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INTERNATIONAL LAWYERS

Washington DC *Toronto*

September 10, 2001

By Fax

The Hon Lord Dervaird
1 Moray Place
Edinburgh, UK
EH3 6DS

Dear Lord Dervaird:

RE: NAFTA UNCITRAL Investor-State Claim
Pope & Talbot, Inc. and the Government of Canada
Our File No. A5236

We are writing in response to the Tribunal's letter of August 14, 2001 requesting the positions of the disputing parties regarding the recent "Interpretation" of NAFTA Article 1105 by the NAFTA Commission. The Investor responds as follows to the questions of the Tribunal:

1. **Should the Commissioners' interpretation be considered to have retroactive effect on rulings previously made by NAFTA Tribunals?**

Canada has reminded the Tribunal that, under NAFTA Article 1131(2), an interpretation by the Commission of a provision of the NAFTA "shall be binding" on this Tribunal. However, it is unclear from Canada's letter of August 10th to the Tribunal what this means in the context of this arbitration. Any ordinary reading of NAFTA Article 1131(2) would lead one to the conclusion that a NAFTA Commission interpretation would only have prospective effect, and could not retroactively apply to decided matters. The following discussion supports this conclusion.

An Interpretation Cannot be Applied Retroactively to Awards

The general principle of non-retroactivity is well established in public international law. Article 28 of the *Vienna Convention on the Law of Treaties*[1], titled "Non-Retroactivity of Treaties", specifically addresses non-retroactivity of treaties and provides that, unless a different intention appears from its provisions, a treaty does not bind a party "in relation to any act or fact that took place or situation which ceased to exist" before the date of entry into force of the treaty for that

[1] *Vienna Convention on the Law of Treaties* (1969) 1155 U.N.T.S. 331, in force 1980. ("*Vienna Convention*")

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party.[2] Article 31(3)(a) of the *Vienna Convention*, titled "General Rule of Interpretation", clearly states a Tribunal such as this should take "into account, together with the context: ... any subsequent agreement between the parties" regarding an interpretation of a treaty or application of its provisions. Moreover, the wording of NAFTA Article 1131(2) uses the phrase "shall be binding" which, upon a plain meaning construction, means the NAFTA Commission interpretations must, in future arbitral decisions, be taken into account by Tribunals.

A reservation permits a Party to not observe a specific treaty obligation and can be considered, in effect, as an accepted violation of the general rule of treaty law *pacta sunt servanda* as set out in Article 26 of the *Vienna Convention*. Reservations, like exceptions or interpretations, modify the legal effect of provisions of a treaty and must be construed restrictively.[3] For example, in the *Jamaican Bauxite Case*[4] the Government of Jamaica attempted, by way of reservation, to retroactively withdraw its previous consent to arbitrate matters with respect to the subject matter of that arbitration. The Tribunal held that a party may not withdraw its consent with retroactive effect.[5]

GATT/WTO panels have consistently upheld the general principle that recommendations and remedies of arbitral panels always have a *prospective* effect and are not retroactive.[6] For example, in the *Bananas* case, Equador argued that the discriminatory treatment of its bananas by the EC in previous years should be 'corrected' retroactively by the arbitral panel. The WTO panel disagreed and stated as follows:

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[2]This supports the general principle that an exception must always be strictly interpreted. In this case, the NAFTA Commission interpretation attempts to read-down the meaning of "international law" from its generally accepted meaning.

[3]This rule is expressed in Latin as *exceptio est strictissimae applicationis* which means exceptions to treaty obligations are construed restrictively. See: *Interpretation of Article 79 of the 1947 Peace Treaty* (French/Italian Conciliation Commission) XIII. UNRIAA 397. *Case Concerning Certain German Interests in Upper Silesia* PCIJ. Series A. No. 7, p. 56 and *Free City of Danzig* case, PCIJ Series A/B, No. 65 at 71. Similarly, within the decisions of the GATT and the WTO, exceptions to trade obligations have been narrowly interpreted. For example see the restrictive positions taken by GATT/WTO panels in *United States - Restrictions on Imports of Tuna* DS21/R and *United States - Standards for Reformulated and Conventional Gasoline*. WT/DS/9.

[4]*Alcoa Minerals of Jamaica, Inc.* and *Government of Jamaica* (1979) IV Yearb. Comm. Arb. 206 (*Preliminary Award Made in 1975*) ("*Jamaican Bauxite Case*"). Two other arbitrations were simultaneously launched by Kaiser Bauxite Company and Reynolds Metals Company and heard by the same Tribunal with identical substantive decisions. See: *Kaiser Bauxite Company* v. *The Government of Jamaica* (1993) I ICSID Reports 296.

[5]Further, the arbitral tribunal concluded that "to decide otherwise 'would largely, if not wholly, deprive the [ICSID] Convention of an practical value.'" *Jamaican Bauxite Case* at 208.

[6]*Brazil - Measures Affecting Desiccated Coconut*, WT/DS22/R, October 17, 1996; *Brazil –Export Financing Programme for Aircraft - Recourse by Canada to Article 21.5 of the DSU*. WT/DS46/RW. May 9, 2000; *United States – Import Measures on Certain Products from the European Communities*, WT/DS165/R, July 17, 2000.

> If we were to rule that the licence allocation to service suppliers of third-country origin were to be "corrected" for the years 1994 to 1996, we would create a retroactive effect of remedies ex tunc. However, in our view, what the EC is required to ensure is to terminate discriminatory patterns of licence allocation with prospective effect as of the beginning of the year 1999.[7]

In the Investor's submission, the NAFTA Commission Interpretation cannot have a retroactive effect upon any decision taken by this Tribunal.

2. If the interpretation is to have retroactive effect,

a. Should the interpretation change the result reached in this proceeding by the Tribunal with regard to "the verification episode"?

In the alternative that this Tribunal determines that the NAFTA Commission Interpretation should have retroactive effect, the Investor submits that the interpretation would not change the result reached in this proceeding. The first question to be addressed by this Tribunal is whether it is even bound by this so-called interpretation of the NAFTA Commission. It is the Investor's position that this Tribunal would not be bound by this Interpretation of the NAFTA Commission with respect to NAFTA Article 1105.

Further, even if Canada was correct in its position concerning the Interpretation, such a position would not change the Tribunal's decision regarding the "verification episode".

This Tribunal is Not Bound by the NAFTA Commission Interpretation

The NAFTA sets out the requirements for the interpretation of the Agreement in NAFTA Article 102(2). This Article provides:

> The Parties shall interpret and apply the provisions of this Agreement in light of its objectives set out in paragraph 1 and in accordance with applicable rules of international law.

In a Press Release dated August 1st, Canada made clear its position concerning the Commission Interpretation regarding NAFTA Article when Minister Pettigrew stated that:

> The Ministers also clarified the interpretation of the NAFTA provision governing the minimum standard of treatment to be accorded to foreign investors. **NAFTA's [Article 1105] standard is the customary international law minimum standard of treatment.** [emphasis added]

NAFTA Article 1105 cannot mean what Minister Pettigrew states that it means. Quite simply, if this is what the NAFTA Commission meant, they would have included those explicit words in the interpretative statement. However, if such words had been included in the NAFTA

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[7] *European Communities –Regime for the Importation, Sale and Distribution of Bananas –Recourse to Article 21.5 by Equador*, WT/DS27/RW/ECU, April 12, 1999.

Commission Interpretation, such a statement would have been a clear amendment of NAFTA Article 1105, and not an interpretation.

In conducting its interpretation of NAFTA Article 1105, the NAFTA Commissioners were obliged to meet two requirements. The Commission was required to interpret the NAFTA (1) in light of its objectives in NAFTA Article 102(1), and (2) do so in accordance with the "applicable rules of international law".[8]

Vienna Convention Article 31(1) provides the applicable interpretative test under international law that the Commission was obliged to follow. Article 31(1) states that:

> A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in light of its object and purpose.

In particular, when read in plain terms in conjunction with what NAFTA Article 1105 actually provides, it is impossible to reach the conclusion that Canada makes. NAFTA Article 1105(1) states as follows:

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

The key phrase for the purposes of the Commission's Interpretation of this provision is the phrase "treatment in accordance with international law". The concept of "international law", as set out in NAFTA Article 1105, is well-established in international legal practice. The widely accepted definition of "international law" is set out in Article 38 of the *Statute of the International Court of Justice*.[9] Article 38 of the *ICJ Statute* states that there are four sources of international law: (1) treaties, (2) custom, (3) general principles, and (4) case law and academic treatises (as a subsidiary source to the first three sources).

To limit the scope of international law to any one of these sources is not in the realm of possible alternative plain meaning interpretations. Nor would such an interpretation be consistent with the objectives and purpose of the NAFTA, in particular the objective to "increase substantially investment opportunities in the territories of the Parties"[10] and "create effective procedures for the implementation and application of this Agreement, for its joint administration and the

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[8] In its *Award on Jurisdiction*, in *Ethyl Corp and Canada* (Jurisdiction Award) at para. 56, the *Ethyl* Tribunal took a broad view of the objectives of NAFTA and stated that: "The Tribunal reads Article 102(2) as specifying that the "object and purpose" of NAFTA within the meaning of those terms in Article 31(1) of the Vienna Convention are to be found by the Tribunal in Article 102(1), and confirming the applicability of Articles 31 and 32 of the Vienna Convention."

[9] 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* ("*ICJ Statute*").

[10] NAFTA Article 102(1)(c).

resolution of disputes."[11] The only effect of Canada's interpretation of the NAFTA Commission Interpretation would be to narrow the meaning of NAFTA Article 1105, and, accordingly, discourage investment opportunities in the NAFTA zone. This cannot be the intent of the NAFTA Commission as it would be contradictory to the NAFTA itself.

In the interpretation of international treaties, it is frequently stated that if the meaning of a treaty is sufficiently clear, there is no reason to resort to interpretation.[12] For Canada to have the result it suggests - that the NAFTA Article 1105 treatment standard is only the customary international law standard of treatment - an amendment to NAFTA Article 1105 would be required to have such an effect.[13]

A NAFTA Commission interpretation can only have the effect of an interpretation, as the term is understood in international law. If the NAFTA Parties had desired to change the wording of NAFTA Article 1105 to read "customary international law" rather than "international law", only an amendment to the NAFTA would be sufficient. Since the Interpretation regarding NAFTA Article 1105 has not followed the proper procedure for an amendment to a treaty, the Investor submits that this NAFTA Tribunal cannot be bound by the NAFTA Commission Interpretation if it is interpreted in the manner proposed by Canada.

The NAFTA Commission Interpretation Does Not Change This Tribunal's Decision Regarding The Verification Episode

Moreover, if read in light of the actual wording of NAFTA Article 1105, the Interpretation cannot possibly have the meaning suggested by Canada in it's press release. If "international law" is held to mean what it is widely interpreted to mean, there would be no effect on the reasoning of this Tribunal concerning NAFTA Article 1105 in its *Award on the Merits of Phase 2*, dated April 10, 2001 (the *Award*").

For example, paragraph B(1) of the Interpretation confirms that NAFTA Article 1105(1) sets out that the international law standard *includes* the customary international law standard, but it should be interpreted to mean that it is not limited solely to that customary international standard. Similarly, paragraph B(2) refers to the concepts of "fair and equitable treatment" and "full protection and security" and confirms that these concepts need not be considered as requiring treatment beyond the customary standard.

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[11]NAFTA Article 102(1)(c).

[12]See: *Oppenheim's International Law*, 9th ed. Jennings and Watts, ed. (1996), vol. 1, part 4, at 1266, citing Vattel, *Le Droit des gens* (1773), ii, § 263: "It is not allowable to interpret what has no need of interpretation."

[13]A similar situation arises in the confusion between reservations and interpretations. States have in the past made interpretative statements that have been veiled attempts to reserve from certain obligations of a treaty. See Oppenheim (9th ed.) at 1241-42.

Since the concepts of fairness and equity are undoubtably principles of international law as recognized in almost every FIPA signed by Canada in the past 6 years[14], as well as being recognized in customary international law, there should be no contradiction in effect if paragraph B(2) is read in light of the accepted definition of international law under Article 38 of the *ICJ Statute*.[15] It should be highlighted that neither of these interpretative provisions, B(1) or B(2), provide that the content of the fairness and equity standard is the limited "egregious" standard advocated by Canada in its earlier submissions.

Even if this Tribunal accepted Canada's position on the NAFTA Commission Interpretation, that "NAFTA's [Article 1105] standard is the customary international law minimum standard of treatment", there should be no change in this Tribunal's decision regarding the Verification Episode. The Tribunal engaged in an extensive discussion as to whether the "fair and equitable" treatment standard was additive to the requirements of international law or included. The Tribunal concluded that the fairness and equity standard was clearly additive with respect to other BITs[16] while both of the disputing parties submitted that these standards were included as part of international law with respect to the NAFTA. This Tribunal did acknowledge that the language of NAFTA Article 1105 states that "fair and equitable treatment" is included in the international law standard. The main issue between the disputing parties concerned the content of the fairness and equity standard, rather than its categorization. The Investor's position remains that the incorporation of the fairness elements into international law supports its view that "international law standards have progressed and have liberalized the 'egregious' conduct threshold that Canada finds in its older cases."[17]

The Tribunal concluded in its *Award* that Canada had violated the fair and equitable treatment standard under NAFTA Article 1105 in the most patent manner. The Tribunal stated that:

> In its totality, the SLD's treatment of the Investment during 1999 in relation to the verification review process is nothing less than a denial of the fair treatment required by NAFTA Article 1105, and the Tribunal finds Canada liable to the Investor for the resultant damages.[18]

Ultimately, it is not critical to the Tribunal's conclusion whether the fairness and equity standard is categorized as being additive or included vis à vis international law. It may add weight to such a conclusion, but it is not determinative. Based on the conduct of the SLD officials, there seems little doubt that Canada's conduct was a violation of the standard of fair and equitable treatment.

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[14]See the DFAIT website at: http://www.dfait-maeci.gc.ca/tna-nac/fipa-e.asp

[15]Since this arbitration does not address the question of breaches of another provision of the NAFTA, or other treaties, it is not necessary to address paragraph B(3) of the Interpretation.

[16]*Award* at para. 113. See Discussion below re NAFTA Article 1103.

[17]*Award* at para. 109.

[18]*Award* at para. 181.

Accordingly, the NAFTA Commission Interpretation would have no effect on the Tribunal's decision concerning the Verification Episode.

b. If the answer to a. is in the affirmative what would be the implication of Article 1103 on the Tribunal's ruling?

In the further alternative, if the Interpretation has retroactive effect and changes the result reached by the Tribunal regarding "the verification episode", the implication of NAFTA Article 1103 (most-favoured nation treatment ("MFN")) is that Canada's position would lead to a patently absurd result and such a result would have to be rejected. Accordingly, as dealt with by the Tribunal in its *Award*, the Tribunal's ruling would remain unaffected and stand. Moreover, the NAFTA Commission Interpretation does not address the relation of NAFTA Article 1103 with NAFTA Article 1105 and would not affect the Tribunal's conclusions on those issues.

In its *Award*, the Tribunal rejected Canada's threshold limitation "egregious" standard.[19] Moreover, the Tribunal supported its conclusions stating that, since other NAFTA BITs have adopted the additive construction, it would be a violation of NAFTA Article 1103 if NAFTA investors and investments were to receive less favourable treatment. The Investor further submits that, since Canada has taken the view in other Canadian FIPAs subsequent to the NAFTA that fair and equitable treatment should be provided in accordance with principles of international law, not just under customary international law, investors and investments under NAFTA Article 1105 and 1103 should receive no less favourable treatment.

Schwarzenberger commented on the important role of the MFN provision in treaties and its positive contribution to equality in international affairs. He states that "... the standard of m.f.n. treatment has the effect of putting the services of the shrewdest negotiator of a third country gratuitously at the disposal of one's own country..."[20]

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[19] *Award* at para. 116-118.

[20] Georg Schwarzenberger, "The Most-Favoured-Nation Standard in British State Practice" (1948) Brit. Yearb. Int. L. 96 at 99. The full cite states: "Thus [MFN's] main function consists in forming an agency of equality. It prevents discrimination and establishes equality of opportunity on the highest possible plane: the minimum of discrimination and the maximum of favours conceded to any third State... It is clear that m.f.n. clauses serve as insurance against incompetent draftsmanship and lack of imagination on the part of those who are responsible for the conclusion of international treaties. While it is thus that the standard of m.f.n. treatment has the effect of putting the services of the shrewdest negotiator of a third country gratuitously at the disposal of one's own country, another aspect of the matter is more significant ... As long as a country is content to enjoy treatment equal to that of the most-favoured third country, and the subject-matter of the treaty lends itself to such treatment, the use of the m.f.n. standard leads to the constant self-adaptation of such treaties and greatly contributes to the rationalization of international affairs."

In support of the *Award*, a similar reasoning and application of the MFN provision as it applies to investors and investments was adopted in the recent ICSID *Maffezini Case*.[21] In their jurisdiction decision, that Tribunal examined the effect of an MFN clause regarding BITs involving Spain and investors and investments. In that decision, the Tribunal members in the *Maffezini Case* concluded that:

> ... if a third-party treaty contains provisions for the settlement of disputes that are more favorable to the protection of the investor's rights and interests than those in the basic treaty, such provisions may be extended to the beneficiary of the most favored nation clause as they are fully compatible with the *ejusdem generis* principle. Of course, the third-party treaty has to relate to the same subject matter as the basic treaty, be it the protection of foreign investments or the promotion of trade, since the dispute settlement provisions will operate in the context of these matters; otherwise there would be a contravention of that principle.[22]

If Canada's position regarding the NAFTA Commission Interpretation was correct and changed the result reached by this Tribunal in its *Award*, NAFTA Article 1103 would have the effect of making Canada's interpretation of the NAFTA Commission Interpretation a patently absurd result. Accordingly, Canada's position cannot be the intent of the NAFTA Parties. Because of NAFTA Article 1103, the correct interpretation of NAFTA Article 1105 would remain unchanged from the interpretation reached by the Tribunal in its *Award*.[23]

Yours very truly,

per: Barry Appleton
Counsel for the Investor

cc: M. Belman
B. Greenberg, Q.C.
M. Kinnear

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[21] *Emilio Agustin Maffezini* and *The Kingdom of Spain*, Case No. ARB/97/7, January 25, 2000, *Decision of the Tribunal on Objections to Jurisdiction*. see: www.worldbank.com/icsid/cases/emilio_DecisiononJurisdiction.pdf ("*Maffezini Case*").

[22] *Maffezini Case* at para. 56.

[23] *Award* at para. 118.