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

Professor Hans van Houtte, President
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. <u>The Accord Acts</u>

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).

(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

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[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

[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

[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

[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] [redacted]

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

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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$, millions) from 2001 to 2003 were, respectively, [redacted] CE-70 - CE-80, Hibernia 1998-2008 Benefits Reports: E&T annual expenditures (in CDN$, millions) from 1998 to 2008, were, respectively, [redacted]

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]

[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]

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:** <u>Cross-Border Services and Investment</u>
>
> 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

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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

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.

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

[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

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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

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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

[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.

> should be understood as an 'overriding concept' that encompasses in particular the following investment protection principles: (i) "transparency and stability of investment conditions."[93]

129. The Claimants also relied on *Merrill & Ring Forestry L.P. v. Canada,*[94] asserting that the tribunal "undertook its own analysis of state practice in relation to the minimum standard of treatment"[95] and identified the "protection of legitimate expectations and maintaining a stable and predictable framework for investment are both relevant elements under that standard."[96]

130. The Claimants further asserted that the majority of NAFTA tribunals addressing claims under Article 1105, post-dating the FTC Note on *Minimum Standard of Treatment in Accordance with International Law*, have found that "at the very least, the fact that a claimant's legitimate expectations have been repudiated is a relevant consideration when deciding whether a NAFTA Party has violated Article 1105."[97] In support of this statement, the Claimants cite seven arbitral awards: *International Thunderbird Gaming Corporation v. United Mexican States,*[98] *Waste Management, Inc. v. United Mexican States,*[99] *Gami Investments, Inc. v. United Mexican States,*[100] *ADF Group Inc. v. United States of America,*[101] *Merrill & Ring, Glamis Gold and Cargill v. Mexico*.

131. The Respondent noted that the Claimants

> "submitted no evidence of practice of the three NAFTA Parties regarding the protection of legitimate expectations, let alone evidence of practice by

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93 *Id.*, para. 44; Cl. Mem., para. 163. *Metalclad Corporation v United Mexican States,* ICSID Case No. ARB(AF)/97/1, Award, August 30, 2006 ("*Metalclad*").

94 UNCITRAL Award, March 31, 2010 ("*Merrill & Ring*").

95 Cl. P. Brief, para. 46.

96 *Id*., para. 46.

97 *Id*., para. 48.

98 UNCITRAL Award, January 26, 2006 ("*International Thunderbird*").

99 ICSID Case No. ARB(AF)/00/3, Award, April 30, 2004 ("*Waste Management (No. 2)*").

100 UNCITRAL Award, November 15, 2004 ("*Gami*").

101 ICSID Case No. ARB (AF)/00/1, Award, January 9, 2003 ("*ADF Group*").

> any of the other 189 members of the United Nations, as would be necessary to prove that a rule of custom crystallized through widespread and consistent practice undertaken out of a sense of legal obligation."[102]

132. The Respondent further asserted that the three new documents, on which the Claimants rely in their Post-Hearing Brief, the Argentina/US BIT, the Ecuador/US BIT and the European Community "Investment Protection Principles," provide no support for their assertion that the protection of legitimate expectations is part of the minimum standard of treatment of aliens under customary international law.[103] The Respondent argued that "reference to a summary of an unproduced European Community document is not evidence of customary international law"[104] and that the preambles of the two BITs on which the Claimants rely do not address legitimate expectations and are not evidence of state practice or *opinio juris*. The Respondent also asserted that

> "the Claimants rely again on *Merrill & Ring* and suggest that the tribunal 'undertook its own analysis of state practice in relation to the minimum standard of treatment.' This is incorrect. None of the material reviewed by the *Merrill & Ring* tribunal related to state practice concerning legitimate expectations and the tribunal did not make a decision on the role of such expectations in the customary international law standard of treatment."[105]

133. Continuing that

> "[n]one of the other NAFTA cases to which the Claimants refer in their Post-Hearing Brief support the conclusion that the protection of legitimate expectations is part of the customary international law standard of treatment. Nor does *Cargill*, the most recent NAFTA Chapter 11 decision. As Canada noted during the hearing, *Cargill* aptly summarized the

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[102] R. Reply P. Brief, para. 98.

[103] *Id*., para. 101.

[104] *Id*., para. 99.

[105] *Id*., para. 102.

customary international law minimum standard of treatment of aliens and the appropriate Article 1105 analysis as follows:

> 'To determine whether an action fails to meet the requirement of fair and equitable treatment, a tribunal must carefully examine whether the complained of measures were grossly unfair, unjust or idiosyncratic; arbitrary beyond a merely inconsistent or questionable application of administrative or legal policy or procedure so as to constitute an unexpected and shocking repudiation of a policy's very purpose and goals, or to otherwise grossly subvert a domestic law or policy for an ulterior motive; or involve an utter lack of due process so as to offend judicial propriety.'"[106]

134. The Respondent concludes that "[h]ence, mere failure to fulfill legitimate expectations does not fall below the customary international law standard of treatment required by Article 1105 of the NAFTA."[107]

C. THE TRIBUNAL'S APPROACH

135. There is broad agreement between the parties that the minimum standard of treatment guaranteed by Article 1105 is that which is reflected in customary international law on the treatment of aliens. The Tribunal notes what the tribunal said in *Cargill v. Mexico*:

> "In light of the FTC's interpretation and the binding for of that interpretation on this Tribunal by virtue of Article 1132(2), the Tribunal joins all previous NAFTA tribunals in the view that Article 1105 requires no more, nor less, than the minimum standard of treatment demanded by customary international law. As stated by the *Mondev* tribunal, the FTC Note made "clear that Article 1105(1) refers to a standard existing under customary international law, and not to standards established by other treaties of the three NAFTA Parties. Likewise, as explained by Mexico in

106 *Id*, para. 103.

107 *Id.*, para. 104.

> its 1128 Submission to the *ADF* tribunal, ‘‘fair and equitable treatment’ and ‘full protection and security’ are provided as examples of the customary international law standards incorporated in Article 1105(1). (…) The international law minimum standard [of treatment] is an umbrella concept incorporating a set of rules that has crystallized over the centuries into customary international law in specific contexts.”[108]

136. The parties disagree, however, as to what the standard of customary international law is and, in particular, whether it includes a protection of the ‘legitimate expectations’ upon which the Claimants assert they relied in entering into the investment in 1986. Even assuming that the standard does include a protection of ‘legitimate expectations,’ the parties disagree as to whether the facts demonstrate a violation of that standard.

137. Two principal issues therefore fall to be determined by the Tribunal: *first*, to identify the applicable standard under Article 1105; and *second*, to apply that standard to the facts of this case.

D. THE APPLICABLE STANDARD

138. Article 1105 has been the subject of extensive consideration by NAFTA tribunals, and the parties have addressed the case-law with considerable care and attention. There has been considerable convergence between the parties as to the relevant jurisprudence, but they disagree on the interpretation and application of that case-law.

Metalclad

139. On the facts of the case, the tribunal found that the government of Mexico made certain representations, and that

> “Metalclad was entitled to rely on the representations of federal officials and to believe that it was entitled to continue its construction of the landfill. In following the advice of these officials, and filing the municipal

108 *Cargill v. Mexico*, para. 268.

> permit application on November 15, 1994, Metalclad was merely acting prudently and in the full expectation that the permit would be granted."[109]

The construction permit was subsequently denied, in a manner that the tribunal found to be improper.[110] Against this background, the tribunal ruled that Mexico had "failed to ensure a transparent and predictable framework for Metalclad's business planning and investment,"[111] that it had demonstrated "a lack of orderly process and timely disposition in relation to an investor of a Party acting in the expectation that it would be treated fairly and justly in accordance with the NAFTA,"[112] and this gave rise to a violation of the Article 1105 standard.

140. It is to be noted that this award was partly set aside by the Supreme Court of British Colombia, on the grounds that "the Tribunal decided a matter beyond the scope of the submission to arbitration in connection with its finding that there was a failure of transparency."[113] The Tribunal is not aware of any subsequent decisions that have followed the approach taken by the *Metalclad* tribunal.

Waste Management (No. 2)

141. The tribunal identified the customary international law standard as follows:

> "The search here is for the Article 1105 standard of review, and it is not necessary to consider the specific results reached in the cases discussed above. But as this survey shows, despite certain differences of emphasis a general standard for Article 1105 is emerging. Taken together, the *S.D. Myers*, *Mondev*, *ADF* and *Loewen* cases suggest that the minimum standard of treatment of fair and equitable treatment is infringed by

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[109] *Metalclad*, para 89.

[110] *Id.*, para. 97.

[111] *Id.*, para. 99.

[112] *Id.*

[113] Tysoe J, *United Mexican States v. Metalclad Corporation* (Attorney General of Canada and la Procureure General du Quebec on behalf of the Province of Quebec, Intervenors), 2001 BCSC 664, Judgment of May 2, 2001.

> conduct attributable to the State and harmful to the claimant if the conduct is arbitrary, grossly unfair, unjust or idiosyncratic, is discriminatory and exposes the claimant to sectional or racial prejudice, or involves a lack of due process leading to an outcome which offends judicial propriety—as might be the case with a manifest failure of natural justice in judicial proceedings or a complete lack of transparency and candour in an administrative process. In applying this standard it is relevant that the treatment is in breach of representations made by the host State which were reasonably relied on by the claimant.

Evidently the standard is to some extent a flexible one which must be adapted to the circumstances of each case. Accordingly it is to the facts of the present case that the Tribunal turns."[114]

142. On the basis of this standard, and the absence of any representations made by or attributable to Mexico that were relied upon by the claimant, the tribunal found no violation of Article 1105. The Tribunal notes that the award said nothing about the concept of 'legitimate expectation.'

International Thunderbird

143. On Article 1105, the tribunal in *International Thunderbird* cited *Waste Management (No. 2)* and ruled that

> "the threshold for finding a violation of the minimum standard of treatment still remains high, as illustrated by recent international jurisprudence. For the purposes of the present case, the Tribunal views acts that would give rise to a breach of the minimum standard of treatment prescribed by the NAFTA and customary international law as those that, weighed against the given factual context, amount to a gross denial of

[114] *Waste Management (No. 2)*, paras. 98-99.

> justice or manifest arbitrariness falling below acceptable international standards."[115]

144. *Thunderbird* argued that it had "reasonably relied, to its detriment, upon the assurances provided by SEGOB in the *Oficio*,"[116] a claim denied by Mexico. The tribunal found that

> "the concept of 'legitimate expectations' relates, within the context of the NAFTA framework, to a situation where a Contracting Party's conduct creates reasonable and justifiable expectations on the part of an investor (or investment) to act in reliance on said conduct, such that a failure by the NAFTA Party to honour those expectations could cause the investor (or investment) to suffer damages."[117]

The tribunal did "not find that the *Oficio* generated a legitimate expectation upon which EDM could reasonably rely in operating its machines in Mexico."[118]

145. On the facts, the tribunal in the *Thunderbird* case found no violation of the standard because it could "not reasonably rely" on the *Oficio*, there was no failure to provide due process or manifest arbitrariness, and the measures were subject to judicial review before the Mexican courts (from which the Claimant later withdrew).[119]

Glamis Gold

146. The tribunal followed the approach in *Waste Management (No. 2)*, referring to the award as "[p]robably the most comprehensive review"[120] undertaken of the Article 1105 standard. On the applicable standard the tribunal ruled as follows:

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115 *International Thunderbird*, para. 194.

116 *Id.*, para. 146.

117 *Id.*, para. 147.

118 *Id.*, paras. 146-148.

119 *Id.*, paras. 196-201.

120 *Glamis*, para. 559.

> "The fundamentals of the *Neer* standard thus still apply today: to violate the customary international law minimum standard of treatment codified in Article 1105 of the NAFTA, an act must be sufficiently egregious and shocking—a gross denial of justice, manifest arbitrariness, blatant unfairness, a complete lack of due process, evident discrimination, or a manifest lack of reasons—so as to fall below accepted international standards and constitute a breach of Article 1105(1). (…) The standard for finding a breach of the customary international law minimum standard of treatment therefore remains as stringent as it was under *Neer*; it is entirely possible, however that, as an international community, we may be shocked by State actions now that did not offend us previously."[121]

The tribunal also agreed with *International Thunderbird* that

> "legitimate expectations relate to an examination under Article 1105(1) in such situations 'where a Contracting Party's conduct creates reasonable and justifiable expectations on the part of an investor (or investment) to act in reliance on said conduct ....' In this way, a State may be tied to the objective expectations that it creates *in order to induce* investment."[122]

As regards the relationship between Article 1105 and 'legitimate expectations', the tribunal stated that

> "a violation of the customary international law minimum standard of treatment, as codified in Article 1105 of the NAFTA, requires an act that is sufficiently egregious and shocking—a gross denial of justice, manifest arbitrariness, blatant unfairness, a complete lack of due process, evident discrimination, or a manifest lack of reasons—so as to fall below accepted international standards and constitute a breach of Article 1105. Such a breach may be exhibited by a "gross denial of justice or manifest

[121] *Id*., para. 616.

[122] *Id*., para. 621.

> arbitrariness falling below acceptable international standards;" or the creation by the State of objective expectations *in order to induce* investment and the subsequent repudiation of those expectations."[123]

147. The tribunal found, on the facts, that "no specific assurances were made to induce Claimant's 'reasonable and justifiable expectations',"[124] so the tribunal "need not determine the level, or characteristics, of state action in contradiction of those expectations that would be necessary to constitute a violation of Article 1105."[125] The finding is of considerable relevance to the present case. In that case, "a reasoned, complicated legal opinion on an issue of first impression (…) changed a decades-old rule and century-old regime upon which Claimant had based reasonable expectations."[126] The issue for the tribunal therefore was "whether a lengthy, reasoned legal opinion violates customary international law because it changes, in an arguably dramatic way, a previous law or prior legal interpretation upon which an investor has based its reasonable, investment-backed expectations."[127] The tribunal ruled that it did not; such a change would only give rise to a violation of Article 1105 if it occasioned "a gross denial of justice, manifest arbitrariness, blatant unfairness, a complete lack of due process, evident discrimination, or a manifest lack of reasons,"[128] and the tribunal found that it did not, because it was not arbitrary, did not exhibit a manifest lack of reasons, did not exhibit blatant unfairness or evident discrimination to this particular investor, and did not violate Article 1105 based on the unsettling of reasonable, investment-backed expectation, because it was not based on at least a quasi-contractual relationship between the State and the investor, whereby the State has purposely and specifically induced the investment, and did not violate due process standards.[129]

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[123] *Id*., para. 627.

[124] *Id*., para. 622.

[125] *Id*.

[126] *Id*., para. 761.

[127] *Id*.

[128] *Id*., para. 762.

[129] *Id*., paras. 762-5 and 768.

Cargill v. Mexico

148. This award referred with approval to *Waste Management (No. 2)*. The *Cargill* tribunal drew from this award the conclusion that the behavior must be

> "'gross', 'manifest', 'complete' or such as to 'offend judicial propriety'. The Tribunal grants that the words are imprecise and thus leave a measure of discretion to tribunals. But this is not unusual. The Tribunal simultaneously emphasizes, however, that this standard is significantly narrower than that present in the *Tecmed* award where the same requirement of severity is not present."[130]

Having found that the standard in the *Tecmed* award did not reflect customary law, the tribunal concluded that

> "[i]f the conduct of the government towards the investment amounts to gross misconduct, manifest injustice or, in the classic words of the *Neer* claim, bad faith or the wilful neglect of duty, whatever the particular context the actions take in regard to the investment, then such conduct will be a violation of the customary obligation of fair and equitable treatment."[131]

149. The *Cargill* tribunal also addressed the claimant's argument that Article 1105 requires NAFTA Parties "to provide a stable and predictable environment in which reasonable expectations are upheld."[132] The tribunal noted that this argument was premised exclusively on the Preamble to the NAFTA, and concluded that

> "[n]o evidence … has been placed before the Tribunal that there is such a requirement in the NAFTA or in customary international law, at least

[130] *Cargill*, para. 285.

[131] *Id*., para. 286.

[132] *Id*., para. 289.

> where such expectations do not arise from a contract or quasi-contractual basis."[133]

In reaching its conclusion the tribunal stated that:

> "In summation, the Tribunal finds that the obligations in Article 1105(1) of the NAFTA are to be understood by reference to the customary international law minimum standard of treatment of aliens. The requirement of fair and equitable treatment is one aspect of this minimum standard. To determine whether an action fails to meet the requirement of fair and equitable treatment, a tribunal must carefully examine whether the complained-of measures were grossly unfair, unjust or idiosyncratic; arbitrary beyond a merely inconsistent or questionable application of administrative or legal policy or procedure so as to constitute an unexpected and shocking repudiation of a policy's very purpose and goals, or to otherwise grossly subvert a domestic law or policy for an ulterior motive; or involve an utter lack of due process so as to affect judicial propriety. The Tribunal observes that other NAFTA tribunals have expressed the view that the standard of fair and equitable treatment is not so strict as to require 'bad faith' or 'wilful neglect of duty'. The Tribunal agrees. However, the Tribunal emphasizes that although bad faith or wilful neglect of duty is not required, the presence of such circumstances will certainly suffice."[134]

150. Applying this standard, the tribunal found as

> "most determinative the fact that the import permit was put into effect by Mexico with the express intention of damaging Claimants' … investment to the greatest extent possible [and for this reason found the action did]

[133] *Id*., para. 290.

[134] *Id.*, para. 296.

> surpass the standard of gross misconduct and [was] more akin to an action in bad faith."[135]

For this reason the *Cargill* tribunal found a violation of Article 1105.

151. The Tribunal notes that no allegation of a similar nature has been made by the Claimants in the present case. In particular, there is no evidence before the Tribunal that the Respondent, or any other bodies for which it is internationally responsible, acted in a manner that was intended to damage the Claimants' investments, whether to the maximum extent possible or even at all.

E. THE TRIBUNAL'S ASSESSMENT OF THE STANDARD UNDER ARTICLE 1105

152. On the basis of the NAFTA case-law and the parties' arguments, the Tribunal summarizes the applicable standard in relation to Article 1105 as follows:

> (1) the minimum standard of treatment guaranteed by Article 1105 is that which is reflected in customary international law on the treatment of aliens;
>
> (2) the fair and equitable treatment standard in customary international law will be infringed by conduct attributable to a NAFTA Party and harmful to a claimant that is arbitrary, grossly unfair, unjust or idiosyncratic, or is discriminatory and exposes a claimant to sectional or racial prejudice, or involves a lack of due process leading to an outcome which offends judicial propriety.
>
> (3) in determining whether that standard has been violated it will be a relevant factor if the treatment is made against the background of
>
> > (i) clear and explicit representations made by or attributable to the NAFTA host State in order to induce the investment, and

[135] *Id*., para. 298.

(ii) were, by reference to an objective standard, reasonably relied on by the investor, and

(iii) were subsequently repudiated by the NAFTA host State.

153. This applicable standard does not require a State to maintain a stable legal and business environment for investments, if this is intended to suggest that the rules governing an investment are not permitted to change, whether to a significant or modest extent. Article 1105 may protect an investor from changes that give rise to an unstable legal and business environment, but only if those changes may be characterized as arbitrary or grossly unfair or discriminatory, or otherwise inconsistent with the customary international law standard. In a complex international and domestic environment, there is nothing in Article 1105 to prevent a public authority from changing the regulatory environment to take account of new policies and needs, even if some of those changes may have far-reaching consequences and effects, and even if they impose significant additional burdens on an investor. Article 1105 is not, and was never intended to amount to, a guarantee against regulatory change, or to reflect a requirement that an investor is entitled to expect no material changes to the regulatory framework within which an investment is made. Governments change, policies changes and rules change. These are facts of life with which investors and all legal and natural persons have to live with. What the foreign investor is entitled to under Article 1105 is that any changes are consistent with the requirements of customary international law on fair and equitable treatment. Those standards are set, as we have noted above, at a level which protects against egregious behavior. It is not the function of an arbitral tribunal established under NAFTA to legislate a new standard which is not reflected in the existing rules of customary international law. The Tribunal has not been provided with any material to support the conclusion that the rules of customary international law require a legal and business environment to be maintained or set in concrete.

F. APPLICATION OF THE STANDARD TO THE FACTS

154. Having regard to the above conclusions, in support of its claim that there has been a breach of Article 1105, the burden is on the Claimants to establish a number of factual propositions. They must establish that (1) clear and explicit representations were made by or attributable to

Canada in order to induce the investment, (2) such representations were reasonably relied upon by the Claimants, and (3) these representations were subsequently repudiated by Canada.

155. The Claimants assert that when they made the decision to proceed with their investment in the Hibernia project 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."[136] According to the Claimants, they had watched the Board administer the Accord Acts with the support of the Federal and Provincial governments over a period of a decade, and concluded that it was therefore "reasonable for the Claimants to rely on that experience as a guide."[137] The implication that was drawn, allegedly, was that there would be no change in the scope of their benefit commitments.[138] According to the Claimants, this extensive history of State conduct, by the Federal and Provincial governments and the Board, created legitimate expectations that the regulatory arrangements in relation to the Benefits Plan would not change in a way that would materially and negatively affect the Claimants.[139] Put another way, the Claimants assert that by changing the rules, the Respondent failed to provide a 'stable regulatory framework' for the conduct of petroleum development projects in the Newfoundland offshore area, and thereby frustrated the Claimants' legitimate expectations.[140]

156. At the heart of these claims is an assertion that the Federal and Provincial governments, and the Board, made a series of express promises – in the form of representations - which they then broke. For the reasons set out below, having carefully studied the record and all the evidence the Tribunal is unable to conclude that any such 'promises' were made, either expressly or by any pattern of behavior over a ten year period, such as to give rise to a representation that there would not be changes to the regulatory regime. In order to be able to rely upon an expectation that is said to exist, evidence would need to be tendered to show

[136] Cl. Mem., para. 211.

[137] *Id*.

[138] *Id*.

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

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

clear and explicit representations together with an indication as to reliance being placed upon such representations. The record in this case shows no such evidence, including of any subjectively held expectation that might be claimed to have existed.

157. For its part, the Respondent asserts that there is an affirmative and continuing obligation on the Claimants to make expenditures on R&D.[141] The Respondent further argues that the Federal Accord and Provincial Accord Acts did not give the Claimants a discretion regarding payments. It is Respondent's case that it did not make any representations contrary to the above, or that they would not exercise their discretion to issue new guidelines as to the application and administration of Section 45 of the Federal Accord Act.[142] The Respondent also relies on the fact that the Canadian courts confirmed that the Board had the legal authority to impose the 2004 Guidelines as a matter of Canadian law, and that the courts' reasoning on this point was not further challenged by the Claimants in these proceedings.[143] The Respondent made the further point that the Claimants had introduced no documents or witness statements in support of the claim that representations were made upon which the Claimants relied.[144]

158. In assessing the facts by reference to the evidentiary record, it is appropriate to bear in mind the regulatory framework within which the Claimants decided to make their investment. That framework within which the benefits plan was adopted has been described in full at paragraphs 33-45 above. As the Claimants are prudent and experienced investors, the Tribunal proceeds on the basis that they must have carefully considered the regulatory framework before proceeding. That framework comprised of three different instruments:

(1) the Atlantic Accord, Sections 51 and 52 of which provide that before the start of exploration or field development, a Benefits Plan that is satisfactory to the Board must be submitted, and that it

[141] R. Counter, para. 274.

[142] *Id*., paras. 274-5.

[143] *Id*., para. 276.

[144] R. Rejoinder, paras. 221-224, *et seq*.

will be reviewed by the Board in consultation with both governments;[145]

(2) the Federal Accord Act, Section 45 of which provides that a Benefits Plan must contain a proposal for R&D and E&T expenditures to be carried out by the project proponent, and Section 151 of which provides that the Board may publish, in a manner it deems appropriate, guidelines and interpretation notes, and that such guidelines and interpretation notes shall not be deemed statutory instruments;[146] and

(3) Provincial Accord Act, Section 147, which provides that the Board is authorized to adopt guidelines with respect to the application and administration of the Benefits Plan requirements.[147]

159. It is readily apparent that the Atlantic Accord does no more than establish the basis for the Federal and Provincial governments to impose benefits plans imposing R&D requirements. There is nothing in the text of the Atlantic Accord that expressly prevents the Federal or Provincial governments from establishing a prescribed level of R&D, as opposed to the system of self-assessment of R&D levels imposed by the original Benefits Plans. Nor does the Tribunal see any basis for concluding that a change to the Benefits Plans, by imposing a prescribed level of R&D, is necessarily contrary to a reading of the Atlantic Accord. In short, those Accords cannot be seen as containing any promise or representation to not change an existing benefits plan or to impose a new plan that is consistent with the requirements of the Atlantic Accords.

160. The Tribunal also finds no such requirements in the Federal Accord Act, or the Provincial Accord Act. Section 45 of the Federal Accord Act is broad in its terms and does not specify the kind of benefits plan that might be adopted' it cannot be read to prohibit *per se* a benefits plan that establishes a 'prescribed level of R&D.' Moreover, the fact that the Federal Accord

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145 CA-10.

146 CA-11.

147 CA-12.

Act includes Section 151.1, which allows the Board to "issue and publish (…) guidelines and interpretation notes with respect to the application Section 45," will have alerted the Claimants to the possibility that an amendment to an existing benefits plan could not be excluded and might be made. There is nothing in Section 151.1, on its face or otherwise, that prevents such an amendment establishing a Benefits Plan that establishes a prescribed level of R&D as such. The same conclusions apply in relation to the Provincial Accord Act, Section 45 of which cannot be read to expressly or impliedly prohibit a benefits plan that establishes a prescribed level of R&D, and Section 147 of which provides an analogous provision to Section 151.1 of the Federal Accord Act. In short, neither the Federal Accord Act nor the Provincial Accord Act may be interpreted as making any promise or representation not to change an existing benefits plan or to impose a new plan that is consistent with the requirements of the Federal Accord Act and/or the Provincial Accord Act.

161. Did the Board by other means make a promise or representation that the Benefits Plan would not be amended or, if it was, that it would not establish a Benefits Plan that established a prescribed level of R&D? The Tribunal has carefully studied the record and has been unable to find any evidence that such a "promise" or representation was made. The 1986 Hibernia Benefits Plan does not contain any such promise or representation. Adopted on the basis of the Federal Accord Act and the Provincial Accord Act, the conclusions set out in the preceding paragraph apply with equal force to the Benefits Plan itself; the 1986 Benefits Plan does not on its face offer a promise or representation that it will not be changed or that a new benefits plan might not be adopted that is consistent with the requirements of the Federal Accord Act and/or the Provincial Accord Act. What can be said, however, is that at the time of the Board's decisions approving the Hibernia Benefits Plans, there was no discernible dissatisfaction with the actions that were proposed to be taken by the Claimants, and no suggestion as to whether the regulatory framework governing that investment might change. The Terra Nova Decision indicated increased monitoring requirements and additional conditions, but that too did not appear to indicate, at the time, that the Board was fundamentally dissatisfied with the then actions of the Claimants, with respect to these investment projects. Thus, no specific assurances were provided, and there was no clear indication at the time that the actions to be taken by the Claimants were in some way fundamentally unsatisfactory to the Respondent.

162. The Claimants also assert that the Respondent made promises or representations by other means, namely the framework agreement concluded in 1990, regarding Hibernia[148] and the Foreign Investment Review Act ("FIRA").[149] The Respondent argues that neither is relevant to these proceedings. The Tribunal agrees that neither of these instruments could amount to a representation, made by or on behalf of the Respondent, that the 1986 Benefits Plan would not be changed or that a new Benefits Plan that is consistent with the requirements of the Federal Accord Act and/or the Provincial Accord Act, might not be adopted. As regards the framework agreement, the Tribunal notes the force of the Respondent's point that it had no connection with any obligations the Claimants had under Section 45 of the Atlantic Accord, and that the Board was not even a party to the framework agreement.[150] As regards the FIRA, the Tribunal cannot see how the Claimants can eke out a representation out of a Federal Accord Act that was not in force at the time they made their investment, having regard to the fact that the FIRA was replaced in 1985 by the Investment Canada Act.[151] Whatever context the FIRA may have provided, it cannot amount to a representation that gives rise to any expectation on behalf of the Claimants.[152]

163. Moreover, there is nothing in the record to show that any person acting for or on behalf of the Board made any explicit future oriented promise or representation prior to the adoption of the Benefits Plan in 2004, or at any time thereafter that the approach adopted in the Plan would be maintained as a constant in the future. Counsel for the Respondent reiterated this point on the final day of the hearing, stating that the Claimants

> "have not identified any specific assurances that are relevant to this dispute. They have identified no promises from the Board that the Operators can just undertake research and development necessary for the projects. They have identified no promises that the Operators could unilaterally determine how much they could spend. They have identified

[148] Cl. Mem., para. 71.

[149] Cl. Reply, para. 9.

[150] Day 1 Transcript, p. 280-283:7-12 (Washington, D.C., October 19, 2010) (Gallus).

[151] R. Rejoinder, para. 222; Day 1 Transcript, p. 280-283:7-12 (Washington, D.C., October 19, 2010) (Gallus).

[152] Day 4 Transcript, p. 1145:22 (Washington, D.C., October 22, 2010) (Rivkin).

> no promise that the Guidelines would not be issued; no promise that the Board would not rely on its authority under Section 151.1(1)1 to issue such Guidelines; and, finally, no promise that the Board would not enforce the Claimants' obligation under Section 45(3)(c) to expand on research and development and education and training in the Province."[153]

Since the Claimants have not asserted that any such specific assurance was made, that point is not in dispute between the parties. The Claimants argued, as noted above, that they had obtained assurances from the Board that their existing Benefits Plans were satisfactory and met regulatory requirements, and further argued that this served as the basis for their expectation that conditions would not be altered.

164. This is the heart of what is left to support the Claimants' argument that a promise or representation was made. In short, the Claimants' argument is that the 1986 and 1997 Benefits Plans amounted to agreements in the nature of a contract, and that it was implicit in those agreements that there would be no changes to the Benefits Plans of the kind that were later adopted. The point was put in the following way:

> "The 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."[154]

165. In making this argument, the Claimants have to show that the Benefits Plans amounted to a contractual arrangement, and that the contractual arrangement contained an implicit undertaking that there would be no material changes. They would also have to show that by entering into such a contractual undertaking the Board had, by taking decisions to approve the Benefits Plans, in some way fettered its ability to act under obligations arising from the

[153] *Id*., p. 1296:6 (Gallus).

[154] Cl. Mem., para. 207.

Atlantic Accord, the Federal Accord Act and the Provincial Accord Act. Each of these claims is difficult to sustain on the facts of this case.

166. The Tribunal is not able to accept these arguments. Both Benefits Plans were adopted by Decision of the Board. Whatever discussions, negotiations or exchanges that may have occurred before these decisions, the decisions are not in the form of a contractual agreement and, in the view of the Tribunal, cannot otherwise be said to amount to a contractual undertaking. The Board’s decisions amounted to an exercise of administrative or public authority. The essential point, however, is that the Claimants have not been able to point to any promise or representation made by any person on behalf of the Board or the Respondent that the Benefits Plans, or the decisions that adopted them, would not be supplemented by any changes, including changes that were consistent with and lawful under the Atlantic Accord, the Federal Accord Act and the Provincial Accord Act. It follows that the Claimants are unable to show that in some way they were induced into making the investment by certain promises.

167. The question of consistency with the Atlantic Accord, the Federal Accord Act and the Provincial Accord Act was fully addressed by the Canadian courts, and resolved as a matter of Canadian law by the judgment of September 4, 2008 of the Newfoundland and Labrador Court of Appeal. In that case the majority rejected an appeal from a decision that found that the Board had acted lawfully under Canadian law. Leave to appeal to the Canadian Supreme Court having been rejected; the Court of Appeal’s ruling on Canadian law is dispositive. Although this Tribunal has a different task from that of the Court of Appeal, namely to determine whether there has been a violation of the law of NAFTA, it is not for us to express a view as to whether the Court of Appeal got its decision on Canadian law wrong. That decision is dispositive of the issues that arise as a matter of Canadian law. The conclusions reached by the Court of Appeal are relevant to and underpin our ruling that no violation of Article 1105 has occurred.

168. The Court of Appeal concluded that as a matter of Canadian law the Board had acted reasonably and lawfully in exercising its authority to apply the 2004 Guidelines to the

Hibernia and Terra Nova projects.[155] In reaching that conclusion, the Court of Appeal considered the regulatory framework within which the Claimants made their investment, the Benefits Plans approved, and the 2004 Guidelines adopted. In reaching its judgment the Court of Appeal interpreted the Federal Accord Act and the Benefits Plans, and it carefully considered Section 151.1. Judge Walsh, writing for the majority concluded:

> "There is no indication section 151.1 or the Guidelines were intended to operate retrospectively. However, under section 138(2), an operating licence expires on March 31 of each year, and is renewable only for one year periods. A production authorization is required for each work or activity, and an authorization can be suspended or revoked for failure to comply with a requirement in the authorization (subsections 138(4) and (5)). Section 45(3) requires that the benefits plan "contain provisions intended to ensure" that expenditures will be made for research and development in the Province. *When Hibernia Management and Petro-Canada entered into their agreements and their benefits plans were approved, they were aware of these provisions, and could, at the initial stage, have sought more specific language and particulars regarding expenditures on research and development*."[156] (emphasis added)

Justice Walsh also addressed the function of the Board's monitoring role:

> "A reasonable inference flowing from the monitoring function is that the Board may determine that the expenditures of a company do not meet the requirements of the benefits plan. Further to this point, the effect of the Guidelines is to advise companies regarding what to expect when the Board undertakes its monitoring function." [157]

Justice Berry concurring with Justice Walsh, added that the Board:

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[155] CA-53, *Hibernia and Petro-Canada v. C-NOPB*, paras. 58 and 70.

[156] *Id*., para 65.

[157] *Id*., para. 67.

> "approved the Hibernia and Terra Nova projects on condition that the Board have the authority to continuously monitor research and development expenditures and intervene by issuing guidelines requiring higher expenditures should the appellants' level of expenditures fall below that which the Board considered appropriate. *These were the rules of the game when development approvals issued. The same rules apply today*."[158] (emphasis added).

169. The Court of Appeal's findings, as here emphasized, are not without relevance to our assessment of whether the Claimants had a legitimate expectation that a certain standard of conduct would be met in relation to measures adopted under the Federal Accord Act and the Provincial Accord Act. In the present instance the Claimants need to show a specific assurance attributable to the Respondent. They need to be able to show that there were clear and explicit representations made by or attributable to the Respondent, in relation to future changes to the regulatory framework or requirements under Benefits Plans. Yet, as the Court of Appeal makes clear, the Claimants did not seek more specific language in respect of any future changes. There is no evidence before us that they sought assurances that Section 151.1 would not be relied upon to adopt new guidelines, or that any new guidelines would not be applied to their projects. Nor is there any evidence to show that they sought assurances that the Board's requirement to monitor the projects (to ensure that the Claimants' expenditures met the requirements of the benefits plans, as the Court of Appeal explained) would not lead to a situation in which the Board, having found that such expenditures were insufficient, would then impose additional requirements which were lawful under Canadian law. If the Claimants identified ambiguities in relation to the regulatory framework established by the Atlantic Accord and the Federal Accord and Provincial Accord Acts, provisions with which they were clearly familiar, then it was for them to seek clarifications and obtain specific assurances. If indeed the need to avoid future changes to the Benefits Plans was a matter of central concern, one assumes that the point would have been raised in the exchanges between the Claimants and the Board. There is no evidence before us that the point was so raised. Indeed, there is no evidence before us that any specific assurances were sought by the

[158] *Id*., para. 135.

Claimants in relation to future changes that might be adopted under Sections 45.3(c) and 151.1, and there is no evidence that any such assurances were given.

G. CONCLUSIONS ON ARTICLE 1105

170. In the absence of evidence indicating that the Claimants were induced to make their investments by clear and explicit representations in relation to any future change to the regulatory framework, or the Benefits Plans, whether by or attributable to the Respondent, the Tribunal concludes that there can be no violation of Article 1105 of the NAFTA on the ground alleged by the Claimants.

171. That being the basis for the Claimants' arguments as to the alleged violation of Article 1105, the Tribunal concludes that the Respondent's behavior did not amount to conduct that was arbitrary, grossly unfair, unjust or idiosyncratic, or discriminatory, or involved a lack of due process leading to an outcome which offends judicial propriety.

VI. ARTICLE 1106

A. INTRODUCTION

172. The Claimants allege that the required spending on R&D and E&T pursuant to the 2004 Guidelines constitute an impermissible performance requirement within the meaning of Article 1106(1)(c) of the NAFTA. As noted above, Article 1106 of the NAFTA ("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."

173. The Tribunal begins by setting out the parties' argument as to whether the 2004 Guidelines constitute a prohibited performance requirement under Article 1106 of the NAFTA. The legal issues that arise concern two questions; first, what constitutes the proper scope and interpretation of Article 1106, and in particular, do the R&D and E&T requirements under the 2004 Guidelines (and the application thereof) constitute 'services' within the meaning of Article 1106; and second, whether the 2004 Guidelines compel spending on R&D and E&T such that they constitute a 'requirement' to "purchase, use, accord a preference to goods produced or services provided in its territory, or to purchase goods or services from persons in its territory."[159] After addressing the parties' arguments, the Tribunal sets out its conclusions.

[159] NAFTA, Article 1106(1)(c).

B. INTERPRETING ARTICLE 1106: WHETHER R&D AND E&T CONSTITUTE 'SERVICES'

174. The parties agree that the interpretation of Article 1106 is governed by the 1969 Vienna Convention on the Law of Treaties ("VCLT"), and that the starting point is Article 31(1), which requires interpretation of a treaty to be undertaken "in good faith and in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in light of its object and purpose."[160]

1. Claimants' Arguments

175. The Claimants argue that "[o]n its face, Article 1106(1) prohibits NAFTA Parties from imposing or enforcing a requirement to purchase R&D services or goods in the territory, or to accord a preference to R&D services or goods provided in the territory."[161]

176. In the Claimants' view, the NAFTA prohibits performance requirements because "they subjugate the business judgment of foreign investors to the development goals of the host State and, in so doing, create investment and trade distortions."[162] Undertaking R&D as required by the 2004 Guidelines represents the substitution of the Board's own judgment and

[160] Article 31 of the VCLT provides: General Rule of Interpretation

1. A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.
2. The context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes:
   (a) any agreement relating to the treaty which was made between all the parties in connection with the conclusion of the treaty;
   (b) any instrument which was made by one or more parties in connection with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty.
3. There shall be taken into account, together with the context:
   (a) any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provision;
   (b) any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation;
   (c) any relevant rules of international law applicable I the relations between the parties.

A special meaning shall be given to a term if it is established that the parties so intended.

[161] Cl. Mem., para. 146.

[162] *Id*., para. 147.

development objectives for the business judgment of the project operators, and to this end reflects a distortion of investment flows.[163]

177. The Claimants' core argument is that R&D and E&T are 'services' within the meaning of Article 1106(1)(c). They refer to Webster's Third New International Dictionary which defines 'services' as "useful labor that does not produce a tangible commodity - usu. used in pl. (railroads, telephone companies, and physicians perform services although they produce no goods)."[164] They rely on the ordinary meaning of 'services' to argue that it includes R&D and E&T services, which makes spending requirements under the 2004 Guidelines a prohibited performance requirement.[165]

178. The Claimants further argue that the expenditure on R&D invariably involves the purchase of services from technical experts in the Province; "[t]hey also may entail (though to a much lesser extent) the purchase of goods as needed to support those services."[166] According to the Claimants, since 1106(1)(c) lists 'services' without any limitation or exclusion, the Respondent bears the burden of proving a special meaning of that term, that excludes R&D and E&T services.[167]

179. As R&D is expressly mentioned in Article 1106(4) which permits conditioning the receipt of an advantage on a requirement to carry out research and development in its territory, the Claimants argue that Article 1106(1) prohibits performance requirements involving services including R&D. [168]

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163 *Id*., para. 148.

164 Cl. Reply, para. 24.

165 *Id*., paras. 23-29.

166 *Id*., para. 151.

167 *Id*., paras. 23, 32.

168 *Id*., paras. 40-45; Cl. Reply, para. 42 elaborates that "The prohibition in paragraph 1 of Article 1106 applies to the *imposition or enforcement* of any of the seven categories of requirements specified in subparagraphs (a) through (g) of that paragraph, including 'services' as specified in subparagraph (c). By contrast, the prohibition in paragraph 3 of the Article applies to the *conditioning of the receipt or continued receipt of an advantage* on compliance with any of the four categories of requirements specified in subparagraphs (a) through (d) of that paragraph. In particular, subparagraph (b) of Article 1106(3) differs in important respects from the comparable requirement stated by Article 1106(1)(c), as it refers only to 'goods' and not to 'services.'" Cl. Reply, para. 43 states: "With this background, the import of Article 1106(4) is clear: because 'carry[ing] out research and development' and 'train[ing] … workers' are *services*, '[n]othing in paragraph 3' prohibits conditioning an

180. Although other NAFTA tribunals have considered Article 1106, the Claimants see these cases as offering little guidance because the Article 1106 dimension was ancillary to the claim, or the requirements at issue did not, on their face, fall squarely within Article 1106, which they argue is the case in the present dispute.[169]

181. The Claimants look to other provisions of the NAFTA for contextual support for their interpretation that services in the NAFTA include R&D and E&T services. For example, the scope and coverage provisions of NAFTA's chapter on government procurement referred to 'goods' and 'services'.[170] Moreover, with respect to services, the NAFTA Parties agreed on a common classification system for reporting purposes, and that system included 'research and development services' and 'educational and training services.'[171] The Claimants argue that this demonstrates that the Respondent understood that R&D and E&T included services.[172]

182. As regards the negotiating history of the NAFTA, as a supplementary means of interpretation pursuant to Article 32 of the VCLT, the Claimants argue that Canada had proposed an exception for R&D and E&T to the main prohibition now contained in Article 1106(1), in addition to the text which is the predecessor to the current Article 1106(4).[173] Canada's proposed text was not accepted by the other NAFTA Parties. Nevertheless, according to the Claimants, this proposed draft text of Article 1106 reflects Canada's recognition that R&D and E&T were covered by the term 'services.'

183. The Claimants also reference the classification instruments in the Uruguay Round, which was negotiated contemporaneously with the NAFTA, to confirm their interpretation that the

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advantage on a requirement that such services take place in Canadian territory. In other words, because Article 1106(3) does not apply to services, it cannot be construed to prevent a Party from adopting measures with respect to R&D or E&T services."

169 Cl. Mem., para.149; *See also* fn. 285.

170 NAFTA, Article 1001(1).

171 Cl. Reply, para. 25.

172 Cl. Reply, paras. 25-27.

173 Cl. Reply, para. 50: That draft text reads: "2. Notwithstanding paragraph 1, a party may nonetheless condition the establishment or acquisition of an investment, and its subsequent conduct or operation, on commitments to locate production, carry out research and development, train or employ workers, construct or expand particular facilities in its territory." NAFTA, Chapter 11, Trilateral Negotiating Draft Text, Doc No. INVEST. 710, pp. 10-11 (July 10, 1992) 32.

ordinary meaning of the term ‘services’ encompasses R&D and E&T services.[174] Moreover, the Claimants note that UNCTAD has issued reports that classify requirements to conduct R&D as performance requirements.[175]

184. The Claimants further consider the terms and structure of the 2004 Guidelines as being relevant to the context within which the interpretation occurs. The 2004 Guidelines have attached to them an Expenditure Application Form that is designed to provide some ‘concrete idea’ of the R&D services that the Guidelines cover. The form provides check-boxes for ‘engineering, design, computer programming”, ‘mathematical analysis and testing of psychological research,” among other classifications.[176] According to the Claimants, each of these clearly falls within the ordinary meaning of ‘services.’[177]

185. The Claimants argue that the Respondent is requiring a special interpretation of services that excludes R&D and E&T, and as such it bears the burden of proof in establishing that this special meaning, in Article 1106(1), excludes R&D and E&T services, on the grounds that they are “different types of performance requirements.”[178] The Claimants argue that “none of the sources on which [the Respondent] relies qualifies among the primary sources of treaty interpretation stated in the VCLT.”[179]

186. The Claimants agree with the Respondent that the only requirements prohibited under Article 1106(1) are those listed in that provision. However, they do not agree that a specified list of prohibited conduct means that those listed features should be interpreted restrictively. In the Claimants’ view, the limitations of Article 1106(5) do not apply to services, since it is

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174 *Id*., para. 28.

175 Cl. Mem., para.152: “UNCTAD has issued reports on at least two occasions classifying requirements to conduct R&D as performance requirements.”

176 CE-1, 2004 Guidelines.

177 Cl. Reply, para. 29.

178 *Id*., para. 32.

179 Cl. P. Brief (Redacted), p. 14 and fn. 25.

expressly mentioned in Article 1106(1)(c).[180] Article 1106(5) provides: "Paragraphs 1 and 3 do not apply to any requirements other than the requirements set out in those paragraphs."

187. Referencing a number of WTO cases which they view to be supportive of a non-restrictive approach to treaty interpretation, the Claimants argue that terms in a closed list should be interpreted in accordance with the "Vienna Convention and to achieve the goals of the treaty, and not in an restrictive manner."[181]

188. The Claimants further argue that such an interpretation of Article 1106(1)(c) accords with the NAFTA's objective of "eliminating barriers to trade in, and facilitating the cross-border movement of goods and services between the territories of the Parties."[182]

2. Respondent's Arguments

189. The Respondent argues that that the 2004 Guidelines do not breach Article 1106 of the NAFTA because Article 1106(1)(c) does not prohibit either R&D or E&T expenditure requirements. It also argues that R&D and E&T expenditure requirements are outside the scope of 'services' under Article 1106(1)(c). Thus, there is a fundamental disagreement between the parties as to whether R&D and E&T requirements constitute conduct that is included within, and hence prohibited by, Article 1106(1).

190. The Respondent asserts that Article 1106(1) identifies seven specific prohibited 'performance requirements,' and that only those expressly set out in Article 1106(1) are caught by Article 1106. They rely on the ordinary meaning of the terms in Article 1106(5) to assert that the list of performance requirements in Article 1106(1) is exhaustive, that it should be interpreted restrictively, and that accordingly, a performance requirement will not contravene the NAFTA unless explicitly prohibited by Article 1106(1).[183] Accordingly, the Respondent asserts that when considering whether R&D and E&T expenditure requirements are covered

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180 *Id*., p. 10: "Because services are specifically mentioned in Article 1106(1)(c), the exclusion in Article 1106(5) for matters not mentioned does not apply here."

181 Cl. Reply, para. 30, fn. 34.

182 *Id*., paras. 46-48; *See* NAFTA, Article 102.

183 R. Counter, paras. 144-154.

by Article 1106(1)(c), the treaty interpreter is required by Article 1106(5) to adopt a restrictive approach and determine that such requirements "fall squarely and specifically into the prohibited performance requirements of purchase, use or preference for local goods or services."[184] A measure will not contravene Article 1106(1) unless it is explicitly prohibited by it.[185]

191. The Respondent argues that Article 1106(1)(c) does not mention either R&D or E&T. They reason that:

> "[s]ince Article 1106(1) must be interpreted restrictively(…), as a threshold matter, it cannot be presumed, as the Claimants do, that a requirement for an investor to conduct or support R&D or E&T falls within the scope of Article 1106(1)(c)."[186]

To conclude otherwise, the Respondent argues, would be inconsistent with previous NAFTA decisions and would render Article 1106(5) redundant and inconsistent with the proper interpretation of the NAFTA; that each provision of the treaty be given effect.[187] The Respondent draws support for its view from several NAFTA cases.[188]

192. Moreover, in the Respondent's view, R&D and E&T represent distinct types of performance requirements. It notes, for example, that an UNCTAD survey of performance requirements treats "sourcing/local content performance requirements which are covered by NAFTA 1106(1) differently from research and development requirements and training requirements."[189] The Respondent argues that UNCTAD recognizes that R&D requirements are not encompassed by the TRIMS Agreement and are precluded in only a few bilateral or

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184 *Id.*, para. 152.

185 *Id.*, para. 146.

186 *Id.*, para. 157.

187 *Id.*, citing *S.D. Myers v. Canada*, UNCITRAL Partial Award, of November 13, 2000 ("*S.D. Myers*"), and *Pope & Talbot v. Canada*, UNCITRAL Interim Award, of June 26, 2000 ("*Pope & Talbot*"); *See also* R. Rejoinder, paras. 18-19.

188 R. Counter, para. 147.

189 *Id.*, para. 162.

regional treaties.[190] Similarly, training is considered a distinct form of performance requirement. R&D and E&T requirements "serve different policy goals than requirements to purchase, use or accord a preference to local goods or services."[191]

193. Another related line of argumentation in the Respondent's case is that where States have wanted to prohibit R&D and E&T, they have done so explicitly. It refers to several examples. The 1994 Model US BIT, which was developed at the same time of the NAFTA, contains an explicit prohibition on requiring a particular type or percentage of R&D, and numerous other treaties have explicitly referenced R&D when they wished to contain a prohibition to R&D requirements. The Multilateral Agreement on Investment ("MAI") also made a distinction between R&D and the requirement to purchase or use local goods and services.[192] The Canada-US Free Trade Agreement, which predated the NAFTA, drew a distinction between a prohibition on purchasing local goods or services as a condition of entry and operation of an investment, and R&D, which was not precluded.[193] Thus, the Respondent asserts that local content and R&D and E&T performance requirements are not the same and should not be treated as such when applying Article 1106. [194]

194. The Respondent also argues that requirements such as those set out in the 2004 Guidelines, which only incidentally result in the purchase, use or accord of preference to local services, are not prohibited under the NAFTA. According to Canada, to hold otherwise would be a slippery slope nullifying almost all requirements on foreign investors that indirectly implicate the use of local services.[195] The Respondent asserts that the Claimants have failed to understand the structure of Article 1106, or appreciate why certain clarifications were made to Article 1106(4) during the drafting process.[196] They refer to the risk of conflicting obligations with respect to R&D subsidies between the NAFTA and WTO subsidy

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[190] *Id*., paras. 162-164.

[191] *Id*., para.168.

[192] *Id*., para. 177.

[193] *Id*., para. 180.

[194] *Id*., para. 171.

[195] R. Reply P. Brief, paras. 15-16, citing *S.D. Myers*, *Merrill & Ring*, and *Lemire v. Ukraine*, ICSID Case No. ARB/06/18, Decision on Jurisdiction & Liability, of January 14, 2010 ("*Lemire*").

[196] R. Rejoinder, para.63.

agreement, and the resulting agreement in the NAFTA that permitted conditioning the receipt of an advantage on the performance of R&D in the territory.[197]

195. The Respondent further contests the Claimants' understanding of the draft negotiating text. It argues that the only "reasonable inferences that can be drawn from the NAFTA negotiating text and the ICA Reservations are [that] while there may have been some uncertainty in July 1992 as to whether R&D requirements were covered by what would become Article 1106(1), that uncertainty was resolved by August 1992 by virtue of what would become Article 1106(5)."[198]

C. CANADA'S ARTICLE 1108 RESERVATION

1. Claimants' Arguments

196. In support of their claim that R&D and E&T expenditures constitute a performance requirement under Article 1106, the Claimants reference Canada's Annex I Reservation for the Federal Accord Act. According to the Claimants' view, Canada's reservation of the R&D and E&T provisions of the Federal Accord Act in its Schedule to Annex I forms part of the context in interpreting Article 1106(1).[199] The Annex, they argue, was to list "existing measures *that do not conform* with obligations imposed by (…) Article 1106 (Performance Requirements)."[200] By listing the Federal Accord Act and specifically describing its R&D expenditure requirements separately from the basic requirement to have a benefits plan, the Claimants assert that "Canada acknowledged that a requirement to provide for R&D expenditures is itself inconsistent with Article 1106."[201] In other words, according to the Claimants, the reservation was necessary because, otherwise Article 1106(1) prohibited local content requirements for R&D services.

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[197] *Id*., para. 64.

[198] *Id*., paras. 67-72.

[199] Cl. Reply, para. 35.

[200] Cl. Mem., para. 153.

[201] *Id*., para. 154.

2. Respondent's Arguments

197. The Respondent rejects the Claimants' argument, and does not accept that by including the Federal Accord Act in Annex I of the NAFTA, it was in any way acknowledging that R&D expenditures are inconsistent with Article 1106(1).[202] Rather, the Respondent maintains that the reservation "should be considered in light of all the elements set out in the reservation, including the description of the reservation and the reserved articles."[203] The Respondent asserts that Canada adopted a "belt and suspenders"[204] approach because

> "[w]hen the reservation was drafted, there were no decisions to guide how Article 1106 might be interpreted by future arbitral tribunals, [and] [i]n light of that uncertainty and the complexity of the NAFTA's performance requirements provision, it makes sense that the reservation description was drafted to be fulsome and over-inclusive, even at the risk of including aspects of the Benefit Plans that did not necessarily violate Article 1106(1)."[205]

D. COMPULSION UNDER THE 2004 GUIDELINES

198. The parties agree that in order to be caught by Article 1106(1) of the NAFTA, a performance requirement must contain a requisite degree of compulsion.

1. Claimants' Arguments

199. The Claimants argue that compliance with the 2004 Guidelines is mandatory, and will compel Hibernia and Terra Nova to spend $189 million more on R&D throughout the remaining life of the Hibernia and Terra Nova projects, than they would have otherwise undertaken.[206] According to the Claimants, expenditures in excess of what would otherwise

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202 R. Counter, para. 203.

203 *Id.*, para. 205.

204 *Id.*, para. 213.

205 *Id.*

206 Cl. Mem., para.150.

be undertaken under the original Benefits Plans confirms the existence of compulsion and demonstrates that the 2004 Guidelines constitute a performance requirement within the meaning of Article 1106(1).[207]

200. The Claimants also argue that there is no doubt that the Guidelines constitute a 'requirement' within the meaning of Article 1106(1). They note, for example, that even though the 2004 Guidelines are characterized as 'guidelines' rather than requirements, "every available indicator, including their text, functionality and purpose, makes clear that the Guidelines establish compulsory obligations."[208] The term 'requirements' appears in numerous places in the 2004 Guidelines, with respect to areas such as Section 2 which is captioned 'Required Expenditure Commitments.'[209] Section 2.2.2, concerning expenditure targets, uses the word 'requirement' five times, including three times in the phrase "production phase R&D expenditure requirement."[210]

201. The Claimants further highlight that the Section dealing with expenditure management further provides for unspent expenditure commitments into an "R&D fund in the event that there are not sufficient projects to absorb the required level of expenditure in a given POA period."[211] Furthermore, when an operator "overspends its R&D requirement, the excess may be applied against its requirement in the subsequent POA period."[212] The Claimants further argue that the Board requires the project operator to comply with the Guidelines as a condition to issuance of a POA.[213]

202. The Claimants argue that Article 1106(1) applies to 'services' in the broad sense, which is inclusive of both R&D and E&T, and accordingly E&T is not exempt from coverage. Moreover, Article 1106(1) applies to requirements "to purchase, use or accord a preference to goods produced or services provided in the territory, or to purchase goods or services from

207 *Id.*, paras. 151 and 155.

208 *Id.*, para. 156.

209 *Id.*, para. 157.

210 *Id*.

211 *Id.*, para. 158.

212 *Id*.

213 *Id.*, para. 160.

persons in its territory," irrespective of the form of the transaction. The examples that the Respondent references such as funding a professorial chair, or providing scholarships or classroom furnishings or various research and educational projects in the Province, are not outside Article 1106(1)(c)'s prohibition because they are E&T expenditures that do not involve the purchase of local goods or services.[214] According to the Claimants, the requirement contained in the 2004 Guidelines includes actions that "accord[s] a preference" to educational services provided in the province, which is what these expenditures represent.[215] The Claimants assert that to suggest that the "Claimants can now avoid any conflict with the NAFTA by making expenditures exclusively on E&T" [is] "both ineffective given the prohibition in Article 1106 (1) (c) of local content requirements for services (including E&T services), and disingenuous in view of the clear orientation of the Guidelines to expenditures on R&D."[216]

203. The Claimants further argue that the Accord Acts themselves, at Section 45(3), tie E&T expenditures to "education and training to be provided in the Province," and the wording of the 2004 Guidelines make clear that such expenditures are designed to accord a preference to E&T services provided in the Province. The 2004 Guidelines state, at Section 3.4, that "the definition of education and training in the Province (…) shall include expenditures for (…) scholarships and work terms including provincial residents who may study or work outside the Province."[217] In this way, even study abroad programs are designed to according a preference to services in the Province as the Claimants are paying funds to those students.[218]

204. The Claimants also reject the arguments advanced by the Respondent, to the effect that there are examples of spending that fail to require the use, or accordance, of a preference of goods or services provided in the Province.[219] In the case of an in-house R&D facility, for example,

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214 Cl. Reply, para. 80.

215 *Id*.

216 *Id*., para. 84.

217 CE-1, 2004 Guidelines.

218 Day 1 Transcript, p. 80 (Washington, D.C., October 19, 2010).

219 Cl. P. Brief, p. 11.

which the Respondent has characterized as "incidental spending,"[220] the Claimants note that there is no way to create or conduct such a facility without using or according a preference to local goods and services in its construction and operation. It relies on the testimony of one of Canada's witnesses at the oral hearing to support this proposition.[221] According to the Claimants, the basic purpose of the 2004 Guidelines was to "extract greater commitment to R&D from the oil and gas sector,"[222] so that the Board developed a specific expenditure requirement based on a statistical index for nationwide R&D spending by the oil and gas sector.

2. Respondent's Arguments

205. The Respondent argues that even if R&D and E&T could fall within the scope of Article 1106(1)(c), and even if some R&D and E&T expenditures may involve local goods or services, the 2004 Guidelines do not necessarily compel the purchase, use or accordance of a preference to local goods and services.[223] They rely on the premise that if a measure allows an investor the option of expending on something that is not prohibited, then there is no compulsion, and, therefore, no breach of the NAFTA obligations.[224] The Respondent asserts that if "an impugned measure does not specifically require the investment of the investor to purchase, use or prefer local services, and allows compliance by means which do not implicate 1106(1)(c), then the claim of a violation must be rejected."[225]

206. The Respondent further asserts that the 2004 Guidelines are sufficiently broad and flexible that Claimants could make qualifying expenditures without necessarily purchasing or using local goods and services, and the Guidelines do not even "necessarily require the Claimants

[220] *Id*.

[221] *Id*. *See* fn. 21; Day 3 Transcript, p. 742:8-21 (Washington, D.C., October 21, 2010) (Way) Q: In order to build that in-house research and development facility, of course, the Hibernia owners would have to buy local goods in order to build the facility, right? A: I presume some local goods. Q. And they would have to buy local services because those are the people who are going to build the facility; right? A. Yes. Q. And once the Facility was up and running, the services would be—the R&D in house facility would be providing research services in the Province of Newfoundland; correct? A. Yes." Mr. Frederick Way was one of Canada's three fact witnesses.

[222] Cl. Reply, para. 82.

[223] R. Counter, para. 183.

[224] *Id*., paras.184-185; R. Reply P. Brief, para. 7.

[225] *Id*.

to undertake R&D because the Claimants may fulfill their obligations exclusively through expenditures on E&T."[226]

207. Moreover, in the Respondent's view, while the 2004 Guidelines require expenditures, many of the eligible expenditures do not necessarily "impose or enforce a requirement or enforce a commitment or undertaking to purchase use or accord a preference for local goods or services."[227] In support of this proposition, the Respondent refers to the endowment of a chair at a university, the contribution of various ice research equipment to a university, or sponsorship of the furnishings of a classroom, as examples that do not result in the purchase of goods or services.[228] The example of endowing a chair at a university is not seen as resulting in the purchase of goods or services. Rather it bestows funds on the educational institution to be used for a specific educational purpose.[229] According to the Respondent, fellowships do not compel the purchase, use or accordance of a preference to local goods or services; "[r]ather it involves the contribution of funds to an educational institution or individual to support E&T."[230] The Respondent also references examples of specific R&D expenditures undertaken by Hibernia and Terra Nova in the Province that did not necessarily compel the purchase of goods or services.[231]

208. The Respondent cites further examples (such as endowment of academic research chairs, student scholarships and work abroad programs for students) of expenditures under the 2004 Guidelines that do not violate Article 1106(1)(c), on the ground that there is no exchange of services for expenditure.[232] The Respondent stresses that the 2004 Guidelines do not prescribe how the Claimants make such expenditures on R&D and E&T, as long as they are

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226 R. Counter, para. 186.

227 *Id*., para. 198.

228 *Id*., para. 199.

229 *Id*., paras. 198-199; *See also* R. Reply P. Brief, para. 8.

230 R. Counter, para. 198.

231 *See Id*., para. 199. Specifically, Respondent references sponsorship of an industrial research chair in ocean engineering; contribution of various ice research equipment to MUN and C-Core; sponsorship of the furnishing of a classroom for the MUN Centre of management development and contribution to C-Core's general trust fund, among others.

232 R. Rejoinder, para. 42; R. Reply P. Brief, paras. 7-8; Respondent indirectly conceded that R&D and E&T are 'services' within the meaning of Article 1106(1)(c).

carried out in the Province.[233] They reason that if the operators use domestic entities to carry out R&D in the Province for business reasons, this will not amount to an imposition of a requirement.[234]

209. The Respondent, relying on the ordinary meaning of the terms "provided" and "purchase[d] (…) from persons" in Article 1106(1)(c), argues that Article 1106(1)(c) is only brought into play when the "service supplier and the service consumer are separate entities [and] when a requirement *compels* the provision of a service from a domestic service provider to the investment of the investor."[235] The requirement under the 2004 Guidelines to 'carry out' R&D and that E&T 'be provided' in the territory does not, according to the Respondent, fall under the prohibition of Article 1106(1)(c).[236] According to the Respondent, establishing an in-house R&D facility in the Province would not result in a transaction that violates Article 1106(1)(c), and, yet, could qualify under the Guidelines.[237]

E. THE TRIBUNAL'S FINDINGS

1. Treaty Interpretation and the Scope of Article 1106

210. As required by Article 1131(1) of the NAFTA, the Tribunal is bound to apply "this Agreement [the NAFTA] and the applicable rules of international law." Accordingly, the Tribunal will also apply as "applicable rules" the rules of interpretation of treaties as set forth in Articles 31 and 32 of the VCLT. We interpret the requirements of Article 1106 in accordance with their ordinary meaning, in their context, and in light of their object and purpose.

211. Article 1106(1) prohibits the imposition of certain listed performance requirements in connection with the establishment, acquisition, expansion, management, conduct or operation of an investment. In the view of the Tribunal, there can be little doubt that the 2004

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233 R. Rejoinder , paras. 36, 40.

234 *Id*., para. 39.

235 *Id*., para. 22.

236 *Id*., para. 25.

237 *Id*., para. 38.

Guidelines purport to impose conditions on the Claimants with respect to their management, conduct or operation in the Province. The relevance of the preamble language of Article 1106 has not been challenged by the parties.

212. The question before the Tribunal is whether those 2004 Guidelines impose requirements "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" within the meaning of Article 1106(1)(c), and whether R&D and E&T constitute 'services' within the meaning of Article 1106(1)(c).

213. As outlined above, the Claimants and the Respondent agree that the prohibited requirements are specifically enumerated in Article 1106. The Claimants argue that R&D and E&T are 'services' within the meaning of Article 1106(1)(c). By contrast, the Respondent asserts that the enumerated list set out in Article 1106(1)(c) does not mention R&D and E&T, that States have specified when R&D and E&T is to be covered, that there is a distinction between R&D, E&T and performance requirements, and that reading Article 1106(1) to cover R&D and E&T is improper and would ignore the requirements of Article 1106(5).

214. The question as to whether a closed list, such as the enumerated impermissible performance requirements in Article 1106(1), should be read restrictively or not can only be partially addressed in the abstract. At one level of generality, there is no dispute that Article 1106(1) must be read in a manner that is consistent with the text as well as the object and purpose of the treaty.

215. Turning to the text, the Tribunal accepts the point made by the Respondent that the text of Article 1106 does not refer specifically to R&D and E&T as such. However, the Tribunal is not convinced that the absence of such express reference necessarily means that the terms are to be interpreted to the effect that the term 'services' does not include R&D and E&T.

216. The Tribunal considers that the more persuasive view is that the ordinary meaning of the term 'services' is broad enough to encompass R&D and E&T. On its face, the term 'services' covers a broad range of economic activities, and R&D and E&T may be seen as mainstream

forms of service sector activity. Thus, on its face, it would appear that there is nothing inherent in the term 'services' in Article 1106(1) that necessarily excludes R&D and E&T.

217. As noted by the parties, there is no single and comprehensive definition of services in the NAFTA. The Claimants and the Respondent have had to find support for their respective positions in provisions in the NAFTA that address services more generally,[238] or in particular articles of the NAFTA that refer to R&D and E&T, in dictionary definitions, in the terms of other trade agreements, and in the 2004 Guidelines themselves.

218. The Claimants reference the Webster's definition of 'services' to underscore the ordinary meaning, which provides that services include "useful labor that does not produce a tangible commodity."[239] In our view, the concepts of R&D as well as E&T would appear to fit into that broad definitional category of economic activity. The Tribunal further notes that research and development is defined in the Oxford English Dictionary as "work directed on a large scale toward the innovation, introduction and improvement of products and processes."[240]

219. Interpreting 'services' to include R&D and E&T is consistent with how services are to be treated within the treaty text of the NAFTA more broadly. Specifically, certain other references to services in the NAFTA, such as the classification system for services, provide some content as to the meaning of R&D services and E&T services, and support the conclusion that 'services' as a concept is broad enough to include R&D and E&T.[241] This is, in our view, necessary context for understanding a NAFTA provision.

220. Looking more specifically at the classification system developed under the NAFTA's procurement chapter, 'services' includes a category called R&D, which is defined as follows:

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[238] For example, Chapter 12 covers cross border trade in services, including professional services, foreign legal consultants and temporary licensing of engineers. Certain chapters of the NAFTA cover particular service sector areas such as telecommunications (Chapter 13) and financial services (Chapter 14).

[239] Cl. Reply, para. 24.

[240] Oxford English Dictionary, Online Version March 2012, available at: http://www.oed.com/view/Entry/274046?redirectedFrom=research%20and%20development#eid

[241] CA-71, NAFTA, Appendix 1001.1b-2-B, Section A; Cl. Reply, para. 25. R&D is then itself subject to different subgroups such as agriculture, education, energy, environmental protection, general science & technology, among others.

> "Procurement of research and development services include the acquisition of specialized expertise for the purposes of increasing knowledge in science; applying increased scientific knowledge or exploiting the potential of scientific discoveries and improvements in technology to advance the state of art; and systematically using increases in scientific knowledge and advances in state of the art to design, develop, test or evaluate new products or services."

The same classification system includes a category called 'educational and training services,' which has some 11 subcategories including such matters as; scientific and management training, vocational and technical, lectures for training, tuition registration and membership fees, faculty salaries for schools overseas, and other education and training services.[242] The Tribunal notes that there are several categories of services that are subject to explicit exclusion from open procurement in Canada's schedule; including 'research and development' and 'education and training.'

221. In our view, this NAFTA classification system is relevant in that it illustrates that:

(1) the category of services is defined broadly;

(2) research and development and education and training are recognized as categories of services, including by the NAFTA parties;

(3) the types of activities that are recognized in each such category as comprising R&D and E&T comport with the types of activities that are being undertaken pursuant to the 2004 Guidelines and the Hibernia and Terra Nova Benefits Plans to meet the R&D and E&T spending requirements in the Province; and

(4) such services cover a range of activities which are amenable to exploitation through the "purchase" "use" or "accord [of]a

[242] CA-71, NAFTA, Appendix 1001.1b-2-B, Section U.

preference," in the manner that is referred to by Article 1106 of the NAFTA.

222. The Respondent also argues that 1106(1)(c) is aimed at a particular closed set of performance requirements that would otherwise reduce the cross-border flow and importation of goods and services, while R&D requirements are aimed at increasing the knowledge base of the country. By this logic, the Respondent argues that R&D is not encompassed by the broad category of 'services.'[243] In the Tribunal's view, while the policy purposes may differ in some respects as between different types of performance requirements, the requirement to utilize domestic sources of R&D and E&T appears rather clearly to be a form of performance requirement imposed on an investor. Promoting economic development and improving the skills and education of Canadians in the Province would also seem to be in furtherance of economic policy objectives. Excluding R&D and E&T from a definition of 'services' because the form of transmission is not always cross-border (or the policy purpose of the requirement is not just strictly economic) is an argument for a special meaning to be given for R&D and E&T, which we do not see reflected in the NAFTA text. Nor does this interpretation comport with the NAFTA classification system for services, or the ordinary meaning of the term 'services.'

223. The Claimants emphasize that R&D is specifically mentioned in Article 1106(4), which clarifies that the prohibition on conditioning the receipt of an advantage for goods, as contained in 1106(3)(b), does not prevent a party from conditioning the receipt of an advantage with respect to a "service, train or employ workers, construct or expand particular facilities, or carry out research and development in its territory," as contained in Article 1106(4). The Respondent argues that the provision was included to eliminate any doubt that parties were permitted to condition receipt of an advantage on the performance of R&D in its territory, and it should not be interpreted to mean that R&D comes under services.[244]

224. In the view of the Tribunal, the specific mention of R&D in Article 1106(4) may be seen as a means of indicating the NAFTA drafters' view that they intended to exclude R&D for the

[243] R. Counter, paras. 160-168.

[244] R. Rejoinder, para. 64.

purposes of investment incentives enumerated in Article 1106(4), but that they did not explicitly do so, for purposes of Article 1106(1).[245]

225. In the Tribunal's view, this interpretation of Article 1106 is not an expansive reading of 'services' but is rather one that is consistent with the treatment of R&D and E&T in the NAFTA and the object and purpose of the treaty, which is to eliminate barriers to trade and increase investment opportunities within the NAFTA Parties.[246] Such a conclusion does not render Article 1106(5) inutile, which is an important provision in addressing the scope of the prohibitions elaborated in Article 1106(1) and (3), but is one that does not provide guidance on interpreting the exact coverage of the enumerated performance requirements.[247]

2. Reference to Other Treaties, Agreements and Sources

226. The Claimants and the Respondent have both referenced other agreements, treaties, documents and the NAFTA preparatory materials, as relevant for interpreting Article 1106 of the NAFTA. The Respondent, for its part, has relied *inter alia* upon the US and Japanese BITs, UNCTAD reports, the draft MAI, and the Canada-US Free Trade Agreement. The Respondent also points to certain agreements as providing contextual support for the purposes of the VCLT.[248] The Claimants, for their part, have referred to *inter alia*, the Uruguay Round Agreements, which were negotiated contemporaneously with the NAFTA, and certain draft NAFTA negotiating text, as well as other UNCTAD reports and BITs as support for its interpretation.

227. The Tribunal is mindful that Article 32 of the VCLT allows recourse to supplementary means of interpretation

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245 Cl. Reply, para. 40. The Claimants argue that 1106(4) is an 'avoidance of doubt' provision that provides an exception whereby a NAFTA Party may condition the receipt of an advantage on the enumerated conduct which includes research and development in the territory.

246 NAFTA, Article 102.

247 In this sense, this Tribunal is mindful of the restricted scope of Article 1106(5) that the performance requirements that are prohibited are those that are mentioned in paragraph (1) and (3).

248 R. Counter, paras. 180-182; R. Rejoinder, para. 27. For example, Canada argued that the Canada-US FTA Article 1603(1)(c) formed the 'basis' of NAFTA Article 1106(1)(c).

> "in order to confirm the meaning resulting from the application of Article 31, or to determine the meaning when the interpretation according to Article 31: (a) leaves the meaning ambiguous or obscure; or (b) leads to a result which is manifestly absurd or unreasonable."

228. While treatises and materials can provide relevant context for the NAFTA, draft reports, other BITs, the draft MAI, or the Uruguay Round are not preparatory works for the purposes of Article 32 of the VCLT. The specific NAFTA draft negotiating texts advanced by the Claimants could be viewed as such,[249] but the weight to be ascribed to these texts is contested by the Respondent, which properly reminds the Tribunal not to assume what was in the minds of the negotiators.[250]

229. The Tribunal does not feel it necessary to resort to supplemental means of interpretation, and does not rely on such supplemental materials. Moreover, quite apart from the question whether these sources constitute relevant context, support or are properly viewed as supplementary means of interpretation for purposes of Article 32 of the VCLT, in the Tribunal's view, recourse to these other sources as supplementary means of interpretation does not assist in confirming either the Claimants' or the Respondent's views as to the scope of services under Article 1106.

230. These agreements and sources are not the NAFTA, they did not involve entirely the same parties to the negotiation, at times raise inter-temporal discontinuities, and the extent to which they did or did not influence the NAFTA parties in the preparation of the NAFTA text is not well established. Moreover, the purposes of these agreements are not identical to that of the NAFTA, for example, BITs are focused on investment related matters, while the NAFTA's performance requirements in Article 1106 are part of a larger treaty that is focused primarily on international trade. The reason for the exclusion of a provision in one treaty versus another is contested by the parties to this dispute.

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[249] Cl. Reply, para. 53.

[250] R. Rejoinder, para. 73.

231. Additionally, recourse to those materials that meet the test of supplementary materials for purpose of the VCLT, is also in doubt because the circumstances of such reliance do not seem present in this case, namely, that it is necessary to

> "determine the meaning when the interpretation according to Article 31 (…) 'leaves the meaning ambiguous or obscure' or 'leads to a result which is manifestly absurd or unreasonable.'"[251]

232. For these various reasons, the Tribunal is of the view that the other treaties or sources, discussed with great erudition by the parties, are in some instances of only limited relevance, and in other instances, are of no relevance for the purposes of interpreting or confirming the NAFTA text. Moreover, as the Tribunal reminded the parties during the discovery stage of this dispute, Articles 31 and 32 of the VCLT attaches the greatest importance for interpretation to the ordinary meaning of the treaty, taken in its context.

3. Compulsion

233. At a certain point in the pleadings, the Respondent does not contest that R&D and E&T can be a service. Instead, it shifts its emphasis to an argument that the 2004 Guidelines do not contain the requisite compulsion to run afoul of Article 1106.[252] Article 1106 refers to a "*requirement* 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." Indeed, it follows that a degree of legal obligation is necessary for the 2004 Guidelines and their implementation, to be caught by Article 1106.

234. We see ample evidence of the requisite degree of compulsion for the purposes of Article 1106. The Accord Acts state unambiguously that "expenditures shall be made for research

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[251] Article 32 of the VCLT provides: Supplementary means of interpretation

Recourse may be had to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of article 31, or to determine the meaning when the interpretation according to article 31:

(a) leaves the meaning ambiguous or obscure; or

(b) leads to a result which is manifestly absurd or unreasonable.

[252] R. Rejoinder, para. 14.

and development to be carried out in the Province and for education and training to be provided in the Province."[253] The 2004 Guidelines are designed to be applied as a matter of legal obligation by means of Benefits Plans, whilst leaving some flexibility for operators to design the specific modalities that could make the most sense for their project. The purpose is to introduce an obligatory *expenditure* requirement. The new guidelines offer specific and mandatory guidance as to what those expenditure levels need to be, and they are intended to be implemented by Benefits Plans that impose legal obligations that are subject to monitoring and supervision by the Board.

235. The 2004 Guidelines introduce a new and different approach, and it is obviously not the case that an operator may choose for itself whether to follow the requirements or not. The operator is required to file an R&D and E&T Expenditure Application form for each activity that it plans to undertake, which is reviewed by the Board for approval prior to the commencement of the activity.[254] The 2004 Guidelines take the position those expenditures on a "successful R&D program should not fluctuate widely,"[255] and there is a requirement that a fund should be established for "any POA period in which there are not sufficient projects to absorb the required level of expenditure, (…). The fund will be managed by the Board in conjunction with the operator consistent with these guidelines."[256] Thus, as these various elements make plain, the requirements of the 2004 Guidelines are to be implemented by means of a legal mechanism in the form of a Benefits Plan that will achieve compliance with the expenditure requirement.

236. The Respondent has argued that the requirement to carry out R&D or that E&T be provided in the Province does not automatically compel the Claimants to purchase, use or accord a preference to any particular domestic goods or services. It asserts that there are alternative ways for the operators to comply without providing a preference to local services or requiring the purchase, use or accordance of a preference for local goods or services. The Respondent

[253] *See* Section 45.

[254] CE-1, 2004 Guidelines, Section 4.1.

[255] *Id*., Section 4.2.

[256] *Id*.

emphasizes the absence of mandatory consumption of local goods or services or the provision of services provided to the investment of the investor.[257]

237. The Tribunal does not find these arguments compelling. It is no doubt possible to identify a small number of examples indicating that operators may not necessarily be compelled to purchase domestic goods or services. Nevertheless, the reality is that the implementation of the 2004 Guidelines would, in practice, require local expenditures.[258] Moreover, a number of the examples referenced by the Respondent cannot be implemented without according a preference to services provided in the Province. Endowing a university chair, furnishing a classroom, or providing scholarships are all requirements that accord, or are likely to accord, a degree of preference to local educational facilities or individuals. Even an in-house research facility would seem to require according a preference to local goods and services in order to undertake its construction and operation, as noted by the Claimants.[259]

238. Similarly, while one might be able to conceive of certain expenditures that have incidental effects, these examples are difficult to imagine in practice, and they are not the central intent of the 2004 Guidelines. Nor do they accord with the realities of commercial and related activities. In our view, the possibility of hypothetical alternative spending examples does not distract from requirements that would otherwise be caught by Article 1106. In practice, the Tribunal fails to see how the operators could, in reality, be required to spend millions of dollars on R&D and E&T in the Province without in practice being required to purchase, use, or accord a preference to domestic goods or services.

239. The Respondent has also made an argument that Article 1106(1)(c) only applies where the service provider and the service recipient are separate entities and one party is "providing" something to another party. Article 1106(1)(c), in the Respondent's view, requires reciprocal consideration for the service rendered, and the requirement compels the provision of a service from a domestic service provider to the investment of the investor.[260] This reasoning

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257 R. Reply P. Brief, paras. 2, 12-15. *See also* RA-104.

258 Cl. Reply, paras. 80-84.

259 Cl. P. Brief (Redacted), p. 11.

260 R. Rejoinder, para. 22.

allows the Respondent to argue that the Claimants can satisfy the 2004 Guidelines expenditures through certain types of transactions that do not have the compulsion that is required by Article 1106.[261] As noted above, the fact that it is theoretically possible to imagine arrangements allowing R&D or E&T expenditures to be undertaken in the Province that do not require the direct purchase of the service from another party fails to address the central purpose of the 2004 Guidelines, which is to require expenditures in the Province. Moreover, the Tribunal sees no requirement of separate entities or reciprocal consideration in the text of Article 1106, or in its underlying rationale.

240. Finally, although several previous cases address interpretative matters that this Tribunal has considered carefully, we note that this dispute has some significant differences from other cases that have involved NAFTA performance requirements. Perhaps most importantly, in the present case, the 2004 Guidelines are not only imposing incidental effects with respect to the purchase, use or accordance of a preference to local goods or services, which was the case with respect to most of the previous disputes that came before NAFTA arbitral panels under Article 1106. For example:

§ *S.D. Myers*[262] addressed an export ban introduced by Canada that the Claimant argued was a violation of Article 1106 because it required carrying out a major part of its proposed business - the physical disposal of PCB waste - in Canada, requiring it to consume goods and services in Canada. The majority of the tribunal, however, noted that the ban "was not cast in the form of an express condition attached to a regulatory approval"[263] and found that no requirements were imposed on the Claimant that fell squarely within those listed in Article 1106.

§ In *Pope & Talbot Inc.*[264] the investor claimed that Canada's softwood lumber export control regime violated Article 1106, in circumstances

[261] *Id*., para. 25. An expenditure requirement does not automatically require that a service "from a third party service provider, domestic or foreign, be purchased, used or accorded a preference."

[262] CA-44.

[263] *Id*., para. 273.

[264] CA-41.

where the regime had been introduced to comply with the US Canada Softwood Lumber Agreement. This regime permitted a certain level of softwood lumber to be exported from Canada without any fees up to a certain amount, with increasing fees attached thereafter. The tribunal stressed that the aim of performance requirements was to increase exports of goods or services but the wording of 1106(1)(a) would apply to a requirement to export at any level, and the measures at issue did not impose or enforce any requirements to export because exporters could pay export fees and undertake additional exports. While these fees deterred exports, there was no requirement to export at any particular level in return for the right to operate in Canada and thus the regime did not breach Article 1106(1)(a).[265]

§ In *Merrill & Ring*[266] the Claimant argued that the implementation of Canada's Log Export Regime imposed performance requirements in breach of Article 1106, notably in connection with the obligation to cut and sort timber, to scale timber rafts metrically and to follow certain other rules for properties located in remote areas, all of which impacted the way it managed its investments. The tribunal rejected the argument, holding that a requirement related to the advertisement of goods as a step in the process of obtaining an export permit cannot be seen as a restriction on exports themselves. It further held that the cutting requirements are not a performance requirement designed to restrict or enhance exports, and that metric scaling is a measurement system used throughout Canada. Thus, while these requirements may have an incidentally adverse effect, they do not amount to the kind of prohibited performance requirement banned by Article 1106.

[265] *Id*., paras. 74-75; *See also* CA-58

[266] RA-104, paras. 114-116, 118.

241. There is one case where the requirements fell squarely within the ambit of Article 1106, *ADF Group Inc. v. United States of America*.[267] This case involved the procurement of steel components to a highway interchange construction project in Northern Virginia, where the claimant, a Canadian company, challenged the Buy America clause that applied to the fabrication of steel. The tribunal ruled that the US measures appeared, by their own terms, to be local content requirements contrary to Article 1106(1)(b), as well as a requirement to accord a preference to goods or services produced or provided in the US (under Article 1106(1)(a)), which the Respondent did not dispute. Instead, the Respondent argued that it came within Article 1108 exclusions, which argument the tribunal accepted.

242. Most previous NAFTA disputes involving performance requirements have found the restraints to be ancillary. As argued in *S.D. Myers*, and noted in *Merrill & Ring*, “the fact that there might have been incidental consequences of the regulatory regime does not mean that these are performance requirements.”[268] In the circumstances of this dispute, the 2004 Guidelines are designed to ensure that expenditures for R&D and E&T services occur in the Province, and thereby implying a legal requirement for the purposes of Article 1106. It is plain, in the view of the Tribunal, that such spending on R&D and E&T in the Province is a central feature of the 2004 Guidelines, and not an ancillary objective or consequence.

F. THE ARTICLE 1108 EXEMPTION

243. The Tribunal addresses the structure and operation of Article 1108 in detail in the following section of this Decision. Nevertheless, the Tribunal considers it appropriate to briefly address the issue of Canada’s decision to include the Accord Acts provisions on R&D and E&T in its Article 1108 exemptions, and the weight to be attached to that decision for the purposes of an evaluation under Article 1106.[269]

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267 CA-16, *ADF Group Inc. v. United States of America*, ICSID Case No. ARB (A)/00/1, Award of January 9, 2003, paras. 159-160, 170-174 (“*ADF Group*”).

268 *Merrill & Ring*, para. 110.

269 R. Counter, para. 213.

244. In its listing of non-conforming measures, Canada identifies the Accord Acts' requirement that Benefits Plans include R&D expenditures as one such measure in Annex I to the NAFTA. It argues that no negative inference should be drawn from this listing.[270]

245. The Tribunal's analysis of Article 1106 has been undertaken on its own terms. The inclusion of the Accord Acts and their provisions governing R&D and E&T, and the specific reference to Article 1106, tend to confirm that the R&D and E&T requirements of the Accord Acts might be seen as constituting a prohibited performance requirement under Article 1106 of the NAFTA. While the Tribunal does not rely on the Respondent's use of the exemption as the basis for its finding that that the 2004 Guidelines are caught by Article 1106, it nevertheless notes that Canada's decision is consistent with the finding.

G. CONCLUSIONS ON ARTICLE 1106

246. In conclusion, the Tribunal finds that:

1) R&D and E&T requirements imposed by the 2004 Guidelines are 'services' within the meaning of Article 1106;

2) the 2004 Guidelines and their implementation impose legal requirements on operators to undertake R&D and E&T expenditures in the Province; and

3) subject to the requirements of Article 1108, the R&D and E&T requirements of the 2004 Guidelines, and the implementation thereof, constitute a prohibited performance requirement under Article 1106 of the NAFTA.

[270] R. Rejoinder, para. 61: "If the Tribunal accepts that Canada's interpretation of Article 1106(1)(c) is correct, then the only reasonable inference to draw from the Annex 1 Accord Act description is that the R&D and E&T expenditure obligation was included for comfort. If the Tribunal finds that the R&D and E&T requirements in the Guidelines are inconsistent with Article 1106 (1)(c), then the wisdom, of Canada's 'belt and suspenders' decision to include those provisions in its Annex 1 reservation will be confirmed."

VII. ARTICLE 1108

A. INTRODUCTION: THE TREATMENT AND SCOPE OF THE NAFTA RESERVATIONS

247. Having concluded that the requirements imposed by the 2004 Guidelines, made pursuant to Section 45 of the Accord Acts, are performance requirements subject to and caught by NAFTA Article 1106(1), the next issue to be determined is whether these non-conforming measures are exceptions covered by NAFTA Article 1108(1), as the Respondent argues.

248. In its Schedule to Annex I, Canada listed the Federal Accord Act as an existing measure that is reserved from Article 1106.[271] The Respondent argues that the Provincial Accord Act, which was not expressly listed, was also covered by agreement between the Parties under the listing of the Federal Accord Act.[272]

249. The scope of Article 1108, and the issue of whether the 2004 Guidelines are covered by the reservation, was fully argued by the parties. The Tribunal expresses its appreciation for the quality of the submissions that raise important issues as to the proper approach to be taken in the interpretation and application of the reservations under Article 1108. Consideration of Article 1108 and the NAFTA reservations is largely a matter of first impression. It was apparent that both parties, and the two other NAFTA Parties that each made two Article 1128 submissions, recognize the importance of the issues raised and the potential significance of this Award for the NAFTA system.

250. All three NAFTA Parties have made reservations under Article 1108, as well as other provisions of the NAFTA that permit reservations. The Claimants and the Respondent also extensively addressed the correct approach to be undertaken in the interpretation and

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[272] RE-11, Government of Canada Exchange of letters with the other NAFTA Parties (March 29, 1996); Day 4 Transcript, p. 1121:11-17 (Washington, D.C., October 22, 2010): While the Claimants suggested during the hearing that the reservations for existing Provincial measures were invalid, they did not pursue this point in their Post-Hearing Brief. *See* R. P. Brief, fn. 13: Canada demonstrated that this suggestion has no merit. The Provincial Accord Act provisions are the same as the Federal Accord Act but limited merely to the Provincial level.

application of reservations.[273] By the close of the proceedings there appeared to be a degree of convergence between the parties, in particular with respect to the proposition that Article 1108 reservations are to be interpreted and applied in accordance with the VCLT.

251. The Claimants argued that Article 1108 reservations are to be interpreted restrictively. They find support for this argument in a NAFTA panel report, *Cross-Border Trucking*.[274] The Claimants also draw on the language of Article 1108(1) and the interpretative note to Annex I that states that each reservation must "identify the laws, regulations or other measures (...) for which the reservation is taken." [275] They go on to identify other provisions of the interpretative note, including the requirement that a description of the measure must set out the "non-conforming aspects of the existing measure for which the reservation is taken."[276] Drawing on these requirements, the Claimants assert that the NAFTA Parties intended that Article 1108(1) reservations be interpreted restrictively.

252. For its part, the Respondent argues that the reservations to the NAFTA must be interpreted according to Article 31 of the VCLT, and that subsequent jurisprudence has applied the VCLT to construe the plain terms, for example with respect to the exception for procurement within NAFTA Article 1108. The Respondent argues that there are no grounds for interpreting reservations restrictively and notes that this approach has been expressly rejected in *Aguas del Tunari SA v. Bolivia*.[277] The WTO Appellate Body in *EC-Hormones* is also referenced, where the Appellate Body refused to undertake a restrictive reading of Article 3.3 of the SPS Agreement because it is an exception to the rule under Article 3.1. [278] The Respondent also rejects the Claimants' argument that the interpretative note to Annex 1 of the NAFTA requires that reservations be interpreted restrictively[279] and further argues that the Claimants' reliance on *Cross-Border Trucking* is misplaced because that tribunal relied

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273 Cl. Mem., paras. 163, 166.

274 *Id*., para. 163.

275 *Id*., para. 166.

276 *Id*.

277 R. Rejoinder, fn. 99. RA-2, *Aguas del Tunari SA v. Bolivia*, ICSID Case No. ARB/02/3, Decision on Respondent's Objections to Jurisdiction, of October 21, 2005, para. 91 ("*Aguas del Tunari*").

278 R. Counter, para. 218.

279 *Id*., para. 217.

on decisions that pre-dated the VCLT and any principle of treaty interpretation "which those decisions supported have since been supplanted by the Vienna Convention."[280]

253. Mexico and the United States, in their Article 1128 submissions, do not specifically address the question of whether reservations should be interpreted broadly or restrictively.

254. The Tribunal is not required to undertake a theological approach to the question of treaty interpretation. As stated in Annex I of the NAFTA, the Schedule of a NAFTA Party pursuant to Article 1108, sets out the "reservations taken by that Party with respect to existing measures that do not conform with the obligation imposed by…(d) Article 1106 (performance requirements)." Each NAFTA Party was free to identify and put forth its own reservations, which represented one Member's binding commitment. That said, it is important to stress that the reservations are an integral part of the NAFTA. The task of ascertaining the meaning of a reservation, like the task of interpreting any other treaty text, involves understanding the intention of the NAFTA Parties, and it is to be achieved by following the customary rules of interpretation of public international law, as reflected in Articles 31 and 32 of the VCLT. There is no dispute on this point between the parties. The Tribunal proceeds on that basis.

255. In carrying out its task, the Tribunal is therefore guided by the principles of interpretation that are set forth in Articles 31 to 32 of the VCLT. These provisions are recognized by the NAFTA Parties to be applicable, both to the provisions of the NAFTA and to the reservations made by each Party. In interpreting the NAFTA provisions and the terms of the Respondent's Article 1108 reservation, the Tribunal will also adopt a balanced approach that respects the interests of the Claimants, and of the Respondent, without seeking to give priority to either. In doing so, the Tribunal is mindful of the implications of its decision for the system of reservations as a whole, as well as the specific implications for the interpretation and application of the Respondent's reserved measure.

256. To address the application and effect of Article 1108, it is necessary to look carefully at the scheme established by NAFTA with regard to two distinct types of instruments, namely,

[280] *Id*., para. 220

"measures" and "subordinate measures", as reflected in the combined effects of NAFTA Article 1108 (entitled 'Reservations and Exceptions'), Annex I of NAFTA, and the Respondent's Article 1108 reservation. The parties are in fundamental disagreement as to whether the 2004 Guidelines are covered by the Respondent's reservation, and whether that determination is made by reviewing the 2004 Guidelines as a subordinate instrument, solely with the measure that is the specific subject of the Article 1108 reservation, or whether it should also consider other subordinate measures that were introduced pursuant to the reserved measure. More concretely, this difference would mean that the 2004 Guidelines should either be reviewed against the relevant portions of the Federal Accord Act alone or, alternatively, should also be reviewed against the Hibernia and Terra Nova Benefits Plans and board decisions, together with the Federal Accord Act. The Tribunal is then required to consider the meaning and application of the standard and address whether the 2004 Guidelines are lawful as applied to Hibernia and Terra Nova. As set out below, addressing these matters requires the Tribunal to consider the following issues:

i. The scheme established by the NAFTA: Article 1108 and Annex I;

ii. The reserved measure that was in effect as of January 1, 1994, when the NAFTA came into force;

iii. The new subordinate measure adopted by the Respondent after that date, and consideration of when a subordinate measure, subject to a reservation, is taken by a NAFTA Party;

iv. The standard to determine whether a subordinate measure is subject to a reservation taken by a NAFTA Party with respect to obligations imposed by 1106; and

v. In applying that standard, consideration of whether the Respondent's new measure is lawful under NAFTA Article 1108.

1. The Scheme Established by NAFTA: Article 1108 and Annex I

257. When the NAFTA came into force in 1994, it barred the NAFTA Parties from utilizing performance requirements pursuant to Article 1106. It also introduced in Article 1108 and Annex I arrangements to allow the Parties to make reservations where existing measures did not conform to NAFTA obligations, such as Article 1106.

258. Article 1108(1) provides *inter alia* that Article 1106 does 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."

Article 1108(2) provides that each Party is to

> "set out in its Schedule to Annex I, within two years of the date of entry into force of [the NAFTA], any existing non-conforming measure maintained by a state or province, not including a local government."

259. Annex I of the NAFTA provides the NAFTA Parties with greater guidance as to the details they are to set out in their Schedules. Annex I is entitled 'Reservations for Existing Measures and Liberalization Commitments', and it provides:

> “1. The Schedule of a Party sets out, pursuant to Articles 1108(1) (Investment) … 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.”

260. Paragraph 2 of Annex I specifies eight elements that “each reservation must set out.” It requires the identification of (a) sectors, (b) subsectors, (c) industry classification, (d) type of reservation, (e) level of government, (f) laws, regulations or other measures for which the reservation is taken,[281] (g) description, and (h) phased out, if any.

261. Paragraph 3 of Annex I addresses the interpretation of a reservation:

> “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**

[281] Being of particular relevance to the present instance, subsection (f) stipulates the following: “(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.”

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."

262. Several preliminary observations may be useful in respect of Article 1108 and Annex I. *First*, these instruments make clear that the NAFTA Parties explicitly envisaged the possibility that each Party should be able to adopt reservations in relation to Article 1106. That is not in dispute between the parties.

263. *Second*, the Parties agreed on a number of requirements to be fulfilled in making a reservation, including the provision of certain detailed information as to the "elements" that are to be set out in relation to any reservation. This too is not in dispute between the parties.

264. *Third*, at the heart of the scheme, and of relevance to this dispute, is the distinction between a "measure" and a "subordinate measure," the meaning and effect of which is examined in this section. Indeed, the Parties drafted Article 1108 and Annex I in such a way as to reflect a distinction between these two kinds of measures that may form part of a reservation. Any reservation extends to and encompasses both:

(i) the "non-conforming measure" that is set out in the Schedule to Annex I (as referred to in Article 1108(1): it is referred to as "the measure" in Annex I, paragraph 2(f)(i)); and

(ii) "any subordinate measure" (as referred to in Annex 1, paragraph 2(f)(ii)).

265. The "non-conforming measure" and "any subordinate measure" are however, distinct instruments. The relationship between a "non-conforming measure" and a "subordinate

measure," and the conditions under which a "subordinate measure" will be evaluated and determined to be compatible with an earlier "non-conforming measure," have emerged as the issues that lie at the heart of this case.

2. The Reserved Measure in effect as of January 1, 1994

266. Article 1108(1)(a) excludes from the application of Article 1106 any "existing non-conforming measure." In the present case, the existing "non-conforming measure" is the measure maintained by Canada at the Federal level, as set out in its Schedule to Annex I, as at January 1, 1994. As noted above, in accordance with paragraph 2(f) of Annex I, the Respondent was required to include in the reservation a number of elements, including the "measure" (meaning the law, regulation or other measure) and the "description element" (meaning the non-conforming aspects of the existing measures for which the reservation is taken).

267. The Respondent's reservation is set out in Canada's Annex I reservation. The law set out under the "Measures element" is the "*Canada - Newfoundland Atlantic Accord Implementation Act*, S.C. 1987, c. 3" (the Federal Accord Act). In its second Article 1128 submission the United States refers to this as the non-conforming measure entry[282] and the Tribunal will also refer to it as such in this Award. The "Description element" that delineates and qualifies the "Measures element" references the same requirements for a benefits plan as those set forth in the *Canada Oil and Gas Operations Act*, S.C. 1992, c. 35. A Benefits Plan is a

> "plan for the employment of Canadians and for providing Canadian manufacturers, consultants, contractors and service companies with a fair and full opportunity to participate on a competitive basis in the supply of goods and services used in proposed work or activity referred to in the benefits plan."

268. The Federal Accord Act requires that

[282] U.S. 2nd Art. 1128, para. 10.

> "benefits plan[s] (...) ensure that (…) (c) 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."[283]

269. There is no dispute between the parties that the Federal Accord Act, as qualified by the "Description element," constitutes the existing non-conforming measure to which the application of Article 1106 has been reserved. This "Measures element" is adopted at the Federal level, is a reservation taken with regard to Article 1106, and is not qualified by a "liberalization commitment from the Description element" (see NAFTA Annex 1, paragraph 3(b)).

270. Two observations may be made in relation to the Respondent's "non-conforming measure." The *first* concerns what the "Description element" does and does not say. The "Description element" references the Federal Accord Act by addressing the requirement that Benefits Plans must ensure that expenditures be made for research and development to be carried out in Newfoundland, and for education and training to be provided in the Province. This "non-conforming measure" is thus limited to the requirement that any Benefits Plan, as provided for by the Federal Accord Act, *ensures* that the expenditure requirements that would otherwise be prohibited by Article 1106, shall be imposed. It does not specify any further detail on content. All that the Federal Accord Act, as qualified, does is address the issue of an expenditure requirement reflected in Benefits Plans. It does not elaborate as to (i) how exactly Benefits Plans are to ensure that the expenditure requirement is met, (ii) the nature and level of expenditure that would be required for an investor to meet the requirements of the reserved measure, and (iii) the means for review of the expenditures under a Benefits Plan. Under the referenced portion of the Federal Accord Act, the legal instrument that is specifically referenced to implement the requirement to spend on research and development, and education and training, are the Benefits Plans, which must be prepared and approved for each investment project.

271. The *second* observation concerns a determination of the relevant portions of the Federal Accord Act. Neither the "Measures element" nor the "Description element" refer to any

283 Section 45(3).

particular part or Section of the Federal Accord Act. Which provisions of the Federal Accord Act are to be treated as reflecting or giving effect to the existing "non-conforming measure?" The Respondent has argued that the entire Federal Accord Act is reserved,[284] but the Claimant disagrees with this.[285]

272. In the course of argument, two provisions of the Federal Accord Act were the subject of particular attention by the parties: Section 45,[286] which addresses the Canada-Newfoundland Benefits Plan, and Section 151.1,[287] which addresses the publication of guidelines and interpretation notes with respect to Section 45.

273. It appears that by the close of the proceedings there was no disagreement between the parties that Section 45 of the Federal Accord Act was an "existing non-conforming measure" within the meaning of Article 1108(1)(a). The Tribunal adopts the same view; Section 45 is plainly covered by the law referred to in the "Measures element" (the Federal Accord Act) and the subject it addresses is almost identical to the terms of the "Description element" (it is directly concerned with a Benefits Plan to ensure that expenditures are made for research and development to be carried out in the Province, and for education and training to be provided in the Province). The Tribunal therefore concludes that Section 45 is an "existing non-conforming measure" within the meaning of Article 1108(1)(a).

274. A further provision of the Federal Accord Act at issue in this case is Section 151.1. On its face, Section 151.1 is connected to the application and administration of Section 45, a provision of the Federal Accord Act to which it expressly refers. There is no dispute between the parties that it was pursuant to Section 151.1 that the 2004 Guidelines, that have given rise to this dispute, were adopted.[288] The parties disagree, however, as to whether Section 151.1 is an existing non-conforming measure that was subject to the reservation made by the Respondent.

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284 R. Counter, paras. 222 – 223.

285 Cl. Mem., para. 163.

286 *See* Section 45 *supra*., para. 37.

287 *See* Section 151.1 *supra*., para. 38.

288 Transcript Day 1, p. 93:4-5 (Washington, D.C., October 19, 2010) (Rivkin).

275. During the hearings, the Claimants framed their argument as follows:

> "Under Headnote 2(f) of Annex I, the measure includes the qualification as it is described, the description element, for which the reservation is taken. As we already noted, the Guidelines were adopted under the authority of Section 151.1, and *Canada's description of the non-conforming aspects of the Accord Acts does not extend to Section 151*, so as a matter of an international law, it simply does not fit within the terms of the Annex."[289] (Emphasis added)

The Claimants further explained that

> "[w]hen you're looking at the question of authority, as I said, Section 151.1 is nowhere mentioned in the schedule and nowhere described as a non-conforming aspect."[290] (Emphasis added)

The Claimants' argument was centered on the point that the failure to make express reference to Section 151.1 indicates that it is not to be considered as being subject to the reservation.

276. The Respondent disagreed, setting out its argument as follows:

> "Let's go back to the Atlantic Accord Implementation Acts in Section 151.1, which is the next slide. In addition to requiring these expenditures on research and development and education and training, the Acts also gave the Board express authority to issue Guidelines with regard to this requirement. You can see there in the highlighted part that it says, "The Board may issue Guidelines with respect to the application and administration of Section 45." Consequently, the Board is given express authority to issue Guidelines with respect to this requirement to expand on research and development and education and training."[291]

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[289] *Id.*, p. 93:19 *et seq*.

[290] *Id.*, p. 96:21 *et seq*.

[291] *Id.*, p. 169:22 *et seq*. (Mr Gallus).

The Respondent added:

> "The key part of local law to understand the relationship between the Benefits Plans and the Guidelines is the Accord Implementation Acts. And in the Accord Implementation Acts, it states that the Operators must provide Benefits Plans, and those Benefits Plans must ensure benefits for the Province. It also states that those Benefits Plans must ensure expenditures on research and development and education and training in the Province. The same Act gives the Board authority to issue Guidelines with respect to this requirement. […] in Section 151.1(1), the Board is given the authority to issue Guidelines with regard to Section 45. Consequently, both the Benefits Plans and the Guidelines derive their authority under domestic law from the Accord Implementation Acts."[292]

277. The Respondent also addressed the reservation's failure to refer to Section 151.1:

> "And whilst the Claimants are right that the description does not expressly mention Section 151.1, it does not expressly mention the authority to issue Guidelines with respect to their obligation to expend on research and development and education and training, *it would simply make no sense to reserve the obligation to expend on research and development and education and training without reserving the means to implement that*. Consequently, even if we accept the Claimants' argument that the description does limit the reservation, the Guidelines are still reserved here because the obligation to expend on research and development and education and training is expressly reserved within the reservations of the Accord Implementation Act."[293] (Emphasis added)

278. In the Tribunal's view, one difficulty with the Claimants' argument is that the Respondent's reservation, as qualified by the "Description element," does not specifically mention any

[292] *Id*., p. 206:3 *et seq*.

[293] *Id*., p. 1238:1 *et seq*. (Mr Gallus).

provision of the Federal Accord Act. No mention is made of either Section 151.1 or Section 45, although Section 45's content is set out. The Claimants' approach would appear to lead to the result that a failure by a NAFTA Party to refer to a particular provision of domestic legislation, that has been reserved, could mean that such a provision is to be treated as having not been reserved at all. As the NAFTA Parties have reserved many legislative acts without referring to any particular provision, the Claimants' argument may not provide a reliable methodology for understanding the scope of a reservation.

279. The Tribunal considers that the more plausible approach is to examine the reserved measure as qualified by the "Description element," and then in accordance with the VCLT determine whether a particular provision of the Federal Accord Act is covered or not. In the present case, the qualification addresses the requirement that the Benefits Plan ensure that 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. Section 151.1 of the Federal Accord Act is not specifically mentioned in the "Description element" but looking at the Federal Accord Act as a whole, the 2004 Guidelines issued pursuant to Section 151.1 provide a means, not necessarily the only means, by which guidance is offered on how to ensure that expenditures on research and development are carried out in the Province. The Board is authorized to issue and publish guidelines and interpretation notes but it is not required to do so. Thus, the application and administration of the expenditure requirement of Section 45 may be contained in guidelines and interpretation notes issued by the Board, but such expenditures must be made through requirements contained in Benefits Plans, as specifically mentioned in Section 45.

280. As noted, Sections 45 and 151.1 are closely connected. Section 151.1 expressly refers to Section 45 and Section 151.1 offers an instrument for addressing the content of the expenditure requirement, while the Benefits Plans are the means for implementing the requirement contained in the "Description element." If the Board issues an instrument called 'guidelines', then in the Tribunal's view, the threshold evaluation will be as to whether those particular guidelines are actually designed to give effect to Sections 45, 138 or 139 of the Federal Accord Act, as stated in Section 151.1. If the content and subject matter of any such guideline is directed to the application and administration of Section 45, including the

expenditure requirement contained in Benefits Plans, the Tribunal is of the view that such guidelines are covered by the reservation.

281. To say that a new subordinate measure, taken in the form of guidelines, to further implement Section 45, is subject to the reservation does not however insulate it from review and challenge. Importantly, whether a *particular* set of guidelines are covered or not by the reservation, and consistent with the NAFTA, will require an evaluation to determine whether those particular guidelines meet the legal standards articulated in Annex I.

282. Before doing so, the Tribunal notes that for the purposes of this case, it is not required to form a view as to whether any other provision of the Federal Accord Act forms part of the existing non-conforming measure reserved by the Respondent.

283. Beyond the Federal Accord Act, no other measure relevant to this case has been included in the "Measures element" of the reservation set out by the Respondent in its Schedule to Annex I. In particular, the Board Decisions approving the Hibernia Benefits Plan and the Terra Nova Benefits Plans were not referred to expressly in the "Measures element." They are not the "non-conforming measures" set out in the Schedule to Annex I, but, as discussed below, are for purposes of the NAFTA subordinate measures. The Tribunal turns in the section that follows to their relationship to the "non-conforming measure" set out in Annex I as well as the 2004 Guidelines, which are another set off subordinate measures.

3. <u>The New Subordinate Measure and Consideration of When a Subordinate Measure, Subject to a Reservation, is Taken by a NAFTA Party</u>

284. Articles 1106 and 1108 of the NAFTA do not refer to the term "subordinate measure," and it is not found in Chapter 11 of the NAFTA at all. However, it appears in paragraph 2(f) of Annex I. Provided it meets certain conditions, a subordinate measure forms a part of a reservation made by a NAFTA Party with respect to existing measures that do not conform with obligations imposed by Article 1106.

285. Paragraph 2(f) of Annex I is divided into two sentences. The first sentence provides that "[m]easures identifies the laws, regulations or other measures, as qualified (…) by the Description element". It is clear that the term "Measures" is here limited to such measures as

are expressly referred to in a Party's Schedule to Annex I, and only to the extent "qualified (…) by the Description element."[294]

286. The second sentence of paragraph 2(f) distinguishes between "the measure" and "any subordinate measure." It provides that:

> "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 [the NAFTA], and
>
> (ii) includes any subordinate measure adopted or maintained under the authority of and consistent with the measure."

With respect to the facts before the Tribunal, neither party has argued that the Hibernia and Terra Nova Benefits Plans and Board Decisions 86.01 and 97.02, are to be regarded as being "the measure" within the meaning of paragraph 2(f)(i). For the purposes of this case, "the measure" referred to is the Federal Accord Act (and more specifically, Sections 45 and 151.1). The Board Decisions 86.01 and 97.02 are covered by paragraph 2(f)(ii). Both parties have proceeded on the basis that each of these measures are a "subordinate measures adopted or maintained under the authority of and consistent with the [Federal Accord] Act." In our view that is the correct basis on which the matter falls to be addressed.

287. However, this appears to be the limit to the parties' converged views. They disagree as to what paragraph 2(f)(ii) means, and in particular, the meaning and effect of the words "adopted or maintained," the basis for the interpretation of "consistency," and the meaning and effect of the term "the measures" at the end of the sentence. The Tribunal must therefore consider each of these elements and also clarify its interpretation of this second sentence of paragraph 2(f) as a whole, for purposes of determining what measures are to be examined with respect to this dispute.

294 *See* discussion *supra*., paras. 266 – 270.

The Meaning of 'Adopted or Maintained'

288. With respect to the meaning and effect of the words "adopted or maintained," one aspect of the disagreement relates to the temporal question of whether a "subordinate measure" referred to in paragraph 2(f)(ii) needs to be adopted before the entry into force of the NAFTA, or whether it may be adopted before or after the entry into force of the NAFTA (subject in both cases to the conditions of authority and consistency having been met). The Claimants advocate for the first view and the Respondent for the second. These differences emerged in the course of the written pleadings.

289. Beyond making passing reference to the language of paragraph 2(f)(ii), the Claimants did not explicitly address this issue.[295] The Respondent adopts the opposite view:

> "The use of the term "maintain" and "adopt" in Article 1108 demonstrates that a measure which is maintained is one that exists at the time the Agreement entered into force and is maintained after that date. A measure which is adopted is one that came into existence after this date. Consequently, by including within the reservation for Article 1108(1)(a) "any subordinate measure adopted or maintained under the authority of and consistent with the [expressly reserved] measure, the NAFTA reserves both subordinate measures which existed at the date of entry into force of the Agreement as well as those which came into existence afterwards."[296]

The Claimants maintain their original position and advance a number of further arguments challenging the Respondent's position. The Claimants argue that the NAFTA Parties understood the difference between existing and future measures, and knew how to make clear when they wished to address one or the other, or both. The Claimants further argue that the interpretative note focuses on "existing measures" that do not conform with Article 1106 obligations, that the textual comparison of "maintained" does not support the Respondent's

[295] Cl. Mem., para. 54.

[296] R. Counter, para. 231.

argument, and that the Respondent's reading cannot be reconciled with the object and purpose of NAFTA, as it would "render Article 1108(1) ineffective."[297]

290. The Respondent provides further argument as to its alternative view. It references the context to the reservation in Article 1108(1)(a), which includes reservations 1108(1)(b) and (c). Reservation 1108(1)(b) reserves the subsequent "continuation or prompt renewal of any non-conforming measure" and (c) reserves a subsequent amendment. The Respondent argues that there "is no reason for the NAFTA to reserve continuations, renewals and amendments after the NAFTA entered into force but not to reserve subsequent subordinate measures."[298] Respondent also argues that the use of "adopted or maintained," or variations thereof, appears elsewhere in the NAFTA over a hundred times, and refers to measures after the NAFTA entered into force. It is further argued that the temporal reference is confirmed by the NAFTA drafting directions.[299] These differences were maintained during the oral arguments.

291. The Tribunal invited submissions from the two other NAFTA Parties on this issue. The first United States Article 1128 submission broadly adopted the approach taken by the Respondent, recognizing that paragraph 2(f)(ii) of Annex I provides for existing and new "subordinate measures" to be covered by a NAFTA Party's reservation. The United States submission stated:

> "By including subordinate measures that are "adopted or maintained" by a Party, the headnote to Annex I provides that each measure listed on a Party's Schedule pursuant to Article 1108(1) includes any existing subordinate measures—i.e. subordinate measures in effect on the date of entry into force—that are "maintained" by a Party, as well as any new subordinate measures—i.e. subordinate measures that come into effect after entry into force—that are "adopted" by a Party, so long as such

[297] Cl. Reply, paras. 96 - 100.

[298] R. Rejoinder, para. 79.

[299] *Id*., paras. 83 - 87.

> subordinate measures are adopted or maintained under the authority of and consistent with the listed measure."[300]

The United States derived support for this conclusion by "analyzing the text of Annex I in the context of other provisions in Chapter Eleven, as well as the drafting conventions employed by the NAFTA Parties when negotiating the Agreement."[301]

292. In its Article 1128 submission Mexico agrees that

> "subordinate measures that are adopted *after* the NAFTA entered into force are covered by the reservations in Article 1108(1)(a)(i) and (ii)."[302]

293. The Claimants disagree with the position adopted by all three NAFTA Parties. They assert that their common position

> "is based on the demonstrably false premise that "maintained" is always used in the NAFTA to signify "in effect at the time of NAFTA's entry into force" and "adopted" to signify "entered into effect after the date of NAFTA's entry into force."[303]

The Claimants seek to find support for the argument of alternative uses of the words "maintained" and "adopted" in the NAFTA text.[304]

294. On this issue, the Tribunal is not persuaded by the Claimants' arguments. Having regard to the rules governing the interpretation of treaties, as agreed by both parties,[305] it is appropriate to take the ordinary meaning of the words "adopted" and "maintained." There is no evidence before us to support the conclusion that the words "adopted or maintained" as used in

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300 U.S. 1st Art. 1128, para. 5.

301 *Id*., para. 6.

302 Mex. 1st Art. 1128, para. 3.

303 Cl. Response 1st Art. 1128, para. 17.

304 *Id*., paras. 18 *et seq*.

305 *Supra* para. 250.

paragraph 2(f)(ii) were intended to have a special meaning, as per Article 31(4) of the VCLT.[306]

295. It is evident that the ordinary meanings of the terms “adopted” or “maintained” are not the same. In particular, the word “maintained” necessarily implies the application of a measure over time, whereas the word “adopted” refers to a particular moment in time. When examining the context in which these terms are used, and the object and purpose of the NAFTA to address a wide range of measures that pre- and post-date the entry into force of the NAFTA, the Tribunal consider that the correct interpretation of these words is as argued by the Respondent, and supported by the United States and Mexico.

296. We do not need to have regard to supplementary means of interpretation to reach this conclusion, nor do we rely on such supplementary means of interpretation. However, we note that supplementary means of interpretation are available, which provide strong confirmation that this is the correct interpretation. In particular, the NAFTA Parties’ agreed *Conventions to be used in the NAFTA texts* as adopted on July 9, 1992, confirms this interpretation:

> “‘Adopt’/’maintain’: To the extent possible, use ‘adopt’ to refer to the establishment or introduction of new measures and ‘maintain’ to refer to existing measures, or to the enforcement or application of measures. Thus, the obligation will often be to ‘adopt and maintain’.”[307]

This text makes it clear that when the NAFTA Parties intended to refer to existing measures (in force on January 1, 1994) they would use the term “maintain,” and when they intended to refer to new measures (in force on January 1, 1994) they would use the term “adopt.”

297. Against this background, the Tribunal concludes that a “subordinate measure” that has been “adopted” refers to a subordinate measure adopted after the NAFTA came into force. The Tribunal will refer to this as a “new subordinate measure.”

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[306] Article 31(4): “A special meaning shall be given to a term if it is established that the parties so intended.”

[307] U.S. 1st Art. 1128, attachment.

298. The implications of this conclusion with respect to this dispute means that the Hibernia Benefits Plan and Decision 86.01, having been adopted before January 1, 1994, are “subordinate measures” that are “maintained,” within the meaning of paragraph 2(f)(ii) of Annex I.

299. With respect to the Terra Nova Benefits Plan and Decision 97.02, as well as the 2004 Guidelines, (having been adopted after January 1, 1994) they are “subordinate measures” that have been “adopted,” within the meaning of paragraph 2(f)(ii) of Annex I, and are each to be considered “new subordinate measures.”

4. <u>The Legal Standard: Whether a Subordinate Measure is Subject to a Reservation</u>

300. We turn next to the question of the standard that is to be applied in determining whether a “subordinate measure” is to be considered as covered by a reservation made by a NAFTA Party, with the effect that a particular provision of the NAFTA is not applicable. In the present case, the specific issue is whether the 2004 Guidelines are constitute a “new subordinate measure” that is covered by the Respondent’s reservation, with the consequence that the obligations set forth in Article 1106 do not apply to the 2004 Guidelines. This determination requires an examination of several additional areas of disagreement between the parties as noted above, namely the meaning and effect of the terms “under the authority of” and “consistent with” as well as the meaning of the final phrase “the measure,” as contained in paragraph 2(f)(ii) of Annex I.

301. Paragraph 2(f)(ii) sets forth the conditions that must be met for any “subordinate measure” to be covered by a reservation, i.e. that it has been “adopted or maintained *under the authority of and consistent with the measure*.” A number of preliminary points may be made with respect to this entire provision.

302. *First*, the Tribunal notes that the ordinary meanings of the words indicate that there are two conditions that must be met, and they are cumulative. Thus, the subordinate measure must be

- under the authority of the reserved measure set out in the Party’s Schedule to Annex I, and

- consistent with the reserved measure set out in the Party's Schedule to Annex I.

There is no dispute between the parties on this point.[308] In their Article 1128 submissions the United States and Mexico have adopted the same position.[309]

303. *Second*, the Tribunal notes that the ordinary meaning of these words indicates that the two conditions are exhaustive, and that there are no other conditions that have to be met. Again, there is no dispute between the parties on this point.[310] In their Article 1128 submissions the United States and Mexico have not adopted a contrary position.[311]

304. *Third*, the ordinary meaning of these words indicates that the same two conditions are applicable to "existing subordinate measures" (the Hibernia Benefits Plans and related Board Decision) and "new subordinate measures" (the Terra Nova Benefits Plans, related Board Decisions, and the 2004 Guidelines). The Tribunal sees no dispute between the parties on this point.

305. *Fourth*, the ordinary meaning of these words indicates that the two conditions for the adoption of "existing subordinate measures" and "new subordinate measures" are different from the conditions governing an amendment to the reserved measure identified in a Party's Schedule to Annex I (Federal Accord Act). NAFTA Article 1108(1)(c) excludes from the application of Article 1106

> "an amendment to any [existing] non-conforming measure (…) to the extent that the amendment does not decrease the conformity of the measure, as it existed immediately before the amendment, with [Article 1106]."

306. The applicable standard in determining whether an amendment to the Federal Accord Act is covered by the reservation is that it must "not decrease the conformity of the [Federal Accord

308 Cl. Mem., fn. 86; R. Counter, para. 224.

309 U.S. 1st Art. 1128, para. 8; U.S. 2nd Art. 1128, para. 6; Mex. 1st Art. 1128, para. B3; Mex. 2nd Art. 1128, para. 1.

310 Cl. Mem., fn. 86; R. Counter, para. 224.

311 U.S. 1st Art. 1128, para. 8; U.S. 2nd Art. 1128, para. 6; Mex. 1st Art. 1128, para. B3; Mex. 2nd Art. 1128, para. 1.

Act], as it existed immediately before the amendment, with [Article 1106]." This is not the same language that is set forth in paragraph 2(f)(ii) which uses the term "consistent with" the measure. The Tribunal notes that as a matter of Canadian law, the Federal Accord Act has been amended on numerous occasions. Sections 45 and 151.1 have only been amended in 1992, before the NAFTA came into force.[312] The NAFTA came into force on 1 January 1994, and since then, there have been no amendments to Sections 45 or 151.1.[313] The Tribunal shall subsequently discuss the significance of the differences between "not decreasing the conformity" of the Federal Accord Act and "consistent with the measure," in greater detail from paragraph 103 below.

307. *Fifth*, neither party has argued that the Hibernia and Terra Nova Benefits Plans and related Board Decisions are to be treated as amendments to the Federal Accord Act, within the meaning of NAFTA Article 1108(1)(c). Regarding the 2004 Guidelines, the Claimants argued that "the 2004 Guidelines cannot fairly be viewed as an amendment to measures existing at the time of the entry into force of the NAFTA in 1994."[314] The Respondent adopts the same position.[315] The parties' position did not change during the course of the oral hearing.

308. The Tribunal agrees with the position adopted by the parties; neither the "existing subordinate measures" (the Hibernia Benefits Plan and related Board Decision) nor the "new subordinate measure" (Terra Nova Benefits Plan and related Board Decision and the 2004 Guidelines) are to be considered as amendment to the Federal Accord Act.

(a) The Meaning of 'the Measure' under Paragraph 2 of Annex I

309. A further important issue on which the parties do not agree, concerns the meaning of "the measure" as used in paragraph 2(f)(ii) of Annex I and more particularly, what measure or measures are to be examined for evaluating "the authority" and "consistency" of a new

[312] *See* 1992, c. 35 s. 47 and s. 65.

[313] Other provisions of the Federal Accord Act have been subject to such amendments: see e.g. Section 174(1)(a) and (b), subject to a 2007 amendment that is not yet in force.

[314] Cl. Mem., paras. 170-178; *See also* Cl. Reply, para. 106.

[315] R. Counter, para. 239.

subordinate measure, the 2004 Guidelines. In their written pleadings and during the hearings neither party made detailed arguments on this point. The meaning of "the measure" arose fairly late in the case as the arguments focused in on the key matters.

310. The point is a significant one. The Claimants argue that in this dispute "the measure" does not only mean the Federal Accord Act, as the reserved non-conforming measure, but it also encompasses existing subordinate measures; namely the Hibernia and Terra Nova Benefits Plans and related Board Decisions. From this, an assessment of whether the 2004 Guidelines are adopted "under the authority of and consistent with the measure" would require that they must be consistent with the Federal Accord Act <u>and</u> the Hibernia and Terra Nova Benefits Plans, and the related Board Decision.[316] The point was made with particular clarity by the Claimants:

> "Most importantly, the [2004] Guidelines cannot be viewed to be *consistent with* the excepted measure as it existed in 2004. Under the NAFTA Parties' reading of the headnote to Annex I, the excepted measure includes all subordinate measures adopted under its authority, whether before or after the NAFTA's entry into force. Accepting *arguendo* that reading, the relevant excepted measure as of 2004 included not only the Accord Acts, but also the Board decisions adopting the Benefits Plans for Hibernia and Terra Nova."[317]

311. The Respondent disagrees with equal vigor; on its approach, the words "the measure" means that an assessment of whether the 2004 Guidelines are adopted "under the authority of and consistent with the measure" is to be carried out only by reference to the Federal Accord Act.[318]

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[316] Cl. Mem., para. 170: "As noted, a measure identified as such "means the measure as amended, continued or renewed *as of the date of entry into force of* [*the treaty*], … [and] includes any subordinate measure adopted or maintained under the authority of and consistent with the measure[.]" *See also Id*., para. 54, fn 86.

[317] Cl. Response 1st Art. 1128, para. 37.

[318] R. Counter, paras. 224 - 5 ("When reserving the Accord Acts from the scope of Article 1106, Canada also reserved any measures subordinate to those acts. […] Consequently, by reserving the Accord Acts from the scope of Article 1106, Canada also reserved from the scope of the Article any measure adopted under the authority of, and consistent with, those Acts.")

312. Although the other NAFTA Parties twice provided useful submissions on questions posed by the Tribunal, this specific issue has not been addressed with absolute specificity by the United States and Mexico in their Article 1128 submissions. In its first submission, the United States states that:

> "By including subordinate measures that are "adopted or maintained" by a Party, the headnote to Annex I provides that each measure listed on a Party's Schedule pursuant to Article 1108(1) includes any existing subordinate measures—i.e. subordinate measures in effect on the date of entry into force—that are "maintained" by a Party, as well as any new subordinate measures—i.e. subordinate measures that come into effect after entry into force—that are "adopted" by a Party, so long as such subordinate measures are adopted or maintained under the authority of and consistent with the listed measure."[319]

313. It is not entirely clear from this text whether the United States intended to speak to the question of whether a new subordinate measure had to be consistent with other subordinate measures, as well as the reserved measure. In our reading, the United States' submission, by stating that "each measure listed on a Party's Schedule (…) includes any existing subordinate measure...that are maintained by a Party, as well as any new subordinate measure," suggests that consideration is needed of both the reserved non-conforming measure and subsequent subordinate measures, and it does not limit the subordinate measures that are covered by this provision.

314. In its second submission, in response to the Tribunal's question on the legal basis for evaluating consistency with respect to a subordinate measure that imposed additional or more onerous burdens in a particular case, the United States stated that such determination would be made by reference to several factors:

> "(i) the domestic legal context of the measure; (ii) the particular elements of the non-conforming measure entry and the subordinate measure,

[319] U.S. 1st Art. 1128, para. 5.

> including*, inter alia, the extent of non-conformity of each with the obligation against which the measure is reserved, and (iii) the specific facts and circumstances of the case*."[320] (Emphasis added)

315. This submission is a helpful and precise articulation of the elements to be examined. However, it does not address the exact question before the Tribunal, as to whether existing subordinate measures are part of "the measure" for the purposes of evaluating a new subordinate measure.

316. For its part, Mexico also did not directly address this question, and states that:

> "Legal systems (national laws) are not finished or at rest, to the contrary they are in continuous process of creation (i.e. a legal system is a succession of momentary legal systems; a constant process of building regulations); consequently in order to preserve the uniformity of a legal system, the system must be provided with the necessary rules to determine whether a certain measure is valid, as well as the means to correct it."[321]

From this observation, Mexico argues that the determination of whether a subordinate measure fulfils the requirements of paragraph 2(f)(ii) of Annex I, would be an assessment under the national law governing the measure.

317. At paragraphs 49 and 50 above, the conclusion is set out that the Hibernia and Terra Nova Benefits Plans and related Board Decisions cannot be considered "non-conforming measures" set out in the Schedule to Annex I, but are "subordinate measures." This does not, however, dispose of the issue of whether they are to be treated as "the measure(s)" for the purpose of assessing whether the 2004 Guidelines were consistent with "the measures," the issue on which the parties are divided. The Tribunal is called upon to decide whether in this case "the measure" in paragraph 2(f)(ii) means, for purposes of this dispute, either:

- the Federal Accord Act, or

320 U.S. 2nd Art. 1128, para. 10.

321 Mex. 2nd Art. 1128, para. 2.

- the Federal Accord Act together with existing and new “subordinate measures’ that meet the conditions of paragraph 2(f)(ii) (the Hibernia and Terra Nova Benefits Plans and related Board Decisions).

318. Following the close of the hearings, the potential importance of this point emerged with greater clarity, and hence the Tribunal considered that it would be helpful and appropriate to hear more from the parties on this point, and to provide Mexico and the United States with a further opportunity to address the issue directly, if they wished. Accordingly, by letter dated June 23, 2011, the Tribunal asked the Parties about the meaning of the term “measure,” and specifically whether it refers:

> “(1) only to the ‘existing non-conforming measure that is maintained by (…) a Party at the federal level, as set out in its Schedule to Annex I’; or
>
> (2) to the ‘existing non-conforming measure that is maintained by (…) a Party at the federal level, as set out in its Schedule to Annex I’ and other subordinate measures that are ‘adopted or maintained under the authority of and consistent with the measure.’”[322]

319. Mexico[323] and the United States[324] declined to respond to the Tribunal’s question.

320. The Claimants’ response is that

> “‘the measure’ refers to the measure specifically listed in a party’s Annex I Schedule, *including* any subordinate measures that have been adopted or maintained under the authority of and consistent with that measure.”[325]

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322 Letter from the Tribunal to the parties (June 23, 2011).

323 Mexico’s Response to Tribunal’s Letter of June 23, 2011 (July 29, 2011).

324 U.S. Response to Tribunal Letter of June 23, 2011 (August 1, 2011).

325 Claimants’ Response to Tribunal’s Letter of June 23, 2011, para. 4 (July 29, 2011).

321. In support of this view the Claimants rely on paragraph 2(f) of the interpretative note to Annex I, which provides that "the measure" is to be interpreted to include any prior subordinate measures adopted under the authority of, and consistent with, the measure specifically listed in the Schedule to Annex I. The Claimants submit that "[t]he Interpretative Note provides no exception that would *exclude* a subordinate measure from the definition of the listed measure."[326] Hence, according to the Claimants, once the Board approved the Hibernia Benefits Plan in Decision 86.01 and the Terra Nova Benefits Plan in Decision 97.02, those Decisions became part of the specifically listed measure, the Federal Accord Act, for the purposes of Canada's Schedule to Annex I. The Claimants note that the Respondent advanced the same argument during the oral hearing,[327] and that the United States' and Mexico's Article 1128 submissions support this approach.[328] In its response to Canada's submission, amongst other submissions, the Claimants argue that Canada ignores the ordinary meaning of "the measure" in its context, the NAFTA Drafting Conventions, and the previous position adopted by Canada.[329]

322. The Respondent responded that "the measure" refers only to the "existing non-conforming measure that is maintained by (…) a Party at the federal [or provincial] level, as set out in its Schedule to Annex I."[330] Specifically, the Respondent submitted that

> "[t]he word "measure" at the end of paragraph 2(f)(ii) is qualified by the definite article "the." Under its ordinary meaning, "the" "designat[es] one or more persons or things already mentioned …" Thus, "the measure" refers to a measure which has already been mentioned. Consequently, "the measure" refers to the "measure cited in the Measures element" of an Annex I reservation, mentioned at the start of the sentence in which "the

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[326] *Id*., para. 8.

[327] *Id*., para. 15; *See also* Transcript Day 1, p. 240:9-16 (Washington, D.C., October 19, 2010).

[328] *Id*., para. 17.

[329] Claimants' Reply to Respondent's Response to Tribunal's Letter of June 23, 2011, para. 6 (August 26, 2011).

[330] Respondent's Response to Tribunal's Letter of June 23, 2011, para. 6 (August 2, 2011).

measure" appears. In this dispute, "the measure" refers only to the Federal and Provincial Accord Implementation Acts."[331]

323. The Respondent further asserts that the Claimants' approach is circular and inconsistent with the ordinary meaning of paragraph 2(f)(ii),[332] and that by contrast to other places where it is used, the words "the measure" are not qualified in paragraph 2(f)(ii).[333] The Respondent further argues that the Claimants' approach is inconsistent with the purpose of paragraph 2(f)(ii), which is to preserve "flexibility for the NAFTA Parties in sensitive areas through effective reservations."[334] The Respondent denies that it previously adopted the approach argued for by the Claimants, and argues that the Claimants misunderstood the United States' and Mexico's submissions as they do not support their position.[335] Finally, the Respondent reiterates its position that this matter is regulated by domestic law, and that the Canadian courts have confirmed that the 2004 Guidelines are consistent with the Federal Accord Act.[336]

324. Against this background, the Majority turns to the text of paragraph 2(f) of the interpretative note to a Party's Schedule to Annex I.[337] The second sentence of paragraph 2(f) states that:

> "A measure cited in the Measures element (ii) *includes* subordinate measure adopted or maintained under the authority of and consistent with the measure".

The Majority is of the view that the ordinary meaning of these words is quite clear; a measure (in this case the Federal Accord Act) includes a subordinate measure that meets certain criteria, namely, that it is adopted or maintained under the authority of, and is consistent with, the measure.

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331 *Id.*, para. 7.

332 Respondent's Reply to Claimants' Response to Tribunal's Letter of June 23, 2011, para. 13 (August 26, 2011).

333 *Id.*, paras. 15 - 16.

334 *Id.*, para. 20.

335 *Id.*, paras. 23-24.

336 *Id.*, paras. 28 *et seq*.

337 Hereinafter, 'the Majority' is used, in distinction to 'the Tribunal' which indicates where there is consensus amongst the arbitrators hereto.

325. In this dispute, the measure cited in the Measures element is the Federal Accord Act, which contains the existing non-conforming provision, most specifically the provision that Benefits Plans shall ensure that expenditures will be made for research and development to be carried out in the Province, and for education and training to be provided in the province. The Hibernia and Terra Nova Benefits Plans and the Boards Decisions adopting those Benefits Plans are subordinate measures introduced for particular investment projects and adopted pursuant to the reserved measure, the Federal Accord Act. The 2004 Guidelines are a new subordinate measure that introduced further spending requirements with respect to research and development and education and training in the Province. In our view, under a proper interpretation of paragraph 2(f) of the interpretative note, the new subordinate measure, the 2004 Guidelines, is to be textually and logically evaluated with respect to the reserved measure and the existing subordinate measures that meet the criteria of paragraph 2(f).

326. The Majority agrees with the argument advanced by the Claimants that there is nothing in the interpretative note that provides an exception so as to exclude a subsequent subordinate measure that meets the test in paragraph 2(f). In our reading of this text, once a subordinate measure passes the crucial test laid out in paragraph 2(f)(ii), it is correctly "included" within the ambit of the non-conforming and expressly listed measure for the purposes of evaluating a subsequent subordinate measure. Thereafter, and depending on the facts of the case, the reserved measure and the subordinate measure should be interpreted together for the purposes of Annex I. It is in this way that the non-conforming measure includes the subordinate measure.

327. The Majority is not of the opinion that the use of the article "the," before "measure" at the end of paragraph 2(f)(ii) excludes the reading that the consistency of a new subordinate measure can be evaluated against an existing subordinate measures. It is our view that 'the measure' at the end of the sentence of 2(f)(ii), which reads that a measure shall "include any subordinate measure adopted or maintained under the authority of and consistent with the measure," refers to the subject of the entire sentence.

328. In the Majority's view, the text of the reserved measure, at Section 45(3), itself further supports this interpretation as it specifically references the requirement that "benefits plan[s]

(...) ensure that (…) 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." The subordinate measures (the Hibernia and Terra Nova Benefits Plans and the related Board Decisions) that are maintained or adopted 'under the authority of and consistent with' the reserved measure are exactly on the subject matter of the reservation. The 2004 Guidelines are a new subordinate measure that introduces further expenditure and other requirements with respect to research and development, and education and training in the Province. An interpretation that ignores subordinate measures that are explicitly referenced as the instruments necessary to implement the requirements of the non-conforming measure would ignore a potentially crucial part of the legal framework. The Majority does not see such an interpretation as required by, nor harmonious with, the text of paragraph 2(f).

(b) The Meaning of 'Under the Authority'

329. What is the meaning of "under the authority of (…) the measure" and how should the issue of "authority" be understood, with respect to the subordinate measures that are encompassed by the terms "the measure?" Authority is not defined in the NAFTA. The ordinary meaning of "authority" according to Webster's New International Dictionary, includes "a citation used in defense or support", or "the source from which the citation is drawn", or "power to influence or command thought, opinion or behaviour."[338] The Oxford English Dictionary defines "authority" as "the power to enforce obedience".[339] In the context of Annex 1, "under the authority of the measure" suggests that the subordinate measure is under the "power or influence" of 'the measure' or the measure is the "the source from which" the subordinate measure is drawn. In our reading of paragraph 2 (f)(ii), "under the authority of (…) the measure" clearly requires an examination of a subordinate measure against the reserved measure. It is the reserved measure that provides the legal basis or origin for the subsequent subordinate measures. If a subordinate measure cannot be traced to the reserved measure, then it obviously cannot be "under the authority" of that measure. This also raises the

[338] Webster's New International Dictionary, Online Version, available at: http://www.merriam-webster.com/dictionary/authority.

[339] Oxford English Dictionary, Online Version March 2012, available at: http://www.oed.com/view/Entry/13349?redirectedFrom=authority#eid.

question of what is the applicable law for determining whether a subordinate measure is authorized. Is it domestic law, the law of the NAFTA, or both? This question is specifically addressed in the section that follows. For purposes of this discussion which considers what is encompassed by the term "the measure" it is evident that if a subordinate measure is not in fact, and as a matter of applicable law, "under the authority of (…) the measure," then it would not make sense for it to be of any relevance for purposes of determining whether that subordinate measure or measures are encompassed by the terms "the measure." Assuming that the subordinate measure or measures are "authorized," should the evaluation of the subordinate measure have to be authorized only by direct reference to the reserved measure that is listed, or does the term suggest that the subordinate measure must be in a direct vertical relationship with respect to every other subordinate measure in order for that universe of measures to be considered "under the authority of (…) the measure?"

330. In the Majority's reading, "authority" certainly requires that the subordinate measure must be determined in relation to the reserved measure. Whether other existing subordinate measures, in addition to the reserved measure, are also a critical part of that evaluation of "the measure" will depend on the facts of the case. On the facts we have before us, the Hibernia and Terra Nova Benefits Plans and related Board Decisions are "under the authority" of the Federal Accord Act. The 2004 Guidelines are also issued pursuant to the Federal Accord Act. It clearly makes no sense to suggest that the 2004 Guidelines, which are measures of general application, have to be "under the authority" of the Hibernia and Terra Nova Benefits Plans and Board Decisions, which are subordinate measures that apply to particular investment projects. Both sets of subordinate measures are authorized separately by the Federal Accord Act in a vertical relationship to that Act, but are not in a vertical relationship with each other. In this case, "the measure" that is the necessary reference for determining the "authority" of the 2004 Guidelines is the Federal Accord Act alone. It does not necessarily follow that this fact pattern will always be the case. The Majority can envision other factual circumstances, *arguendo*, where there are a number of subordinate measures that are in a vertical relationship to each other, such that a new rule or regulation is specifically introduced in order to implement a provision of an existing subordinate measure, both of which legally owe their existence to the reserved measure. In such circumstances, to understand whether the new subordinate measure is under the authority of the reserved measure, the treaty

interpreter would be required to look at the reserved measure as well as other subordinate measures in the vertical chain in order to make sense of the legal framework.

331. For these reasons, the Majority is of the view that "under the authority of (…) the measure" requires consideration of the subordinate measure with the reserved measure. Whether it also requires consideration of other subordinate measures with the reserved measure turns on the facts of the case.

(c) The Meaning of "Consistent With the Measure"

332. Having considered that a subordinate measure is authorized by the reserved measure, either directly or informed by intermediate subordinate measures, it can then be examined from the point of "consistency." In this case, the measure or measures that must be examined for purposes of giving meaning to the terms "consistent with the measure" are also in dispute. The parties are in agreement that consistency of a new subordinate measure has to be evaluated against the reserved measure. In the first instance, "consistent with the measure" is to be determined by virtue of a comparison of a new subordinate measure with the reserved measure. In our view, once a subordinate measure meets the test of authority and consistency with the reserved measure under paragraph 2(f), it can then become part of the legal framework of "the measure" for purposes of evaluating new subordinate measures. If existing subordinate measures were to be excluded from the analysis, it would diminish the basis for evaluating the consistency of the measure, and amount to only a partial review thereof. Consideration of the latest subordinate measure exclusively against the reserved measure, even if other subordinate measures have been introduced, would reduce the evaluation of consistency to only a subset of the framework of measures that apply to the investment project. The Majority does not see that such an approach is consistent with the text, the context or the object and purpose of the NAFTA.

333. Here again, which subordinate measures are relevant to an interpretation of consistency will depend on the facts of the case. Not all subordinate measures issued under a reserved measure are necessarily relevant. In this dispute, the measures that apply to each investment project would include the Federal Accord Act along with the particular Benefits Plans and related Board Decisions. There is little basis for evaluating the consistency of the new

subordinate measure without examining the totality of measures that apply to the investment project. Those measures become the legal framework against which the consistency of the new subordinate measure (the 2004 Guidelines) would need to be evaluated. At the same time, the Benefits Plans and Board Decisions related to Hibernia and Terra Nova are likely to be of little utility with respect to the evaluation of consistency of the 2004 Guidelines for another investment project.

334. An alternative reading that would interpret "consistent with the measure" by only requiring an evaluation of the consistency of a subordinate measure in respect of the reserved measure alone, even if the NAFTA Party had introduced other subordinate measures that were authorized and consistent with the reserved measure, is highly likely to result in a superficial and partial examination of the legal system. Without consideration of existing subordinate measures, how is the treaty interpreter to understand and evaluate the extent of consistency or inconsistency introduced by the new subordinate measure *vis-a-vis* the obligation against which the reservation is taken?

335. The Majority recognizes, and is not troubled by, the implication that consistency, as well as authority, could be evaluated by reference to a different mix of measures. In both instances, such evaluation must centrally focus on the reserved measure. Depending on the facts of the case, consistency could be determined in reference to the reserved measure along with other subordinate measures that are themselves under the authority of, and consistent with the reserved measure.

336. While there is an attractive simplicity to suggest that the consistency-test will always be in respect of the same exact measure alone, namely the measure that is the subject of the initial reservation, such an approach has several serious failings. In our view, it does not take full account of the text of paragraph 2(f), it potentially negates part of the legal framework that applies to each investment project, and it ignores subordinate measures that have been introduced by the NAFTA Party pursuant to the reserved measure. In so doing, it fails to provide the necessary basis upon which to evaluate whether the new measures enlarge the non-conforming features of the reservation.

337. The Majority is well aware that, along with the treaty text itself, it relies in part on an interpretative note to the NAFTA. The Majority does not consider reliance on this interpretative note to be problematic. It represents the agreed understanding between the NAFTA Parties for interpreting the treaty.

338. Our colleague submits that this interpretation is problematic because it does not impose a fixed and single standard against which to evaluate a new subordinate measure, and obliges a NAFTA Party to act in a manner that is consistent with all previous subordinate measures that it has introduced. As noted above, the Majority thinks that the extent to which previous subordinate measures become part of the universe of measures that must be examined for purposes of consistency of a new subordinate measure will depend on the facts of the case. The Majority is aware that this methodology implies an evolving legal and regulatory framework, which holds NAFTA Parties potentially accountable to subordinate measures that differ in significant ways from their initial non-conforming reservation. Moreover, the interpretation the Majority has suggested could constrain a NAFTA Party from departing, without consequence, from measures that they themselves have introduced because those new subordinate measures extend the non-conformity of the legal framework *vis-a-vis* the obligation against which the original measure is reserved.[340] As the Majority sees it, when the reserved measure provides a general framework and the NAFTA Party then introduces subordinate measures that are under the authority of and consistent with that reservation, they are altering their framework of laws and associated measures, in the manner reflected in such subordinate measures. The resulting regulatory framework becomes the relevant benchmark against which new subordinate measures are then evaluated for purposes of consistency.

339. Once again, this interpretation does not mean that every subordinate measure must be consistent with every other existing subordinate measure, and that the character of burdens introduced by subordinate measures cannot vary. In circumstances where there are no subordinate measures that apply to a proposed investment project, i.e. there are no Benefits Plans in place and no board decisions with respect thereof, the new subordinate measure

[340] We should recall that the NAFTA only provides for the possibility of monetary compensation in circumstances of a breach of an obligation under Chapter 11. Unlike many domestic courts, there is no injunctive relief under the NAFTA.

(such as the 2004 Guidelines) would only be evaluated against the reserved measure. Thus a prospective investment project could face a somewhat different legal framework than an investment project that had already commenced pursuant to agreed upon Benefits Plans and related Board Decisions.

340. Our interpretation of paragraph 2(f) of the interpretative note needs to be considered in the context of Articles 1106 and 1108, and in light of the object and purpose of the NAFTA. The Majority recognizes the delicate balance that is reflected in the NAFTA's history. The central purpose of the NAFTA was to be a far ranging free trade agreement, designed to permit the free flow of goods, services and investment amongst the NAFTA Parties. As stated in Article 102 of the NAFTA, the purpose of the agreement was to eliminate barriers to trade in, and facilitate the cross-border movement of, goods and services between the territories of the Parties. Other objectives were to "increase substantially investment opportunities in the territories of the Parties," amongst others. The NAFTA reservations are unilateral submissions by the NAFTA Parties that preserve certain policy flexibility for the NAFTA Parties. However, only in limited circumstances and subject to explicit reservations could NAFTA Parties derogate from their free trade obligations.

341. Reservations still remain subject to certain disciplines and some potential degree of ongoing scrutiny, as demonstrated by the evaluation of consistency under the interpretative note, and Article 1108's amendment provision. If a NAFTA Party were to amend a measure subject to a reservation, such amendment cannot decrease the conformity of the reserved measure. The Majority sees nothing in the structure of the NAFTA to suggest that a NAFTA Party can potentially circumvent the constraint imposed by the amendment provision through the issuance of a disguised amendment, executed via a subordinate measure that was to unduly expand the non-conforming features of a reservation. While the amendment standard in Article 1108 and the consistency standard in paragraph 2(f) are not identical provisions, they are substantively reinforcing and tug in the same direction, namely, to ensure that the reservations are not expanded or altered to such a degree so as to enlarge the non-conformity of the reservation *vis-a-vis* the obligation against which the measure is reserved. An evaluation of "consistency" and that of an amendment both consider whether and how the scope of the reservation has been impacted. Here, an evaluation of "consistency" under the

NAFTA must consider the consistency with the reserved and subordinate measures in the context of the recognized and limited exception to Article 1106.

342. The Majority does not think that it is appropriate to examine how this interpretation would apply to the operation of specific laws that are not in dispute before us and have not been examined in detail in submissions by the parties.[341]

343. In conclusion, mindful of the text of the interpretative note and of the Federal Accord Act, as well as the object and purpose of the NAFTA, the Majority concludes that "the measure" not only refers to the reserved measure listed in a Party's Schedule to Annex 1, but also includes any subordinate measures that have been adopted and maintained under the authority of, and consistent with, that measure. Therefore, for the purposes of this dispute, in order to determine whether the 2004 Guidelines are covered by the Canada's Annex 1 reservations, we shall examine whether those 2004 Guidelines were adopted under the authority of and consistent with the Federal Accord Act, as well as the subordinate measures, in this case the Hibernia and Terra Nova Benefits Plans and related Board Decisions.[342]

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[341] *See* Cl. Response 1st Art. 1128, para. 31: The Claimants raise the U.S. 1108 reservation for the US Atomic Energy Act as an illustrative example of their argument that Article 1108 does not include subordinate measures introduced after the NAFTA came into effect unless explicitly contemplated by the Annex I exception, which they do not believe was the case for the 2004 Guidelines. The attached Dissent elects , however, to use the example of licenses granted under the US Atomic Energy Act not to engage on the dimension of Article 1108 coverage as raised by the Claimant, but rather to criticize the Majority's interpretation that subsequent subordinate measures must, depending on the facts, be consistent with each other. In our view, as the operation of that Act was never examined in this proceeding, we decline to engage on that example nor to speculate on which subordinate measures must be consistent with others under that Act. Moreover, the US reservation excluded the entire Atomic Energy Act from the National Treatment obligation under Article 1102, and indicated that "a license is required for any person in the United States to transfer, manufacture, produce, use or import any facilities that produce or use nuclear materials. Such license may not be issued to any entity known or believed to be owned, controlled or dominated by an alien, a foreign corporation or a foreign government." The exclusion of aliens from activities, covered by the Atomic Energy Act, also excludes their reliance upon Chapter 11 of the NAFTA. Moreover, the issue of whether a subordinate measure may be considered as a "measure" for purposes of Article 1106, would seem not to arise in the context of a total sector-exclusion under the NAFTA.

[342] After lengthy and substantive exchanges, the Tribunal has regrettably been unable to reach a full meeting of the minds on the meaning and application of "the measure". In this section, the Majority has addressed the meaning of the text of Article 2(f)(ii) in light of the object and purpose of the NAFTA. It does not consider it useful at this stage to engage in a point by point rebuttal of the points asserted in the Dissent. The Majority disagrees with the characterization in the Dissent that the Majority's detailed consideration of the meaning of "the measure" amounts to a mere assumption of "the conclusion it comes to." Such was not its mindset and would not be appropriate for an arbitrator.

344. The conclusion that the consistency of the 2004 Guidelines must be evaluated together with existing subordinate measures, along with the explicitly reserved measure, namely the Federal Accord Act, is limited to the facts and law of this case alone.[343]

5. The Application of the Standard to the 2004 Guidelines

345. The Majority next turns to the meaning and effect of the words "under the authority of and consistent with the measure" as applied to the 2004 Guidelines. A preliminary issue concerns the law to be applied. In this case, when determining whether the 2004 Guidelines were adopted "under the authority of and consistent with the measure," is authority and consistency to be determined by reference to Canadian law, or the law of the NAFTA, or both?

(a) Applicable Law

346. In response to questions posed by the Tribunal, the United States has stated that "both the law of the NAFTA and national law are relevant."[344] According to the United States, because a measure is taken by a Party under its national law, "the Tribunal must look to the national law context under which the subordinate measure in question was adopted (…) to determine whether it is in fact authorized under and consistent with the relevant measure."[345] As regards the law of the NAFTA, this too is relevant because that law determines "the definition of a 'measure' that has been exempted from conforming to certain NAFTA obligations, [and] the consistency of a subordinate measure with the reserved measure must be determined by reference both to the national law governing the measure and the NAFTA."[346]

347. Mexico adopts a different approach, expressing the view that

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343 We have posited, *arguendo*, certain circumstances where new subordinate measures, such as the 2004 Guidelines, would need to be evaluated only with respect to the Federal Accord Act if no Benefits Plans were in existence, or were in existence with respect to a third party. Neither of these circumstances is before this Tribunal and such cases would doubtless raise other issues, not fully addressed or considered herein.

344 U.S. 2nd Art. 1128, para. 3.

345 *Id*., para. 6.

346 *Id*., paras. 7, 9.

> "in order to determine whether a subordinate measure fulfils the requirements set out in paragraph 2(f)(ii) of Annex I, it would be necessary to carry on an assessment of the subordinate measure under the national law governing the measure listed in Annex I."[347]

348. In response to the United States' and Mexico's Article 1128 submissions, the Claimants set out their position as follows:

> "4. Applying the VCLT principles leads the United States and Claimants to the same conclusion: "both the law of the NAFTA and national law are relevant" to the determination of whether a subordinate measure is "consistent with" a measure listed in a Party's Annex I reservation. Claimants agree that domestic law is a relevant consideration: it presents an essential first hurdle which a subordinate measure must clear before the question of consistency as a matter of the NAFTA even arises. If a measure is not a "subordinate measure" as a matter of domestic law, then it can never fall within the scope of a Party's Annex I reservation. As noted above, Mexico's conclusion that "consistency" is determined by domestic law is correct only in part. Further, while "authority" may be viewed predominantly as a question of domestic law, "consistency" must have an international law content for the reasons stated by the United States, with which Claimants agree. If a measure does constitute a "subordinate measure" as a matter of domestic law, then the question of its "consistency" with the listed measure must be determined as a matter of the law of the NAFTA. This result applies because "a 'subordinate measure' falls within the definition of a 'measure' that has been exempted from conforming to certain NAFTA obligations."[348]

349. In its response, the Respondent expresses its agreement with the position adopted by Mexico, confirming the position it has adopted in earlier pleadings:

[347] Mex. 2nd Art. 1128, para. 3.

[348] Cl. Response 2nd Art. 1128, para. 4 – 5.

> "When deciding whether a domestic measure is subordinate to another domestic measure listed in Annex I, the Tribunal is directed by 'the law of the NAFTA' to apply domestic law."[349]

The Respondent argues that all three NAFTA Parties

> "agree that the Tribunal 'must' examine domestic law when deciding if an alleged subordinate measure is 'consistent with' a measure listed in Annex I [and that accordingly we] should apply the decisions of the Canadian courts that the [2004] Guidelines are authorized by, and consistent with, these Acts."[350]

350. Taking these arguments as a whole, it appears that both parties, the United States and Mexico, broadly agree that the question of whether a "subordinate measure" has been adopted under "the authority of (…) the measure" is essentially a matter of domestic law. The Tribunal agrees. As the pleadings and submissions recognize, it is difficult to see what the rules of the NAFTA could add to a determination of whether a "subordinate measure" is authorized by the measure that has been reserved. The Claimants correctly assert that "[i]f a measure is not a "subordinate measure" as a matter of domestic law, then it can never fall within the scope of a Party's Annex I reservation."[351] It must be equally correct that where a measure is a "subordinate measure" under the authority of domestic law, then no rule of international law could change that situation. Accordingly, the Tribunal concludes that under the NAFTA, and with respect to the measures at issue in this dispute, it will be a matter of Canadian law to determine whether the subordinate measure, namely the 2004 Guidelines, were adopted 'under the authority of' the reserved non-conforming measure.

(b) Adoption of the 2004 Guidelines

351. The Majority now considers whether the 2004 Guidelines were adopted under the authority of the Federal Accord Act.

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349 R. Response 2nd Art. 1128, para. 8; *See also* R. P. Brief, para. 26; R. Reply P. Brief., paras. 36 - 7.

350 R. Response 2nd Art. 1128, paras. 11-12.

351 Cl. Response 2nd Art. 1128, para. 4.

352. As noted, the Respondent argues that whether a domestic measure is adopted under the authority of another domestic measure can only be determined under domestic law. According to the Respondent, the Trial Court "identified the issues it had to address as follows: (…) 1. Does the Board have the authority to establish the R&D Guidelines? 2. If so, has the Board exceeded its authority by implementing the Guidelines in their current form?"[352]

353. The Respondent states that the

> "courts concluded that the Guidelines were authorized and did not exceed—or were consistent with—that authority. They concluded that the Guidelines were authorized because section 151.1(1) of the Federal Accord Implementation Act (and section 147(1) of the Provincial Accord Implementation Act) expressly gives the Board the authority to issue guidelines with regard to section 45 (3) c of the Acts. The courts concluded that the Guidelines did not exceed that authority because the Guidelines were consistent with section 45 (3) c of the Acts as well as the Hibernia and Terra Nova Benefits Decisions. Indeed, the courts expressly stated that the Guidelines were within the Board's "authority" and "were consistent with" the Benefits Decisions."[353]

354. The Claimants argue that it was improper for the Respondent to rely on domestic court decisions to support the contention that the 2004 Guidelines were adopted under the Federal Accord Act. The Newfoundland Trial Court and Court of Appeal did not hold so. Rather, according to the Claimants, the Court only held that it was "reasonable for the Board to find that the Guidelines were authorized by the Act," [354] which is very different from an express finding that the 2004 Guidelines were authorized by the Federal Accord Act. The Claimants argue that the Canadian court judges did not actually consider whether the Board was authorized by the prior legislative scheme to apply the 2004 Guidelines to Hibernia and Terra

[352] R. P. Brief, para. 28.

[353] *Id*., paras. 28 - 29.

[354] Cl. P. Brief (Redacted), para. 17.

Nova. Instead, the Canadian courts applied a standard of "reasonableness" under Canadian administrative law. Even if they had decided that the Board had the authority to promulgate the 2004 Guidelines under Canadian law, that "would in no way decide the issues in dispute in this arbitration, [as under NAFTA] a Tribunal established under Chapter 11 shall decide the issues in dispute in accordance with this Agreement and the applicable rules of international law."[355] The standard that a subordinate measure must be adopted "under the authority of (...) the measure" is an international law requirement involving international law analysis.

355. The Majority has carefully considered the rulings of the Trial Court and Court of Appeal. The Trial Court concluded that a degree of deference was appropriate with respect to the Board's interpretation of its own "constitutive statute" and the appropriate standard of review was "reasonableness". [356] In examining the actions of the Board, the Trial Court noted that the Board had relied on Sections 45 and 151.1 of the Federal Accord Act "to ground its authority" [357] to issue the 2004 Guidelines and that it had not acted unreasonably. The Court of Appeal upheld that ruling and concluded that as a matter of Canadian law the Board had acted reasonably in exercising its authority to apply the 2004 Guidelines to the Hibernia and Terra Nova projects.[358] Since leave to appeal to the Canadian Supreme Court was rejected, the Court of Appeal's ruling on Canadian law is dispositive as a matter of Canadian law. This being the case, we see no basis for questioning whether the 2004 Guidelines were adopted under the authority of the Federal Accord Act as a matter of Canadian law. The Tribunal thereby concludes that the 2004 Guidelines were adopted under the authority of the reserved non-conforming measure, namely Sections 45 and 151.1 of the Federal Accord Act.

B. MEANING AND APPLICATION OF 'CONSISTENT WITH THE MEASURE'

356. Turning now to the issue of consistency with the measure, the Tribunal agrees with the Claimants and the United States, that "consistency" cannot be determined exclusively by the

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[355] Cl. Response 1st Art. 1128, para. 48.

[356] CA-52, *Hibernia and Petro-Canda v. C-NOPB*, para. 27.

[357] *Id*., para. 29.

[358] CA-53, *Hibernia and Petro-Canda v. C-NOPB*, paras. 58,70,79.

national law of the Party adopting the subordinate measure. National law is plainly relevant (at the very least, a subordinate measure that was not consistent with a reserved measure as a matter of domestic law could not meet the conditions to be fulfilled under Annex I). However, the criterion "consistent with" is set forth in a treaty and must be determined with reference to the rules of international law. If a measure does constitute a subordinate measure as a matter of domestic law, it is then that the question of its consistency with the reserved measure arises. As clarified by the United States, the determination of consistency must be in reference to both the national law governing the measure, and the NAFTA. For the NAFTA, considerations of consistency include the context of the reservations that the Parties negotiated, the NAFTA obligation from which the listed measure is reserved, and the degree of the reserved measure's and the subordinate measure's non-conformity with that obligation, in light of the other elements of the reservation that would be relevant. Included is the degree of the reserved measure's, and the subordinate measure's non-conformity with that obligation, in light of the other elements of the reservation that would be relevant.[359] The Tribunal agrees with the standard and reasoning put forth by the United States and the Claimants. Accordingly, it will be a matter of Canadian law and the law of the NAFTA to determine whether the 2004 Guidelines were adopted 'consistent with' the Federal Accord Act, and the relevant subordinate measures, namely the Hibernia and Terra Nova Benefits Plans and the related Board Decisions.

357. It is now necessary to consider the meaning of "consistent with" and to determine whether the 2004 Guidelines are "consistent with" the Federal Accord Act and subordinate measures.

358. The Claimants argue that the 2004 Guidelines, which impose additional and/or more onerous burdens than existed prior to their adoption, are not consistent with the Federal Accord Act because "a subordinate measure that imposes additional and/or more onerous burdens prohibited by Article 1106 cannot be consistent with a listed measure."[360] The Claimants summarize the new burdens as follows:

[359] U.S. 2nd Art. 1128, para. 9.

[360] Cl. Reply P. Brief, para. 24.

> “The Guidelines: (*i*) prescribe an arbitrary level of expenditures on R&D/E&T that in practice amounts to approximately $147 million in forced spending, in addition to the estimated $146 million that Hibernia and Terra Nova already expect to spend in the Province, over the remaining life of the projects; (*ii*) require the project operators to submit individual R&D/E&T spending decisions to the Board for pre-approval; (*iii*) require the project operators to submit a detailed accounting to the Board at the end of each calendar year and empower the Board to assess whether each reported expenditure is eligible under the Guidelines; (*iv*) require the project operators to submit work plans and financial instruments to address any spending shortfall assessed by the Board; and (*v*) condition Board authorization to continue operating the investments on compliance with the Guidelines.”[361]

According to the Claimants,

> “None of these burdens is reflected in — or equivalent to — Claimants’ prior commitments to make some unspecified amount of expenditures on R&D/E&T and to report those expenditures to the Board. Each **decreases the conformity of** the preexisting measures by magnifying in both quantity and quality the requirements to purchase, use or accord a preference to local R&D and E&T services.”[362] (Emphasis added)

359. The Claimants’ argument is premised on the view that ‘consistent with’ is to be treated as synonymous with the requirement that a new subordinate measure must not “decrease the conformity” of Canada’s compliance with Article 1108. The Claimants argue that

> “the drafters of the NAFTA could not have intended for there to be any substantive difference between the “consistent with” standard (in Section

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

[362] *Id*.

> 2(f)(ii) of the Interpretative Note to Annex I) and the "not decreasing the conformity of" standard (in Article 1108(1)(c))."[363]

The Claimants argue that

> "[w]hile the language may be slightly different, both require the subsequent measure to meet certain requirements: an amendment will only be covered by the reservation if it 'does not decrease the conformity of the [listed] measure,' and a subordinate measure will only be covered if it is adopted '… consistent with the [listed] measure.'"[364]

360. In support of that argument, the Claimants largely rely on the textual difference between "consistent with" and "not decreasing the conformity of," but argue that this is not dispositive:

> "Even if the words are not identical, Canada has made no coherent case that the meaning is different. Although it tries … to overcome the fact that the French language version of the Treaty, drafted by Canada, uses two forms of the same word — *conformément* and *conformité* — the distinction that it attempts to draw between those terms is without a difference. Both words have the same root: *conforme*. It is therefore as if Canada were urging the Tribunal to accord a fundamentally different meaning to the words "consistent" and "consistently" simply because one has a different suffix than the other. Canada supplies no principled basis for such a reading. Indeed, Canada even acknowledges that one meaning of the word *conforme* is "consistent with." For the reasons already explained, this equivalency of terms is clearly the meaning intended by the drafters of the NAFTA."[365]

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363 *Id*., para. 27.

364 *Id*.

365 *Id*., para. 32.

361. For its part, the Respondent asserts that "the law of the NAFTA directs the application of domestic law to determine if a subordinate measure is "consistent with" the listed measure."[366] It further asserts that the NAFTA contains no independent standards for determining such consistency.[367]

362. Having argued that the NAFTA contains no standard of its own as to the determination of consistency, the Respondent turns to the arguments as to the assessment of consistency. It argues that "consistent with" and "decreases the conformity" are, however, different standards, and that "the obligations and tests in Article 2(f)(ii) of the Interpretative Note to Annex I and Article 1108(l)(c) are fundamentally different and cannot be conflated."[368]

363. The Respondent points out that

> "Article 1108(l)(c) states that an amendment to a listed measure is not reserved if it "decreases the conformity" of that listed measure with the NAFTA obligations. Burdens imposed by an amendment to a listed measure will help determine whether it decreases that conformity. Since the [2004] Guidelines do not amend the [Federal Accord Act], as the Claimants have agreed, the application of Article 1108(l)I is irrelevant to this dispute."[369]

It argues that

> "[a] measure can be 'consistent with' a measure listed in Annex I of the NAFTA if it imposes additional and/or more onerous burdens on a legal or natural person who is subject to that measure. The effect of additional and/or more onerous burdens on a legal or natural person is addressed in

[366] R. P. Brief, para. 31.

[367] *Id*. It has been set out above that we do not agree that the requirement of consistency is to be determined solely by reference to the domestic law of Canada. The assessment of whether the 2004 Guidelines are "consistent with" the Federal Accord Act for the purposes of the NAFTA must also be determined by reference to the Hibernia and Terra Nova Benefits Plans and related Board Decisions, considered in the context of the NAFTA reservation from Article 1106.

[368] *Id*., para. 47.

[369] *Id*., para. 35.

> NAFTA Article 1108(l)(c), not Article 2(f)(ii) of the Interpretative Note to Annex I. Those Articles have different purposes, contain different tests, and cannot be conflated."[370]

364. In support of that textual argument, the Respondent also refers to linguistic differences. It notes that

> "in the French text, Article 2(f)(ii) of the Interpretative Note to Annex I uses the word *conformement* instead of "consistent with" and Article 1 108(l)(c) uses the words *la conformité.* The Claimants argue that *conformement* should be given the same meaning as *la conformité* because the words have the same base - *conforme*. However, *conformement* and *conformité* do not have the same meaning. Moreover, *conforme* has several meanings, including "consistent with". Finally, the Spanish text, like the English, does not use the same words. Hence, the tests under Article 2(f)(ii) of the Annex I Interpretative Note and Article 1108(l)(c) use different words."[371]

365. Finally, the Respondent argues that even if the words "consistent with" do imply a requirement to assess whether a new subordinate measure "decreases conformity with" a NAFTA obligation, the measure at issue here, namely the 2004 Guidelines, "do not decrease the conformity of the [Federal Accord] Act with NAFTA obligations" under Article 1106.[372]

366. The Tribunal also received submissions from the United States and Mexico on this point. The United States submitted that "'[c]onsistent' is not defined in the NAFTA [and that] the ordinary meaning of the term 'consistent' is 'in accord', 'compatible,' or 'without contradiction'."[373] In support of that submission it refers to dictionary definitions taken from the Oxford English Dictionary ("defines 'consistent' in its 'usual and current sense' as 'agreeing or according in substance or form; congruous; compatible'") and Webster's New

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[370] *Id*., para. 33.

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

[372] *Id*., paras. 48 *et seq*.

[373] U.S. 2nd Art. 1128, para. 5.

International Dictionary ("defines 'consistent' as 'coexisting and showing no noteworthy opposing, inharmonious or contradictory qualities'").[374] Having argued that "the consistency of a subordinate measure with the reserved measure must be determined by reference both to the national law governing the measure and the NAFTA," the United States submitted that

> "[f]or the NAFTA, considerations in relevant cases would include the context of the reservation the Parties negotiated, including the NAFTA obligation from which the listed measure is reserved and the degree of the reserved measure's and subordinate measure's non-conformity with that obligation, in light of the other elements of the reservation that would be relevant."[375]

367. In response to the question from the Tribunal as to whether a subordinate measure could be "consistent with the measure" if it imposed additional and/or more onerous burdens, the United States responded that

> "the answer to this question in a specific case would be determined by reference to (i) the domestic legal context of the measure; (ii) the particular elements of the non-conforming measure entry and the subordinate measure, including, inter alia, the extent of noncomformity of each with the obligation against which the measure is reserved; and (iii) the specific facts and circumstances of the case. Such a determination would be difficult to make in the abstract or as a general rule."[376]

368. For its part, Mexico submitted that consistency was to be determined exclusively by reference to national law.[377] Mexico submitted that "[a] subordinate measure can be 'consistent with the [listed] measure' if it imposes additional and/or more serious burdens, [and that] [b]urdens might be characterized as more onerous or additional but this does not mean that those burdens are automatically inconsistent with the measure listed in Annex

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[374] *Id*., fn 3.

[375] *Id*., para. 9.

[376] *Id*., para. 10.

[377] Mex. 2nd Art. 1128, para. 3.

I."[378] Finally, Mexico submitted that whether an additional and/or more onerous burden imposed by a subordinate measure is consistent with a listed measure set out in Annex I is "difficult to assess in general terms (or in the abstract) [and that accordingly a] case by case analysis is required."[379]

369. Both parties provided written responses to the United States' and Mexico's submissions.[380]

370. In interpreting and applying the words "consistent with," the Tribunal adopts the approach set forth in the VCLT. The NAFTA is to be interpreted "in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of [the treaty's] object and purpose."[381] Further, "there shall be taken into account, together with context, any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions."[382]

371. It is appropriate to begin with ordinary meaning. There is no disagreement between the Claimants and the Respondent that the ordinary meaning may be ascertained by reference to reputable dictionaries, which include the Oxford English Dictionary and Webster's New International Dictionary (as referred to by the United States). On this approach, the 2004 Guidelines will be "consistent with" the Federal Accord Act if they are "congruous" or "compatible" with the Federal Accord Act, or if they may "coexist" with the Federal Accord Act and show "no noteworthy opposing, inharmonious or contradictory qualities." It is apparent from this that the 2004 Guidelines do not have to be the same as, or identical to, the Federal Accord Act.

372. This is also confirmed by the text of other parts of the NAFTA, which reflect the intent of the drafters to use different formulations in seeking to establish the relationship between two or more different obligations or requirements. The drafters of the NAFTA used the words "consistent with" in a number of different locations. By way of example, the Preamble refers

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378 *Id.*, paras. 4 - 5.

379 *Id.*, para. 6.

380 R. Response 2nd Art. 1128; Cl. Response 2nd Art. 1128.

381 Article 31(1).

382 Article 31(3)(a).

to the requirement that NAFTA obligations will be undertaken in a manner that is "consistent with environmental protection and conservation," and that the NAFTA's free trade area is "consistent with Article XXIV of the [GATT]."[383] Additionally, a number of provisions of the NAFTA use the negative formulation of the same standard, that is to say they use the words 'not inconsistent with'.[384] Yet other provisions use the words "inconsistent with," usually when addressing a party's burden on establishing an inconsistency.[385] These different formulations do not clarify the meaning of "consistent with," although they do demonstrate their broad use.

373. By contrast, other formulations used in the NAFTA are somewhat helpful in interpreting the words "consistent with." The Majority notes that Article 104 provides that where a Party has a choice among equally effective and reasonably available means of complying with obligations under certain environmental and conservation agreements, the Party must choose the alternative that is "the least inconsistent with the other provisions of this Agreement." This indicates that the NAFTA directed the behavior of the parties where a range of possibilities exist. Another example is Article 1004, which prohibits a Party from applying a rule of origin to goods imported from another Party for the purposes of government procurement that is "different from or inconsistent with the rules of origin the Party applies in the normal course of trade." Article 2(f)(ii) of the interpretative note could have prohibited a subordinate measure that is different from the measure.

374. From this it appears to the Majority that when applied to the measures at issue in this case, whilst the 2004 Guidelines must be "consistent with" "the measure," within the meaning of Article 2(f)(ii), that does not preclude the possibility that they may be different from "the measure" or that they might not be the "least inconsistent means" to attain the objectives of the reserved measure. In their submissions, the three NAFTA Parties (Canada, Mexico, and the United States) appear to have agreed that a new subordinate measure could impose some additional and/or more onerous commitments than those that were imposed by the earlier

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383 Article 101. *See also* Articles 402, 509(9)(b), 603, 713(2), 905, 1210(4), 1403(4), 1405(5), Annex 1705.7 and 2104.

384 *See* Articles 1101(4), 1106(1)(f), 1201(1)(3(b), 1702, 1703(3)(a), 1902 and 1911.

385 *See* Articles 801(1), 914, 1105(3) and 2004.

measure, however this will depend, as the US stated, "on the facts and circumstances of the case."[386]

C. APPLICATION OF THE MEASURES AT ISSUE IN THIS CASE

375. Against this background, the Majority now turns to a key issue, namely whether the 2004 Guidelines are "consistent with" the Federal Accord Act and the Boards Decisions, with respect to the Hibernia and Terra Nova Benefits Plans, within the meaning of the NAFTA. The Claimants argue that they are not, whereas the Respondent argues that they are.

376. In order to address this issue, two sets of measures have to be compared: on the one hand, the reserved measure, namely the Federal Accord Act, and the existing subordinate measures (the Hibernia and Terra Nova Benefits Plans and related Board Decisions), and on the other hand, the new subordinate measures, namely the 2004 Guidelines. The reserved measure is addressed at paragraphs 19 – 36 above. We noted that the Federal Accord Act as the measure mentioned in the reservation allows the Respondent to give effect to the requirement that

> "[the] benefits plan (...) ensure that (…) (c) 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."[387]

The relevant provisions of the Federal Accord Act, as qualified, do not specify (i) how to ensure that such expenditures be made, but indicate that the benefits plans must ensure such expenditures. The Federal Accord Act also does not specify (ii) the level of expenditure that would be required for an investor to meet the requirements of the reserved measure.

377. The reserved measure is not, however, entirely open-ended. In order to be consistent with, and thus covered by, the reserved measure, the subordinate measure under the Federal Accord Act must meet certain conditions:

(i) it must be imposed in relation to a "<u>benefits plan";</u>

[386] U.S. 2nd Art. 1128, para. 10.

[387] Section 45(3)(c).

(ii) it must be made in relation to a requirement concerning "<u>expenditures"</u>;

(iii) it must be made in relation to either a requirement concerning expenditures on (a) "<u>research and development</u>" or (b) "<u>education and training</u>;

(iv) it must be made in relation to a requirement concerning expenditures on research and development or education and training "<u>to be carried out in the province</u>" or "<u>provided in the province</u>.

378. There appears to be no dispute between the parties that the Benefits Plans and related Board Decisions meet these four conditions.

379. The dispute between the parties is whether the additional requirements that were introduced in the 2004 Guidelines alter the expenditure requirements such that the 2004 Guidelines are not consistent under the rules of the NAFTA, with the reserved measure, or the Federal Accord Act, the Hibernia and Terra Nova Benefits Plans and related Board Decisions.

1. <u>The Characteristics of the Hibernia and Terra Nova Benefits Plans and Board Decisions</u>

380. The Hibernia and Terra Nova Benefits Plans and related Board Decisions, put into operation the expenditure requirement, with a set of specific plans and commitments regarding concrete and identified projects; a strategy designed to guide ongoing activities on the part of the Operators over the short and long term; and a set of principles guiding the Board. The Board Decisions also include certain specific conditions associated with the Board's review of the Benefits Plans. Considerable emphasis was placed in the Plans and by the Board on the general requirement to provide a "full and fair opportunity" to Canadians, and in the case of the Terra Nova project, additional regular forecasting and reporting of initiatives and expenditures were introduced. Together, these instruments constituted the legal framework that applied to these investment projects prior to the introduction of the 2004 Guidelines, which are described in greater detail below.

(a) Hibernia

381. The Claimants, in their Benefits Plan, identified some six general objectives for the development of the Hibernia Field and the operation of the production facilities.[388] The industrial benefits stress the objective of providing qualified Canadian suppliers with a full and fair opportunity to bid on an internationally competitive basis; to evaluate bids on the criteria of best value, to encourage the development of internationally competitive Canadian sources of supply, to encourage enhancement of Canadian technology, expertise and facilities, to encourage and help in transferring foreign technology and expertise to Canadian suppliers, to obtain reliable information and understanding about Canadian suppliers, and encourage Project contractors to adopt all these objectives. [389]

382. The Plan reviews and assesses the capability of industry in Canada to supply goods and services required for the Hibernia project.[390] As one such example, it identifies areas where manufacturing and assembly capabilities can be made within Canada, and various items that will need to be purchased outside Canada. The Hibernia Plan identifies various elements of its fabrication and construction needs, such as the five phases of construction associated with its Gravity Base Structure[391] (GBS), the Articulated Loading Platform,[392] whether materials and services are available from Canadian sources or whether non-Canadian sources may be

[388] CE-45, Hibernia Benefits Plan, para. 2.1; The objectives include: "The project will be carried out in an expeditious and economic manner without compromising the efficiency, operation and maintenance of the production system, or the safety and welfare of personnel; Newfoundland and other Canadian industry will be provided with a full and fair opportunity to participate on a worldwide competitive basis in the supply of goods and services to the project; Supplier development initiatives will be carried out to encourage the participation of local and national industry in the project; Qualified Newfoundlanders and other qualified Canadians will be provided with the opportunity to obtain employment during development and production; this will be accomplished with due regard for the safety and efficiency of all operations; Employment disadvantaged groups will be provided with full and fair consideration for job opportunities which interest them; To the extent that it is practical and cost effective, the project will be designed, constructed and operated to provide net benefits to those local areas and regions which will be directly influenced by project activities."

[389] *Id*., para. 3.1.

[390] *Id*., para. 3.3.

[391] *Id*., para. 3.3.1.

[392] *Id*., para. 3.3.1.2.

necessary,[393] and the practices that the Claimants will deploy with respect to procurement. It states that

> "Mobil's industrial benefits objectives dictate that where bids are equally competitive on best value criteria, preference be given to companies that provide services or manufacture goods in Canada."[394]

383. The Hibernia Benefits Plan identifies six areas of potential research and development activity, again particular to this investment project, including: iceberg management, iceberg detection, remote valve actuation, quality assurance, remote component replacement and sonic transmission of bottom hole pressure to the surface.[395] The Plan's employment benefits objectives clearly state that

> "employment opportunities will be provided to qualified Newfoundlanders and other qualified Canadians and project activities will be implemented using personnel and equipment in a manner that neither compromises Mobil's safety standards, nor the attainment of the project schedule."[396]

The Plan identifies the labor demand in the development phase and it estimates the labor supply capability in Newfoundland Canada,[397] the regional benefits expected from the project,[398] and a plan around Canada/Newfoundland benefits implementation.[399]

384. Board Decision 86.01, which approved the Hibernia Benefits Plan, stated that

> "any benefits plan is, in large measure, a commitment to principles. The fundamental principles incorporated in the Atlantic Accord and its implementing legislation are designed to ensure that the resources off

393 *Id*., para. 3.3.2 - 3.3.4.

394 *Id*., p. 44.

395 *Id*., para. 3.5.4.

396 *Id*., para. 4.1.

397 *Id*., para. 4.3.

398 *Id*., para. 5.

399 *Id*., para. 6.

> Newfoundland's coasts are developed in such a way that maximum benefits accrue to the Province and to Canada." [400]

385. In Decision 86.01, the objectives of the Hibernia Management and Development Company, the Proponent in the Benefits Plan, of which Claimants were the main stakeholders, were stated as follows:

> "The objectives stated in the Proponent's Benefits Plan are to provide Canadian suppliers with a full and fair opportunity to bid on an internationally competitive basis and to evaluate bids on the criteria of best value, with best value meaning the best combination of price, technical ability, quality and assurance of supply, delivery and service. Where bids are equally competitive on a best value basis, the Proponent's objective is to give preference to companies which provide services or manufactured goods in Canada."[401]

386. Furthermore, the Decision indicated that the Claimants committed themselves to do the following:

> "Utilize, to the extent practical and cost effective, the principle of first consideration to Newfoundland and Canada in procurement, contracting and employment policies for the project including the construction, development and operating phases. Provide Newfoundland industry and other Canadian industry with full, fair and timely opportunities to participate in the supply of goods and services on a competitive basis in terms of price, quality and delivery."[402]

387. The Board concluded that the Proponent's Benefits Plan does meet the principle of full and fair opportunity for Canadians, and first consideration for Newfoundlanders, to participate in the provision of goods, services and employment. In a number of specific project areas it

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[400] CE-47, Board Decision 86.01, para. 2.0.

[401] *Id*., para. 2.2.1.

[402] CE-46, Supplementary Benefits Plan, p. 1.

required further clarification of the Proponent's intentions and the Benefits Plan was approved subject to specific conditions tied to particular projects that are noted in the Decision, e.g. with respect to maximum Canadian participation in the shuttle tanker construction, and the preparation of a training and staffing plan.[403]

388. The Decision further states that in considering the regulatory options available to the Board for ensuring "the greatest possible economic benefit accrues to both Newfoundland and Labrador and the rest of Canada, (...) 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 Board's opinion, be more effective than attempting to negotiate specific requirements for the multitude of elements of which the project will consist. The Board will monitor the project, as it proceeds, to ensure that the Proponent complies with the commitments."[404] It further notes 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." [405]

(b) Terra Nova

389. Subsequently in December 1997, Decision 97.02 approved the Terra Nova Development Plan and Benefits Plan, proposed by the Terra Nova Oil and Development Project, a joint venture of which the Claimants were the main participants, subject to certain conditions. Decision 97.02 states again that two fundamental principles are embodied in the Accord Acts:

> "The first requires that Canadian enterprises and individuals be provided a full and fair opportunity to participate in the supply of goods and services

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403 CE-47, Board Decision 86.01, para. 2.0.

404 *Id*., para. 2.1.

405 *Id*., para. 2.1. A later Decision 97.01, amended the Hibernia Development Plan and reviewed the conditions associated with the Hibernia Benefits Plan, but it did not amend that Plan.

to offshore oil and gas activities with first consideration being given to those located within the Province provided they are competitive in terms of fair market price, quality and delivery and the second requires that first consideration for training and employment be given to residents of the Province".[406]

390. The Decision states that "the Proponent has presented a Canada-Newfoundland Benefits Plan which addresses these principles."[407] The Board approved the Terra Nova Benefits Plan but developed conditions "to help ensure that these commitments are met, and to ensure it will have access to the documentation necessary to corroborate this."[408] The Decision states that "the Board believes the Proponent will undertake significant training and research in the Province and that it understands the education and training capabilities available within the Province. The Board will require regular forecasting and reporting of education and training and research and development initiatives and expenditures."[409] As one condition for approval it requires that the Proponent report to the Board by March 31 of each year, commencing in 1998, its plans for the conduct of research and development and education and training in the Province, including its expenditure estimates, for a three year period, and on its actual expenditures for the preceding year.[410]

D. THE 2004 GUIDELINES

391. The Federal Accord Act contained an expenditure requirement with little detail except that such expenditures needed to be reflected in Benefits Plans. In contrast, the 2004 Guidelines, as outlined in the introduction, identify research and development expenditures required at various stages of a project from exploration through production. The 2004 Guidelines expect that the level of research and development expenditures to be consistent "with the norms for

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406 CE-57, Board Decision 97.02, para. 1.2.

407 *Id*., para. 1.2.

408 *Id*., p. 2.

409 *Id*.

410 *Id*., p. 24, condition 7.

such expenditures by the upstream petroleum industry in Canada."[411] From 2003 on, during the exploration phase, research and development expenditures "up to a maximum of 5 percent of the expenditure bid [would] be allowed."[412] The expenditure requirement for the production phase of a project is calculated for each period covered by the POA issued by the Board, as the difference between the total requirement and the development phase requirement.[413] The production phase expenditure requirement is "distributed over each POA period during the production life of the project in proportion to production."[414] The 2004 Guidelines introduce a requirement that operators file an R&D and E&T Expenditure Application form for each activity they plan to undertake, which are to be reviewed by the Board for approval prior to the commencement of the activity.[415] The Guidelines state the expectation that a successful research and development program should not fluctuate widely. Thus,

> "for any POA period in which there are not sufficient projects to absorb the required 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." [416]

392. With these factual characteristics of the measures and arguments of the parties before us, the Majority returns to the question of whether the 2004 Guidelines are consistent with the Federal Accord Act, together with the Hibernia and Terra Nova Benefits Plans and related

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[411] CE-1, 2004 Guidelines, Section 1.0.

[412] *Id.*, Section 2.1. *See also* Section 2.2.1: For the development and production phase, and "in the absence of experience on which to base a benchmark for such expenditures, the Board developed a benchmark based on expenditures by petroleum companies in Canada. For example, according to the Guidelines, experience during the development phase of a project, R&D expenditures have amounted to approximately 0.5% of total project cost (C). The C_NOPB accepts this as a reasonable R&D expenditure level for the development phase of a project" and they then propose a calculation based thereon. DPR&D=0.005XC

[413] *Id.*, Section 2.2.2

[414] *Id.*

[415] *Id.*, Section 4.1.

[416] *Id.*, Section 4.2.

Board Decisions, within the meaning of the NAFTA. In answering this question, the Majority examines both the general attributes of the changes introduced by the 2004 Guidelines as well as certain specific facts that arise with respect to these Benefits Plans and Board Decisions applicable to this operator. For example, the Majority shall consider factors such as:

(1) can there be a change in the methodology for requiring and calculating the expenditures to be made for research and development to be carried out in the province, and for education and training to be provided in the province, as compared with that which pertained on 1 January 1994, and what are the key characteristics of the methodology introduced by these 2004 Guidelines as compared with the existing measures;

(2) can there be an extension of the requirement to make such expenditures in relation to the development and production phase, as compared with it being limited to the exploration phase as pertained on 1 January 1994, and what are the consequences of this extension;

(3) can the amounts of such expenditures to be imposed in a Benefits Plan be specified, rather than determined through the self-identified needs of the project operator, and also increased beyond those that would have pertained under the previous Benefits Plans as now required by the 2004 Guidelines; and

(4) can additional oversight and reporting requirements be introduced that reduce the discretion of the operators via the now mandatory pre-approval process, and against what standard should such adjustments as required by the 2004 Guidelines be evaluated?

393. Turning first to the mandatory expenditure requirements contained in the 2004 Guidelines, the Claimants argue that the Respondent is not authorized to change the methodology for

requiring and calculating the expenditures that pertained as of 1 January 1994. Specifically the Respondent is not permitted to change from a methodology that allowed the Claimants to determine the expenditures to be made in view of the self-identified needs, to one that allows the Respondent to calculate expenditures by reference to the new formula contained in the 2004 Guidelines. [417]

394. The Majority notes that the reserved measure is silent about the level of expenditures and does not reference any particular methodology for determination thereof. Instead, it merely refers to Benefits Plans as to ensure that such expenditures are made. The Majority of the Tribunal is therefore unable to conclude that a mere change of methodology is *per se* inconsistent with the Federal Accord Act. Instead, one must evaluate whether and how the 2004 Guideline methodology differs from the approach outlined in the reserved portion of the Federal Accord Act, and contained in the particular Benefits Plan and related Board Decisions that are applicable to these investment projects, and whether those changes are imposing such additional burdens that are of an inhospitable, inharmonious, incompatible, contradictory nature, and are otherwise inconsistent with the existing legal framework.

395. Unlike earlier Guidelines or existing Benefits Plans and Board Decisions, which identified particular projects or priorities, the 2004 Guidelines introduced a specific formula to determine the target amount of expenditures that must be spent on research and development and education and training in the Province. This formula, developed by the Board, is based on an average level of spending in the industry in Canada. It is not based on the particular needs or history of the Hibernia or Terra Nova investment projects. As noted by Respondent's witness, Mr. Fitzgerald, the previous Vice Chair of the Board, the Accord Acts themselves do not contain any particular expenditure thresholds for research and development and do not require the Board to impose any particular expenditure thresholds.[418] The earlier approach had the project operators identifying potential areas of research and development as part of the Benefits Plan approval process, without specifying expenditure

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[417] *See* Cl. Mem., para. 181.

[418] Day 2 Transcript, p. 489 – 490:22-8 (Washington, D.C., October 20, 2010) "Q: And the Accords Acts themselves do not contain any particular expenditure thresholds for research and development do they? A: That's quite correct, sir. Q: And they don't require the Board to impose any particular expenditure thresholds on R&D either, do they? A: There is no explicit requirement that the Board do that."

amounts *a priori*. The Claimants argue that earlier Exploration Guidelines were also silent on the subject of expenditure amounts.[419] Similarly, even in 1997, the Decision approving the Terra Nova Benefits Plan did not impose a "mandatory spending requirement."[420] However, according to the Respondent, the Terra Nova Decision preserved the Board's authority to intervene and issue Guidelines if the operators failed to fulfill their obligation to expend on research and development, and education and training.[421]

396. The Majority notes that the Board explicitly recognized in the Terra Nova Decision the difficulty to provide, in advance, detailed research and development and education and training plans for the entire duration of the development stage of the project. For this reason, in order to provide a framework for monitoring the activities in this regard, it established the condition that the Hibernia and Terra Nova Projects Boards report to the Board by March 31 of each year, commencing in 1998, their plans for the conduct of research and development and education and training in the Province, including their expenditure estimates, for a three year period and report on their actual expenditures for the preceding year.[422]

397. The Majority is of the view that the abovementioned statements from the Terra Nova Decision show that Board was aware that the Accords Act did not provide for fixed expenditures, and that the Board acknowledged the complexity associated with any such methodology. The 2004 Guidelines then introduced a mandatory spending requirement at a

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419 *Id*., p. 531:11-15 "Q….Yes, and in April 1987, when the Board reissued the exploration benefits guidelines, it was silent on the issue of expenditure amounts? A: yes."

420 *Id*., p. 537 - 538:6-7 "Q...In its approval of the Terra Nova Benefits Plan the Board asked Terra Nova--made a condition to Terra Nova that it provide on an annual basis information about its R&D and E&T expenditures right? A. That's right.

Q. And in its approval of the Terra Nova Benefits Plan, the Board asked Terra Nova--made a condition to Terra Nova that it provide on an annual basis information about its R&D and E&T expenditures; correct? A. That's right. And report on its past year and a projection of its next three. Q. Okay. And--but at the time the Board was still looking to the industry to take the lead in identifying where it wished to direct its expenditures; correct? A. Yes. Q. And again condition seven did not impose mandatory spending requirements. A. No, it did not state a threshold, as you have described it previously. Q. And it did not impose pre-approval of R&D expenditures. A. No, no. Q. And it didn't impose that research and development be undertaken on a basis other than laid out in 45(3)(c) and (d), namely, first consideration to local suppliers on a competitive basis. A. It didn't speak to that at all."

421 CE-57, Board Decision 97.02, p. 2.

422 *Id*., p. 24, condition 7.

prescribed level, based on a methodology that is unrelated to the specific needs of the project, but rather based on industry averages irrespective of the stage of the project.

398. The particular approach contained in the 2004 Guidelines has introduced expenditure requirements, reporting requirements, and financial administrative adjustments that result in a set of additional obligations with respect to the Hibernia and Terra Nova projects that are different in nature and degree than those previously applied to these investment projects. Examining all of these attributes together, the Majority is of the view that the changes that have been introduced and applied to Hibernia and Terra Nova amount to more than mere changes in the methodology, but in fact reflect a fundamentally different approach to compliance, compared to the Federal Accord Act and the Hibernia and Terra Nova Benefits Plans.

399. A further characteristic of the methodology of the new 2004 Guidelines is the extension of the requirement to spend, at prescribed levels, in the development and production phase of the project. The language of the reserved measure, the Federal Accord Act, does not limit itself to the exploration phase. The Respondent has argued that in the Hibernia Benefits Plan, the Claimants committed to "continue to support local research institutions and promote further R&D in Canada to solve problems unique to the Canadian offshore environment"[423] and to spend over the lifetime of the projects. The Hibernia Decision described the "Proponent's overall strategy to achieve benefits to Newfoundland and the rest of Canada throughout the Hibernia Project."[424] For Canada, this is far broader than a commitment to support and promote only necessary local research and development. During the oral hearing, the Respondent's witness, Mr. Fitzgerald, confirmed that since the Board's inception, it had taken the view that the requirement for a Benefits Plan had to do with the full life of the project. This means that as long as the project was in existence, there would be a continuing stream of required expenditures on research and development and that it was communicated to the developer.[425] This aspect of his testimony appears unchallenged by the Claimants. The

[423] CE-47, Board Decision 86.01,p. 5; R. Counter,fn.48; R. Rejoinder, para. 170.

[424] CE-47, Board Decision 86.01, p. 24.

[425] *Id*., p. 5, 8: "the Panel's recommendations] form the basis for much of the Board's [Hibernia] Benefits Plan Decision (…)"; R. Counter, para. 45; R. Rejoinder, para. 175; R. Reply P. Brief, para. 75 - 80; Day 2 Transcript, p. 571:15-17, p. 572:10-21, p. 573:12-14 (Washington, D.C., October 20, 2010); p. 548:12-18 "Q: Do you think

Tribunal is of the view that extension of the requirement to spend on research and development, and education and training, into the development and production phase of the projects certainly reflects an extension of the expenditure requirement that is not explicitly delineated in the Federal Accord Act or existing Benefits Plans. Nevertheless, the expenditure requirement in the Act or the Benefits Plans are neither time nor phase bound and thus its extension is not, in and of itself, inconsistent with the reservation made under the NAFTA with respect to the Federal Accord Act or the existing Benefits Plans and related Board Decisions.

400. The Majority turns now to the question whether the additional amounts of "expenditures" that are imposed pursuant to the application of the 2004 Guidelines may be said to be inconsistent with the reserved measures, as applied to Hibernia and Terra Nova under the NAFTA. As noted above, the Federal Accord Act is silent as to the amounts that are to be expended in relation to a Benefits Plan. It does not set an amount, or a ceiling, or a floor. The scheme of the Federal Accord Act leaves it to the Benefits Plan to determine the amounts or specific types of expenditures that will be imposed. Moreover, the NAFTA Parties agreed that an additional or more onerous burden cannot *per se* be deemed to be an inconsistency. For these reasons, the Tribunal does not conclude that the mere fact that additional expenditures may be imposed, make the 2004 Guidelines inconsistent with the reserved and subordinate measures for purposes of the NAFTA. There is no specific benchmark against which to evaluate the required expenditures. In this case, however, the characteristics of the financial profile of the 2004 Guidelines are noteworthy. Claimant argues:

> "On an annual basis, during the first three full years of the Guidelines application to Hibernia (ie 2005-2007), the Board required the project to

the report of the Hibernia Environmental Assessment Panel would be a likely source of the Claimants' expectations? A: I would think so. They were prominently present for the hearings and provided information at it. It was their Environmental Impact Statement that the panel was reporting upon."; p. 544:8-16 "Q: So, the commitment that the Operators made to the Board was to promote research and development to solve problems unique to the Canadian offshore environment. A: Yes. Q: and did the Board understand that to be confined to just the needs of their project, or was it broader than that? A: The Board read it to be broader than that."

spend an average of five times more on R&D and E&T than HMDC had reported prior to the introduction of the Guidelines."[426]

401. There is no statutory bright line test for determining whether the shift to an identified level of expenditures and the additional amounts required are of a degree so as to impermissibly extend the scope of the NAFTA reservation. Instead, the treaty interpreter is left having to evaluate the nature of the reserved measure in light of the subsequent measures and come to a judgment as to whether the burden introduced by the new subordinate measure is of such a degree as to make it inhospitable or incompatible with the reserved measure; the Federal Accord Act, the applicable Benefits Plans and Board Decisions. In our view, the additional spending requirement, even taking the Respondent's numbers as a base line**,** involves expenditures of millions of dollars beyond that which would have likely been spent but for the 2004 Guidelines. This additional financial burden *taken in combination* with the other new reporting, pre-authorization requirements, and new funding mechanisms of the 2004 Guidelines, amount to substantial adjustments to the regulatory framework, as compared with the framework that was in place pursuant to the Federal Accord Act, the Hibernia and Terra Nova Benefits Plans and related Board Decisions. Thus the Majority is of the view that the effect of the 2004 Guidelines bespeaks a set of requirements to purchase, use or accord a preference to local goods and services that have undergone a substantial expansion as compared with the earlier legal framework.

402. The Majority shall briefly elaborate further on the altered monitoring and reporting requirements under the 2004 Guidelines. Canada points out that the Hibernia Decision already required reporting to monitor the level of expenditure. The Board, according to the Respondent, emphasized that the development and implementation of a Benefits Plan was an evolutionary process and that it expected investors to continue to contribute to the benefits through the duration of the project and that it would intervene when concerned.[427]

403. As a feature of the Hibernia Benefits Plan and Decision, the Claimants committed to report their expenditures so that they could be monitored by the Board, they agreed to respond to

[426] Cl. Reply P. Brief, para. 33.

[427] R. Counter, para. 279.

concerns through the duration of the project, and recognized that the process was evolving. In the case of the Terra Nova Decision, the Board introduced a somewhat different monitoring and reporting approach than was utilized in the Hibernia Decision, namely requiring regular forecasting and reporting of research and development, and education and training initiatives and expenditures, as well as more detailed tracking of expenditures. In addition, the Board stated that it would undertake periodic audits to confirm the reports submitted by the operators.[428] However, the Terra Nova Decision still did not require a specific expenditure level.

404. In our view, after examining the 2004 Guidelines in total, they have introduced not only an additional spending requirement, but a different form of Board oversight than previously existed. Prior to the 2004 Guidelines, there was no Board pre-approval of research and development expenditure. After the 2004 Guidelines, at the end of each POA, the project operator has to provide a detailed accounting of research and development, and education and training expenditures during the POA period. The Board assesses the claimed expenditure and determines whether it counts towards the guideline requirement. Before the 2004 Guidelines there was no direct relationship between the particular level of research and development spending and the POA approval process. After the 2004 Guidelines, as Claimants argue, the POA has been conditioned on compliance with the Guidelines.[429]

E. CONCLUSION ON ARTICLE 1108

405. The Tribunal turns now to what this means for the assessment of consistency. There appears to be broad agreement that the issue of consistency, where additional or more onerous burdens are being imposed, must be determined on a case-by-case basis. The United States has identified the factors that it considers to be pertinent in determining whether, in a particular case, an additional or more onerous burden would make a new subordinate measure inconsistent with a listed and reserved measure. The three factors identified by the United States are (i) the domestic legal context of the measure; (ii) the particular elements of the non-conforming measure entry and the subordinate measure, including the extent of non-

[428] CE-57, Board Decision 97.02, p. 2.

[429] Day 1 Transcript, p. 64:19-20 (Washington, D.C., October 20, 2010).

conformity of each with the obligation against which the measure is reserved; and (iii) the specific facts and circumstances of the case.[430] The Claimants have referred to these factors with apparent approval, and argued that their application leads to the conclusion that the 2004 Guidelines are inconsistent with the Federal Accord Act, together with the Hibernia and Terra Nova Benefits Plans and related Board Decisions.

406. For their part, the Claimants argue that the 2004 Guidelines are not covered by Canada's Annex I reservation:

> "(*i*) it is, at best, questionable whether the Guidelines are "consistent" with the prior legal regime as a matter of domestic law; (*ii*) the Guidelines were not adopted under the authority of any of the non-conforming aspects of the Accord Acts as listed in the Description element of Canada's reservation; (*iii*) the Guidelines impose more onerous burdens on Claimants than the pre-2004 local content regime; and (*iv*) the Guidelines render the pre-existing local content regime more non-conforming with Article 1106." [431]

407. For reasons referenced above, the Tribunal cannot share the Claimants' view that it is "questionable" whether the 2004 Guidelines are "consistent with" the Federal Accord Act as a matter of Canadian law. The Court of Appeal found that the 2004 Guidelines do not violate Canadian law, and whilst this is not dispositive of any determination as to whether there is consistency within the meaning of the NAFTA, the position under Canadian law is clear since the Canadian Supreme Court declined to review the decision of the Court of Appeal.

408. With respect to the second point, the Tribunal has already set out its conclusion that the 2004 Guidelines were adopted under the authority of the Federal Accord Act.

409. Regarding the third point, as has been noted above, the mere fact that the 2004 Guidelines impose additional burdens on the Claimants is not *per se* dispositive of the matter. "Consistency" with "the measure" requires an assessment of the Federal Accord Act along

430 U.S. 2nd Art. 1128, para. 10.

431 Cl. Response 2nd Art. 1128, para. 19.

with the Hibernia and Terra Nova Benefits Plans and related Board Decisions in the context of the NAFTA reservation. "Consistency" must be examined in light of the obligation against which the measure is taken. A detailed examination of the 2004 Guidelines in light of the Federal Accord Act, the Hibernia and Terra Nova Benefits Plans, and related Board Decisions demonstrate, in the view of the Majority that the 2004 Guidelines introduce additional and different expenditure, reporting, oversight and administrative requirements that are quantitatively and qualitatively different, and more burdensome from that which existed prior to the introduction of the 2004 Guidelines. In so doing, the 2004 Guidelines render the local content regime that arises, more non-conforming with Article 1106 than was the case when the measures that applied to the Hibernia and Terra Nova investment projects were defined by the Federal Accord Act, the Hibernia and Terra Nova Benefits Plans, and related Board Decisions.

410. In coming to this conclusion, the fundamental question turns on whether the additional burden imposed by the 2004 Guidelines was beyond some threshold so that they are not "consistent with" the Federal Accord Act and the existing subordinate measures in the context of the NAFTA reservation. In our view, the treaty interpreter should at least consider whether the specific attributes of the subsequent measure are connected with the attainment of the object and purpose of the reserved measure, and whether it represents a continuation of the approach of the reserved measure together with the existing subordinate measures. Or in the alternative, whether it represents a change in approach through the new subordinate measure that alters the legal framework in a fundamental manner.

411. As the Majority discussed above, viewed holistically, the 2004 Guidelines as applied to Hibernia and Terra Nova significantly alter the legal obligations required of the Claimants in such ways as to render the local content regime more contradictory and incompatible with Article 1106, as applied to these investment projects.

412. This conclusion is reached with respect to the 2004 Guidelines as they pertain to the Claimants' interest in the investment projects, the Hibernia and Terra Nova, which have required an evaluation of the 2004 Guidelines in light of the Federal Accord Act, the Hibernia and Terra Nova Benefits Plans, and related Board Decisions. We have not been

asked to address the implications for other investors in these projects, for other investment projects, or the White Rose project, which could have a different set of applicable measures, and hence we do not do so.[432]

413. For these reasons, the Majority concludes that in the context of the NAFTA reservation, the 2004 Guidelines are "inconsistent" with the Federal Accord Act, the Hibernia and Terra Nova Benefits Plans, and related Board Decisions.

[432] Our Colleague expects in his Dissenting Opinion, para. 42 that "[t]he Claimants and the Respondent, and perhaps also the other NAFTA Parties and even other investors, will no doubt reflect on the consequences of the findings of the Majority." However, this Decision only addresses the damages suffered by the Claimants and does not address the application of the 2004 Guidelines to other investors and to other projects.

VIII. DAMAGES

414. The Claimants seek compensation for incremental expenditures that will arise as a result of the introduction of the 2004 Guidelines and their application for the period from 2004 until 2036. The parties do not dispute that the claim concerns purely monetary damages which is permissible under NAFTA Article 1135. The dispute raises a number of preliminary issues associated with damages that will be addressed before turning to the substance of the damages claimed.

A. JURISDICTION UNDER ARTICLE 1116(1)

1. Respondent's Arguments

415. The Respondent has raised objections of a jurisdictional nature based upon the requirement under NAFTA Article 1116(1) that the claim should cover "incurred loss or damage."

416. The Respondent's principal objection concerns the question of whether the Tribunal has jurisdiction to compensate damages, which, in its opinion, were incurred after the filing of the claim on November 1, 2007 (but during the arbitral proceedings) or will be incurred in the future (up to 2036). Effectively, the objection is to the Tribunal awarding future or prospective damages.

417. According to the Respondent, under Article 1116(1), the Tribunal cannot grant compensation for damages that are only future or prospective. The Respondent starts from the position that losses must have been actual (*i.e.* out of pocket expenses which have been paid) to be *incurred*, and that this by definition means that future and prospective[433] damages are not compensable. It refers to *Feldman v Mexico*, where the tribunal held that only losses actually incurred can be awarded,[434] and to *LG & E Energy Corp. and others v. Argentina* which

[433] The Respondent makes the same assertion with respect to "past" damages (i.e. those pertaining to the 2004 – 2008 period), R. Counter, para. 309.

[434] CA-29, *Marvin Roy Feldman v United Mexican States*, ICSID ARB(AF)/99/1, Award, December 16, 2002 ("*Feldman*"), paras. 194 and 199. *See* also R. Counter, para. 329.

specified that losses are "actual" when they are caused by unlawful acts that already have been "committed."[435]

418. Referring to the judgment in *Chorzow Factory*[436] and to the *Lusitania* award,[437] the Respondent asserts that to award damages for losses not yet sustained or suffered would be inconsistent with international law.[438] It invokes the commentary to Article 36 of the International Law Commission's Draft Articles on State Responsibility, which says that "*the function of compensation is to address <u>actual</u> loss incurred as a result of internationally wrongful act…Monetary compensation is intended to offset, as far as may be, the <u>damages suffered</u> by the injured State as a result of the breach*."[439] The Respondent argues that this confirms that the Tribunal may only award damages that the investor *has incurred* (meaning paid) and not those that will be incurred at some future point in time.[440]

419. The Respondent highlights the more recent decision in *LG&E v. Argentina*[441] where a claim for dividends that would be lost in the future through the continued application of the challenged legislation was rejected.[442] The Respondent further relies on *Occidental v. Ecuador*[443] for the proposition that reimbursement of amounts that are not due or paid is not permitted.[444] Moreover, in *Grand River,*[445] the Respondent observes, the Tribunal decided

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[435] RA-25, *LG&E Energy Corp., LG&E Capital Corp. and LG&E International Inc. v. Argentine Republic*, ICSID ARB/02/1, Award, July 25, 2007 ("*LG&E v. Argentina*"), paras. 44 and 45.

[436] CA-28, *Factory at Chorzów*, 1928 P.C.I.J. (Ser. A) No. 17, Decision of September 13, 1928 ("*Factory at Chorzów*"), p. 47.

[437] RA-27, Opinion in the Lusitania Case, p. 39.

[438] R. Counter, para. 334.

[439] RA-8 A, James Crawford, *The International Law Commission's Articles on State Responsibility: Introduction, Text and Commentaries* (Cambridge University Press, 2002).

[440] R. Counter, paras. 328-331. *See* RA-8 A, RA-16.

[441] *See supra*, fn 435.

[442] *Id.*, para 45.

[443] CA-39, *Occidental Exploration and Production Company v. Republic of Ecuador,* LCIA Case No. UN3467, Final Award, July 1, 2004 *("Occidental").*

[444] *Id.*, para 210.

[445] CA-95, *Grand River Enterprises Six Nations Ltd v. United States,* UNCITRAL, Decision on Objections to Jurisdiction, July 20, 2006 ("*Grand River*").

that Grand River did not incur loss or damages on the date the escrow statutes were adopted, but on the successive annual dates that they actually were required to place into the escrow account a percentage of their revenue from selling cigarettes.[446]

2. Claimants' Arguments

420. The Claimants disagree with the Respondent's assertions.

421. According to the Claimants, the compensable damage was incurred at the adoption of the 2004 Guidelines, which they assert created a legal obligation for HMDC and Suncor to undertake additional expenditures over the life of the projects. This obligation to make future expenditures is, the Claimants say, "loss or damage" within the meaning of Article 1116. The Claimants appear to characterise this situation as a "continuing treaty violation" or a "continuing investment impairment scenario."[447] The Claimants recognise that the amount of any incremental spending is fully determined and known only at a later date, following the Board's assessment, and argue that nonetheless, the obligation to make a future expenditure is a "*loss incurred.*"[448] The fact that no *actual* payment has been made is not relevant for the Claimants and does not affect the validity of their claim.

422. The Claimants argue that the universally acknowledged international law standard of full reparation[449] requires that future damages should be compensated. For instance, Article 36(2) of the ILC Draft Articles on State Responsibility provides that "*compensation shall cover*

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446 *Id.*

447 Cl. P. Brief, para. 55. *See* also Cl. P. Brief para. 62, where the term "continuing wrong" is used by the Claimants. *See* also *UPS v. Canada* regarding continuing breaches: "A continuing course of conduct might generate losses of a different dimension at different times. RA-71, *United Parcel Service of America v. Canada*, UNCITRAL, Award on the Merits, May 24, 2007 ("*UPS v Canada*"), para. 30.

448 CA-95, *Grand River*, para. 77; Cl. Reply, para. 238.

449 *See, e.g.*, CA-15, *ADC Affiliate Ltd. and ADMC Management Limited v. Republic of Hungary*, ICSID Case No. ARB/03/16, Award, October 2, 2006, para. 493 (reviewing numerous decisions and concluding that "there can be no doubt about the present vitality of the *Chorzów Factory* principle, its full current vigor having been repeatedly attested to by the International Court of Justice."); CA-44, *S.D. Myers*, para. 311; CA-22, *Compañiá de Aguas del Aconquija S.A. & Vivendi Universal v. Argentine Republic*, ICSID Case No. ARB/97/3, Award, August 20, 2007 ("*Vivendi v. Argentina*"), paras. 8.2.4-8.2.5; CA-46, *Siemens A.G. v. Argentine Republic*, ICSID Case No. ARB/02/8, Award, February 6, 2007, para. 351; CA-21, *CMS Gas Transmission Company v. Argentine Republic*, ICSID Case No. ARB/01/8, Award, May 12, 2005, para. 400; CA-17, *AMOCO International Finance Corporation v. Iran*, Award, July 14, 1987, para. 191; CA-48, *Starrett Housing Corp. v. Iran*, Case No. 24, Award, August 14, 1987, para. 264.

any financially assessable damage, including loss of profit insofar as it is established." Moreover, the Claimants reference the UNIDROIT Principles of International Commercial Contracts, which they say confirm that "future harm" can be compensated.[450] The Claimants also refer to *Grand River*, where the Tribunal decided, in the specific context of NAFTA Article 1116, that

> "A party is said to incur losses, debts, expenses or obligations, all of which may significantly damage the party's interests, even … if the obligations are to be met through future conduct. Moreover, damage or injury may be incurred even though the amount or extent may not become known until some future time."[451]

423. The Claimants also reference a noted legal commentator who states that

> "In principle, international law allows recovery of both past and future losses. Future losses encompass losses that lie in the future both in relation to the breach and in relation to the arbitral award, and usually manifest themselves in the form of loss of profits or incidental expenses"[452]

Consequently, the Claimants say, the future incremental expenses that are not yet paid fall to be compensated as future losses under international law.[453]

424. For the Claimants, the decision of the tribunal in *LG & E v. Argentina* does not support the Respondent's proposition that an international tribunal may only award compensation for damages already incurred, but simply confirms that damages, whether historic or prospective, must be established with reasonable certainty (this is discussed in greater detail below).[454]

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[450] Cl. Reply, para. 250.

[451] This decision dealt with the issue whether claims for damages were time-barred under Article 1116(2) and allowed Grand River to claim compensation for the recurrent consequences of a statutory provision even after three years from when the statute was introduced.

[452] CA-150, Ripinsky, *Cross-cutting Issues*, p. 115. That compensation can be sought in respect of both actual and prospective harm is also confirmed in a leading commentary on NAFTA Investment Law and Arbitration (*See* CA-162, Weiler, p. 203).

[453] *See* Cl. Reply, paras. 252 and 253; CA-114, *SOABI v. Senegal*, ICSID Case No. ARB/82/1, Award, February 25, 1988.

[454] Cl. Reply, paras. 255-259.

425. The Claimants seek to distinguish *Occidental* by pointing out that there, the economic harm did not arise from a loss existing as of the date of the award or earlier. The loss would not be incurred until a future rebate was sought and then denied.[455] Here, in contrast, the Claimants say they are already "exposed" to a loss which follows from an ongoing obligation created by the 2004 Guidelines.[456]

426. The Claimants assert that NAFTA Article 1116(1) is a claims enabling provision. It only requires the existence of a loss as a prerequisite to bringing a claim. Article 1116(1) does not speak to the assessment of the compensation.[457]

3. The Majority's Finding

427. For jurisdictional purposes, Article 1116(1) requires *inter alia* that the investor must have incurred "loss or damage by reason of, or arising out of, that breach" of Chapter XI of the NAFTA. A breach giving rise to future and prospective damage may, in general terms, fall within Article 1116. There is nothing in the language of Article 1116 (1) that convinces us that the provision is directed only to damages that occurred in the past and does not extend, in principle, to damages that are the result of a breach which began in the past (the adoption of the 2004 Guidelines) and continues (the implementation of the 2004 Guidelines)[458], resulting in the *incurring* of losses which crystallise (i.e. become quantifiable) and must be paid sometime in the future (hereafter "future damages"). We consider by extension that the same reasoning applies to damages in the past which are already identified or quantified, but must be paid in the future.

428. This view is confirmed by the *Grand River* decision, which states that "damage or injury may be incurred even though the amount or extent may not become known until some future

[455] Cl. Reply, para. 248.

[456] *Id.*

[457] *Id.*, para. 237.

[458] The Majority of the Tribunal notes that the question of what was called "continuing breaches" was considered (albeit in the context of how Article 1116(2) of NAFTA applies to continuing breaches) in *UPS v. Canada*. There the tribunal stated that "continuous courses of conduct constitute continuing breaches of legal obligations" (para. 28). The Majority further notes the Claimants' assertion that "no NAFTA tribunal has yet been faced with a continuing treaty violation or continuing investment impairment scenario" (meaning a claim which involves a breach which is *still continuing when the claim is filed*), Cl. P. Brief, para. 55).

time.''[459] The *Grand River* decision also confirms that it is not required that there be an "immediate outlay of funds" for there to be damage which can be compensated under NAFTA Article 1116.[460] A call for payment may be sufficient.

429. In the present case, the introduction of the 2004 Guidelines triggered an obligation to make expenditures that would continue over the life of the projects. It amounts to a continuing breach resulting in ongoing damage to the Claimants' interests in the investment. Thus, Article 1116(1) does not, in our view, as a jurisdictional matter, preclude the Tribunal from deciding on appropriate compensation for future damages. However, this conclusion only determines *whether* a claim for damages is admissible. It does not determine *how* compensation for future damage is to be assessed or whether it is appropriate for this Tribunal to consider damages or make an award of compensation with regard to the future damages claimed in this particular case. These matters remain to be addressed.

430. With regard to the question of whether the Claimants are entitled to claim compensation for damages that accrued after the Notice of Arbitration but in the course of the proceedings, the Majority considers that this is encompassed by its finding that the Tribunal has jurisdiction to grant compensation for future damages.

B. PROOF OF DAMAGES INCURRED

431. As mentioned above, the issue of whether the damages are *incurred* so as to allow the Tribunal to exercise jurisdiction under Article 1116(1) and grant compensation is different from the issue of whether the amount of these damages can be established with sufficient certainty to be compensated. We now turn to the legal standards that apply to such assessment.[461]

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459 *Grand River*, para. 77.

460 *Id*.

461 As stated in the *LG & E v. Argentina* decision.

1. Claimants' Arguments

432. Since NAFTA does not prescribe how monetary damages ought to be calculated, the Claimants refer to the oft-cited principle set out in *Chorzów Factory* that "reparation must, so far as possible, wipe out all the consequences of the illegal act and reestablish the situation which would, in all probability, have existed if that act had not been committed."[462] Using this principle in *Chorzów Factory* as a foundation, the Claimants go on to advocate that with respect to future damages (i.e. expenditures that would not have been made in the usual course of project operations but for the introduction of the 2004 Guidelines) a "*but for*" approach – should be utilized.

433. As for the standard of proof, the Claimants submit that *reasonable* certainty is only needed as to the fact or occurrence of future damages[463] (i.e. as to the existence of damage, for instance that future profits would have been made if no breach had occurred, as opposed to the extent of that damage[464]) and "less certainty" is required to prove the amount of damages.[465] As a result, "proof of the amount may be an estimate, uncertain or inexact."[466] However, the estimates should not be too remote, as the tribunal in *S.D. Myers* indicated.[467]

434. The Claimants submit that this Tribunal enjoys considerable discretion in determining the amount of compensation, and that similar flexibility applies to the proof required in doing so. In support of this position, the Claimants variously refer to the *Feldman, S.D. Myers, Enron*

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462 CA-28, *Factory at Chorzów*, p. 47.

463 *See* Cl. Reply, para. 261: "Absence of absolute certainty is no answer to a claim for monetary compensation." The Claimants cite *Himpurna California Energy v. PLN*, UNCITRAL, Award, May 4, 1999, para. 237: "in this case, as in so many others, it is impossible to establish damages as a matter of scientific certainty. This does not, however, impede the course of justice;" and CA-116, *Southern Pacific Properties v. Arab Republic of Egypt*, ICSID Case No. ARB/84/3, Award, May 20, 1992, para. 215: "it is well settled that the fact that damages cannot be settled with certainty is no reason not to award damages when a loss has been incurred."

464 *See* Cl. Reply, para. 235.

465 *See* Cl. Reply, para. 257, *See* CA-140, Kantor, *Valuation for Arbitration*, at 75 (Wolters Kluwer Law 2008) and at 72 (citing Dunn, *Recovery of Damages for Lost Profits*, § 1.6, at 17): "less certainty is required (perhaps none at all) in proof of the amount of damages. While the proof of the fact of damages must be certain, proof of the amount may be an estimate, uncertain or inexact." *See* also Cl. P. Brief, para. 63.

466 *Id.* In *Vivendi v. Argentina*, para. 8.3.3, the tribunal noted that the various awards relied upon by the investor indeed distinguished the level of certainty required as to the fact of future probability of lost profits from the proof required as to the extent of such losses.

467 CA-44, *S.D. Myers Inc. v. Government of Canada* (UNCITRAL), Second Partial Award of October 21, 2002, para. 160; Cl. P. Brief, para. 53.

and Azurix decisions which acknowledged that the NAFTA itself only addresses the measure of compensation in cases of expropriation,[468] but is silent as to the measure of damages to be awarded following treaty violations other than Article 1110, and "leave[s] it open to tribunals to determine a measure of compensation appropriate to the specific circumstances of the case."[469]

2. Respondent's Arguments

435. The Respondent emphasizes that in *Chorzow Factory*, the PCIJ recognized that "reparation must...reestablish the situation which would, in all probability, have existed if that act had not been committed." The Respondent asserts that the Claimants' alleged damages from 2009 to 2036, however, are merely speculative.[470]

436. Furthermore, in the Respondent's view, the Claimants' submission that future damages require reasonable certainty as to their occurrence but less certainty as to their quantum, is without merit. The PCIJ[471] and the ILC[472], for instance, did not distinguish between the fact and quantum of damages. Moreover, other tribunals such as those in *S.D. Myers*[473] and

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468 *See* Article 1110(2) of the NAFTA, which contemplates expropriation as determined by Article 1110(1).

469 CA-29, *Feldman*, para. 195-197; CA-44, *S.D. Myers*, para. 309; CA-26, *Enron Corporation and Ponderosa Assets, L.P. v. Argentine Republic* (ICSID Case No. ARB/01/3), Award, May 22, 2007, para. 360; CA-19, *Azurix v. Argentine Republic* (ICSID Case No. ARB/01/12), Award of July 14, 2006, para. 422.

470 *See* R. Rejoinder, para. 299, stating that, among other things, the future exchange rate, future oil production, future StatsCan Factor and the future SR&ED tax savings and royalty deductions, future cost savings and the continued existence of the 2004 Guidelines in their present form are still uncertain.

471 CA-28, *Chorzow*, p. 47: "reparation must….reestablish the situation which would, *in all probability*, *have existed if that act had not been committed.*" (emphasis added)

472 RA-16, ILC Articles, p. 104, para. 27:"Tribunals have been reluctant to provide compensation for claims with inherently speculative elements."

473 RA-44, para. 173:"[A] claimant who has succeeded on liability must establish the quantum of his claims to the relevant standard of proof; and, to be awarded, the sums in question must be neither speculative nor too remote."

Amoco International Finance Corp v Iran[474] have expressly held that both the fact and the quantum must be sufficiently certain.[475]

3. The **Majority's Finding**

437. The Majority of this Tribunal accepts that the Claimants do not have to prove the quantum of damages with absolute certainty. The Majority further accepts that no strict proof of the amount of future damages is required and that "a sufficient degree" of certainty or probability is sufficient. However, the amount claimed "must be probable and not merely possible."[476]

438. Future damages, as the Claimants have advanced, must only be proved with *reasonable certainty*.[477] However, as stated in *S.D. Myers*, "to be awarded, the sums in question must be neither speculative nor too remote."[478] Similar sentiments were expressed in *Amoco International Finance Corp v Iran*.[479]

439. The Majority shall apply this standard of reasonable certainty to determine whether the Claimants have established their case with respect to the amount of damages incurred as a result of the 2004 Guidelines.

440. In addition, for the purposes of determining the quantum of damages, the Majority will consider any loss which is incurred, *i.e.* which is actual, as of the date of the Award. In the Majority's view, actual damages occur when there is a firm obligation to make a payment and there is a call for payment or expenditure, or the occurrence of payment or expenditure has transpired. Indeed, expenditure of money is not always required for damages to be compensable. Expenditures which have not yet been paid may be included as compensation

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474 RA-77, para. 238: "One of the best settled rules of the law of international responsibility of States is that no reparation for speculative or uncertain damage can be awarded. This holds true for the existence of the damage and of its effect as well…It does not permit the use of a method which yields uncertain figures for the valuation of damages, even if the existence of damages is certain."

475 R. Rejoinder, paras. 296-298.

476 *See* RA-134, S. Ripinsky and K. Williams, *Damages in International Investment Law* (BIICL 2008), p. 164.

477 Cl. Reply, para. 256.

478 RA-44, *S.D. Myers*, para. 173.

479 RA-77, *Amoco*, para. 238.

if a claimant can prove that they are under an obligation to pay such expenses (*e.g.* there has been some kind of call for payment).

C. EVIDENCE OF DAMAGES PRESENTED

441. Damages are claimed for a period of 32 years from April 1, 2004 until December 31, 2036. This lengthy period can be subdivided into three distinct periods, each of which raises different factual and legal considerations: the period from April 1, 2004 until December 31, 2008 (the "2004 – 2008 period"); the period from January 1, until January 31, 2009 (the "2009 period"); and the period between 2010 and 2018 (Terra Nova) and 2036 (Hibernia) (the "2010 – 2036 period"). We address each of these time periods in turn.

1. Compensation for Losses for the 2004 – 2008 Period

442. The Claimants have calculated their incremental expenses under the 2004 Guidelines on the basis of several variables. They used actual data from 2004 until 2008 to establish the production volume, the oil price, the Statistics Canada Benchmark Factor, the Development Phase Credit ("DPC"), and the R&D expenditures in the ordinary course of business.[480] The Claimants state that the shortfall for the 2004 – 2008 period is finally and fully known.[481]

443. The Claimants submit that, on the basis of detailed damage calculations of their expert, Mr. Rosen,[482] the spending shortfall for the 2004 – 2008 period is CDN$ 32.48 million for the Hibernia Project and CDN$ 8.94 million for the Terra Nova Project.[483] Taking account of their shares in the Projects,[484] the Claimants' required incremental spending would thus be CDN$ 10.87 million[485] and CDN$ 3.04 million[486] respectively for Hibernia and Terra Nova.

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480 Cl. Mem., para. 218. *See* CE-116, Letter from F. Smyth, CNLOPB, to P.Sacutta, HMDC, (February 26, 2009); CE-117, Letter from F. Smyth, CNLOPB, to G.Vokey, Petro-Canada, (March 3, 2009).

481 Cl. Reply, para. 201.

482 Mr. Rosen's initial estimates (*see* Cl. Reply, paras. 196-199; Rosen Report I, para. 60) were subsequently updated.

483 Cl. Mem., para. 219, Updated Calculation Report of Howard N. Rosen ("Updated Rosen Report"), para. 18.

484 Subject to a final determination regarding the interest held by Murphy Oil, *see supra* fn. 1.

485 33.45 % Mobil + 6.5 % Murphy of CDN$ 32.48 million.

486 22% Mobil + 12 % Murphy of CDN$ 8.94 million.

444. The Respondent's expert, Mr. Walck, stated that for the 2004 - 2008 period, CDN$ 10.25 million and CDN$ 2.86 million were the maximum damages the Claimants could have sustained for Hibernia and Terra Nova.[487]

445. According to the Respondent, however, these amounts should be additionally reduced for two reasons.

446. First the Claimants' damage evaluation did not take into account the possibility that the participation of Murphy Oil in Terra Nova may be reduced from 12% as of 2004 to 10.5% – an issue that is currently being arbitrated. According to the Respondent, the decreased ownership may further decrease the Claimants' past and future damages.[488]

447. Second, the Respondent argues that the Claimants fail to take into account the benefits the Claimants will receive from any additional R&D and E&T expenditures that they plan to undertake to cover their 2004 - 2008 shortfalls and which are reflected in their Work Plans for Hibernia[489] and Terra Nova.[490]

2. Compensation for Losses for the 2009 Period

448. On February 11, 2010, the Board assessed that the R&D obligation for both Projects for the year 2009 was CDN$ 7.286 million under the 2004 Guidelines.[491] HMDC submitted to the Board expenditures for Hibernia totaling [redacted], of which the Board approved [redacted] (the final figure may be higher as the Board is still considering two items

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[487] *See* Report Walck III, para. 77, corresponding to CDN$ 10.42 million for Mobil and CDN$ 2.69 million for Murphy in respect of both projects.

[488] R. Rejoinder, para. 276.

[489] CE-212, March 31, 2010.

[490] CE-234, Undated.

[491] CE-225, GFA-31, February 11, 2010 Letter from J. Bugden to P. Sacuta re Hibernia 2009 expenditure requirements (CDN$ 12.01 million); CE-226, GFA-33, February 11, 2010 Letter from J. Bugden to G.Vokey re Terra Nova 2009 expenditure requirements (CDN$ 7.43 million).

worth [redacted].[492] No exact data reflecting approved R&D expenditures for Terra Nova is currently before this Tribunal.

3. Compensation for Losses for the 2010 – 2036 Period

449. The Claimants are also seeking compensation for the future incremental spending requirements under the 2004 Guidelines from 2010 until 2018 for the Terra Nova Project and until 2036 for the Hibernia Project. They calculate this future compensation in the same manner as the other damages: i.e. the difference between the total R&D and E&T expenditures required by the 2004 Guidelines and the amount that they would have spent on R&D and E&T in the usual course of project operations from 2009 until 2036 if the 2004 Guidelines had not been issued.[493]

450. However, from 2010 onwards, the yearly amounts of actual R&D and E&T expenses and required incremental expenses for each of the next 27 years are not yet known.[494] The Claimants rely exclusively on estimates based on a number of variables, which in the Claimants' view give *reasonable certainty*. In doing so, the Claimants estimated their incremental spending to be:[495]

Hibernia Project (2010 – 2036)	:	CDN$ 45.07 million[496]
Terra Nova (2010– 2018)	:	CDN$ 14.94 million[497]

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492 CE-186, Letter from P. Phelan, HMDC, to J. Bugden, CNLOPB (Mar. 31, 2010), *attaching* Hibernia Project – R&D / E&T Expenditure Submission (2009). CE-248, Letter from J. Bugden, CNLOPB, to P. Phelan, HMDC (November 1, 2010).

493 *See* Updated Rosen Report, para. 8:"In any given year, I calculate Incremental Spending as follows:-

i. Gross Revenue, calculated as the price per barrel of oil multiplied by the total number of barrels produced in the year, is multiplied by a revenue-based benchmark for R&D spending (the "StatsCan Factor") to determine the Total Requirement, per the Guidelines;

ii. From the Total Requirement, the Development Credit is deducted to determine the Net R&D Requirement, per the Guidelines; and,

iii. From the Net R&D Requirement, R&D expenditures in the ordinary course of the Projects' operations are deducted, to determine the Incremental Spending."

494 Even for the past two years (2010 and 2011), no accurate data of incremental expenditures under the 2004 Guidelines, approved expenditures and shortfall have been submitted to the Tribunal.

495 These estimates were made as of June 30, 2010. *See* Updated Rosen Report, Schedule I.

496 Mobil: CDN$ 37.68million + Murphy: CDN$ 7.39 million.

451. According to the Respondent, the assumptions upon which the Claimants base their forecasts are unproven, unsupported and uncertain. They also argue that the Claimants inflate the amount of damages claimed.

452. The Parties undertook fairly extensive submissions and submitted elaborate expert reports on damages to be paid under the 2004 Guidelines for the 2010–2036 period. For the sake of completeness, we here set out a summary of the respective positions of the Parties with regard to the elements on which the Claimants have based their forecasted shortfall for the 2010 – 2036 period.

(a) Production Volume

453. The Projects' yearly incremental expenditures are calculated on the basis of their oil production for that year. The key point of difference between the Parties here is certainty. For oil production until May 31, 2010, the Claimants have submitted actual data.[498] For the production volume thereafter, they rely on forecasts that the operators of the Hibernia and Terra Nova oil fields submitted to the Board in 2009 and which the Board – at least in respect of Hibernia – apparently considered to be reasonable.[499] The Respondent says that oil production forecast relied upon by the Claimants is highly speculative and therefore unreliable.[500] According to the Respondent, unforeseen circumstances have often created significant gaps between forecast and actual oil production.[501] For instance, the Terra Nova field produced no oil for several months in 2006 whilst equipment underwent maintenance, resulting in production that was less than a third of that forecast.[502] For Hibernia, the 2007 level of production was reduced because of a backfire aboard the platform. The Respondent

497 Mobil: CDN$ 9.67 million + Murphy: CDN$ 5.27 million.

498 Claimants updated their calculation during the course of arbitration proceedings, *see* Claimants' Updated Damages Calculation of August 6, 2010.

499 Rosen Report II, April 8, 2010, paras. 25- 33. R. Reply P. Brief, para. 140 denies that this forecast has been approved.

500 Walck Report I, paras. 33-64, Walck Report II, para. 149.

501 Walck Report I, paras. 47-49, 57 and 61 and Figure 1 at page 13.

502 CE-59, Decision 2005.03. Respecting the Amendment to the Terra Nova Development Plan, December 2005, s. 20 and Walck Report I, para. 56.

questions the extent to which the Claimants have taken account of unforeseen events in producing estimates of future oil production which they rely upon.[503]

(b) Oil Revenue

454. Ms. Sarah Emerson of Energy Security Analysis, Inc., an expert economist who specializes in oil market analysis and price forecasting, developed the future pricing assumptions for the Claimants.[504] Ms. Emerson posits that her oil price forecast is conservative and will lead to conservative estimates of the amounts of required incremental expenditures.

455. In support of the assertion that her forecasts are conservative, Ms. Emerson pointed out that the oil price forecasts of her firm, which are frequently used by corporate clients and governments (including Canada) for long term planning and budgeting, are lower than those of, for example the U.S. Energy Information Administration ("EIA"), the International Energy Agency ("IEA") and, importantly for present purposes, the National Energy Board ("NEB") of Canada.[505]

456. In response, the Respondent again argues uncertainty, stating that the Claimants' annual oil price predictions for the 27 coming years are "highly speculative" and cannot be the basis for compensation.[506] Further, the Respondent says that Ms. Emerson's assertion that her forecasts

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[503] Walck Report I, para. 50.

[504] Cl. Mem., para. 218 and Sarah Emerson Report, dated June 2009 ("Emerson Report I"), at p. 11 *"Long term Hibernia or Terra Nova Price Outlook"*.

[505] The NEB does not actually forecast the price of oil (Cl. Reply, para. 282). Rather, once in every four years, it issues a report called "Reference Case Scenario" with hypothetical long term supply and demand trends for energy in Canada based upon its own assumptions with respect to *inter alia* the future prices of a number of energy commodities including oil, natural gas and coal. The assumed oil prices are merely a probable work hypothesis; they are not solid forecasts.

[506] R. Rejoinder, para. 301. *See* Davies Report I, para. 40 (showing the forecast of EIA where the actual outcome was different). In 1997, the oil forecasts range for 2005 was $22-25 per barrel. The actual outcome was $60. The 2010 forecast range in 2005 was $25-$41. In 2009, the range of forecasts for 2010 increased to $56-$106. None of the forecasts in the sample predicted that the current 2010 oil price would exceed $60 per barrel until the 2006 survey. Current (November 2009) nominal oil prices are approximately $75 per barrel. During the hearing, Ms. Emerson, when asked by the Tribunal whether her forecast was "*reasonably certain*" replied, ""Reasonably certain" to me means, first and foremost, not certain. And, secondly, I think it means--I think the term "reasonable" to me means based upon careful consideration of the facts and information at hand. So, if I combine the two, it's a view that is based on the facts at hand, but it's not certain." Further, during direct examination, when asked by counsel, "Ms Emerson, in your experience, are long-term oil price projections ever perfectly accurate?" she replied, "I wish they were. No I don't think." (Day 2 Transcript, p. 636, (Washington D.C., October 20, 2010)).

are conservative is not accurate and the pricing needs to be re-evaluated. Moreover, it is irrelevant that the Claimants' forecasts allegedly are more conservative than those of NEB, IEA and EIA because the latter do not purport to actually forecast future oil prices but rather use hypothetical prices as assumptions for commercial scenarios.

457. The Respondent further asserts that although corporate entities and governments use oil price forecasts to predict market tendencies and they are the only basis to determine the fair value of an expropriated oil company, they are too inaccurate to serve as a basis to project recurring damages.[507] The Respondent also points out that the price forecasts use the United States Dollar, while the oil revenues for Hibernia and Terra Nova will be obtained in Canadian Dollars, creating further uncertainty because of the likely fluctuation in exchange rates.[508]

(c) R&D and E&T Expenditures in the Ordinary Course of Business

458. The Claimants expect that for the immediate future the Hibernia and Terra Nova projects, which are midway through their production cycles, will have yearly consistent R&D needs, which they estimate to be equal to their average R&D expenditures "in the ordinary course of business" for the period of 2004 through 2009.[509] However, for Hibernia these expenditures would decrease by 50 % as of 2028 and again by another 50 % as of 2032; for Terra Nova, they would decrease by 50 % in 2016.[510]

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507 For instance, in *Philips Petroleum*, the Iran - US Claims Tribunal considered a reasonable buyer's forecast of the future price of oil, to determine the fair market value of an expropriated oil company; however, it expressly added that it would not accept such forecast for any other purpose (R. Rejoinder para. 310).

508 Until 2013, the Claimants used the forecasted conversion rates of *The Economist*. However, for the period from 2014 onwards where no *The Economist* forecasts were available, a constant conversion rate of 1 US$ = 1. 04 CDN$ was applied (Rosen Report II, paras. 57-63).

509 Cl. Mem., para. 218. In fact, the Claimants have used the 'normalized' average, i.e. the full value of R&D expenditures undertaken from 2004 through 200 [redacted] *See* Graham Statement I, para. 15; Phelan Statement I, para. 26. Moreover, the 2006 R & D spending have been excluded because it was assumed to be an 'outlier' and the expenditures for 2004 have been annualized (Updated Rosen Report, Schedule 2, p. 5).

510 Updated Rosen Report, para. 31; Schedule 2, p. 5; Schedule 3, p. 6.

459. The Respondent, referring to the report of its expert, Professor Noreng,[511] argues that the investment projects in a stage of mature production require more R&D than the Claimants assert. The Respondent also claims that the Claimants have misconstrued certain factors and variables[512] and have relied on past averages, which is not a reliable methodology.[513]

(d) The Qualification of R&D Expenses

460. The Parties disagree on whether all the R&D and E&T, submitted in the Work Plans, are indeed additional incremental expenditures, as the Claimants argue, or whether some of them were expenditures which the Claimants would have made anyway in the ordinary course of business, as the Respondent argues.[514]

(e) Statistic Canada Benchmark Factor

461. Under the 2004 Guidelines, the Board is required to determine the required R&D and E&T expenditures for each year on the basis of a benchmark, distilled by Statistic Canada (StatsCan) from the R&D and E&T spending within the oil and gas extracting industry as a whole. To estimate the required spending for 2009 until 2036, the Claimants initially used the average of the StatsCan benchmarks for 2004 to 2008, i.e. 0.39%.[515] However, in his Updated

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511 Noreng Report, para. 22.

512 *E.g.* the inclusion of new projects (R. Counter, paras. 365 and 366).

513 R. Counter, para. 364; Walck Report I, paras. 91 and 94. Canada remarks that annual R&D expenditures have ranged from [redacted] in the case of Hibernia and from [redacted] at Terra Nova. [redacted] As to Terra Nova, a [redacted] range is hardly a "fluctuation" in the context of that project's gross annual expenditures of approximately [redacted]

514 At the hearing, the Parties debated how expenditures should be treated for a number of specific research projects such as: the Ben Nevis-Avalon Field, an Offshore Loading System, a study to leverage stranded gas outside the Hibernia field, a study to improve radar technology for detecting and managing icebergs, and of a scholarship fund to honor the victims of a helicopter crash (*see* e.g., Days 3 & 4 Transcript, pp. 1302:3-5; 964:2-8; 875:3-7; 964:2-4; and 1072:13-18 (Washington D.C., October 21-22, 2010)).

515 Cl. Mem., para. 218. The Claimants submitted that this forecast is conservative for 2 reasons (i) it is reasonable to expect the level of R&D required to locate and access as-yet unexploited reserves in new projects across Canada, which will be included in future Statistics Canada surveys, will rise over time, because companies inevitably develop the most accessible oil fields first and save the more technologically challenging projects for later; (ii) R&D expenditures in the Province, and therefore in the Statistics Canada survey, will increase as a result of the 2004 Guidelines requirement. As noted, even a minor variance in the benchmark can have a major impact on the R&D expenditure requirement for a project with production volumes as significant as Hibernia.

Report of August 6, 2010, the Claimants' expert, Mr. Rosen, suggested that an average of 0.46% should be used for the years 2010 and 2011 and 0.40 % should be used from 2012 onward.[516]

462. The Respondent points out that R&D and E&T benchmark change substantially over the years so that a forecast of the benchmark over a period of more than 20 years is uncertain.[517] It underscores a point that the Claimants themselves have admitted, i.e. that "even a minor variance in the benchmark can have a major impact on the R&D expenditure requirement…."[518]

(f) Deductible R&D Expenditures

463. The Respondent observes that the Claimants did not prove the amount of deductible R&D and E&T expenses. The Claimants acknowledge that it will be the Board which ultimately has to agree on the level of deductibility. Although, as a general rule, the Board will be guided in this matter by the Canada Revenue Agency,[519] the Board retains discretionary powers to admit actual R&D and E&T expenses.[520] Consequently, the deductible amount of R&D and E&T expenses remains uncertain.

4. The Majority's Finding

(a) The 2004 – 2008 Period

464. We appreciate the arguments and data that were diligently advanced by both Parties for the 2004 – 2008 period.

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516 *See* Updated Rosen Report at page 8: "Based on the historical Benchmarks provided above, of 0.50% in 2004; 0.50% in 2005; 0.60% in 2006; and, 0.50% in 2007, a StatsCan Factor of 0.40% in 2011 would be impossible to achieve – the 2008 Benchmark would have to be negative 0.10%. In my Updated Calculation, I have calculated the StatsCan Factor on the assumption that the 2010 Benchmark would be at the lowest level that it has been since 1997, which was 0.20% in 2003.20 Based on this assumption and the Benchmarks from 2004 to 2007, provided above, I have calculated a StatsCan Factor of 0.46% in 2011, which I employ in my Updated Calculation."

517 Walck Report I, para. 84.

518 Cl. Mem., p. 112, fn. 400; *See* also R. Counter, paras. 356-358; Walck Report I, fn 400 and para. 85.

519 *I.e.* whether the CRA grants Scientific Research and Experimental Development (SR & ED) tax credit for these expenditures.

520 *See* Phelan Statement I, paras. 16-21.

465. We consider important the Board's decision that the shortfall for the 2004 – 2008 period is CDN$ 32,718,226 for the Hibernia Project and CDN$ 8,972,126 for the Terra Nova Project, and the fact that neither the Claimants nor the Respondent have challenged the Board's decision. Taking into account that the shares of the Claimants' ownership in these Projects are respectively 39.625% for Hibernia[521] and 34% (or 32.5%) for Terra Nova,[522] the Claimants' shortfall is CDN$ 12,964,597 for Hibernia and CDN$ 3,050,522.8 or CDN$ 2,915,940 for Terra Nova.

466. We are well aware that in the Respondent's view, these amounts are only the possible maximum amounts and should be reduced to respectively CDN$ 10,332,780 for Hibernia and CDN$ 2,876,643 for Terra Nova. However, we are unable to agree with the Respondent that incremental spending should be reduced because of another allocation of the DPC and because of the impact of benefits that flow to the Claimants from these expenditures.

467. The 2004 Guidelines do not indicate how the DPC has to be applied to projects already in their production phase. We have been told by the Claimants' witness, Mr. P. Phelan, that the Board expected that the DPC would be applied pro-rata over the remaining life of the oil fields, but that the Board had allowed the credit to be paid upfront for Hibernia and Terra Nova.[523] Consequently, we consider that the Claimants did not act unreasonably by allocating the credits for Hibernia and Terra Nova in the way that they did. Moreover, in fact the question of how the credits are allocated in the operation phase will not change the totality of incremental expenditures for the projects under the 2004 Guidelines. Credits which reduce these expenditures in one year cannot reduce the expenditures in another year.

468. Nor should this shortfall be reduced by the alleged benefits the Claimants would derive from incremental expenditures, as the Respondent suggests. The 2004 Guidelines do not indicate that the alleged benefits from R&D and E&T investments have to be added to the incremental expenditures as determined under the 2004 Guidelines. Incremental expenditures, which are not actually spent on R&D and E&T, have to be placed in an R&D

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[521] Mobil: 33.125 %; Murphy Oil: 6.5 %.

[522] Mobil: 22 %; Murphy Oil: 12 % or 10.5 %.

[523] *See* Phelan Statement I, para. 23 and Phelan Statement III, para 2.

fund managed by the Board. Payment to the fund is an alternative for actual R&D expenditures which is provided for in the 2004 Guidelines. The 2004 Guidelines do not provide that companies, which make payments into the fund, are in turn credited for the benefits that the fund may draw from its R&D and E&T expenditures (e.g. royalties on know how or patents) so that their incremental spending under the 2004 Guidelines is reduced.[524] As the companies are not credited for the benefits the fund derives from the R&D and E&T expenditures they finance, conversely they should not be debited for the benefits they derive from their own R&D and E&T expenditures which are undertaken as a result of the incremental spending requirement.

469. We turn now to the crucial issue of whether there is *actual* loss in this case; which is relevant to *all* damages. As indicated in paragraph 440, the Majority considers that in the present case, for purposes of determining whether any compensation is due to the Claimants, damages are incurred and compensation is due when there is a firm obligation to make a payment and there is a call for payment or expenditure, or when a payment or expenditure related to the implementation of the 2004 Guidelines has been made.

470. With regard to the 2004 – 2008 period, the various actions of the Board to implement the 2004 Guidelines, such as the calculation of the required incremental expenditures, the crediting for actual expenses and the determination of the spending shortfall, the conditioning of the POA on compliance with the 2004 Guidelines, all confirm that the Board was seriously pursuing the Claimants' spending obligation under the 2004 Guidelines for the 2004 – 2008 period. However, we are not aware that the Respondent has actually required the Claimants to make such payments by a certain date, nor whether it has indicated the prospect of sanctions for noncompliance. The Claimants have indicated that there may have been actions the Board has taken to date in pursuance of the spending obligation, namely a requirement for HMDC and Suncor to provide a promissory note secured by a letter of credit,[525] but they have not provided evidence as to any steps being taken in furtherance of this requirement to show that it amounts to a firm obligation to pay or has entailed costs. Until the Claimants

524 The fund being a collective operation, it will not be feasible to allocate to each of its contributors the benefits from the respective sums they paid into the fund.

525 CE-179; Cl. Reply, Annex B, p. B-8.

submit evidence of actual damage, the claim for the cost of compliance with the 2004 Guidelines for the 2004 – 2008 period is not ripe for compensation by this Tribunal.[526]

(b) The 2009 Period

471. With regard to the 2009 period, we agree with the Respondent that the amount of the incremental expenses for the 2009 period remains uncertain. Because a part of the Hibernia expenses and all the Terra Nova expenses still need to be approved, the spending shortfall for 2009 cannot yet be established.[527] On the basis of the amount of required spending under the 2004 Guidelines and the approved spending for Hibernia, the shortfall for the Hibernia and Terra Nova Projects would be in the order of [redacted] However, this amount may be further reduced by additional approved expenditures for Hibernia and by the approved expenditures for Terra Nova. Moreover, whilst the share of Mobil in the Hibernia and Terra Nova Project and Murphy's share in Hibernia are undisputed, it is uncertain whether Murphy's share in Terra Nova is ultimately 12 % or 10.5 %.

472. A number of factors indicating the Board's seriousness with respect to pursing the Claimants' spending obligations under the 2004 Guidelines are equally present, yet several critical pieces of data with respect to the incremental spending amount are still missing. In addition, the Tribunal is again not informed as to whether the Respondent has requested payment of the shortfall for 2009, nor is it yet clear what the incremental expenditure (and therefore the potential damages) will be for the 2009 period. In this sense, we have been presented with no evidence of actual damages. Consequently, we are again of the view that the claim for the cost of compliance with the 2004 Guidelines for the 2009 period is either not yet ripe for determination by this Tribunal or we do not have the information before us.

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[526] It is unclear to the Tribunal whether the Respondent accepts that the Claimants have suffered actual damages before the date of the claim, November 1, 2007.

[527] R. Rejoinder, paras. 284-286.

(c) The 2010 – 2036 Period

473. Turning to future damages, under the facts before us, we are not yet able to properly assess the Claimants' claim for future damages; too many critical questions remain open. Although the Majority recognizes that the Claimants are likely to incur a legal liability that would give rise to potentially compensable losses, the claim for such losses is not yet ripe for determination.

474. As detailed above, we were presented with evidence relating to at least two types of variables on which the Claimants base their assumptions for their incremental expenditure analysis. One group of variables consists of objective, market-based factors, and the second consists of the results of the Board's regulatory decisions.[528] The critical market-based variables, oil production forecasts for each of Hibernia and Terra Nova as well as future oil prices and exchange rates (inter alia), routinely experience considerable fluctuations. The contents of the second group of variables are derived from regulatory outcomes and require an estimation of the deductible R&D expenditures which have not yet been made or even identified from 2010 onwards. Ultimately, after undertaking a critical examination of these variables, the Majority considers that there is insufficient certainty and too many questions still remain unanswered to allow it to assess with sufficient certainty the amounts of damages incurred under the 2004 Guidelines for the 2010 – 2036 period. The Tribunal has applied the reasonable certainty standard discussed above, which has not led to a conclusion *per se*, but rather to a finding that there is too much *uncertainty* at this stage for the Tribunal to make a determination.

475. We note that several purportedly relevant decisions and awards which were put before us were either not apt for the current circumstances,[529] or, like us, the tribunals involved expressed doubt as to the calculations and certainty of the evidence. However, we do find the award in *LG & E v. Argentina* (which involved – as in this case – a breach giving rise to continuing losses) to be of some relevance. In that case the tribunal found that "the impact of

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[528] The exact variables used by the Claimants were: production volume, oil revenues, R&D and E&T expenditures in the ordinary course of business, the allocation of DPC and qualification of R&D expenses, actual deductible v R&D expenditures.

[529] *See, e.g. Cargill* and *S.D. Myers*, both involving *past* lost profits.

Argentina's conduct on the value of the investments has not crystallized" and that "lost future profits are uncertain and their calculation is speculative."[530] As the Claimants also acknowledged,[531] the tribunal in *LG & E v. Argentina* only awarded compensation for "*damages actually suffered*"[532] and declined to compensate for decreased future dividends.[533] Moreover, we also find *Merrill & Ring*[534] to be pertinent, a case in which the arbitral panel denied granting damages for future losses for 6 years (until 2016) because it did not have sufficient confidence in the "but for" calculations of the claimants. It did not consider the suggested benchmarks to be sufficiently certain to function as a basis to estimate future losses.

476. Many of the decisions to which we were referred concerned unlawful termination of contracts and the international awards frequently concerned "one off" breaches of international law, such as expropriations[535] and termination of contracts. Such circumstances are entirely different from the facts in this proceeding: whilst it is true that these cases may recognise a general principle that future losses or damages are compensable, they are not useful for arguing that this principle should be applied here. In the case of expropriation, for instance, not only the assets are lost, but – often more importantly – so too are future profits. Consequently, arbitrators in these scenarios have had to estimate the potential future lost profits of the terminated investment. In the present case, however, the investment is not destroyed but encumbered, and the Respondent's breach gives rise to continuing losses, whereby the Claimants' losses unfold over time. In the former situation, because the assets, shares, etc. no longer exist or are no longer in the claimant's possession, the adjudicating

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530 *LG&E v. Argentina*, para. 96.

531 Cl. Reply, para. 258.

532 *LG&E v. Argentina*, para. 96.

533 The *LG&E v. Argentina* award thus does not merely address "the evidentiary hurdle that any claimant must meet in seeking to establish the extent of its losses" as the Claimants allege (Cl. Reply, para. 255). *LG&E*, para. 96.

534 RA-104.

535 The Claimants referred to *e.g.* the awards in CA-100, *Karaha Bodas Co. LLC v. Pertamina & Others*, UNCITRAL, December 18, 2000 and CA-22, *Vivendi v. Argentina,* to argue that tribunals have even assessed long term future lost profits with a reasonable degree of confidence (respectively for 30 and 27.5 years). These cases concerned, however, "one off" expropriations where lost profits necessarily were part of the fair compensation.

body has no choice but to project future damages in the form of lost future profits. Decisively, the situation at hand is starkly different, in that the future damages that are being claimed may be required by the Respondent to be paid at some point as the required incremental spending under the 2004 Guidelines, and will at that point be fully ascertainable and "actual."[536]

477. As we have noted, in considering and distinguishing the practice of other tribunals, the fact that the damages in this case will eventually be "actual" (thereby removing the necessity to forecast losses which has been present in other cases) is a decisive distinguishing factor. However, it is also worth noting some of the differing circumstances under which other cases concerning future damages have been determined. The number of variables that have to be taken into account in determining the incremental expenditure requirements are much greater in this dispute than was the case of the relevant markets in *Cargill* and *S.D. Myers.* In *Cargill,* the taxes the Mexican government had introduced in June 2002, were abolished at the end of 2006. The arbitrators decided in 2009 what the past lost profits were from June 2002 until the end of 2007. In *S.D. Myers*, an export ban introduced in November 1995, was removed in February 2007. Here again, the arbitrators, deciding in 2002, had to assess past lost profits related to the short period from November 1995 till February 1997. In both cases, the past lost profits related to a relatively short period (5.5 and 1.5 years respectively). The market conditions that impacted these lost profits were well known and ascertainable. The same cannot be said here. While some variables in the current case may be more amenable to assessment than others (e.g. production level estimates for developed production sites in the near term may be more likely to be accurate than those that focus on longer term production forecasts), looking at the totality of relevant and necessary variables that would comprise the calculation of damages, we are simply unable to have confidence that the estimation of the entire picture is one that meets a test of "reasonable certainty." The evaluation of future damages for such a long period is extremely hazardous and it does not, on balance, seem to us that the estimates are more probable than not.

[536] *See* para. 440 below for discussion of "actual."

478. With regard to the 2010 – 2036 period, we have discussed at length how estimated future losses caused by 'one off' breaches are compensable. However, this principle does not apply here because in the present case the breach (i.e. the application and enforcement of the 2004 Guidelines) gives rise to continuing losses which are typically not known until well after the relevant year has passed. Although ultimately it is not strictly relevant given that we are not inclined to compensate for expenditures not paid or levied (i.e. required to be paid), we have also highlighted the uncertainty of the evidence pertaining to the amount of incremental expenditures in this largely future period. In our view, there is no basis to grant at present compensation for uncertain future damages. Given that the implementation of the 2004 Guidelines is a continuing breach, the Claimants can claim compensation in new NAFTA arbitration proceedings for losses which have accrued but are not actual in the current proceedings.

(d) Other Matters

479. Before turning to our final conclusions, three further matters should be noted.

480. Firstly, the Tribunal requested that the parties consider whether a formula could be identified by which the Claimants' future damages could be monitored. The Claimants acknowledged that such a formulation could have been included in the Tribunal's award and undertook to discuss same with the Respondent.[537] The Respondent was unwilling to participate in such discussions.[538]

481. Secondly, the Claimants have requested that in the event the Tribunal is unable to identify future damages, it nevertheless establishes a baseline for ordinary expenditures which can then serve as a basis for determining the incremental spending amounts. Under NAFTA Article 1135 the Tribunal can only grant monetary damages; it cannot come forward with criteria to establish the R&D and E&T expenditures the Claimants should actually spend.

482. Thirdly, although we are aware that this Decision makes no final determination as to the quantum of damages that are to be awarded, we nevertheless feel that it is appropriate to

537 Cl. P. Brief, para. 83.

538 Cl. Reply P. Brief, para. 35.

address the Claimants' requests to 'gross up' the damages to compensate taxes, as we have sufficient information and analysis before us to address this issue now. The Parties have fully argued this question and the matter is ready for decision, which may be relevant to any subsequent proceedings, as well as for the Parties' amicable dealings. By contrast, we have not felt it necessary to deal with any discounts which may or may not apply to any compensation which may be awarded, nor with the question of interest attaching to any prospective compensation. These issues we feel are better dealt with when the question of compensation is determined, as they are more intrinsically connected with the question of compensation than is the issue of tax gross up.

483. The Claimants, Delaware corporations operating in Canada, argue that all compensation will be transferred to their U.S. parent companies and that, although expenditures relating to incremental spending would likely be deductable for tax purposes in Canada, any compensation awarded would likely be taxable in the United States at a rate of 38%. In order to obtain full reparation, therefore, the Claimants argue that the amount to be granted has to be 'grossed up' by 38% to fully compensate them for their losses.[539] They do not provide reasons as to why compensation would have to flow back to the U.S. parent. They only argue that payment to the Canadian enterprises would "create other issues that would then have to be compensated for in an Award," without identifying these issues.[540]

484. The Respondent objects to the gross up request. According to the Respondent, the request should be categorically rejected. Two reasons are advanced by the Respondents in this objection. Firstly, the Claimants quantified their alleged loss with regard to their Canadian enterprise and not the US parents. They failed to justify why the damages have to revert to the US parent companies. Secondly, under NAFTA Article 1135(2), the Tribunal has to award monetary damages to the "enterprise" which suffered the damage.

485. The Majority sees little basis for incorporating the Claimants' request for a 38% 'gross up' for tax reasons. The Claimants did not justify why compensation could not remain with the

539 *See* Schedule 2 and Schedule 3 of the Updated Rosen Report. This 'gross up' would, in the Claimants' calculations, amount to [redacted] (*see* Walck Report III, para. 46).

540 Cl. P. Brief, para. 81.

Canadian enterprises, nor why it had to be taxed in the United States, nor what the tax rate was, nor why this is a necessary part of any resulting compensation. Moreover, we are not aware of a requirement under international law to gross up compensation as a result of tax considerations.

D. CONCLUSION ON DAMAGES

486. In view of the above, in respect of the issue of damages the Majority concludes that:

487. First, the introduction and implementation of the 2004 Guidelines to the Hibernia and Terra Nova projects is a breach of Article 1106 of the NAFTA which is not covered by Canada's reservation under Article 1108 and which gives rise to a right to claim compensation for the damages that the Claimants have incurred by virtue of the required incremental expenditures, and such breach continues with the on-going implementation of the 2004 Guidelines.

488. Second, damages incurred shall only be compensated when there is sufficient evidence that a call for payment has been made or that damages have otherwise occurred (i.e. that they are "actual").

489. Therefore, the Claimants are invited to submit further evidence on any actual damages incurred because of the application of the 2004 Guidelines, no later than 60 days from the date of this Decision. The Respondent is invited to respond to such filing no later than 60 days of its receipt. The Tribunal will subsequently promptly rule on the outstanding question of any quantum of damages due to the Claimants in a final Award that will incorporate the present Decision.

IX. DECISION

490. On the basis of the foregoing, the Tribunal decides:

(1) Unanimously, the adoption and application of the 2004 Guidelines do not violate Article 1105 of the NAFTA;

(2) Unanimously, the 2004 Guidelines are subject to and caught by Article 1106 of the NAFTA;

(3) By a majority, the 2004 Guidelines as applied to the investment projects Hibernia and Terra Nova are not covered by Canada's reservation under Article 1108(1) of the NAFTA and therefore violate Article 1106 of the NAFTA;

(4) By a majority, the Tribunal has jurisdiction to consider damages in this case pursuant to Article 1116(1) of the NAFTA;

(5) By a majority, the Claimants are entitled to recover damages incurred as a result of the Respondent's breach provided that the Claimants submit evidence of any such damages no later than 60 days of receipt of this Decision and that the Tribunal finds such evidence persuasive; and

(6) The allocation of the costs of the arbitration and the parties' legal fees and expenses will be decided in the final Award.

H. Houtte

Professor Hans van Houtte
President

Date: May 9, 2012

Merit E. Janow

Professor Merit E. Janow

Date: May 14, 2012

Philippe Sands

Professor Philippe Sands

Date: 15 May 2012.