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

BETWEEN:

POPE & TALBOT, INC.

Claimant / Investor

and

THE GOVERNMENT OF CANADA

Respondent / Party

REPLY COUNTER-MEMORIAL AND SUPPORTING AFFIDAVITS AND AUTHORITIES

(PHASE 3 – DAMAGES)

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and International Trade
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PART I: Burden of Proof and Document Production Issues

A. Test For Burden Of Proof

1. The burden of proof in arbitration is uncontroversial: it is the well-accepted "balance of probability" standard. In this phase the Investor must prove on a balance of probability that it (a) incurred the damages claimed, and (b) it incurred that damage by reason of, or arising out of, the verification episode. Failure to meet this standard means that the Investor cannot recover compensation for the particular item claimed.

2. Canada does not propose a burden of proof more onerous than the balance of probability. The suggestion that Canada proposes a criminal burden of proof or in any way suggests fraud by the Investor is incorrect.[1]

3. Nor has Canada misconstrued the law concerning burden of proof, as alleged by the Investor.[2] The text in question affirms the obvious proposition it is cited for: each party must prove on the balance of probability the facts upon which it relies in support of its case.[3]

4. The suggestion that a more rigourous degree of proof should be required where an assertion of fact is improbable or unsupported by evidence is Canada's submission. It is not a novel proposition. As noted by Redfern and Hunter, the common response to a failure to produce necessary materials in common law[4] and civil law[5] countries is to draw an adverse inference unless a reasonable excuse is given.

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[1] Reply Memorial, Damages Phase, September 17, 2001 ("Reply Memorial"), paras 5, 8, 10 & 11.
[2] Reply Memorial, para. 9.
[3] Counter-Memorial, Damages Phase, August 18, 2001 ("Counter-Memorial"), para. 21 and Tab 2 of Canada's Authorities, Damages Phase, August 18, 2001.
[4] Alan Redfern & Martin Hunter, *Law and Practice of International Commercial Arbitration,* 3rd ed., (London: Sweet & Maxwell, 1999) at 317. [Canada's Authorities, Reply Counter-Memorial, Tab 1]
[5] *Ibid,* at 318.

5. The problem here is not a divergence on the standard of proof. The real issue is that the Investor has simply not met the accepted burden of proof for the vast majority of its claims.

6. The Investor attempts to justify its failure to prove its damages by asserting that it need not prove each item. Indeed, it claims that such proof would "be impossible" [6] and "an unreasonable exercise".[7]

7. The expectation that the Investor will meet its burden of proof is neither unreasonable nor impossible. To the contrary, it is the standard onus on a party asserting damages. It is an expectation that is universally applied in arbitration and by courts. To do otherwise would result in an inaccurate and unfair "guesstimate" of damages.[8]

8. The Investor also maintains that it is unnecessary to prove its case because "the amounts claimed are not large"[9], "the Investor is credible",[10] and "it is reasonable to assume that all, if not a high proportion" of the expenses are related to the verification review.[11]

9. These excuses must fail. A Tribunal cannot assume damages or causation in the absence of a properly proved claim. There is nothing unreasonable in requiring proof. The Investor's claim must be assessed based solely on the evidence on record.

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[6] Reply Memorial, para. 1.
[7] Reply Memorial, paras 1, 21.
[8] Canada has drafted schedules showing which items might be considered to arise out of the verification review episode. ("Schedules Relating to Investor's Productions Received August 14, 2001"). These were provided to the Tribunal and the Investor on August 29, 2001. Further schedules are attached to this Reply Counter-Memorial showing the same analysis for the remaining claims of damages. The schedules demonstrate that the damages claimed are only in small measure causally related to the verification review episode [Schedules Related to Legal Expenses and Expert Fees, October 8, 2001, Reply Counter-Memorial on Damages].
[9] Reply Memorial, para. 15.
[10] Reply Memorial, para. 16.
[11] Reply Memorial, para. 22. The same assertion is made in paras 24 and 37.

B. Insufficiency of Document Production

10. The Investor's submissions concerning document production also confuse the requirement to produce evidence with its desire to rely on unsubstantiated assertions of loss. While the rules of evidence in arbitration are more informal than in a court, they do not allow an absence of proof.

11. Where the Investor does not have any, or sufficient, documentary proof to meet its burden, it may file affidavits attesting to the cost incurred and explaining how the verification review episode caused the loss.[12] Instead of doing this, the Investor alleges loss with no evidence,[13] or has Mr. Rosen attest that he relied on a representation about the claim.[14] This is inadequate.

12. Canada made timely, reasonable requests for documentation from the Investor.[15] Numerous of these are outstanding and have not been addressed by the Investor.[16]

13. Production of appropriate evidence would enable Canada to assess the claim and to narrow and join issue on those items that remain contentious. This is impossible where insufficient production is made. Failure to provide evidence supporting a claim also deprives the Tribunal of the ability to assess or test a claim.

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[12] The Investor's suggestion at para. 14 of its Reply Memorial that a lack of documents excuses it from proof is untenable.
[13] For example, paras 14-15 of the Reply Memorial.
[14] For example, paras 16 and 28 of Reply Memorial.
[15] Canada made its requests on June 26 and reiterated outstanding requests on July 18, July 30, August 1, August 13, August 14, August 15, September 4, and September 24, 2001.
[16] Contrary to the assertion of the Investor at para. 12 of the Reply Memorial. For example, as of the date of this Reply Counter-Memorial, Canada still had not received the December 2000 Castlegar Operating Statement, weekly production reports by mill or any further information supporting the claim for management time. Equally, the material provided on the eve of filing Canada's Counter-Memorial was not "merely back-up material" as the Investor asserts at para. 13 of its Reply Memorial; it is the only evidence that the particular item was claimed and what it was claimed for.

PART II: Damages Claimed Are Not Recoverable

A. Articles 1116 and 1117: Direct or Derivative Damage

14. The Tribunal remains seized of this arbitration. It issued a partial award on liability, and not a final award in this case. It is therefore appropriate for Canada to raise the provisions of NAFTA governing assessment of damages.[17]

15. Any damage award must conform to the text of NAFTA, the pleadings and the evidence. As explained in Canada's Counter-Memorial,[18] NAFTA imposes some limits on a damages award under Chapter Eleven.

16. The Investor misstates Canada's position regarding Articles 1116 and 1117.[19]

17. Article 1116 addresses claims by investors on their own behalf. Article 1117 addresses claims by investors on behalf of enterprises that they own or control. This means that the disputing investor must claim under Article 1116 for damages incurred directly by the investor. On the other hand, Article 1117 allows claims by investors for damages incurred where the investor has suffered derivative loss because of a direct injury to its enterprise.

18. In each case the investor determines which of these Articles is appropriate, or indeed whether both are appropriate. In this instance the Investor elected to claim under Article 1116, and hence it can only recover direct damages it suffered.

19. Article 1117(3) recognises that distinct types of claims are brought under Article 1116 and Article 1117. It contemplates consolidation of claims made under Articles 1116 and 1117 that arise out of the same events.

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[17] Contrary to the Investor's submission at para. 50 of its Reply Memorial.
[18] Counter-Memorial, paras 30–58.
[19] Reply Memorial, paras 50–54.

20. Similarly, Article 1121 reflects the distinct nature of claims under Article 1116 and 1117 by tailoring the waiver requirement to the type of claim brought by the disputing investor.

21. Counsel for the Investor suggests this reading of Articles 1116 and 1117 is a "novel theory"[20] and "a fundamental error".[21]

22. This is incorrect. The Canadian *Statement of Implementation* and the American *Statement of Administrative Action* also affirm the intent of the drafters to distinguish between the type of a claim made by an investor on its own behalf (Article 1116) from a claim made on behalf of its enterprise (Article 1117).[22]

23. As noted in the U.S. Statement of Administrative Action:

> Articles 1116 and 1117 set forth the kinds of claims that may be submitted to arbitration: respectively, allegations of direct injury to an investor, and allegations of indirect injury to an investor caused by injury to a firm in the host country that is owned or controlled by an investor.[23]

24. Nor does Article 1120 affect the meaning of Articles 1116 and 1117 as suggested by the Investor.[24] Article 1120 provides that a disputing investor must submit the claim. It does not say the investment of a disputing investor can submit a claim. Notwithstanding Article 1120, the disputing investor must still elect which of Articles 1116, 1117 (or both) it relies on when it submits a claim.

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[20] Reply Memorial, para. 50.
[21] Reply Memorial, para. 52.
[22] Counter-Memorial, paras 49 – 50.
[23] *North American Free Trade Agreement Implementation Act*, Statement of Administrative Action, H.R. Doc. No. 103-159, Vol. I (1993) at 145.
[24] Contrary to the Reply Memorial, paras 51–52.

B. Article 1101: Not At Issue

25. The Investor addresses Articles 1101 at paragraphs 55 and 56 of its Reply Memorial. Canada has made no arguments related to Article 1101 in this phase and suggests that Article 1101 does not assist in resolution of this phase of the arbitration.

C. Article 1105: Treatment Accorded Investments

26. Even if one accepts the Investor's position that Article 1105 does not prevent recovery of direct damages by an investor, Articles 1116 and 1117 still apply. This means that an investor must claim under Article 1117 for derivative loss arising out of a breach of Article 1105 and under Article 1116 for direct loss to the investor arising out of the breach of Article 1105. In this case the losses claimed by the Investor arising from the verification review are almost completely of a derivative nature and should have been claimed under Article 1117.

D. Mitigation

27. The Investor is under a legal obligation to mitigate its loss, yet it offers no evidence of any attempt to do so. From a practical perspective, the Investor could have mitigated its loss.

28. The suggestion of pursuing available options in the Federal Court of Canada is not as naïve as the Investor would suggest: in fact, the Investor seeks damages for research done by Davis & Co.[25] and by Appleton & Associates[26] on this exact topic. Given the evident want of jurisdiction on the interim measures motion, this would have been a more appropriate course of action.

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[25] Reply Memorial, para. 28.

[26] See for example, Schedules Related to Legal Expenses and Expert Fees, October 8, 2001, Tab 2, 29/04/99, 30/04/99) and Tab 3 (i.e., 05/05/99, 19/05/99, 26/05/99, 31/05/99).

29. Canada is not relying on the international law obligation to pursue local remedies in the context of mitigation.[27] The point made is simply that judicial review in the Federal Court of Canada was available and provided a viable option for the Investor to mitigate its loss.

30. Similarly, the Investor exaggerates the difficulty of mitigating by diverting some sales to markets other than the U.S. market. The Investor sells 10% or more of its lumber in Canada every year.[28] Further, the Investment's business plan contemplated steadily increasing sales in Canada to avoid quota restrictions imposed by the Export Control Regime.[29] Such mitigation would be consistent with the Investment's business plan.

E. Causation

(i) Generally

31. NAFTA Articles 1116 and 1117 require damage to be caused by the breach found.[30] The issue in this case is whether the damages claimed have been proved to arise out of or be by reason of the verification review episode. This is a finding of fact based on the record. The Investor has largely failed to address, much less prove, that the damages claimed were caused by the breach found.

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[27] As argued at paras 60–61, Reply Memorial.
[28] Supplementary Harder Report, paras 19-21.
[29] Gray Testimony, May 2, 2000, p.86, lines 17-25.
[30] Counter-Memorial, paras 39–48.

(ii) Causation and Specific Claims of Loss

32. As noted by Canada in the Counter-Memorial[31] and below, the Investor has failed to prove causation in respect of most of the invoices submitted in the out of pocket, management, legal and expert fee categories.

33. Canada has prepared colour-coded charts[32] to address the problem with causation and these claims for loss. The charts visually demonstrate that most items claimed do not arise from the verification review episode or that their relationship to that episode cannot be assessed based on the record before the Tribunal.

(iii) Causation and the Claim for Loss of Incremental Revenue

34. The Investor has never explained how a week of delayed sales equates with any loss in revenue. To establish a loss in revenue there must be an inability or failure to sell lumber during the week in question caused by the verification review episode.

35. Even if one accepts the premise that a delay in production caused lost revenue, the Investor has still not proved that the verification review caused the delay. The Investor suggests that such a causal link must exist because to find otherwise would defeat the NAFTA Article 102 objective of substantially increasing investment opportunities.[33]

36. The Investor's premise is illogical. Whether a causal link exists is a question of fact. Whether such a finding would advance NAFTA objectives is irrelevant to a determination that the breach caused the loss claimed. An unsubstantiated and unwarranted conclusion of fact does not advance the NAFTA objectives.

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[31] Counter-Memorial, paras 95–141.
[32] Reply Counter-Memorial on Damages. Tabs 2-28, Schedules Related to Legal Expenses and Expert Fees, October 8, 2001.
[33] Reply Memorial, para. 30.

37. Canada reiterates its position[34] that the record made contemporaneous to the verification review does not support the Investor's new thesis that the verification episode review motivated the decision to shut down for the 1999 Christmas holidays.

38. Mr. Friesen had never before asserted that the verification review caused the Christmas 1999 shut down until the damages phase of the arbitration. Canada never had the opportunity to test this assertion, nor has the Tribunal ever been called upon to determine his credibility with respect to this issue.[35]

39. Mr. Friesen's assertion contradicts what was said in all of the Investor's witnesses' previous testimony and all of the documents filed by the Investor in this arbitration. It is also inconsistent with established industry practice.[36]

40. The Investor's new thesis is equally difficult to reconcile with the Investment's appreciation of the fact that its quota allocation level was based on a 1 to 2% error in the Investment's favour. The Investor asserts that Mr. Gray is incorrectly quoted as estimating a 1 to 2% possible loss in quota.[37] Canada submits that Mr. Gray's testimony[38] affirms, not contradicts, the statement of Mr. George. Similarly, the Investor received Canada's assurance by November 19, 1999 that a reduction in quota would not exceed 5%.[39]

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[34] Counter-Memorial, paras 68 – 87.
[35] Contrary to the claims in para. 34 of the Reply Memorial.
[36] Counter-Memorial, paras 84-86.
[37] Reply Memorial, para. 38.
[38] Gray Affidavit, December 7, 1999, para. 26. Paragraph 26 of the Gray Affidavit states:
At paragraph 110 of Mr. George's affidavit, he states that I believed that "the allocation level of the company would only have to be reduced by 1-2% as a result of the verification." I do not agree with Mr. George's view of our converstion, it was my recollection that I stated that there might be a one to two percent error. I did not admit to Mr. George that Pope & Talbot should have its quota allocation revised on the basis of a one to two percent error. I noted to Mr. George that, in light of the almost three months it took Mr. George to respond on the results of the verification review, it would also be difficult for Pope & Talbot to meet his schedule.
[39] Counter-Memorial, para. 17.

41. Most significantly, the Investor's position ignores the fact that the Investor had almost exhausted its maximum fee-free quota for the first three-quarters of the quota year, leaving only slightly more than [redacted] of fee-free quota for the entire fourth quarter.

42. The Investor now maintains that "it is reasonable to conclude that the verification review episode was the proximate cause" of the Christmas 1999 shutdown.[40] Again, the task is for the Tribunal to make a finding of fact, not an assumption. The finding of fact urged by the Investor is not tenable given the extensive contemporaneous record that attributes the shut down to lack of quota and the SLA quota system.

(iv) Further Problems With Loss of Incremental Revenue Claim

43. Predictably, the Investor wholeheartedly endorses the Harder Report where it is to its advantage and equally wholeheartedly rejects the Harder Report where it would be to its detriment.

44. Nor can the three flaws identified in the Harder Report be characterised as "mere disagreements between experts"[41]. The undisputed fact is that the Rosen spreadsheet contained three calculation errors that result in incorrect conclusions.[42]

(v) Random Lengths or Actual Realised Prices

45. The Rosen assumption that Random Lengths prices are a better proxy for reality than the actual prices received by the Investment is untenable. In effect, the Investor asks the Tribunal to reject the prices achieved by its investment in favour of an industry average that only roughly approximates what the investment received. The Random Lengths price is an inexact proxy that should not be used when the actual realised price is available.

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[40] Reply Memorial, para. 37.
[41] Reply Memorial, para. 62.
[42] Harder Report, para. 32.

46. Random Lengths prices are weekly average prices for "Western SPF 2 x 4 standard and better, kiln dried, random lengths".[43] It is a benchmark price for "2 x 4" lumber. The product mix the Investment sells to market is not made up exclusively of "2 x 4" lumber. In fact, the Investment sells a wide range of lumber products.[44] The actual realised price is more accurate than Random Lengths because it shows the price received for all dimensions of the Investment's product.

47. Nor is the Investment a mere "price taker in a commodity market" as urged by the Investor.[45] In fact, the Investment's own financial statements show that it consistently obtains prices in excess of Random Lengths.[46] The Random Lengths prices underestimate the Investment's proven strength in the market.

48. The Investor incomprehensibly suggests that it is "neither practical nor helpful" to determine weekly price, yet in the same paragraph urges that the more appropriate measure is the weekly selling price found in Random Lengths.[47] This makes no sense. The Investor has had Mr Rosen calculate incremental loss on a weekly basis and hence should be relating loss to weekly production numbers.

49. Mr. Harder derived weekly prices realised by the Investment using the monthly financial statements of the Investment. This was the best basis to calculate weekly prices realised by the Investment, given the Investor's continued refusal or inability to produce actual weekly prices.[48]

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[43] Counter-Memorial, para. 93(a).
[44] http://www.poptal.com/wood/woodhome.htm [Canada's Authorities, Reply Counter-Memorial, Tab 2]. See also Gray Statement, January 27, 2000, para. 2; Harder Supplementary Report, para. 18.
[45] Reply Memorial, para. 66.
[46] Harder Report, para. 33.
[47] Reply Memorial, para. 66.
[48] By letter dated October 2, 2001, the Investor advised that weekly data on prices was not available. Previously in its letter of August 13, 2001 it declined to confirm that no document indicating prices realized by the Investment's mill's existed.

50. The use of average monthly prices to derive weekly prices does not understate the loss alleged.[49]

51. Similarly, the Investor suggests that Random Lengths prices account for weekly exchange rate fluctuations while actual realised prices do not.[50] This is incorrect. Actual realised prices reflect exchange rate fluctuations as well as Random Lengths prices.[51]

52. Nor do the prices used by Mr. Harder inappropriately account for a number of factors suggested by the Investor.[52] In particular:

- fees paid under the Export Control Regime: Mr. Harder confirms that these were excluded from his calculation.[53] As the Investment's financial statements clearly show, both "Tariff/Border Tax" and "Freight and Handling" are excluded from the net sales price in the Investment's financial reports.[54]

- sales and inventory adjustment: Mr. Rosen suggests such adjustments might have arisen,[55] yet never identifies or quantifies such adjustments. The use of actual prices should not be discarded based on such unsubstantiated supposition. In any event, Random Lengths prices also do not account for any sales or inventory adjustments by the investment.

- exchange factors: Mr. Harder accounted for exchange factors by converting actual prices in Canadian dollars at the average exchange rate for the month in question published in the Bank of Canada Review.[56]

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[49] Harder Supplementary Report, para. 16.
[50] Reply Memorial para. 67.
[51] Supplementary Harder Report, para. 15.
[52] Reply Memorial, para. 67; Rosen Supplementary Statement, para. 10.
[53] Supplementary Harder Report, para. 15.
[54] Oddly, Mr. Rosen states (Supplementary Statement, para. 10) that he cannot confirm whether duties paid were included in the calculations as Canada has not responded to a request concerning calculation of average monthly prices. Canada never received any such request, and so advised the Investor immediately upon reading this incorrect assertion by Mr. Rosen. By letter dated October 2, 2001, the Investor advised this request "had been misplaced". In any event, the average monthly prices were derived from financial statements provided by the Investor, and Mr. Rosen therefore has the same information as Mr.Harder.
[55] Rosen Supplementary Statement, para. 10.
[56] Harder Supplementary Report, para. 15.

53. Finally, Mr. Rosen suggests that by using monthly average prices from the Investment's financial statements Mr. Harder masked fluctuations in weekly selling prices.[57] In fact, Mr. Harder calculated average daily production then multiplied it by the number of production days in a week. In effect, both Mr. Harder and Mr. Rosen converted monthly production to average daily and weekly production volumes. Using monthly sales prices from the same financial statements from which the monthly production values were obtained should not produce an inaccurate result.[58]

(vi) Time of Sales

54. The Investor continues to deny that the incremental revenue claim should reflect the fact that in practice sales occur a month after production, notwithstanding that it agrees that sales do occur a month after production.[59] In effect, the Rosen approach requires the Tribunal to ignore reality in favour of an artificial and inaccurate construct.

55. The Investor tries to justify ignoring the reality that sales occur one month after production by stating that it is necessary to remove the effect of the post-SLA period.[60] Again, the Investor urges the Tribunal to base its assessment of damages on an assumption that is exactly the opposite of what actually occurred.

56. The far better input for the model is the actual realised price in each month. The price increase at the end of the SLA is a fact that cannot be assumed out of existence if a fair and accurate assessment is to be arrived at.

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[57] Rosen Supplementary Statement, para. 11.
[58] Harder Supplementary Report, para. 16.
[59] Rosen Report, para. 7.
[60] Reply Memorial, para. 68; Rosen Supplementary Statement, paras 13 – 14.

57. There is no reason to stop the revenue loss calculation at the end of March 2001. To ignore the prices received after March 31, 2001, when lumber produced during the SLA was shipped, results in an incomplete revenue loss calculation.[61]

(vii) Failure to Discount for Canadian Portion of Sales

58. The Investor calculated its incremental revenue claim as if the Investment made all its' sales to the U.S. at U.S. commodity prices. In fact, the record is clear that at a minimum, 10% of the Investment's lumber is sold in Canada at Canadian prices.[62] The Investor's approach has the effect of further inflating the loss allegedly attributable to the delay in production.[63]

59. Adjusting for this factor further decreases the revenue loss claim. If only 10% of the delayed sales had gone to Canada, the investment's revenue loss would be $304,000.[64]

F. Foreseeability

60. The Investor alleges that Canada applied a subjective test for foreseeability of damages.[65] In fact, Canada agreed with the Investor's formulation of the test for foreseeability: "to be foreseeable damages claimed must have been reasonably anticipated by the disputing parties at the time of the breach".[66]

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[61] Harder Supplementary Report, paras 22-23.
[62] Testimony of Kyle Gray, May 2, 2000, Transcript p. 86. The Harder Supplementary Report, Table 1 in paragraph 19 on page 8 shows that the Investment's Canadian sales were 11% in 1997, 12% in 1998, 16% in 1999 and 26% in 2000.
[63] Harder Supplementary Report, paras 19-20.
[64] Harder Supplementary Report, para. 21 and Schedule 1.
[65] Reply Memorial, para. 46.
[66] Memorial, para. 11. At footnote 37 of this document the Investor quotes from the *Shufeldt* claim that states damages should be direct and "reasonably supposed to have been in the contemplation of both parties as the probable result of the breach".

61. In the Reply Memorial the Investor alleges all that is required to meet the foreseeability test is that "the verification review episode caused the Investor to take downtime in December 1999".[67] This confuses the two distinct concepts of causation and foreseeability.

62. To recover damages the loss must be foreseeable. Canada maintains that it was not foreseeable that the investment would take a seven day shut down because they were in the process of a verification review.

63. This is especially true since, at the relevant time, it was entirely possible that the quota of the Investment could increase, stay the same or decrease, depending on the result of the verification review and revised questionnaire. Mr. George states that the quota might be increased, decreased or remain the same depending on the result of the verification and the revised questionnaire.[68] Similarly, Mr. Gray expected that "there might be a 1 to 2% error"[69] and on November 19, 1999 Canada affirmed that at most an adjustment of 5% was possible.[70]

64. The only thing that is reasonably foreseeable under an Export Control Regime is that a quota holder will receive the amount of quota to which it is entitled in accordance with the scheme. There can be no reasonable expectation to receive any more or any less quota than that to which the quota-holder is entitled. As Mr. Friesen put it, "If we in fact have more quota than we should have, then other people would be paying more than they should have."[71]

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[67] Reply Memorial, para. 46.
[68] George Affidavit #1, November 26, 1999, paras 41, 44, 105; George Affidavit #3, October 4, 2000, para. 88.
[69] Gray Affidavit, December 7, 1999, para. 26; George Affidavit #1, November 26, 1999, para. 110.
[70] Harvey letter to Tribunal, November 19, 2001.
[71] Friesen Testimony, January 7, 2000, p. 321.

65. Indeed, in January 2000, Mr. Friesen testified that he thought it was foreseeable that "there is probably some errors on the positive and on the negative, and I will assume that applies to every company across the country".[72]

66. Given these expectations of both disputing parties, it cannot be said that at the time of the breach the disputing parties reasonably foresaw that verification would cause a seven-day shut down and damages claimed to exceed US$ $2 million.

PART III: Specific Claims

A. Management Time

(i) A Non-Recoverable Cost

67. The Investor never addresses the general principle in assessing damages that management time is a fixed cost of business and therefore is not a recoverable expense.[73] Such expenses would have been incurred regardless of the verification review episode. This principle governs the claim for management time and dictates that these expenses or costs cannot be recovered.

68. The Investor asserts now that this claim represents a lost opportunity cost, as management spent time on tasks that were not a normal part of the job.[74] The Investor submitted no evidence of any of the normal tasks of a Pope & Talbot manager, the nature of the opportunity lost due to work on verification or the value of that opportunity.

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[72] Friesen Testimony, January 7, 2000, p. 319.
[73] Reply Memorial, para. 17. This principle is discussed in the Counter-Memorial, paras 62 – 66.
[74] Reply Memorial, para. 17.

69. It is implausible to assert that the verification review fell outside the scope of management duties. The Investor and its Investment operate in a highly regulated industry where compliance with governmental regulations is a concern. In particular, the Investment specifically undertook to cooperate with verification reviews in its application for quota under the SLA. Hence, it ought to have expected that a verification review could be one of management's tasks during the SLA.[75]

70. The Investor continues to assert its claim for management time without offering any proof as to the basis for the claim or why it alleges the time claimed was expended by reason of the verification review. Instead, it asserts the Tribunal and Canada should accept this claim without further inquiry because Pope and Talbot managers do not keep dockets, the amounts claimed are not large, Mr. Rosen relied on these assertions and the Investor assures us that it is credible in all respects.[76]

71. While it is not surprising that Pope & Talbot managers do not docket in the same fashion as lawyers, it seems odd that they would not even keep a calendar, palm pilot, day book or other agenda[77] that might assist in establishing the utilisation of their time.

72. In the absence of sufficient documentary evidence, the usual practice would be for the manager to swear an affidavit explaining the amount of time spent and how it was linked to the verification review. Such affidavits are conspicuously absent in this case.

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[75] George Affidavit #3, October 4, 2000, para. 80 and Exhibit "B" of George Affidavit #1, November 26, 1999.
[76] Reply Memorial, paras 15 – 16.
[77] All of which Canada requested.

73. The Rosen Supplementary Statement suggests that the Investor undertook to provide further documentation and that a related document is attached to the statement.[78] No document was attached to the statement provided to Canada, nor did the Investor provide any further information when Canada inquired into the absence of the attachment.[79]

74. Mr. Rosen also attests that the amounts claimed are reasonable and that management time was spent on such tasks as consulting with experts on audit, government, public relations and legal experts or preparation and attendance at tribunal hearings.[80]

75. There are various problems with this statement. First, it is the role of the Tribunal to determine what amounts are reasonable and recoverable, based on their assessment of the facts and the application of relevant law. They are unable to do so on the state of the record established by the Investor.

76. Second, even on the face of Mr. Rosen's statement, it is clear that the Investor claims expenses and costs that were not caused by the verification review episode and are not recoverable. For example, Mr. Rosen says that time claimed on behalf of the Investor's management is attributable to preparation and attendance of key management personnel at Tribunal hearings.[81] In Canada's submission attendance at NAFTA Chapter 11 hearings are not related to verification review and such an expenditure of time cannot be causally related to the breach.

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[78] Rosen Supplementary Statement, para. 3.
[79] By letter dated October 2, 2001, Counsel for the Investor advised Canada that "Mr. Rosen inadvertently indicated [the] materials were attached". Nothing has been provided.
[80] Rosen Supplementary Statement, para. 3.
[81] Rosen Supplementary Statement, para. 3. This appears to include attendance at hearings other than the interim measures motion.

B. Legal Fees and Disbursements - Appleton & Associates

(i) Recoverable Legal Expenses

77. Canada accepts that reasonable legal fees and disbursements incurred by the Investor in connection with the verification review episode are recoverable as damages by the Investor in this phase. For example, legal fees for providing advice to the Investor on the scope and authority for Canada to verify the Investment's quota are properly recoverable.[82]

(ii) Insufficient Evidence

78. The Investor submits that it is "excessive and unreasonable" to expect it to segregate verification related expenses from non-verification related expenses.[83] In essence, it maintains that there is a blank cheque for disbursements and services rendered between April 1999 and January 2000.[84] Further, it asks the Tribunal to award all expenses in the time frame because "it is reasonable to assume that all, if not a high proportion, of the remaining disbursements are related to the verification review episode". This means that the Investor expects the Tribunal to award damages unrelated to the verification episode simply because they fall within a specified time period.

79. The Investor submits that "Canada is incorrect in its exaggerated statement that the Rosen report assumes that predominantly all costs incurred between April 1999 and January 2000 were verification costs".[85] In fact, this is a verbatim quote from Mr. Rosen's report.[86]

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[82] Canada has attempted to categorize these in its' schedules (items in black script).
[83] Reply Memorial, para. 21.
[84] Reply Memorial, para. 22.
[85] Reply Memorial, para. 24.
[86] Rosen Report, June 14, 2001, p. 3, footnote 1. Rosen Supplementary Statement, para. 6.

80. Canada submits that this is an odd and unacceptable manner of assessing damages. Assessment of damages is just that – assessment based on evidence. The Investor would substitute an imprecise assumption that all expenses in a given time period are recoverable. This completely ignores the requirement of causation in Articles 1116 and 1117. Further, it produces an imprecise and unfair assessment.

81. To provide a graphic illustration of this, Canada has colour coded these dockets.[87] One can see that fees are claimed for the interim measures motion, other services rendered during the arbitration or costs unrelated to the arbitration in any way. Many of the items cannot be explained in any fashion.

82. This is not just a question of burden of proof or balance of probability.[88] On the face of the Investor's dockets it is clear that a substantial amount of the fees and disbursements do not relate to the verification review episode. A claim which is incapable of being assessed does not meet the balance of probability test. Moreover, it is not proved.

83. The Investor would have the Tribunal award all of these fees, clearly resulting in overcompensation. The Investor can and must attempt to segregate verification costs from other claims. If it does not, it has not met its burden of proof or the NAFTA requirement that damages be caused by the breach.

84. The Investor also submits that because it has not claimed disbursements during August to November 1999[89] this should somehow roughly balance any imprecision in its approach to what is recoverable. Similarly, the Investor submits that where it has not proved its damages, it is

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[87] See Schedules Related to Legal Expenses and Expert Fees, Tab 2-28.
[88] Reply Memorial, para. 20.
[89] Reply Memorial, paras 23 & 35. The Investor states that "*It is reasonable to assume that all, if not a high proportion, of the remaining disbursements are related to the verification review*".

"reasonable to assume that "a high proportion", "if not all" are recoverable.[90]

85. Of course, these approaches would result in an even more imprecise process. Assessment of damages requires assessment based on the record for each head of damage claimed.

(iii) Interim Measures Costs Are Costs, Not Damages

86. The Investor tries to expand its recoverable legal costs by including all legal costs related to the interim measures motion.[91]

87. Costs arising out of the interim motion measures are not recoverable as damages. These are part of the costs of the arbitration generally and are to be assessed in phase 4. The Investor cannot transform these costs of the arbitration into damages.

88. Even if the Tribunal accepts that legal costs for the interim measures motion should be recoverable as damages, these costs should not be awarded in this case. The interim measures motion was clearly beyond a tribunal's jurisdiction. It is not a necessary expense arising out of the verification review episode.

89. No party should have to indemnify another party for incurring costs and taking futile actions that have no hope of success. This is especially so where a legitimate recourse existed in the Federal Court of Canada but the Investor chose not to take it.

90. The Investor argues that the reasons of the Tribunal estop Canada from challenging whether expenses were necessary expenses related to the

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[90] Reply Memorial, paras 22 & 24.
[91] See items in green script in Schedule complied by Canada for examples of claims related to the interim measures motion.

verification review.[92] It suggests that by definition, every expense it incurred related to verification was a necessary expense.

91. To the contrary, part of the damage assessment required by the Tribunal is to determine whether, as a matter of fact and law, an expense claimed is causally related to verification. Canada suggests that an expense which was not necessary does not "arise out of" and was not incurred "by reason of" the verification review episode. The Tribunal retains discretion to determine whether a particular expense was in fact necessary and ought to be recoverable.

92. The interim measures motion was not an expense related to verification review. It was a part of the Investor's claim to arbitration and is to be assessed in the next phase in accordance with the Tribunal's procedural order dated April 20, 2001.

(iv) Other Arbitration Costs are Not Damages

93. A review of the dockets of Appleton & Associates demonstrates that the Investor seeks to recover substantial that do not arise from the verification review episode.[93] These are costs that were incurred to prosecute the NAFTA Chapter Eleven claim more specifically.

94. The Schedules compiled by Canada show in pink script items that clearly do not arise out of the verification review episode. For example, claims are made for tasks such as researching national treatment and expropriation law, preparing memorials submitted in Phase I, and researching the qualifications of potential arbitrators. Costs attributable to such items cannot be recovered as damages in this phase.

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[92] Reply Memorial, para. 20.

[93] The Investor emphasizes its' waiver of solicitor-client privilege for the sake of resolving this matter. Of course, legal dockets do not contain legal advice and are not privileged, especially where relied upon to claim damages. A review of these dockets shows that they do not contain privileged advice.

(v) Calculation Errors

95. There appear to be calculation errors in the invoices claimed by the Investor. For example, the February 2, 2000 invoice bills US$ 282,485.00 on account of legal fees.[94] However, the accompanying dockets identify $249,035.00. on account of legal fees. Canada is unable to understand this difference of US$ 33,450.00.

C. Out of Pocket Costs

96. The Investor has now provided evidence as to the $10,000 expense of "AA Co". Having reviewed the invoice, Canada accepts that this is an expense "arising out of" the verification review.

97. The remaining out of pocket expenses have not been addressed by the Investor, who simply states that these "largely relate"[95] to the Interim Measures motion and the verification review. This does not sufficiently address the causal link to the verification review. Canada relies on its position in the Counter-Memorial with respect to these claims.[96]

D. Expert Fees – LRTS

98. Mr. Rosen now affirms in his Supplementary Statement that his work between April 1999 and January 2000 related exclusively to the verification review.[97] This dubious assertion can be tested in cross-examination. However, it should be noted that Mr. Rosen included expenses related to his preparation for the interim measures motion,[98] which Canada submits is not part of verification related costs but rather part of the costs of the arbitration to be assessed in phase 4.

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[94] Appendix B, Reply Memorial (Damages), Tab "Jan".
[95] Reply Memorial, para. 26.
[96] Counter-Memorial, paras. 114 – 115.
[97] Supplementary Statement of Rosen, para. 6.
[98] *Ibid.*

E. Expert Fees – Davis & Co.

99. Again, the Investor provided new information relating to this expense. Mr. Rosen (and not the person who retained or performed these services) now asserts that this is related to government relations issues and potential judicial review advice given by Mr. Dean Crawford of Davis & Co.[99]

100. Canada accepts that fees for advice concerning potential judicial review are attributable to the verification review. Canada does not accept that there is a causal link between lobbying and the verification review, especially in the absence of any evidence that the lobbying was with respect to the verification and not with respect to the arbitration under Chapter 11 of NAFTA challenging implementation of the SLA.[100]

F. Expert Fees – Apco Canada

101. No further information has been provided with respect to Apco Canada. Canada maintains its position[101] that these do not demonstrate any causal link to the breach and cannot be recovered.

G. Expert Fees – Barnes & Thornberg

102. The time entries provided by Barnes & Thornberg clearly show the work was not related to the verification review, as noted by Canada in its Counter-Memorial.[102]

H. Expert Fees – Stoel Rives

103. The Investor has made no submissions concerning the fees of Stoel Rives. Canada maintains its position as set out in the Counter-

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[99] Supplementary Statement of Rosen, para. 7.
[100] See Schedules Related to Legal Expenses and Expert Fees, Tabs 22-25.
[101] Counter-Memorial, paras 128–131. See also Schedules Related to Legal Expenses and Expert Fees, Tabs 19-20.
[102] Counter-Memorial, paras 132-134. See also Schedules Related to Legal Expense and Expert Fees, Tab 21.

Memorial.[103] In Canada's submission, none of this work arises out of the verification review.[104]

PART IV: Interest

104. Canada proposed a reasonable rate of interest for this arbitration. The Investor cited no "accepted international interest rate" nor is there one. While the Tribunal obviously is not bound by domestic law, Canada has addressed this as it constitutes a helpful benchmark for setting interest.

105. Canada maintains its position on simple interest and the start date for an award of interest.[105]

PART V: Costs

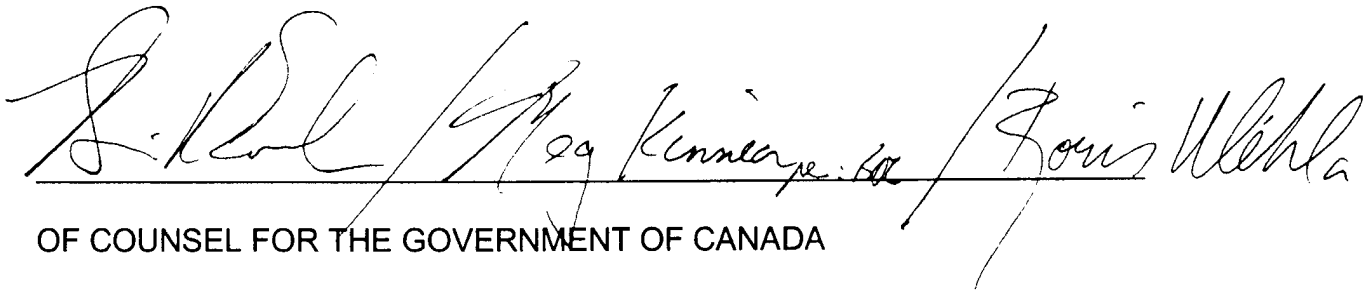
106. The Investor argues that costs of the interim motion should be awarded as damages.[106] There is no principled basis to do so. An award that reflects

[103] Counter-Memorial, paras 139-141.
[104] See Schedules Related to Legal Expenses and Expert Fees, Tabs 26-28.
[105] Counter-Memorial, paras 150–161.
[106] Reply Memorial, paras 71–73.

costs of the interim measures motion is no more appropriate within the damages phase than an award that reflects costs of any other part of the arbitration. Costs of the arbitration are to be assessed in phase 4 of the hearing.

ALL OF WHICH IS RESPECTFULLY SUBMITTED

Dated in the City of Ottawa, the Province of Ontario, this 5th day of October, 2001



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