

**CITATION:** Attorney General of Canada v. Mobil et al., 2016 ONSC 790  
**COURT FILE NO.:** CV-15-11079-00CL  
**DATE:** 20160216

**SUPERIOR COURT OF JUSTICE – ONTARIO**

**COMMERCIAL LIST**

**RE:** Attorney General of Canada, Applicant

**AND**

Mobil Investments Canada Inc. and Murphy Oil Corporation, Respondents

**BEFORE:** Conway J.

**COUNSEL:** *Karen Lovell and Roger Flaim*, for the Applicant

*John Terry and Emily Sherkey*, for the Respondents

**HEARD:** January 29, 2016

**REASONS FOR DECISION**

[1] Mobil Investments Canada Inc. and Murphy Oil Corporation (the “**Investors**”)<sup>1</sup> are investors in the Hibernia and Terra Nova offshore petroleum extraction projects located off the coast of Newfoundland and Labrador (the “**Projects**”).

[2] The Investors submitted a claim to arbitration under the North American Free Trade Agreement (the “**NAFTA**”)<sup>2</sup> against the Government of Canada (“**Canada**”). They alleged that domestic measures requiring certain fixed expenditures for the Projects breached the prohibition against “performance requirements” in Article 1106 of the NAFTA.

[3] The arbitral tribunal (the “**Tribunal**”) found that Canada had breached Article 1106(1)(c) of the NAFTA and ordered Canada to pay the Investors damages (including interest) of approximately \$19 million (Cdn.) (the “**Award**”).

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<sup>1</sup> Both of the Investors are U.S. corporations, incorporated under the laws of the State of Delaware.

<sup>2</sup> *North American Free Trade Agreement Between the Government of Canada, the Government of Mexico and the Government of the United States*, 17 December 1992, Can. T.S. 1994 No. 2.

[4] Canada seeks to set aside the Award on the basis that the Tribunal exceeded its jurisdiction in making the Award. For the reasons that follow, Canada's application is dismissed.

### **Overview**

[5] The NAFTA is a trade agreement among three trading parties, Canada, the United States and Mexico (a "**Trading Party**"). Chapter 11 of the NAFTA provides various protections to investors of one Trading Party that make investments in another Trading Party's territory.

[6] One of those protections is contained in Article 1106, which prohibits a Trading Party from imposing "performance requirements" on an investor from another Trading Party. In particular, Article 1106(1)(c) prohibits a Trading Party from requiring an investor "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."

[7] At the time the NAFTA was negotiated, each of the Trading Parties had existing domestic measures that conflicted with some of the protections afforded by Chapter 11. Article 1108(1)(a) therefore provided that each Trading Party could "reserve" existing non-conforming measures from the application of specific articles of Chapter 11, by listing the measures in that party's Schedule to Annex I of the NAFTA.

### **The Accord Act, Benefits Plans and the 2004 Guidelines**

[8] The "reservation" at issue in this case is the *Canada-Newfoundland Atlantic Accord Implementation Act* (the "**Accord Act**").<sup>3</sup> That statute, together with comparable provincial legislation,<sup>4</sup> governs offshore petroleum projects in Newfoundland and Labrador. Canada listed the *Accord Act* in its Schedule to Annex I of the NAFTA, thereby exempting the *Accord Act* from the prohibition on performance requirements in Article 1106.

[9] The *Accord Act*, s. 45, requires all off-shore projects to have a "benefits plan", approved by the Canada-Newfoundland Offshore Petroleum Board (the "**Board**"), before the Board can authorize activity or work to proceed on the project. Among other things, a "benefits plan" must ensure that "expenditures shall be made for research and development [**R&D**] to be carried out

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<sup>3</sup> S.C. 1987, c. 3.

<sup>4</sup> *Canada-Newfoundland and Labrador Atlantic Accord Implementation Newfoundland and Labrador Act*, R.S.N.L., 1990, c. C-2. These statutes implemented the *Memorandum of Agreement on Offshore Oil and Gas Resource Management and Revenue Sharing*, an agreement signed in 1985 between the Government of Canada and the Government of Newfoundland and Labrador to manage offshore oil and gas resources adjacent to Newfoundland and Labrador.

in the Province and for education and training [**E&T**] to be provided in the Province” (s. 45(3)(c)).

[10] The Board approved benefits plans for the Hibernia and Terra Nova Projects in 1986 (updated in 1990) and 1997, respectively (the “**Benefits Plans**”). The Benefits Plans set out general principles regarding R&D or E&T expenditures but did not require fixed expenditure levels.

[11] In November 2004, the Board issued Guidelines under the *Accord Act* (the “**Guidelines**”).<sup>5</sup> The Board explained that the Guidelines were a response to decreasing R&D and E&T expenditures by offshore operators. The Guidelines established a formula, based on industry practice in Canada, for determining fixed R&D and E&T expenditures.

[12] According to the Investors, the Guidelines had a significant financial impact on them by imposing fixed expenditures for R&D and E&T, regardless of whether the Projects required that level of research and development activity.

[13] The operators for the Projects (including the Investors) brought an application in the courts of Newfoundland to challenge the Board’s authority to issue the Guidelines. They were unsuccessful at the trial and appeal levels.

[14] In November 2007, the Investors initiated an arbitration against Canada under Chapter 11 of the NAFTA, alleging that the imposition of the Guidelines violated Articles 1105(1)<sup>6</sup> and 1106(1)(c) of the NAFTA.

### **The NAFTA Arbitration**

[15] The arbitration Tribunal consisted of three members – Professor Hans van Houtte (President of the panel); Professor Merit E. Janow (appointed by the Investors); and Professor Philippe Sands Q.C. (appointed by Canada).

[16] The oral hearing took place in Washington D.C. from October 19 to 22, 2010. After the hearing, by letter dated June 23, 2011, the Tribunal posed follow-up questions to the parties, as

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<sup>5</sup> The Board had issued previous guidelines in 1986, 1987 and 1988. Those did not require fixed expenditure levels for R&D or E&T.

<sup>6</sup> Article 1105(1) provides “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.”

explained further below. The parties responded with written submissions in the summer of 2011.<sup>7</sup>

[17] The Tribunal released its decision on liability on May 22, 2012. It unanimously decided that Canada had not violated Article 1105(1) of the NAFTA.

[18] The Tribunal also unanimously decided that the Guidelines violated the prohibition on performance requirements in Article 1106(1)(c). Canada does not challenge that part of the decision.

[19] However, the Tribunal was split on the issue of whether the Guidelines fell within the scope of Canada's reservation from the requirements of Article 1106(1)(c) pursuant to Article 1108(1)(a). As explained below, the majority (Professors van Houtte and Janow) concluded that the Guidelines did not fall within the scope of the reservation and therefore found that Canada was liable for the breach of Article 1106(1)(c). Professor Sands dissented and found that the Guidelines fell within the reservation and there was consequently no breach.

[20] The parties then proceeded through the damages phase of the arbitration. They filed written submissions and an oral hearing was held. The Tribunal released the damages Award on February 20, 2015.

### **Interpretation Issue: Whether the Guidelines fell within the scope of Canada's Reservation**

[21] The determination of whether the Guidelines fell within Canada's reservation pursuant to Article 1108 involved the interpretation of Annex I to the NAFTA. Annex I sets out the details that the Trading Parties must include in their Schedules to reserve an existing non-conforming measure from the application of Article 1106. One of those details is the "Measure" being reserved. Paragraph 2(f) defines that term as follows:

"**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.

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<sup>7</sup> The other NAFTA parties, Mexico and the United States, were present at the hearing. They were invited to state their position with respect to the follow-up questions posed by the Tribunal in its June 23, 2011 letter but declined to do so.

[22] As noted above, Canada listed the *Accord Act* as a reserved measure in its Schedule to Annex I.

[23] The parties (and the Tribunal) agreed that the Guidelines were not an amendment of the *Accord Act*. The test for whether an amendment of a listed measure is reserved from the application of Article 1106 is set out in Article 1108(1)(c) – the amendment is reserved “to the extent that the amendment does not decrease the conformity of the measure, as it existed immediately before the amendment, with Article...1106”. Canada refers to this as the “ratchet” test.<sup>8</sup>

[24] The Tribunal agreed that the Guidelines were a “subordinate measure”. The Tribunal therefore had to analyze whether the Guidelines fell within the wording of paragraph 2(f)(ii) of Annex I, namely whether they were a “subordinate measure adopted or maintained under the authority of and consistent with the measure.” If so, the Guidelines would fall within the scope of the reservation.

[25] After the oral hearing on liability, the Tribunal asked the parties for their views on the meaning of the words “the measure” for purposes of analyzing whether the Guidelines were “consistent” with “the measure” and fell within the scope of the reservation. In its letter dated June 23, 2011, the Tribunal asked whether the words “the measure” were to be interpreted only as the listed measure set out in the Schedule to Annex I (i.e. only the *Accord Act*) or as the listed measure and other previous subordinate measures (i.e. the *Accord Act* and the existing Benefits Plans). The parties made extensive submissions in response to the Tribunal’s letter.

[26] In its decision on liability, the majority analyzed the words of paragraph 2(f)(ii) in great detail. It concluded that “the measure” against which the Guidelines were to be compared was the *Accord Act* and any previous subordinate measures, including the Benefits Plans. It found that the Guidelines, which “significantly alter the legal obligations” of the Investors compared to the *Accord Act* and Benefits Plans, were not “consistent” with “the measure” and therefore did not fall within the scope of Canada’s reservation.

[27] Professor Sands Q.C., in dissent, also conducted a detailed analysis of the words of paragraph 2(f)(ii). He found that “the measure” was to be interpreted as only the *Accord Act*. He concluded that the Guidelines were consistent with that statute and therefore fell within the scope of Canada's reservation.

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<sup>8</sup> Canada, in its factum, explains that, “like a ratchet that locks to prevent the tool from going back to its original position once it has moved forward, the [Trading Parties] agreed to prohibit each other from amending a listed measure to make it less liberal than it was previously, while ensuring that any future liberalizing amendments would be locked in and prevented from rolling back.”

### **Positions of the Parties**

[28] Canada acknowledges that the Tribunal had the jurisdiction to determine whether the Guidelines constituted a breach of Article 1106(1)(c) and whether they were reserved pursuant to Article 1108. However, Canada's position is that the majority used the wrong criteria for determining whether the Guidelines fell within the scope of the reservation. Canada argues that the majority incorrectly concluded that the words "the measure" included both the *Accord Act* and the Benefits Plans, thereby using the wrong comparator to determine whether the Guidelines were consistent with "the measure". It also argues that while the majority said it was applying the "consistency test", in reality it applied the "conformity" test. Canada argues that, in so doing, the majority conflated the "ratchet" test in Article 1108(1)(c) (applicable to amendments to listed measures) with the "consistency" test in paragraph 2(f)(ii) (applicable to subordinate measures).

[29] On this basis, Canada argues that the Tribunal exceeded its jurisdiction. It argues that this is a jurisdictional issue because if a measure is reserved, the obligations in Article 1106(1)(c) of the NAFTA do not apply, there can be no breach and there is no basis for an award of damages. Therefore, if the majority applied the wrong criteria in determining that the Guidelines were not within the scope of the reservation, the Tribunal exceeded its jurisdiction.

[30] The Investors' position is three-fold. First, they argue that Canada failed to raise this jurisdictional issue before the Tribunal and is precluded from raising it for the first time on this application. Second, they argue that the interpretation of the NAFTA reservations is not a true question of jurisdiction that would give the court the power to set aside the Award. Third, they argue that even if this is a true jurisdiction issue, the majority made no error in its analysis that would warrant setting aside the Award.

### **Setting Aside a Decision of an Arbitral Tribunal**

[31] The Tribunal designated Toronto as the place of arbitration. The parties agreed the Ontario Superior Court of Justice is the court in which applications concerning the arbitration would be filed.

[32] In an arbitration involving the federal Crown, the *Commercial Arbitration Act* applies.<sup>9</sup> It provides that the *Commercial Arbitration Code*, which is attached as a Schedule to the statute, has the force of law in Canada.

[33] Article 34 of the *Code* sets out the grounds on which a court may set aside an award. Canada relies on Article 34(2)(a)(iii), which provides (my emphasis added):

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<sup>9</sup> *Commercial Arbitration Act*, R.S.C. 1985, c. 17 (2<sup>nd</sup> Supp), s. 5 and *Commercial Arbitration Code* in Schedule 1, Article 6.

(2) An arbitral award may be set aside by the court specified in article 6 only if:

(a) the party making the application furnishes proof that:

...

(iii) the award deals with a dispute not contemplated by or not falling within the terms of the submission to arbitration, or contains decisions on matters beyond the scope of the submission to arbitration, provided that, if the decisions on matters submitted to arbitration can be separated from those not so submitted, only that part of the award which contains decisions on matters not submitted to arbitration may be set aside;

[34] The Ontario Court of Appeal examined the scope of Article 34(2) in *United Mexican States v. Cargill, Inc.* (“*Cargill*”).<sup>10</sup> Feldman J.A., for the court, observed that Article 34(2) provides that an award may only be set aside on limited grounds and that none of those grounds allows for a review of the merits of the tribunal’s decision.

[35] In *Cargill*, the arbitral tribunal had awarded Cargill damages for Mexico’s breach of the NAFTA. Cargill was a U.S. producer of high fructose corn syrup (HFCS) and had built a distribution centre in Mexico. In response to initiatives taken by Mexico to protect its sugar industry, Cargill proceeded to arbitration. One of the issues was whether Cargill was entitled to damages as a producer and exporter of HFCS in the United States (“upstream damages”) or only those suffered as an investor in Mexico (“downstream damages”). The arbitral tribunal determined that it had the jurisdiction to award damages “by reason of, or arising out of” Mexico’s breaches and was not limited to awarding downstream damages. Mexico applied to set aside the tribunal’s award. The application judge in the Superior Court of Justice declined to set aside the award.

[36] The Court of Appeal dismissed Mexico’s appeal. The court held that the arbitral panel was correct in its analysis of the limits on its jurisdiction to award damages and observed that Mexico was seeking to expand the jurisdictional question into issues that go to the merits of the case. Feldman J.A. noted that if there had been language in the NAFTA prohibiting an award of damages in the investor’s home business operation, that would have been a jurisdictional

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<sup>10</sup> 2011 ONCA 622. The court in *Cargill* interpreted Article 34(2)(a)(iii) of the *UNCITRAL Model Law on International Commercial Arbitration*. The wording of that article of the *Model Law* is the same as Article 34(2)(a)(iii) of the *Code*.

limitation precluding the arbitration panel from awarding such damages. There was no such limiting language.<sup>11</sup>

[37] Justice Feldman, in explaining the scope of a review of a tribunal's decision on jurisdictional grounds under Article 34(2)(a)(iii), set out the following principles for the reviewing court to apply:

- The standard of review on a matter of jurisdiction is correctness – the tribunal must be correct in identifying the limits of its decision-making authority;
- However, that does not give the courts a broad scope for intervention in the decisions of international arbitral tribunals. To the contrary, courts are expected to intervene only in rare circumstances where there is a true question of jurisdiction;
- Courts are obliged to take a narrow view of what constitutes a question of jurisdiction and to resist broadening the scope of the issue to effectively decide the merits of the case. This latter approach is magnified in the international arbitration context;
- Courts are to be circumspect in their approach to determining whether an error alleged under Article 34(2)(a)(iii) is a true question of jurisdiction. When they do identify such an issue, they are to carefully limit the issue they address to ensure that they do not, advertently or inadvertently, stray into the merits of the question that was decided by the tribunal;
- The onus is on the party that challenges the award.<sup>12</sup>

[38] Justice Feldman provided two examples of true jurisdictional issues. One was if the submission to arbitration made a claim for damages for the years 2007 and 2008 but the tribunal awarded damages for 2009 and 2010. Another was if the investment made by a party was in Brazil and the tribunal awarded damages for losses sustained in that country (even though the NAFTA defines an investment as being located in the territory of one of the Trading Parties).<sup>13</sup>

[39] She summarized her approach by stating that the role of the reviewing court is to:

...identify and narrowly define any true question of jurisdiction. Specifically, under Article 34(2)(a)(iii), did the tribunal decide an issue

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<sup>11</sup> *Cargill*, at para. 72.

<sup>12</sup> *Cargill*, at paras. 27-51.

<sup>13</sup> *Cargill*, at para. 49.



that was not part of the submission to arbitration, or misinterpret its authority under the NAFTA? Another way to define the proper approach is to ask the following three questions:

- What was the issue that the tribunal decided?
- Was that issue within the submission to arbitration made under Chapter 11 of the NAFTA?
- Is there anything in the NAFTA, properly interpreted, that precluded the tribunal from making the award it made?<sup>14</sup>

### Analysis

[40] Canada's application to set aside the Award cannot succeed as there is no "true jurisdictional" issue in this case. In my view, Canada is seeking to challenge the merits of the Tribunal's decision. Given my conclusion on the Investors' second argument, I do not propose to address the Investors' preliminary and alternative arguments.

[41] As noted, Canada acknowledges that the Tribunal had the jurisdiction to decide whether the Guidelines breached the prohibition on performance requirements contained in Article 1106(1)(c).

[42] Canada also acknowledges that the Tribunal had the jurisdiction to determine whether the Guidelines fell within the scope of Canada's reservation pursuant to Article 1108. This is consistent with Article 1132 of the NAFTA, which provides that a party can request a tribunal to seek an interpretation of the NAFTA Free Trade Commission on whether a measure falls within the scope of a reservation. If the Commission fails to submit an interpretation within 60 days, "*the Tribunal shall decide the issue*" (my emphasis added).

[43] Canada's position, however, is that the Tribunal exceeded its jurisdiction by using the wrong criteria to conclude that the Guidelines were not a reserved subordinate measure.

[44] I reject Canada's characterization of this as a jurisdictional issue.

[45] I view the determination of the NAFTA breach and the "scope of the reservation" issues as merits issues, for four reasons.

[46] First, these were the merits issues that the Tribunal was called upon to decide: did the Guidelines breach Article 1106(1)(c) and, if so, did they fall within the scope of Canada's reservation pursuant to Article 1108? These were the merits issues that the parties argued in

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<sup>14</sup> *Cargill*, at para. 52.

their written and oral submissions. These were the very issues that the Tribunal did decide. These were issues clearly within the terms of the submission to the Tribunal.

[47] Second, to determine whether the Guidelines were a reserved subordinate measure (and whether there was a breach of Article 1106(1)(c)), the Tribunal was required to interpret the provisions of the NAFTA. In particular, the Tribunal was required to interpret the words “the measure” in paragraph 2(f)(ii) of Annex I to determine the comparator against which to assess the Guidelines. The fact that Canada prefers the minority’s interpretation to that of the majority does not convert this into a matter of jurisdiction.

[48] Third, Canada acknowledges that the majority articulated the “consistency” test (in determining whether the Guidelines were “consistent with the measure”). Canada simply takes issue with the manner in which the majority applied that test to the facts at hand. In my view, this is a challenge to the conclusion reached by the majority, not a matter of jurisdiction.

[49] Fourth, a jurisdictional issue must be narrowly cast. In *Cargill*, Feldman J.A. looked at whether there was any limiting language that precluded the tribunal from awarding damages suffered by the investor in its home business operation. She held that in the absence of such limiting language, there was no jurisdictional issue and that any determination of damages was “a quintessential question for the expertise of the tribunal, rather than an issue of jurisdiction”.<sup>15</sup>

[50] In this case, Canada has failed to establish that there was anything in the NAFTA that precluded the Tribunal from making the Award it made. To be a reserved subordinate measure, the Guidelines had to fall within the language of paragraph 2(f)(ii). However, this wording was subject to interpretation. Casting this interpretive exercise as a jurisdictional issue goes far beyond the “narrow view of what constitutes a question of jurisdiction”, as required by *Cargill* and as demonstrated by the approach followed by Feldman J.A. in that case.<sup>16</sup>

[51] I do not regard this as one of the “rare circumstances” where there is a true question of jurisdiction. The majority decided that the Guidelines breached Article 1106(1)(c) and did not fall within the scope of Canada’s reservation. Those were merits issues. In my view, Canada is seeking to re-litigate the merits of the case.

## **Decision**

[52] Canada’s application to set aside the Award is dismissed.

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<sup>15</sup> *Cargill*, at para. 72.

<sup>16</sup> *Cargill*, at paras. 45-47.

[53] If the parties are unable to agree on costs of this application, written submissions not exceeding 3 pages (double spaced) may be made, by the Investors within 15 days and by Canada within 10 days thereafter.

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Conway J.

**Date:** February 16, 2016