IN THE ARBITRATION

UNDER CHAPTER ELEVEN OF THE NORTH AMERICAN FREE TRADE AGREEMENT

BETWEEN

MOBIL INVESTMENTS CANADA INC. & MURPHY OIL CORPORATION

(Claimants)

AND

CANADA

(Respondent)

ICSID Case No. ARB(AF)/07/4

DECISION ON LIABILITY AND ON PRINCIPLES OF QUANTUM

Tribunal

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Professor Merit E. Janow
Professor Philippe Sands QC

Secretary of the Tribunal

Ms. Martina Polasek

Date of Dispatch to the Parties: May 22, 2012

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TABLE OF ABBREVIATIONS

2004 Guidelines	Guidelines for Research and Development Expenditures adopted by the Canada-Newfoundland Offshore Petroleum Board in November 2004
Arbitration Rules	Arbitration (Additional Facility) Rules of 2006
BIT	Bilateral Investment Treaty
BNA	Ben Navis Avalon
Board	Canada-Newfoundland Offshore Petroleum Board
CAPP	Canadian Association of Petroleum Producers
C-CORE	Center for Cold Ocean Research
CA	Claimants' Authorities
CE	Claimants' Exhibits
Claimants	Mobil Canada and Murphy Oil
CNLOPB or the "Board"	Canada-Newfoundland and Labrador Offshore Petroleum Board
CRA	Canada Revenue Agency
CUSFTA	Canada-United States Free Trade Agreement
Cl. Mem.	Claimants' Memorial of August 3, 2009
Cl. Reply	Claimants' Reply Memorial of April 8, 2010
Cl. P. Brief	Claimants' Post-Hearing Brief (Redacted) of January 7, 2011
Cl. Reply P. Brief	Claimants' Reply Post-Hearing Brief of January 31, 2011
Cl. Response 1st Art. 1128	Claimants' Response to 1st Article 1128 Submissions of Mexico and the United States of America of September 1, 2010
Cl. Response 2nd Art. 1128	Claimants' Response to 2nd Article 1128 Submissions of Mexico and the United States of America, of February 7, 2011
DPC	Development Phase Credit
E&T	Education and Training
FET	Fair & Equitable Treatment
FTC	Free Trade Commission
GATT	General Agreement on Tariffs and Trade

GDP	Gross Domestic Product
HCOM	Host Country Operational Measures
HBP	Hibernia Benefits Plan
HMDC	Hibernia Management and Development Company Ltd.
MAI	Multilateral Agreement on Investment
Mex. 1st Art. 1128	First Article 1128 Submission of Mexico, of July 8, 2010
Mex. 2nd Art. 1128	Second Article 1128 Submission of Mexico, January 21, 2011
MNC	Multinational Corporation
Mobil Canada	Mobil Investments Canada Inc.
MUN	Memorial University of Newfoundland
Murphy Oil	Murphy Oil Corporation
NAFTA	North American Free Trade Agreement
NL	Province of Newfoundland and Labrador
OECD	Organization for Economic Cooperation and Development
POA	Production Operations Authorization
PRAC	Petroleum Research Atlantic Canada
R&D	Research and Development
RA	Respondent's Authorities
RE	Respondent's Exhibits
Respondent	Government of Canada
R. Counter	Respondent's Counter Memorial of December 1, 2009
R. Rejoinder	Respondent's Rejoinder Memorial of June 9, 2010
R. P. Brief	Respondent's Post-Hearing Brief of December 3, 2010
R. Reply P. Brief	Respondent's Reply Post-Hearing Brief of January 31, 2011
SR&ED	Scientific Research and Experimental Development
TNBP	Terra Nova Benefits Plan
TRIMS	Agreement on Trade Related Investment Measures
UNCTAD	United Nations Conference on Trade & Development
U.S. 1st Art. 1128	First Article 1128 Submission of the United States of America, of July 8, 2010
U.S. 2nd Art. 1128	Second Article 1128 Submission of the United States of America,

	of January 21, 2011
VCLT	Vienna Convention on the Law of Treaties
WTO	World Trade Organization

I. INTRODUCTION AND THE PARTIES

A. INTRODUCTION

1. This case concerns a dispute submitted to the International Centre for Settlement of Investment Disputes ("ICSID" or "Centre") under the Centre's Additional Facility Rules, on the basis of Chapter Eleven of the North American Free Trade Agreement ("NAFTA"). The dispute relates to two petroleum development projects: the Hibernia and Terra Nova projects off the coast of the Province of Newfoundland and Labrador in Canada (hereinafter "the Projects"). The Claimants allege that Guidelines for Research and Development Expenditures adopted in 2004 by the Canadian Newfoundland and Labrador Offshore Petroleum Board (the "2004 Guidelines") are more restrictive and onerous than the provisions of existing agreements concerning the Projects requiring the Claimants to undertake certain minimum research and development expenditures, as adopted under the Accord Act (enacted by Canada in 1994) and implementing laws. The 2004 Guidelines allegedly require the Claimants and other investors in offshore petroleum projects to pay millions of dollars per year for research and development in the Province of Newfoundland and Labrador. As a result of the promulgation and enforcement of the 2004 Guidelines, the Claimants assert that Canada has breached the performance requirement prohibition in NAFTA Article 1106 and the minimum standard of treatment guarantee in NAFTA Article 1105.

B. THE PARTIES

2. The Claimants are Mobil Investments Canada Inc. and Murphy Oil Corporation ("the Claimants"), two corporations incorporated under the laws of the State of Delaware, United States of America. They are represented in this proceeding by Mr. David W. Rivkin, Ms. Jill van Berg, Ms. Samantha J. Rowe, Ms. Sophie Lamb of the law firm of Debevoise & Plimpton LLP, Mr. Barton Legum of the law firm of Salans, Mr. Rene J. Mouledoux, Mr. Tomasz J. Sikora and Mr. Eugene J. Silva of Exxon Mobil Corporation, as well as Mr. Walter Compton of Murphy Oil Corporation.

3. Mobil Investments Canada Inc. ("Mobil Canada") is an indirect subsidiary of Exxon Mobil Corporation, a corporation organized under the laws of New Jersey, United States of America. It controls a 33.125% share in the Hibernia Oil Development Project ("Hibernia") through its ownership and control of companies incorporated in Canada, including a corresponding interest in the company that operates the project, Hibernia Management and Development Company Ltd. ("HMDC"). Mobil Canada indirectly controls a 22% share in the Terra Nova Oil Development Project ("Terra Nova"), which is an unincorporated joint venture with other energy companies.

4. Murphy Oil Corporation ("Murphy Oil") indirectly owns a 12% share in Terra Nova,[1] and a 6.5% share in Hibernia through its ownership of companies incorporated in Canada.

5. The Respondent is Canada, represented by Mr. Nick Gallus, Mr. Mark Luz, Mr. Adam Douglas and Mr. Pierre-Olivier Savoie, all from Trade Law Bureau of the Department of Foreign Affairs and International Trade Canada.

6. Both the United States of America and Canada are contracting States to the NAFTA. The USA has been a contracting State to the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (the "ICSID Convention" or "Convention") since 1966. Canada has yet to ratify the Convention.

[1] The Tribunal is aware of a dispute concerning the redetermination of owner interest in Terra Nova during the course of the proceeding but, absent any information to the contrary, assumes that the ownership interest has not changed as of the date of this Decision.

II. PROCEDURAL HISTORY

7. On November 2, 2007, the Secretary-General of ICSID received a Request for Arbitration ("the Request") for institution of proceedings under Article 2 of the Arbitration (Additional Facility) Rules, submitted by the Claimants against the Government of Canada. Simultaneously, the Claimants submitted a request for approval of access to the Additional Facility under its Article 2(a). On December 19, 2007, the request for approval of access to the Additional Facility was approved pursuant to Article 4(2) of the Additional Facility Rules, and the Request was registered by the Secretary-General pursuant to Article 4 of the Arbitration (Additional Facility) Rules.

8. On November 5, 2008, in the absence of an agreement between the parties on the number of arbitrators and the method of their appointment, the Claimants invoked Article 1123 of the NAFTA and appointed Professor Merit E. Janow, a U.S. national, as an arbitrator.

9. On November 6, 2008, the Respondent requested that the Secretary-General issue an order taking note of the discontinuance of the proceeding pursuant to Article 51 of the Arbitration (Additional Facility) Rules. Article 51 provides that the parties shall be deemed to have discontinued the proceeding if they "fail to take any steps in the proceeding during six consecutive months or such period as they may agree with the approval of [...] the Secretary-General," and that the "Secretary-General shall, after notice to the parties, in an order take note of the discontinuance." According to the Respondent, there was no step in the proceeding in the six months prior to the Claimants' letter of November 5, 2008. It argued that certain communications exchanged between the parties during the period could not be viewed as "steps in the proceeding" under Article 51. According to the Respondent, Article 51 provides for an automatic discontinuance in these circumstances.

10. On November 10, 2008, the Claimants filed observations opposing the Respondent's request. They argued that discontinuance could only occur after due notice from ICSID and that, in any event, the parties' actions and communications in view of reaching an amicable resolution of the dispute following the registration of the Request must be considered as "steps." The Claimants further stated that a discontinuance would only serve to delay the

proceedings because it would result in the Claimants' immediate resubmission of the same request for arbitration.

11. The parties submitted a further round of observations on the Respondent's request for discontinuance on November 14 (Respondent) and 19 (Claimants). On December 10, 2008, the Acting Secretary-General rejected the request for discontinuance based on the principle *in dubio pro actione*, since it was not clear that the actions of the parties in the relevant period would all fail to qualify as "steps" for the purposes of Article 51, or that termination of the proceeding would automatically result from the parties' inaction, irrespective of any notice by the Centre. The Acting Secretary-General thus invited the parties to continue with the process of constituting the Tribunal pursuant to Article 1123 of the NAFTA.

12. On December 18, 2008, the Respondent appointed Professor Philippe Sands, a British and French national. On March 2, 2009, the parties jointly appointed Professor Hans van Houtte, a Belgian national, as the President of the Tribunal. The Tribunal was deemed to be constituted and the proceeding to have begun on March 9, 2009, in accordance with Article 13 of the Arbitration (Additional Facility) Rules. Mr. Marat Umerov, Counsel, ICSID, was designated as the Tribunal's Secretary and was later replaced by Ms. Martina Polasek, Senior Counsel, ICSID.

13. Pursuant to Article 21 of the Arbitration (Additional Facility) Rules, the Tribunal held its first session with the parties in New York on May 6, 2009. Among other matters, the parties agreed that the applicable arbitration rules would be the ICSID Arbitration (Additional Facility) Rules of April 2006, except to the extent that they were modified by Section B of NAFTA Chapter 11. The parties also agreed that the procedural language would be English, that hearings would be held in Washington D.C. and that the International Bar Association Rules on the Taking of Evidence (IBA Rules) would be taken into account to the extent that this may be useful. The parties further agreed on a tentative timetable for the proceeding and that the Tribunal could consider non-disputing party submissions in accordance with the recommendations of the NAFTA Trade Commission.

14. Following a proposal made by the parties, the Tribunal issued a Confidentiality Order at the first session for the protection of confidential information. The Order set out provisions

concerning the designation of confidential information which could only be used in the present arbitration proceedings and be disclosed solely to persons identified in the Order. It further provided for public hearings, but that, at the request of a party, the Tribunal would hold *in camera* sessions during a hearing to protect confidential information. If a party wished to disclose certain materials from the proceedings to the public, it could do so provided that it gave the other party thirty days notice so as to give it an opportunity to identify and redact confidential information from such materials.

15. The parties were unable to reach an agreement on the place of arbitration at the first session (Articles 19 and 20 of the Arbitration (Additional Facility) Rules, Article 1130 of the NAFTA). The Claimants proposed Washington, D.C., USA, while the Respondent proposed St. John's (Newfoundland and Labrador) or Ottawa (Ontario), Canada. If a place in Canada were to be selected, the Claimants proposed Toronto (Ontario). The parties made oral submissions on this issue at the first session and filed further written submissions following certain questions from the Tribunal.

16. In the meantime, on August 3, 2009, pursuant to the procedural timetable agreed by the parties, the Claimants filed their Memorial. The Memorial was accompanied by six witness statements by Andrew Ringvee, Cal Buchanan, Ed Graham, Paul Phelan, Rod Hutchings and Ted O'Keefe and three expert reports by Howard Rosen, Sarah A. Emerson and W. David Montgomery, as well as exhibits and legal authorities.

17. On October 6, 2009, the Respondent filed a request for production of documents. The parties filed several rounds of comments on the Respondent's request (the Claimants' submissions of October 28 and November 21, and the Respondent's submissions of October 29 and November 25, 2009).

18. On October 7, 2009, the Tribunal issued Procedural Order No. 1, designating Toronto as the place of arbitration. In reaching its decision, the Tribunal took into account a range of factors, including the neutrality of the courts, Article 22 of the UNCITRAL Notes, the proximity of evidence and the ability to obtain evidence, and various arbitration statutes. As the Claimants had requested that the Ontario Superior Court of Justice have exclusive jurisdiction if Toronto were selected, the Tribunal invited the parties to comment on the request. The

parties subsequently agreed that the Ontario Superior Court of Justice would be the exclusive court of the place of arbitration in which any and all applications concerning the arbitration would be filed. On November 5, 2009, the Tribunal issued Procedural Order No. 2 confirming the parties' agreement.

19. On November 30, 2009, the Tribunal issued a decision on the Respondent's request for production of documents, granting certain requests and denying others.

20. The Respondent filed its Counter-Memorial on December 1, 2009, including five witness statements by Ray Gosine, Charles Randell, Frank Smyth, Fred Way and John Fitzgerald, three expert reports by Peter A. Davis, Wade Locke and Richard E. Walck, as well as exhibits and legal authorities.

21. On March 15, 2010, the Claimants submitted a request for production of documents in the form of a Redfern Schedule which included the Respondent's comments. The Tribunal ruled on the Claimants' request in a decision of March 27, 2010.

22. The Claimants filed a Reply on April 8, 2010, including two supplementary witness statements by Paul Phelan and Andrew Ringvee, two supplementary expert reports by Sarah Emerson and Howard Rosen, as well as exhibits and authorities. By letter of April 30, 2010, the Respondent requested the Tribunal to order the Claimants to supplement their Reply with a quantification of damages. After hearing the Claimants' comments, the Tribunal decided that the Claimants were free to state the amount of their claim in due course, provided however that they used the method of evaluation of damages used in their submissions. Any new methodology would be viewed as new evidence and would only be admissible with the prior authorization of the Tribunal.

23. On May 24, 2010, the Tribunal issued a decision on production of documents concerning the second request made by the Respondent.

24. The Respondent filed a Rejoinder on June 9, 2010, including supplementary witness statements by Frank Smyth, Fred Way, John Fitzgerald and Ray Gosine, supplementary expert reports by Davies, Noreng and Walck, as well as exhibits and authorities.

25. In accordance with the timetable agreed upon at the first session of the Tribunal, the Governments of the USA and Mexico filed their respective written submissions under NAFTA Article 1128 on July 8, 2010, to which the Claimants and the Respondent submitted their respective replies simultaneously on September 1, 2010.

26. On August 6, 2010, the Claimants submitted their Updated Damages Calculations, to which the Respondent responded on September 8, 2010.

27. The Tribunal held the oral hearing on the merits in Washington D.C. from October 19 to October 22, 2010. In addition to the Tribunal and the Secretary, the following persons were present:

On behalf of the Claimants:
Mr. David W. Rivkin, Debevoise & Plimpton LLP
Ms. Sophie Lamb, Debevoise & Plimpton LLP
Ms. Jill van Berg, Debevoise & Plimpton LLP
Ms. Samantha Rowe, Debevoise & Plimpton LLP
Mr. Bart Legum, Salans
Ms. Toni Hennike, Exxon Mobil Corporation
Ms. Anna Taylor Knull, Exxon Mobil Corporation
Mr. Walter Compton, Murphy Oil Corporation
Mr. Nathan Baines, Exxon Mobil Canada Ltd.
Mr. Rene Mouledoux, Exxon Mobil Corporation
Mr. Paul Phelan, Witness
Mr. Andrew Ringvee, Witness
Ms. Sarah Emerson, Expert
Mr. Howard Rosen, Expert

On behalf of the Respondent:
Mr. Hugh Cheetham, Director and General Counsel, Department of Foreign Affairs and Trade, Trade Law Bureau
Mr. Nick Gallus, Counsel, Trade Law Bureau

Mr. Mark Luz, Counsel, Trade Law Bureau

Mr. Adam Douglas, Counsel, Trade Law Bureau

Mr. Pierre-Olivier Savoie, Trade Law Bureau

Mr. Gordon Voogd, Natural Resources Canada

Mr. Matthew Tone, Foreign Affairs and International Trade Canada

Ms. Margaret Gillies, Government of Newfoundland & Labrador

Mr. Paul Scott, Government of Newfoundland & Labrador

Mr. Peter A. Davies, Expert

Mr. Richard (Rory) E. Walck, Expert

Mr. Frank Smyth, Witness

Mr. Fred Way, Witness

Mr. John Fitzgerald, Witness

28. Representatives of the United States and Mexico were also present at the hearing. The hearing was open to the public, except for certain portions that the parties had designated as confidential, pursuant to the Tribunal's Order of May 6, 2009. The hearing was recorded and a verbatim transcript was made. At the end of the hearing, the Tribunal put certain questions to the parties, which were addressed during the closing arguments and subsequently in the parties' Post-Hearing Briefs.

29. After the hearing, by letter of October 26, 2010, the United Mexican States and the United States of America were invited to provide clarifications concerning their respective submissions made pursuant to NAFTA Article 1128.

30. By joint letter of November 5, 2010, the parties made certain proposals concerning a post-hearing calendar, which the Tribunal approved by letter of November 9, 2010, and in which it also ruled on certain disagreements between the parties. Accordingly, the parties filed their first Post-Hearing Briefs simultaneously on December 3, 2010, addressing the other party's closing arguments made at the hearing, and the Tribunal's questions handed to the parties during the hearing. Following an objection from the Respondent concerning the length of the Claimants' Post-Hearing Brief and the number of new accompanying legal authorities, the Tribunal granted an extension until January 31, 2011 for the parties to file their Reply Post-

Hearing Briefs, directing the parties to select a maximum of six authorities relied upon in regard to a question posed by the Tribunal. The Claimants submitted their list of selected authorities on December 23, 2010, and an amended Post-Hearing Brief which discussed only those authorities on January 7, 2011. Pursuant to the Tribunal's directions, the parties submitted their Reply Post-Hearing Briefs on January 31, 2011.

31. On invitation by the Tribunal, the United States and Mexico filed clarifications to their first NAFTA Article 1128 submissions on January 21, 2011. The parties submitted their responses to these submissions on February 7, 2011. Following objections by the Respondent that the Claimants had addressed questions, in their February 7 response, that went beyond the Tribunal's directions, on February 18, 2011, the Tribunal ruled that Part III of the Claimants' response would not be considered as part of the record.

32. By a letter dated June 23, 2011, the Tribunal posed questions to the parties as to the meaning of the words "the measure" in NAFTA Annex I, paragraph 2(f)(ii). The Claimants responded on July 29, 2011, followed by the Respondent on August 2, 2011. Both parties replied to the other's responses on August 26, 2011. The non-disputing NAFTA Parties were also invited to state their position but declined to do so.

33. Each party filed a statement of costs on November 9, 2011.

III. FACTUAL BACKGROUND

34. This section provides a background to the parties' dispute, the underlying facts of which are for the most part undisputed. It describes the regulatory framework governing research and development ("R&D") and education and training ("E&T") expenditures of petroleum operators in the Province of Newfoundland and Labrador ("NL" or "Province") (A); the Hibernia and Terra Nova projects (B); and how the regulatory framework was applied to the projects (C), including the events leading up to this arbitration.

A. THE REGULATORY FRAMEWORK

1. The Accord Acts

35. The conduct of petroleum projects in the NL offshore area is governed by parallel Federal and Provincial legislation: the Canada-Newfoundland Atlantic Accord Implementation Act, 1987, c. 3[2] (the "Federal Accord Act") and the Canada-Newfoundland and Labrador Atlantic Accord Implementation Newfoundland and Labrador Act, R.S.N.L. 1990, c. C-2[3]. (the "Provincial Accord Act"). The Federal Accord Act and the Provincial Accord Act are collectively known as the "Accord Acts." The Accord Acts implement the Canada-Newfoundland Atlantic Accord, an agreement between the Federal Government of Canada and the Province of NL concerning the joint regulation of the offshore petroleum sector (the "Atlantic Accord").[4] The main purpose is to provide a legal regime for resource management, and revenue sharing to promote economic growth and development in NL, in particular, and Canada as a whole.

(a) The Board

36. The Accord Acts established the Canada-Newfoundland Offshore Petroleum Board[5] (the "Board"), which regulates oil development projects in NL. Operators of offshore oil projects

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2 CA-11.

3 CA-12.

4 CA-10.

5 Accord Acts, s. 9.

wishing to exploit a field in the area must submit proposals which are subject to approval by the Board. The proposals consist of a Development Plan concerning the general approach of developing an oil field and a Benefits Plan explaining the process by which benefits would accrue to NL and Canada. The Board also approves the extraction of oil for specific periods of time through the granting of a Production Operations Authorization ("POA"). A POA may be conditioned on requirements set by the Board and can be suspended or revoked if an operator fails to comply with any condition on which it was granted.[6]

(b) Benefits Plans

37. Section 45 of the Accord Acts entitled "Canada-Newfoundland Benefits Plan" provides as follows:

> (1) In this section, "Canada-Newfoundland benefits plan" means a plan for the employment of Canadians and, in particular, members of the labour force of the Province and, subject to paragraph (3)(*d*), for providing manufacturers, consultants, contractors and service companies in the Province and other parts of Canada with a full and fair opportunity to participate on a competitive basis in the supply of goods and services used in any proposed work or activity referred to in the benefits plan.
>
> (2) Before the Board may approve any development plan pursuant to subsection 139(4) or authorize any work or activity under paragraph 138(1)(*b*), a Canada-Newfoundland benefits plan shall be submitted to and approved by the Board, unless the Board directs that that requirement need not be complied with.
>
> (3) A Canada-Newfoundland benefits plan shall contain provisions intended to ensure that

[6] Federal Accord Act, s. 138(5); Provincial Accord Act, s. 134(5).

before carrying out any work or activity in the offshore area, the corporation or other body submitting the plan shall establish in the Province an office where appropriate levels of decision-making are to take place;

consistent with the Canadian Charter of Rights and Freedoms, individuals resident in the Province shall be given first consideration for training and employment in the work program for which the plan was submitted and any collective agreement entered into by the corporation or other body submitting the plan and an organization of employees respecting terms and conditions of employment in the offshore area shall contain provisions consistent with this paragraph;

expenditures shall be made for research and development to be carried out in the Province and for education and training to be provided in the Province; and

first consideration shall be given to services provided from within the Province and to goods manufactured in the Province, where those services and goods are competitive in terms of fair market price, quality and delivery.

(5) The Board may require that any Canada-Newfoundland benefits plan include provisions to ensure that disadvantaged individuals or groups have access to training and employment opportunities and to enable such individuals or groups or corporations owned or cooperatives operated by them to participate in the supply of goods and services used in any proposed work or activity referred to in the benefits plan.

(6) In reviewing any Canada-Newfoundland benefits plan, the Board shall consult with both Ministers on the extent to which the plan meets the requirements set out in subsections (1), (3) and (4).

CA326-020

(7) Subject to any directives issued under subsection 42(1), the Board may approve any Canada-Newfoundland benefits plan."

38. Section 151.1 of the Federal Accord Act, dealing with Regulation of Operations, provides as follows:

(1) The Board may issue and publish, in such manner as the Board deems appropriate, guidelines and interpretation notes with respect to the application and administration of Sections 45, 138 and 139 or any regulations made under Section 149.

(2) Guidelines and interpretation notes issued pursuant to subsection (1) shall be deemed not to be statutory instruments for the purposes of the *Statutory Instruments Act*."

39. As per Section 45.3, a Benefits Plan must contain a proposal for R&D and E&T expenditures to be carried out in NL by the project proponent. Under the Atlantic Accord the expenditures must be approved by the Board.[7] The Accord Acts themselves do not specify any fixed amount or percentage of revenue to be spent on R&D and E&T under the Benefits Plan.

(c) Guidelines

40. The Accord Acts authorize the Board to adopt guidelines with respect to the application and administration of the Benefits Plan requirements.[8]

(i) 1986 Guidelines

41. The Board adopted the first set of Benefits Plan guidelines, the *Guidelines for Benefits Plan Approval and Reporting Requirements for Exploration Activities in the Newfoundland Offshore Area,* in 1986 (the "1986 Guidelines").[9] The 1986 Guidelines stated that Benefits Plans must include "proposed expenditures and activities on research and development [and

[7] CA-10, s. 55.

[8] Federal Act, s. 151.1, Provincial Act, s.147.

[9] CE-32.

education and training] to be carried out within the Province."[10] Annual reports were also required to that effect. The 1986 Guidelines also stated that further "[g]uidelines for expenditure amounts, etc. [would] be developed by the Board."[11]

(ii) 1987 Guidelines

42. In 1987, the Board issued the *Exploration Benefits Plan Guidelines: Newfoundland Offshore Area* (the "1987 Guidelines"). [12] The 1987 Guidelines applied only to the exploration phase of the projects and did not apply to the development and production phases. They provided at s. 3.5:

> "Section 45(3)(c) of the legislation requires that a Benefits Plan contain provisions intended to ensure expenditures are made for research and development and education and training in the Province. The company is expected to outline its plans in this regard by describing its program and identifying the expenditure amounts."

43. The 1987 Guidelines also provided that

> "[w]hen preparing a Benefits Plan, a company should state its intentions concerning…utilization of Newfoundland and other Canadian firms and institutions to undertake research and development" and "assistance to…private and public training institutions in identifying and developing suitable pre-employment training programs."[13]

The 1987 Guidelines further stated that they "may be revised from time to time following consultation with the industry."[14] These guidelines were updated in 2006.

(iii) 1988 Guidelines

44. In 1988, the Board issued the *Development Application Guidelines: Newfoundland Offshore Area* (the "1988 Guidelines").[15] Despite the title, these guidelines did not specifically address

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[10] 1986 Guidelines, ss. 4.0, 4.2.3.

[11] 1986 Guidelines, s. 3.5

[12] CE-33.

[13] 1987 Guidelines, s. 2.2.

[14] 1987 Guidelines, s. 1.0

the development and production phases of a project. They did, however, provide guidance with respect to the preparation of a Benefits Plan. The 1988 Guidelines provided that project proponents were expected to describe "specific education and training programs, including associated expenditures," and their plans concerning the "utilization of Newfoundland and other Canadian firms and institutions to undertake offshore–related research and development; and proposed research and development projects, and associated expenditures to be carried out in the Province pursuant to Sections 45(3)(c) of the Acts."[16] The 1988 Guidelines further stated that "[i]t is the Board's intention to…require submission, by the proponent, of project expenditure and employment reports on a regular basis. Details of the Board's monitoring and reporting requirements will be established in consultation with the proponent after submission of the Benefits Plan."[17]

(iv) 2004 Guidelines

45. In November 2004, the Board issued the guidelines which gave rise to the dispute that is the subject of this arbitration, the *Guidelines for Research and Development Expenditures* (the "2004 Guidelines,").[18] The 2004 Guidelines state in relevant part:

> "2.0 Required Expenditure Commitments
>
> R&D expenditures in the development phase of projects tend to focus primarily on education & training activities, whereas it is expected that in the production phase there will tend to be more focus on research & development activities. Both will be legitimate and eligible expenditures in either phase of a project. Further an operator, or group of operators, may propose an R&D program in lieu of the requirement of the guidelines. The acceptability of such a proposal will be assessed by the Board.
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> 2.1 Exploration Phase

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[15] RE-9.

[16] 1988 Guidelines, ss. 5.2.4 and 5.2.5

[17] 1988 Guidelines, s. 5.5.2

[18] CE-1.

From 2003 on, during the exploration phase, R&D expenditures up to a maximum of 5 percent of the expenditure bid will be allowed.

2.2 Development Phase and Production Phase

In the absence of experience on which to base a benchmark for such expenditures, the C-NOPB examined the levels of such expenditures by petroleum companies in Canada. These data (Statistics Canada, Catalogue No. 88-202-X1B) reveal that R&D expenditure by oil and gas extracting companies in Canada averaged about 0.6 percent of revenue between 1995 and 2000.

Establishing a benchmark (B) based on industry practice in Canada seems to be a reasonable approach and the Board will apply the most recent five-year data reported by Statistics Canada. The Total R&D expenditure (TRr&d) during the development and production phase will be determined by the Statistics Canada benchmark for oil and gas extraction companies, total recoverable oil (RO) as defined by the approved Development Plan and the long term oil price (LTOP) as follows:

TRr&d = B x (RO x LTOP)

A similar calculation will apply to the production of Natural Gas Liquids and Natural Gas.

2.2.1 Development Phase

Experience to date has been that R&D expenditures during the development phase of a project have amounted to approximately 0.5 percent of total project capital cost (C). The C-NOPB accepts this as a reasonable R&D expenditure level for the development phase of a project. The development phase R&D expenditure (DPr&d) will be calculated as follows:

DPr&d = 0.005 x C

2.2.2 Production Phase

The production phase R&D expenditure requirement will be calculated for each project for the period covered by each Productions Operations Authorization (POA) issued by the Board.

The production phase R&D expenditure requirement (PPr&d) will be calculated as the difference between the Total Requirement (TRr&d) and the development phase requirement (DPr&d), as follows:

PPr&d = TRr&d – DPr&d

The production phase expenditure requirement will be distributed over each POA period during the production life of the project in proportion to production. In other words the requirement for each POA period will be the same proportion of the production phase R&D expenditure requirement as production in that POA period is of total anticipated project production.

At the end of each POA period, there will be a re-calculation based on actual production levels and prices.

[…]

4.2 Expenditure Management

A successful R&D program should not fluctuate widely. Therefore, for any POA period in which there are not sufficient projects to absorb the required level of expenditure, the balance may be placed in a R&D fund. The fund will be managed by the Board in conjunction with the operator consistent with these guidelines. In a POA period where an operator overspends its R&D requirement, the excess may be applied against its requirement in the subsequent POA period.”

46. The 2004 Guidelines were the first set of guidelines to directly address R&D expenditure at the production phase of a petroleum project and were the first set of guidelines to require fixed amounts of expenditures to be made. The rationale behind the 2004 Guidelines, as presented by CNLOPB, was to ensure effective administration of Section 45 of the Accord Acts so that the exploitation of offshore petroleum created a lasting economic legacy for the people of the Province of NL.[19] This, according to the 2004 Guidelines, was best achieved by building on the intellectual capital and human resources of the Province.

47. As indicated above, the required amount of R&D expenditures for a specific period is determined on the basis of a benchmark derived from Statistics Canada reports on R&D spending by oil and gas companies in Canada. Statistics Canada relies on the oil and gas companies' responses to its survey rather than data obtained directly from the Canada Revenue Agency ("CRA"). The Board calculates the benchmark using the most recent five-year average of R&D expenditures.

B. THE HIBERNIA AND TERRA NOVA PROJECTS

1. <u>Hibernia</u>

(a) The Oilfield

48. Hibernia is the first and largest offshore oil project in NL. The oilfield was discovered in 1979. It is located in the North Atlantic Ocean, 315 kilometers east-southeast of St. John's, Newfoundland. The project was constructed from 1990 to 1997. The gross capital investment in the construction of the facility was approximately $5.8 billion.

49. Oil production at the facility began in November 1997. As of June 30, 2009, approximately 642 million barrels had been produced. At peak production, in 2005, about 200,000 barrels were produced per day. Since 2005, production has been in decline and averages about 140,000 barrels per day. Production is expected to continue through 2036. Hibernia's

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[19] CE-127, Presentation by CNLOPB to HMDC, Draft Guidelines for Research and Development Expenditures (Jul. 24, 2003).

revenues between 2004 and 2008 were $19.3 billion, while projected revenues between 2009 and 2036 [redacted]

50. Certain portions of the oilfield have not yet been developed and are not subject to this arbitration.

51. The Hibernia project is owned by a consortium of working interest holders, including the Claimants. Mobil Canada controls the largest participation interest in Hibernia at 33.125%, while Murphy Oil controls 6.5%. In 1988, HMDC was established to manage and operate the project on behalf of the interest owners.

(b) The Benefits Plan

52. In September 1985, the Hibernia project participants submitted a Development Plan and a Benefits Plan for the Board's approval.[20] The Benefits Plan included a section on R&D:

> "Mobil promotes local and Canadian research and development by entrepreneurs and institutions who are of our technical problems and who have the interest and resources to develop commercial applications.
> Potential areas for research and development activity include the following:
>
> - Iceberg management – developing better methods to track icebergs and attach towing apparatus in adverse weather
> - Iceberg detection – further development of advanced remote sensing systems
> - Remote valve actuation – further development of sonar methods of actuating subsea valves
> - Quality assurance – developing inspection techniques for items such as subsea flowline bundles to provide greater assurance of operation without failure

[20] CE-45, Hiberia Benefits Plan.

- Remote component replacement – extending existing submarine manipulator technology to enable remote replacement of manifold and wellhead components

- Sonic transmission of bottom hole pressure information to the sea surface."[21]

53. In December 1985, the Hibernia Environmental Assessment Panel submitted a report recommending that the Hibernia operators undertake R&D in specific areas including: "Research and development to improve the ability to detect and manage ice under adverse weather conditions" and research to develop "effective countermeasures" to offshore oil spills.[22] The Panel also recommended that the implementation of the operators' plan to provide local benefits, including R&D and E&T expenditures, should be closely monitored.

54. Upon the Board's request, a Supplementary Benefits Plan was submitted to the Board. The Supplementary Benefits Plan contained a commitment to:

> "[c]ontinue to support local research institutions and promote further research and development in Canada to solve problems unique to the Canadian offshore environment."[23] It further provided that the project operators would "[c]arry out a program of timely reporting to the [Board] to enable the Board to monitor the level of efforts and benefits achieved and to assist in promoting maximum benefits […]."[24]

55. The Board approved the Hibernia Benefits Plan ("HBP") in June 1986, incorporating the Supplementary Plan. In its decision approving that plan, the Board stated:

> "It was the decision of the Board that the most effective approach would be to encourage the commitment of the Proponent to a series of basic principles. The implementation of these basic principles would, in the

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[21] *Id.*, para. 3.5.4.

[22] RE-6, Report of the Environmental Assessment Panel, Hibernia Development Project (Dec. 1985), pp. 46-7.

[23] CE-46, Supplementary Benefits Plan, p. 7.

[24] *Id.*, p. 4.

> Board's opinion, be more effective than attempting to negotiate specific requirements for the multitude of elements of which the project will consist."[25]

It also stated that "effective monitoring and reporting will be necessary to ensure that the Benefits Plan objectives are accomplished during the execution of the project"[26] and provided that:

> "The development and implementation of a Benefits Plan is, because of the nature of the subject matter, an evolutionary process. The Board has found the Proponent willing to amend its positions to comply with regulatory requirements and to respond positively to issues of concern. It is the Board's expectation that the Proponent's demonstrated responsiveness in the area of benefits will continue through the duration of the project." [27]

56. The Hibernia development plan (which is not in dispute) was updated and re-approved by the Board six times between its approval and 2003, but the approved Benefits Plan was not amended. It did not contain specific targets or amounts to be spent on local R&D or E&T, nor did the Board impose additional conditions with respect to R&D or E&T when it issued POAs for Hibernia in 1997 and 2000.

(c) R&D Expenditures and Reporting to the Board

57. HBP reporting began in 1990, when construction commenced. During the development phase, HMDC submitted monthly reports on various benefits commitments. However, the reports did not contain information on R&D expenditures. Starting in 1998, after the Hibernia project had moved into the production phase, HMDC began submitting annual benefits reports summarizing benefits expenditures in the prior year, including R&D. Regarding R&D, annual reports have provided a breakdown by research area of cumulative

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[25] CE-47, Board Decision 86.01, para. 2.1.

[26] *Id.*, para. 2.5.

[27] *Id.*, para. 2.1.

expenditures since 1990, and have typically quantified total expenditures in the Province in the prior year. The annual reports have also furnished an R&D expenditures estimate, likely to be incurred in the current year, and have indicated the total expenditures percentage incurred from 1997 onward.[28]

58. HMDC has relied exclusively on data collected in connection with Canada's Scientific Research and Experimental Development ("SR&ED") tax incentive program for its R&D reporting. Pursuant to the SR&ED program, businesses subject to taxation in Canada may earn tax credits for R&D undertaken in the country that will lead to new, improved, or technologically advanced products or processes. To qualify for SR&ED credit, "work must advance the understanding of scientific relations or technologies, address scientific or technological uncertainty, and incorporate a systematic investigation by qualified personnel."[29]

59. In 1986, 1988 and 1989, the Board issued letters acknowledging receipt of annual benefits reports and confirming that they "fully [met] the requirements outlined in the Board's Exploration Benefits Plan Guidelines."[30]

60. From 1990, when the development phase commenced for Hibernia, through 2008, HMDC reported R&D expenditures over $226 millio Hibernia R&D and E&T expenditures decreased significantly from 1997 to 2001. In 1997, the reported R&D expenditure was in 1998 in 1999 and in 2000 During the first five years of the 2004 Guidelines, Hibernia's

[28] CE-70-CE-80, Hibernia Benefits Reports, 1998-2008.

[29] CE-142, Canada Revenue Agency, What is the SR&ED Program; CA-14, Income Tax Act, 1985, c. 1 (5th Supp.), § 248(1) (Can.).

[30] CE-64, Letter from T. O'Keefe, CNLOPB, to W. Abel, Mobil Oil Canada (May 5, 1998).

[31] CE-74 - CE-75, Hibernia 2002/2003 Benefits Reports: R&D annual expenditures (in CDN$, millions) from 2001 to 2003 were, respectively. CE-70 - CE-80, Hibernia 1998-2008 Benefits Reports: E&T annual expenditures (in CDN$, millions) from 1998 to 2008, were, respectively,

R&D expenditure was [redacted] in 2004, [redacted] in 2005, [redacted] in 2006, [redacted] in 2007, and [redacted] in 2008.[32] Examples of R&D and E&T spending included: sponsorship of an Industrial Research Chair in Ocean Engineering at Memorial University of Newfoundland ("MUN"), sponsorship of the furnishing of a classroom for the MUN Centre of Management Development, and a donation to the general trust fund of the Center for Cold Ocean Research (C-CORE).

61. Over the next five to ten years, the Claimants estimate the R&D needs of the Hibernia projects to be consistent with the usual needs of offshore projects with aging facilities and declining production. R&D may include new or improved technologies to increase oil recovery from the reservoir and enhanced systems to monitor and assess the integrity of project infrastructure. In addition, Hibernia has a large secondary reservoir known as the Ben Nevis Avalon ("BNA") that is largely undeveloped due to its technical complexity and associated economic risk. New technologies will likely be required to economically develop the BNA.[33]

2. Terra Nova

(a) The Oilfield

62. The Terra Nova field was discovered in 1984. It is located in the North Atlantic Ocean, 350 kilometers east-southeast of St. John's, Newfoundland, and 33 kilometers from Hibernia. The project was constructed from 1999 until 2001. The gross capital investment in the construction of the facility was approximately $2.985 billion.

63. Oil production from the field began in January 2002. As of June 30, 2009, approximately 275 million barrels of oil had been produced. Peak production occurred in 2007, when the facility produced approximately 100,000 barrels per day. Production is now in decline and averages less than 100,000 barrels per day. Production is expected to continue through 2018. Terra Nova's revenues between 2004 and 2008 were $10.7 billion, while projected revenues between 2009 and 2018 are [redacted]

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[32] CE-177, Letter from P. Phelan, HMDC, to J. Bugden, CNLOPB (November 12, 2009).

[33] Cl. Mem., para. 94.

64. The Terra Nova project is organized as an unincorporated joint venture. The largest shareholder, Petro-Canada, which owned a 33.99% interest, managed and operated the project for a consortium of working interest owners, including the Claimants. In 2009, Petro-Canada merged with Suncor, who is now the operator. Mobil Canada controls a 22% interest in Terra Nova, while Murphy Oil controls 12%.[34]

(b) The Benefits Plan

65. In February 1995, prior to submitting a Benefits Plan to the Board, Petro-Canada met with the Board. At the meeting, Petro-Canada asked how the Board intended to apply the provisions of the Accord Acts relating to R&D. In response, the Board encouraged Petro-Canada to "enunciate its policies and procedures which would provide for expenditures on R&D and E&T in Newfoundland" and "to describe, in the Benefits Plan, the nature and current level of support to R&D in the Province (eg. C-CORE) and, to the extent possible, its future plans in this regard."[35] Further, "Petro-Canada indicated that should there be any benefits undertakings agreed to with the Governments beyond the statutory requirements, they would be contained, if possible, in their Benefits Plan."[36] The minutes also recorded that

> "the Petro-Canada officials seemed to be well informed of the requirements of the Atlantic Accord Acts and the [1987] Guidelines. To a large extent, they see the benefits requirements to be 'process' oriented rather than related to prescribed targets and outcomes. Nevertheless, the need for an assessment of the outcomes in terms of the potential level and nature of benefits to Canada and, in particular, to Newfoundland seemed to be understood."[37]

66. The Terra Nova Benefits Plan ("TNBP") was submitted to the Board in 1996. It provided that "[t]o ensure benefits are flowing effectively to Newfoundland and other regions of Canada, the Proponents will work with the [Board] to effect efficient monitoring of the Proponents'

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[34] *See supra*, fn. 1.

[35] CE-55, Meeting Minutes (February 13, 1995), p. 2.

[36] *Id.*

[37] *Id.*

performance relative to their commitments to this benefits plan."[38] The Plan included a commitment to spend money on local R&D, but did not specify amounts. The Plan also stated that the "Operator will report to the [Board] yearly … [a] summary of R&D expenditures reported by program and total expenditure…"[39]

67. The TNBP was reviewed by an Environmental Assessment Panel, which recommended:

> "that the Board require operators of offshore oil projects to fund basic research. This initiative should include support of the Department of Fisheries and Oceans to conduct basic research on the mechanisms and processes by which chemicals in produced water may have impacts on the biological community. Also, support for research on cumulative and sub-lethal effects should be included."[40]

68. Following the assessment by the Environmental Panel, the Board assessed the Benefits Plan submitted by the Terra Nova participants and approved it by a decision issued in December 1997.[41] In its Decision, the Board reiterated the statement made in the decision approving the HBP that "[a]ny benefits plan is, in large measure, a commitment to principles." It then cited the two fundamental principles embodied in the Accord Acts—full and fair opportunity to Canadians and first consideration to Newfoundlanders—and found that the Benefits Plan as presented addressed those principles.[42] The Board also stated that:

> "[t]he Board believes the Proponent will undertake significant training and research in the Province and that it understands the education and training capabilities available with the Province. The Board will require regular forecasting and reporting of education and training and research and development initiatives and expenditures.

38 RE-12, Terra Nova Benefits Plan, para. 9.2.

39 *Id.*

40 RE-14, Report of the Terra Nova Project Environmental Assessment Panel (August, 1997), p. 50.

41 CE-57, Board Decision 97.02.

42 *Id.*, para. 1.2.

> The Board believes the Proponents commitments in the Benefits Plan will be fulfilled. However, the Board also has an obligation as the regulator to ensure that the Proponents commitments are met. Accordingly, it will develop, in consultation with the Proponent, reporting mechanisms for the timely review of contracts and appropriate reporting formats for tracking employment and expenditures. The Board will conduct periodic audits to confirm the accuracy of the reports." [43]

69. The Board went on to endorse the Environmental Panel's recommendation that the operators fund basic research and stated that the TNBP "does not fully satisfy the statutory requirement that the Benefits Plan contain provisions intended to ensure that expenditures are made on [R&D] and [E&T] in the Province."[44] The Board further placed the following requirements on the operators of the Terra Nova project:

> "The Board appreciates the difficulty in providing, in advance, detailed [R&D] and [E&T] plans for the entire duration of the Development and, therefore, to provide a framework for monitoring the Proponent's activities in this regard, establishing a condition to its approval of the Benefits Plan that:
>
> > The Proponent report to the Board by March 31 of each year, commencing in 1998, its plans for the conduct of [R&D] and [E&T] in the Province, including its expenditure estimates, for a three-year period and on its actual expenditures for the preceding."[45]

In addition, the Board stated:

> "The Proponent's commitments vis-à-vis its future support of such [R&D] activities are at best qualified, particularly inasmuch as there is no measure of the level of effort the Proponent intends to make in

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[43] *Id.*

[44] *Id.*, para. 3.5.3.

[45] *Id.*

this regard (e.g. there are no expenditure estimates provided in the Benefits Plan). While the relevant provisions of the Accord Acts do not prescribe levels of expenditure, the Acts require that the Benefits Plan contain provisions intended to ensure that expenditures are made on [R&D] in the Province."[46]

70. The Terra Nova Development Plan was amended twice, however, the Benefits Plan was not.[47]

(c) R&D Expenditures and Reporting to the Board

71. Terra Nova benefits reporting began in 1999. At the beginning of each calendar year, Petro-Canada has submitted a report summarizing benefits expenditures in the prior year. With regard to R&D, the reports have quantified total expenditures in the prior year and provided an estimate of R&D expenditures likely to be incurred in the next three-year period. Terra Nova has similarly based its reporting on the SR&ED tax credits program.

72. With respect to their reporting obligation, in the March 1999 R&D Report, for example, the Terra Nova Proponents reported that they "will continue to support technically worthy research and development activities and programs in the province where the results of such activities and programs have application to the Terra Nova Development and/or to the development of an offshore oil industry in the province." Similarly in the 1999 E&T Report, the Terra Nova Proponents stated that

> "[i]n addition to implementing training initiatives aimed at meeting the specific training requirements of the development, the Proponents also continue to work actively…in various areas related to the furthering of opportunities for the establishment of offshore related skills in the province."[48]

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[46] *Id.*, para. 3.5.1.

[47] CE-58, Board Decision 2002.01, p. 2; CE-59, Baord Decision 2005.03, p. 11.

[48] CE-84, 1999 Terra Nova E&T Benefits Report, p. 3.

73. In February 1999, the Board wrote to Petro-Canada to "express a measure of concern" with respect to an R&D project involving large holes drilled in the sea-bed called glory holes. The Board stated:

> "This [glory holes research] is a legitimate research and development target for operators in the Newfoundland offshore area, as evidenced by failure of 1998 efforts to excavate the glory holes. Section 45(3)(c) of the Atlantic Accord legislation specifically requires that expenditures for research and development be carried out in the province."[49]

74. The Terra Nova participants spent approximately $24 million on R&D for the project as of August 2009. However, the R&D expenditures were decreasing between 1997 and 2001. According to Terra Nova's 2000 Benefits Report, the R&D expenditures were at [redacted] in 1997, [redacted] in 1998, [redacted] in 1999, and [redacted] in 2000.[50] Between 1998 and 2000, the Terra Nova participants spent approximately $12 million on E&T.[51] The Terra Nova participants made investments in technology directly applicable to the design of its own project, as well as funding for the establishment of a junior research chair in Ocean Environmental Risk Engineering at MUN, and funding for the MUN Chair for Women in Science in Engineering. The 2001 report projected [redacted] as the average annual expenditures for R&D and E&T until the end of 2004.

75. Over the next five to ten years, the R&D needs of the Terra Nova project are, according to the Claimants, expected to be consistent with the usual needs of offshore projects with aging facilities and declining production. R&D may include new or improved technologies to increase oil recovery from the reservoir and enhanced systems to monitor and assess the integrity of project infrastructure. Petro-Canada, as operator, is planning to undertake research in the Province related to ship side valve isolation tooling. Petro-Canada may have additional R&D projects in mind, of which Claimants state they are not aware.

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[49] RE-18, Letter from H. Stanley, CNOPB, to G. Bruce, Petro-Canada (February 3, 1999).

[50] CE-87, Terra Nova 2000 R&D Report. *See also* CE-96 – CE-97, Terra Nova 2007/2008 Benefits Reports: R&D annual expenditures (in CDN$, millions) from 2001 to 2007 were, respectively, [redacted]

[51] *See* CE-96 – CE-97: E&T annual expenditures (in CDN$, millions) from 1998 to 2007, were, respectively, [redacted]

C. THE 2004 GUIDELINES: THE CIRCUMSTANCES OF THEIR ADOPTION AND THEIR APPLICATION TO HIBERNIA AND TERRA NOVA

76. In 2001, the Board began drafting a new set of R&D expenditure guidelines. This came as a result of both the decreasing expenditures on R&D and E&T by the operators, and a report by a Public Review Commissioner issued in the context of its review of a third project in NL called White Rose. The Commissioner recommended that the Board

> "release publically a definitive statement as to how the Board intends to interpret the Atlantic Accord and the Accord Acts, and how the Board will implement or administer it [sic] benefits responsibilities, including requirements for, and evaluation of, the Benefits Plans."[52]

In its Decision regarding White Rose, the Board imposed a minimum amount for R&D and E&T spending for the first time.[53]

77. In 2002, in view of developing guidelines on R&D and E&T expenditures consistent with the Accord Acts, the Board commissioned a report on industry R&D expenditures and examined reports by Statistics Canada on average R&D expenditures by oil companies in Canada. The Board produced draft guidelines in August 2002 and revised them in July 2003, at which time the draft was presented to the Claimants.

78. In May 2004, the Board met with HMDC to discuss the proposed guidelines. At this meeting, HMDC proposed that the guidelines should only require operators to conduct R&D and E&T that is necessary for the project.[54] The Board rejected this proposal.[55] The Board indicated that it was open to considering alternate approaches to the benchmark but that it was not prepared to revert to a regime lacking quantifiable targets.[56] These parameters were

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52 RE-22, White Rose Decision 2001.01, p. 151.

53 *Id.*, p. 31.

54 CE-136, Memo from J. MacDonald to CNLOPB/Industry Representatives (May 26, 2004).

55 CE-137, Meeting Minutes, CNLOPB/Industry Representatives (June 3, 2004).

56 *Id.*

unacceptable to the project operators, and therefore the project operators did not recommend an alternate approach.[57]

79. The Board then agreed to postpone the implementation of the 2004 Guidelines, while the operators sought an alternative solution on the understanding that if no alternative were found, the Guidelines would apply as from the previous April.

80. In July 2004, the Board met again with the operators and encouraged them to provide an alternative proposal to the Guidelines in writing. No proposal was provided before the Board released the 2004 Guidelines on November 5, 2004. The 2004 Guidelines specified that they were in effect as from April 2004.

81. Shortly after the 2004 Guidelines were issued, the POA for Terra Nova was up for renewal. Petro-Canada, as project operator, had submitted an application for a new POA on July 14, 2004, before issuance of the 2004 Guidelines, but the Board extended the deadline for renewal of the POA until January 29, 2005. On January 27, 2005, the Board granted the application subject to a set of appended conditions. Condition 15 read:

> "The Operator shall comply with the *Guidelines for Research and Development Expenditures* as issued by the Board November 5, 2004 and with effect from April 1, 2004."[58]

Petro-Canada did not countersign the conditions. A project operator has no choice but to accept conditions imposed unilaterally by the Board in a POA and cannot continue production without a valid POA.

82. On February 18, 2005, the Board issued letters to the project operators regarding their R&D commitments under the 2004 Guidelines, from the effective date of April 1, 2004 through the end of 2004 (January 26, 2005 in the case of Terra Nova). The Board assessed HMDC's commitments for those nine months at $9.16 million, and Petro-Canada's commitments at $5.31 million.

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[57] CE-41, Letter from F. Way, CNLOPB, to J. Taylor, HMDC (November 5, 2004), at EMM0000466.

[58] CE-107, Terra Nova Production Operations Authorization (January 27, 2005 – March 31, 2008).

83. In a separate letter on March 3, 2005, the Board indicated that it would not seek to enforce compliance with the 2004 Guidelines while a court proceeding by the operators, challenging the legality of the 2004 Guidelines under Canadian law, was pending. The Board stated that the calculated amounts were mandatory and would be enforced if the Guidelines were upheld under Canadian law.

84. On October 25, 2005, HMDC submitted an application for a new POA. At the Board's insistence, the application included the same condition appended to the Terra Nova authorization: "The Operator shall comply with the *Guidelines for Research and Development Expenditures* as issued by the Board November 5, 2004 and with effect from April 1, 2004."[59] Along with the application, HMDC submitted a protest letter in which it indicated that it was "signing and submitting the Application prescribed by the Board, subject to (…) objections." Among the objections noted was HMDC's view that the Board lacked authority to impose the Guidelines. HMDC also annotated the application form supplied by the Board to indicate that the application was subject not only to the Board's condition, but also to the objections stated in the protest letter. On October 28, 2005, the Board responded, indicating that it would not accept the application as qualified and HMDC resubmitted its POA application without qualification on October 31, 2005. HMDC asked that a copy of its letter of October 25, 2005 and a copy of the Board's letter of October 28, 2005 be filed and attached to the POA for informational purposes to record the respective positions of HMDC and the Board. The Board issued a new POA for Hibernia on November 1, 2005, effective until October 29, 2008, and attached the letters as requested. That POA was twice extended as of October 30, 2009.

85. On February 4, 2005, HMDC and Petro-Canada challenged the 2004 Guidelines in the Trial Division and the Court of Appeal of the Supreme Court of Newfoundland and Labrador.

86. On January 22, 2007, the Trial Division held that the Board possessed the legal authority under the Accord Acts to issue the 2004 Guidelines, and that the Board could condition the issuance of the POA upon compliance with the 2004 Guidelines. On September 4, 2008, the

[59] CE-100, Hibernia POA Application (October 25, 2005), Condition 7.

Court of Appeal upheld the ruling of the lower Court. In particular, the Court of Appeal held, in a majority decision of two to one, that

> "application of the Guidelines to the Hibernia and Terra Nova Projects does not involve an amendment to the benefits plans. Rather, the Guidelines set parameters consistent with the Board's responsibility to monitor expenditures for research and development required under the benefits plans."[60]

This conclusion was predicated on the finding of the Court that

> "the Board (…) reserved for itself authority to determine on a continuing basis by its monitoring process whether the companies were making adequate expenditures on research and development."[61]

On February 19, 2009, leave to appeal the decision of the Court of Appeal was rejected by the Supreme Court of Canada. The Claimants have therefore exhausted all possibilities to appeal these decisions in Canada.

87. As the proceedings before the Canadian Courts were pending, on November 1, 2007, the Claimants filed their Request for Arbitration with ICSID.

88. On February 26, 2009 and March 3, 2009, the Board issued letters to HMDC and Petro-Canada, respectively, advising them of their expenditure requirements under the 2004 Guidelines from the effective date of April 1, 2004 through December 31, 2008. The Board assessed HMDC's obligation at $66.52 million, and Petro-Canada's obligation at $34.04 million. The Board directed each operator to submit a report by April 30, 2009 detailing its R&D and E&T expenditures for the period in question. Both operators requested and received an extension of the reporting deadline to September 30, 2009.

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[60] CA-53, *Hibernia and Petro-Canada v. C-NOPB*, Supreme Court of Newfoundland and Labrador Court of Appeal, 2008 NLCA 46 (Sept. 4, 2008), para. 105.

[61] *Id.*, para. 125.

89. As stated above, over the course of their reporting to the Board, prior to the 2004 Guidelines, Hibernia and Terra Nova based their reported R&D expenditures on SR&ED claims pending with the CRA. On September 30, 2009, HMDC submitted a report to the Board detailing R&D and E&T expenditures of approximately [REDACTED] over the relevant period (April 1, 2004-December 31, 2008). On December 10, 2009, the Board formally communicated that it had rejected as ineligible R&D and E&T expenditure of almost [REDACTED]

90. Having confirmed that the remaining development phase credit of $10.1 million could be applied towards HMDC's outstanding obligations, on January 8, 2010, the Board confirmed HMDC's net shortfall at $43,556,526.275. On March 9, 2010, [REDACTED] the Board confirmed that the R&D expenditure shortfall for the Hibernia project had been further reduced to $32,718,226.

91. On October 1, 2009, Suncor (who had merged with Petro-Canada) submitted a report detailing R&D and E&T expenditures of [REDACTED] over the April 1, 2004-December 31, 2008 period. On December 15, 2009, the Board formally communicated that it had rejected as ineligible R&D and E&T expenditures of [REDACTED] Having confirmed that all remaining development phase credit could be applied upfront against Terra Nova's obligations, the Board confirmed Suncor's net shortfall as $11,860,092, and later reduced it again to $8,972,126.

92. With regard to the approval of prospective R&D and E&T expenditures (as of April 8, 2010) of the two operators, only the Terra Nova participants submitted proposed expenditures of several projects for pre-approval by the Board. The Board has so far denied approval of an engineering and design project, estimated to cost a maximum of $80,000 that would allow installment of certain equipment onshore rather than in the field. The Board denied the application because it viewed the activity to be an application of existing technology and

therefore ineligible under the 2004 Guidelines. The Board did however approve a $250,000 contribution to MUN to support research training over a period of five years.

93. In December 2009, the Board informed HMDC and Suncor that they were required to provide a Work Plan detailing their proposals to rectify their shortfall in R&D and E&T spending over the 2004-2008 period by March 31, 2010. The operators were also required to provide the Board with unrestricted access to a promissory note secured by a letter of credit. The Work Plans were provided. The Board extended the deadline for provision of the financial instrument until April 30, 2010. The Board then established a deadline of March 31, 2015, at which time it will draw down from the provided financial instruments any unspent R&D shortfall from the 2004-2008 period and transfer it to a recognized research or education agency. The provision of a financial instrument has been included as an express condition to HMDC's POA. The current Terra Nova POA expired on September 30, 2011.

IV. Summary of the Parties' Claims and the Relief Sought

94. The NAFTA entered into force on January 1, 1994, after the HBP was approved, but before the TNBP and the 2004 Guidelines were adopted. The parties' dispute concerns the legality of the 2004 Guidelines in view of Articles 1105, 1106 and 1108 of the NAFTA and its Annex I. The Tribunal's jurisdiction under Article 1116 and 1117 of the NAFTA and the Centre's Additional Facility has not been challenged, except with regard to the quantum of the Claimants' claims (see below).

95. Article 1105 of the NAFTA entitled "Minimum Standard of Treatment" provides as follows:

> "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.
>
> 2. Without prejudice to paragraph 1 and notwithstanding Article 1108(7)(b), each Party shall accord to investors of another Party, and to investments of investors of another Party, non-discriminatory treatment with respect to measures it adopts or maintains relating to losses suffered by investments in its territory owing to armed conflict or civil strife.
>
> 3. Paragraph 2 does not apply to existing measures relating to subsidies or grants that would be inconsistent with Article 1102 but for Article 1108(7)(b)."

96. Article 1106 of the NAFTA entitled "Performance Requirements" provides that:

> "1. No Party may impose or enforce any of the following requirements, or enforce any commitment or undertaking, in connection with the establishment, acquisition, expansion, management, conduct or operation of an investment of an investor of a Party or of a non-Party in its territory:
>
> (a) to export a given level or percentage of goods or services;

(b) to achieve a given level or percentage of domestic content;

(c) to purchase, use or accord a preference to goods produced or services provided in its territory, or to purchase goods or services from persons in its territory;

(d) to relate in any way the volume or value of imports to the volume or value of exports or to the amount of foreign exchange inflows associated with such investment;

(e) to restrict sales of goods or services in its territory that such investment produces or provides by relating such sales in any way to the volume or value of its exports or foreign exchange earnings;

(f) to transfer technology, a production process or other proprietary knowledge to a person in its territory, except when the requirement is imposed or the commitment or undertaking is enforced by a court, administrative tribunal or competition authority to remedy an alleged violation of competition laws or to act in a manner not inconsistent with other provisions of this Agreement; or

(g) to act as the exclusive supplier of the goods it produces or services it provides to a specific region or world market.

2. A measure that requires an investment to use a technology to meet generally applicable health, safety or environmental requirements shall not be construed to be inconsistent with paragraph 1(f). For greater certainty, Articles 1102 and 1103 apply to the measure.

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

(a) to achieve a given level or percentage of domestic content;

(b) to purchase, use or accord a preference to goods produced in its territory, or to purchase goods from producers in its territory;

(c) to relate in any way the volume or value of imports to the volume or value of exports or to the amount of foreign exchange inflows associated with such investment; or

(d) to restrict sales of goods or services in its territory that such investment produces or provides by relating such sales in any way to the volume or value of its exports or foreign exchange earnings.

4. Nothing in paragraph 3 shall be construed to prevent a Party from conditioning the receipt or continued receipt of an advantage, in connection with an investment in its territory of an investor of a Party or of a non-Party, on compliance with a requirement to locate production, provide a service, train or employ workers, construct or expand particular facilities, or carry out research and development, in its territory.

5. Paragraphs 1 and 3 do not apply to any requirement other than the requirements set out in those paragraphs.

6. Provided that such measures are not applied in an arbitrary or unjustifiable manner, or do not constitute a disguised restriction on international trade or investment, nothing in paragraph 1(b) or (c) or 3(a) or (b) shall be construed to prevent any Party from adopting or maintaining measures, including environmental measures:

(a) necessary to secure compliance with laws and regulations that are not inconsistent with the provisions of this Agreement;

(b) necessary to protect human, animal or plant life or health; or

(c) necessary for the conservation of living or non-living exhaustible natural resources."

97. Article 1108 of the NAFTA entitled "Reservations and Exceptions" provides as follows:

"1. Articles 1102, 1103, 1106 and 1107 do not apply to:

(a) any existing non-conforming measure that is maintained by

(i) a Party at the federal level, as set out in its Schedule to Annex I or III,

(ii) a state or province, for two years after the date of entry into force of this Agreement, and thereafter as set out by a Party in its Schedule to Annex I in accordance with paragraph 2, or

(iii) a local government;

(b) the continuation or prompt renewal of any non-conforming measure referred to in subparagraph (a); or

(c) an amendment to any non-conforming measure referred to in subparagraph (a) to the extent that the amendment does not decrease the conformity of the measure, as it existed immediately before the amendment, with Articles 1102, 1103, 1106 and 1107.

2. Each Party may set out in its Schedule to Annex I, within two years of the date of entry into force of this Agreement, any existing nonconforming measure maintained by a state or province, not including a local government.

3. Articles 1102, 1103, 1106 and 1107 do not apply to any measure that a Party adopts or maintains with respect to sectors, subsectors or activities, as set out in its Schedule to Annex II.

4. No Party may, under any measure adopted after the date of entry into force of this Agreement and covered by its Schedule to Annex II, require an investor of another Party, by reason of its nationality, to sell or otherwise dispose of an investment existing at the time the measure becomes effective.

5. Articles 1102 and 1103 do not apply to any measure that is an exception to, or derogation from, the obligations under Article 1703 (Intellectual Property National Treatment) as specifically provided for in that Article.

6. Article 1103 does not apply to treatment accorded by a Party pursuant to agreements, or with respect to sectors, set out in its Schedule to Annex IV.

7. Articles 1102, 1103 and 1107 do not apply to:

   (a) procurement by a Party or a state enterprise; or
   (b) subsidies or grants provided by a Party or a state enterprise, including government supported loans, guarantees and insurance.

8. The provisions of:

   (a) Article 1106(1)(a), (b) and (c), and (3)(a) and (b) do not apply to qualification requirements for goods or services with respect to export promotion and foreign aid programs;
   (b) Article 1106(1)(b), (c), (f) and (g), and (3)(a) and (b) do not apply to procurement by a Party or a state enterprise; and
   (c) Article 1106(3)(a) and (b) do not apply to requirements imposed by an importing Party relating to the content of goods necessary to qualify for preferential tariffs or preferential quotas."

98. Annex I of the NAFTA ("Reservations for Existing Measures and Liberalization Commitments") provides, in relevant part, that:

> "1. The Schedule of a Party sets out, pursuant to Articles 1108(1) (Investment), 1206(1) (Cross-Border Trade in Services) and 1409(4) (Financial Services), the reservations taken by that Party with respect to existing measures that do not conform with obligations imposed by:
>
> [...]
>
> (d) Article 1106 (Performance Requirements)
>
> [...]
>
> and, in certain cases, sets out commitments for immediate or future liberalization.
>
> 2. Each reservation sets out the following elements:
>
> (a) Sector refers to the general sector in which the reservation is taken;
>
> (b) Sub-Sector refers to the specific sector in which the reservation is taken;
>
> (c) Industry Classification refers, where applicable, to the activity covered by the reservation according to domestic industry classification codes;
>
> (d) Type of Reservation specifies the obligation referred to in paragraph 1 for which a reservation is taken;
>
> (e) Level of Government indicates the level of government maintaining the measure for which a reservation is taken;
>
> (f) Measures identifies the laws, regulations or other measures, as qualified, where indicated, by the Description element, for which the reservation is taken. A measure cited in the Measures element

(i) means the measure as amended, continued or renewed as of the date of entry into force of this Agreement, and

(ii) includes any subordinate measure adopted or maintained under the authority of and consistent with the measure;

(g) Description sets out commitments, if any, for liberalization on the date of entry into force of this Agreement, and the remaining non-conforming aspects of the existing measures for which the reservation is taken; and

(h) Phase-Out sets out commitments, if any, for liberalization after the date of entry into force of this Agreement.

3. In the interpretation of a reservation, all elements of the reservation shall be considered. A reservation shall be interpreted in the light of the relevant provisions of the Chapters against which the reservation is taken. To the extent that:

(a) the Phase-Out element provides for the phasing out of non-conforming aspects of measures, the Phase-Out element shall prevail over all other elements;

(b) the Measures element is qualified by a liberalization commitment from the Description element, the Measures element as so qualified shall prevail over all other elements; and

(c) the Measures element is not so qualified, the Measures element shall prevail over all other elements, unless any discrepancy between the Measures element and the other elements considered in their totality is so substantial and material that it would be unreasonable to conclude that the Measures element should prevail, in which case the other elements shall prevail to the extent of that discrepancy.

[…]”

99. Pursuant to Annex I of the NAFTA, on March 29, 1996 the Respondent made a number of reservations to the NAFTA, including one in relation to the Atlantic Accord. That reservation provides as follows:

> "**Sector:** Energy
>
> **Sub-Sector:** Oil and Gas
>
> **Industry Classification:** SIC 071 - Crude Petroleum and Natural Gas Industries
>
> **Type of Reservation:** Performance Requirements (Article 1106) Local Presence (Article 1205)
>
> Level of Government: Federal
>
> **Measures:** Canada Oil and Gas Production and Conservation Act, R.S.C. 1985, c. O-7, as amended by Canada Oil and Gas Operations Act, S.C. 1992, c. 35 *Canada - Nova Scotia Offshore Petroleum Resources Accord Implementation Act*, S.C. 1988, c. 28 *Canada - Newfoundland Atlantic Accord Implementation Act*, S.C. 1987, c. 3 Measures implementing Yukon Oil and Gas Accord Measures implementing Northwest Territories Oil and Gas Accord
>
> **Description:** Cross-Border Services and Investment
>
> 1. Under the Canada Oil and Gas Operations Act, the approval of the Minister of Energy, Mines and Resources of a "benefits plan" is required to receive authorization to proceed with any oil and gas development project.
>
> 2. A "benefits plan" is a plan for the employment of Canadians and for providing Canadian manufacturers, consultants, contractors and service companies with a full and fair opportunity to participate on a competitive basis in the supply of goods and services used in any

proposed work or activity referred to in the benefits plan. The Act permits the Minister to impose an additional requirement on the applicant, as part of the benefits plan, to ensure that disadvantaged individuals or groups have access to training and employment opportunities or can participate in the supply of goods and services used in any proposed work referred to in the benefits plan.

3. The Canada - Nova Scotia Offshore Petroleum Resources Accord Implementation Act and the Canada - Newfoundland Atlantic Accord Implementation Act have the same requirement for a benefits plan but also require that the benefits plan ensure that:

   (a) prior to carrying out any work or activity in the offshore area, the corporation or other body submitting the plan establish in the applicable province an office where appropriate levels of decision-making are to take place;
   (b) expenditures be made for research and development to be carried out in the province, and for education and training to be provided in the province; and
   (c) first consideration be given to goods produced or services provided from within the province, where those goods or services are competitive in terms of fair market price, quality and delivery.

4. The Boards administering the benefits plan under these Acts may also require that the plan include provisions to ensure that disadvantaged individuals or groups, or corporations owned or cooperatives operated by them, participate in the supply of goods and services used in any proposed work or activity referred to in the plan.

5. In addition, Canada may impose any requirement or enforce any commitment or undertaking for the transfer of technology, a

production process or other proprietary knowledge to a person of Canada in connection with the approval of development projects under the applicable Acts.

6. Provisions similar to those set out above will be included in laws or regulations to implement the Yukon Oil and Gas Accord and Northwest Territories Oil and Gas Accord which for purposes of this reservation shall be deemed, once concluded, to be existing measures.

Phase-Out: None"

A. CLAIMANTS' POSITION

100. The Claimants argue that the imposition of the 2004 Guidelines requiring investors to spend a fixed percentage of project revenues on R&D in NL, and the enforcement of this requirement by the Board, constitute a prohibited performance requirement and violate NAFTA Article 1106(1). They assert that the 2004 Guidelines compel the Hibernia and Terra Nova project operators to spend several million more dollars per year on R&D activities under their revised Benefits Plans than they would otherwise be required to spend by reference to Benefits Plans that reflect the approach set forth in the 1986, 1987 and 1988 Guidelines. As a result, the Claimants argue that the Board substitutes its own development objectives for the business judgment of investors, and distorts investment flows in favor of the Province. According to the Claimants, the 2004 Guidelines are not exempted by Article 1108(1)(a) of the NAFTA (as an existing non-conforming measure) and are not covered by Canada's Annex I Reservations, which describe the aspects of the Federal Accord Act that do not conform with Article 1106. Moreover, in the Claimants' view , the 2004 Guidelines cannot amount to an amendment of an existing non-conforming measure pursuant to Article 1108(1)(c) of the NAFTA, or to the adoption of a "subordinate measure adopted … under the authority of and consistent with the measure" that has been reserved, pursuant to Annex 1, paragraph 2(f)(ii) of the NAFTA.

101. Second, the Claimants claim that the 2004 Guidelines violate Article 1105(1) of the NAFTA in that the Respondent has failed to "accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security." According to the Claimants, Canada has breached the obligation by failing to provide a stable regulatory framework for the conduct of petroleum development projects in the NL offshore area, and by frustrating Claimants' legitimate expectations with regard to that regulatory framework.

102. As a result, the Claimants request the following relief, as set out in their Reply Memorial:

> "301. In order to protect Claimants' rights and reduce the possibility of future disputes, Claimants request the Tribunal:
>
> a) Find that the promulgation and enforcement of the R&D Expenditure Guidelines constitute a performance requirement within the meaning of Article 1106(1) of the NAFTA, and that Canada has breached its obligations under the Article as a result;
>
> b) Find that the [2004] Guidelines are not covered by Article 1108(1) of the NAFTA or Canada's Annex I reservation to the treaty for the Federal Accord Act;
>
> c) Find that Canada has breached its obligations under Article 1105(1) of the NAFTA by failing to provide Claimants and their investments the guarantee of fair and equitable treatment in accordance with international law;
>
> d) Order Canada to pay to Claimant Mobil Investments Canada Inc., or alternatively, to its indirectly controlled enterprises, money damages in an amount to be established at the hearing, plus interest as applicable when the Tribunal issues its final award, to compensate Claimant Mobil Investments Canada for the cost of its compliance with the Guidelines

including through the remaining life of the Hibernia and Terra Nova projects, in which it is an investor;

e) Order Canada to pay to Claimant Murphy Oil Corporation, or alternatively, to its directly or indirectly controlled enterprises, money damages in an amount to be established at the hearing, plus interest as applicable when the Tribunal issues its final award, to compensate Claimant Murphy Oil Corporation for the cost of its compliance with the Guidelines including through the remaining life of the Hibernia and Terra Nova projects, in which it is an investor;

f) Order Canada to pay to Claimants the full measure of legal fees and costs, to be determined at the conclusion of the proceedings, that they will have incurred as a result of this arbitration;

g) Find that Claimants are entitled to recover all costs incurred in seeking to enforce the Tribunal's Award, including any costs incurred in seeking compensation in respect of the Board's future application of the Guidelines to the Projects; and

h) Order such further relief as it deems appropriate."[62]

103. On August 6, 2010, the Claimants submitted an updated calculation of damages as follows:

Damages: Projects

Oil Field Damages
Hibernia CDN$ 113.74MM
Terra Nova CDN$ 43.95MM

Damages: Mobil Investments Canada Inc.

Oil Field Ownership Share of Economic Damages

[62] Cl. Reply, para. 301.

Hibernia 33.125% CDN$ 37.68MM

Terra Nova 22% CDN$ 9.67MM

Total CDN$ 47.35MM

Damages: Murphy Oil Corporation

Oil Field Ownership Share of Economic Damages

Hibernia 6.5% CDN$ 7.39MM

Terra Nova 12% CDN$ 5.27MM

Total CDN$ 12.67MM

B. RESPONDENT'S POSITION

104. The Respondent rejects that it has breached any provision of the NAFTA.

105. First, the Respondent argues that Article 1106(1)(c) of the NAFTA does not prohibit requirements regarding R&D or E&T. Its position is that the relevant provision does not encompass R&D and E&T performance requirements because such performance requirements must be distinguished from the requirement to purchase local goods or services. Even if R&D and E&T requirements could fall within the scope of Article 1106, the 2004 Guidelines do not necessarily compel the purchase, use or accordance of a preference to local goods or services. Further or alternatively, the Respondent argues that the 2004 Guidelines fall within the scope of Canada's Annex I Reservation to Article 1106, and in particular that the 2004 Guidelines are measures subordinate to the Accord Acts, that have been adopted "under the authority of and consistent with" the Accord Acts and are therefore compatible with the NAFTA (as provided by paragraph 2(f)(ii) of Annex 1 of the NAFTA).

106. Second, the Respondent argues that the standard for finding a violation of Article 1105 has not been met in the circumstances of this case. According to the Respondent, the protection of legitimate expectations and a stable regulatory environment does not fall under the Article 1105 standard. The Respondent's position is also that the Tribunal has no authority to review the decisions of domestic courts which have ruled on a claim for a breach of Article

1105 of the NAFTA. In this case, Canadian courts have confirmed that the Board acted consistently with the regulatory framework.

107. Third, as to the Claimants' case on the quantum of damages, the Respondent states that the Claimants are not entitled to any compensation as it is premature to calculate damages at this stage, and in any event, the claim is exaggerated.

108. As a result, the Respondent requests the following relief, as set out in its Counter-Memorial:

> "387. Canada requests that the Tribunal reject the claims and order that the Claimants pay the costs and legal fees of Canada incurred as a result of this arbitration."[63]

[63] R. Counter, para. 387.

V. ARTICLE 1105

A. INTRODUCTION

109. Article 1105 is entitled *Minimum Standard of Treatment* and provides that:

> "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."

110. In 2001 the NAFTA Parties adopted an Interpretative Note on *Minimum Standard of Treatment in Accordance with International Law* that provides, in relevant part, as follows:

> "1. Article 1105(1) prescribes the customary international law minimum standard of treatment of aliens as the minimum standard of treatment to be afforded to investments of investors of another Party.
>
> 2. The concepts of "fair and equitable treatment" and "full protection and security" do not require treatment in addition to or beyond that which is required by the customary international law minimum standard of treatment of aliens.
>
> 3. A determination that there has been a breach of another provision of the NAFTA, or of a separate international agreement, does not establish that there has been a breach of Article 1105(1)."

B. THE PARTIES' ARGUMENTS

1. Claimants' Arguments

111. The Claimants assert that, by its acts or acts attributable to it, the Respondent has violated Article 1105 of the NAFTA by "failing to provide a stable regulatory framework for the conduct of petroleum development projects in the Newfoundland offshore area and by

frustrating Claimants' legitimate expectations with regard to that regulatory framework."[64] The Claimants argue that

> "[a] series of arbitral awards punctuated by a binding Interpretative Note issued jointly by the NAFTA parties establishes three salient points: *first*, the source of the minimum standard of treatment guaranteed by the treaty is customary international law on the treatment of aliens; *second*, the content of the standard is not static, but rather evolves over time with the development of customary international law; and *third*, the minimum standard of treatment afforded to foreign investors by current customary international law includes a protection of the legitimate expectations upon which the investor relied in entering into the investment."[65]

112. The Claimants further assert that

> "[s]everal tribunals have found violations of an investor's legitimate expectations by virtue of state action making fundamental changes to the terms of an administrative permit upon which the investment had been premised, or revoking such permit on the basis of minor performance issues without giving the investor an opportunity to remedy them."[66]

113. In support of this proposition the Claimants rely principally on two arbitral awards: *Técnicas Medioambientales Tecmed, S.A. v. United Mexican States ("TecMed")*[67], and *Metalclad Corporation v. Mexico ("Metalclad")*[68]. The Claimants also argue that

> "[l]ikewise, fundamental changes to a contractual relationship such as failure by the State to deliver on a contractual promise, express threats to

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[64] Cl. Mem., para. 194.

[65] *Id.*, para. 195.

[66] *Id.*, para. 202.

[67] ICSID Case No. ARB (AF)/00/2, Award of May 29, 2003.

[68] ICSID Case No. ARB(AF)/97/1, Award of August 30, 2000.

> terminate a contract or unilateral suspension of a contract have been held to violate the investor's legitimate expectations.
>
> Other tribunals have held that the protection afforded by the fair and equitable treatment provision requires more broadly that a State maintain a stable legal and business environment for investments."[69]

114. The Claimants assert that

> "the imposition of the [2004] Guidelines and the Board's actions to enforce compliance with their terms [changed] the economic basis on which Claimants invested and depart from the regulatory framework that had governed the conduct of the Hibernia and Terra Nova projects since their inception,"[70] and that therefore the 2004 Guidelines "undermined the legitimate expectations of the interest owners as to the scope of their R&D obligations when they decided to proceed with their investments."[71]

115. They argue that

> "[t]he reality is that the Guidelines fundamentally transformed the R&D expenditure obligations or operators with approved benefits plans in the province, and thus violated the Claimants' legitimate expectations."[72]

116. According to the Claimants, they relied

> "on a series of assurances from the Board and the federal and provincial governments that the commitments articulated in their [existing] Benefits Plans with respect to R&D were satisfactory to meet the requirements of the Accord Acts and would define the scope of their obligations"[73] and

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[69] *Id.*, paras. 202-203.

[70] *Id.*, para. 204.

[71] *Id.*

[72] Cl. Reply, para. 181.

[73] Cl. Mem., para. 205.

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they had a legitimate expectation that "the Benefits Plans' provisions would define [their] R&D expenditure obligations for the life of the investment."[74]

117. They further claim that

> "[t]he Board's actions in approving the Benefits Plans, and the federal and provincial governments' actions in approving the Board's decisions, engendered a legitimate expectation on the part of the project proponents that the provisions made in the Benefits Plan with respect to R&D satisfied the requirement of the Accord Acts and would not be supplemented by the Board."[75]

118. The Claimants assert that

> "[a]t no point was there any suggestion that the project owners would undertake a prescribed level of R&D, much less an arbitrary level of R&D calibrated to match the average expenditures of an undifferentiated sample set of oil and gas companies operating both onshore and off,"[76] and that "[b]y the time the Hibernia interest owners made the decision to proceed with the project, they did so on the basis of further assurances by the federal and provincial governments that they would not be subject to further R&D-related requirements."[77]

119. They add:

> "When the Hibernia project participants made the decision to proceed with the investment in 1990, they did so on the basis of a series of express promises by the federal and provincial governments, and indeed by the Board, as to the scope of their benefits commitments. By the time the

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74 Cl. Reply, para. 140.

75 Cl. Mem., para. 207.

76 *Id.*, para. 206.

77 *Id.*, para. 208.

Terra Nova project arose, the Claimants had over a decade of experience watching the Board administer the Accord Acts with the support of the federal and provincial governments at Hibernia. It was reasonable for the Claimants to rely on that experience as a guide."[78]

120. The alleged breach of Article 1105 is summarized by the Claimants as follows:

> "This extensive history of State conduct by the federal and provincial governments and the Board created legitimate expectations on the part of the Hibernia and Terra Nova project participants with respect to the extent of the R&D-related regulatory requirements that would govern conduct of the projects. The 2004 R&D Expenditure Guidelines represent a fundamental shift in that regulatory framework and in the contractual understanding expressed in the Benefits Plans and the Hibernia Framework Agreement. The Guidelines therefore undermine the legitimate expectations engendered by the State and relied upon by the project participants when they decided to proceed with the investments. This State conduct amounts to a violation of the minimum standard of treatment guaranteed to investors by customary international law and, in turn, by NAFTA Article 1105(1)."[79]

2. <u>Respondent's Arguments</u>

121. In response, the Respondent argues that the Article 1105 claim should be dismissed because:

> "(a) Article 1105 prescribes that the NAFTA Parties must accord the customary international law minimum standard of treatment of aliens and the Claimants have failed to prove that this standard includes protection of a foreigner's legitimate expectations of the obligation to maintain a stable legal and business environment for investments. These are not obligations

[78] *Id.*, para. 211.

[79] *Id.*, para. 212.

that form part of customary international law and accordingly are not part of Canada's obligations under article 1105; and

(b) even if the Claimants had proven that the protection of legitimate expectations and a stable regulatory environment were part of customary international law, which they have not, the Guidelines do not frustrate the Claimants' legitimate expectations. Nor has Canada failed to provide a stable regulatory framework for the Claimants' investment."[80]

122. The Respondent further argues that

> "[t]he Claimants allege that the Guidelines breach Article 1105 of the NAFTA because they are inconsistent with the Claimants' legitimate expectations. There is no dispute between the parties that only a failure to provide the minimum standard of treatment of aliens under customary international law will breach Article 1105.There is also no dispute that the Claimants have the burden to prove that the protection of a foreign investor's legitimate expectations is part of that standard."[81]

123. The Respondent refutes the Claimants' argument that it has breached Article 1105 on the ground that they have failed to prove that the minimum standard of treatment under customary international law encompasses legitimate expectations. It argues that

> "[t]he Claimants [have submitted] no evidence of state practice or *opinio juris* to support their assertion that the minimum standard of treatment afforded to foreign investors by customary international law includes a protection of legitimate expectations or the obligations to provide a stable regulatory environment for foreign investments."[82]

124. The Respondent further asserts that

80 R. Counter, para. 242.

81 R. Reply P. Brief, para. 97.

82 R. Counter, para. 254.

> "while NAFTA tribunals have considered as a relevant element the repudiation of the legitimate expectations of foreign investors, assuming they reasonably existed at the time of the investment and are based on specific representations (…) they have not found that the failure to fulfill legitimate expectations constituted in and of itself a breach of a rule of customary international law part of the minimum standard of treatment under Article 1105."[83]

125. The Respondent argues, in the alternative, that even if Article 1105 requires the protection of legitimate expectations, the Claimants do not meet four "prerequisites necessary for the expectations of a foreign investor to be entitled to protection."[84] First, the Claimants' legitimate expectations must be based on objective expectations; second, the investor must have relied on a specific assurance by the state to induce the investment; third, the legitimate expectations must be those which existed at the time the investment was made and; fourth, to assess the legitimacy of the expectations, all circumstances must be taken into account.[85] As such, the Respondent argues that

> "the only expectations of the Claimants with respect to its investment in Canada which meets these conditions are that:
>
> - the legal framework governing their investment would reflect the importance of R&D and E&T to the sustainable development of NL;
> - the Claimants would be required to make expenditures on R&D and E&T in NL;
> - these expenditures would be monitored and approved by the Board; and

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83 *Id.,* para. 270.

84 *Id.,* para 271

85 *Id.,* para. 271; *see also* R. Rejoinder, paras. 152-153.

- the Board had the authority to issue guidelines on the R&D and E&T expenditure requirement."[86]

126. On the standard applicable under Article 1105, the Respondent relies in particular on the decisions in *Glamis Gold, Ltd. v. United States of America*[87] and *Cargill, Incorporated v. United Mexican States*[88] to the effect that the customary international law standard "has not evolved from the 'shocking and egregious' standard described in *Neer*"[89] but that "what is 'egregious and shocking' has developed since 1926."[90]

3. The Parties' Responses to the Tribunal's Question

127. The Tribunal posed the following question to the parties during the hearing:

> "What evidence of "state practice" and *opinio juris* is available, if any, to support the conclusion that "fair and equitable treatment" encompasses a substantive obligation to protect the legitimate expectation of the parties?"[91]

128. The Claimants referred to various authorities in their pleadings. In addition, the Claimants invoked two bilateral investment treaties that "explicitly tie fair and equitable treatment to the provision of a stable and predictable framework,"[92] namely the Argentina/US BIT, and the Ecuador/US BIT. The Claimants also referred to two NAFTA Chapter 11 tribunals. They argued that the tribunal in *Metalclad Corporation v United Mexican States*

> "had before it further evidence of state practice … [f]or example, the European Community "Investment Protection Principles" in October 1992, which state in part that the "'fair and equitable' treatment standard

86 R Rejoinder, para. 154; *See also* para. 227.

87 UNCITRAL Award, May 16, 2009 ("*Glamis Gold*").

88 ICSID Case No. ARB(AF), Award, September 18, 2009. ("*Cargill v. Mexico*").

89 R. Rejoinder, para. 122.

90 *Id.*, para. 125.

91 Legal Questions to the Parties from the Tribunal, to be Addressed in Closing Arguments (October 21, 2010).

92 Cl. P. Brief, para. 43.