the ones who were producing and exporting softwood lumber for the Japanese market, not the US market.

97. Although British Columbia producers on the coast received a higher stumpage reduction than interior producers, companies like Pope & Talbot were required to pay the same increased price of LFB and UFB softwood lumber as coastal producers. Similarly, as usage of UFB was not uniform throughout British Columbia, those companies that used the greatest share of UFB under the Export Control Regime would be disproportionately disadvantaged compared to those producers who paid little or no UFB fees. In response to the Tribunal's question concerning why the settlement was not proportionate to the stumpage reductions, Canada has offered a memorandum of the British Columbia Lumber Trade Council that sets out the framework of the implemented measure, but does not address the question as to why the measure was not proportionate to the stumpage reductions.[82]

98. In questioning by the Tribunal during the May 2000 Tribunal Hearings, Douglas George admitted that the settlement was the result of "horse trading" between the disputing parties. He further admitted that the negotiating positions of the parties were based upon

[79] See Schedule 14, First Submission of the United States of America, *British Columbia's June 1, 1998 Stumpage Reduction*, December 30, 1998, at para. 22. Also see Schedule 15: This was admitted by Canada in the Counter-Submission of Canada, *In the Matter of British Columbia's June 1, 1998 Stumpage Reduction*, January 25, 1999, at para. 30 ("*BC Stumpage Case*").

[80] See Schedule 49, Smyth Report at 245, Table 83.

[81] Canada's Response to Questions of Tribunal, August 8, 2000, "Documents Responding to the Tribunal's Document Requests" at 16.

[82] See Schedule 16, Memorandum, British Columbia Lumber Trade Council, September 2, 1999.

the economic effects of the reduction of the British Columbia stumpage rate.[83] In this case, it is clear that the economic effect of the SFB levy for Pope & Talbot was disproportionately adverse in comparison with whatever benefit it received from the reduction of the stumpage rate for the interior.

99. As part of the implementation of the SFB levy, Canada has admitted that because certain softwood lumber producers did not benefit from the stumpage reduction, such as holders of "non-tenure" timber or companies paying a fixed rate of stumpage, these producers would be compensated a total of 3 million board feet out of the allocation of Trigger-Price Bonus in quarters 12 and 13 of the Regime.[84]

100. Further, it should be noted that from this Q12 and Q13 bonus allocation in British Columbia, all other British Columbia producers, such as Pope & Talbot, were allocated quota on a *pro-rata* basis out of a total of 75 million board feet that was remaining. Pope & Talbot received [redacted] of bonus quota from this allocation.[85] This allocation was not made on the basis of compensating Pope & Talbot for the adverse effect of the SFB measure.

[83] Hearing Transcripts, May 3, 2000, Vol. 6 at 77:20 - 78:12.

[84] See Schedule 17, Memorandum from EPS to MINT, "Allocation of Trigger Price Bonus", September 2, 1999 at para. 10.

[85] Canada's Response to Tribunal Question #9 at 3 - 4; and Schedule 19, Pope & Talbot bonus allocation letter dated September 9, 1999.

SECTION THREE: THE INTERNATIONAL LAW STANDARD OF TREATMENT

I. THE LAW

A. Overview and Evolution of the International Standard

101. The NAFTA requires Canada to provide investments of investors from other NAFTA Parties with "treatment in accordance with international law". This obligation, contained in NAFTA Article 1105, reads:

> 1. Each Party shall accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security.

102. The NAFTA does not define the extent of treatment to be provided to the investments of investors from other NAFTA Parties other than to state that it must be in accordance with international law, including fair and equitable treatment and full protection and security. Accordingly, "fair and equitable treatment" and "full protection and security"[86] can be seen as two non-exhaustive examples of the level of treatment that Canada must provide to NAFTA investments to be in compliance with NAFTA Article 1105 specifically, and "international law" generally.

103. Article 38 of the Statute of the International Court of Justice[87] (the "ICJ") sets out the definition of international law that is generally regarded as a complete statement of the sources of international law.[88] Under Article 38, the International Court of Justice considers the following indicia in determining what constitutes international law:

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[86] The ICJ examined the meaning of a similar term "constant protection and security" in the *Electtronica Sicula Case* (1989) ICJ Rep. at 65. The court found that this term resulted in obligations for governments to give protection to the investments of foreign investors in its territory. In *American Manufacturing & Trading v. Republic of Zaire* (1997) ICSID Reports at para. 38: the Tribunal interpreted a BIT that contained provisions analogous to Article 1105 of the NAFTA and held that the obligation owed by Zaire to the US Investor was an obligation of vigilance, in that Zaire should have taken all measures necessary to ensure the full enjoyment of protection and security of the US Investor. At para. 44: The Tribunal held that Zaire was obliged to take every measure necessary to protect and ensure the security of the Investment made by the US company in its territory. At para 43: The Tribunal also dismissed Zaire's argument that all other Investors were treated in a similar manner and held that Zaire's treatment of the US Investor clearly fell below the minimum standard of treatment under international law thereby depriving the US Investor of its treaty rights to fair and equitable treatment and full protection and security.

[87] The Statute of the International Court of Justice is a part of the United Nations Charter and the Court is the principal judicial organ of the United Nations according to Article 92 of the U.N. Charter.

[88] See Brownlie, *Principles of Public International Law* (1990) at 3.

(a) international conventions, whether general or particular, establishing rules expressly recognized by the contesting States;

(b) international custom, as evidence of a general practice accepted as law;

(c) the general principles of law recognized by civilized nations;

(d) subject to the provisions of Article 59, judicial decisions and the teachings of the most highly qualified publicists of the various nations, as subsidiary means for the determinations of the rules of law.

104. Canada's *Statement on Implementation* provides that whereas the national treatment obligation requires NAFTA Parties to provide a relative standard of treatment to NAFTA investments, in comparison to the treatment accorded to domestic investments, NAFTA Article 1105 provides "a minimum absolute standard of treatment, based on the long-standing principles of customary international law."[89] The *Statement on Implementation* does not elaborate as to what these "longstanding principles"might be.

105. The heading to NAFTA Article 1105 describes a NAFTA Party's compliance with international law as the "Minimum Standard of Treatment". Nowhere within the operative article does this term "minimum standard of treatment" appear. The concept of the minimum standard of treatment has evolved over the last century from being a controversial topic to a well-respected concrete precept of international law. The international minimum standard of treatment is synonymous with other terms such as the "broad concept" of denial of justice.[90] It has been used to distinguish itself from the application of what has been termed as the "national standard", or the "equality standard", which are also sometimes known as the old concept of "national treatment".[91] At its most basic, the equality standard states that an alien should receive treatment from the State that is no more, nor less, favourable than that which has been provided to similarly situated nationals. Of course, in the context of what is termed as the Calvo doctrine, the equality standard is both a minimum and maximum standard.

106. It is generally accepted that the broad purpose of an obligation such as NAFTA Article 1105 is "to provide a basic and general standard which is detached from the host State's

[89] *Statement on Implementation*, at 149.

[90] Brierly, *The Law of Nations*, 1st ed. (1928), at 139-140 quoting Borchard, *Diplomatic Protection of Citizens Abroad* (1915) at 330.

[91] This is a different concept from the concept of national treatment in international trade law.

domestic law".[92] In its *Statement on Implementation*, Canada confirms that NAFTA Article 1105 is "intended to assure a minimum standard of treatment of investments of NAFTA investors".[93] However, with its explicit reference to the "fair and equitable" treatment standard, NAFTA Article 1105 goes even further, by confirming that the "minimum standard" of treatment that must be accorded to NAFTA investments includes treatment in accordance with the requirements of *jus aequum* – fairness and reasonableness.

107. When a provision such as NAFTA Article 1105 not only requires a government to treat foreign investments in accordance with the minimum standard specified under international law, but goes so far as to expressly include "fair and equitable" treatment as part of that international standard, the result can be described as the most potent of investment security obligations. Treatment in accordance with international law, which includes fair and equitable treatment and full protection and security, requires states to accord a level of legal security to foreign investments that can often surpass any obligations that may be owed to those investments under their own domestic laws.

108. NAFTA Article 1105 addresses the responsibility of governments for any failure to meet international law standards resulting in an injury to the investment of an investor from another NAFTA Party. This failure to meet the standard is very much like the concept of a tort or delict under international law. In his discussion of the recognition of delictual responsibility under international law, Professor Brownlie concludes that there is no single standard to be applied when a state fails to undertake due diligence in its duties and a foreign Investment is harmed. He states:

> International law is not a system replete with nominate torts or delicts, but the rules are specialized in certain respects. Thus reference may be made to the source of harm, such as unauthorized acts of officials, insurrection, and so on, or to the object and form of harm, as, for example, territorial sovereignty, diplomats and other official agents, or injury to nationals. The category of injury to nationals involves the problems considered in the preceding sections and also certain special topics, the principal of which are denial of justice and expropriation.[94]

B. Good Faith

109. The concept of good faith is one of the most fundamental precepts of international law. Tribunal decisions, treatises of publicists and the texts of treaties have applied this

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[92] Dolzer and Stevens, *Bilateral Investment Treaties* at 58.

[93] *Canada Gazette Part I*, January 1, 1994, 68 at 149.

[94] Brownlie, *Principles of International Law* (5th ed.) at 531.

concept to almost every conceivable area of international law. Good faith is also considered to be a formal source of international law that underpins the international standard of treatment that NAFTA Article 1105 assures to the investments of investors.[95] The international principles of *pacta sunt servanda* and abuse of rights are particular expressions of the good faith principle in international law.

110. In the *Nuclear Test Case (Australia* v. *France)*, the ICJ recognized the principle of good faith in international law, as follows:

> One of the basic obligations governing the creation and performance of legal obligations, whatever their source, is the principle of good faith. Trust and confidence are inherent in international co-operation, in particular in an age when this co-operation in many fields is becoming increasingly essential. Just as the very rule of *pacta sunt servanda* in the law of treaties is based on good faith, so also is the binding character of an international obligation assumed by unilateral declaration.[96]

111. As Professor Bin Cheng has noted:

> It is submitted that, in reality, with the assumption of every obligation, all the rights of the State suffer a limitation to a greater or lesser extent. When a State assumes a treaty obligation, the principle of good faith -- which governs the performance of treaty obligations – imposes a general limitation on every right of the State so that none may be exercised in a manner incompatible with the bona fide execution of the obligation assumed.[97]

112. The NAFTA has created a good faith obligation under international law for its members to follow with respect to the investments of investors from other NAFTA Parties operating in its territory. This good faith obligation carries with it the international law concept of state responsibility for a Party's failure to meet its international law obligation. This concept of state responsibility is well-settled in international law[98]. For example, in his decision in the *Spanish Zone of Morocco* Claim, Judge Huber states:

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[95] J.F. O'Connor, *Good Faith in International Law* (1991) at 1.

[96] (1974) ICJ Rep. 253 at 268.

[97] Bin Cheng, *General Principles of Law* (1953) at 124.

[98] Professor Brownlie states that "Today one can regard responsibility as a general principle of international law, a concomitant of substantive rules and of the supposition that acts and omissions may be categorized as illegal by reference to the rules establishing rights and duties". Brownlie, *Principles of International Law* (5th ed.) at 436.

> Responsibility is the necessary corollary of a right. All rights of an international character involve international responsibility. If the obligation in question is not met, responsibility entails the duty to make reparation. [99]

113. Furthermore, this principle was also re-affirmed by the Permanent Court of Justice in the *Chorzow Factory Case* where the court stated:

> It is a principle of international law that the breach of an engagement involves an obligation to make reparation in adequate form. Reparation therefore is the indispensable complement of a failure to apply a convention and there is no necessity for this to be stated in the convention itself.[100]

114. *The Restatement (Third) of the Foreign Relations Law* of the United States provides:

> **§ 711 State Responsibility for Injury to Nationals of Other States**
>
> A state is responsible under international law for injury to a national of another state caused by an official act or omission that violates:
>
> (a) A human right that, under § 701, a state is obligated to respect for all persons, subject to its authority;
>
> (b) A personal right that, under international law, a state is obligated to respect for individuals of foreign nationality; or
>
> (c) A right to property or another economic interest that, under international law, a state is obligated to respect for persons, natural or juridical, of foreign nationality, as provided in § 712.

Commentary (e) to § 711 of the Restatement (Third) provides that:

> *Clause (b) refers to individuals but the interests of a juridical person of foreign nationality also enjoy some protection, for instance, against denials of procedural justice; for a juridical person, such violations would normally result in economic injury and fall within clause (c) of § 712.*

115. In his treatise on International Law, Professor Hyde wrote:

> Before a State prefers a claim on behalf of an aggrieved citizen it should appear that the foreign territorial sovereign upon which the demand for redress is made has itself been guilty of a denial of justice. A denial of justice, in a broad sense, occurs whenever a State, through any department or agency, fails to observe with respect to an alien, any duty imposed by international law or by treaty

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[99] *Spanish Zones of Morocco*, II RIAA 615 at 641.

[100] (1927) PCIJ, Ser. A, no. 9, 21. This quote was also cited in part in the ICJ *Advisory Opinion on Reparations*, (1949) ICJ Reports, 184.

with his country. Such delinquency may, for example, be manifest in arbitrary or capricious action on the part of the courts, or in legislative enactments destroying the exercise of a privilege conferred by treaty, or in the action of the executive department in ordering the seizure of property without due process of law. [101] (Emphasis in text)

116. Generally, state responsibility is based on an objective basis without the general need to establish any concept of intention (*dolus*) or negligence (*culpa*). This general observation can be specifically changed in circumstances where international law may require a certain *dolus*. For example there is a requirement that an expropriation be intended for a public purpose. For most international obligations, there is no requirement for there to be any specific intent, only some specific effect. For example, in order to act inconsistently with the obligation of national treatment, there is no obligation that a government actually intend to discriminate, only that its conduct results in differences in treatment between two similarly situated investments.

117. The operation of NAFTA Article 1105 guarantees to NAFTA investors making an investment in the territory of another NAFTA Party a sense of legal security. This sense of security means that an investor can expect that the governments of NAFTA Parties will behave in a good faith and transparent manner so that the investor can assess the status of its own rights. Legal security also means that the government cannot act capriciously so as to abuse the rights of the investor, nor obstruct the rights of the investor to have an independent review in situations when an investor's rights may be infringed.

118. It is clearly established under international law that there are international standards of treatment that every Investor and Investment can expect to receive from other NAFTA Parties pursuant to NAFTA Article 1105. These standards, which all relate to the principle of good faith, include, but are not limited to, the following principles:

a) *Pacta Sunt Servanda*,
b) Fair and Equitable Treatment,
c) Transparency,
d) Protection against Abuse of Rights,
e) National Treatment,
f) International Economic Rights

[101] *International Law Chiefly as Interpreted and applied by the United States*, (1922)Vol. 1 at 491 - 492.

1. Pacta Sunt Servanda

119. The rule of *pacta sunt servanda* is perhaps the most fundamental peremptory norm of international law.[102] Grounded in the principle of good faith, the *pacta sunt servanda* rule is a positive, substantive obligation of the NAFTA Parties. It is recognized as a basic international principle under the *Vienna Convention*, which states as follows:

> Article 26 - *Pacta Sunt Servanda*
>
> Every treaty in force is binding upon the parties to it and must be performed in good faith.

Furthermore, the Preamble to the *Vienna Convention* states: "Noting that the principles of free consent and of good faith and the *pacta sunt servanda* rule are universally recognized".

120. *Pacta sunt servanda* is an element of the international law obligation of countries to act in good faith. Pursuant to this "golden rule" of treaty law, the NAFTA Parties are obliged to steadfastly honour each of their treaty obligations in good faith, including ensuring that obligations under the NAFTA will not be overridden by obligations contained within any other international agreement, unless explicitly permitted in the NAFTA text.

121. While a state is free to regulate as it sees fit, its actions must conform to its treaty obligations and to the norms of international law. In the *North Atlantic Coast Fisheries Case*, the Court determined that the *pacta sunt servanda* rule of good faith requires a line to be drawn between legitimate and non-legitimate state action. It held:

> The line in question is drawn according to the principle of international law that treaty obligations are to be executed in perfect good faith, therefore excluding the right to legislate at will concerning the subject-matter of the treaty, and limiting the exercise of sovereignty of the State bound by a treaty with respect to that subject-matter to such acts as are consistent with the treaty.[103]

122. The obligation of *pacta sunt servanda*, as a fundamental principle of international law, requires a state to act in a manner that is in accordance with its treaty obligations. NAFTA Parties are obliged to promulgate measures in accordance with its obligation, under NAFTA Article 1105, to accord an international standard of treatment to

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[102] Thomas Franck, *Fairness in International Law and Institutions* (1995) at 42-43; also see Bin Cheng, *General Principles of Law* (1953) at 113, who notes that *pacta sunt servanda* is "but an expression of the principle of good faith which above all signifies the keeping of faith, the pledged faith of nations, as well as that of individuals."

[103] *North Atlantic Coast Fisheries Case* [1910] XI RIAA 188.

investments, including treatment that is fair and equitable. As Professor Bin Cheng has noted:

> The reasonable and bona fide exercise of a right implies an exercise which is genuinely in pursuit of those interests which the right is destined to protect and which is not calculated to cause any unfair prejudice to the legitimate interests of another State, whether these interests be secured by treaty or general international law.[104]

123. A NAFTA Party has an obligation of good faith to ensure that it meets its international law obligations through its own acts. The WTO panel in the *US-Section 301 Case* has made the following comments on the good faith observance of existing treaty obligations:

> There can be very good reasons related to norms of transparency, democracy and the rule of law which explain why Members may wish to have such legislation. However, when a Member adopts any legislation it has to be mindful that it does not violate its WTO obligations. Trade legislation, important or positive as it may be, which statutorily reserves the right for the Member concerned to do something which it has promised not to do under Article 23.2(a), goes, in our view, against the ordinary meaning of Article 23.2(a) read together with Article 23.1.[105]
>
> Likewise, is it a good faith interpretation to construe the obligations in Article 23 to allow a Member that promised its WTO partners – under Articles 23.1 and 23.2(a) – that it will generally, including in its legislation, have recourse to and abide by the rules and procedures of the DSU which specifically contain an undertaking not to make a determination of inconsistency prior to exhaustion of DSU proceedings, to put in place legislation the language of which explicitly, urbi et orbi, reserves to its Executive Branch the right to make a determination of inconsistency – that which it promised it would not do? This Panel thinks otherwise.[106]
>
> ***The good faith requirement in the Vienna Convention suggests, thus, that a promise to have recourse to and abide by the rules and procedures of the DSU, also in one's legislation, includes the undertaking to refrain from adopting national laws which threaten prohibited conduct.***[107] (Emphasis added)

124. The WTO panel in the *US-Section 301* case further noted that a government's breach of its treaty obligations is not only relevant with respect to state to state disputes, but has important effects on private economic actors such as foreign investors. Specifically, the Panel noted:

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[104] Bin Cheng, *General Principles of Law* (1953) at 131-132.

[105] *United States - Sections 301-310 of The Trade Act of 1974*, WT/DS152/R, December 22, 1999 at para. 7.63 (*"US-Section 301 Case"*).

[106] *US-Section 301 Case* at para. 7.67.

[107] *US-Section 301 Case* at para. 7.68.

> Trade is conducted most often and increasingly by private operators. It is through improved conditions for these private operators that Members benefit from WTO disciplines. The denial of benefits to a Member which flows from a breach is often indirect and results from the impact of the breach on the market place and the activities of individuals within it. Sections 301-310 themselves recognize this nexus. One of the principal triggers for US action to vindicate US rights under covered agreements is the impact alleged breaches have had on, and the complaint emanating from, individual economic operators.[108]
>
> **Indirect impact on individuals is, surely, one of the principal reasons. In treaties which concern only the relations between States, State responsibility is incurred only when an actual violation takes place. By contrast, in a treaty the benefits of which depend in part on the activity of individual operators the legislation itself may be construed as a breach, since the mere existence of legislation could have an appreciable "chilling effect" on the economic activities of individuals.[109]** [Emphasis added]

125. NAFTA Article 1105 assures that NAFTA Parties provide treatment to the investments of investors that is in accordance with international law. The rule of *pacta sunt servanda*, as an expression of the principle of good faith, obligates NAFTA Parties to observe all of their treaty obligations in good faith by meeting any positive requirement to be performed under those treaties. A failure by one of the NAFTA Parties to perform its treaty obligations with respect to an investment of an investor of another NAFTA Party is a breach of the *pacta sunt servanda* rule and of the principle of good faith, and, accordingly, constitutes a breach of international law under NAFTA Article 1105. When such a failure takes place, and there is resulting harm to NAFTA investors and their investments, NAFTA Parties are required to pay compensation to those investors for their conduct.[110]

2. *Fair and Equitable Treatment*

126. Fair and equitable treatment refers to a number of issues, principally, the right not to be denied justice and the right to equitable treatment and procedural fairness. These obligations arise out of the international law obligation of good faith.

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[108] *US-Section 301 Case* at para. 7.77.

[109] *US-Section 301 Case* at para. 7.81.

[110] But for the existence of NAFTA Article 1105, a NAFTA Party could breach its international obligations in respect of an investment from another Party and have only the Party to answer to, in the dispute settlement forum chosen by the Parties by way of treaty or through *ad hoc* arbitration. In a state-to-state arbitration, the remedy is one in which the offending domestic measure can be ordered changed or struck down. By virtue of NAFTA Article 1105, the NAFTA Parties have agreed to Investor-State arbitration as an alternative to such state-to-state disputes, but with a remedy of compensation only. Accordingly, the two dispute mechanisms can be said to be complementary.

127. Each of the NAFTA Parties are parties to Bilateral Investment Treaties ("BITs") and the NAFTA itself is a plurilateral version of a BIT Agreement.[111] Accordingly, the terms of the NAFTA itself can provide evidence of international law. The terms "fair and equitable treatment" and "full protection and security" used in this NAFTA Article have been frequently used in BITs over the past 40 years and the use of these terms in the NAFTA is a reflection of a long process of development and use.[112] The importance of BITs lie "in the contribution they make to the development of customary international law, in their being a source of law".[113]

128. For example, Dr. F.A. Mann, a significant authority on this topic, particularly emphasises the importance of the standard of fair and equitable treatment when he concludes that:

> The paramount duty of States imposed by international law is to observe and act in accordance with the requirements of good faith. From this point of view it follows that, where these treaties express a duty which customary international law imposes or is widely believed to impose, they give very strong support to the existence of such a duty and preclude the Contracting States from denying its existence.
>
> These remarks apply, in particular, to the overriding effect of the standard of fair and equitable treatment, to the duty not to expropriate except on certain terms and to the duty to observe any obligation arising from a particular commitment it may have entered into with regard to a specific investment'. The cold print of these treaties is a more reliable source of law than the rhetorics in the United Nations.[114]

129. Although the terms "fair and equitable treatment" and "full protection and security" are frequently used terms, especially in BITs, they had not been the subject of a great deal of international consideration until the last century. Scholars such as Dr. Mann have placed the fair and equitable treatment standard as the pre-eminent substantive standard in investment-type treaties, which states:

> ... it is submitted that the right to fair and equitable treatment goes much further than the right to most-favoured-nation and to national treatment .... So general a provision is likely to be almost sufficient to cover all conceivable cases, and it may well be that other provisions of the

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[111] In other words, the NAFTA is a trilateral investment treaty rather than a bilateral one.

[112] F.A. Mann, "British Treaties for the promotion and protection of Investments" (1981) 52 Brit. Y.B. Int'l Law 241; Dolzer and Stevens, *Bilateral Investment Treaties* (1995), at 58-60.

[113] Mann at 243.

[114] Mann at 249-250.

> Agreements affording substantive protection are no more than examples of specific instances of this overriding duty.[115]

130. There exists in international law a standard of treatment dealing with non-discrimination which is particularly applicable to the fair and equitable treatment standard. Sir Robert Jennings and Sir Arthur Watts wrote in the ninth edition of *Oppenheim's International Law* that:

> An alien must in particular not be wronged in person or property by officials or courts of a state. Thus the police must not arrest him without cause, administrative officials must not treat him arbitrarily and courts must treat him justly and in accordance with the law.[116]

131. This is an example of how international law has established treatment obligations in relation to government activity. These obligations of fair and equitable treatment can be seen throughout the entire area of the law of state responsibility. For example, government actions cannot be undertaken on an arbitrary basis and without due process of law.[117] Professors Jennings and Watts give two examples of these fundamental fairness obligations under international law:

> Perhaps the most clearly established condition is that expropriation must not be arbitrary and must be based on the application of duly adopted laws. Another well established condition is that the expropriation should be in the public interest (and not, for example, a matter of individual animosity against a particular alien). [118]

132. International law requires that there be certain substantive due process guarantees for the determination of any controversy. These due process guarantees involve notice, the full opportunity to be heard, impartial consideration and reasoned judgment. As the Tribunal in the *Salvador Commercial Company Case* stated:

> It is abhorrent to the sense of justice to say that one party to a contract, whether such party be a private individual, a monarch, or a government of any kind, may arbitrarily, without hearing and without impartial procedure of any sort, arrogate the right to condemn the other party to the contract, to pass judgment upon him and his acts and to impose upon him the extreme penalty of forfeiture of all his rights under it, including his property and his investment of capital made on the

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[115] Mann at 243-244; also see Brownlie at 524-528 for his discussion of the minimum standard and national standard debate.

[116] *Oppenheim's International Law* (Ninth Ed.) Vol I, Peace, Parts 2-4 at 910 - 911. (footnotes omitted)

[117] This obligation is most commonly applied to the area of expropriation, but its application to this area comes from the underlying obligation of fair and equitable conduct, including the obligation of good faith.

[118] *Oppenheim's International Law* (Ninth Ed.) Vol I, Peace, Parts 2-4 at 919-920. (footnotes omitted)

> faith of that contract. Before the rights and their reciprocal remedies, are of equal dignity and are equally entitled to invoke for their redress and for their defence the hearing and the judgment of an impartial and disinterested tribunal. [119]

133. Accordingly, in order to meet the basic requirements of fairness under international law, a party is entitled to:

i) know the case against it;
ii) view the evidence against it;
iii) have an impartial administrative or judicial process; and
iv) have a right of independent and impartial redress from a determination.

134. The United States – Panama Claims Commission in the *de Sabla Case* held that a country fails to accord a minimum standard of treatment to a foreign national where it imposes a measure affecting private interests that is not transparent or properly administered.[120] Arbitrariness, either by design or in application, is a hallmark of a violation of the international standard of treatment owed by countries to foreign nationals operating within their territory.

135. This obligation is reflected in the express terms of NAFTA Article 1110(1)(c), which equates the prohibition of arbitrary conduct with compliance with the international law standards established by NAFTA Article 1105. In its findings in the *Elettronica Sicula Case*, the International Court of Justice determined that arbitrary conduct violated the "rule of law" and thereby international law itself. The court stated:

> It is a wilful disregard of due process of law, an act which shocks or at least surprised, a sense of juridical propriety.[121]

136. The international law obligation is a general obligation that applies to all levels of a government. The acts of government officials bind the state. Bin Cheng refers to this obligation when he states "whatever his rank, his act *qua* an official is an act of the

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[119] [1902] XV RIAA 467 at 478.

[120] *de Sabla (United States)* v. *Panama*, [1955] VI *RIAA* 358 at 362-363. Mrs. de Sabla, an American landowner in Panama, claimed for damages arising from improper land redistribution. Panama asserted that under its laws, its authorities were required to grant all applications for the land unless opposition was made by the owner. It asserted that its system of land distribution was not confiscatory by international standards because the land laws in question gave the Claimant adequate means of protecting her interests by allowing her to file papers in opposition in the local courts. The Claims Commission found the procedures for relief to be so burdensome and unpractical that they denied her proper access to the justice system.

[121] *Elettronica Sicula* at para. 128.

Government and hence of the State".[122] Professor Cheng also cites the decision of the umpire in the *Moses Case*, stating:

> An officer or person in authority represents pro tanto his government, which in an international sense is the aggregate of all officers and men in authority. [123]

137. The principles of fair and equitable treatment have been considered recently by the United Nations Human Rights Committee considered the application of the *International Covenant on Civil and Political Rights*. The United Nation Human Rights Committee found that in order for a regulatory scheme not to be considered arbitrarily imposed, it should be specific, fair and reasonable, and its application should be transparent.[124]

138. The term "denial of justice" encompasses a number of different types of unfair actions that have occurred in all aspects of government administration and can be considered as part of the international standard. The broad concept of denial of justice was used by the US - Mexico Mixed Claim Commission in the *Roberts* Claim when it determined that the executive acts of the Mexican Government violated international law standards in how it treated Mr. Roberts after he dealt with the judicial system.[125] Professor Brownlie, who does not support the use of the term "denial of justice" to describe breaches of all government obligations, suggests that:

> The term "denial of justice" has been employed by claims tribunals so as to be coextensive with the general notion of state responsibility for harm to aliens, but it is widely regarded as a particular category of deficiencies on the parts of the organs of the host state, principally concerning the administration of justice.[126]

139. There is some debate between writers about whether the acts of the executive branch of government are properly described by the term "denial of justice" or whether they are another type of international law violation, such as those arising under the obligations of good faith, fair and equitable treatment or full protection and security. However, there is no debate that all the acts of a government (legislative, executive or judicial) are the subject of state responsibility under international law or that the same obligations

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[122] Bin Cheng, *General Principles of Law* (1953) at 196.

[123] *Moses Case*, Mexico-US Claims Commission (1868) 3127 at 3129.

[124] United Nations, Human Rights Committee, *Communication No. 633/1995: Canada 05/05/99*, CCPR/C/65/D/633/1995 at para.13.6.

[125] *Harry Roberts Case*, Mexico – US Claims Commission (1926).

[126] Brownlie, *Principles of International Law* (5th ed.) at 531 - 532.

examined by tribunals under the concept of denial of justice are also applicable to the other areas of government activity.

140. Many international disputes have been examined on a sub-set of governmental misbehaviour connected to arbitrary or unfair behaviour, inconsistent with the obligation of good faith, which has been primarily concerned with access to justice. This area is generally referred to under the broad rubric of "denial of justice". The denial of justice case law reveals that the judicial process of a country, including its rules of civil procedure, can clearly affect a denial of justice contrary to international law. In reviewing the judicial process in *Chattin*,[127] the US-Mexican Claims Commission found that the Mexican courts made serious deviations from the course of justice. The Commission stated:

> Irregularity of court proceedings is proven with reference to absence of proper investigations, insufficiency of confrontations, withholding from the accused the opportunity to know all of the charges brought against him, undue delay of the proceedings, making the hearings in open court a mere formality, and a continued absence of seriousness on the part of the court.[128]

The Commission concluded:

> Bringing the proceedings of Mexican authorities against Chattin to the test of international standards . . . there can be no doubt of their being highly insufficient . . . Since this is a case of alleged responsibility of Mexico for injustice committed by its judiciary, it is necessary to inquire whether the treatment of Chattin amounts to outrage, bad faith, to wilful neglect of duty, or to an insufficiency of governmental action recognizable by every unbiased man . . . and the answer here again can only be in the affirmative.[129]

141. The international standard used in *Chattin* comes from an earlier decision of this same Claims Commission in the *Neer* Claim.[130] In deciding whether the official Mexican investigation of Mr. Neer's murder constituted a denial of justice, the Claims Commission inquired into whether there was convincing evidence either:

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[127] *B.E. Chattin (U.S.A) v. United Mexican States*, United States-Mexican Claims Commission, (1927) IV RIAA at 282. Chattin, a US citizen, was a railroad employee incarcerated on embezzlement charges. He escaped from jail and returned to the US where he brought a claim for illegal arrest, denial of justice, and mistreatment.

[128] *Chattin* at 295.

[129] *Chattin* at 295.

[130] *L.F. Neer (U.S.A.) v. United Mexican States*, [1927] IV RIAA 555. The claim was on behalf of the widow and daughter of Paul Neer, an American citizen who was killed in Mexico in 1924. The claim is grounded on an assertion of a denial of justice growing out of the failure of Mexican authorities to take adequate measures to apprehend and punish the killer.

(i) _ that the authorities administering the Mexican law acted in an outrageous way, in bad faith, in wilful neglect of their duties, or in a pronounced degree to improper action, or

(ii) that Mexican law rendered it impossible for them to fulfil their task.[131]

142. The application of this standard in *Chattin* resulted in the Claims Commission finding that there was a denial of justice. This case underscores how delays and unfairness in judicial procedure can constitute outrageous and unacceptable conduct by a state. It also establishes liability for cases where municipal law makes it impossible to obtain fair treatment. An example of such conduct can be seen in the *de Sabla* case[132] where an international tribunal found that unfair legal and administrative procedures violated the level of treatment that a state must give to foreigners. These cases confirm the inherent right of an international tribunal to judge the fairness of a nation's judicial procedures and to impose international minimum standards of fair and equitable treatment in relation to foreigners.

143. The term "denial of justice" has been interpreted in a broad sense as including all the acts or omissions capable of leading to international responsibility by the State for injuries caused to the person or property of aliens.[133] The case law has established that beyond acts of courts, government acts could contribute to a denial of justice.[134] However, there is some debate regarding the extent to which a state must provide fair and full access.[135] There are many possible ways in which a country may fall below this standard without closing the doors of the courts to foreigners. Such acts would include:

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[131] *Neer* at 556-557. The Commission noted that no attempt was made to establish the second point.

[132] *de Sabla* (USA) v. *Panama* [1955] VI RIAA 358 at 362-363.

[133] Brierly, *Law of Nations*, 1st ed. (1928) at 139-140.

[134] For example, in the case of *Robert E. Brown (United States) v. Great Britain* [1923] VI RIAA at 120-131, the International Court of Justice found that all three branches of the government (executive, legislative and judicial) contributed to the Investor's denial of justice. While the claim of the United States on behalf of its investor was dismissed on unrelated grounds, the court nevertheless found that the executive branch, in addition to the judicial branch, of the government could also be held liable for a denial of justice. See also, *Interoceanix Railway of Mexico*, (Great Britain) v. *Mexico* (1931), 5 RIAA 133, 178-190, though it was held in this last case that no denial of justice had occurred.

[135] For Example, Presiding Commissioner Van Vollenhoven in *Chattin* held that applying the term "denial of justice" to acts of executive and legislative authorities would seriously dilute the meaning of the term. However, this comment deals with the narrow concept of denial of justice and not the broader concept of good faith, which most certainly would apply to executive and legislative acts.

(i) unwarrantable delay;[136]
(ii) flagrant abuse of judicial procedure;[137] and
(iii) certain acts or omissions of organs of government other than courts, which are closely connected with the administration of justice.[138]

144. The duty to grant foreigners free access to court has been interpreted to mean access to a *bona fide* judicial institution. Other entities, such as boards, commissions or public agencies designated by the state for the trial of causes, will not suffice. The laws creating the courts and the procedure under which they will have to function must provide adequate guarantees for the safeguard of personal and property rights so that the alien's defence of these interests may be effectively raised.[139]

145. The international prohibition on arbitrary conduct is not simply restricted to situations surrounding the administration of the courts. Modern international tribunals have been able to apply the international disapproval of arbitrary conduct to other areas. For example, the WTO Appellate Body hearing the *Shrimp-Turtle Case* stated:

> The certification processes followed by the United States thus appear to be singularly informal and casual, and to be conducted in a manner such that these processes could result in the negation of rights of Members. There appears to be no way that exporting Members can be certain whether the terms of Section 609, in particular, the 1996 Guidelines, are being applied in a fair and just manner by the appropriate governmental agencies of the United States. It appears to us that, effectively, exporting Members applying for certification whose applications are rejected are denied basic fairness and due process, and are discriminated against, vis-a-vis those Members which are granted certification.[140]

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[136] *Antoine Fabiani Case*, [1902] X RIAA 83.

[137] *Chattin* and *de Sabla*.

[138] *de Sabla*.

[139] "If through the composition of its courts or through its procedure, a State makes possible a decision which does not offer the minimum guarantees for the proper administration of justice which are inseparable from the idea of civilization, we consider that it is guilty of denial of justice..." Cavaglieri at the Hague Codification Conference, minutes, at 110, as cited in Freeman, *The International Responsibility of States For Denial of Justice* (1938) at 547.

[140] *United States - Import Prohibition of Certain Shrimp and Shrimp Products*, WT/DS58/AB/R, October 12, 1998 at para. 180.

The Appellate Body in the *Shrimp-Turtle Case* recognized that administrative discretion is subject to international standards of fairness and due process that prohibit governments from acting in an arbitrary manner.

146. In its decision in the *India Patents Case*, the WTO panel found that there must be a generally available mechanism to foreign investors in order for their rights to be considered fully effective. The panel stated:

> The term right connotes an entitlement to which a person has a just claim and that, as such, it implies general non-discretionary availability in the case of those eligible to exercise it . . . In this connection, we would also note that India considers that exclusive marketing rights are to be granted in response to requests from those who are eligible. **In our view, a request based system of rights cannot operate effectively unless there is a mechanism in place that establishes general availability and enables such requests to be made.**[141] (Emphasis added)

147. A state may not escape its international obligations merely by proving that its courts are open and accessible to aggrieved foreigners. For example, Panama failed to meet its international obligations in the de Sabla case as its judicial administrative machinery did not constitute an adequate remedy to protect the property of the Claimant. Even with access to courts, one must look to how the nation's administrative process is applied. Laws may be such that when applied, they fail to provide the minimum safeguards deemed essential by the international community.

3. *Transparency*

148. Transparency is an important element of the fairness doctrine in modern international law. The requirements of transparency occur commonly in international economic law agreements.[142] Indeed, the international law principle of transparency is listed as one of three interpretative principles of the NAFTA.[143] Transparency provides foreign investors with the means to enforce their rights. Without a clear understanding of the reasons for the treatment they are receiving, as well as a basic understanding of the nature and extent of that treatment, foreign investors simply cannot effectively look after their interests.

149. The principle of transparency is a necessary constituent of international law and thus of a Party's international law obligations contained in NAFTA Article 1105. In its unanimous

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[141] *India-Patents Protection for Pharmaceutical and Agricultural Chemical Products*, WT/A579/R, August 24, 1998 at para. 7.65.

[142] For example, as provided below, NAFTA Chapter 18 and GATT Article X.

[143] NAFTA Article 102.

final award in the *Metalclad* claim,[144] the NAFTA Investor-State Tribunal found that the requirement of transparency was an essential international law obligation within the NAFTA Article 1105 obligation.

150. According to the *Metalclad* Tribunal, NAFTA Article 1105 includes the requirement that a government have a transparent administrative mechanism available whereby an investor can have its applications for government licenses reviewed and processed.[145] This Investor-State Tribunal went on to state that the principles which underscore the concept of legal security are contained within a Party's obligations under NAFTA Article 1105. The Tribunal stated:

> Mexico failed to ensure a transparent and predictable framework for Metalclad's business planning and investment. The totality of these circumstances demonstrates a lack of orderly process and timely disposition in relation to an investor of a Party acting in the expectation that it would be treated fairly and justly in accordance with the NAFTA.[146]

151. While acknowledging that the issue of India's transparency obligations under the TRIPS Agreement were outside its terms of reference, the Panel in the *India Patents Case* went to great lengths to emphasize the general importance of the principle of transparency as providing legal security to other WTO Members and foreign investors. The Panel noted that an administrative system based on undisclosed criteria may be inherently incapable of providing legal security and transparency to foreign investors. The panel stated:

> It is also recalled that the administrative instructions relied on by India in the present case are unwritten and unpublished. . . While Article 70.8 does not explicitly provide for a publication obligation, doubts have to remain as to whether an unwritten and unpublished system . . could be construed as a means which adequately responds to the requirements of Art. 70.8 [for legal security] .[147]

152. The NAFTA does not define the content of the principle of transparency *per se*, but it does contains examples of basic transparency obligations that are in accordance with this international law principle.

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[144] Final Award, *Re: Metalclad and Mexico*, (NAFTA Investor-State Claim) dated August 25, 2000.

[145] *Re: Metalclad and Mexico* at para. 88.

[146] *Re: Metalclad and Mexico* at para. 93.

[147] *India-Patents Protection for Pharmaceutical and Agricultural Chemical Products*, WT/A579/R, August 24, 1998 at para. 7.56.

153. The Preamble to the NAFTA includes the following three elements which all underscore the need for legal security to protect investors and investments of NAFTA investors operating in the territory of another NAFTA Party. It states:

> The Government of Canada, the Government of the United Mexican States and the Government of the United States of America, resolved to: .....
>
> ENSURE a predictable commercial framework for business planning and investment;
>
> BUILD on their respective rights and obligations under the *General Agreement on Tariffs and Trade* and other multilateral and bilateral instruments of cooperation;
>
> ENHANCE the competitiveness of their firms in global markets;

154. Like the WTO, the NAFTA contains specific obligations of its Parties regarding the publication, notification and administration of laws in an open and transparent manner.[148] The NAFTA has expressed the basic norms of the principle of transparency in NAFTA Articles 1802 to 1805, which require Parties to:

a) Publish laws, procedures and administrative rulings;
b) Notify other NAFTA Parties of changes in measures that could impair the fulfilment of NAFTA obligations;
c) Provide fair and transparent administrative proceedings;
d) Provide a right to due process and independent review of proceedings.

155. In particular, NAFTA Articles 1804 and 1805 state:

> **Article 1804: Administrative Proceedings**
>
> With a view to administering in a consistent, impartial and reasonable manner all measures of general application affecting matters covered by this Agreement, each Party shall ensure that in its administrative proceedings applying measures referred to in Article 1802 to particular persons, goods or services of another Party in specific cases that:
>
> (a) wherever possible, persons of another Party that are directly affected by a proceeding are provided reasonable notice, in accordance with domestic procedures, when a proceeding is initiated, including a description of the nature of the proceeding, a statement of the legal authority under which the proceeding is initiated and a general description of any issues in controversy;

[148] NAFTA Articles 1802 - 1804. GATT obligations under Article X contain virtually identical obligations to NAFTA Chapter 18, and is titled "Publication and Administration of Trade Regulations".

(b) such persons are afforded a reasonable opportunity to present facts and arguments in support of their positions prior to any final administrative action, when time, the nature of the proceeding and the public interest permit; and

(c) its procedures are in accordance with domestic law.

Article 1805: Review and Appeal

1. Each Party shall adopt or maintain judicial, quasi-judicial or administrative tribunals or procedures for the purpose of the prompt review and, where warranted, correction of final administrative actions regarding matters covered by this Agreement. Such tribunals shall be impartial and independent of the office or authority entrusted with administrative enforcement and shall not have any substantial interest in the outcome of the matter.

2. Each Party shall ensure that, in any such tribunals or procedures, the parties to the proceeding are provided with the right to:

(a) a reasonable opportunity to support or defend their respective positions; and

(b) a decision based on the evidence and submissions of record or, where required by domestic law, the record compiled by the administrative authority.

3. Each Party shall ensure, subject to appeal or further review as provided in its domestic law, that such decisions shall be implemented by, and shall govern the practice of, the offices or authorities with respect to the administrative action at issue.

156. The GATT has also expressed these basic norms of the principle of transparency in GATT Article X, as follows:

Article X: Publication and Administration of Trade Regulations

1. Laws, regulations, judicial decisions and administrative rulings of general application, made effective by any contracting party, pertaining to the classification or the valuation of products for customs purposes, or to rates of duty, taxes or other charges, or to requirements, restrictions or prohibitions on imports or exports or on the transfer of payments therefor, or affecting their sale, distribution, transportation, insurance, warehousing inspection, exhibition, processing, mixing or other use, shall be published promptly in such a manner as to enable governments and traders to become acquainted with them. Agreements affecting international trade policy which are in force between the government or a governmental agency of any contracting party and the government or governmental agency of any other contracting party shall also be published. The provisions of this paragraph shall not require any contracting party to disclose confidential information which would impede law enforcement or otherwise be contrary to the public interest or would prejudice the legitimate commercial interests of particular enterprises, public or private.

2. No measure of general application taken by any contracting party effecting an advance in a rate of duty or other charge on imports under an established and uniform practice, or imposing a new or more burdensome requirement, restriction or prohibition on imports, or on the transfer of payments therefor, shall be enforced before such measure has been officially published.

> 3. (a) Each contracting party shall administer in a uniform, impartial and reasonable manner all its laws, regulations, decisions and rulings of the kind described in paragraph 1 of this Article.
>
> (b) Each contracting party shall maintain, or institute as soon as practicable, judicial, arbitral or administrative tribunals or procedures for the purpose, inter alia, of the prompt review and correction of administrative action relating to customs matters. Such tribunals or procedures shall be independent of the agencies entrusted with administrative enforcement and their decisions shall be implemented by, and shall govern the practice of, such agencies unless an appeal is lodged with a court or tribunal of superior jurisdiction within the time prescribed for appeals to be lodged by importers; Provided that the central administration of such agency may take steps to obtain a review of the matter in another proceeding if there is good cause to believe that the decision is inconsistent with established principles of law or the actual facts.
>
> (c) The provisions of sub-paragraph (b) of this paragraph shall not require the elimination or substitution of procedures in force in the territory of a contracting party on the date of this Agreement which in fact provide for an objective and impartial review of administrative action even though such procedures are not fully or formally independent of the agencies entrusted with administrative enforcement. Any contracting party employing such procedures shall, upon request, furnish the CONTRACTING PARTIES with full information thereon in order that they may determine whether such procedures conform to the requirements of this sub-paragraph.

157. Both the US and Canada have publicly stated during the implementation of the NAFTA that these transparency and fairness obligations reflect basic guarantees to investors and investments. For example, in its NAFTA *Statement of Administrative Action*, the US stated:

> Article 1804 requires each government to accord basic procedural guarantees to firms and individuals from other NAFTA countries in specific types of administrative proceedings that affect matters covered by the Agreement. These guarantees include reasonable notice of proceedings and the opportunity to present arguments.
>
> In addition to those basic guarantees, Chapter Eighteen provides for review and appeal of final administrative actions. Article 1805, similar to GATT Article X.3(b), requires each government to establish or maintain independent administrative or judicial review procedures. These appeal rights must include a reasonable opportunity to present arguments and to obtain a decision based on evidence in the administrative record.[149]

158. Canada has explained the origins and the purpose of these provisions in its NAFTA *Statement on Implementation* as follows:

> While NAFTA's rules provide the rights and obligations that ensure that the three countries will pursue their trade and economic policies on the basis of the objectives of non-discrimination and transparency set out in Chapter One, the provisions of Chapters Eighteen, Nineteen and Twenty set out the procedures that will ensure that these rules are implemented. Without the guarantee

[149] *US Statement of Administrative Action* at 193.

> furnished by these provisions, business would not have the confidence to undertake the restructuring necessary for the growth and prosperity that is the ultimate goal of the Agreement.
>
> This chapter sets out provisions that will help the Parties avoid disputes and facilitate the smooth operation of the Agreement. It is based on similar provisions in article X of the GATT. A commitment to transparency and due process is found throughout the Agreement. The Parties must ensure that producers, traders, investors and other interested parties throughout the free-trade area have the opportunity to learn about measures taken by them regarding matters covered by the Agreement. Chapter eighteen sets out means for complying with this commitment. Each Party is required to establish or maintain basic procedures necessary to meet the requirements of due process and natural justice for all matters covered by the Agreement. Parties must warrant that administrative proceedings provide for notice that includes a description of the nature of the proceeding, its legal authority, and a description of the issues in controversy. They must also provide those affected by the proceeding the opportunity to present arguments. Each Party must ensure that there are judicial, quasi-judicial or administrative tribunals in place to review final administrative actions regarding matters covered by the *Agreement*.[150]

159. In the *Shrimp - Turtle Case*, the WTO Appellate Body had occasion to consider the principle of transparency as applied in the chapeau of GATT Article XX. Within this context, the Appellate Body commented on the role of transparency in the GATT, including its place in GATT Article X, by stating:

> It is also clear to us that Article X:3 of the GATT 1994 establishes certain minimum standards for transparency and procedural fairness in the administration of trade regulations which, in our view, are not met here. The non-transparent and ex parte nature of the internal governmental procedures applied by the competent officials in the Office of Marine Conservation, the Department of State, and the United States National Marine Fisheries Service throughout the certification processes under Section 609, as well as the fact that countries whose applications are denied do not receive formal notice of such denial, nor of the reasons for the denial, and the fact, too, that there is no formal legal procedure for review of, or appeal from, a denial of an application, are all contrary to the spirit, if not the letter, of Article X:3 of the GATT 1994.[151]

160. In light of what it saw as basic requirements for transparency in the administration of any regulatory regime, the Appellate Body further indicated that if a measure is applied too rigidly or inflexibly such application would constitute "arbitrary discrimination" within the meaning of GATT Article XX.[152]

161. A measure that is not transparent and predictable, or that fails to provide affected parties with sufficient notice, an opportunity to be heard or a formal procedure for review or

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[150] *Canadian Statement on Implementation* at 196-7.

[151] *US - Import Prohibition of Certain Shrimp and Shrimp Products*, WT/DS58/AB/R, October 12, 1998 at para. 183.

[152] At para. 177-180.

appeal may be found to be arbitrary or discriminatory. The WTO Appellate Body made such a finding in *Standards for Reformulated and Conventional Gasoline*, where the United States' failure to offer consultation to member countries on the harmonization of standards was found to constitute arbitrary and discriminatory conduct.[153]

162. The WTO Appellate Body has also recognized the critical role of the transparency principle embodied in GATT Article X for the promotion and protection of trade and investment in cases such as: *United States - Restrictions on Imports of Cotton and Man-made Fibre Underwear* where it stated:

> Article X:2, General Agreement, may be seen to embody a principle of fundamental importance - that of promoting full disclosure of governmental acts affecting Members and private persons and enterprises, whether of domestic or foreign nationality. The relevant policy principle is widely known as the principle of transparency and has obviously due process dimensions. The essential implication is that Members and other persons affected, or likely to be affected, by governmental measures imposing restraints, requirements and other burdens, should have a reasonable opportunity to acquire authentic information about such measures and accordingly to protect and adjust their activities or alternatively to seek modification of such measures. We believe that the Panel here gave to Article X:2, General Agreement, an interpretation that is appropriately protective of the basic principle there projected.[154] [Emphasis added]

163. The WTO panel in the *Fuji/Kodak Case*, in accepting the Article X analysis of the panel in *United States - Underwear*, held that Article X:1 does not only apply to measures of general application, but can also apply to administrative rulings in individual cases where such rulings establish or revise principles or criteria applicable in future cases.[155] Therefore, individual investors can expect to receive the same fundamental rights embodied in the principle of transparency whether the actions of the government are of a general or specific nature.

164. Both Canada and the US have indicated that the terms of NAFTA Chapter 18 draw on similar expressions contained in GATT Article X.[156] Canada has also expressed its commitment to abide by the principles of transparency and fairness more generally by stating:

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[153] *United States - Standards for Reformulated and Conventional Gasoline*, WT/DS2/AB/R at 27-29.

[154] *United States - Restrictions on Imports of Cotton and Man-made Fibre Underwear* (February 10, 1997), WT/DS24/AB/R, Section VI, at 19-20.

[155] *Japan - Measures Affecting Consumer Photographic Film and Paper*, WT/DS44/R, March 31, 1998 at para. 10.388.

[156] *Canadian Statement on Implementation* at 197, *US Statement of Administrative Action* at 193.

> The Government will be vigilant in monitoring the implementation of transparency procedures and due process where they do not exist and will ensure that existing procedures complying with the obligations of the chapter are maintained and respected, both in letter and in spirit. Canada will strongly encourage that the procedural obligations be made a part of the law of each Party and be promulgated and disseminated in clear, straightforward and easily understood language. Canada will seek to ensure that interested persons from any of the three countries can easily ascertain and avail themselves of any rights created by the NAFTA.[157]

165. The fundamental principles of transparency (i.e. the publication and disclosure of government measures and actions) and what is widely known as due process (i.e. fundamental fairness) are clearly articulated in GATT Article X. As the basic obligations of transparency under the NAFTA and GATT are virtually identical, the WTO Appellate Body's interpretation of role and function of the transparency principle is applicable to the obligations in NAFTA Chapter 18 and generally incorporated into international law, and thereby, applicable through NAFTA Article 1105.

4. Protection Against Abuse of Rights

166. The principle of abuse of rights, or "abuse of discretion", is well-established in international law. It provides protection for foreign nationals and their investments from arbitrary or malicious actions taken by host governments. In his two volume treatise, *The Changing Law of International Claims,* Professor Garcia-Amador discusses the fundamental principle in international law prohibiting the abuse of rights.[158] Professor Sir Hersch Lauterpacht (prior to his elevation to the International Court of Justice) has also remarked that:

> the law of torts is confined to very general principles, and the part which the doctrine of abuse of rights is called upon to play is therefore particularly important.[159]

167. Other scholars support this view of the integral place of the theory of abuse of rights in international law.[160] Professor Schwarzenberger argues that the theory is so well-ensconced in the principle of good faith and in the customary minimum standard for the

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[157] *Canadian Statement on Implementation* at 197.

[158] F.C. Garcia-Amador, *The Changing Law of International Claims* (Oceana Publishing, 1984) Vol 1 at 108. From 1955 - 1965, Professor Garcia-Amador was the Rapporteur of the International Law Commission's Draft Convention on State Responsibility.

[159] H. Lauterpacht, *The Function of Law in the International Community* (1933) at 298.

[160] See, for example: Chapter 4 on the Theory of Abuse of Rights in Bin Cheng, *General Principles of Law* (1953), where professor Cheng explains how the theory is woven into the principle of good faith in international law.

treatment of aliens in international law that it may not even be necessary to conceive of the abuse of rights theory as a stand-alone concept, except for the "hard core" of the theory, concerning "the arbitrary or unreasonable exercise of rights or powers within the exclusive jurisdiction of States."[161] Professor Schwarzenberger notes:

> Arbitrariness in any form is – or ought to be – abhorrent to *homo juridicus*. His whole professional outlook is dominated by the attitude that, in the eyes of the law, equal situations require equal remedies.
>
> Yet, anybody who is acquainted with the techniques by which judicial precedents are applied and distinguished is aware of the element of subjectivity which is inseparable from deciding even on a judicial level what situations are supposed to be equal.
>
> In the fields of quasi-judicial, administrative or political decisions, it is even more difficult to verify the arbitrary exercise of discretion. The wider the scope of discretion, the easier it is to find plausible arguments to hide irrelevant or objectionable reasons behind such reasons. If discretion is exercised within as wide a framework as territorial jurisdiction, only the most patent abuses of sovereignty could possibly be caught by any prohibition of the arbitrary use of sovereign right.[162]

Prof. Schwarzenberger was not at all concerned about the question of whether it should be considered an international law tort for discretion to be exercised arbitrarily, capriciously, or unreasonably. As evidenced in this quotation, his primary concern was with the ability to identify government officials who attempt to mask an arbitrary exercise of their discretion with ostensibly legitimate reasons. It is submitted that this risk of possible evasion is exactly why rules such as the national treatment obligation have acquired a *de facto* orientation in recent decades, although it will nonetheless remain within a tribunal's authority – in consideration of whether an abuse of rights has taken place – to infer from whatever evidence is available that such an abuse has indeed taken place.

168. Bin Cheng states, in his summary of the principle of abuse of discretion, that:

> ... discretion must be exercised in good faith, and the law will intervene in all cases where this discretion is abused. .... Whenever, therefore, the owner of a right enjoys a certain discretionary power, this must be exercised in good faith, which means that it must be exercised reasonably, honestly, in conformity with the spirit of the law and with due regard to the interest of others.[163]

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[161] Georg Schwarzenberger, *International Law and Order* (1971) at 89-90, 99-100.

[162] Schwarzenberger (1971) at 100-101.

[163] Bin Cheng, *General Principles of Law* (1953) at 132-134.

169. In the *Boffolo Case*, the Italian-Venezuelan Commission ruled that while expelling aliens from a country was considered to be a valid exercise of state sovereignty, it was nevertheless subject to limits. The Tribunal, in ruling in favour of the expelled alien, held that the government had therefore not only the legal obligation but also the duty imposed by international courtesy to declare the reasons for the sudden and violent expulsion of the claimant. The Tribunal further noted that if the government did not provide reasons, they were justified in believing that such reasons did not exist.[164]

170. According to Professor Sir Hersch Lauterpacht, the *Boffolo Case*, amongst others, stand for the proposition that if a state fails to provide a just reason for its differential treatment of a foreign alien, this may amount to an abuse of rights requiring compensation: Specifically, Professor Lauterpacht in his treatise has observed:

> The conspicuous feature of these awards is the view that the undoubted right of expulsion degenerates into an abuse of rights whenever an alien who has been allowed to take up residence in the country, to establish his business and set up a home, **is expelled without just reason, and that such an abuse of rights constitutes a wrong involving the duty of reparation.**[165]

171. The Mexico-US General Claims Commission in the case of *North American Dredging Company of Texas (USA) v. United Mexican States*, addressed the abuse of rights doctrine in international law. While the Tribunal dismissed the Claimant's case on a technical ground that the contract specified that the Investor was bound by domestic Mexican law, it nevertheless stated the following on the international law of abuse of rights:

> The present stage of international law imposes upon every international tribunal the solemn duty of seeking for a proper and adequate balance between the sovereign right of national jurisdiction, on the one hand, and the sovereign right of national protection of citizens on the other. No international tribunal should or may evade the task of finding such limitations of both rights as will render them compatible within the general rules and principles of international law. **By merely ignoring world-wide abuses either of the right of national protection or of the right of national jurisdiction no solution compatible with the requirements of modern international law can be reached.**[166] (emphasis added)

Therefore, despite the fact that the Claimant was bound by a Calvo clause in its contract with the Mexican government, the Tribunal nevertheless considered the international law doctrine of abuse of rights so fundamental that it applied the principle to the dispute.

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[164] *Boffolo Case*, [1903] X RIAA 528 at 530.

[165] Lauterpacht, *The Function of Law in the International Community*, (1933) at 289.

[166] *North American Dredging Company of Texas (USA) v. United Mexican States*, Mexico-US General Claims Commission (1926) at 27.

This case confirms the fact that parties can never "contract out" from international law standards.

172. The International Court of Justice has recognized that abuse of rights is an integral part of international law in its decision in the *Anglo-Norwegian Fisheries Case*.[167] In commenting about the affects of this case and others, Professor Cheng has gone so far as to state:

> The principle of good faith requires that every right be exercised honestly and loyally. Any fictitious exercise of a right for the purpose of evading either a rule of law or a contractual obligation will not be tolerated. Such an exercise constitutes an abuse of the right, prohibited by law. [168]

173. Another example of the existence of a general prohibition against the abuse of rights in international law can be seen in the customary international law of diplomatic protection. Prof. Schwarzenberger notes that while a state may exercise its right to deny entry to a diplomatic envoy from another country to whom it had previously granted entry, it must not:

> exercise that right arbitrarily, capriciously or unjustly, and without being able to assert and prove that the consul against whom the measure was to be directed had misconducted himself in the performance of his duties.[169]

174. A specific sub-genre of the international law obligation of good faith further ensures that a government must not exercise its sovereign power to maliciously harm or otherwise injure an investment. This malicious injury prohibition goes beyond the general prohibition against the abuse of rights. The decision of the Tribunal in the *Bering Fur Seal Arbitration* embodies this traditional element of the principle of good faith. In that case, the Tribunal was asked to determine whether the US had a right to complain about the hunting of pelagic seals by British fishermen in the waters off the American Pribilof Islands. The Tribunal held that the US did have such a right, in stating:

> Sir **Charles Russell**: Where is the right that is invaded by that pelagic sealing?... It is not enough to prove that their industry may be less profitable to them because other persons, in the exercise of the right of sealing on the high seas, may intercept seals that come to them - that may be what lawyers call a damnum, but it is not an injuria... ; but a damnum does not give a legal right of action...

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[167] *Anglo-Norwegian Fisheries Case* (1951) ICJ Reports 116 at 142.

[168] Bin Cheng, *General Principles of Law* (1953) at 123.

[169] Schwarzenberger (1971) at 97, citing Article 23 of the *Vienna Convention of 1963 on Consular Relations*, (1963), 57 A.J.I.L. 1003, as a codification of this customary rule.

> **The President**: Unless done maliciously...
>
> **Sir Charles Russell**: ... They would have a right to complain... if it could be truly asserted that any class or set of men had, for the malicious purpose of injuring the lessees of the Pribilof Islands and not in regard to their own profit and interest and in the exercise of their own supposed rights, committed a series of acts injurious to the tenants of the Pribilof Islands, I agree that they would probably have a cause of action; and, therefore, they have the further (what I might call the negative right) of being protected against malicious injury ...[170]

175. In its final award in the *Azinian* case, the NAFTA Investor-State Tribunal discussed how abuse of rights was contained within the international law covered by NAFTA Article 1105. It stated:

> There is a fourth type of denial of justice, namely clear and malicious misapplication of the law. This type of wrong doubtless overlaps with the notion of "pretence of form" to mask a violation of international law.[171]

176. Bin Cheng has summarized the prohibition of malicious injury as an element of the principle of good faith in his treatise on the general principles of international law:

> The exercise of a right - or a supposed right, since the right no longer exists - for the sole purpose of causing injury to another is thus prohibited. Every right is the legal protection of a legitimate interest. An alleged exercise of a right not in furtherance of such interest, but with the malicious purpose of injuring others can no longer claim the protection of the law.[172]

177. By incorporating compliance with international law standards as part of NAFTA Article 1105, Canada is obliged to ensure that its actions comply with this obligation of good faith and fairness in all of its activities in relation to investors from other countries and their investments.

5. National Treatment

178. NAFTA Article 102 refers to the need to interpret the NAFTA in light of the international law principles of national treatment, most-favoured nation treatment and transparency. While these principles are not defined within the text of the NAFTA, it is clear that each of these principles constitutes a part of the international law standard that Canada must provide to investors and investments from other NAFTA Parties under NAFTA Article 1105.

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[170] *Fur Seal Arbitration (1893)* G.B./U.S., 1 Int.Arb., p.755, at 889-890.

[171] *Re: Azinian and Mexico* (NAFTA Investor-State Claim) (2000) 39 ILM 537 at para. 102.

[172] Bin Cheng, *General Principles of Law* (1953) at 122.

179. The content of the international principle of national treatment has been evolving throughout the last 100 years. Today, the principle of national treatment ensures that all foreign investments are entitled to be treated as well as the best treated domestic investment. The principle of national treatment has been well set out by the Investor in its Memorial (Initial Phase) at paragraphs 46 - 97. The customary principle of national treatment differs from this principle only in the absence of a developed requirement that "like circumstances" be applied. Under customary law, the issue is whether one investment is being treated as well as other investments operating in that country. If there is a difference of treatment, then the foreign Investment is entitled to receive treatment equivalent to the best treatment provided in that state.

180. As part of the customary law of national treatment, there is the operation of an international law concept that creates greater security for foreign investments during time of changing circumstances. The principle "*diligentia quam in suis*" provides that during a time of change, foreign investments are entitled to the best treatment provided and at no time are they to be treated less well as they were before the change was made. Thus, while a national government may decide to not provide police protection to domestic investments without violating international law, it cannot alter the policy by removing police protection to foreign investments unless protection to all investments is simply impossible to provide.

181. In a 1910 speech, former US Secretary of State, Elihu Root explains the then new concept of the minimum standard of treatment as it relates to the national standard, as follows:

> Each country is bound to give to the nationals of another country in its territory the benefit of the same laws, the same administration, the same protection and the same redress for injury which it gives to its own citizens, and neither more nor less; provided the protection which the country gives to its citizens conforms to the established standard of civilization...The condition upon which any country is entitled to measure the justice due from it to an alien by the justice it accords to its own citizens is that its system of law and administration shall conform to this general standard. If any country's system of law and administration does not conform to that standard, although the people of the country may be content or compelled to live under it, no other country can be compelled to accept it as furnishing a satisfactory measure of treatment of aliens.[173]

182. Efforts to codify international law in the 1920s and 1930s highlighted this debate and is the root of the distinction between the two. For example, in the 1930 Codification Conference at the Hague, the equality doctrine was supported by 17 countries, mainly the developing states from South and Central America. Twenty-one countries opposed it, including all of the developed European States and the United States. Professor Roth

[173] Elihu Root, *The Basis of Protection of Citizens Residing Abroad* (A.S., Proceedings, 1910) at 20-21.

reported that the controversy over these two standards resulted in a failure to approve the draft convention.[174]

183. State practice and international courts have established that there is a customary international law standard of treatment that must be given to foreigners and their investments.[175] For example, in the *Hopkins Case*, the U.S.-Mexican Claims Commission held:

> it not infrequently happens that under the rules of international law applied to controversies of an international aspect a nation is required to accord to aliens broader and more liberal treatment than it accords to its own citizens under its municipal laws...The citizens of a nation may enjoy many rights which are withheld from aliens, and conversely, under international law aliens may enjoy rights and remedies which the nation does not accord to its own citizens.[176]

184. Countries may have an almost free hand in how they treat their own citizens in their own country.[177] However, while a government's treatment of a foreigner may be perfectly lawful in terms of the state's own national laws, it may nonetheless be unlawful under international law. International law is fundamentally based on the idea that countries must observe their treaty obligations. Accordingly, the argument that a country cannot meet its international law commitments due to contrary domestic laws holds very little weight[178]. Judge Lauterpacht of the International Court of Justice made this point in his decision on *Certain Norwegian Loans*:[179]

> The question of conformity of national legislation with international law is a matter of international law. The notion that if a matter is governed by national law it is for that reason at the same time outside the sphere of international law is both novel and, if accepted, subversive of international law. It is not enough for a State to bring a matter under the protective umbrella of its legislation,

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[174] Roth, *Minimum Standard of International Law Applied to Aliens* (1948) at 74-75.

[175] Brierly, *The Law of Nations*, 2ed., (1936) at 172, *I Hyde, International Laws,* (1922) at 266-267, *Hall, International Law*, (8th ed.), by Higgins at 59-60.

[176] *The United States of America On Behalf of George W. Hopkins*, v. *The United Mexican States* (1926) 21 Am. J. Intl Law 160 at 166-167.

[177] Schwebel, *International Arbitration: Three Salient Problems* (1987) at 109.

[178] See the *Neer Case* (1927) IV RIAA at 61 where the General Claims Commission stated "The propriety of governmental acts should be put to the test of international standards."

[179] *Certain Norwegian Loans* (1957) ICJ Reports at 9, 37, 38. In the same case, Judge Lauterpacht observed that "The question of the treatment by a State of the property rights of aliens--including property rights arising out of international loans--is a question of international law."

possibly of a predatory character, in order to shelter it effectively from any control by international law.

185. In his treatise, *the Minimum Standard of Treatment*, Professor Freeman compared the equality standard to the "international standard of substantive justice". In his discussion, he addressed the right of an alien to acquire property and made the following conclusion:

> But once this ownership is permitted, the State falls under an international obligation to provide the same or as effective legal protection for it [the alien] as is required for those rights which are guaranteed by the law of nations...The same is true, of course, with regard to any right the State may confer over and above the minimum rights required of it.[180]

186. Once certain rights are granted, the alien has the right of the better of the national treatment or international standards. This is recognizing that there may be situations in which the national standard exceeds the international standard, or that the national standard may fall under the international standard. In either case, the best standard would prevail, with the international standard being the minimum which cannot be by-passed by any standards of municipal law. In other words, the international law standard prevails over municipal, unless the municipal law is of a higher standard. In that case, the more favourable municipal law standard prevails. [181]

187. There is no single standard of national treatment. For example, Professor Brownlie identifies a commonly recognized variation of the national treatment standard known by the Latin term *diligentia quam in suis*, which can be considered an exception to the pre-eminence of the international treatment standard. This Latin term denotes a form of national treatment generally accepted in international law that is "on the basis of the standard *ordinarily* observed by the particular state in its own affairs"[182] in such situations as an outbreak of war, insurrection or mob violence. In other words, an alien is permitted to seek a standard of treatment from a government that is equivalent to the treatment given to its own nationals.[183]

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[180] Freeman at 513. Roth, *Minimum Standard of International Law Applied to Aliens* (1948) confirms this view at 166.

[181] Roth provides a concise statement of the relation between the two standards when he states that "As a general rule, 'national treatment' of a foreigner is sufficient, if the nationals themselves are treated according to international standards." Roth, *Minimum Standard of International Law Applied to Aliens* (1948) at 121.

[182] Brownlie at 529, footnote 36.

[183] Brownlie at 457.

188. As a rule, the international standard prevails over the equality standard. In addition, as a sub-rule, national treatment is applicable in the instance municipal law is at a higher standard than the standard international law provides.[184] This international law principle of national treatment is distinct from conventional national treatment law as found in international trade and investment agreements, BITs or the NAFTA.

189. As discussed in the Investor's Memorial (Initial Phase), the conventional law of national treatment has greatly developed in the past 50 years, in particular through GATT/WTO case law. The general content of the equality standard as it has developed over the past 200 years is certainly similar to the present understanding of national treatment.[185] The modern concept of national treatment, in light of the pre-eminence of the international standard, has evolved into a minimum standard subordinate to international law.

6. International Economic Rights

190. International treaties, both in the area of international economic law and human rights, have recognized the importance of individual rights. Individual economic rights are addressed, *inter alia*, by the GATT/WTO (for example, in the *TRIPS Agreement*) and are also addressed within Chapter 11 of the NAFTA, which provides basic protections for investors and their investments. With respect to individual human rights, the General Assembly of the United Nations has adopted numerous conventions on the rights of

[184] Roth, *Minimum Standard of International Law Applied to Aliens* (1948) criticizes this relation as enunciated by Root and Freeman, at 122, as ignoring the distinctiveness of the two standards and suggests that there is in fact no relation between the two standards. With the greatest respect to Roth, he is missing the point that the international standard does remain pre-eminent in this relation, as he asserts throughout his treatise, and that in effect what Root and Freeman are stating is that there is this relational sub-rule according the best treatment of the two standards to aliens as well as nationals.

[185] Roth, *Minimum Standard of International Law Applied to Aliens* (1948) at 65 - 68, discusses the traditional equality standard by focusing on national treatment jurisprudence as it developed in the 19th Century. Roth quotes from the American-British Claims Arbitrations' *Cadenhead Case* (1914) 8 A.J. 663-665 to support the general view of the time that national treatment is "a generally recognized rule of international law that a foreigner within a State is subject to its public law, and has no greater rights than the nationals of that country."

individuals including the *Universal Declaration of Human Rights*[186] and the *International Convention on Civil and Political Rights.*[187]

191. Professor Ernst-Ulrich Petersmann recognizes the important interface between international economic agreements and human rights and observes the following:

> Human rights and liberal trade rules (including WTO rules) are based on the same values: individual freedom and responsibility (e.g. to adjust to competition); non-discrimination; rule of law; access to courts and adjudication of disputes; promotion of social welfare through peaceful cooperation among free citizens; parliamentary approval of national and international rules.[188]

192. The rights that are accorded to individuals in the context of human rights are also applicable to individual economic actors as well. International treaties involving human and economic rights recognize some of the same overlapping fundamental rights of due process, non-discrimination and fairness. Moreover, international tribunals, such as the WTO panel in the *US - Section 301 Case*, have confirmed these basic individual rights especially as they relate to state responsibility towards foreign private economic actors.[189]

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[186] *Universal Declaration of Human Rights*, adopted on December 10, 1948 by the General Assembly of the United Nations (U.N. Doc. A/811). Article 8 states: "Everyone has the right to an effective remedy by the competent national tribunals for acts violating the fundamental rights granted him by the constitution or by law." Article 17 further provides that: "(1) Everyone has the right to own property alone as well as in association with others.(2) No one shall be arbitrarily deprived of his property."

[187] *International Covenant on Civil and Political Rights*, adopted on December 16, 1966 by the General Assembly of the United Nations. Part II of the *Covenant* at Article 2 provides:

Each State Party to the present Covenant undertakes:

(a) To ensure that any person whose rights or freedoms as herein recognized are violated shall have an effective remedy, notwithstanding that the violation has been committed by persons acting in official capacity;

(b) To ensure that any person claiming such a remedy shall have his right thereto determined by competent judicial, administrative or legislative authorities, or by any other competent judicial, administrative or legislative authorities, or by any other competent authority provided for by the legal system of the State, and to develop the possibilities of judicial remedy.

Part IV of the *Covenant* at Article 25 provides:

Every citizen shall have the right and the opportunity, without any of the distinctions mentioned in Article 2 and without unreasonable restrictions:

...(c) To have access, on general terms of equality, to public service in his country.

[188] Ernst-Ulrich Petersmann, "The WTO Constitution and Human Rights" (2000) 3 *Journal of International Economic Law* 1 at 19.

[189] *US-Section 301 Case* at para. 7.81

193. The interface of human rights and individual economic rights in international law is relevant to the consideration of the international standard of treatment that a state must accord to a foreign investor and its investment. Therefore, the fundamental principles of international human rights law are applicable to international economic agreements such as the NAFTA generally, and Article 1105 of the NAFTA more specifically.

II. THE INTERNATIONAL LAW STANDARD APPLIED TO THE FACTS

194. Canada has breached its obligations to meet international minimum standards as set out in NAFTA Article 1105 by, among other things:

(a) Failing to provide fair and equitable treatment to the Investment by providing worse treatment to it than was provided to other softwood lumber manufacturers operating in Canada who were exporting softwood lumber to the United States;

(b) By not fairly or equitably allocating quota to the Investor's Investment initially, and having continuing breaches in those allocations made in subsequent years; and

(c) By engaging in harmful and abusive conduct through the actions of officials of Canada in the administration of the Investment's quota allocation.

195. More specifically, the following seven issues illustrate in detail how Canada breached its obligations to meet international law standards.

(a) **Lack of Administrative Fairness** - By designing an Export Control Regime that lacked any real appeal mechanism and in which crucial information was not provided to producers, Canada violated several international law standards that are rooted in the principle of good faith such as, fair and equitable treatment, transparency, and abuse of rights.

(b) **Misallocation of Discretionary Reserves** - The quota bonus allocation and the allocations made by the Minister from the various discretionary reserves were made in an unfair and arbitrary way that discriminated against producers in British Columbia and generally denied them their fair share of bonus and reserve allocations over the first 18 months of the Export Control Regime. The detrimental distributive effects of these unfair bonus and reserve allocations were multiplied under the growth mechanism. This entire arbitrary and non-transparent scheme represents a violation by Canada of several international law standards such as, fair and equitable treatment, transparency, and abuse of rights.

(c) **Wholesaler Problem** - Pope & Talbot not only suffered harm due to the problems surrounding the wholesaler under-reporting, but they were also harmed by the "Made in British Columbia" solution to the problem. This solution compensated a select group of companies with extra quota while companies like Pope and Talbot, which did not have access to an official appeal or review mechanism despite having a legitimate grievance, were forced to sacrifice quota in the ensuing redistribution. Canada's conduct with respect to the wholesaler issue violates several international standards such as, the principles of fair and equitable treatment and transparency.

(d) **The Flawed Verification Review Exercise** - Canada's verification review process with respect to Pope & Talbot was flawed in that Canada failed to provide Pope & Talbot with a transparent and predictable process. In addition, Canada abused its discretion by refusing to provide any statement of legal authority for the initiation of the process and by denying Pope & Talbot the opportunity to present its own arguments. The entire process was a breach of Canada's international obligations relating to transparency and abuse of rights.

(e) **The SFB Levy** - The design and implementation of the Super Fee Base Levy in 1999, which specifically and significantly harmed the Investor and its Investment, constitutes a violation of Canada's NAFTA obligation to provide national treatment as well as its obligation to act in a fair and equitable manner. The implementation and administration of the Super Fee Base Levy was done on an arbitrary basis and constituted an abuse of discretion by Canada.

(f) **Canada's Failure to Follow its International Treaty Obligations** - By failing to meet its international treaty law obligations under other international treaties to which the three NAFTA Parties are parties, including the WTO, Canada failed to observe one of the most fundamental rules of international law: *pacta sunt servanda*. The Investor relied on Canada to adhere to its international treaty obligations to act in good faith and Canada's failure to do so caused harm to the Investor and its Investment.

(g) **Inequitable Allocation Between Producers** - By providing producers in unlisted provinces with free and secure access to the United States market while Pope & Talbot was forced to curtail its exports (or face prohibitive export levies), Canada provided worse treatment to the Investment than was provided to similarly situated competitors. This constitutes a violation of the "fair and equitable treatment" standard and this violation caused significant harm to the Investor and the Investment.

A. Lack of Administrative Fairness

196. During the official preparations for the implementation of the Export Control Regime, memoranda exchanged between the Minister's office and Claudio Valle clearly show that Canada attempted to camouflage and suppress potential problems arising out of the Export Control Regime. In response to the Minister's concerns about the lack of a formal means of administrative appeal or review, Claudio Valle stated that:

> *There will invariably be firms that will want to contest the allocation entitlement. There is no formal appeal body under the Export and Imports Permits act. The Minister retains ultimate discretion to review cases...moreover, we do not favour the establishment of a formal appeal process as it becomes the magnet attracting both reasonable and unreasonable requests.*[190] [Emphasis added]

197. As a result, only the most vocal and politically-connected producers would have received access to the limited remedies made available by Canada: recourse by the Minister to the completely discretionary allocation reserves and Trigger-Price Bonus quota. Canada's failure to provide affected investments with a fair and effective hearing - even within an administrative context - constitutes a denial of justice under international law.

198. Since its inception, Canada's administration of the Export Control Regime has lacked transparency and accountability. Canada has defended this lack of transparency by claiming the need to maintain the confidentiality of companies involved in the process.[191] However, Canada has failed to provide any convincing reasons why apart from protecting confidential information of individual companies, the allocation process itself was not transparent. This is especially apparent in Canada's administration of various Ministerial discretionary reserves, which represents the most blatant example of the secretive and non-transparent nature of the Export Control Regime.

B. Misallocation of Discretionary Reserves and Trigger Price Bonus Quota

199. The "New Entrants", "Transitional" & "Ministerial" Reserves, as well as later bonus allocations, were not allocated on the agreed-upon historical levels (i.e. 23% for Quebec, 10.3% for Ontario, 7.7% for Alberta and 59% for British Columbia). These levels were agreed upon through a considerable amount of "horse-trading" between federal and

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[190] See Schedule 6 Memorandum from Claudio Valle to Minister Eggleton dated September 19, 1996. This memorandum was a reply to a memorandum written by the Minister's Executive Assistant, where concern was expressed with the Export Control Regime's lack of an appeal mechanism.

[191] May 2000 Merits Hearing Transcripts, May 3, Vol.6, at 65-67.

provincial officials and selected members of the Industry. While the Investment did not directly participate in the process that apparently led to a consensus about the proportions by which quota would be allocated, it was understood that softwood lumber manufacturers in each region of Canada could be assured that their allocations would reflect these agreed-upon historical levels. This view was held commonly throughout the industry and by provincial government officials in British Columbia and Alberta.

200. It is neither fair nor equitable for Canada to design a system that arbitrarily deprives certain producers of their share of a limited amount of quota -- in favour of producers located elsewhere in Canada -- particularly after it has established an allocation formula that was supposed to reflect a consensus on the appropriate historical share of such allocations by producers in each province. Canada is obligated, under international law, not to exercise its "sovereign right" to impose an Export Control Regime in an arbitrary or discriminatory manner (such that an unfair or inequitable result is engineered).

201. Canada was always particularly concerned with how allocation of quota under the Export Control Regime would impact upon, and be perceived by, producers from Quebec. Canada knew - even prior to the implementation of the quota allocation regime -- that the discretionary reserves and bonus allocations could be used to particularly advantage Eastern Canadian producers. When the inequitable distributive effects of these discretionary allocations became known to Canadian officials, rather than remedy the problem, they actually sought to convey privately to the beneficiaries of this inequitable distribution (particularly producers in Quebec) exactly how well they had fared as a result.

202. Knowledge of the negative distributive effects of the Minister's inequitable allocation policy can be seen in a briefing memorandum discussing options for the allocation of quota for the 1997/98 year. In that memorandum, Mr. Moroz of the Softwood Lumber Task Force, confirms that proposals from Quebec and Ontario were opposed by Alberta and BC, since "they would accelerate the eastward shift of quota". Mr. Moroz further confirms that Quebec was benefiting from the discretionary elements of the Export Control Regime by stating that "quota is already moving east due to the higher share of New Entrant allocations and hardship adjustment allocations going to eastern producers".[192]

203. That Canadian officials specifically set out to take advantage of this phenomenon by ensuring that Quebec politicians and stakeholders were made aware of the benefits

[192] See Schedule 4 Memorandum to Minister of International Trade from A. R. Moroz, Softwood Lumber Task Force dated February 27, 1997 at 2. See also Schedule 12, Memorandum from J. L. Wallace (EPS) to EPMT) dated July 15, 1995 (*sic*) at 2.

accruing to them demonstrates how the interests of producers in certain provinces were always more highly regarded than those of others.[193] This particular concern for the interests of Quebec producers over all others can be seen in numerous memoranda and status reports that always seem to focus on "the Quebec issue" or Quebec producers, but never "the Alberta issue" and rarely on the particular plight or successes of producers operating in British Columbia.[194]

204. This type of discriminatory behaviour violates international law because such favouritism represents an abuse of rights by Canada of the right of the Investor to receive non-discriminatory behaviour. While Canada may be entitled to employ a discriminatory allocation regime under its municipal law, and even discriminate among Canadian-owned softwood lumber producers under international law, it cannot treat foreign-owned producers in a similar fashion. Such favouritism towards Quebec and Ontario producers (resulting in an inequitable allocation of quota) falls below the "fair and equitable treatment" standard set out in NAFTA Article 1105 because such a result is neither fair nor equitable to foreign-owned producers operating elsewhere in Canada.

205. Moreover, the process used by the Minister to allocate his reserves and the Trigger Price Bonus quota was so closed and secretive that it clearly exacerbated the unfair distributive impacts generated under his discretionary policy. This lack of transparency constitutes both a denial of justice under international law and the arbitrary imposition of a measure that withholds from producers such as the Investment the fair and equitable treatment owed to it under NAFTA Article 1105. A measure that is either arbitrary in its design or application is the antitheses of a measure that provides "fair" or "equitable" treatment to Investments that are subject to it.

206. Rather than ensuring that at least foreign investments were accorded the kind of fair and equitable treatment under the Export Control Regime that was owing to them under international law, Canada determined that all softwood lumber producers would be subjected to the same closed and secretive allocation process. It is axiomatic that a non-transparent measure that does not provide ready access to means to safeguard one's rights or interests is exactly the kind of measure that one would want to employ if the goal of such a measure was to procure an unfair or inequitable result. Accordingly, international tribunals have consistently found that deficiencies in the transparency of a measure, or in

[193] See Schedule 4 - Memorandum from A. R. Moroz, Softwood Lumber Task Force, to Minister dated February 27, 1997 at 4.

[194] See, for example, Schedule 4 - Memorandum to Minister from A.R. Moroz dated February 27, 1997 at 4; also see Schedule 12 - Memorandum from Wallace H. Dowswell, Director of Softwood Lumber Division to Louis Gionet (EPMT) entitled "Quebec's interests in the Softwood Lumber Agreement", dated July 15, 1995.

the measure's provisions for protection of investment rights, constitute arbitrary or unfair treatment that falls below accepted international standards.[195]

C. Wholesaler Problem

207. The Investor submits that Canada has acted in an arbitrary and unfair manner with respect to the allocation of quota to the Investment with respect to wholesalers and, accordingly, is in violation of its international law obligations with respect to the Investment. In particular, Canada's conduct represents a lack of administrative fairness resulting in a denial of justice, a failure of transparency, and an abuse of its discretion under international law.

208. Further, the Investor and its Investment have been harmed as a result of Canada's breach of its international law obligations with an unfair [redacted] reduction of its EB quota allocation in Year 2 of the Regime amounting to over [redacted] of softwood lumber.

209. Canada knew the wholesaler contribution issue would be a problem before the allocation policy was formally announced.[196] As noted in a memo to the Deputy Minister's office from Claudio Valle, dated September 26, 1996, "intense efforts" were undertaken to gauge "potential quota shock."[197] The memo shows that British Columbia manufacturers were deeply concerned about the wholesaler component of the allocation prior to the allocation of quota in November 1996. The Memo reads in part: "We received calls late last evening from the BC contingent [redacted] expressing severe concern at our proposal to use the "wholesaler co-efficient" as a way of dealing with primary mills sales to wholesalers." Canada rejected the solutions proposed by the BC contingent and

[195] See, for example: *de Sabla (United States)* v. *Panama*, [1955] VI RIAA 358 at 362-363; United Nations, Human Rights Committee, *Communication No. 633/1995: Canada 05/05/99*, CCPR/C/65/D/633/1995 at para.13.6; and *US - Import Prohibition of Certain Shrimp and Shrimp Products*, WT/DS58/AB/R, October 12, 1998 at para's. 177-183.

[196] The non-transparency of the wholesaler component of a primary manufacturer's allocation was expressed by A. Kaufman, Executive Assistant to the Minister of International Trade, in a Memo to trade officials concerning the quota transfer and draw down mechanisms: "I am a bit surprised that we are not allowing a primary mill to ascertain this kind of information [e.g. names of wholesalers], as it will make it more difficult for a primary mill to ascertain as the end of a quarter approaches, whether it is likely that the transferred quota which it gave to wholesaler #1 will all be exported to the U.S."; see Schedule 5, Memorandum from A. Kaufman (O/MINT) to John Gero (ER), October 15, 1996 at 2.

[197] See Schedule 5, Memorandum from DMT to EPD, September 26, 1996 re: British Columbia's expected "significant reaction" to potential "quota shock".

pushed ahead with what Canada clearly knew was a flawed wholesaler allocation, and one that would have adverse effects on British Columbia softwood lumber manufacturers.

210. The memo continues to explain the concerns of the British Columbia contingent regarding the wholesaler problem:

> - They see a major inequity in the proposal, in that it would reward those mills that sold to wholesalers but whose lumber was never exported to the U.S. For example, on the basis of the B.C. co-efficient (0.26) even a company which sold 100 units only on the domestic market would get rewarded with 26 units of export quota.
>
> - Apsey/ Kerr indicated that unless this was changed, there would be significant uproar in B.C. once the quota letters would become known....
>
> - The only solution on which B.C. says they an (sic) agree is to **continue the current system of first come first served, within the agreed provincial limits, until the end of the current quota year i.e. for the next two quarters.**[198] (emphasis added)

211. After detailing the pros and cons of the British Columbian proposal, Canadian officials merely recommended that the *status quo* remain with the "first come, first served" system ending, as scheduled, after the end of the second quarter of Year 1 of the Regime. Officials advised the Deputy Minister that there would be a number of "pros" to extending the "first come, first served" for two further quarters, including: avoiding political fall-out over quota allocations, and an extra six months would allow officials to address the new entrants issue "and get it right". With respect to the wholesaler problem, the Memo concluded that a major benefit would be:

> No difficulty in compiling the allocation for 1997/ 98, as it will be derived from actual permit data (fair and seen to be fair).[199]

212. This memo highlighted one of the key problems of the wholesaler component - a complete lack of reliability of what has been readily admitted, and identified, as faulty wholesaler data. As with any data based exercise, in particular the creation of a formula such as the B.C. wholesaler co-efficient, if the data on which a formula is based is faulty, the formula and the allocation will also be faulty.

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[198] See Schedule 5, Memorandum from DMT to EPD, September 26, 1996.

[199] See Schedule 5, Memorandum from DMT to EPD, September 26, 1996 at 2.

213. As seen in the comparison of the wholesaler data provided to the Investor from Canada and Pope & Talbot's own wholesaler sales data,[200] there is a dramatic difference in the quality of the data with most wholesalers not reporting or significantly under-reporting their sales. This is the kind of faulty data on which the wholesaler allocation was based.

214. As stated to the Trade Minister's highest official, the Deputy Minister, actual permit data would allow for a proper compilation of the quota allocation and would not only be fair, but be "seen to be fair." Pope & Talbot has asked for no less than what the Minister of Trade's own officials advised and rejected in September 1996.

215. The "wholesaler problem", as it was identified by the British Columbia Advisory Committee, continued to be contentious, as predicted, after the initial allocation of quota in November 1996. Rather than provide an overall solution to the wholesaler problem, which recognized the general flaws in the wholesaler component for quota holders in all of the Listed Provinces, such as extending the "first come first served" to the end of Year 1 of the Regime, Canada imposed a "made-in-British Columbia solution" re-allocation of quota in response to the "uproar" from those wholesaler quota holders who complained the loudest.

216. This re-allocation of quota provided special treatment to a limited number of companies, but not to the majority of British Columbia softwood lumber manufacturers such as Pope & Talbot. Not only did Pope & Talbot not receive the special treatment, it had to pay out for other companies to receive that treatment. This treatment was a non-transparent and arbitrary attempt to solve a problem directly under Canada's control and to avoid the need for a broader solution for all holders of wholesaler quota.

217. The principles of administrative fairness and transparency require that an investor or investment subject to an administrative arrangement such as the Export Control Regime be made aware of state administrative actions and the reasons behind those actions. In addition, once a state meets these initial obligations, an investor or investment subject to the administrative action must be permitted the opportunity to respond to such action. By not providing any information concerning the generally flawed wholesaler allocation process to the industry as a whole, and only dealing with problems as they arose, Canada did not meet its international obligations to treat Pope & Talbot fairly or provide it an open and transparent Regime.

218. The "made-in-British Columbia" solution is another example of Canada's deeply flawed process with respect to how it handled the on-going quota allocation process. The Minister rubber-stamped the re-allocation decisions made by the advisory body in British

[200] See Schedule 33.

Columbia. The 1997/ 98 re-allocation of 3.1% was then imposed on producers such as Pope & Talbot with almost no explanation and no chance of appeal or review. This was a process that was clearly neither fair, nor one that could be seen to be fair.

219. The wholesaler contribution method and the British Columbia reallocation process detrimentally impacted Pope & Talbot in a manner that could not be remedied under the Export Control Regime. Canada did not provide an effective means for producers such as Pope & Talbot to protect their rights. As evidenced in the *de Sabla* award of the United States - Panama Claims Commission, Canada was obliged to provide such a mechanism in the Export Control Regime and failed.

D. Verification Review Episode

220. The Investor submits that the arbitrary and unfair conduct of Canada with respect to the verification review episode was a violation of its international law obligations with respect to the Investment. In particular, Canada's conduct represents a lack of administrative fairness resulting in a denial of justice and an abuse of its discretion under international law.

221. Further, the Investor and its Investment have been harmed as a result of Canada's breach of its international law obligations. The Investor has been required to expend significant resources to address the allegations of Canada with respect to statistically negligible errors in its softwood lumber questionnaire, which this Tribunal confirmed in its award were "immaterial in the context of Pope & Talbot's total quota and past action by Canada in implementing the measure."[201]

222. The Investor submits that the conduct of Canada concerning the verification review process has become material with respect to this Phase of the arbitration. Canada threatened Pope & Talbot for the fifth time in its letter of November 10, 1999[202] that it would unilaterally revise Pope & Talbot's quota allocations without receiving additional information from Pope & Talbot. Although in the end result, Canada did not pursue the unilateral revision of the Investment's quota allocation as it threatened, the egregious conduct of Canada leading up to the Interim Measures Motion should appropriately be considered by this Tribunal during this phase of the arbitration dealing with treatment in accordance with international law.

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[201] *Pope & Talbot and Canada*, Ruling by the Tribunal on Claimants' Motion for Interim Measures, January 7, 2000.

[202] See Schedule 34, Letter from Douglas George to Appleton & Associates, received November 10, 1999.

223. This Tribunal has confirmed in its order that the verification review is part of the measure at issue in this NAFTA Claim, the Export Control Regime. Accordingly, the Tribunal has the jurisdiction to address this issue in this phase of the arbitration. In particular, the Investor submits that this Tribunal should place the conduct of Canada under the scrutiny of international standards.

1. Denial of Justice

224. One of the key requirements of the principle of denial of justice is that a State must provide certain substantive process guarantees for the determination of a controversy involving administrative decisions by a NAFTA Party. The requirements of fairness would suggest that the conduct of Canada during the verification review process with respect to Pope & Talbot was arbitrary and, accordingly, in violation of its international obligations. Canada failed to provide Pope & Talbot with a transparent and predictable process, in particular Canada did not provide Pope & Talbot:

(i) complete access to information, including reliable data, regarding the case against it, such as the background to Canada's decision to revise the Investment's Questionnaire and unilaterally cancel or revise its softwood lumber quota allocation;

(ii) a reasoned explanation for Canada's proposed actions, in particular regarding Canada's repeated threats to cancel or revise Pope & Talbot's quota allocation;

(iii) a statement of the legal authority under which the verification review process was initiated; or

(iv) an opportunity to present its arguments in a meaningful and informed manner to the appropriate Canadian officials to respond properly to the case against it.

(i) Knowing the case against Pope & Talbot

225. The Investor made significant efforts to ensure that any data collected as a result of the verification review process would be an accurate basis on which to assess Pope & Talbot's Questionnaire. Canada refused to follow the proposals of Pope & Talbot and conducted an audit that was not in accordance with accepted auditing principles. Canada attempted to rely on the results of the faulty audit despite the fact that Canada did not follow accepted statistical sampling methodology to support its allegations of errors by Pope & Talbot.

226. After the verification review, Pope & Talbot requested of Canada the basis on which the verification review was being conducted and received no information until receipt of the Lund Report five months after the verification review. Pope & Talbot was not provided the opportunity to view the information regarding the case against it. Nor was Pope & Talbot in a reasonable position to assure itself that the audit was truly being conducted to support Canada's stated goal of cancelling or revising Pope & Talbot's quota allocation.

227. Even after Canada produced the full Lund Report to the Investor prior to the Interim Measure Motion, it became apparent there was also a significant lack of information provided to allow the Investor to assess the accuracy of the Report. In particular, Pope & Talbot did not receive sufficient information with respect to the wholesaler quota allocation to allow it to make a complete assessment of the case made against it. In fact, the full extent of the wholesaler data was not provided until Canada's response to the Investor's Request for Documents was provided on July 26, 2000. At each step of the verification review and Interim Measures Motion process, Canada denied the Investor the information necessary for it to know the case against it. This conduct was in violation of Canada's international obligations.

(ii) A Reasoned Explanation

228. In response to the verification review process, Canada wrote to Pope & Talbot on October 6, 1999 to advise it that the verification had revealed a number of "systemic errors that are of a sufficient magnitude to necessitate a revised submission from Pope & Talbot Ltd." on which basis Pope & Talbot was told to submit a revised Questionnaire.[203] In response to Canada's letter, the Investor objected to providing a revised Questionnaire because Canada had failed to provide the Investor with preliminary findings from the review and the opportunity to review those findings. As stated in the Investor's letter:

> Without being able to review the basis of your decision, we believe that Pope & Talbot will not be able to properly respond to the EICB's request for a revised questionnaire.
>
> Accordingly, before beginning the onerous and costly process of revising its questionnaire for the full two year period, our client requires further information regarding the basis on which you have arrived at your conclusions, in particular with respect to the exact nature and magnitude of any errors. The subjective nature of the findings and conclusions made from the verification review make it critical for our client to have the opportunity to review the basis for those conclusions. Pope & Talbot will be able to further advise you when it will provide a revised questionnaire once it receives this information.

[203] See Schedule 35, Letter from Douglas George to Gary McGrath, October 6, 1999.

> Please provide us with copies of the working papers from the verification review and any summary documentation, including computer spreadsheets, prepared from those working papers. We also request copies of any reports made to your office and any memos or other documents dealing with recommendations and conclusions made regarding the verification review.[204]

229. Canada's response to the Investor's request was merely to reiterate its threat to unilaterally revise Pope & Talbot's Questionnaire and quota allocation. The Lund Report, the basis on which Canada advised Pope & Talbot on October 6, 1999 to re-submit its Questionnaire, was not provided to the Investor except in response to the making of the Interim Measures Motion. The Investor received the Lund Report, redacted of all relevant numbers and calculations, on November 30, 1999 as part of Canada's Reply to the Investor's Interim Measures Motion. Even on the orders of the Tribunal, the un-redacted version of the Lund Report was not provided to the Investor until December 22, 1999.

230. The Investor was thwarted by Canada at each step of the process from receiving information to allow it to have an understanding of the reasons behind Canada's desire to revise its Questionnaire and quota allocation. In light of these steps, it cannot be said that Canada has met its international obligation to provide reasons for its administrative actions when it forces companies such as Pope & Talbot to launch an arbitral motion simply to find out information that should have been provided to it in the normal course.

(iii) Statement of Legal Authority

231. For an administrative proceeding such as a verification review to be commenced against an investment such as Pope & Talbot, it is a basic tenet of the principle of transparency and due process that a state Party provide the basis of its legal authority. The Investor repeatedly denied that Canada had lawful authority and sought confirmation of such authority. The Investor received no evidence from Canada of its authority at any point during the verification review process or during the Interim Measures Motion. The verification review was held on a consensual basis with the Investor and its Investment under the threat of its quota being unilaterally revised or cancelled.

232. The Investor submits that Canada has not met its international obligation to Pope & Talbot to assure that administrative proceedings proceed on the basis that it is not only lawful, but that notice is provided with respect to the basis of that lawful authority.

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[204] See Schedule 36, Letter to Douglas George on behalf of the Investor, October 25, 1999.

(iv) Opportunity to Present Arguments

233. Since Canada failed to meet its international obligations to allow Pope & Talbot to know the case against it, receive a reasoned explanation for Canada's actions, or the legal basis on which such acts were authorized, Pope & Talbot was not provided by Canada with the opportunity to present its own reasoned response to the findings of the verification review directly to Canadian officials, save through the Interim Measure Motion. The Investor submits that Canada has not met its international obligations to Pope & Talbot to assure it the opportunity to present arguments in response to an administrative proceeding such as the verification review.

(v) Summary

234. These four failures by Canada can be summarized as a violation of administrative fairness as reflected in the international principles of transparency and denial of justice. As part of these principles, Pope & Talbot should have been permitted to have access to the information relied upon by Canada in support of its decision to unilaterally revise Pope & Talbot's Questionnaire. In addition, Pope & Talbot should have been permitted by Canada to independently ensure that the data on which any decision was based was accurate and done under accepted audit principles. In neither case did Canada meet its international obligations to Pope & Talbot.

2. Abuse of Discretion

235. The Investor submits that the conduct of Canada before and after the verification audit, and after the Investor submitted its Motion on Interim Measures, was an abuse of discretion and showed a lack of good faith to the Investor and its Investment under international law. An abuse of discretion is an arbitrary application of a measure by a State with respect to a foreign national, which leads to an unfair and unreasonable result.

236. Bin Cheng states in his summary of the principle of abuse of discretion that:

> *... discretion must be exercised in good faith, and the law will intervene in all cases where this discretion is abused. .... Whenever, therefore, the owner of a right enjoys a certain discretionary power, this must be exercise in good faith, which means that it must be exercised reasonably, honestly, in conformity with the spirit of the law and with due regard to the interest of others.*[205]

237. In this case, the Canadian officials in the Export and Import Controls Bureau ("EICB") acted without lawful authority and exercised their discretion in a manner that exhibited a

[205] Bin Cheng, *General Principles of Law* (1953) at 132-134.

lack of good faith. This lack of good faith is evidenced in particular by the repeated threats of the unilateral revision or cancellation of Pope & Talbot's quota allocation without lawful authority and on the basis of a flawed and unreliable verification report and process. In addition, Canada made allegations about Pope & Talbot's Questionnaire with respect to its wholesaler allocation based on what was admitted to be a flawed process. Canada did not meet the terms of the Agreement on which the audit was conducted, in particular by not providing information required by Pope & Talbot to respond to the allegations made against it.

238. The conduct of Canada was an arbitrary and unreasonable exercise of discretion by the EICB officials showing a lack of good faith, and, accordingly, is an abuse of discretion under international law.

E. SFB Issue

239. In September, 1999 Canada promulgated the SFB Levy measure in settlement of the *BC Stumpage Case*. As Canada has stated in its own briefing notes, the adverse impact of the SFB Levy was minimal for most of the industry.[206] The effect of the measure was directed at companies that

(1) operated in the interior of British Columbia;
(2) exported LFB levy quota softwood lumber; and
(3) exported UFB levy quota softwood lumber.

A softwood lumber manufacturer from the coast of British Columbia that only exported EB levy softwood lumber would have received benefits from the stumpage reduction with no corresponding adverse impact from the SFB Levy. However, Pope & Talbot, which operated in the interior and relied on exports of LFB and UFB levy softwood lumber, was disproportionately and unfairly impacted by the SFB levy.

240. Accordingly, the Investor submits that Canada's design and implementation of the SFB Levy measure was a violation of Canada's international law obligation exhibiting an abuse of discretion and failure to treat Pope & Talbot in a fair and equitable manner. The Investor and its Investment have been harmed as a result of Canada's breach of its international obligations by depriving it of over 25% of its LFB quota and repricing it at what would in normal markets be an uneconomic level and making it virtually impossible to export softwood lumber at the new SFB level.

[206] See Schedule 3, Government of Canada Press Release, "B.C. Stumpage Fees: Canada – U.S. Settlement", August 30, 1999, states that: "At current volumes these changes will affect about 1 percent of B.C.'s total lumber exports to the United States".

241. The international principle of good faith requires that NAFTA Parties do not abuse their discretion in the treatment of investors and their investments. Accordingly, in the design and implementation of a measure such as the SFB Levy, Canada had an obligation to conduct itself by acting reasonably, honestly and, as Bin Cheng states, "with due regard to the interest of others."[207]

242. Canada has provided no reason for the differential and arbitrary treatment of Pope & Talbot in its design and implementation of the SFB Levy measure. The Investor submits that, in view of the evidence, Canada's most senior officials designed and implemented the SFB Levy measure in a manner that would specifically penalize Pope & Talbot. This is an abuse of discretion in international law.

243. In the *BC Stumpage Case*, the US Government put at issue the reductions in the British Columbia stumpage rate to coastal and interior softwood lumber producers. The SFB levy measure did not reflect the stumpage reductions, in particular it did not reflect the disproportionate lowering of the coastal and interior rates: the coastal rate reduction of CDN$8.10 per cubic metre compared to the interior rate of CDN$3.50 per cubic metre. As Canada has admitted, the SFB levy measure was intended to act as a "general export restraint" of all British Columbia softwood lumber manufacturers,[208] not just the coastal manufacturers who received a disproportionate benefit from the lowering of the stumpage rates. By applying the SFB levy measure to all British Columbia companies, the effect of the measure was that Canada disproportionately placed the burden of the settlement on interior companies, in particular Pope & Talbot.

244. As part of the SFB levy measure, 25% of Pope & Talbot's LFB quota was repriced to what was the previous UFB level. Since a company like Pope & Talbot always utilized 100% of its LFB quota allocation, Pope & Talbot was required to shoulder an unfair and disproportionate burden of the SFB Levy. That Pope & Talbot would be adversely affected by the measure was acknowledged by Canada in the Minister's decision document when the measure was promulgated.[209] Pope & Talbot was specifically mentioned in Canada's decision document.

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[207] Bin Cheng, *General Principles of Law* (1953) at 134.

[208] Canada's Response to Questions of the Tribunal, August 8, 2000, "Documents Responding to the Tribunal's Document Requests" at 16.

[209] See Schedule 8.

245. Since Canada was aware of the impact of the LFB repricing upon Pope & Talbot, it would also have been aware that [redacted] UFB levy wood and that a re-pricing of the UFB levy to the US$146.25 SFB level could make it completely uneconomical [redacted] to export softwood lumber. [redacted] The effect of Canada's measure was not to restrain those coastal manufacturers who primarily benefited from the stumpage reduction, but to punish interior manufacturers that Canada knew had been efficient exporters of LFB and UFB levy softwood lumber, such [redacted] Given its special mention in decision documents, one can only conclude that Canada's actions were specifically directed at Pope & Talbot. Such conduct can be considered to be an abuse of discretion and a breach of Canada's international law obligations.

246. Canada has implied that Pope & Talbot received a bonus allocation in quarters 12 and 13 to ameliorate the burden of the SFB levy. This is not true. Pope & Talbot received only a *pro-rata* share of the allocation in question, as it did not qualify for the criteria set out by the British Columbia Advisory Committee (and apparently rubber-stamped by the Minister) for such amelioration. Moreover, even if this bonus quota allocation was provided in connection with imposition of the SFB levy, it completely failed to compensate Pope & Talbot for the losses it has suffered as a result of the imposition of the SFB levy.

F. Canada's Failure to Follow its International Treaty Obligations

247. In April 1994, the *Final Act of the Uruguay Round and the Marrakesh Agreement Establishing the World Trade Organization* (the "*WTO Agreement*") was signed at the Marrakesh Ministerial Meeting. Canada, Mexico and the United States are all members of the WTO and attended those meetings. Annex 1A of the *WTO Agreement* contains the *Agreement on Safeguards*, which all three countries ratified. The *Agreement on Safeguards* provides for the prohibition and elimination of certain measures. Article 11(1)(b) of the *Agreement on Safeguards* provides as follows:

> *1. (b) Furthermore, a Member shall not seek, take or maintain any voluntary export restraints, orderly marketing arrangements or any other similar measures on the export or the import side. These include actions taken by a single Member as well as actions under agreements, arrangements and understandings entered into by two or more Members. Any such measure in effect on the date of entry into force of the WTO*

> *Agreement shall be brought into conformity with this Agreement or phased out in accordance with paragraph 2.*[210] (Emphasis added)

248. The *Softwood Lumber Agreement* is a "voluntary restraint arrangement".[211] Moreover, in its answers to the Tribunal's questions dated August 8, 2000, Canada further confirms this by admitting that the SFB levy was "intended to act as an export restraint for all exporters of softwood lumber first manufactured in B.C."[212] The Export Control Regime is an export restraint that was imposed voluntarily by Canada in implementation of the *Softwood Lumber Agreement.*

249. Article 1(b) of the *Agreement on Safeguards* clearly prohibits WTO Members, including Canada and the United States, from even ***seeking*** voluntary export restraints, much less taking or maintaining such measures. The Export Control Regime works to reduce the volume of softwood lumber exported from Canada to the United States, in clear contravention of Article 1(b) of the *Agreement on Safeguards.*

250. In accordance with the principle of *pacta sunt servanda*, Canada is obligated to comply fully with its obligations under the WTO *Agreement on Safeguards.* Canada's implementation of the SLA clearly breaches its obligations under the WTO Agreement and violates an "indisputable rule of international law" contrary to NAFTA Article 1105.

251. The Investor and the Investment are entitled to expect that Canada will act in good faith in accordance with its treaty obligations. The Investor and the Investment relied on its expectation that Canada would act in good faith.[213] By implementing a measure having the effect of restraining exports, i.e. the Export Control Regime, Canada breached the *pact sunt servanda* principle by not observing Article 1(b) of the *Agreement on Safeguards*, and therefore failed to treat the Investment in accordance with international law.

G. Inequitable Allocation Between Producers

252. In applying the "fair and equitable treatment" standard, the Tribunal is empowered to ensure that a just result is achieved in this arbitration. It is consistent with the equitable

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[210] *Agreement on Safeguards*, Annex 1A to the *Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations*, GATT Doc. MTN/FA (December 15, 1993), 33 I.LM. 9 (1994).

[211] Canada made this admission in paragraph 67 of its Statement of Defence.

[212] Canada's Response to the Tribunal's Questions, August 8, 2000 at 16.

[213] May 2000 Merits Hearing Transcripts, Vol. II, May 2, 2000 Testimony of Kyle Gray at 166-168.

principle that similarly situated actors must be treated similarly and that producers in Listed and Non-Listed Provinces can be treated differently under the Export Control Regime. It is simply not fair that competing producers can be provided with free and secure access to the United States market while Pope & Talbot is forced to curtail its exports or face severe export levies and monitoring of its business affairs under the Export Control Regime.

H. Damage

253. The Investor and the Investment have been damaged as a result of Canada's failure to meet its international law obligations. The witness statement of Howard Rosen provides evidence of some of the damage to the Investment and the Investor arising from Canada's breach of its NAFTA Article 1105 obligation.[214] These damages include, but are not limited to:

a) Damages resulting from the Investment's failure to receive the full amount of softwood lumber export quota that it should have received under a fair application of Canada's Export Control Regime; and

b) Damages resulting from the Investment's failure to receive fair and equitable discretionary allocations of softwood lumber export quota that it should have received under Canada's Export Control Regime or alternatively the failure to receive its *pro rata* share of the remainder of softwood lumber quota that should have been available to it as a British Columbia producer if discretionary allocations were made on a fair and equitable basis in good faith and with transparency;

[214] See Schedule 33, Witness Statement of Howard Rosen.

SECTION FOUR: NATIONAL TREATMENT

I. THE INTERNATIONAL LAW OF NATIONAL TREATMENT

254. The Investor adopts the arguments contained within paragraphs 46 to 89 and 91 to 97 of its Memorial; paragraphs 37 to 78 of the Supplemental Memorial; and paragraphs 4 to 18 of the Investor's Reply to the Post-Hearing Submissions of the United States and Mexico.

255. NAFTA Article 1102 must be interpreted in light of the general principle of national treatment in NAFTA Article 102 and is well established in the jurisprudence of international trade law. NAFTA Article 1102 refers to investors and investments in like circumstances, but in all substantive respects the scope and quality of the national treatment obligation is well-established in international trade law.

256. State responsibility requires, with respect to national treatment, that a state provide legal security to an investor that it will not be subject to discrimination *de jure* or *de facto*. National treatment means that a government must guarantee that an investor and its investments will not be subject to the risk of discrimination in any government measure.

257. The recent WTO Panel in the *United States – Section 301 Case* recently characterised the type of legal security provided through the national treatment obligation as follows:

> In treaties which concern only the relations between States, State responsibility is incurred only when an actual violation takes place. By contrast, in a treaty the benefits of which depend in part on the activity of individual operators the legislation itself may be construed as a breach, since the mere existence of legislation could have an appreciable "chilling effect" on the economic activities of individuals. . . . A domestic law which exposed imported products to future discrimination was recognized by some GATT panels to constitute, by itself, a violation of Article III, even before the law came into force. **Finally, and most tellingly, even where there was no certainty but only a risk under the domestic law that the tax would be discriminatory, certain GATT Panels found that the law violated the obligation in Article III.** . . . The rationale in all types of cases has always been the negative effect on economic operators created by such domestic laws. An individual would simply shift his or her trading partners – buy domestic products, for example, instead of imports – so as to avoid the would be taxes announced in the legislation or even the mere risk of discriminatory taxation. . . . In this sense, Article III:2 is not only a promise not to discriminate in a specific case, but is also designed to give certain **guarantees to the market place** and the operators within it that discriminatory taxes will not be imposed.[215] (Emphasis added)

258. Legal security is not provided, and the obligation to abstain from providing less favourable treatment is not met, in cases where a measure is applied in an arbitrary or

[215] *US-Section 301 Case* at 322-323.

non-transparent manner, since in such circumstances the investor faces an inherent risk that the conduct will be discriminatory.

259. NAFTA Article 1102 provides investors and their investments with a guarantee against less favourable treatment – because it requires NAFTA Parties to impose measures that are demonstrative of their good faith commitment to provide "treatment no less favourable". It is not sufficient for a government to impose a measure that only appears to avoid discrimination on its face. The measure must embody a guarantee of freedom from discrimination for investors and their investments, because even the risk of inappropriate treatment constitutes a breach of a NAFTA Party's obligation to honour its NAFTA Article 1102 obligation in strict good faith.

260. When the NAFTA Parties agreed to provide national treatment to NAFTA investors and their investments under NAFTA Article 1102, they agreed to provide "treatment no less favourable" to these investors and their investments in strict good faith, as expressed in the *pacta sunt servanda* rule of international law. This is the nexus between a Party's obligation to provide treatment in accordance with international law, as expressed by NAFTA Article 1105, and its obligation to provide "treatment no less favourable" under NAFTA Article 1102. A measure that fails to provide the best available treatment to investments of NAFTA investors who are similarly situated to domestic investments because of a lack of transparency or through arbitrariness in its application is a measure that is capable of breaching a Party's obligations under both NAFTA Article 1102 and NAFTA Article 1105.

261. NAFTA Article 1102 requires NAFTA Parties to accord treatment no less favourable to the Investor and its Investment than that which it accords to their domestic competitors operating in like circumstances. This standard of treatment is clearly not limited to cases of direct discrimination based upon the nationality of the Investor. Canada has claimed throughout its written response to the Tribunal's questions (set out in the Interim Award) that it did not intend to discriminate against American investors. The absence of such intention is not required to answer the question of whether Canada acted consistently with its NAFTA obligations. It also includes *de facto* discrimination that results in the Investor or its Investment receiving less favourable treatment than that which has been received by a competing Canadian investor under the same measure. In *Canada - Measures Affecting the Automotive Industry*[216] and *European Communities -- Bananas*,[217]

[216] *Canada – Certain Measures Affecting the Automotive Industry*, WT/DS139/R, WT/DS/142/R, February 11, 2000.

[217] *EC – Regime for The Importation, Sale and Distribution of Bananas*, WT/DS27/R/USA, May 22, 1997. Appellate Body Report, WT/DS27/AB/R, September 9, 1997.

two WTO Panels found, and two chambers of the Appellate Body affirmed, that the failure of a quota regime to provide the **best available treatment to all foreign and domestic businesses competing in the same market**, rather than a pre-determined few, violated various WTO "national treatment" and "most favoured nation treatment" provisions. These WTO Panel and Appellate Body reports provide an authoritative approach as to how the principle of national treatment should be applied in interpretation of NAFTA Article 1102 (whose text clearly supports application both to cases of *de jure* **and** *de facto* discrimination).

262. The question of whether goods, services, service-providers, investors or their investments are "like", or operate in "like circumstances" with each other, revolves around a determination of whether they operate in the same market place. Whether one business has obtained a cost-advantage over another from access to a less expensive supply of raw materials, or from locating closer to a market, may make that business more "competitive" with respect to the other – but it does not fundamentally affect the question of whether they are in "like circumstances" with each other. What matters is to ensure equality of competitive opportunities – not to create a level playing field, which would in effect deprive enterprises of their ability to utilize their competitive advantages. For example, the GATT panel stated in *Canada-Beer* that:

> The Panel noted that minimum prices applied equally to imported and domestic beer did not necessarily accord equal conditions of competition to imported and domestic beer. Whenever they prevented imported beer from being supplied at a price below that of domestic beer, they accorded in fact treatment to imported beer less favourable than that accorded to domestic beer; when they were set at the level at which domestic brewers supplied beer - as was presently the case in New Brunswick and Newfoundland - they did not change the competitive opportunities accorded to domestic beer but **did affect the competitive opportunities of imported beer which could otherwise be supplied below the minimum price.**[218]

263. It may be in some circumstances that differential treatment of investors operating in the same marketplace may be justified on the basis of non-market factors, such as environmental externalities. Differential treatment of actors operating in the same market place raises a strong presumption that discrimination exists. The burden to rebut this presumption is upon the party engaging in discriminatory practices. As stated by the panel in the *US-Section 337* case:

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[218] *Canada – Import, Distribution and Sale of Certain Alcoholic Drinks by Provincial Marketing Agencies*, (DS17/R-39S/27) adopted on February 18, 1992 at 55-56.

> Given that the underlying objective is to guarantee equality of treatment, it is incumbent on the contracting party applying differential treatment to show that, in spite of such differences, the no less favourable treatment standard of Article III is met [219]. (Emphasis added)

II. NATIONAL TREATMENT APPLIED TO THE FACTS OF THIS CLAIM

A. The Best Treatment Available Under the Export Control Regime is Provided to Producers in Provinces Not Covered Under the Export Control Regime

264. Canada has provided material in response to the Tribunal's request for documents set out in the Appendix to the Interim Award in part 2 of its request respecting Non-Covered Provinces. These materials dealing with CVD Investigations and determinations by the US Department of Commerce, have provided evidence that assists this Tribunal to better appreciate the actual risk of CVD actions being brought against softwood lumber manufacturers in Canada.

265. Manitoba and Saskatchewan, which are Non-Listed provinces, were investigated by the US in its CVD investigation ("Lumber III") in 1992. The preliminary investigation report shows that while the stumpage or subsidy systems in Manitoba and Saskatchewan were "specific" subsidies under US trade remedy law, their export volumes were *de minimis* and therefore not subject to countervailing duties.[220] Only because of the low export volumes was the investigation dismissed. The US in its CVD investigation was clearly not differentiating the Listed versus Non-Listed provinces as Canada has suggested.

266. Canada claims that the purpose of the *Softwood Lumber Agreement* was to protect against future CVD actions. Given that exports from Non-Listed Provinces, such as Manitoba and Saskatchewan, have increased significantly during the course of the Export Control Regime,[221] it is untenable for Canada to suggest that producers in these provinces are not in like circumstances with the the Investment because of the threat of CVD action. In fact, given that producers in these two Non-Listed Provinces were actually investigated by the US International Trade Administration ("ITA") before, it may be that their inherent risk of attracting CVD action is now greater due to significant increases in their exports over the past four years.

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[219] *US – Section 337 of The Tariff Act of 1930*, L/6439 - 36S/345, January 16, 1989, at para. 5.11.

[220] Commerce Preliminary Determination, 1992 set out in Documents Requested From Canada by Tribunal (August 9, 2000) Vol. VI.

[221] See Schedule 49, Smyth Report at 304.

267. The American lumber industry vigorously argued in Lumber III in 1992 that the provinces of Manitoba and Saskatchewan be included in the ITA's determination of subsidy. In light of the ITA's 1992 finding that Saskatchewan and Manitoba softwood lumber exports constituted "specific" subsides, the surge in softwood lumber exports from the Non-Listed Provinces makes it more likely that softwood lumber manufacturers in these provinces would be subjected to CVD claims from the US in the absence of the *Softwood Lumber Agreement.*

268. Canada has provided no evidence to this Tribunal to rebut the presumption of renewed CVD threats, not just against producers from the Listed Provinces, but from all provinces. Indeed, the export surges caused by the operation of the Export Control Regime make future subsidy determinations of manufacturers in Manitoba and Saskatchewan more likely.

269. Professor Kalt, Canada's expert, has argued that producers operating in the provinces not covered under the Export Control Regime cannot be in like circumstances with the Investment because only producers in British Columbia, Alberta, Ontario and Quebec were ever threatened with action under United States countervailing duty laws.[222] Canada has suggested that the provincial stumpage measures under which the Investment operated led to countervailing duty threats from competitors in the US, and that these threats could not be made against competitors from Saskatchewan or Manitoba because of how different stumpage policies were in those provinces.

270. These alleged grounds for differentiating between producers in British Columbia and producers such as Manitoba and Saskatchewan are completely without merit. Not only do they not reflect the reality of a countervailing threat, but, more importantly, they also cannot be rationally connected to any legitimate objectives for the Export Control Regime. The restraint of softwood lumber exports is not a legitimate objective because such an objective would be in breach of Canada's good faith obligation to observe its WTO obligations.

271. A threat by competitors in another country to initiate countervailing duty action against producers from the four most successful exporting provinces cannot be used to determine whether the Investor and Investment operate in like circumstances with producers operating in Manitoba or Saskatchewan.

272. There is simply no nexus between this threat and the question of whether manufacturers in any given region are in competition with each other. In the *Bananas Case*, the European Union attempted to justify the less favourable treatment that it accorded to

[222] May 2000 Merits Hearing Transcripts, May 2, 2000 Vol. III at 4-5.

banana imports and to the wholesalers responsible for their importation by claiming that it was obligated to do so under another international agreement, the *Lome Convention*. Neither the Panel nor the WTO Appellate Body accepted the EU's arguments that bananas, or the wholesalers who imported them, were not like products or like service providers because of their relative standing under the regime imposed by the EU to implement its obligations under the *Lome Convention*. For example, with regard to the EU's national treatment obligation under the GATT, the Appellate Body stated:

> It has been argued by the European Communities that there are two separate EC import regimes for bananas, the preferential regime for traditional ACP bananas and the erga omnes regime for all other imports of bananas. Submissions made by the European Communities raise the question whether this is of any relevance for the application of the non-discrimination provisions of the GATT 1994 and the other Annex 1A agreements. The European Communities argues, in particular, that the non-discrimination obligations of Articles I:1, X:3(a) and XIII of the GATT 1994 and Article 1.3 of the Licensing Agreement, apply only within each of these separate regimes. The Panel found that the European Communities has only one import regime for purposes of applying the non-discrimination provisions of the GATT 1994 and Article 1.3 of the Licensing Agreement.
>
> The issue here is not whether the European Communities is correct in stating that two separate import regimes exist for bananas, but whether the existence of two, or more, separate EC import regimes is of any relevance for the application of the non-discrimination provisions of the GATT 1994 and the other Annex 1A agreements. **The essence of the non-discrimination obligations is that like products should be treated equally, irrespective of their origin. As no participant disputes that all bananas are like products, the non-discrimination provisions apply to all imports of bananas, irrespective of whether and how a Member categorizes or subdivides these imports for administrative or other reasons. If, by choosing a different legal basis for imposing import restrictions, or by applying different tariff rates, a Member could avoid the application of the non-discrimination provisions to the imports of like products from different Members, the object and purpose of the non-discrimination provisions would be defeated.** It would be very easy for a Member to circumvent the non-discrimination provisions of the GATT 1994 and the other Annex 1A agreements, if these provisions apply only within regulatory regimes established by that Member.
>
> Non-discrimination obligations apply to all imports of like products, except when these obligations are specifically waived or are otherwise not applicable as a result of the operation of specific provisions of the GATT 1994, such as Article XXIV. In the present case, the non-discrimination obligations of the GATT 1994, specifically Articles I:1 and XIII, apply fully to all imported bananas irrespective of their origin, except to the extent that these obligations are waived by the Lomé Waiver. We, therefore, uphold the findings of the Panel that the non-discrimination provisions of the GATT 1994, specifically, Articles I:1 and XIII, apply to the relevant EC regulations, irrespective if there is one or more "separate regimes" for the importation of bananas.[223]

[223] *EC – Regime for The Importation, Sale and Distribution of Bananas*, WT/DS27/AB/R, September 9, 1997 at 81-82.

In any event, the simple threat of a foreign trade remedy case says nothing about the competitive relationship between producers in any province.

273. Further, it is apparent that Canada never actually regarded the threat of countervailing duty action from United States softwood lumber producers as credible. There is no evidence before this Tribunal to support a finding that softwood lumber producers operating anywhere in Canada ever received subsidies of the kind that would support action under a WTO-consistent countervailing duty regime. The history of the softwood lumber dispute also fails to support the contention that producers in provinces other than those covered by the Export Control Regime could not be made subject to countervailing duty action if their exports posed a significant enough threat to United States competitors.[224]

274. The Tribunal has heard expert evidence from Professor Howse that the countervailing duty laws threatened by some United States producers are not consistent with the United States government's obligations under the WTO Agreement.[225] Further, in concluding the *Softwood Lumber Agreement* and in imposing the Export Control Regime, Canada took great pains to insist that it had never admitted any legitimately countervailable subsidies ever existed in any of its provinces.

275. While Canada's position on the legitimacy of the quality of the threat of countervailing duty action may have actually shifted for the purposes of this arbitration (as evidenced in the following statement made by counsel for Canada during the May 2000 hearing), it is submitted that Canada's actions speak louder than the following words:

> **The Investor's only real reply has been to tender the Affidavit of Professor Howse, who opines that there should have been an action undertaken by Canada before the WTO [about the legitimacy of the countervailing laws threatened by producers operating in the United States]...I need only say to you that at this stage Canada disagrees with his proposal...Canada views this matter as a matter involving an examination of reality, not utopia.**[226]

276. On May 19, 2000, only two weeks after these submissions were made, Canada formally requested consultations with the United States concerning the very aspects of its countervailing duty laws upon which Professor Howse opined. On August 4, 2000 Canada formally served notice at the WTO that it would challenge those provisions

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[224] Commerce Preliminary Determination, 1992 set out in Documents Request from Canada by Tribunal (August 9, 2000), Vol. VI.

[225] May 2000 Merits Hearing Transcripts, May 2, 2000 Vol. III at 62.

[226] May 2000 Merits Hearing Transcripts, May 1, 2000 Vol. I at 25-26.

(which had apparently "compelled" Canada to impose the Export Control Regime).[227] Canada's recent activities at the WTO belie the fact that Canada had the option in 1995 to challenge any United States countervailing laws that affected its softwood lumber exports, rather than imposing an export-control measure that fell unevenly among affected competitors in Canada.

277. If the Export Control Regime was repealed today, there is little doubt that lumber exports from Non-Listed Provinces would also be subjected to attacks from the same interests that threatened CVD action before the Export Control Regime was imposed. Accordingly, far from demonstrating how producers in different provinces do not operate in like circumstances, the only available evidence concerning the threat of United States producers initiating a countervailing duty action in response to Canadian softwood lumber exports, demonstrates that the only real qualification for being the subject of a countervailing duty threat is to be considered a sufficiently large competitor in the United States market.

278. Of course, it must be stressed that, regardless of whether the threat of a WTO-consistent countervailing duty action was ever real, Canada simply had no justification in imposing a measure that provided less favourable treatment to the Investor than that which was provided to producers operating in Non-Listed provinces such as Manitoba or Saskatchewan. Canada's measure offered less favourable treatment to the Investor based upon a completely arbitrary threat of countervailing duty action from foreign-based competitors.

279. The real reason that producers operating in different provinces were treated differently was because of the horse-trading that took place between Canada and the United States in negotiating the *Softwood Lumber Agreement*. Essentially, Canada appears to have bargained with the United States to obtain free access to its market for producers in certain provinces at the expense of agreeing to limit exports from producers in its four largest provinces using an Export Control Regime. The effect of Canada's imposition of this bargain was to arbitrarily discriminate against the Investor and its Investment, as compared to the treatment offered to their competitors in Saskatchewan and Manitoba. Canada's treatment of the Investor and its Investment constitute arbitrary discrimination because it imposed a measure that penalised them for nothing more than having the misfortune to be operating in the wrong province at the wrong time.

280. Under NAFTA Article 1102, Canada must provide the Investor and its Investments with treatment equivalent to the highest level of treatment it makes available to any of their

[227] See Schedule 40 *Financial Post*, August 5, 2000, "*Canada challenging US policy on duties: Complaint before WTO*" at D6.

domestic competitors, absent a legitimate reason to objectively differentiate between them. The best treatment available in Canada to the competitors of Pope & Talbot is that which is received by softwood lumber producers operating in the provinces that were not covered under the Export Control Regime. These producers, located in provinces such as Saskatchewan and Manitoba, received better treatment because they have not been required to pay fees to export their lumber to the United States.

B. The Best Treatment Available in Allocation of the Trigger Price Bonus Was Provided to Producers in Other Listed Provinces

281. Greater Trigger Price Bonus allocations were made to producers who were operating in similar circumstances to the Investment, merely because they were located in another province or had better access to the Minister or his staff. Such differential treatment raises a presumption of discrimination. Canada has not provided any evidence that would meet the burden of proof to rebut this presumption in its answers to the Tribunal's questions set out in the Interim award. The information provided only demonstrates that Canada allocated Trigger Price Bonus quota and returns of allocated quota inequitably to producers in each province.

C. The Best Treatment Available in Resolution of the Wholesaler Attribution Issue Was Provided to Producers Other Than Pope & Talbot

282. Canada knew, even before it made the initial allocation of quota to producers, that the information supplied to it by wholesalers – which was supposed to be used by Canada to attribute exports to the United States to individual producers in order to provide them with a fair and accurate allocation – was seriously flawed. Rather than take the necessary steps to gather more reliable information from wholesalers – either before making the initial allocation or before making subsequent allocations – Canada decided to ignore the problem. Canada even avoided providing any adequate means for recipients of inadequate quotas to review or appeal their allocations. Worse still, there does not appear to be any evidence that Canada even took any steps to inform producers that their allocations could be flawed because of this wholesaler attribution problem. In so acting, Canada violated its international law obligation to implement national treatment in such a way as to guarantee to the Investor and its Investment that it would not be exposed to the risk of discrimination.

283. The documents supplied by Canada in its response to the Tribunal's questions demonstrates that, by the end of the second year of the Export Control Regime, pressure from individual producers in British Columbia had apparently grown so great that Canada finally decided to somehow "remedy" the situation. Since Canada had already allocated the Transitional Reserve, the Minister's Discretionary Reserve, the New Entrants Reserve

– and any available Trigger Price Bonuses inequitably to producers outside of British Columbia, the only apparent remedy available appears to have been to take away a portion of quota held by every other producer in British Columbia (i.e. those who had not complained about the wholesaler attribution problem) and redistribute it to those who had complained loudly enough to obtain Canada's attention.

284. Of course, from the perspective of an individual producer that did not receive the amount of quota it was expecting under the initial allocation, it would not really matter whether Canada provided more fee-free quota by way of a Discretionary Reserve, a Trigger Price Bonus or redistribution from other producers – so long as more quota was provided. This perspective could only be enhanced by the lack of transparency inherent in the Export Control Regime. Producers were simply not informed as to why they really did or did not receive the allocation they expected – except for the more politically connected producers who were able to successfully lobby the Minister for an increased allocation, no matter how it was granted.

285. In the case of four of the seven largest recipients of the redistribution of EB quota from British Columbia producers such as Pope & Talbot, while they did not receive the fee-free quota they requested under the New Entrants Reserve, they nonetheless received much of the quota they requested – albeit in the form of redistributed EB quota instead.[228]

286. That there were many producers who did not complain about the wholesaler attribution problem was likely because Canada never widely communicated to producers that the wholesaler attribution problem even existed. For example, Pope & Talbot was not made aware of the wholesaler attribution problem until it was subjected to the verification review audit. Pope & Talbot was forced to lose approximately 3.1% of its quota in Year 3 – to be redistributed to other victims of the wholesaler attribution problem. This redistribution was magnified as a function of the "growth mechanism", which operated to permanently shift that quota for use by producers other than Pope & Talbot.

287. The best treatment available in resolution of the wholesaler attribution problem was provided to those producers who were the recipients of re-distributed quota and to those producers who were recipients of various discretionary reserves to remedy their wholesaler attribution, or other hardship, complaints. Pope & Talbot was entitled to that level of treatment. Instead, it suffered under the wholesaler attribution problem; neither

[228] See: Schedule 20 and Schedule 40. Timber West asked for 26 MMBF of new entrants quota; while Dunkley asked for 38.8 MMBF, J.S. Jones asked for 31.2 MMBF and Landmark Trust asked for 332 MMBF, but all were rejected. Instead, Timber West received 39.3 MMBF of redistributed EB quota; while Dunkley received 17.0 MMBF, J.S. Jones received 28.6 MMBF and Landmark Trust received 8.1 MMBF.

receiving a reserve allocation for its hardship nor re-distributed quota. To add insult to this injury, Pope &Talbot was even required to surrender some of the quota it did receive in order to remedy the more well-placed complaints of others.

D. The Best Treatment Available under the Export Control Regime is that which is Provided to Producers not Subjected to Payment of the SFB Levy.

288. NAFTA Article 1102 provides that national treatment is based on two fundamental tests - (1) if investors or investments of another NAFTA Party are in "like circumstances" with domestic investors and investments, then (2) it must be determined whether these foreign investors and investments have been accorded "treatment no less favourable" in comparison with the like domestic investors.

289. In September of 1999, Canada promulgated the SFB levy measure in settlement of the *BC Stumpage Case*. The measure was directed at softwood lumber companies operating solely in British Columbia, in particular it was directed at companies that (1) operated in the interior of British Columbia, (2) exported LFB levy softwood lumber, and (3) exported UFB levy softwood lumber

290. Since it is uncontradicted that the SFB levy measure only applies to British Columbia softwood lumber manufacturers, it is clear that British Columbia softwood lumber companies, such as Pope & Talbot, received differential treatment from other softwood lumber companies operating under the Export Control Regime in the other Listed and Non-Listed Provinces. Pope & Talbot is entitled to the best treatment available in Canada - the payment of no SFB levy.

291. In addition, there was an adverse impact on Pope & Talbot caused by the distinction made in the application of the SFB levy measure between interior and coastal softwood lumber manufacturers even though all British Columbia companies can be considered to be in like circumstances. As an interior British Columbia manufacturer of softwood lumber, Pope & Talbot received treatment less favourable than other softwood lumber manufacturers operating in the coastal area of British Columbia. Coastal companies received a significantly larger stumpage reduction than interior companies yet were subject to the identical settlement in the form of the SFB levy measure. Pope & Talbot, as an interior company, in effect paid for the benefit of the coastal companies and incurred greater harm from the SFB levy because it received a disproportional lesser benefit than like coastal companies.[229]

[229] See Schedule 11 Merits Hearing Transcripts, May 1999, Vol. VII at 2; see also Canada's submissions in the *BC Stumpage Case* provided to the Tribunal.

292. Further, since the design of the SFB levy was to make it uneconomic for companies to export softwood lumber at the repriced LFB level and new SFB level, a company like Pope & Talbot that relies on exports at these levels would again shoulder a disproportionate burden resulting from the implementation of the measure. As one of the largest exporters of UFB level softwood lumber in 1998, representing 35% of UFB levy exports in British Columbia in that year, the implementation of a measure directed at UFB level exporters would have a disproportionate and direct effect on Pope & Talbot. In effect, the new SFB levy has made it particularly uneconomic for Pope & Talbot to export softwood lumber that it previously exported at the UFB level. In addition, the SFB Levy has made it much more costly for Pope & Talbot to export at the LFB level.

293. Pope & Talbot operates in like circumstances with coastal manufacturers, British Columbia manufacturers that do not rely on LFB and UFB levy exports, and softwood lumber manufacturers in other Listed and Non-Listed Provinces, yet it has directly been targeted by Canada to bear the burden of the SFB levy measure. The effect, directly and indirectly, of this amendment to the Export Control Regime has been to discriminate against this US Investor and its Investments. Pope & Talbot has been accorded treatment less favourable than these other softwood lumber manufacturers resulting in a breach of Canada's NAFTA Article 1102 obligations. Pope & Talbot should be compensated accordingly.

E. Damage

294. The Investor suffered damage as a result of Canada's failure to accord to it national treatment on the terms set out in NAFTA Article 1102.[230] The witness statement of Howard Rosen provides evidence of some of the damage to the Investment and the Investor arising from Canada's breach of its NAFTA Article 1102 obligation.[231] These damages include, but are not limited to:

a) Damages resulting from the Investment's failure to receive the full amount of softwood lumber export quota that it should have received under the application of Canada's Export Control Regime done on the basis of national treatment;

b) Damages resulting from the Investment's failure to receive fair and equitable discretionary allocations of softwood lumber export quota that it should have received under Canada's Export Control Regime or alternatively the failure to

[230] See Schedule 33, Witness Statement of Howard Rosen and Testimony of Howard Rosen, May 2000 Merits Hearing Transcripts, May 2, Vol. V at 12-62.

[231] See Schedule 33, Witness Statement of Howard Rosen.

receive its *pro rata* share of the remainder of softwood lumber quota that should have been available to it as a British Columbia producer if discretionary allocations were made on a fair and equitable basis in good faith and with transparency; and

c) Damages to the Investor resulting from the application of Canada's Export Control Regime to the investments of the Investor (namely: Pope & Talbot Ltd. and the Investor's interest in Harmac-Pacific before its amalgamation into Pope & Talbot Ltd.), rather than providing the Investment with the treatment equivalent to the best treatment provided to softwood lumber producers in like circumstances in Canada.

SECTION FIVE: BURDEN OF PROOF

295. The Investor has provided this Tribunal with evidence available to it to substantiate its claims regarding Canada's NAFTA-inconsistent implementation of the Export Control Regime. Professor Bin Cheng suggests that where proof of a fact presents extreme difficulty that a Tribunal can be satisfied by the making of a *prima facie* case.[232] The Tribunal in the *Kling Case* defined *prima facie* as:

> *Evidence which is unexplained or uncontradicted is sufficient to maintain the proposition affirmed.*[233]

296. The Investor has made a *prima facie* case demonstrating how Canada has violated its NAFTA obligations under NAFTA Article 1102 and 1105. The failure of a disputing party to provide evidence can be used by a Tribunal to make a finding of fact. For example, the Tribunal in the *Kling* case found:

> A claimant's case should not necessarily suffer by the non-production of evidence by the respondent. It was observed by the Commission in the Hatton Case, Op. Of Com., Wash., 1929, pp. 6, 10, that, while it was not the function of a respondent government to make a case for the claimant government, certain inferences could be drawn from the non-production of available evidence in the possession of the former. See also the Melczer Mining Co. Case, ibid., pp. 228, 233. The Commission has discussed the conditions under which, when a claimant government has made a prima facie case, account may be taken of the non-production of evidence by the respondent government, or of unsatisfactory explanation of the non-production of evidence. Case of L.J. Kalklosch, ibid., p. 126. [In this case, the Commission said: 'In the absence of official records the non of which has not been satisfactorily explained, records contradicting evidence accompanying the Memorial respecting wrongful treatment of the claimant, the Commission can not properly reject that evidence' (p. 130)].[234]

In the absence of the production of evidence by Canada, the burden of proof must shift to Canada to demonstrate how the Export Control Regime is consistent with its NAFTA obligations.

297. This standard evidentiary rule has been applied by international tribunals. For example, the WTO Appellate Body in *United States - Shirts and Blouses* confirmed this rule as follows:

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[232] Bin Cheng, *General Principles of Law* (1953) at 232.

[233] *Kling Case* [1930] IV RIAA 575 at 585.

[234] *Kling Case* [1930] IV RIAA 575 at 582.

> We agree with the Panel that it was up to India to present evidence and argument sufficient to establish a presumption that the transitional safeguard determination made by the United States was inconsistent with its obligations under Article 6 of the ATC. **With this presumption thus established, it was then up to the United States to bring evidence and argument to rebut the presumption.**[235]

298. Canada must now discharge its burden to produce the relevant evidence to refute the Investor's claim that the Export Control Regime has violated Canada's NAFTA and international law obligations.

299. Finally in the *Canada-Aircraft Case*, the WTO panel concluded that where a disputing party withholds evidence, it may be possible to make a finding on the basis of a *prima facie* case. The panel stated:

> *We note that Brazil asked us to make "adverse inferences" in light of Canada's refusal to provide details of the ASA transaction. In certain circumstances when direct evidence is not available, we consider that a panel may be required to make such inferences when there is sufficient basis to do so. This is especially true when direct evidence is not available because it is withheld by a party with sole possession of that evidence.*[236]

In fact, this WTO panel found that the suppression of evidence by a disputing party can be the basis for the Tribunal deeming the claimant to have made a *prima facie* case on the basis of adverse inference.

300. Thus, in this present case, Canada's failure to produce direct evidence cannot be used to defeat the *prima facie* case made by the Investor regarding Canada's inconsistency with its NAFTA obligations.

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[235] *United States - Measure Affecting Imports of Woven Wool Shirts and Blouses from India*, WT/DS33/AB/R, April 25, 1997 at page 13.

[236] At Para. 9.181.

SECTION SIX: SUBMISSIONS

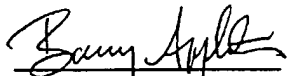
In view of the facts and arguments set out in this Memorial, may it please the Tribunal to declare and adjudge the following:

A. Through the introduction and ongoing implementation of the Export Control Regime, Canada has violated Article 1105 of the North American Free Trade Agreement.

B. Through the introduction and ongoing implementation of the Export Control Regime, Canada has violated Article 1102 of the North American Free Trade Agreement.

C. Due to Canada's breach its obligations arising under the terms of the North American Free Trade Agreement, Canada is liable to pay compensation to the Investor, in such amount as will be determined in the Damages Phase of this proceeding and that Canada pay all the costs of these proceedings, including all fees and expenses incurred by the Investor.

Submitted this 5th day of September 2000 at Toronto, Canada.



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