

**IN THE MATTER OF AN ARBITRATION UNDER CHAPTER ELEVEN OF  
THE NORTH AMERICAN FREE TRADE AGREEMENT  
AND THE ICSID ARBITRATION (ADDITIONAL FACILITY) RULES**

**BETWEEN:**

**MOBIL INVESTMENTS CANADA INC. AND  
MURPHY OIL CORPORATION**

**Claimants/Investors**

**AND:**

**GOVERNMENT OF CANADA**

**Respondent/Party**

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**GOVERNMENT OF CANADA**

**REJOINDER**

**9 June 2010**

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**TABLE OF ABBREVIATIONS**

BIT	Bilateral Investment Treaty
CRA	Canada Revenue Agency
CUSFTA	Canada-United States Free Trade Agreement
DCF	Discounted Cash Flow
DPC	Development Phase Credit
E&T	Education and Training
EIA	Energy Information Administration
FIRA	Foreign Investment Review Act
GATT	General Agreement on Tariffs and Trade
HMDC	Hibernia Management and Development Company Ltd.
ICA	Investment Canada Act
ICJ	International Court of Justice
IEA	International Energy Agency
ILC	International Law Commission
MAI	Multilateral Agreement on Investment
MUN	Memorial University of Newfoundland
NAFTA	North American Free Trade Agreement
NEB	National Energy Board
NL	Newfoundland and Labrador
OECD	Organization for Economic Co-operation and Development
PCIJ	Permanent Court of International Justice
POA	Production Operation Authorization

R&D	Research and Development
SR&ED	Scientific Research and Experimental Development
TRIMS	Agreement on Trade Related Investment Measures
UNCTAD	United Nations Conference on Trade & Development
VCLT	Vienna Convention on the Law of Treaties
WTO	World Trade Organization

## **I. INTRODUCTION**

1. The Claimants' Reply to Canada's Counter Memorial demonstrates that the facts at issue in this arbitration are, largely, not in dispute. The parties agree that in 2004 the Offshore Petroleum Board issued Guidelines for Research and Development Expenditures ("Guidelines") which require the Claimants to spend a certain percentage of their revenues on research and development and education and training in the province of Newfoundland and Labrador. However, the parties continue to disagree whether these Guidelines breach Articles 1106 and 1105 of the NAFTA.

2. The dispute presents the following issues for resolution by the Tribunal:

- Are requirements to perform research and development ("R&D") and education and training ("E&T") in a territory prohibited under Article 1106? Specifically, are the Guidelines a requirement "to purchase, use or accord a preference to ... services provided in its territory, or to purchase ... services from persons in its territory" prohibited by Article 1106(1)(c)?
- If so, are the Guidelines covered by Canada's NAFTA Annex I reservation for the Accord Acts? The answer to this question appears to depend entirely on whether the reservation for a measure listed in Annex I of the NAFTA includes measures subordinate to the listed measure which are adopted after the entry into force of the NAFTA.
- Does the customary international law minimum standard of treatment required by Article 1105 include the protection of legitimate expectations? If so, what are the expectations that the Claimants could have legitimately formed?
- If Canada has breached the NAFTA, what is the proper measure of damages? Does the Tribunal have jurisdiction under Articles 1116 and 1117 of the Agreement to award compensation for damages incurred after the claim was brought and that will be incurred in the future?

3. In their Memorial, the Claimants asserted that the Guidelines breach Article 1106(1)(c) of the NAFTA. Yet, Article 1106 only proscribes an exhaustive list of performance requirements which does not include requirements for local R&D and E&T. In their Reply, the Claimants focus on the fact that R&D and E&T can be provided as a service. The Claimants overlook that Article 1106(1)(c) only proscribes requirements concerning services *provided or purchased* in the territory. The Guidelines do not compel the purchase, use or accordance of a preference to services *provided or purchased* in Canada. The Claimants can fulfil their obligation by expending on R&D and E&T which does not involve the provision or purchase of a service in Canada, such as in-house R&D and scholarships.

4. In any event, the Guidelines do not breach Article 1106(1)(c) because they fall within the Annex I reservation for the Accord Acts. The NAFTA not only reserves measures listed in Annex I, such as the Accord Acts, but also measures subordinate to those listed, such as the Guidelines. The Claimants seem to accept that the Guidelines are subordinate to the Accord Acts but argue that they cannot be reserved because the NAFTA only reserves subordinate measures adopted *before* the Agreement entered into force. The Claimants note that only subordinate measures “adopted or maintained” are reserved and argue that the phrase uses the past tense, thereby confining reserved subordinate measures to those adopted or maintained before the NAFTA entered into force. However, “adopted or maintained” in this context is not the past tense form of “adopt or maintain,” it is the passive. The reservation is simply for subordinate measures “adopted or maintained” *by the NAFTA parties*. This conclusion is confirmed by the use of the phrase “adopted or maintained” throughout the Agreement to refer to measures adopted after the NAFTA entered into force as well as those maintained from before.

5. Reservations for subordinate measures adopted after the NAFTA entered into force give effect to the object and purpose of the Agreement. The NAFTA parties only agreed to undertake the ambitious commitments in the Agreement on the understanding that they could retain certain flexibility in sensitive areas. This was done, in part, by listing in Annex I measures that existed at the time the Agreement entered into force which could be contrary to specific obligations. However, the NAFTA parties were not

forced to freeze the listed measures as they existed in 1994. The parties reserved subsequent continuations, renewals and amendments as long as they did not decrease the conformity of the measures with NAFTA obligations. The parties also clarified that the reservation includes measures subordinate to the listed measures. This enables the parties to effectively maintain the measures listed in Annex I by allowing them to clarify ambiguities or apply the measures to circumstances which were not foreseen when the measures were drafted.

6. The Claimants argue that interpreting Annex I reservations as including subordinate measures adopted after the NAFTA entered into force opens the door to abuse. However, the definition of a subordinate measure prevents such abuse. Only those measures which are adopted under the authority of, and are consistent with, the Annex I listed measures are subordinate and, therefore, reserved.

7. In addition to claiming a breach of Article 1106, the Claimants allege that the Guidelines breach Article 1105 by failing to fulfil their legitimate expectations. In its Counter Memorial, Canada noted that the recent NAFTA Chapter 11 decision in *Glamis* held that there was no evidence that the customary international law minimum standard of treatment required by that Article had changed from the “egregious or shocking” standard expressed in *Neer*. The Claimants focused their Reply on dismissing *Glamis* as an outlier. However, *Glamis* was endorsed in the NAFTA Chapter 11 decision of *Cargill*, released since the Claimants submitted their Reply.

8. In its Counter Memorial, Canada also noted the Claimants’ failure to provide any evidence of state practice or *opinio juris* necessary to establish that the customary international law standard requires the protection of legitimate expectations. Instead of providing that evidence in their Reply, the Claimants rely on the customary international law regarding contractual breach. The Claimants allege that this law provides a “foundation” for the customary international law concerning failure to fulfil legitimate expectations. However, the Claimants fail to confront the decisions under the NAFTA, and other treaties, which have held that a breach of contract is not a breach of customary international law. Since a breach of contract is not a breach of customary international

law, then the failure to fulfil a lesser assurance which gives rise to a legitimate expectation certainly is not.

9. In any event, the Claimants have not established that the Guidelines were inconsistent with any legitimate expectations. The Claimants have provided no evidence that they legitimately expected that they could unilaterally decide to spend nothing on R&D and E&T in the province because they believed it was unnecessary for the projects. The Claimants had no legitimate expectation that the Board would not enforce the obligation in section 45(3)(c) of the Accord Acts 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.” They could not have legitimately expected that the Board would not enforce this obligation through its authority under section 151.1(1) of the Acts to issue guidelines. Indeed, Canadian courts held that the Claimants should have expected exactly the opposite. According to the Newfoundland and Labrador (“NL”) Trial Court, the Board “has the authority to establish reasonable levels of expenditure required to be made for research and development and education and training as part of its ongoing monitoring and enforcement role under the Accord and the Act.”<sup>1</sup>

10. The Claimants continue to argue that the decisions approving the Hibernia and Terra Nova Benefits Plans generated the legitimate expectation that the Board would not exercise its authority to issue guidelines to enforce the Accord Acts R&D and E&T obligation. However, in their Reply, the Claimants fail to identify any language in those decisions which generated such an expectation. Again, the Canadian courts held that the expectation generated by the decisions was precisely the opposite. According to the NL Court of Appeal, the Board “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

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<sup>1</sup> CA-52, Trial Court Decision, ¶ 74.

appellants' level of expenditures fall below that which the Board considered appropriate."<sup>2</sup>

11. Instead of confronting the Canadian court decisions, the Claimants argue, for the first time in their Reply, that the Guidelines are inconsistent with their legitimate expectations generated by the Foreign Investment Review Act. However, their investments in Hibernia and Terra Nova were not governed by this legislation. The Claimants cannot draw legitimate expectations from a law to which they were not subject.

12. The Claimants' arguments on damages are equally unavailing. The Claimants continue to seek compensation for damages until 2036 when the Hibernia field is projected to stop producing oil. Canada explained in its Counter Memorial that Articles 1116(1) and 1117(1) of the NAFTA prevent the Tribunal from taking jurisdiction over a claim for damages which had not yet been incurred. Canada also explained that international principles of compensation do not allow compensation for damages not yet incurred because they are too speculative. The Claimants respond that their entire damages were incurred the moment that the Guidelines were imposed in November 2007. However, since the Guidelines only require operators to spend a percentage of their revenue on R&D and E&T, they impose no obligation if an operator generates no revenue. Until the Claimants produce oil in any given year, they do not incur an obligation under the Guidelines in that year and do not incur any damages.

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<sup>2</sup> CA-53, Court of Appeal Decision, Justice Barry, ¶ 135, quoted in Counter Memorial, ¶ 137. See also CA-52, Trial Court Decision, ¶ 47.

**II. THE GUIDELINES DO NOT BREACH ARTICLE 1106****A. Canada Has Not Violated Article 1106(1)(c) of the NAFTA**

13. In their Memorial, the Claimants made conclusory statements that carrying out R&D in the province invariably results in a violation of Article 1106(1)(c).<sup>3</sup> In its Counter Memorial, Canada explained that not all types of performance requirements are prohibited by the NAFTA and that Article 1106(5) expressly provides that requirements are not prohibited unless they fall squarely into one of the seven specifically enumerated performance requirements set out in Article 1106(1). Canada further established that a requirement to carry out R&D and to provide E&T in the province does not fall squarely into the ordinary meaning of Article 1106(1)(c), nor do these very different types of performance requirements share the same object and purpose. The treaty practice of other States, including the United States, confirms Canada's interpretation.

14. The Claimants' Reply Memorial does not address this. Instead, the Claimants focus their argument on demonstrating that R&D and E&T can be a "service." Canada does not contest this. What the Claimants fail to prove is that, by requiring expenditures to carry out R&D and provide E&T in the province, the Guidelines compel them to purchase, use or accord a preference to domestic services. Without such compulsion, there is no violation of Article 1106(1)(c).

15. In support of their arguments, the Claimants draw inferences from Article 1106(4), the Annex I reservations for the Accord Act and Investment Canada Act and the NAFTA negotiating drafts. However, all fall short of proving that the Guidelines' R&D and E&T requirements are prohibited by Article 1106(1)(c). Read in their context, these texts suggest that the NAFTA negotiators wanted to ensure that requirements other than those listed but which were commonly used by the parties would not be inadvertently precluded by Article 1106. Further, in taking reservations for existing measures, the parties were cautious to ensure there was no risk that certain aspects of those measures would not be covered by the reservations and found in violation of NAFTA.

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<sup>3</sup> Claimants' Memorial, ¶ 151.

**1. Article 1106(5) Prevents An Expansive Reading of Article 1106(1)(c) That Includes A Prohibition Against Requirements to Carry Out R&D or Provide E&T in the Province**

16. As Canada argued in its Counter Memorial,<sup>4</sup> the ordinary meaning of Article 1106(5) is straightforward: Article 1106(1) does not prohibit *any* other type of performance requirement *other than* the requirements set out therein. The use of “any” in this context means the list of requirements is exhaustive and no other type of requirement is covered.<sup>5</sup> Simply put, if the impugned requirement is different from those prohibited by Article 1106(1), it is allowed.

17. The Claimants have conceded that they “agree with Canada that the only requirements prohibited under Article 1106(1) are those listed in that provision.”<sup>6</sup> The Claimants argue nevertheless that Article 1106(5) does not mean that Article 1106(1)(c) should be interpreted restrictively.

18. The Claimants’ assertion is inconsistent with all previous NAFTA decisions, including the recent *Merrill & Ring* decision:

[T]he Tribunal is mindful of the *restricted scope* of Article 1106(5) in that performance requirements that are prohibited are *limited to the specific matters* identified in paragraphs (1) and (3). The Tribunal finds the views of *Pope & Talbot* and *S.D. Myers* tribunals to be convincing in this respect.<sup>7</sup>

19. Moreover, the Claimants’ assertion would render Article 1106(5) redundant, which is contrary to the rule of interpretation which requires each treaty provision to be

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<sup>4</sup> Counter Memorial, ¶¶ 144-154.

<sup>5</sup> “Any” “[w]ith a preceding negative (express or implied)” is defined as “none at all of, no – of any kind; not even one.” **RA-119**, *Shorter Oxford English Dictionary*, 5<sup>th</sup> ed., Vol. 1, s.v., “any”.

<sup>6</sup> Claimants’ Reply Memorial, ¶ 31.

<sup>7</sup> **RA-104**, *Merrill & Ring Forestry L.P. v. Government of Canada*, (UNCITRAL) Award, 31 March 2010, ¶ 111 (hereinafter “*Merrill & Ring*”), emphasis added. See Counter Memorial, ¶¶ 147-149. The WTO decisions on which the Claimants rely to argue that a “closed list” in a trade agreement should not be interpreted restrictively are inapposite in the context of Article 1106. Claimants’ Reply Memorial, ¶ 30, fn. 34. None of the WTO agreements at issue in those decisions have any provision equivalent or similar to Article 1106(5).

given effect.<sup>8</sup> Article 1106(5) was included by the NAFTA parties for a reason: to make it clear that any requirement that does not “fall squarely” into the “express terms” of the seven listed requirements of Article 1106(1) cannot be considered a prohibited performance requirement.<sup>9</sup>

20. Given the unanimity of previous NAFTA tribunals on this issue, Article 1106(5) dictates that the Claimants must show that a requirement to carry out R&D or to provide E&T in the province specifically requires that local goods or services be purchased, used or accorded a preference as per Article 1106(1)(c). A requirement that may or may not, depending on the business choices of the investment, result in an investment making an expenditure covered by Article 1106(1) is not a prohibited performance requirement.<sup>10</sup>

**2. Article 1106(1)(c) Does Not Prohibit Requirements to Carry Out R&D or To Provide E&T in the Province**

**a) Article 1106(1)(c) Prohibits Requirements That *Compel The Provision Of A Local Service To The Claimants, Or The Purchase Of A Service From Local Persons***

21. Canada demonstrated in its Counter Memorial that Article 1106(1)(c) does not encompass the R&D and E&T requirements set out in the Guidelines. Canada explained that whereas Article 1106(1)(c) precludes a compulsion to purchase, use or accord a

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<sup>8</sup> **RA-88**, *The Corfu Channel Case (Merits)*, 1949 I.C.J. Reports 15, p. 24; **RA-101**, *Libyan Arab Jamahiriya v. Chad*, 1994 I.C.J. Reports 648, p. 23; **RA-97**, Jennings & Watts, *Oppenheim's International Law*, 9<sup>th</sup> ed. (Oxford University Press: 1996), vol. 1, Parts 2-4, pp. 1280-1281 (hereinafter “Jennings & Watts - Oppenheim's”).

<sup>9</sup> See Counter Memorial, ¶¶ 147-151.

<sup>10</sup> **RA-104**, *Merrill & Ring*, ¶ 118 (discussing Article 1106 (1)(c): “The same holds true of the complaint about a requirement to hire services in Canada for the purposes of cutting, sorting and scaling logs or retrieving logs that have broken loose...it has been convincingly explained by [Canada] that the Investor is free to hire these services from anyone it wishes. To the extent it hires in Canada is because of business convenience. The higher cost of hiring elsewhere is certainly the core of this business decision.”). See also **RA-100**, *Joseph Charles Lemire v. Ukraine*, (ICSID ARB/06/18) Decision on Jurisdiction and Liability, 14 January 2010, ¶¶ 501-511 (hereinafter “*Lemire*”) (deciding that a requirement for a certain percentage of music to be authored, composed or produced by Ukrainian artists did not violate the prohibited performance requirement that “goods or services must be purchased locally or which impose any other similar requirements,” even if *de facto*, all such artists were located in Ukraine).

preference to domestic goods or services,<sup>11</sup> the Guidelines' requirement to carry out R&D and to provide E&T in the province does not compel the Claimants to purchase domestic goods or services.<sup>12</sup>

22. The Claimants argue that Canada is ignoring the ordinary meaning of Article 1106(1)(c).<sup>13</sup> In fact, Canada relies on the specific terms of Article 1106(1)(c) in support of its position. The text of Article 1106(1)(c) plainly provides that the obligation applies with respect to "services provided" or services "purchase(d)...from persons" "in a Party's territory." The ordinary meaning of the word "provided" is to "supply, furnish (person *with* thing, thing *for* or *to* person),"<sup>14</sup> which implies one party "providing" something to another party. Similarly, a purchase "from persons" implies at least two persons involved in the transaction: a person purchasing a service from a service provider. Hence, the prohibition in Article 1106(1)(c) applies only in situations where the service supplier and the service consumer are separate entities and only when a requirement *compels* the provision of a service from a domestic service provider to the investment of the investor.

23. This ordinary meaning interpretation is confirmed by the French and Spanish texts of Article 1106(1)(c).<sup>15</sup>

24. The Claimants ignore every word in Article 1106(1)(c) and focus instead on the term "services" to argue that, because R&D and E&T may be provided as a service, the

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<sup>11</sup> Counter Memorial, ¶ 156.

<sup>12</sup> Counter Memorial, ¶¶ 183-202.

<sup>13</sup> Claimants' Reply Memorial, ¶ 23.

<sup>14</sup> **RA-87**, *The Concise Oxford Dictionary, New Edition*, 6<sup>th</sup> ed., Vol. 2, s.v., "provided", emphasis in original.

<sup>15</sup> The French version of Article 1106(1)(c) states: "acheter, utiliser ou privilégier les produits ou *les services* produits ou *fournis* sur son territoire, ou *acheter* des produits ou *services de personnes* situées sur son territoire", **RA-109**, NAFTA, Article 1106 – French. The Spanish version states: "adquirir o utilizar u otorgar preferencia a bienes producidos o a *servicios prestados* en su territorio, o adquirir bienes de productores o *servicios de prestadores* de servicios en su territorio", **RA-110**, NAFTA, Article 1106 – Spanish. NAFTA Article 2206 states: "The English, French and Spanish texts of this Agreement are equally authentic", **RA-113**, NAFTA, Chapter 22.

requirement violates Article 1106(1)(c).<sup>16</sup> Of course certain kinds of R&D and E&T may, in some circumstances, be provided to a recipient as a service.<sup>17</sup> An entity can provide a research service to another entity. A person can provide a training service to another person. Canada never claimed otherwise. However, Article 31 of the Vienna Convention on the Law of Treaties does not permit an interpretation of Article 1106(1)(c) that fails to give meaning to Article 1106(1)(c) as a whole.

25. In contrast to Article 1106(1)(c), the Guidelines, which implement section 45(3)(c) of the Accord Acts, state 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.” A requirement to “carry out” R&D in the province does not automatically require that a service from a third party service provider, domestic or foreign, be purchased, used or accorded a preference.<sup>18</sup> Nor does a requirement that E&T “be provided” in the territory of the host state automatically require that a domestic service be purchased, used or accorded a preference. Neither of the requirements stipulated in the Guidelines compel the Claimants to purchase, use or accord a preference to domestic goods or services, which is, as the Claimants agree, the ordinary meaning of Article 1106(1)(c).

**b) The Context and Object and Purpose of Article 1106(1)(c), As Compared to Requirements to Carry Out R&D and Provide E&T, Support Canada’s Interpretation**

26. The context and object and purpose of the performance requirements at issue in this arbitration confirms Canada’s interpretation of Article 1106(1)(c).

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<sup>16</sup> Claimants’ Reply Memorial, ¶¶ 24-33.

<sup>17</sup> Canada takes no position as to whether Claimants’ characterization at ¶¶ 25-28 of Canada’s NAFTA and WTO obligations with respect to R&D and E&T services is accurate or correct. Since the question of whether R&D and E&T can be considered a “service” in certain circumstances is not at issue, Claimants’ lengthy discussion on this point is mostly irrelevant.

<sup>18</sup> Indeed, the “development” phase of R&D may only implicate the development of a good or creation of a “process” and may or may not involve any provision or purchase of a service at all. See Claimants’ Expert Report of W. David Montgomery, p. 4.

27. As Canada explained in its Counter Memorial, the Canada-U.S. Free Trade Agreement (“CUSFTA”) Article 1603(1)(c) formed the basis of NAFTA Article 1106(1)(c) – both apply when a requirement compels an investor to purchase, use or accord a preference to a domestic service.<sup>19</sup> Canada also noted that R&D requirements (as well as technology transfer and product mandate) were not part of the package of performance requirements proscribed by CUSFTA Article 1603. It was agreed to proscribe technology transfer and product mandate requirements in NAFTA Articles 1106(1)(f) and (g), in addition to local content (subsection (c)).<sup>20</sup> R&D requirements were not included in Article 1106(1).<sup>21</sup>

28. The TRIMs also provides context regarding requirements imposed on investments of concern to WTO members and what is generally understood by local content requirements. The TRIMs Annex Illustrative List 1(a), which the Claimants note was negotiated contemporaneously with NAFTA,<sup>22</sup> deals with measures which require “the purchase or use by an enterprise of products of domestic origin or from any domestic source...” This provision shares the same purpose as Article 1106(1)(c) (of course,

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<sup>19</sup> Counter Memorial, ¶¶ 180-182. CUSFTA Article 1603(1)(c) states: “purchase goods or services used by the investor in the territory of such Party or from suppliers located in such territory or accord a preference to goods or services produced in such territory,” **RA-9**, CUSFTA, reprinted in J.D. Richard and R.G. Dearden, *The Canada-U.S. Free Trade Agreement: Final Text and Analysis*, (CCH Canadian Limited, 1988), p. 265 (hereinafter “CUSFTA – Article 1603 & Synopsis”). The CUSFTA is part of the context of the NAFTA and part of the circumstances of its conclusion. **RA-80**, *Bayview Irrigation District, et al., v. United Mexican States*, (ICSID ARB(AF)/05/01), Submission of the United States of America, 27 November 2006, ¶ 13 (“United States’ negotiators based the negotiations for the NAFTA’s investment chapter on the predecessor Canada-U.S. Free Trade Agreement...”). CUSFTA has not been abrogated and remains in force, although Canada and the United States have suspended its operation, Claimants’ Reply Memorial, ¶ 62, fn. 64.

<sup>20</sup> **CA-59**, Meg N. Kinnear et al., *Article 1106*, in *Investment Disputes Under NAFTA: An Annotated Guide to NAFTA Chapter 11* (Kluwer 2006), pp. 12-1106-13-1106.

<sup>21</sup> The Claimants downplay the relevance of the reference to R&D in the CUSFTA synopsis cited by Canada because it refers to the “negotiation” of R&D requirements, rather than the imposition of a requirement. Claimants’ Reply Memorial, ¶ 63. However, CUSFTA Article 1106(3) states that the enforcement of a negotiated undertaking or commitment constitutes a requirement: “...a Party “imposes” a requirement or commitment on an investor when it requires particular action of an investor or when...it enforces any undertaking or commitment of the type described in paragraphs [1603]1 and 2...” **RA-9**, *CUSFTA - Article 1603*, p. 265. This is the same with respect to NAFTA Article 1106(1): “No Party may impose or enforce any of the following requirements, or enforce any commitment or undertaking...”

<sup>22</sup> Claimants’ Reply Memorial, ¶ 28.

TRIMS only applies with respect to goods, not services). In a submission to the TRIMS Negotiating Group, the United States provided its views on various sets of trade-related investment measures “which limit the sale, purchase and use of imports in the host country.”<sup>23</sup> The first category of measures described by the U.S. was local content requirements which specified that a certain percentage or amount be purchased from local sources.<sup>24</sup> In contrast, a *distinct* set of TRIMS described by the United States were:

technology requirements [which] commonly require that specified technologies be transferred by [a] foreign investor on non-commercial terms, and/or that *specific levels of research and development must be conducted on an ongoing basis*.<sup>25</sup>

29. The United States further elaborated its position that local content requirements and R&D requirements were distinct in a subsequent submission to the TRIMS Negotiating Group.<sup>26</sup> The United States described the former as “essentially the same as local sourcing or import substitution requirements as the investor is obliged in both cases to source inputs locally rather than import.”<sup>27</sup> R&D requirements, again, were dealt with separately under the rubric of “Technology Transfer and Licensing Requirements,” which the United States described as encompassing a requirement “to conduct a specified minimum amount of R&D in the host country during the life of the investment.”<sup>28</sup>

30. The European Community also understood that a local content requirement is distinct from a R&D requirement. In a submission to the TRIMS Negotiating Group, the EC identified fourteen separate types of TRIMS, including:

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<sup>23</sup> **RA-128**, Negotiating Group on Trade-Related Investment Measures: Submission by the United States, MTN.GNG/NG12/W/4 (11 June 1987), p. 2.

<sup>24</sup> *Id.*

<sup>25</sup> *Id.*

<sup>26</sup> **RA-129**, Negotiating Group on Trade-Related Investment Measures: Submission by the United States, MTN.GNG/NG12/W/9 (9 February 1988), pp. 3, 5.

<sup>27</sup> *Id.*, p. 3.

<sup>28</sup> *Id.*, p. 5.

(vi) local content requirements require that a given percentage of the value of the final output must be either of local origin, or purchased from local sources.

[...]

(xii) technology transfer requirements require the foreign investor to adopt production or processing techniques that incorporate specific technology into the product or *to conduct a specific minimum amount of R&D in the host country*.<sup>29</sup>

31. These TRIMS submissions explain the differing object and purpose of local content performance requirements (such as those prohibited by Article 1106(1)(c)) and requirements to carry out R&D in the territory of the host State. Whereas the object and purpose of Article 1106(1)(c) is to preclude requirements aimed at providing a guaranteed market to domestic producers, the object and purpose of the R&D requirement is technology spill-over, strengthening knowledge capacity, intellectual capital and creating high-value added activities.<sup>30</sup> Carrying out R&D in the host State territory, whether done in-house or in conjunction with foreign and domestic suppliers and research institutions, whatever the industry or discipline,<sup>31</sup> builds capacity to absorb and adapt technologies to local conditions and has been shown to have generally positive, not trade-distorting, economic effects.<sup>32</sup> While some investment treaties (including some

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<sup>29</sup> **RA-127**, Negotiating Group on Trade-Related Investment Measures: Submission by the European Communities, MTN.GNG/NG12/W/10 (24 May 1988), p. 2, 3.

<sup>30</sup> Counter Memorial, ¶¶ 167-168.

<sup>31</sup> As the Guidelines and the Claimants themselves acknowledge, R&D is not limited to science and engineering. The Guidelines permit consideration of expenditures that are broader than the science and technology SR&ED definition of R&D, including “research in such areas as fiscal regimes, business models and socio-economic and environmental matters.” **CE-1**, Guidelines, s. 3.3. See Claimants’ Memorial, ¶ 91, fn. 160 (“The 2004 Guidelines reflect a notion of R&D that is broader in many respects than the SR&ED definition.”).

<sup>32</sup> Counter Memorial, ¶¶ 168-170 and exhibits cited therein.

U.S. and Japanese BITs) have sought to eliminate R&D requirements, many, like the NAFTA, have not.<sup>33</sup>

32. E&T requirements also have a distinct object and purpose from that of Article 1106(1)(c): to transfer knowledge, expertise and skills to the local population, including through support for local education institutions.<sup>34</sup>

33. In its Counter Memorial, Canada explains at length how the different object and purpose of R&D and E&T requirements versus local content requirements supports the argument that these requirements are treated differently (or at least distinctly) by States. The Claimants did not respond to Canada's arguments on this point.<sup>35</sup>

34. Clearly, carrying out R&D and providing E&T in the territory of the host state can involve the consumption of domestic services, but this does not mean that an R&D and E&T requirement is the same as a local content requirement.

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<sup>33</sup> **RA-69**, *UNCTAD World Investment Report 2005: Transnational Corporations and the Internationalization of R&D* (New York and Geneva: United Nations, 2005), p. 229 (hereinafter "UNCTAD, World Investment Report").

<sup>34</sup> *Id.*, p. 184 ("Training undertaken by [transnational corporation] foreign affiliates conducting R&D can help develop new and advanced skills among local engineers and researchers. The types of training may range from on-the-job training to seminars and overseas training, including at the parent company [...] Some [transnational corporations] that undertake R&D in developing countries to tap pools of low-cost technical manpower support local universities and engage in curriculum development and talent fostering. They may help increase or upgrade training in specific skills. Others provide internship and fellowship programs to high-performing students. Their research collaboration with local universities can offer a means of supporting higher education while simultaneously diffusing knowledge.")

<sup>35</sup> Counter Memorial, ¶¶ 168-170. On this issue, the Claimants only say that UNCTAD has classified local R&D requirements as performance requirements. Claimants' Reply Memorial, ¶ 76. This simply restates what Canada said in its Counter Memorial, but does not answer the question whether R&D and E&T performance requirements share the same object and purpose as Article 1106(1)(c).

### 3. The Claimants Accept that Article 1106(1) Only Proscribes a Compulsion to Make a Prohibited Expenditure

35. The Claimants have not contested Canada's submissions with respect to the ordinary meaning of "impose or enforce" in the chapeau of Article 1106(1)(c).<sup>36</sup> Nor do the Claimants contest Canada's submission that if an impugned measure allows for expenditures on non-prohibited activities, then there is no compulsion to make a prohibited expenditure and, hence, no breach of Article 1106(1)(c).<sup>37</sup> These concessions are fatal to the Article 1106(1)(c) claim because, as Canada explained in its Counter Memorial, there are many ways for the Claimants to fulfil their Guidelines obligation to carry out R&D and to provide E&T that do not involve the provision of domestic services.

### 4. The Guidelines Do Not Compel What Article 1106(1)(c) Prohibits

#### a) The Guidelines Only Require That Expenditures Be Made For R&D To Be Carried Out In the Province

36. The Guidelines require that "expenditures shall be made for research and development to be carried out in the province." How the Claimants make such expenditures is not prescribed by the Guidelines, as long as the R&D is carried out in the province.<sup>38</sup> As Canada noted in its Counter Memorial and elaborates further below, there are R&D expenditure possibilities that do not involve the provision of a service from a local provider.

37. The Claimants and other offshore operators have historically used a combination of in-house resources and sub-contractors, both foreign and domestic, to carry out R&D

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<sup>36</sup> Counter Memorial, ¶¶ 184-185. Article 1106(1) states: "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 [...]"

<sup>37</sup> Counter Memorial, ¶¶ 184-185.

<sup>38</sup> The criteria for determining eligible R&D expenditures is set out in the Guidelines. CE-01, Guidelines, s. 3.

in the province.<sup>39</sup> Nothing has changed with the adoption of the Guidelines, which permits any and all of these options, as long as the R&D is undertaken in the province.

38. The Claimants are wrong to say that “expenditures” in the Guidelines “denotes payment for services not implicated by achieving a level of R&D internally.”<sup>40</sup> R&D expenditures are eligible for SR&ED tax credits regardless of whether they are spent in-house or out-sourced<sup>41</sup> and R&D projects that are SR&ED eligible are eligible under the Guidelines.<sup>42</sup> For example, as Canada noted in its Counter Memorial as an illustrative

<sup>39</sup> **Hibernia**: See **CE-149**, HDMC, Scientific Research and Experimental Development 1995 Projects (May 16, 1996) (indicating HMDC SR&ED expenditures). See also **CE-120**, Letter from P. Sacuta, HMDC, to F. Smyth, CNLOPB, transmitting Preliminary Summary Report of Hibernia R&D Expenditures (2004-2008) (Apr. 30, 2009) (Includes 2004-2008 HDMC R&D expenditures declared Guidelines eligible by the Board. **CE-178**, Staff Analysis of the Research and Development Education and Training Report, Hibernia Project, April 2004 to December 2008 (Dec. 2009), pp. 4, 5. See also **RE-52**, Report prepared by Environment Canada and others, “The Newfoundland Offshore Burn Experiment – NOBE” (1993). In 1993, HDMC sponsored a landmark research experiment offshore Newfoundland involving 25 different government agencies and private companies from Canada and the United States to analyze the effects and utility of in situ oil burning in the event of a major offshore oil spill. This experiment recently garnered international attention in the initial efforts made by BP to contain the oil spill disaster currently unfolding offshore Louisiana. See **RE-63**, CBC News, “Gulf Oil Burn Method has Newfoundland Roots,” (Apr. 29, 2010). **Terra Nova**: See **CE-81**, Terra Nova Development, Canada-Newfoundland Benefits Annual Report on R&D (Mar. 1999), p. 4 (Seacore (UK) to undertake R&D in NL); **CE-187**, Letter from G. Vokey, Suncor Energy Inc., to F. Smyth, CNLOPB, attaching Suncor, Research and Development Education and Training Report: April 2004 to December 2008 (Oct. 1, 2009), pp. 5, 13, 21 (Includes 2004-2008 Terra Nova R&D expenditures declared Guidelines eligible by the Board: In-house Oiled Seabird Cleaning Center; Oceanengineering Intervention Engineering (Houston, TX) to develop new technology for FPSO shipside valves.) **CE-188**, CNLOPB, Staff Analysis of the Research and Development Education and Training Report, Suncor Energy Terra Nova Development, April 2004 to December 2008 (Dec. 1, 2009), pp. 5, 7. See also, **RE-53**, Hibernia Frontier, “Taking Credit for R&D” (Jul/Aug. 1998), p. 3.

<sup>40</sup> Claimants’ Reply Memorial, ¶ 72.

<sup>41</sup> See **RA-94**, *Income Tax Act*, (1985, c. 1 (5<sup>th</sup> Supp.)), s. 248(1) provides that SR&ED eligible work qualifies for the tax credit whether performed by the Claimant (taxpayer) or on the Claimants’ (taxpayer’s) behalf: “‘scientific research and experimental development’ means systematic investigation or search that is carried out in a field of science or technology by means of experiment or analysis and [...] in applying this definition in respect of a taxpayer, includes (d) work undertaken by or on behalf of the taxpayer with respect to engineering, design, operations research, mathematical analysis, computer programming, data collection, testing or psychological research, where the work is commensurate with the needs, and directly in support, of work described in paragraph (a), (b) or (c) that is undertaken in Canada by or on behalf of the taxpayer...” (emphasis added). The Claimants’ SR&ED eligibility is assessed under the *Income Tax Act*, s. 248(1). **CE-151**, Letter from James Muir, Canada Revenue Agency, to Rod Hutchings, HMDC (Jan. 14, 2008), attaching SR&ED Preliminary Technical Review Report (“The technical review serves to assess the work claimed under the definition of SR&ED per subsection 248(1) of the *Income Tax Act*.”). See also **RA-83**, “The Advantages of Doing Research in Canada 2008-2009”, Invest in Canada Bureau and Canada Revenue Agency, p. 4.

<sup>42</sup> Second Witness Statement of Frank Smyth, ¶ 4 (hereinafter “Smyth Statement II”).

example, establishing an in-house R&D facility in the province could qualify under the Guidelines but not result in a transaction that is prohibited by Article 1106(1)(c).<sup>43</sup>

39. The Claimants have argued they seek “financial efficiency and low administrative maintenance” when fulfilling their R&D obligations.<sup>44</sup> If the Claimants use domestic entities or persons to carry out R&D in the province because of business convenience, this does not equate to the imposition of a requirement.<sup>45</sup>

**b) The Guidelines Only Require That Expenditures Be Made For E&T To Be Provided In the Province**

40. The Guidelines also require that “expenditures shall be made for...education and training to be in the province.” How the Claimants make such expenditures is not prescribed by the Guidelines, as long as the E&T is being provided in the province.<sup>46</sup> As Canada noted in its Counter Memorial and elaborates further below, the Claimants have E&T expenditure options that do not involve the compulsory provision of a service by a domestic provider proscribed by Article 1106(1)(c).

41. The Claimants and other offshore operators have historically used a combination of in-house resources, foreign and domestic training companies and institutions to

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<sup>43</sup> Counter Memorial, ¶ 198. ExxonMobil has opened R&D facilities in other parts of the world besides Houston. ExxonMobil established an LNG R&D facility in Qatar. See **RE-56**, Qatar Science & Technology Park Press Release, “*ExxonMobil Announces new LNG Research Facility in Qatar*” (May 31, 2004); **RE-62**, Qatar Science & Technology Park Press Release, “*ExxonMobil Research Qatar Announces Funding to Top 218 Million QR At QSTP*” (Apr. 11, 2010). See also **RE-60**, “Newfoundland R&D: Regional VP Visit,” (Apr. 29, 2009), p. 4 (noting that ExxonMobil decided to have an in-house R&D presence in Qatar via a 100% ExxonMobil affiliate in that country). Esso Norway (“EEP”) (ExxonMobil’s subsidiary in Norway) also “funds and manages [its] own R&D program,” *Id.*

<sup>44</sup> First Witness Statement of Andrew Ringvee, ¶ 12; Second Witness Statement of Andrew Ringvee, ¶ 4 (hereinafter “Ringvee Statement II”).

<sup>45</sup> As noted by Canada in its Counter Memorial, even a measure which deters an action is not the same as a measure which requires an action. Counter Memorial, ¶ 185, fn. 308. See **RA-104**, *Merrill & Ring*, ¶ 118; See also **RA-100**, *Lemire*, ¶¶ 501-511.

<sup>46</sup> The criteria for determining eligible E&T expenditures is set out in the Guidelines, **CE-01**, Guidelines, s. 3.

provide E&T in the province.<sup>47</sup> Nothing has changed with the adoption of the Guidelines, which permits any and all of these options, as long as the E&T is provided in the province (with some, more generous, exceptions, as explained below). The Claimants may find some options more financially efficient than others,<sup>48</sup> but without a compulsion to engage in a transaction that is squarely prohibited by Article 1106(1)(c), there can be no violation of that provision.

42. Some types of E&T expenditures can even occur outside the province and still qualify under the Guidelines. As explained in Canada's Counter Memorial, the Guidelines permit expenditures for "work terms including provincial residents who may

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<sup>47</sup> **CE-90**, Terra Nova 2001 Benefits Report, p. 18 (ABB Industri AS, Norway, provided training at Bull Arm (Newfoundland) on the Terra Nova specific thruster system; Kelton Engineering Ltd, United Kingdom provided training at Bull Arm for the fiscal metering system; Micropack (Engineering), Aberdeen, Scotland, provided fire and gas detection equipment training); **CE-92**, Terra Nova 2003 Benefits Report, p. 15 (Weir Engineering Services, Great Britain provided training on water injection pumps); **CE-93**, Terra Nova 2004 Benefits Report, p. 16 (Thomassen Turbine Systems (Netherlands) provided training on gas turbine MS 6001 and Speedtronic Mark 5 Controls); **CE-95**, Terra Nova 2006 Benefits Report, pp. 15, 17 (Kelton Engineering (UK) training re. flow measurement systems/metering systems; Tristate Bird Rescue (USA) training re. rehabilitation and cleaning of oiled wildlife); **CE-96**, Terra Nova 2007 Benefits Report, p. 16 (Micropak Engineering of Aberdeen, Scotland delivered a two day course in St. John's on the Terra Nova CCTV Flame Detection System; Thomassen Turbine (The Netherlands) delivered courses on the operation and maintenance of gas turbines; Tracerco (Texas, USA) provided radiation instruction training); **CE-97**, 2008 Terra Nova Benefits Report, pp. 5 (Baker Petrolite (Houston, USA) training re. prediction modeling and oilfield microbiology); **CE-85**, Terra Nova 1999 E&T Report, p. 6 (describing training in NL by Norwegian companies Kongsberg Offshore and Grenland Offshore); **CE-95**, Terra Nova 2006 Benefits Report, p. 15 (Petro-Canada delivered in-house training for Petro-Canada and Contractor personnel on the Bailey (ABB Infi-90) modules installed on the FPSO); **CE-186**, Letter from Paul Phelan, HMDC, to J. Bugden, CNLOPB *attaching* Hibernia Project – R&D / E&T Expenditure Submission (2009) (Mar. 31, 2010) (*attaching* chart of vendor provided training, including USA company Forsthoffer & Associates and UK company Register Larkin which "came to NL to do the training", pp. EMM3148-9). See also **CE-94**, Terra Nova Development Canada-Newfoundland Benefits Annual Report 2005, p. 15 ("Petro-Canada continued to focus on improving the efficiency and effectiveness of the delivery of its training. In order to ensure we receive maximum value from our training dollar, Petro-Canada, when required and whenever possible, opts to bring in expertise into the province to deliver the required training. This not only enables the ability to train a greater number of Terra Nova employees but also has allowed us to partner with other operators and contractors (i.e., Husky, Hibernia/ExxonMobil, BR); thus achieving a greater trained provincial labour market.").

<sup>48</sup> For example, the Claimants could establish their own training facility in the Province. ExxonMobil has done this in other parts of the world besides Houston. For example, ExxonMobil established the ExxonMobil Technology Center in Abu Dhabi, managed and operated by ExxonMobil staff, to provide training courses to UAE nationals **RE-59**, ExxonMobil, The Lamp, "Breaking ground at Antwerp: ExxonMobil and Abu Dhabi promote cooperation," (2009 No. 2), p. 19 ("The technology center is the first to be established at an ExxonMobil joint-interest facility. It's managed and operated by ExxonMobil staff...[t]he center places a strong emphasis on training. From 2007 through 2008, it conducted 11 courses for more than 122 people.").

study or work outside the province.”<sup>49</sup> Establishing a scholarship for students from NL to study at a university in the United States or Europe could qualify under the Guidelines. Such expenditures do not implicate Article 1106(1)(c).

43. A contribution to a local educational institution is clearly an “expenditure” that will result in E&T being provided in the province, and accordingly qualifies under the Guidelines. The operators have made many such expenditures in the past and continue to do so, submitting such expenditures to the Board for approval under the Guidelines.<sup>50</sup> However, such expenditures do not run afoul of Article 1106(1)(c) because there is no receipt of a service in exchange for the contribution, as Article 1106(1)(c) requires.

44. The Claimants respond that a requirement to make expenditures that fund a university chair or scholarship violates Article 1106(1)(c) because “[t]he Guidelines’ requirement for such spending clearly ‘accord[s] a preference’ to educational services provided in the Province.”<sup>51</sup> The Claimants again misconstrue the ordinary meaning of Article 1106(1)(c): when an investor donates money to a university to, for example, establish a research chair or scholarship fund, there is no reciprocal provision of a service *by the university to the Claimants* in consideration for that contribution. There is no

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<sup>49</sup> CE-1, Guidelines, s. 3.4.

<sup>50</sup> CE-124, Terra Nova E&T Pre-Approval Application (Young Innovator Award) and CNLOPB Response (May 25, 2009); CE-178, CNLOPB, Staff Analysis of the Research and Development Education and Training Report Hibernia Project (April 2004 to December 2008) (Dec. 1, 2009), pp. 12, 14-15. Approved educational expenditures included grants and contributions to MUN Engineering Faculty, NL Science Center Connections Program, Educational Resource Centre (Techsplorations Program), College of North Atlantic Scholarship Fund, Engineers Without Borders, Golden Jubilee Scholarship, Easter Seals House, School Lunch Association, Johnson Geo Center. CE-188, CNLOPB, Staff Analysis of the Research and Development Education and Training Report, Suncor Energy Terra Nova Development, April 2004 to December 2008 (Dec. 1, 2009), p. 16. Approved education expenditures included grants and contributions for MUN Chair in Asset Integrity Management and Chair in Ocean Environmental Risk Engineering, “Youth & the Ocean Conference, Women in Resource Development, Shallaway Scholarship and Mentorship Program, Sea Cadets.

<sup>51</sup> Claimants’ Reply Memorial, ¶ 80.

*purchase* of a service by the Claimants *from* the university. Indeed, the definition of a donation or gift is that there is no valuable consideration in exchange therefore.<sup>52</sup>

45. The Claimants admit that “there will always be opportunities to direct funding to E&T projects,”<sup>53</sup> but complain that this is a “convenient end-run around the treaty.”<sup>54</sup> This is both a mischaracterization and disingenuous. Canada has never argued that the Guidelines are “really just requirements for educational donations.”<sup>55</sup> The Claimants committed themselves in both the Hibernia and Terra Nova Benefits Plans to “[c]ontinue to support local research institutions” and to “consider ways it can support education and training generally in the Province.”<sup>56</sup> The Claimants reported their E&T expenditures and efforts since the Benefits Plans were approved and before the Guidelines were issued,<sup>57</sup>

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<sup>52</sup> Gift is defined as “[t]he voluntary transfer of property to another without compensation.” **RA-81**, *Blacks Law Dictionary*, 8<sup>th</sup> ed., s.v., “gift”. Donation is defined as a “gift.” **RA-95**, *Blacks Law Dictionary*, 8<sup>th</sup> ed., s.v., “donation”.

<sup>53</sup> Claimants’ Reply Memorial, Annex A, ¶ 18, fn. 23. The Claimants further “confirm that they are not challenging E&T capacity in the Province.” Claimants’ Response of October 2, 2009 to Canada’s Revised Request for Documents dated September 29, 2009, request 13.

<sup>54</sup> Claimants’ Reply Memorial, ¶ 84.

<sup>55</sup> Claimants’ Reply Memorial, ¶ 81.

<sup>56</sup> **CE-46**, Hibernia Supplementary Benefits Plan (May 28, 1986), p. 7; **CE-47**, CNLOPB, Decision 86.01: Application for Approval: Hibernia Benefits Plan and Development Plan (Jun. 18, 1986), p. 25; **CE-57**, CNLOPB, Decision 97.02: Application for Approval: Terra Nova Benefits Plan and Development Plan (Dec. 1997), p. 23.

<sup>57</sup> Claimants’ Memorial, ¶ 91, fn. 160 (“HMDC and Petro-Canada typically report on E&T expenditures in their annual reports to the Board.”); **Hibernia: CE-62**, Hibernia 1986 Benefits Report (Apr. 20, 1987); **CE-63**, Hibernia 1987 Benefits Report (Mar. 25, 1988); **CE-66**, Hibernia 1988 Benefits Report (Mar. 31, 1989); **CE-68**, Hibernia 1989 Benefits Report (Mar. 31, 1990); **CE-70**, Hibernia 1998 Benefits Report (1999); **CE-71**, Hibernia 1999 Benefits Report (Mar. 14, 2000); **CE-72**, Hibernia 2000 Benefits Report (Jan. 1, 2001); **CE-73**, Hibernia 2001 Benefits Report (Apr. 15, 2002); **CE-74**, Hibernia 2002 Benefits Report (Apr. 17, 2003); **CE-75**, Hibernia 2003 Benefits Report (Apr. 6, 2004); **Terra Nova: CE-82**, Terra Nova 1998 E&T Report (Mar. 1999); **CE-85**, Terra Nova 1999 E&T Report (Mar. 2000); **CE-88**, Terra Nova 2000 Benefits Report (Apr. 2001); **CE-90**, Terra Nova 2001 Benefits Report (Mar. 2002); **CE-91**, Terra Nova 2002 Benefits Report (Mar. 2003); **CE-92**, Terra Nova 2003 Benefits Report (Mar. 2004).

and the Claimants know full well that their E&T expenditures count towards the Guidelines, admitting this even before Canada raised the issue in its Counter Memorial.<sup>58</sup>

46. Nothing in the Guidelines indicate what percentage of expenditures needs to be spent on one category or the other.<sup>59</sup> The Claimants are apparently more interested in R&D projects because they believe they will reap greater benefits and R&D projects also “constitute significant tax savings for the Owner Companies,”<sup>60</sup> but this does not change the fact that E&T expenditures are eligible under the Guidelines and the Claimants can, just as with R&D, make many different types of E&T expenditures that do not fall into the terms of Article 1106(1)(c).

**5. Supplementary Means of Interpretation Confirm that R&D and E&T Requirements are Not Proscribed by Article 1106(1)(c)**

**a) Article 32 of the Vienna Convention on the Law of Treaties Permits Treaties *In Pari Materia* to be Used to Confirm the Ordinary Meaning of Article 1106(1)(c)**

47. Article 32 of the Vienna Convention on the Law of Treaties permits the Tribunal to look at supplementary means of interpretation to confirm the ordinary meaning of a treaty provision.<sup>61</sup> Such supplementary means includes reference to “other treaties on the

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<sup>58</sup> See Claimants’ Memorial, ¶ 108, fn. 201 (“According to the Guidelines, qualifying E&T expenditures count towards an operator’s R&D expenditure target.”); First Witness Statement of Paul Phelan, ¶ 21 (hereinafter “Phelan Statement I”) (“[t]he SR&ED definition does not recognize E&T expenditures, which, as noted, are supposed to count toward the spending requirement imposed by the Guidelines.”).

<sup>59</sup> First Witness Statement of Frank Smyth, ¶ 41 (hereinafter “Smyth Statement I”). Indeed, the Guidelines specifically acknowledge that spending on R&D and E&T would fluctuate during the different phases of the projects and that both types of expenditures were acceptable in any phase. See CE-1, Guidelines, s. 2 (“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 and development activities. Both will be legitimate and eligible expenditures in either phase of a project.”).

<sup>60</sup> CE-147, E-mail from Susan Coombs, ExxonMobil, to Distribution List (Mar. 15, 2004). See Claimants’ Reply Memorial, Annex A, ¶ 17, fn. 22 (“operators naturally are looking for spending opportunities with at least some potential benefit to industry.”).

<sup>61</sup> CA-9, Vienna Convention on the Law of Treaties, Article 32 (“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.”).

same subject matter adopted either before or after the one in question which use the same or similar terms.”<sup>62</sup> As noted in *Asian Agricultural Products*, “when there is need of interpretation of a treaty it is proper to consider stipulations of earlier or later treaties in relation to subjects similar to those in the treaty under consideration.”<sup>63</sup> International courts and tribunals often look to treaties whose terms and provisions are the same or

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<sup>62</sup> **RA-79**, Anthony Aust, *Modern Treaty Law and Practice*, 2<sup>nd</sup> ed. (Cambridge: 2000), p. 200. See also **RA-102**, Ulf Linderfalk, *On the Interpretation of Treaties: The Modern International Law as Expressed in the 1969 Vienna Convention on the Law of Treaties*, (Springer: 2009), p. 255 (hereinafter “Linderfalk”) (“By a treaty in pari materia we are to understand an instrument, the subject matter of which is identical – at least partly – with the subject matter covered by the treaty interpreted...the question is whether...treaties in pari materia may be considered as a means of interpretation in and of itself. In my judgement, the answer to this question should be in the affirmative.”); **RA-97**, Jennings & Watts - *Oppenheim’s*, p. 1274, fn. 18 (“Previous treaties between the parties, and treaties between one of the parties and a third state, particularly if in pari materii with the treaty being interpreted, may sometimes be referred to for purposes of clarifying the meaning of the text, as by showing the then contemporary usage of terms used.”); **RA-115**, O’Connell, *International Law*, 2<sup>nd</sup> ed. (Stevens & Sons: 1970), p. 260 (“When a treaty for interpretation forms part of a system of treaties it is permissible to interpret it in the light of the other treaties, particularly to discover the true intendment of the terms used.”)

<sup>63</sup> **RA-78**, *Asian Agricultural Products Ltd. v. Sri Lanka*, (ICSID ARB/87/3) Final Award, 27 June 1990, reprinted in ICSID Review - FILJ 526, p. 542.

substantially similar to confirm the meaning of the terms used in the treaty under examination.<sup>64</sup>

**b) Provisions in Treaties Identical and Substantially Similar to NAFTA Article 1106(1)(c) Confirm that R&D and E&T Requirements are Not Proscribed**

48. As Canada noted in its Counter Memorial, the distinction between the prohibited performance requirement in Article 1106(1)(c) and R&D and E&T requirements is confirmed by reference to various U.S. BITs.<sup>65</sup> Consistent with the U.S. understanding explained during the TRIMS negotiations,<sup>66</sup> many U.S. BITs confirm the understanding that a requirement to carry out R&D in a host State's territory is distinct from the obligations encompassed by a local content requirement, such as Article 1106(1)(c).

49. Comparing the language of NAFTA Article 1106(1)(c), Article VI(a) of the 1994 Model U.S. BIT and the Accord Act/Guidelines, confirms Canada's submission:

<sup>64</sup> **RA-102**, Linderfalk, pp. 255-259 (concluding that, in the view of the ICJ, "treaties *in pari materia* can be used as a means of interpretation in and of itself). See e.g., **RA-85**, *Case Concerning Oil Platforms (Islamic Republic of Iran v. United States of America)*, I.C.J., 12 December 1996, General List No. 90, ¶¶ 27-31 (using similar provisions in other treaties to interpret the meaning of the treaty at issue); **RA-86**, *Case concerning rights of nationals of the United States of America in Morocco*, Judgment of 27 August 1952, 93 I.C.J. Reports 1952, pp. 191-192 (using similar treaties to interpret MFN provision at issue); **RA-96**, *Interpretation of the Agreement of 25 March 1951 between the WHO and Egypt, Advisory Opinion*, 457 I.C.J. Reports 1980, 20 December 1980, ¶¶ 45-47 (using similar treaties to interpret host state agreement at issue); **RA-103**, *Maffezini v. Spain*, (ICSID ARB/97/7) Decision of the Tribunal on Objections to Jurisdiction, 25 January 2000, ¶¶ 52-53, 58-60 (using other BITs to interpret MFN clause); **RA-123**, *Tokios Tokelos v. Ukraine*, (ICSID ARB/02/18) Decision on Jurisdiction, 29 April 2004, ¶¶ 34-36 (use of prior and subsequent treaties to interpret nationality provision at issue); **RA-116**, *Plama v. Bulgaria*, (ICSID ARB/03/24), Decision on Jurisdiction, 8 February 2005, ¶ 195 (referring to subsequent BITs by one of the parties: "It is true that treaties between one of the Contracting Parties and third states may be taken into account for the purpose of clarifying the meaning of a treaty's text at the time it was entered into."); **RA-122**, *Suez, Sociudad General de Aguas de Barcelona S.A., and Vivendi Universal S.A. v. The Argentine Republic*, (ICSID ARB/03/19) Decision on Jurisdiction, 3 August 2006, ¶¶ 57-58 (drawing inference from subsequent treaties to interpret the preexisting intention of the dispute resolution provision at issue); **CA-15**, *ADC v. Republic of Hungary*, (ICSID ARB/03/16) Award of the Tribunal, 27 September 2006, ¶¶ 345, 359 (inferring that failure to include a certain term in one treaty but included in subsequent treaties is evidence that the treaty being interpreted cannot be construed as having the same meaning as it would if the omitted term had been included); **RA-124**, *United States – Import Prohibition of Certain Shrimp and Shrimp Products*, WTIDS58/AB/R, 12 October 1998, ¶¶ 127-134 (using the UN Convention on the Law of the Sea definitions of "natural resources" and "living resources" to interpret GATT Article xx(g) term "exhaustible natural resources").

<sup>65</sup> Counter Memorial, ¶¶ 173-176.

<sup>66</sup> Rejoinder, ¶¶ 28-31.

NAFTA	1994 MODEL U.S. BIT <sup>67</sup>	Accord Act/Guidelines
1106(1)(c) "to purchase, use or accord a preference to goods produced or <i>services provided in its territory</i> , or to purchase goods or services <i>from persons in its territory</i> ."	Art. VI(a) "...to purchase, use or otherwise give a preference to products or <i>services of domestic origin or from any domestic source</i> ."  Art. VI(f) "to carry out a particular type, level or percentage of <i>research and development in the Party's territory</i> ."	s. 45(3)(c) "expenditures shall be made for research and development <i>to be carried out in the province and for education and training to be provided in the Province</i> ."

50. The phrase "to purchase, use or otherwise give a preference to products or services of domestic origin or from any domestic source" as used in Article VI(1) of the 1994 Model U.S. BIT is the same in substance as Article 1106(1)(c).<sup>68</sup>

51. In contrast, Article VI(f) of the 1994 Model U.S. BIT proscribes the type of requirement contained in the Accord Act and Guidelines: a requirement "to carry out a particular type, level or percentage of research and development in the Party's territory."<sup>69</sup>

52. The Claimants say that "Canada errs in suggesting" that the 1994 Model US BIT was developed at the same time as NAFTA and submit that Canada's reference to the 1994 Model U.S. BIT and its progeny "should be rejected as anachronistic and inadmissible" because the NAFTA negotiators did not have access to such treaties.<sup>70</sup> However, the point is not that the NAFTA negotiators were influenced by the 1994 Model U.S. BIT and the many U.S. BITs based thereon. Rather, it was likely NAFTA

<sup>67</sup> As explained in the Counter Memorial at ¶ 174, the performance requirement provisions of the 1994 Model U.S. BIT were repeated almost verbatim in thirteen U.S. BITs between 1994 and 2004.

<sup>68</sup> The Claimants assert that 1994 U.S. Model BIT Article VI(a) uses "significantly different terms" from NAFTA Article 1106(1)(c), but do not attempt to explain how they differ in substance, Claimants' Reply Memorial, ¶ 67.

<sup>69</sup> RA-72, 1994 U.S. Model BIT in K. Vandeveld, *U.S. International Investment Agreements* (Oxford: 2009), pp. 388-390 (hereinafter "Vandeveld").

<sup>70</sup> Claimants' Reply Memorial, ¶¶ 64-65.

that influenced the text of the 1994 Model U.S. BIT.<sup>71</sup> In contrast to the NAFTA, the treatment of R&D requirements in that model is clearly different.

53. The Claimants assert that there is no evidence that the 1994 Model U.S. BIT prohibited something “new” that was not already prohibited in the NAFTA.<sup>72</sup> However, the Claimants have not explained why the United States thought it necessary to proscribe requirements “to carry out a particular type, level or percentage of research and development in the Party’s territory” in its BITs if they were already proscribed by the provision equivalent to Article 1106(1)(c).<sup>73</sup> It cannot be that the United States inserted a redundant provision into thirteen of its BITs based on its 1994 Model, as this would “run counter to the rule of construction requiring the interpreter to infer that a State party to two or more treaties which employ the same term in the same (or a similar) context intended to give said term the same (or at least a compatible) meaning in all the treaties.”<sup>74</sup>

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<sup>71</sup> **RA-130**, Kenneth J. Vandeveld, *U.S. International Investment Agreements* (Oxford: 2009), p. 95 (“NAFTA negotiations also influenced the revision of the [U.S.] model negotiating text. The process of almost continuous revision that began in 1990 and led to the 1991 and 1992 models finally ended with the approval of a model dated April 1994 (the 1994 model)...which took approximately a year to draft...”); **RA-72**, Vandeveld, pp. 388, 401-402 (“the expansion of the content of the [1994 Model BIT performance requirement] provision and its movement into a separate article both were inspired by the text of NAFTA, which in turn was influenced by the [TRIMS Agreement], which was negotiated contemporaneously with NAFTA.”). Claimants’ own authorities confirm the same. **CA-135**, Hearing Before the Committee on Foreign Relations, United States Senate, *Bilateral Treaties Concerning the Encouragement and Reciprocal Protection of Investment*, U.S. Senate Hearing Doc. 104-289 (Nov. 30, 1995) (“The 1994 prototype embodies the same basic principles as its predecessors. Changes in language and format were made for three major reasons. First, we wanted to capture best practices. Investment negotiations in NAFTA, as well as the BIT practice of the U.S. and other OECD countries, had generated new policy features and higher standards of investment protection, which we wanted to incorporate in our BITs.”), cited at Claimants’ Reply Memorial, ¶¶ 66, fn. 72.

<sup>72</sup> Claimants’ Reply Memorial, ¶ 66.

<sup>73</sup> Claimants’ Reply Memorial, ¶¶ 64-68.

<sup>74</sup> **RA-118**, *Romak S.A. v. Uzbekistan*, PCA Case No. AA280, Award, 26 November 2009, ¶ 195, citing **RA-76**, *Aegean Sea Continental Shelf (United Kingdom v. Greece)*, Judgment, I.C.J. Reports 1978, p. 3, ¶ 57 (“It can hardly be supposed that Greece should at the same time have intended to give a scope to its reservation of ‘disputes relating to the territorial status of Greece’ which differed fundamentally from that given to it both in the General Act and in its declaration under the optional clause.”).

54. The Claimants also do not explain the U.S. decision to omit the R&D requirement in the 1994 Model U.S. BIT from the 2004 Model U.S. BIT:

The sixth category from the 1994 model, requirements to perform research and development in the host state, was deleted. The draft MAI had included a similar performance requirement, but the United States had some concern about whether its own practice was consistent with the prohibition and ultimately decided to omit it from the 2004 model.<sup>75</sup>

55. Indeed, in the current review of the U.S. Model BIT, some have recommended that the R&D requirement prohibition be reinserted into future U.S. BITs.<sup>76</sup>

56. The numerous treaties between Japan and other countries addressing performance requirements also (like the draft MAI) have a provision that replicates the language of Article 1106(1)(c) and a separate provision dealing with R&D.<sup>77</sup> If R&D requirements amount to local content requirements prohibited by a provision that uses the same language as Article 1106(1)(c), the Claimants have failed to explain why States like Japan and the U.S. specifically prohibit requirements to “carry out R&D” in the territory of the host State.

## **6. Canada's Annex 1 Reservation Does Not Give Rise to an Inference that the Guidelines are Inconsistent With Article 1106(1)**

57. As Canada explained in its Counter Memorial, the fact that section 45(3)(c) of the Accord Act was included in Canada's Annex I reservation does not mean that a

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<sup>75</sup> **RA-72**, Vandeveld, cited in Counter Memorial, ¶ 174, fn. 299. The “similar performance requirement” in the draft MAI referred to by Professor Vandeveld was the distinct prohibition on carrying out R&D in the territory of the host State. As Canada noted in its Counter Memorial (¶ 177), the performance requirement provision in the draft MAI contained both a local content provision exactly the same as Article 1106(1)(c) and, separate and distinct from that provision, the R&D performance requirement.

<sup>76</sup> **RA-117**, *Report of the Subcommittee on Investment of the Advisory Committee on International Economic Policy Regarding the Model Bilateral Investment Treaty*, 30 September 2009 (referring to the 2004 Model U.S. BIT: “Performance Requirements (Article 8). The Subcommittee considered the appropriateness of *broadening the prohibition against performance requirements to encompass requirements that (a) research, development, testing, innovation, systems integration or other activity aimed at generating intellectual property be performed in the territory of the host Party*”, emphasis added).

<sup>77</sup> Counter Memorial, ¶ 175, fn. 300.

requirement to carry out R&D and provide E&T in the province violates Article 1106(1)(c).<sup>78</sup> Rather, the R&D and E&T aspects in the Accord Acts Annex I reservation were included out of an abundance of caution.

58. The Claimants assert that Canada “conceded” that it has no evidence to support its “belt and suspenders” argument.<sup>79</sup> This is an inappropriate mischaracterization of Canada’s right to withhold documents protected by solicitor-client privilege.<sup>80</sup> In any event, the Claimants’ submissions on this point only serve to show that they are relying on the Annex I reservation as a substitute for a proper interpretation of Article 1106(1)(c) and the Guidelines R&D and E&T requirement.

59. Canada made a NAFTA reservation for the Accord Act as a whole, and specifically section 45(3). It is evident from the text of the Annex I reservation that it was drafted to reflect the structure and language as it appears in section 45(3) of the Accord Act. Some of Canada’s other reservations were drafted in the same way. For example, Canada’s Annex I reservation for *Duty Free Shop Regulations* includes in the description that a licensed duty free shop operator at a land border crossing into Canada must “be of good character.”<sup>81</sup> Obviously, this was included in the Annex I description because it reflects the legislation being reserved,<sup>82</sup> not because Canada has conceded that a requirement to “be of good character” breaches the NAFTA.

60. Indeed, if Canada had omitted the R&D and E&T aspect of section 45(3)(c) from the Annex I description, the Claimants would surely be arguing today that this omission

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<sup>78</sup> Counter Memorial, ¶¶ 203-213.

<sup>79</sup> Claimants’ Reply Memorial, ¶¶ 36-37.

<sup>80</sup> As Canada explained in its reply to Claimants’ Documents Request 6, the only responsive documents in Canada’s possession are solicitor-client privileged. Redfern Schedule, December 15, 2009, Request No. 6. A negative inference cannot be drawn from a refusal to waive solicitor-client privilege.

<sup>81</sup> CA-7, NAFTA, Annex I-C-19, Schedule of Canada.

<sup>82</sup> RA-89, *Customs Act*, (1985, c. 1 (2nd Supp.)), *Regulations Respecting Duty Free Shops* (SOR/86-1072), ss. 3(3)(c)(i), 3(4)(b).

means that Canada failed to reserve with respect to R&D and E&T. In light of this risk, prudence dictates that it is better to be over inclusive than under inclusive.

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 I Accord Act description is that the R&D and E&T expenditure obligation was included for comfort. If the Tribunal finds that 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 I reservation will be confirmed.

#### **7. The Claimants' *a contrario* Reading of Article 1106(4) is Misplaced**

62. The Claimants argue that the express reference to R&D and training in Article 1106(4) should be inferred to mean that Article 1106(1) precludes these types of performance requirements.<sup>83</sup> This ignores the structure of Article 1106 and why it was necessary to make certain clarifications in Article 1106(4).

63. Article 1106 deals with two different sets of circumstances: performance requirements when imposed in connection with entry and operation (Article 1106(1)) and requirements imposed in connection with advantages, like subsidies and tax credits (Article 1106(3)). While Article 1106(4) clarifies that Article 1106(3) does not proscribe certain requirements, this does not mean *a contrario* these requirements are covered by Article 1106(1). The Claimants rely on the absence of the word "services" in Article 1106(3)(b) to infer that Article 1106(1)(c) must therefore include R&D and E&T requirements.<sup>84</sup> However, since R&D and E&T can be provided as a service, the absence is not decisive as to whether the R&D and E&T requirements in the Guidelines compel the provision of a service by a domestic provider.

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<sup>83</sup> Claimants' Reply Memorial, ¶¶ 40-45.

<sup>84</sup> Claimants' Reply Memorial, ¶¶ 43-44.

64. A more compelling reading of Article 1106(4) comes from its context. Incentives to carry out R&D in the territory of a host State were and remain far more common than mandatory requirements.<sup>85</sup> At the time of the NAFTA negotiations (and still today), Canada and the United States offered R&D tax credits.<sup>86</sup> Subsidies for R&D were an unsettled issue at the Uruguay Round negotiations (which the Claimants correctly note were contemporaneous with NAFTA negotiations<sup>87</sup>), which risked conflicting obligations with respect to R&D subsidies between the NAFTA and the WTO subsidy agreement.<sup>88</sup> In light of this risk and the lack of a general discipline on subsidies in the NAFTA,

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<sup>85</sup> **RA-67**, Foreign Direct Investment and Performance Requirements, p. 28-29 (“[E]fforts by developed countries to impose local R&D requirements as a condition of entry have been used [...] Mandatory applications of R&D requirements, however, appear to be rare.”).

<sup>86</sup> See **RA-99**, G. Kleinfeld and D. Kaye, “Red Light, Green Light? The 1994 Agreement on Subsidies and Countervailing Measures, Research and Development Assistance, and U.S. Policy,” *Journal of World Trade*, vol. 28, December 1994, No. 6; **RA-106**, F. Moris, The U.S. Research & Experimentation Tax Credit in the 1990s, InfoBrief, National Science Foundation (Jul. 2005); **RA-93**, J.R. Hines, “No Place Like Home: Tax Incentives and the Location of R&D By American Multinationals”, Working Paper No. 4574, National Bureau of Economic Research, December 1993; **RA-92**, R. Hamilton, “Tax Incentives and Innovation: The Canadian Treatment of R&D”, 19 *Can.-U.S. L.J.* 233, 1993.

<sup>87</sup> Claimants’ Reply Memorial, ¶ 28.

<sup>88</sup> At the time of the NAFTA negotiations, there was still uncertainty as to what form R&D subsidies would be covered by the WTO Agreement on Subsidies and Countervailing Measures (“SCM Agreement”). See **RA-121**, Terence P. Stewart, *The GATT Uruguay Round: A Negotiating History (1986-1994), Vol. IV: The End Game (Part I)*, (Kluwer: 1999), p. 221 (“On December 20, 1991, the ‘Draft Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations,’ otherwise known as the ‘Dunkel Text’ was tabled at Geneva. From that date to December 1992, a legal drafting group...made technical changes to the Dunkel Text...[h]owever, no further substantive negotiations on the Dunkel Text were undertaken during 1992.”). The Dunkel Text provisions relating to non-actionable subsidies (“green light”) included “assistance for research activities conducted by firms or by higher education or research establishments on a contract basis with firms.” See **RA-120**, Terence P. Stewart, *The GATT Uruguay Round: A Negotiating History (1986-1994), Vol. I: Commentary*, (Kluwer: 1993), pp. 910-912. Research subsidies were eventually covered as non-actionable under the 1994 SCM Agreement Article 8. **RA-133**, World Trade Organization, *The Legal Texts: The Results of the Uruguay Round of Multilateral Trade Negotiations* (Cambridge: 1999), pp. 239-242.

including R&D in Article 1106(4) removed any doubt that it was permitted to condition the receipt of an advantage on the performance of R&D in the territory.<sup>89</sup>

**8. The NAFTA Negotiating Texts and Canada's *Investment Canada Act* Reservation Confirms Canada's Interpretation of Article 1106(1)(c)**

65. The Claimants submit that the NAFTA negotiating drafts and Canada's Annex I reservation regarding the *Investment Canada Act* ("ICA Reservation") support their argument that Article 1106(1)(c) prohibits a requirement for R&D to be carried out and E&T to be provided in the province.<sup>90</sup> This is incorrect. They support Canada's interpretation of Article 1106(1)(c), as well as the "belt and suspenders" approach to clarifications and Annex I reservations.

66. The Claimants have noted that in the July 10, 1992 NAFTA negotiating draft, Canada proposed language to follow what eventually became Article 1106(1):

*CDA*[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.*]<sup>91</sup>

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<sup>89</sup> The risk of conflicting obligations between NAFTA and the WTO subsidies agreement is evident in the NAFTA negotiating texts. In the June 15, 1992 negotiating draft, there was no reference to R&D in the provision that would become Article 1106(4), but there was a provision to permit subsidies consistent with GATT (s. 4(3)), **RA-114**, NAFTA Chapter 11, Trilateral Negotiating Draft Text, Doc. No. INVEST.615, 15 June 1992, p. 10, ss. 3, 4(c). The reference to R&D was inserted into the July 10, 1992 negotiating text and the GATT subsidies provision remained, **CA-75**, NAFTA, Chapter 11, Trilateral Negotiating Draft Text, Doc. No. INVEST.710, p. 11, ss. 3, 4(b) (hereinafter "July 1992 Negotiating Draft"). In the August 11, 1992 negotiating draft, the R&D reference remained in the article that would become Article 1106(4) and the GATT subsidies provision was removed, **CA-77**, NAFTA Chapter 11, Trilateral Negotiating Draft Text, Doc. No. INVEST.811, 11 August 1992, p. 8, s. 4 (hereinafter "August 1992 Negotiating Draft").

<sup>90</sup> Claimants' Reply Memorial, ¶ 38-39.

<sup>91</sup> Emphasis added. **CA-75**, July 1992 Negotiating Draft, s. 1.2, pp. 10-11.

67. This text was dropped in the August 11, 1992 negotiating draft, so the Claimants seek an inference that the “similar” text Canada included in its ICA Reservation must therefore mean that R&D and training is prohibited by Article 1106(1)(c).<sup>92</sup>

68. The Claimants fail to notice that the text and meaning of the ICA Reservation is very different to what was proposed in the NAFTA negotiating text. The NAFTA negotiating draft uses the phrase “[n]otwithstanding [Article 1106(1)], a Party may *nonetheless...*” The term “notwithstanding” means that an exception is being made to an obligation. This meaning is confirmed by Paragraph 11 of the ICA Reservation:

11. *Notwithstanding Article 1106(1)*, Canada may impose requirements, or enforce any commitment or undertaking, in connection with the establishment, acquisition, expansion, conduct or operation of an investment of an investor of another Party or of a non-Party for the transfer of technology, production process or other proprietary knowledge to a national or enterprise, affiliated to the transferor, in Canada, in connection with the review of an acquisition of an investment under the Investment Canada Act.<sup>93</sup>

69. The term “notwithstanding Article 1106(1)” is used to recognize that a technology transfer requirement is explicitly precluded by Article 1106(1)(f).<sup>94</sup>

70. In contrast, the ICA Reservation uses very different language from paragraph 11 and the NAFTA negotiating text with respect to R&D and training requirements.

Paragraph 12 of the ICA Reservation states:

12. Except for the requirements, commitments or undertakings related to technology transfer as set out in paragraph 11, Article 1106(1) shall apply to requirements, commitments or undertakings imposed or enforced under the Investment Canada Act. Article

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<sup>92</sup> Claimants' Reply Memorial, ¶ 51.

<sup>93</sup> CA-7, NAFTA, Annex I, Schedule of Canada, exception for Investment Canada Act et al., ¶ 12. Emphasis added.

<sup>94</sup> Article 1106(1)(f) precludes the imposition or enforcement of requirements “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.”

1106(1) *shall not be construed* to apply to any requirement, commitment or undertaking imposed or enforced in connection with a review under the Investment Canada Act, to locate production, carry out research and development, employ or train workers, or to construct or expand particular facilities, in Canada.<sup>95</sup>

71. Hence, instead of an exception to an obligation – “notwithstanding” – the term “shall not be construed” is used to ensure there is no doubt that a certain provision should not to be interpreted in a particular way. By using this phrase, paragraph 12 of the ICA Reservation confirms that Article 1106(1) does *not* preclude a requirement to carry out R&D or provide training in the host State’s territory.

72. Accordingly, the only reasonable inferences that can be drawn from the NAFTA negotiating text and the ICA Reservation are: (i) 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);<sup>96</sup> and (ii) Canada wanted to make certain that there was no doubt on the issue with respect to the Investment Canada Act, so it included a specific statement that Article 1106(1) should not be construed to mean something that it does not.<sup>97</sup>

73. In general, Canada cautions against drawing inferences from the NAFTA preparatory work because it requires the Tribunal to make assumptions about what was in the minds of the treaty makers that are not actually accessible to the Tribunal.

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<sup>95</sup> CA-7, NAFTA, Annex I, Schedule of Canada, exception for Investment Canada Act et al., ¶ 12. Emphasis added.

<sup>96</sup> The August 1992 negotiating draft version of Article 1106(5) stated “The provisions of paragraphs 1 [1106(1)] or 3 [1106(3)] shall not apply to any requirements other than those listed in those paragraphs.” CA-77, NAFTA Chapter 11, Trilateral Negotiating Draft Text, Doc. No. INVEST.811, 11 August 1992, p. 9, s. 6.

<sup>97</sup> Mexico did something similar in its reservation for Article 1106 with respect to approval for certain foreign investments. In its reservation I-M-3 for the National Commission for Foreign Investment (Comisión Nacional de Inversiones Extranjeras), Mexico included in its description “The Comisión Nacional de Inversiones Extranjeras may impose performance requirements that are not prohibited by Article 1106.” In light of Article 1106(5), such a statement is unnecessary, but Mexico obviously wanted to ensure there would be no question about its ability to impose performance requirements not prohibited by Article 1106, RA-108, NAFTA, Annex I, Schedule of Mexico, pp. 2-3.

Furthermore, there may have been many reasons why certain language in various negotiating drafts was proposed, modified, changed or removed that in reality have nothing to do with the reasons advanced by disputing parties offering competing interpretations of the text. This is the reason why, as the Tribunal rightly noted in its decision on document production, that the Vienna Convention on the Law of Treaties places the highest priority on the ordinary meaning of the text of a treaty in its context and in the light of its object and purpose. Nevertheless, in this case the NAFTA negotiating history confirms Canada's interpretation.

**B. The Guidelines Fall Within the Scope of Canada's Annex I Reservation to Article 1106**

74. Even if the Guidelines are inconsistent with Article 1106, which they are not, they cannot breach that Article because they are reserved. Canada explained in its Counter Memorial that it expressly reserved the Accord Acts from the scope of Article 1106 by including them in Annex I of the Agreement. Canada also explained that by reserving the Accord Acts, Canada also reserved any subordinate measures, including subsequent measures such as the Guidelines.

75. The Claimants appear to accept that the Guidelines are subordinate to the Accord Acts.<sup>98</sup> However, they contend that they cannot be reserved because they were adopted after the NAFTA entered into force. According to the Claimants, the NAFTA reservation for measures subordinate to measures expressly listed in Annex I is confined to subordinate measures adopted before the NAFTA entered into force. The Claimants' interpretation is inconsistent with the ordinary meaning of the treaty in its context and the treaty's object and purpose.

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<sup>98</sup> In their Reply, the Claimants do not challenge that the Guidelines are subordinate to the Accord Acts and admit that "the Newfoundland Court of Appeal ... found that the Board acted within its authority in promulgating the Guidelines." Claimants' Reply Memorial, p. B-4, Annex B.

**1. The Ordinary Meaning of the Treaty in its Context Demonstrates that Subordinate Measures Adopted After the NAFTA Entered into Force are Reserved**

**a) In Annex I, Canada Reserved the Accord Acts and Subordinate Measures “Adopted or Maintained”**

76. Article 1108(1)(a)(i) reserves from the scope of Article 1106 any “existing non-conforming measure” listed in Annex I.<sup>99</sup> In that Annex, Canada listed the Accord Acts as an existing measure that is reserved from Article 1106. The phrase “existing non-conforming measure” in Article 1108(1)(a)(i) is partly defined by Article 2(f)(ii) of the Interpretative Note to Annex I.<sup>100</sup> That Article states that a listed measure:

includes any subordinate measure adopted or maintained under the authority of and consistent with the measure [that is expressly reserved].

77. Thus, by reserving the Accord Acts from the scope of Article 1106, Canada also reserved from the scope of the Article any subordinate measure adopted or maintained under the authority of, and consistent with, those Acts.

78. By extending the reservation in Annex I to both subordinate measures “adopted” and “maintained,” Article 2(f)(ii) of the Interpretative Note to the Annex reserves subordinate measures adopted after a particular date *and* measures maintained from

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<sup>99</sup> Canada explained in its Counter Memorial from ¶ 215 that Article 1108 must be interpreted according to Article 31 of the Vienna Convention on the Law of Treaties, that is, “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.” Canada explained that the Vienna Convention leaves no room for the restrictive interpretation of reservations or exceptions, as contended by the Claimants in their Memorial. The Claimants respond at fn. 99 of their Reply that “the maxim that exceptions to treaty obligations are construed restrictively ... qualifies as a supplemental means of interpretation under VCLT art. 32 ...” The Claimants provide no support for this assertion and it is inconsistent with the authorities to which Canada referred in its Counter Memorial, which explained that such a maxim has no role in treaty interpretation, whether through Article 31, 32 or otherwise. As explained by the investment treaty tribunal in *Aguas del Tunari*, “the Vienna Convention represents a move away from the canons of interpretation previously common in treaty interpretation and which erroneously persist in various international decisions today. For example, the Vienna Convention does not mention the canon that treaties are to be construed narrowly.” **RA-2, *Aguas del Tunari SA v. Bolivia*, (ICSID ARB/02/3) Decision on Respondent’s Objections to Jurisdiction, 21 October 2005, ¶ 91.**

<sup>100</sup> Thus, Article 2(f)(ii) of the Interpretative Note to Annex I is not mere “context” to the phrase “existing non-conforming measures” in Article 1108(1)(a)(i), as the Claimants allege in their Reply Memorial, ¶ 91.

before that date. While the Article does not expressly identify that date, the context demonstrates that it is the date the NAFTA entered into force. Thus, subordinate measures adopted after this date are reserved.

**b) The Reservation for Subsequent Continuations, Renewals and Amendments Confirms that Subordinate Measures Adopted After the NAFTA Entered Into Force are Reserved**

79. The context to the reservation in Article 1108(1)(a) for measures subordinate to those listed in Annex I includes the reservations in Articles 1108(1)(b) and (c). In both Articles, the parties agreed to reserve measures adopted after the NAFTA entered into force which are necessary for the proper administration of the listed measure. The parties agreed in Article 1108(1)(b) to reserve the subsequent “continuation or prompt renewal” of those measures.<sup>101</sup> Similarly, the parties agreed in Article 1108(1)(c) to reserve a subsequent “amendment” to a listed measure, so long as “the amendment does not decrease the conformity of the measure.”<sup>102</sup> 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. All are necessary to effectively maintain the measures listed under Annex I and all are reserved.

**c) Article 1108(1)(c) Confirms that Subordinate Measures Adopted After the NAFTA Entered into Force are Reserved**

80. The full text of Article 1108(1)(c), mentioned above, is:

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

an amendment to any non-conforming measure referred to in subparagraph (a) to the extent that the amendment does not

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<sup>101</sup> Article 1108(1)(b) states: “Articles 1102, 1103, 1106 and 1107 do not apply to ... the continuation or prompt renewal of any non-conforming measure referred to in subparagraph (a) ...”

<sup>102</sup> Article 1108(1)(c) states: “Articles 1102, 1103, 1106 and 1107 do not apply to ... 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.”

decrease the conformity of the measure, as it existed immediately before the amendment, with Articles 1102, 1103, 1106 and 1107.

81. Hence, as explained above, this “ratchet rule” reserves amendments to Annex I measures after the NAFTA entered into force, if the amendment does not decrease the conformity of the measure. To determine this conformity, the amendment is compared with the Annex I measure “as it existed immediately before the amendment.” Consequently, the rule requires a comparison between the amendment and the Annex I measure incorporating any continuations, renewals, amendments *and* subordinate measures since the NAFTA entered into force. This has been accepted by the Claimants. In their alternative submission that the Guidelines are an amendment, the Claimants compare the Guidelines with the Accord Acts *including* subordinate measures adopted after the NAFTA entered into force, such as the Terra Nova benefits decision.<sup>103</sup>

82. Consequently, the Claimants *include* subsequent subordinate measures in the Annex I listed measure for the purposes of deciding if an amendment conforms to that listed measure but seek to *exclude* them otherwise. The Claimants provide no justification for this distinction because there is none. The inclusion of subsequent subordinate measures in the Annex I listed measure when applying the ratchet rule confirms that they are included when the Annex I listed measure is examined in isolation.

**d) The Use of “Adopted or Maintained” in the NAFTA Demonstrates that Subordinate Measures Adopted After the NAFTA Entered into Force are Reserved**

83. The use of the phrase “adopted or maintained,” and its variations, in the NAFTA confirms that the phrase “adopted or maintained” in Article 2(f)(ii) of the Interpretative Note refers to measures adopted after the NAFTA entered into force and measures maintained from before that time. “Adopt or maintain,” “adopts or maintains,” “adopted or maintained,” and “adopting or maintaining” appear over 100 times in the

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<sup>103</sup> Claimants’ Memorial, ¶¶ 180-193; Claimants’ Reply Memorial, ¶¶ 106-110. The Claimants state that the Annex I listed measure to be compared with the Guidelines is “the Federal Accord Act and *every* subordinate measure adopted or maintained thereunder [emphasis added],” including subordinate measures adopted after the NAFTA entered into force, such as the decision approving the Terra Nova Benefits Plan.

Agreement.<sup>104</sup> *In every instance*, the temporal point of reference is the date the NAFTA entered into force. That is, in every instance, “adopted or maintained” and its variations refer to measures adopted after the NAFTA entered into force and measures maintained from before this date.

84. For example, the NAFTA reservation for cultural industries in Annex 2106 states:

... any measure *adopted or maintained* with respect to cultural industries ... shall be governed under this Agreement exclusively in accordance with the provisions of the Canada – United States Free Trade Agreement.<sup>105</sup>

<sup>104</sup> See Articles 302(4), 309(1), 309(3), 309(4), 312(1), 314, 315(1), 509(2), 603(3), 603(4), 604, 605, 607, 701(1), 702(3), 703(3), 705(7)(a), 714(2)(a), 803(3), 908(3)(a), 1001(1), 1005(2)(b), 1018(2), 1101(1), 1105(2), 1106(6), 1108(3), 1111, 1113(1)(b), 1114(1), 1201(1), 1206(3), 1210(1), 1210(5), 1211(1)(a)(ii), 1301(1)(a), 1301(1)(b), 1301(2), 1302(7)(d), 1303(1)(a), 1304(1), 1304(5)(c), 1305(2), 1401(1), 1409(2), 1410(1), 1501(1), 1704, 2005(4)(a), 2104(1), 2104(2)(c), 2104(3), 2104(4). See Annex 301.3, Section B – Mexican Measures, ¶ 2.(b); Annex 301.3, Section B – Mexican Measures, ¶ 4.(a); Annex 314 – Export Taxes – Mexico, ¶ 1; Annex 314 – Export Taxes – Mexico, ¶ 2; Appendix 300-A.1 Canada, *Used Vehicles*, ¶ 4(a)-(f); Appendix 300-A.2 Mexico, *Autotransportation Decree and Autotransportation Implementing Regulations*, ¶ 20; Appendix 300-A.2 Mexico, *Importation of Autotransportation Vehicles*, ¶ 21; Appendix 300-A.2 Mexico, *Used Vehicles*, ¶ 24(a)-(f); Appendix 300-A.2 Mexico, *Used Vehicles*, ¶ 25(a); Appendix 300-A.2 Mexico, *Import Licensing Measures*, ¶ 26; Annex 300-B, Textile and Apparel Goods, Section 5: Bilateral Emergency Actions (Quantitative Restrictions), ¶ 12; Annex 300-B, Appendix 2.4, Tariff Elimination on Certain Textile and Apparel Goods; Annex 300-B, Appendix 3.1, Administration of Import and Export Prohibitions, Restrictions and Consultation Levels – B. Trade between Mexico and the United States, ¶ 10; Annex 702.3 Intergovernmental Coffee Agreement; Annex 703.2 Market Access, Section A – Mexico and the United States, *Customs Duties and Quantitative Restrictions*, ¶ 3; Annex 703.2 Market Access, Section A – Mexico and the United States, *Customs Duties and Quantitative Restrictions*, ¶ 8; Annex 703.2 Market Access, Section A – Mexico and the United States, *Agricultural Grading and Marketing Standards*, ¶ 23; Annex 703.2 Market Access, Section B – Canada and Mexico, ¶ 7(b); Annex 803.3, Administration of Emergency Action Proceedings, Institution of a Proceeding, *Confidential Information*, ¶ 8; Annex 1603, Temporary Entry for Business Persons, Section D – Professionals, ¶ 6; Annex 2106 Cultural Industries, Annex I, Reservations For Existing Measures and Liberalization Commitments, ¶ 2(f)(i)-(ii); Annex I, Reservations For Existing Measures and Liberalization Commitments, I-C-7 to I-C-8; Annex III (Activities Reserved to the State) Schedule of Mexico, Section A – Activities Reserved to the Mexican State; Annex VII, Reservations, Specific Commitments and Other Items, Interpretative Note, ¶ 2(f)(ii); Annex VII, Reservations, Specific Commitments and Other Items, Interpretative Note, ¶ 4; Annex VII, Reservations, Specific Commitments and Other Items, Schedule of Canada, Section B, VII-C-2 to VII-C-3, ¶ 2; Annex VII, Reservations, Specific Commitments and Other Items, Schedule of Mexico, Section B, VII-M-17, ¶ 11. Also, all Annex II reservations except one (II-M-12) (that is, 28 of 29 reservations) provide that the Party “reserves the right to adopt or maintain any measure.”

<sup>105</sup> Emphasis added.

85. This provision obviously refers to measures adopted after the NAFTA entered into force and measures maintained from before this time. This temporal point of reference is just as obvious in Article 314:

... no Party may adopt or maintain any duty, tax or other charge on the export of any good to the territory of another Party, unless such duty, tax or charge is *adopted or maintained* on: (1) exports of any such good to the territory of all other Parties; and (2) any such good when destined for domestic consumption.<sup>106</sup>

86. The reference to measures adopted after the NAFTA entered into force and those maintained from before this time is just as obvious in the other 100 occasions that the phrase “adopted or maintained” and its variations appear in the Agreement. This temporal point of reference for the phrase is confirmed by the NAFTA drafting instructions:<sup>107</sup>

“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.”<sup>108</sup>

87. Hence, the NAFTA drafters were instructed to use “adopt” to refer to a “new” measure and “maintain” to refer to an “existing” measure. Since the NAFTA defines an “existing” measure as one “in effect on the date of entry into force of this Agreement,”<sup>109</sup> a “new” measure must be one adopted since this date.

88. There is no indication that the phrase “adopted or maintained” has a different meaning in Article 2(f)(ii) of the Interpretative Note. Thus, just like in the rest of the NAFTA, “measures adopted or maintained” in the Interpretative Note to the Annex must

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<sup>106</sup> Emphasis added.

<sup>107</sup> **RA-126**, Special Session of the Dispute Settlement Body, *Drafting Conventions – Contribution by the United States*, JOB(03)/2, 16 January 2003 (see *Conventions to be used in NAFTA texts*, 9 July 1992, p. 4, ¶ 6 and *Additional NAFTA Conventions*, 18 September 1992, p. 6).

<sup>108</sup> Emphasis added.

<sup>109</sup> **CA-2**, NAFTA, Article 201.

refer to measures adopted after the NAFTA entered into force and measures maintained from before this date.

**e) The Use of “Adopted” in isolation in the NAFTA Demonstrates that Subordinate Measures Adopted After the NAFTA Entered into Force are Reserved**

89. Rather than drawing on the use of the phrase “adopted or maintained” in the Agreement, the Claimants seek to draw support from the use of the word “adopted” in isolation. The Claimants note that Article 1108(4) uses the words “after the date of entry into force of this Agreement” immediately after the word “adopted.” They argue that the absence of these words after “adopted” in Article 2(f)(ii) of the Interpretative Note indicates an intention to restrict the measures to those adopted before the NAFTA entered into force.<sup>110</sup>

90. However, the Claimants overlook the NAFTA drafting instruction for the word “adopted” and the meaning of “adopted” throughout the NAFTA when it is coupled with “maintained,” described above.<sup>111</sup> The Claimants also overlook that in other articles aside from 1108(4), the phrase “after the date of entry into force of this Agreement” is not

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<sup>110</sup> Claimants’ Reply Memorial, ¶ 98.

<sup>111</sup> See Rejoinder, ¶¶ 83-88.

included immediately after the word “adopted” but that meaning is obvious.<sup>112</sup> By contrast, the Agreement does expressly state when the word “adopted” refers to measures adopted *before* the Agreement entered into force.<sup>113</sup>

**f) The Claimants' Arguments are Unavailing**

**i) The NAFTA Reserves Subordinate Measures Adopted After the Treaty Entered into Force Not Just Those Adopted After the Measure Listed in Annex I**

91. The Claimants accept that there is a distinction between a subordinate measure adopted and a subordinate measure maintained. They also accept that “adopted or

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<sup>112</sup> **RA-111**, NAFTA, Chapter 17, Article 1716(5) (“Each Party shall provide that where provisional measures are *adopted* by that Party's judicial authorities on an *ex parte* basis: (a) a person affected shall be given notice of those measures without delay but in any event no later than immediately after the execution of the measures; (b) a defendant shall, on request, have those measures reviewed by that Party's judicial authorities for the purpose of deciding, within a reasonable period after notice of those measures is given, whether the measures shall be modified, revoked or confirmed, and shall be given an opportunity to be heard in the review proceedings;”); **RA-111**, NAFTA, Chapter 17, Article 1718(4) (“Each Party shall provide that, where pursuant to an application under procedures *adopted* pursuant to this Article, its customs administration suspends the release of goods involving industrial designs, patents, integrated circuits or trade secrets into free circulation on the basis of a decision other than by a judicial or other independent authority, and the period provided for in paragraphs 6 through 8 has expired without the granting of provisional relief by the duly empowered authority, and provided that all other conditions for importation have been complied with, the owner, importer or consignee of such goods shall be entitled to their release on the posting of a security in an amount sufficient to protect the right holder against any infringement. Payment of such security shall not prejudice any other remedy available to the right holder, it being understood that the security shall be released if the right holder fails to pursue its right of action within a reasonable period of time;”); **RA-112**, NAFTA, Chapter 21, Article 2104(6) (“A Party imposing a restriction on cross-border trade in financial services: (a) may not impose more than one measure on any transfer, unless consistent with paragraph 2(c) and with Article VIII(3) of the Articles of Agreement of the IMF; and (b) shall promptly notify and consult with the other Parties to assess the balance of payments situation of the Party and the measures it has *adopted*, taking into account among other elements (i) the nature and extent of the balance of payments difficulties of the Party, (ii) the external economic and trading environment of the Party, and (iii) alternative corrective measures that may be available;”); *Id.*, Article 2104(7) (“In consultations under paragraph 6(b), the Parties shall: (a) consider if measures *adopted* under this Article comply with paragraph 3, in particular paragraph 3(c); and (b) accept all findings of statistical and other facts presented by the IMF relating to foreign exchange, monetary reserves and balance of payments, and shall base their conclusions on the assessment by the IMF of the balance of payments situation of the Party *adopting* the measures;”); *Id.*, Annex 2103.4 (“For purposes of Article 2103(4) (h), the listed tax is any excise tax on insurance premiums *adopted* by Mexico to the extent that such tax would, if levied by Canada or the United States, be covered by Article 2103(4) (d), (e) or (f).”).

<sup>113</sup> **RA-107**, NAFTA, Chapter 3 Annexes, Annex 304.2 (“For purposes of Article 304(2): ... as between Canada and the United States, Article 405 of the *Canada -United States Free Trade Agreement* is hereby incorporated and made a part of this Annex solely with respect to measures *adopted* by Canada or the United States prior to the date of entry into force of this Agreement ...”).

maintained” in Article 2(f)(ii) of the Interpretative Note to Annex I refers to measures adopted after a particular point in time and to measures maintained from before that time. However, they argue that the temporal frame of reference is not the date the NAFTA entered into force but the date of the measure listed in Annex I. Thus, the Claimants argue that subordinate measures “adopted” are those adopted after the listed measure and subordinate measures “maintained” are “subordinate measures ... put into place before the listed measure’s enactment and maintained thereafter under the authority of the provision ...”<sup>114</sup>

92. The Claimants’ interpretation is not only inconsistent with the context described above, it is also inconsistent with the ordinary meaning of Article 2(f)(ii) of the Interpretative Note. Ordinarily, a subordinate act refers to an act which is subsequent to the act to which it is subordinate. It is difficult to conceive how a measure enacted *before* a measure listed in Annex I could possibly be *under the authority* of that listed measure.

**ii) “Adopted or Maintained” is the Passive of  
“Adopt or Maintain,” Not the Past Tense**

93. The Claimants seek to draw support for their interpretation from the particular form of “adopt or maintain” used in Article 2(f)(ii) of the Interpretative Note. They argue that the Article uses the past tense, “*adopted* or *maintained*,” and that this indicates that it refers to past measures.<sup>115</sup> However, Article 2(f)(ii) of the Interpretative Note does not use the past tense. It uses the present tense in the passive form. The Article states:

A measure cited in the Measures element includes any subordinate measure adopted or maintained [by the Parties] under the authority of and consistent with the measure.

94. Many other NAFTA provisions also use this passive form of “adopt or maintain.” For example, Article 314 states:

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<sup>114</sup> Claimants’ Reply Memorial, ¶ 98.

<sup>115</sup> Claimants’ Reply Memorial, ¶¶ 94-96.

Except as set out in Annex 314, no party may *adopt or maintain* any duty, tax, or other charge on the export of any good to the territory of another Party, unless such duty, tax or charge is *adopted or maintained* on[:] a. exports of any such good to the territory of all other Parties; and b. any such good when destined for domestic consumption.<sup>116</sup>

95. The use of the phrase “adopt or maintain” to refer to the same actions as the phrase “adopted or maintained” demonstrates that “adopted or maintained” uses the passive form and not the past tense.

96. Another example is Article 1101(1), which describes the scope and coverage of Chapter 11:

This Chapter applies to measures *adopted or maintained* by a Party relating to:

- (a) investors of another Party;
- (b) investments of investors of another Party in the territory of the Party; and
- (c) with respect to Articles 1106 and 1114, all investments in the territory of the Party.<sup>117</sup>

97. Under the Claimants’ argument, the use of “*adopted or maintained*” in this Article signifies that Chapter 11 only applies to measures adopted or maintained before the NAFTA entered into force. This is obviously incorrect; “adopted or maintained” is clearly used in these circumstances as the passive form of “adopt or maintain.” The use of the same form in Article 2(f)(ii) of the Interpretative Note to Annex I is just as clear.

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<sup>116</sup> Emphasis added. See also **RA-107**, NAFTA, Chapter 3 Annexes, Annex 314 – Export Taxes – Mexico, ¶ 1 (“Mexico may adopt or maintain a duty, tax or other charge on the export of those basic foodstuffs set out in paragraph 4, on their ingredients or on the goods from which such foodstuffs are derived, if such duty, tax or other charge is adopted or maintained on the export of such goods to the territory of all other Parties ...”); **RA-112**, NAFTA, Chapter 21, Article 2104 (“A measure adopted or maintained under this Article shall avoid unnecessary damage to the commercial, economic or financial interests of another Party...”).

<sup>117</sup> Emphasis added. See also Articles 701(1), 1001(1), 1201(1), 1301(1) and 1401(1), which use the same formulation.

**iii) The Reservation for Subordinate Measures Adopted After the NAFTA Entered into Force is not Inconsistent with the Definition of “Existing Measures”**

98. The Claimants also seek to draw support for their interpretation from the use of the phrase “existing measures” in Article 2(f)(ii) of the Interpretative Note and in Article 1108(1)(a)(i).<sup>118</sup> They note that both Articles state that the reservation is for “existing measures.” They argue that because subordinate measures adopted after the NAFTA entered into force cannot be an “existing measure,” such subordinate measures cannot fall within the reservation.

99. However, the “existing measures” to which the two Articles refer are the measures expressly listed in Annex I, such as the Accord Acts. Article 2(f)(ii) of the Interpretative Note to Annex I defines those existing measures to include subordinate measures adopted after the NAFTA entered into force. Thus, Article 2(f)(ii) does not “implicitly create ... a contrary rule,” as alleged by the Claimants.<sup>119</sup> The Article expressly, and consistent with Article 1108(1)(a)(i), defines an “existing non-conforming measure” listed in Annex I as including future measures subordinate to that listed measure.

**iv) The Claimants Misunderstand Article 1108(4)**

100. Finally, the Claimants seek to draw support from Article 1108(4), which provides that “[n]o 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.” The Claimants note that “[w]hile future measures in a sector provided for in Annex II cannot, under Article 1108(4), cause an investor to sell or dispose of an existing investment, no such restriction would apply to future Annex

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<sup>118</sup> Claimants’ Reply Memorial, ¶¶ 93, 97.

<sup>119</sup> Claimants’ Reply Memorial, ¶ 91.

I subordinate measures having that effect.”<sup>120</sup> As a result, they argue that NAFTA Parties cannot have intended to reserve future subordinate measures under Annex I.

101. The Claimants ignore the difference between reservations in Annex I and Annex II. If a Party has taken an Annex II national treatment reservation in a particular sector but has liberalized foreign ownership restrictions in that sector after the entry into force of the NAFTA, a Party may nevertheless return to more restrictive foreign ownership rules. Article 1108(4) tempers the effect of this situation on an existing investment. However, this situation does not arise in the context of an Annex I reservation because of the “ratchet rule” set out in Article 1108(1)(c). Since amendments to Annex I measures are only permitted if they do not decrease the conformity of the listed measure with the NAFTA, a Party could not under Annex I amend its existing legislation or regulations to further limit foreign ownership after the entry into force of the NAFTA. Consequently, for Annex I reservations, there is no need for a provision similar to Article 1108(4).

**g) Summary**

102. Nothing in the Reply affects the conclusion compelled by the ordinary meaning of the treaty in its context. Article 1108(1)(a)(i) and Article 2(f)(ii) of the Interpretative Note to Annex I plainly state that the reserved measures listed in Annex I include subordinate measures “adopted or maintained.” The context to this text confirms that the reservation for subordinate measures which are adopted include those adopted after the Agreement entered into force. The context includes:

- the reservation for continuations, renewals and amendments to the listed measures adopted after the NAFTA entered into force;
- Article 1108(1)(c), which requires a comparison of any amendment to an Annex I listed measure after the NAFTA entered into force with the listed measure *immediately before the amendment*, including subsequent subordinate measures;

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<sup>120</sup> Claimants’ Reply Memorial, ¶ 103.

- the use of “adopted or maintained” over one hundred times in the Agreement to refer to measures adopted after the NAFTA entered into force and measures maintained from before that date; and
- the consistent use of “adopted” in the Agreement to refer to measures adopted after the NAFTA entered into force.

103. The meaning compelled by this context is confirmed by the object and purpose of the NAFTA.

**2. The Object and Purpose of the NAFTA Confirms that Subordinate Measures Adopted After the NAFTA Entered into Force are Reserved**

**a) Reserving Subordinate Measures Adopted After the NAFTA Entered into Force is Essential to the Maintenance of Annex I Measures**

104. The NAFTA parties only agreed to undertake the ambitious commitments in the Agreement if they could retain certain flexibility in sensitive areas. For example, the parties carved out sensitive areas from certain NAFTA obligations, such as through the exception for procurement in Article 1108(7)(a).<sup>121</sup> Similarly, each party reserved country-specific sensitive areas in the seven Annexes to the Agreement.

105. In the investment and services chapters, the parties retained flexibility in sensitive areas by listing in Annex I measures that existed at the time the Agreement entered into force which would be reserved from specific obligations. While the measures reserved in Annex I existed at the time that the NAFTA entered into force, their reservation did not mean that the NAFTA parties were forced to freeze the measure at that date. As explained above,<sup>122</sup> the parties agreed in Article 1108(1)(b) to reserve the subsequent “continuation or prompt renewal” of those measures. Similarly, the parties agreed in Article 1108(1)(c) to reserve a subsequent “amendment” to a listed measure, so long as

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<sup>121</sup> Article 1108(7)(a) states: “Articles 1102, 1103 and 1107 do not apply to: procurement by a Party or a state enterprise ...”.

<sup>122</sup> Rejoinder, ¶ 79.

“the amendment does not decrease the conformity of the measure.” Finally, the parties agreed in the Interpretative Note to Annex I to reserve a subsequent measure that is subordinate to a listed measure.

106. Canada explained in its Counter Memorial that a party cannot effectively maintain a measure without adopting measures subordinate to it.<sup>123</sup> The importance of subordinate measures is evident from any administrative law textbook. For example, a leading Canadian text explains that subordinate measures include “ordinances, regulations, rules, codes, by-laws, and sometimes even directives and policies.”<sup>124</sup> The text explains that such subordinate measures are important because “[t]he technical nature of much government activity requires that only broad principles or a basic legislative framework can be contained in some Acts.” The text also explains that “[t]he power to delegate to an administrator allows greater flexibility in applying statutory provisions to changing circumstances.”<sup>125</sup> Thus, subordinate measures are essential to clarify ambiguities in the main measure and to apply it to circumstances which were not foreseen when it was drafted.

107. The importance of subordinate measures is recognized in the Accord Acts. Section 151.1(1) states: “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.” The Board has subsequently relied on this authority to issue over twenty guidelines.<sup>126</sup> The Board’s extensive use of guidelines to administer the Accord Acts illustrates that reserving measures subordinate to those listed in Annex I, but which are adopted after the NAFTA entered into force, is essential to ensure that the NAFTA parties can effectively maintain those listed measures.

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<sup>123</sup> Counter Memorial, ¶ 232.

<sup>124</sup> **RA-98**, David Phillip Jones and Anne S. de Villars, *Principles of Administrative Law*, 3<sup>rd</sup> ed. (Carswell: 1999), p. 95 (hereinafter “Jones”).

<sup>125</sup> *Id.*, p. 91.

<sup>126</sup> Counter Memorial, ¶ 30.

**b) The Strict Limits on Subordinate Measures Prevent Their Abuse**

108. While the NAFTA allows subsequent subordinate measures, along with continuations, renewals and amendments, to maintain the measures listed in Annex I, the Agreement prevents their abuse through strict limits. Article 2(f)(ii) of the NAFTA defines subordinate measures exclusively as a measure “adopted or maintained *under the authority of and consistent with* the [listed] measure.”<sup>127</sup> Hence, any measure that is not authorized by, or consistent with, the measure listed in Annex I cannot be reserved.

109. Moreover, a subsequent subordinate measure will only be reserved if it falls within the narrow reservation created for the measure listed in Annex I. A subordinate measure cannot be reserved from an obligation from which the listed measure was not reserved. For example, if the listed measure is only reserved from the national treatment obligation in Article 1102, then the subordinate measure can also only be reserved from that obligation. In addition, since only the “non-conforming” aspects of the listed measure are reserved, a subordinate measure will not be reserved if it addresses an aspect of the listed measure that conforms to the NAFTA. For example, if a NAFTA party has described the non-conforming aspect of its measure under the “Description” heading in Annex I, only subordinate measures which address that aspect of the measure will be reserved.

110. The Claimants overlook these limits when they argue that Canada’s interpretation cannot be reconciled with the object and purpose of the NAFTA.<sup>128</sup> The Claimants argue that “[u]nder Canada’s reading, any Party can, at any time, undo the difficult compromises made in the schedules to Annex I simply by putting in place a more restrictive measure that happens to be of a lower order than that listed in the schedule.”<sup>129</sup> However, the Claimants overlook that a more restrictive measure will not be adopted under the authority of and consistent with the expressly listed measure and, therefore,

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<sup>127</sup> Emphasis added.

<sup>128</sup> Claimants’ Reply Memorial, ¶ 99.

<sup>129</sup> Claimants’ Reply Memorial, ¶ 100. See also Claimants’ Reply Memorial, ¶ 92.

will not be a subordinate measure which is reserved. They also overlook that the more restrictive measure may not fall within the narrow reservation for the listed measure.

111. The Claimants also overlook these limits when they argue that the reservation for subordinate measures adopted after the NAFTA entered into force cannot be reconciled with the division between Annex I and Annex II.<sup>130</sup> Annex II reserves all existing and future measures in entire sectors, such as “health care.”<sup>131</sup> Reserving *only those future measures authorized by and consistent with the non-conforming aspects of the Annex I listed measures* is nothing like a reservation for *all future measures in a particular sector*.

112. The Claimants are also wrong when they argue that “Canada’s reading” will “destroy predictability in the framework of business and investments to which a measure listed in a Schedule to Annex I applies.”<sup>132</sup> It is not unpredictable for a country to adopt a measure which a previous measure authorizes it to adopt. Indeed, any investor to which a measure listed in a schedule to Annex I applies is able to review that measure and identify the future subordinate measures which it authorizes. Thus, the investor can determine the future measures to which it will be subject.

113. Contrary to the Claimants’ assertions, there is nothing “absurd” or “unreasonable” about Canada’s interpretation.<sup>133</sup> The Claimants are incorrect when they state that “any provincial measure below the constitutional level (and therefore subordinate) adopted at any point in time would be exempt from national treatment, most-favored-nation treatment, and other obligations pursuant to Article 1108(1).” Annex I only reserves “existing *non-conforming* measures of the provinces ...”<sup>134</sup> Existing provincial measures

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<sup>130</sup> Claimants’ Reply Memorial, ¶ 101.

<sup>131</sup> See CA-74, NAFTA, Annex II, Schedule of Canada, Annex II-C-9.

<sup>132</sup> Claimants’ Reply Memorial, ¶ 100.

<sup>133</sup> Claimants’ Reply Memorial, ¶ 103.

<sup>134</sup> RE-11, Government of Canada exchange of letters with other NAFTA Parties (Mar. 29, 1996).

at the constitutional level conform with the Chapter 11 obligations and, consequently, are not reserved and neither are measures subordinate to them.

114. Hence, the Claimants consistently overlook the limits on the reservation for subordinate measures when they argue that the reservation for those adopted after the NAFTA entered into force is inconsistent with the object and purpose of the Agreement. By confining subordinate measures to those consistent with, and adopted under the authority of, the non-conforming aspect of the existing measure listed in Annex I, the NAFTA prevents the parties from relying on future subordinate measures to avoid their obligations. Indeed, far from inconsistent with the NAFTA's object and purpose, Canada's interpretation is compelled by it. Only if such measures are reserved can the NAFTA parties maintain the measures which they expressly reserved in Annex I.<sup>135</sup>

### 3. Summary

115. The object and purpose of the NAFTA confirms the interpretation compelled by the ordinary meaning of the treaty in its context: the reservation for existing non-conforming measures listed in Annex I also includes subordinate measures, even if they

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<sup>135</sup> At ¶ 105 of their Reply Memorial, the Claimants seek to draw support from decisions of panels under the General Agreement on Tariffs and Trade ("GATT"). Those decisions are irrelevant. They interpreted protocols of accession to the GATT which are very different to Chapter 11 of the NAFTA and which reflect a different bargain between the parties. In *Spain – Soyabean Oil*, the panel interpreted Spain's 1963 protocol of accession of 1963 to the GATT, which stated that Spain would apply Part II of the GATT only "to the fullest extent not inconsistent with its legislation existing on the date of the Protocol." **CA-115**, *Spain – Measures concerning Domestic Sale of Soybean Oil*, GATT Panel Report, L/5142 (unadopted) (17 June 1981), ¶ 3.14. Similarly, the panel in *Norway – Apples and Pears* interpreted ¶ 1(b) of the Protocol of Provisional Application of the General Agreement of 30 October 1947, according to which the signatory contracting parties undertake to apply Part II of the GATT "to the fullest extent not inconsistent with existing legislation." **CA-106**, *Norway – Restrictions on Imports of Apples and Pears*, GATT Panel Report, L/6474 – 36S/306 (22 June 1989) (hereinafter "*Norway – Apples and Pears*"), ¶ 5.1, 5.5 ("The Panel noted in the first place that paragraph 1(b) of the Protocol served a well determined purpose in a particular historical situation. It was to enable, in 1947, governments to accept the obligations of Part II of the General Agreement without having to adjust their domestic legislation. The drafters of the Protocol expected the General Agreement to be superseded soon by the ITO Charter and they felt that legislative changes should not be required at that time because such changes would have delayed the acceptance of the obligations under the General Agreement and could have prejudged the outcome of the negotiations on the Charter. In the light of this purpose of the existing legislation clause, the Panel considered that it would not be justified to give this clause four decades after the entry into force of the Protocol an interpretation that would extend its functions beyond those it was originally designed to serve.").

are adopted after the NAFTA entered into force. Consequently, the Guidelines, which are subordinate to the Accord Acts, are also reserved from Article 1106.

**C. The Guidelines Do Not Amend the *Accord Acts* and Benefits Decisions But, if They Do, They are Still Reserved From Article 1106**

116. In their Reply, the Claimants continue to accept that the Guidelines do not amend the benefits regime.<sup>136</sup> Hence, they continue to accept that the Guidelines are not subject to the “ratchet rule” in Article 1108(1)(c).<sup>137</sup> Canada agrees.<sup>138</sup>

117. Nevertheless, the Claimants continue to assert that, in the alternative that the Guidelines are an amendment to the benefits regime, they fail the test contained in that Article. Specifically, the Claimants assert that the Guidelines decrease the conformity of the benefits regime with Article 1106(1)(c). To support this assertion, the Claimants list features of the Guidelines which they allege decrease the conformity of the benefits regime with Article 1106(1)(c).

118. However, Article 1106(1)(c) proscribes 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.” Thus, to prove that the features of the Guidelines which they challenge decrease the conformity of the benefits regime with Article 1106(1)(c), the Claimants must identify how these features increase a requirement to purchase, use or accord a preference to domestic goods or services. In neither their Memorial, nor their Reply, have the Claimants undertaken this step. Since the Claimants have not explained how the Guidelines are inconsistent with Article 1108(1)(c), their argument based on this Article must fail.

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<sup>136</sup> Claimants’ Reply Memorial, from ¶ 106.

<sup>137</sup> Article 1108(1)(c) states: “Articles 1102, 1103, 1106 and 1107 do not apply to ... 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.”

<sup>138</sup> Counter Memorial, ¶ 239.

119. Indeed, it is difficult to conceive how the Claimants could establish that the features of the Guidelines which they challenge are inconsistent with Article 1108(1)(c). The Claimants challenge the requirement to expend a certain percentage of revenues on R&D and E&T in NL but, as explained in the Counter Memorial, this requirement is consistent with the Claimants' obligation under the Accord Acts and benefits plan decisions to expend on such R&D and E&T and report those expenditures to the Board.<sup>139</sup>

120. The Claimants also challenge the administrative features of the Guidelines. For example, they complain that the “[p]roject operator must seek pre-approval of each R&D expenditure that it plans to undertake”<sup>140</sup> and complain of “detailed accounting of R&D/E&T expenditures” “[a]t the end of each ... POA period ....”<sup>141</sup> However, such administrative features cannot decrease the conformity of the benefits regime with Article 1106(1)(c); they have nothing to do with the purchase, use or accordance of a preference to local goods or services.

121. The Claimants also continue to challenge the Statistics Canada data on which the Guidelines benchmark is based. The Claimants' criticisms of the data are not only unfounded<sup>142</sup> but also have nothing to do with the purchase, use or accordance of a preference to local goods or services.

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<sup>139</sup>Counter Memorial, ¶¶ 131-141.

<sup>140</sup> Claimants' Reply Memorial, ¶ 107.

<sup>141</sup> Claimants' Reply Memorial, ¶ 107.

<sup>142</sup> The Claimants argue at p. A-19 of their Reply Memorial, that the average R&D spending by oil extracting companies in Canada compiled by Statistics Canada is inaccurate because, when a company completes its survey on its R&D expenditures, it does not know how much of that reported expenditure will qualify as SR&ED. However, the Statistics Canada figure is the average R&D expenditures by oil companies in Canada; it is not the average R&D expenditures accepted for SR&ED. Thus, the percentage of reported expenditures which qualify for SR&ED is irrelevant to the accuracy of that average. It is also irrelevant to the suitability of the figure as a benchmark in the Guidelines since eligible R&D under the Guidelines is not restricted to that which qualifies for SR&ED, see Smyth Statement II, ¶ 4.

### III. THE GUIDELINES DO NOT BREACH ARTICLE 1105

122. The Claimants maintain that the Guidelines breach Article 1105 of the NAFTA because they were inconsistent with the Claimants' legitimate expectations. However, the Claimants have still failed to establish that the customary international law minimum standard of treatment requires the protection of legitimate expectations. They have still provided no evidence that either state practice or *opinio juris* supports this requirement. Indeed, the NAFTA Chapter 11 decision in *Cargill* – released since the Claimants submitted their Reply – held that the customary international law minimum standard of treatment has not evolved from the “shocking and egregious” standard described in *Neer*.

123. Even if the Claimants have, somehow, proven a customary international law requirement to protect legitimate expectations, they have failed to prove that the Guidelines were inconsistent with those expectations. As concluded by Canadian courts, the Guidelines are consistent with the Accord Acts and the Board decisions approving the Benefits Plans.

#### A. The Claimants Have Still Not Proven that the Customary International Law Minimum Standard of Treatment Requires the Protection of Legitimate Expectations

##### 1. The Claimants Have Still Not Proven that the Standard has Evolved From *Neer*

##### a) *Glamis* Held that a Breach of the Standard Requires an Act that is “Sufficiently Egregious and Shocking”

124. In its Counter Memorial, Canada described the most recent NAFTA Chapter 11 decision, at that time, to address the meaning of Article 1105. Canada explained that *Glamis* held that it had not been proven that the customary international law standard had changed from that described in the 1926 *Neer* decision:

[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 ...<sup>143</sup>

125. While the tribunal endorsed the “egregious and shocking” standard, it accepted that what is “egregious and shocking” has developed since 1926.<sup>144</sup> According to the tribunal, “[t]he 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.”<sup>145</sup> Consequently, *Glamis* did not hold that the customary international law standard has been “frozen in amber” since 1926, as alleged by the Claimants.<sup>146</sup>

126. The Claimants denounce *Glamis* as an “inexplicable departure” from existing jurisprudence.<sup>147</sup> However, the *Glamis* decision on Article 1105 was confirmed in the recently published NAFTA Chapter 11 decision of *Cargill v Mexico*.

**b) *Cargill* Confirms that a Breach of the Standard Requires an Act that is “Sufficiently Egregious and Shocking”**

127. Like the tribunal in *Glamis*, the *Cargill* tribunal began by confirming that “where a custom is not clear, or is disputed, then it is for the party asserting the custom to establish the content of that custom.”<sup>148</sup> According to *Cargill*:

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<sup>143</sup> CA-32, *Glamis Gold, Ltd. v. United States of America*, (UNCITRAL) Award, 16 May 2009, ¶ 627 (hereinafter “*Glamis*”), quoted in Counter Memorial, ¶ 247.

<sup>144</sup> *Id.*, ¶ 613 (“The Tribunal finds apparent agreement that the fair and equitable treatment standard is subject to the first type of evolution: a change in the international view of what is shocking and outrageous.”).

<sup>145</sup> *Id.*, ¶ 616.

<sup>146</sup> Claimants’ Reply Memorial, ¶ 116.

<sup>147</sup> For example, see Claimants’ Reply Memorial, ¶ 113 (“That much-criticized decision represents an inexplicable departure from a substantial body of arbitral jurisprudence and should not influence the outcome of this case.”).

<sup>148</sup> RA-84, *Cargill, Incorporated v. United Mexican States*, (ICSID ARB(AF)/05/2) Award, 18 September, 2009, ¶ 271 (hereinafter “*Cargill*”).

The burden of establishing any new elements of this custom is on Claimant. The Tribunal acknowledges that the proof of change in a custom is not an easy matter to establish. However, the burden of doing so falls clearly on Claimant. If Claimant does not provide the Tribunal with the proof of such evolution, it is not the place of the Tribunal to assume this task. Rather the Tribunal, in such an instance, should hold that Claimant fails to establish the particular standard asserted.<sup>149</sup>

128. *Cargill* went on to reject the argument that bilateral investment treaty clauses which require an autonomous standard of fair and equitable treatment, not limited by customary international law, provide evidence of customary international law.<sup>150</sup> The tribunal said that “significant evidentiary weight should not be afforded to autonomous clauses inasmuch as it could be assumed that such clauses were adopted precisely because they set a standard other than that required by custom.”<sup>151</sup> The tribunal also considered the number of treaties which contain a provision that requires fair and equitable treatment but noted that States are beginning to renegotiate that provision. According to the tribunal, “[i]n such a fluid situation, the Tribunal does not believe it prudent to accord significant weight to even widespread adoption of such clauses.”<sup>152</sup>

129. *Cargill* also rejected an argument, similar to that raised by the Claimants in this arbitration,<sup>153</sup> that arbitral awards provide evidence of custom: “the awards of international tribunals do not create customary international law but rather, at most, reflect customary international law.”<sup>154</sup> The tribunal further noted that awards are only relevant “if the fair and equitable treatment clause of the BIT in question was viewed by the Tribunal as involving, like Article 1105, an incorporation of the customary

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<sup>149</sup> *Id.*, ¶ 273.

<sup>150</sup> Claimants' Reply Memorial, ¶ 130.

<sup>151</sup> **RA-84**, *Cargill*, ¶ 276.

<sup>152</sup> *Id.*, ¶ 276.

<sup>153</sup> Claimants' Reply Memorial, ¶ 131.

<sup>154</sup> **RA-84**, *Cargill*, ¶ 277.

international law standard rather than autonomous treaty language.”<sup>155</sup> As Canada explained in its Counter Memorial,<sup>156</sup> the majority of the awards on which the Claimants rely are irrelevant because they are based on, and interpret, a provision which does not incorporate the customary international law standard.

130. The *Cargill* tribunal cautioned that “the evidentiary weight to be afforded [arbitral awards] ... is greater if the conclusions therein are supported by evidence and analysis of custom.”<sup>157</sup> As Canada explained in its Counter Memorial,<sup>158</sup> none of the awards on which the Claimants rely contain such evidence or analysis.

131. After rejecting the same arguments as those raised by the Claimants in this case, *Cargill*, like *Glamis*, held that the claimant failed to prove that the articulation of the customary international law standard of treatment had changed from that in *Neer*:

The Tribunal holds that the current customary international law standard of “fair and equitable treatment” at least reflects the adaptation of the agreed *Neer* standard to current conditions ... If the conduct of the government toward 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.<sup>159</sup>

**c) Previous NAFTA Tribunals Have Applied a Similar Standard to that Endorsed in *Glamis* and *Cargill***

132. Many of the NAFTA tribunals which have not used the precise words from *Neer* have endorsed a similar standard. Indeed, the *Cargill* tribunal noted:

... a trend in previous NAFTA awards, not so much to make the

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<sup>155</sup> *Id.*, ¶ 278.

<sup>156</sup> Counter Memorial, ¶¶ 259-263.

<sup>157</sup> RA-84, *Cargill*, ¶ 277.

<sup>158</sup> Counter Memorial, ¶¶ 265-267.

<sup>159</sup> RA-84, *Cargill*, ¶ 286.

holding of the *Neer* arbitration more exacting, but rather to adapt the principle underlying the holding of the *Neer* arbitration to the more complicated and varied economic positions held by foreign nationals today. Key to this adaptation is that, even as more situations are addressed, the required severity of the conduct as held in *Neer* is maintained.<sup>160</sup>

133. The Claimants cite a number of NAFTA decisions to support their position that *Glamis* (and now *Cargill*) did not properly describe the customary international law minimum standard of treatment. However, the majority of the cases on which they rely provide no such support.

134. The Claimants rely on *Thunderbird*, but that decision merely recognized the “evolution of customary law since decisions such as *Neer Claim* in 1926.”<sup>161</sup> This evolution is reflected in the fact that what was egregious and shocking in 1926 is different to what is egregious and shocking today. Indeed, *Thunderbird* went on to recognize that “the threshold for finding a violation of the minimum standard of treatment still remains high.” It said that “acts that would give rise to a breach of the minimum standard of treatment ... amount to a gross denial of justice or manifest arbitrariness ...”<sup>162</sup> The concentration on a *gross* denial of justice and *manifest* arbitrariness demonstrates that the tribunal’s articulation of the standard is consistent with *Neer*, as recognized in *Cargill*.<sup>163</sup>

135. The Claimants rely on *Methanex* but cite to no particular paragraph because none exists. The *Methanex* tribunal merely held that discrimination, on its own, is not a breach

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<sup>160</sup> *Id.*, ¶ 284.

<sup>161</sup> **CA-33**, *International Thunderbird Gaming Corporation v. United Mexican States*, (UNCITRAL) Award, 26 January 2006, ¶ 194 (hereinafter “Thunderbird”).

<sup>162</sup> *Id.*, cited in Claimants’ Reply Memorial, fn. 137.

<sup>163</sup> **RA-84**, *Cargill*, ¶ 285.

of the customary international law minimum standard of treatment and relied on this conclusion to dismiss the claim.<sup>164</sup>

136. The Claimants refer to an innocuous paragraph in *Loewen* which merely acknowledges that a denial of justice is a breach of the customary international law minimum standard of treatment.<sup>165</sup> Indeed, a subsequent NAFTA tribunal held that the decision is consistent with *Neer*.<sup>166</sup>

137. The Claimants rely on the following passage in *Waste Management*:

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 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.<sup>167</sup>

138. However, as recognized in *Cargill*, by using the words “gross,” “manifest,” and “complete,” the *Waste Management* tribunal did not “make the holding of the *Neer* arbitration more exacting, but rather ... adapt[ed] the principle underlying the holding of the *Neer* arbitration to the more complicated and varied economic positions held by foreign nationals today.”<sup>168</sup>

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<sup>164</sup> **RA-28**, *Methanex Corporation v. United States of America*, (UNCITRAL) Final Award, 3 August 2005, Part IV, Chapter C, ¶¶ 14-17, cited in Claimants’ Reply Memorial, fn. 137.

<sup>165</sup> **RA-26**, *The Loewen Group Inc. and Raymond Loewen v. United States of America*, (ICSID ARB(AF)-98/3) Award on the Merits, 26 June 2003, ¶ 133, cited in Claimants’ Reply Memorial, fn. 137.

<sup>166</sup> **RA-104**, *Merrill & Ring*, ¶ 198.

<sup>167</sup> **CA-51**, *Waste Management, Inc. v. United Mexican States*, (ICSID ARB(AF)/00/3) Award, 30 April 2004, ¶ 98 (hereinafter “*Waste Management*”), cited in Claimants’ Reply Memorial, fn. 137.

<sup>168</sup> **RA-84**, *Cargill*, ¶ 284.

139. While both *Mondev* and *ADF* rejected the articulation of the standard in *Neer*, they both applied a standard far different to that endorsed by the Claimants in this arbitration to reject the claim for breach of Article 1105.<sup>169</sup> *Pope & Talbot* also rejected the articulation of the standard in *Neer*<sup>170</sup> but never provided its own articulation. *Merrill & Ring* also rejected the articulation of the customary international law minimum standard of treatment in *Neer*<sup>171</sup> but could not agree if the standard was practically different.<sup>172</sup>

## 2. No NAFTA Tribunal has Held that a Failure to Fulfil Legitimate Expectations Breaches the Customary International Law Standard

140. Some NAFTA tribunals have recognized that a failure to fulfil the legitimate expectations of an investor on which its decision to invest was based could be a factor to be considered when deciding if the State's conduct falls below the customary

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<sup>169</sup> *Mondev* held that "Article 1105(1) did not give a NAFTA tribunal an unfettered discretion to decide for itself, on a subjective basis, what was 'fair' or 'equitable' in the circumstances of each particular case." The tribunal applied this principle to hold that the U.S. did not breach Article 1105 by providing a regulatory authority with immunity from tort claims, **CA-36**, *Mondev International Ltd. v. United States of America*, (ICSID ARB(AF)/99/2), Award, 11 October 2002, ¶¶ 119, 154 (hereinafter "*Mondev*"). In *ADF*, the tribunal also rejected the view that treatment that was unfair or inequitable would automatically breach Article 1105, **CA-16**, *ADF Group Inc. v. United States of America*, (ICSID ARB(A)/00/1, Award, 9 January 2003, ¶ 183 (hereinafter "*ADF*") ("We are not convinced that the Investor has shown the existence, in current customary international law, of a general and autonomous requirement ... to accord fair and equitable treatment and full protection and security to foreign investments. The Investor, for instance, has not shown that such a requirement has been brought into the corpus of present day customary international law by the many hundreds of bilateral investment treaties now extant"). Instead, it required that the conduct be "grossly" unfair and held that a requirement that contractors purchase supplies in the United States did not breach this standard, *Id.*, ¶¶ 189-190, 192.

<sup>170</sup> **CA-110**, *Pope and Talbot Inc. v. Canada*, (UNCITRAL) Award in Respect of Damages, 31 May 2002, ¶ 65 (hereinafter "*Pope and Talbot III*").

<sup>171</sup> **RA-104**, *Merrill & Ring*, ¶¶ 209, 211.

<sup>172</sup> *Id.*, ¶ 219. See also ¶ 243 ("Before determining which of the two above scenarios should guide the conclusions of the Tribunal and whether, under either such scenario, Canada may be said to have breached its Article 1105(1) obligations, matters on which there were different opinions ..."); and ¶ 236 ("Such policy could not be fairly described in this context as meeting any of the adjectives that have been used over the years, such as egregious, outrageous, arbitrary, grossly unfair or manifestly unreasonable.").

international law minimum standard.<sup>173</sup> However, none have held that a failure to fulfil legitimate expectations is sufficient, by itself.

141. The Claimants allege that in *Metalclad* the NAFTA tribunal did find that a failure to fulfil legitimate expectations was a breach of the customary international law standard.<sup>174</sup> This is incorrect. The tribunal held that the circumstances surrounding Mexico's refusal to issue a permit for a landfill breached Article 1105. These circumstances included: Mexico's statement that the refusal was for environmental reasons; domestic law, which only entitled Mexico to rely on the physical construction or defects in the site when deciding to issue the permit;<sup>175</sup> Mexico's allowance of construction at the landfill without any objection;<sup>176</sup> the absence of transparency or due process in the decision not to issue the permit;<sup>177</sup> representations to the investor that it could continue its construction of the landfill;<sup>178</sup> and a government decree after the refusal to issue the permit which "permanently prevented the use by Metalclad of its investment."<sup>179</sup> The tribunal relied on the "totality of these circumstances" to find a breach of Article 1105.<sup>180</sup> Consequently, any failure to fulfil legitimate expectations was just one of many factors which influenced the tribunal's decision.<sup>181</sup>

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<sup>173</sup> See Counter Memorial, ¶ 269.

<sup>174</sup> Claimants' Reply Memorial, ¶ 119.

<sup>175</sup> CA-35, *Metalclad Corporation v. Mexico*, (ICSID ARB(AF)/97/1) Award, 30 August 2000, ¶ 86 (hereinafter "*Metalclad*").

<sup>176</sup> *Id.*, ¶ 87.

<sup>177</sup> *Id.*, ¶¶ 88, 91.

<sup>178</sup> *Id.*, ¶ 89.

<sup>179</sup> *Id.*, ¶ 96.

<sup>180</sup> *Id.*, ¶ 99.

<sup>181</sup> The decision that there was a breach of Article 1105 was set aside on judicial review because "the Tribunal made its decision on the basis of transparency ... [and] there are no transparency obligations contained in Chapter 11," RA-105, *United Mexican States v. Metalclad Corp.*, 2001 BCSC 664, ¶ 72.

142. The Claimants also imply that *S.D. Myers* found that a failure to fulfil legitimate expectations is a breach of the customary international law minimum standard of treatment.<sup>182</sup> However, the Claimants cite no paragraphs in that decision to support their implication. All that the tribunal said of the standard was that a breach:

... occurs only when it is shown that an investor has been treated in such an unjust or arbitrary manner that the treatment rises to the level that is unacceptable from the international perspective. That determination must be made in the light of the high measure of deference that international law generally extends to the right of domestic authorities to regulate matters within their own borders.<sup>183</sup>

### **3. Customary International Law Concerning Breach of Contract Confirms there is no Obligation to Fulfil Legitimate Expectations**

143. In their Reply, the Claimants rely, for the first time, on customary international law concerning breach of contract.<sup>184</sup> The Claimants allege that law provides a “foundation” for the protection of legitimate expectations. However, far from establishing an obligation to fulfil legitimate expectations, customary international law concerning breach of contract establishes the opposite.

144. The Claimants assert “that international law prohibits state violations of contracts with foreign investors.”<sup>185</sup> This assertion is not supported by the authorities on which the Claimants rely and has been rejected by tribunals and commentators.

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<sup>182</sup> Claimants’ Reply Memorial, fn. 125.

<sup>183</sup> CA-44, *S.D. Myers Inc. v. Government of Canada*, (UNCITRAL) Partial Award, 13 November 2000, ¶ 263 (hereinafter “*S.D. Myers*”). The tribunal held at ¶¶ 194, 195, and 266 that Canada’s ban on the export of a certain kind of waste fell below this standard because, according to the tribunal, Canada stated that the ban was to protect the environment but had stated elsewhere that it was to protect local industry. Rather than rely on the actual decision, the Claimants rely at ¶ 125 of their Reply on the assertion of a commentator that *Myers* found a breach through the failure to fulfil legitimate expectations. Just like the Claimants, this commentator cites no paragraph in the actual decision to support this conclusion because none exist.

<sup>184</sup> Claimants’ Reply Memorial from ¶ 134.

<sup>185</sup> Claimants’ Reply Memorial, ¶ 135.

145. The Claimants rely on the UN General Assembly Resolution of 1962 that “[f]oreign investment agreements freely entered into by, or between sovereign States shall be observed in good faith.”<sup>186</sup> The Claimants note commentary stating that the “resolution was considered to constitute evidence of customary international law at the time it was passed.” However, the Claimants fail to note that the same commentary states that this view has since been definitively rejected.<sup>187</sup> The Claimants rely on a comment in *Texaco* that international law had evolved to encompass an “international law of contracts.”<sup>188</sup> Yet, that comment by the *Texaco* tribunal was merely referring to the recent recognition that a private party and a state could choose international law to govern their contract.<sup>189</sup> The decision in *Hofmann* is equally unremarkable. The tribunal simply recognized the “general principle that aliens are entitled to rights secured under international law.”<sup>190</sup> The decision went on to recognize that those rights, whether generated by the domestic law of property or contract, are protected by customary international law concerning expropriation.<sup>191</sup>

146. Thus, the authorities on which the Claimants rely provide no support for “the idea that international law prohibits state violations of contracts with foreign investors.”<sup>192</sup>

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<sup>186</sup> CA-156, UN General Assembly, *Resolution on permanent sovereignty over natural resources*, UN Doc. No. GA/RES/1803 (1962), quoted in Claimants’ Reply Memorial, ¶ 135.

<sup>187</sup> CA-139, Christopher Greenwood, *State Contracts in International Law – the Libyan Oil Arbitrations*, (1982) 58 BYIL 27, p. 43 (“the United Nations debates of 1962 turned out to have been the high point of acceptance of the theory that State contracts might be internationalized. Thereafter, this doctrine encountered growing opposition from developing states. By 1974, Ambassador Casteñada, the chairman of the United Nations working party on the draft Charter on Economic Rights and Duties of the State, was able to report that the overwhelming majority of States were opposed to the internationalization of State contracts.”).

<sup>188</sup> CA-118, *Texaco Overseas Petroleum Co. v. Government of the Libyan Arab Republic*, (1978) 17 I.L.M. 1, quoted in Claimants’ Reply Memorial, ¶ 135 (hereinafter “*Texaco*”).

<sup>189</sup> See the discussion under the heading: “First question: Did the parties have the right to choose the law or the system of law which was to govern their contract?”, *Id.*, ¶¶ 25-35.

<sup>190</sup> CA-97, *Hoffman and Steinhardt (United States v. Turkey)*, Neilsen’s Op. and Rep., pp. 286, 287 quoted in Claimants’ Reply Memorial, ¶ 136 (hereinafter “*Hoffman*”).

<sup>191</sup> *Id.*, ¶ 289 (“There is an abundance of evidence in various forms to show general recognition of the principle that the confiscation of the property of an alien is a violation of international law.”).

<sup>192</sup> Claimants’ Reply Memorial, ¶ 135.

Moreover, this assertion is irreconcilable with modern commentary and jurisprudence, including under the NAFTA.

147. As Canada explained in its Counter Memorial,<sup>193</sup> NAFTA tribunals have consistently held that a breach of contract is not a breach of customary international law.<sup>194</sup> Canada also explained that this view is consistent with other international decisions and commentary. As explained by Professor Brownlie, “[t]he general view is that a breach of contract (as opposed to its confiscatory annulment) does not create state responsibility on the international plane.”<sup>195</sup>

148. This conclusion is also consistent with the inclusion in many bilateral investment treaties of both “umbrella clauses,” which tribunals have found to elevate breaches of contract to a breach of the treaty,<sup>196</sup> and clauses which give investors the right to bring a claim for breach of an “investment agreement.”<sup>197</sup> If breach of contract was a breach of the obligation to provide fair and equitable treatment then there would be no need to include such clauses in the treaty.

149. Since a failure to fulfil a contractual promise is not a breach of customary international law then the failure to fulfil a lesser form of assurance which generates a legitimate expectation certainly is not.

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<sup>193</sup> Counter Memorial, fn. 403.

<sup>194</sup> **CA-51**, *Waste Management*, ¶ 73 (“NAFTA Chapter 11 does not give jurisdiction in respect of breaches of investment contracts such as the Concession Agreement.”); **RA-3**, *Robert Azinian et al. v. United Mexican States*, (ICSID ARB(AF)/97/2), Award, 1 November 1999, ¶ 87 (“NAFTA does not [...] allow investors to seek international arbitration for mere contractual breaches. Indeed, NAFTA cannot possibly be read to create such a regime, which would have elevated a multitude of ordinary transactions with public authorities into potential international disputes.”).

<sup>195</sup> **RA-82**, Ian Brownlie, *Principles of Public International Law*, 7<sup>th</sup> ed. (Oxford University Press: 2003), p. 547.

<sup>196</sup> For example, see **CA-27**, *Eureko B.V. v. Republic of Poland*, Partial Award, 19 August 2005, ¶ 260, interpreting Article 3.5 of the Netherlands-Poland BIT, which reads: “Each Contracting Party shall observe any obligations it may have entered into with regard to investments of investors of the other Contracting Party.”

<sup>197</sup> For example, see **RA-125**, United States-Chile Free Trade Agreement, 6 June 2003, arts. 10.15.1(a)(i)(C), (b)(i)(C), 10.27.

150. In addition to arguing that every breach of contract is a breach of international law, the Claimants appear to make an alternative argument. The Claimants note that international tribunals have found that, *in certain circumstances*, a breach of contract has breached international law. Specifically, the Claimants state that tribunals have found a breach of customary international law through an expropriation of contractual rights, an arbitrary or discriminatory breach of contract, and a breach of a contract governed by international law.<sup>198</sup> The Claimants draw from these decisions a “strong foundation for the conclusion that the minimum standard of treatment encompasses the protection of an investor’s legitimate expectations.”<sup>199</sup>

151. Yet, the only conclusion supported by these decisions is precisely the opposite. If customary international law requires specific circumstances such as expropriation for a breach of contract to amount to a breach of customary international law then the absence of these circumstances establishes that there is no such breach. Since the Claimants do not allege that any of these specific circumstances exist in the present arbitration, the

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<sup>198</sup> Claimants’ Reply Memorial, ¶ 136.

<sup>199</sup> Claimants’ Reply Memorial, ¶ 138.

decisions to which they refer provide no support for the conclusion that Canada has breached customary international law.<sup>200</sup>

**B. Even if Article 1105 Requires Protection of Legitimate Expectations, the Claimants Have Still Failed to Prove that the Guidelines are Inconsistent with Those Expectations**

152. The Claimants have not challenged that legitimate expectations must be based on:

- objective rather than subjective expectations of the investor;
- a specific promise or assurance by the State to induce the investment which was relied on by the investor; and
- expectations at the time the investor decided to invest.<sup>201</sup>

153. The Claimants have also not challenged that in order to determine whether the investor's expectations are legitimate, a tribunal must examine all the circumstances

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<sup>200</sup> Indeed, in each of the cases to which the Claimants refer, it was not the breach of contract that elevated the State's conduct to a breach of international law, but the expropriation, discrimination or internationalization of the contract: **CA-113**, *Singer Sewing Machine Co. (United States v. Turkey)*, Nielsen's Op. and Rep. 490, 491 ("International law does not prescribe rules relative to the forms and legal effects of contracts, but that law may be considered to be concerned with the actions of authorities a government may take with respect to contractual rights. It is believed that in the ultimate determination of responsibility under international law, application can properly be given to principles of law with respect to confiscation, and that the confiscation of property of an alien is violative of international law."); **CA-99**, *Jalapa Railroad and Power Co.*, American-Mexican Claims Commission, 1948, 8 Whiteman, Digest of International Law, 908, 909 (1976) ("Such action under international law has been held to be a confiscatory breach of contract and to constitute a denial of justice."); **CA-97**, *Hoffman*, p. 288 ("Some application may perhaps be given to the general principle that an alien is entitled to rights secured under international law. But in a more comprehensive treatment, it would seem that, in the ultimate determination of responsibility, effect may properly be given to legal principles with respect to confiscation."); **CA-118**, *Texaco*, ¶ 32; **CA-108**, *Phillips Petroleum Co. v. Iran*, Iran-U.S. Claims Tribunal, Award No. 425-39-2 of 29 June 1989, 21 Iran-U.S.C.T.R. 79, ¶ 75 ("The Tribunal considers that the acts complained of appear more closely suited to assessment of liability for the taking of foreign-owned property under international law than to assessment of the contractual aspects of the relationship, and so decides to consider the claim in this light.") (hereinafter "*Phillips Petroleum*"). As explained in Oppenheim's International Law, endorsed by the ICSID Annulment Committee in *Vivendi*: "It is doubtful whether a breach by a state of its contractual obligations with aliens constitutes *per se* a breach of an international obligation, unless there is some such additional element as denial of justice, or expropriation, or breach of treaty, in which case it is that additional element which will constitute the basis for the state's international responsibility." **RA-97**, Jennings & Watts - *Oppenheim's*, p. 927, emphasis added, cited with approval in **RA-131**, *Compania de Aguas del Aconquija S.A. and Vivendi Universal v. Argentine Republic*, (ICSID ARB/97/3) Decision on Annulment, 3 July 2002, fn. 78.

<sup>201</sup> See Counter Memorial, ¶ 271.

concerning the investment, including the political, socioeconomic, cultural and historical conditions prevailing in the host State.<sup>202</sup>

154. As explained in the Counter Memorial,<sup>203</sup> the only expectations of the Claimants with respect to its investment in Canada which meet 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
- the Board had the authority to issue guidelines on the R&D and E&T expenditure requirement.

**1. The Claimants' Legitimate Expectations**

**a) The Importance of R&D and E&T for Sustainable Development in the Province**

155. In its Counter Memorial,<sup>204</sup> Canada explained that when oil was discovered off the coast of NL in the 1970s, the province suffered from chronic unemployment and low income. The Provincial and Federal Governments recognized the importance of developing local skills and expertise by requiring oil companies to perform R&D and E&T in the province.

156. Given this context, the Claimants could only legitimately expect that there would be requirements for R&D and E&T expenditures necessary to promote sustainable development in the province. The Claimants could not have legitimately expected that the governments would recognize the fundamental importance of R&D and E&T and then

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<sup>202</sup> See Counter Memorial, ¶ 271.

<sup>203</sup> Counter Memorial, ¶¶ 273-299.

<sup>204</sup> Counter Memorial, ¶¶ 13-19.

leave it to the oil companies to determine how much was sufficient. Far from irrelevant to their expectations, as contended by the Claimants,<sup>205</sup> the context in which the Claimants invested is fundamental to their legitimate expectations.

**b) The Legislative Requirement to Make Expenditures on R&D and E&T in the Province to be Approved by the Board**

**i) The 1985 Accord**

157. Consistent with the context in which it was negotiated, the 1985 Accord between the Province and the Federal Government requires expenditures on R&D and E&T in the province. The Accord states that operators must have a Benefits Plan approved which “shall provide for expenditures to be made on research and development, and education and training, to be conducted within the province.” The Accord also states that “[e]xpenditures made by companies active in the offshore pursuant to this requirement shall be approved by the Board.”<sup>206</sup> The Accord does *not* state that operators can unilaterally decide the type and amount of those expenditures. Indeed, it would be most unusual to grant such discretion to those subject to a regulatory requirement.

**ii) The Accord Acts**

158. The Claimants’ obligation to make expenditures on R&D and E&T in the province, subject to approval by the Board, was implemented through the Accord Acts.<sup>207</sup> The Acts require the approval of a Benefits Plan and section 45(3)(c) states that the Benefits Plan “shall contain provisions intended to 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.” This section must be read together with the

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<sup>205</sup> Claimants’ Reply Memorial, Annex A, ¶ 3.

<sup>206</sup> CA-10, The Atlantic Accord: Memorandum of Agreement Between the Government of Canada and the Government of Newfoundland and Labrador on Offshore Oil and Gas Resource Management and Revenue Sharing (Feb. 11, 1985), s. 55 (hereinafter “Accord”).

<sup>207</sup> As in the Counter Memorial, a reference to a section of the Accord Acts is a reference to the Federal Accord Act, unless stated otherwise.

Accord,<sup>208</sup> which states that these R&D and E&T “[e]xpenditures made by companies active in the offshore pursuant to this requirement shall be approved by the Board.”<sup>209</sup>

159. Neither section 45(3)(c), nor any other part of the Accord Acts, states that operators can decide how much to expend on R&D and E&T in the province. Moreover, neither this section, nor any other part of the Accord Acts, restricts the obligation to expend on R&D and E&T to what the operators determine is necessary for the project.

160. The ordinary meaning of the Accord Acts and Accord was confirmed by Canadian courts when dismissing the challenge to the Guidelines. The NL Court of Appeal held that “there is nothing in the [Accord] Act ... supporting the conclusion that the company may unilaterally determine the level of expenditure on research and development.”<sup>210</sup> The court went on to say that:

... section 45(3) of the federal Act provides that a Canada-Newfoundland benefits plan *shall* contain provisions intended to ensure that expenditures shall be made for research and development to be carried out in the Province. These mandatory provisions contain no qualification entitling oil companies to refuse to expend on research and development because they are of the opinion the needs of their projects can be met with existing knowledge and technology.”<sup>211</sup>

161. The Claimants contend that the Accord Acts generated a legitimate expectation that the Claimants could unilaterally decide how much to expend on R&D and E&T. The Claimants support this contention with three arguments. None have merit.

162. First, the Claimants note that section 45(3)(c) of the Act states that “[a] *Canada-Newfoundland Benefits Plan* shall contain provisions intended to ensure that ...

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<sup>208</sup> CA-11, Federal Accord Act, s. 17(1) (“The Board shall perform such duties and functions as are conferred or imposed on the Board by or pursuant to the Atlantic Accord or this Act.”)

<sup>209</sup> CA-10, Accord, s. 55.

<sup>210</sup> CA-53, Court of Appeal Decision, Justice Welsh, ¶ 66.

<sup>211</sup> *Id.*, ¶ 130. The emphasis is the Court’s. Quoted in Counter Memorial, ¶ 134.

expenditures shall be made for” R&D and E&T.<sup>212</sup> The Claimants argue that “the Accord Acts do not establish any obligation to make expenditures on R&D and E&T separate and apart from what is agreed to in an approved benefits plan.”<sup>213</sup> However, simply because the obligation to expend on R&D and E&T must be reflected in the Benefits Plans does not change the nature of the obligation. Moreover, as explained below,<sup>214</sup> the decisions approving the Hibernia and Terra Nova Benefits Plans enforce the statutory obligation to expend on R&D and E&T in the province. There is nothing in those decisions which indicates that the Claimants can decide how much to expend.

163. Second, the Claimants rely on a summary of the Federal Accord Act, which states that a Benefits Plan “is to contain provisions *addressing* ... education and training, and research and development.”<sup>215</sup> The Claimants argue that “[t]his document confirms that the only requirement imposed by section 45(3)(c) of the Accord Acts is that the operator includes provisions *addressing* R&D and E&T in its benefits plan.”<sup>216</sup> Thus, the Claimants argue that since the document describes the Accord Acts as only requiring that a Benefits Plan *address* R&D and E&T, those Acts do not actually require expenditures on R&D and E&T.

164. However, reading the quote extracted by the Claimants in context reveals that the document does no such thing. The entire passage in which the quote appears is as follows:

Before the Board may approve any development plan or authorize any work or activity, the Board must approve a Canada-

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<sup>212</sup> Emphasis added.

<sup>213</sup> Claimants’ Reply Memorial, ¶ 148.

<sup>214</sup> Rejoinder, ¶¶ 168-207.

<sup>215</sup> **CE-161**, Memo from J. Carruthers, COGLA, to D. Kilmartin, Parliamentary Liaison, attaching A Summary of Bill C-6: The Canada-Newfoundland Atlantic Accord Implementation Act (Nov. 13, 1986) cited in Claimants’ Reply Memorial, ¶ 149. Emphasis added.

<sup>216</sup> Emphasis added.

Newfoundland Benefits plan. The plan is to contain provisions *addressing*:

- employment of Canadians, in particular Newfoundlanders;
- full and fair opportunities for Canadian and Newfoundland manufacturers, consultants, contractors and service companies to compete in the supply of goods and services used in any proposed work or activity;
- opportunities for disadvantaged individuals or groups; and
- education and training, and research and development.<sup>217</sup>

165. Thus, the summary uses the word “addressing” to refer to all the subjects of a Benefits Plan. Under the Claimants’ reasoning, the use of the word “addressing” would indicate that the Accord Acts allow a Benefits Plan to contain no commitment to any benefits at all. This is clearly incorrect; even the Claimants accept that the Accord Acts require that a Benefits Plan contain some commitments.<sup>218</sup> Hence, the use of the word “addressing” in the summary reveals nothing about the Accord Acts’ obligation to expend on R&D and E&T.

166. Third, the Claimants rely on Canada’s statement in the Counter Memorial that “to a large extent, the benefits requirements under the Accord Acts are process oriented rather than related to prescribed targets and outcomes.”<sup>219</sup> In this statement, Canada was merely noting that two of the four benefits requirements in section 45 are process

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<sup>217</sup> **CE-161**, Memo from J. Carruthers, COGLA, to D. Kilmartin, Parliamentary Liaison, attaching A Summary of Bill C-6: The Canada-Newfoundland Atlantic Accord Implementation Act (Nov. 13, 1986) p. 6. Emphasis added.

<sup>218</sup> For example, see Claimants’ Reply Memorial, ¶ 152 (“Both Benefits Plans were clear that: (1) consistent with the Accord Acts, the nature of the operators’ R&D and E&T commitments would be process-oriented ... [emphasis added]”); ¶ 187 (“... the project operators were left to decide how much to spend on R&D and E&T based on the commercial needs of the project and subject to the requirement that they would look first to local providers as part of the procurement process.”).

<sup>219</sup> Counter Memorial, ¶ 76, quoted in Claimants’ Reply Memorial, ¶ 150.

oriented.<sup>220</sup> The statement does not change the fact that the requirement in Article 45(3)(c) to expend on R&D and E&T is result oriented.

**c) The Board Had the Authority to Issue Guidelines on the R&D and E&T Expenditure Requirement**

167. In addition to making it clear that the Claimants were required to make expenditures on R&D and E&T in the province, which would be reviewed by the Board, the Accord Acts also provide the Board with the authority to issue guidelines concerning that requirement.<sup>221</sup> The Board has previously issued dozens of guidelines on the application of the Accord Acts.<sup>222</sup> Given the Board's authority to issue guidelines, and the Board's exercise of that authority in the past, the Claimants could not have legitimately expected that the Board would not exercise that authority to issue guidelines on R&D and E&T expenditures.

**d) The Hibernia Decision Required Expenditures on R&D and E&T to be Monitored by the Board**

168. The decision approving the Hibernia Benefits Plan also obliges the Claimants to expend on R&D and E&T and provides for the Board to monitor these expenditures to ensure the obligation is fulfilled. It does not limit this obligation to expenditure which the Claimants unilaterally decide is sufficient. Consequently, there is nothing in that decision which supports the Claimants' description of their legitimate expectations.

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<sup>220</sup> CA-11, Federal Accord Act, s. 45(3)(b) and s. 45(3)(d).

<sup>221</sup> *Id.*, s. 151.1(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.")

<sup>222</sup> As noted by the current Vice-Chair of the Board, "[g]uidelines provide direction on how the Board interprets the broadly based legislative requirements governing the offshore area." First Witness Statement of Frederick Way, ¶ 35 (hereinafter "Way Statement I").

**i) The Hibernia Decision Required Expenditures on R&D and E&T Regardless of the Claimants' Views of the Needs of the Project**

169. Prior to its approval of the Hibernia Benefits Plan, the Board rejected the operators' proposed Benefits Plan as inconsistent with their obligations under the Accord Acts. In the Supplementary Hibernia Benefits Plan, the operators committed 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.*"<sup>223</sup> The operators did *not* merely commit to promote further research and development in Canada *which they regarded as necessary for their project*. Similarly, the operators committed to "[s]upport the principle of technology transfer ...."<sup>224</sup> Once again, this commitment was *not* limited to supporting the principle of technology transfer *necessary for the project*.

170. In addition, the contemporaneous Report of the Hibernia Environmental Assessment Panel recommended that the operators undertake R&D in specific areas that the *panel* believed were important.<sup>225</sup> The Claimants assert that this report did not form "part of the regime governing Claimants' R&D and E&T expenditure obligations" and, therefore, was not "a source of Claimants' reasonable expectations as to the content and stability of that regime."<sup>226</sup> However, the Claimants overlook the Terms of Reference for the Hibernia Panel, which include to "examine the major employment and industrial benefits that are *expected* to result from the project."<sup>227</sup> The Claimants also overlook that the Board expressly stated that the Environmental Assessment Panel's "recommendations

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<sup>223</sup> CE-46, Hibernia Supplementary Benefits Plan (May 28, 1986), p. 7 (hereinafter "Hibernia Supplementary Benefits Plan"), emphasis added.

<sup>224</sup> *Id.*, p. 3.

<sup>225</sup> See Counter Memorial, fn. 48.

<sup>226</sup> Claimants' Reply Memorial, ¶ 173.

<sup>227</sup> RE-6, Report of the Environmental Assessment Panel: Hibernia Development Project (Dec. 1985), p. 51, emphasis added (hereinafter "Hibernia Environmental Assessment Panel Report").

concerning employment, technology transfer and supply of goods and services form the basis for much of the Board's Benefits Plan Decision ..."<sup>228</sup>

171. Other contemporaneous documents are also inconsistent with the interpretation of the Hibernia Benefits Plan decision now proffered by the Claimants. In a 1988 paper on the decision, the Board stated that "[t]he [Accord] Acts further require developers to provide for research and development and also for education and training in the Province."<sup>229</sup> The Board did not state that this obligation in the Accord Acts had been limited by their recent decision. They did not state that the Claimants could decide themselves how much R&D and E&T to provide.

172. The Claimants' own reports indicate that they did not believe they were only obliged to expend on what they believed was necessary for the projects. From the very first Hibernia Benefits Report in 1986, the Claimants reported R&D and E&T expenditures which were obviously not necessary for the projects, such as the sponsorship of research chairs.<sup>230</sup> In their Reply, the Claimants argue that the expenditures help "public relations" and "personnel recruitment" and, therefore, are necessary for the projects, "even if they are not intended to respond to specific and identifiable project needs."<sup>231</sup> The Claimants cannot have it both ways. They cannot state in their Memorial that their only requirement under the Accord Acts and Benefits Plan was to expend "based on technical project needs"<sup>232</sup> but then abandon that submission when confronted with expenditures which were obviously broader. Moreover, the Claimants' submission is inconsistent with the Terra Nova Benefits Reports, described

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<sup>228</sup> CE-47, CNLOPB, Decision 86.01: Application for Approval: Hibernia Benefits Plan and Development Plan (Jun. 18, 1986), p. 5 (hereinafter "Hibernia Decision 86.01").

<sup>229</sup> CE-199, CNLOPB, Presentation: Hibernia Supplier Development Seminar (Nov. 23, 1988) p. 2.

<sup>230</sup> Counter Memorial, ¶ 82.

<sup>231</sup> Claimants' Reply Memorial, ¶ 177.

<sup>232</sup> Claimants' Memorial, ¶ 72 ("... at the time NAFTA came into force, the R&D obligations of the Hibernia project, pursuant to the requirements of the Accord Acts and the agreements of the Hibernia interest owners with the Board and with the Canadian and provincial governments were: (i) R&D spending was based on technical project needs ...").

below,<sup>233</sup> in which the Claimants expressly acknowledge that the operators were undertaking expenditures unnecessary for the projects.

**ii) The Hibernia Decision Stated that Expenditures on R&D and E&T Would be Monitored by the Board**

173. In the Hibernia Supplementary Benefits Plan requested by the Board, the operators committed to “[c]arry out a program of timely reporting to the Canada/Newfoundland Board to enable the Board to monitor the level of efforts and benefits achieved and to assist in promoting maximum benefits ...”<sup>234</sup>

174. Despite the clear meaning of this phrase, the Claimants argue that the benefits decision did not necessarily indicate a commitment to monitor R&D and E&T expenditures. The Claimants note that the Hibernia decision also states that “it is neither necessary, nor productive, to monitor and approve all the Proponent’s procurement decisions” and that the Board would concentrate its monitoring activity on “key” procurement decisions, which, according to the Claimants, typically do not include R&D or E&T expenditures.<sup>235</sup> However, John Fitzgerald, who was Vice-Chair of the Board at the time, clarifies that “[w]hile the Board devoted a significant portion of its monitoring effort to those ‘key’ procurement decisions it did not do so to the exclusion of monitoring other elements of the Benefits Plan, including the Proponent’s obligations regarding Research and Development and Education and Training.”<sup>236</sup> Indeed, the Board was obliged to monitor, given the stipulation in the Accord that the Board was to approve expenditures on R&D and E&T.<sup>237</sup>

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<sup>233</sup> Rejoinder, ¶¶ 199-201.

<sup>234</sup> CE-46, Hibernia Supplementary Benefits Plan, pp. 1, 4.

<sup>235</sup> Claimants’ Reply Memorial, ¶ 157.

<sup>236</sup> Second Witness Statement of John Fitzgerald, ¶ 13 (hereinafter “Fitzgerald Statement II”).

<sup>237</sup> See Rejoinder, ¶ 157.

175. The Board did not state that it would monitor expenditures just for the sake of monitoring. The Board indicated in its decision that it expected the operators to respond to requirements to increase local benefits:

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.*<sup>238</sup>

176. As explained by John Fitzgerald:

... in giving its approval the Board stated that it would monitor the proponent's activities *to see how well it was meeting its undertaking.*<sup>239</sup>

177. The Board's decision to monitor the Hibernia operators' fulfilment of the principles in the Supplementary Benefits Plan could not have generated any expectation that the Board was forever abandoning its authority to set an explicit expenditure target. Indeed, the 1986 Exploration Phase Guidelines, issued just before the Hibernia decision, stated that guidelines on "expenditures" for R&D and E&T during the exploration phase "will be established by the Board."<sup>240</sup> Moreover, Mr. Fitzgerald explains that:

[w]hile the Board was confident it had the authority to decide whether the proponent's plan for expenditures for [R&D and E&T] purposes was acceptable, it did not consider that it would be appropriate to exercise that authority by stipulating the amount that should be expended at so early a stage of development in the offshore area.<sup>241</sup>

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<sup>238</sup> CE-47, Hibernia Decision 86.01, p. 8, emphasis added. Quoted in Counter Memorial, ¶ 45.

<sup>239</sup> First Witness Statement of John Fitzgerald, ¶ 47 (hereinafter "Fitzgerald Statement I"), emphasis added.

<sup>240</sup> CE-32, Guidelines for Benefits Plan Approval and Reporting Requirements for Exploration Activities in the Newfoundland Offshore Area (Apr. 14, 1986), ¶ 4.2.3, p. 9.

<sup>241</sup> Fitzgerald Statement I, ¶ 50.

178. Mr. Fitzgerald's evidence that the Hibernia decision was too early to set an explicit expenditure target is consistent with the context in which the decision was taken. When the Board issued its decision in June 1986:

- the Accord was barely a year old;
- neither the provincial nor federal Accord Acts had been finalized;
- the Board had only existed for six months;<sup>242</sup>
- the Hibernia operators had still not committed to the project;<sup>243</sup> and
- first production of oil in NL was still over a decade away.

179. The Claimants were well aware of these circumstances and they should have affected the Claimants' expectations from the Hibernia decision.

180. Mr. Fitzgerald explains that the Board "was conscious that if it set an explicit expenditure level early on that later proved to be too low, it would be very difficult to increase it later."<sup>244</sup> Hence, as explained by Mr. Fitzgerald, the Board:

elected to monitor both the proponent's performance and the capacity in the local scientific and engineering community to do other work and the development of education and training programs. It would reserve judgment on the effectiveness of the proponent's initiatives until experiential evidence was available. It felt it could then consider whether the proponent was acting in good faith and whether a more explicit undertaking, including setting an amount that should be spent for these purposes, should be required.<sup>245</sup>

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<sup>242</sup> *Id.*, ¶ 41.

<sup>243</sup> See Counter Memorial, ¶¶ 58-61, explaining that the Hibernia operators did not commit to the project until the provincial and federal governments agreed to provide substantial fiscal incentives in 1990.

<sup>244</sup> Fitzgerald Statement I, ¶ 50.

<sup>245</sup> *Id.*, ¶ 51.

181. Mr. Fitzgerald's statement is consistent with a contemporaneous internal briefing report to the Federal Minister. The report notes, under the heading "Benefits Plan:"

Post monitoring of Mobil's performance in achieving minimum benefits levels; trigger mechanism built-in to allow intensification of monitoring where appropriate."<sup>246</sup>

182. The Claimants themselves admit this contemporaneous document "contemplates Board intervention in response to benefits monitoring ..."<sup>247</sup>

183. Another contemporaneous document which provides evidence of the importance of monitoring expenditures is the Hibernia Environmental Assessment Panel Report. The Report recommended that the implementation of the operators' plan to provide local benefits, including R&D and E&T expenditures, "should be closely monitored throughout its life."<sup>248</sup>

184. Indeed, the Claimants acknowledge that, from the time of the decision approving the Hibernia Benefits Plan, the Board consistently stressed to the Claimants the need for monitoring to ensure that they fulfilled their Benefits Plan commitments.<sup>249</sup> There would be no need for the Board to monitor expenditures if the Board did not intend to intervene in response to the results of that monitoring.

185. The Claimants argue that if the Board understood that it could intervene if R&D and E&T expenditures were inadequate, that understanding would have been evident in

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<sup>246</sup> **CE-167**, Hibernia Development Project, Briefing to De Montigny Marchand (Dec. 23, 1985) p. 001130.

<sup>247</sup> Claimants' Reply Memorial, fn. 186.

<sup>248</sup> **RE-6**, Hibernia Environmental Assessment Panel Report, recommendation 8, p. 46, quoted in Counter Memorial, ¶ 37. As explained in the Rejoinder above at ¶ 170, the Board acknowledged that the Panel's recommendations "form the basis for much of the Board's Benefits Plan Decision ..." **CE-47**, Hibernia Decision 86.01, p. 7.

<sup>249</sup> Claimants' Reply Memorial, ¶ 161. Note also s. 5.5.2 of the 1988 Development Application Guidelines, which states that "[e]ffective monitoring and reporting of procurement decisions and reporting of expenditure and employment levels are necessary to ensure that the principles of the Benefits Plan are being followed and its commitments are being met." **RE-9**, CNOPB, 1988 Development Application Guidelines: Newfoundland Offshore Area (Dec. 1988) (hereinafter "1988 Development Application Guidelines").

“the Board’s communications with the project operators.”<sup>250</sup> Yet, there was no need to communicate with the project operators what was evident on the face of the Hibernia decision. By stating in that decision that it would monitor expenditures, the Board conveyed that it would intervene if expenditures were inadequate. As recognized by the NL Court of Appeal, “[o]therwise, what was the purpose of the monitoring?”<sup>251</sup> Moreover, as explained further below,<sup>252</sup> there was no need to inform the Claimants what would occur if their expenditures were inadequate because, initially, this was not the case.

186. The Claimants also argue that the Board’s understanding should have been reflected in “the Board’s ... own internal documents.”<sup>253</sup> However, John Fitzgerald and Frederick Way explain that there was no need to internally record their understanding.<sup>254</sup>

### **iii) The Board Monitored Hibernia R&D and E&T Expenditures**

187. The Claimants challenge the fact that the Board monitored expenditures on R&D and E&T because “from project sanction in 1990 until the production phase began in 1997, Hibernia did not even include R&D expenditure data in its annual benefits reports to the Board.”<sup>255</sup> However, this does not mean that the Board was not monitoring R&D and E&T expenditures. As explained by Mr. Fitzgerald:

... the Board adopted a qualitative approach to monitoring activities in this area during the development phase of the project. This approach involved asking the Proponent to provide a description of the initiatives it had taken, and those it intended to

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<sup>250</sup> Claimants’ Reply Memorial, ¶ 156.

<sup>251</sup> CA-53, Court of Appeal Decision, Justice Barry, ¶ 126.

<sup>252</sup> Rejoinder, ¶¶ 208-209.

<sup>253</sup> Claimants’ Reply Memorial, ¶ 156.

<sup>254</sup> Fitzgerald Statement II, ¶¶ 4-6; Second Witness Statement of Frederick Way, ¶ 3 (hereinafter “Way Statement II”).

<sup>255</sup> Claimants’ Reply Memorial, ¶ 157.

take, in these areas. Because the local professional community was relatively small and closely connected, the Board was able to inform itself of the current capabilities of the local research and educational facilities and the extent to which they were being engaged by the Proponent in activities related to the project through its informal consultations ...<sup>256</sup>

188. He goes on to explain that “[a]fter analyzing the information gathered, Board officials would discuss with the Proponent those areas where it might be possible for the Proponent to increase its effort or consider support for a new initiative.”<sup>257</sup>

189. The Board was “generally satisfied” with expenditures in the first half of the 1990s<sup>258</sup> but less satisfied in the second half:

As the project design for Hibernia neared completion, the amount of R&D activity commissioned locally declined. As the Proponent began to focus on preparing for operations, there was an increase in its attention to the training required for operating personnel. There was an increased engagement of the local educational and training institutions and the Proponent invested in an in-house simulator facility in St. John’s to train control room personnel.<sup>259</sup>

190. He goes on to explain that the shift from R&D and E&T “was not unexpected,” but “the fall-off in R&D initiatives brought comments about underutilized R&D capacity to the Board’s ears. This capacity had increased considerably since the Hibernia Development Application was approved ten years earlier.”<sup>260</sup>

191. Mr. Fitzgerald explains that:

[t]he Board expected, albeit with some apprehension because of the earlier fall-off in the number of projects being sponsored by the

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<sup>256</sup> Fitzgerald Statement II, ¶ 19.

<sup>257</sup> *Id.*, ¶ 20.

<sup>258</sup> *Id.*, ¶ 21.

<sup>259</sup> *Id.*, ¶ 21.

<sup>260</sup> *Id.*, ¶ 22.

Hibernia Proponent, that there would be an increase in R&D sponsored by the Proponent after production began.<sup>261</sup>

192. He concludes that the Board:

elected to continue its qualitative approach to monitoring the R&D and E&T efforts associated with the Hibernia project as it approached the start of production operations. But the Board was becoming less content with the absence of a quantitative target against which a Proponent's performance in this area could be measured ...<sup>262</sup>

193. Consequently, as a result of their monitoring of Hibernia expenditures, the Board imposed more rigorous reporting requirements through the Terra Nova Benefits Plan decision.<sup>263</sup>

**e) The Terra Nova Decision Reinforced that Expenditures on R&D and E&T Would be Monitored by the Board**

194. Just like the Hibernia decision, the Board's decision approving the Terra Nova Benefits Plan is perfectly consistent with the Accord Acts and the Accord. The decision obliges the Claimants to expend on R&D and E&T and does not limit this obligation to expenditures which the Claimants unilaterally decide are sufficient. Just like the Hibernia decision, the Terra Nova decision provided that the Board would monitor expenditures to ensure the operators' obligation was fulfilled. As a result of the Board's experience with Hibernia, the decision imposed a more rigorous reporting requirement.

**i) The Terra Nova Decision Required Expenditures on R&D and E&T Regardless of the Claimants' Views of the Needs of the Project**

195. As with Hibernia, the Board rejected the initial Terra Nova Benefits Plan as inconsistent with the operators' obligations under the Accord Acts. According to the Board:

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<sup>261</sup> *Id.*, ¶ 20.

<sup>262</sup> *Id.*, ¶ 22.

<sup>263</sup> *Id.*, ¶ 22.

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 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 research and development in the Province."<sup>264</sup>

196. The Board endorsed the recommendation of the Terra Nova Environmental Assessment Panel that "the Board require operators of offshore oil projects to fund basic research," including research not necessary for the projects.<sup>265</sup> The Panel had also stated that "[f]unding basic research from revenues generated from offshore petroleum resources is a requirement of the Atlantic Accord."<sup>266</sup> According to the Board, the recommendation "related to funding basic research is consistent with the thrust of this legislative requirement."<sup>267</sup>

197. The Claimants object that "while the Board found that the Panel's recommendation that the Terra Nova proponents fund basic research was consistent with the "thrust" of the relevant provisions of the Accord Acts, it did not find that funding research was required by the legislation."<sup>268</sup> However, John Fitzgerald, Acting Chair of the Board at the time, explains that, through this statement, the Board "was signalling clearly that basic research in the subject areas was an acceptable focus for R&D

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<sup>264</sup> CE-57, Terra Nova Decision 97.02, p. 23, s. 3.5.1, quoted in Counter Memorial, ¶ 66.

<sup>265</sup> RE-14, Report of the Environmental Assessment Panel: Terra Nova Project (Aug. 1997), Recommendation 51, p. 50 (hereinafter "Terra Nova Environmental Assessment Panel Report"). The Panel recommended that "[t]his 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." Quoted in Counter Memorial, ¶ 64.

<sup>266</sup> RE-14, Terra Nova Environmental Assessment Panel Report, Recommendation 50, p. 49, quoted in Counter Memorial, ¶ 63.

<sup>267</sup> CE-57, Terra Nova Decision 97.02, p. 23, s. 3.5.1, quoted in Counter Memorial, ¶ 67.

<sup>268</sup> Claimants' Reply Memorial, ¶ 173.

expenditure in the Province and that it was still expecting the Proponent to formulate and submit its intended program.”<sup>269</sup>

198. The Claimants also attempt to dismiss the importance of the report of the Environmental Panel for the same reasons that they challenge the Hibernia Panel report. According to the Claimants, the Panel report did not form “part of the regime governing Claimants’ R&D and E&T expenditure obligations” and, therefore, was not “a source of Claimants’ reasonable expectations as to the content and stability of that regime.”<sup>270</sup> However, the Claimants overlook the Board’s statement that “[t]o the extent that they relate to the Benefits Plan requirements of the legislation, the recommendations of the [Environmental Assessment] Panel have been considered by the Board as an integral part of its review of the Plan.”<sup>271</sup>

199. As with Hibernia, the Claimants’ own reports indicate that they did not believe they were only obliged to expend on what they believed was necessary for the projects.<sup>272</sup> They reported expenditures which were obviously not necessary for the projects, such as the sponsorship of research chairs. Moreover, they 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

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<sup>269</sup> Fitzgerald Statement II, ¶ 16.

<sup>270</sup> Claimants’ Reply Memorial, ¶ 173.

<sup>271</sup> **CE-57**, Terra Nova Decision 97.02, p. 13. See also Fitzgerald Statement I, ¶ 65 (“... the Terra Nova partners were informed that any development application they might submit would be the subject of a full public review as well as the Board’s internal review and any internal reviews that might be undertaken by federal and provincial government departments and that the Board would take the results of all of these reviews into account in making its decision regarding the application.”). See also: **CA-11**, Federal Accord Act, s. 44(2)(a), which authorizes the panel to provide a “comprehensive review of all aspects of the development;” **RE-14**, Terra Nova Environmental Assessment Panel Report, p. 8, which explains that the report explains that it “satisfied the environmental assessment requirements of the parties under the ... Accord Acts;” and the terms of reference for the Panel (at p. 78), which task it to “review ... the employment and industrial benefits that are *expected* to accrue to the Province, and to Canada, from the Project.”

<sup>272</sup> Counter Memorial, ¶ 83.

Nova Development and/or to the development of an offshore oil industry in the province.<sup>273</sup>

200. The Claimants acknowledge that Petro-Canada reported the operators had expended on R&D and E&T projects unnecessary for the Terra Nova project but that they “cannot speak to Petro-Canada’s intended meaning.”<sup>274</sup> Thus, the Claimants implicitly acknowledge that their alleged expectations may not have been shared by their partners.

201. The Claimants also allege that, for Terra Nova, “Canada does not posit a single specific expenditure that it believes was unnecessary.”<sup>275</sup> This is wrong. Two of the examples of unnecessary expenditures given by Canada in its Counter Memorial are clearly described as Terra Nova expenditures.<sup>276</sup>

**ii) The Terra Nova Decision Stated that Expenditures on R&D and E&T Would be Monitored by the Board**

202. In its decision approving the Terra Nova Benefits Plan, the Board declared that it would monitor R&D and E&T expenditures because “the Board also has an obligation as the regulator to ensure that the Proponent’s commitments are met.”<sup>277</sup> The decision stated:

The Board acknowledges that the Proponent’s Benefits Plan indicates that opportunities exist for the conduct of research and development in the Province to continue in the future and that safety-related training will primarily take place in the Province. It is the Board’s overall assessment, however, that the Plan does not fully satisfy the statutory requirement that the Benefits Plan

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<sup>273</sup> **CE-81**, Terra Nova 1998 R&D Benefits Report (Mar. 1999), p. 8, emphasis added, quoted in Counter Memorial, ¶ 83.

<sup>274</sup> Claimants’ Reply Memorial, fn. 235.

<sup>275</sup> Claimants’ Reply Memorial, ¶ 176.

<sup>276</sup> See bullet points four and five in Counter Memorial, ¶ 82: “funding for the establishment of a junior research Chair in Ocean Environmental Risk Engineering at MUN,” reported in **CE-81**, Terra Nova 1999 R&D Benefits Report, p. 5 and “funding for the MUN Chair for Women in Science in Engineering,” reported in **CE-88**, Terra Nova 2000 E&T Benefits Report, p. 11.

<sup>277</sup> **CE-57**, Terra Nova Decision 97.02, p. 2, s. 1.2, quoted in Counter Memorial, ¶ 70.

contain provisions intended to ensure that expenditures are made on research and development and education and training in the Province.<sup>278</sup>

203. The Board went on to state that it:

... appreciates the difficulty in providing, in advance, detailed research and development and education and training plans for the entire duration of the Development and, therefore, to provide a framework for monitoring the Proponent's activities in this regard, establishes 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 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.<sup>279</sup>

204. Thus, the Terra Nova decision required detailed reporting of expenditures on R&D and E&T and stated that those expenditures would be monitored "to ensure that the Proponent's commitments are met."<sup>280</sup> Mr. Fitzgerald explains that the more detailed reporting requirement in the Terra Nova decision reflected the maturing state of the industry:

The new procedure reflected the maturing state of industry activity which had passed from exploration only, through the development of Hibernia ... into sustained production ... The Board felt that it was now possible for operators to be more precise about how they intended to meet their statutory obligations and had decided that it should explicitly require them to do so. Therefore, the Board signaled that it would assess whether the past expenditures and future plans for research and development and education and training ... were adequate and whether improvements were necessary.<sup>281</sup>

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<sup>278</sup> CE-57, Terra Nova Decision 97.02, p. 24, s. 3.5.3.

<sup>279</sup> *Id.*, quoted in Counter Memorial, ¶ 69.

<sup>280</sup> *Id.*, p. 2, s. 1.2, quoted in Counter Memorial, ¶ 70.

<sup>281</sup> Fitzgerald Statement I, ¶¶ 70-71.

205. Mr. Fitzgerald explains that by establishing the condition to report expenditures “the Board signalled its intention to judge the adequacy of the proponent’s past performance and its short term plans each year ...”<sup>282</sup> He states that “the Board ... accepted that if experience showed it to be necessary, it might need to more explicitly describe the quantum and kind of expenditures it would judge acceptable ...”<sup>283</sup>

206. His comments are echoed by Frederick Way, who joined the Board in 1998, shortly after the Terra Nova decision:

The Board reviews Benefits Reports for compliance with Benefits Plans and the legislation. By monitoring such plans the Board is conveying that it would require corrective action if the Operator were not in compliance. In the absence of such a process, there would be no reason to monitor and the Board could not ensure that the Proponent’s commitments were being met.<sup>284</sup>

207. The Claimants argue that the Terra Nova decision only indicates that the Board required monitoring to ensure “that *some* expenditures would be made on R&D and E&T in the Province.”<sup>285</sup> However, the Claimants overlook that the Board’s justification in the decision for the reporting and monitoring requirement is “the difficulty in providing, in advance, detailed research and development and education and training plans *for the entire duration of the Development.*”<sup>286</sup> If the Board’s concern was only to ensure *some* expenditure on R&D and E&T then the Board would not be interested in the proponent’s plans for the entire duration of the development. Moreover, the detailed reporting requirement, including reporting exact expenditures in the previous year and a forecast for the next three years would be unnecessary if the Board was only interested in *some* expenditure.

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<sup>282</sup> Fitzgerald Statement I, ¶ 68.

<sup>283</sup> *Id.*, ¶ 72.

<sup>284</sup> Way Statement I, ¶ 41.

<sup>285</sup> Claimants’ Reply Memorial, ¶ 159, emphasis is the Claimants’.

<sup>286</sup> CE-57, Terra Nova Decision 97.02, p. 24, s. 3.5.3, emphasis added.

### iii) The Board Monitored Terra Nova R&D and E&T Expenditures

208. As with Hibernia, after declaring that it would monitor the Terra Nova R&D and E&T expenditures, the Board did just that. It was initially satisfied with the reported R&D and E&T expenditures, which were significant.<sup>287</sup> Frank Smyth acknowledged these initial significant expenditures when he wrote “[w]e recognize this” and “[v]ery much so” in the margin of a 2003 letter from HMDC which noted “significant expenditures” in the province.<sup>288</sup> Mr. Smyth was not indicating the Board’s satisfaction with spending in 2003,<sup>289</sup> as alleged by the Claimants.<sup>290</sup>

209. While the Board was initially satisfied with reported R&D and E&T expenditures, it still intervened when it felt that expenditures were inadequate. As explained in the Counter Memorial,<sup>291</sup> the Board wrote to Petro-Canada in February 1999 to express its concern that R&D for the Glory Holes project was not being carried out in the province.<sup>292</sup> Thus, the Claimants are incorrect when they state that “[p]rior to the issuance of the Guidelines, the Board had not indicated any dissatisfaction with the Hibernia and Terra Nova projects’ R&D expenditures ...”<sup>293</sup>

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<sup>287</sup> Counter Memorial, ¶ 80, noting that between 1991 and 1995, the Hibernia proponents reported to the Canadian tax authorities spending on R&D of over \$84 million and that, between 1998 and 2000 the Terra Nova proponents spend over \$12 million on E&T.

<sup>288</sup> **CE-194**, Letter from T. Cutt, HMDC, to H. Stanley, CNLOPB (Sep. 22, 2003) quoted in Claimants’ Reply Memorial, ¶ 171.

<sup>289</sup> Smyth Statement II, ¶ 3 (“The Board was not ‘satisfied with the level of R&D and E&T activity reported by Hibernia and Terra Nova around the time it developed the Guidelines.’ My notation referred to earlier expenditures. All that it means is that the Board recognized that the operators had made significant expenditures in the past. It does not refer to expenditure levels on a go forward basis or for the entire life of the projects or to the declining expenditures reported from 1997 to 2000.”).

<sup>290</sup> Claimants’ Reply, ¶ 171.

<sup>291</sup> Counter Memorial, ¶ 86.

<sup>292</sup> **RE-18**, Letter from H. Stanley, CNOPB, to G. Bruce, Petro Canada (Feb. 3, 1999).

<sup>293</sup> Claimants’ Reply Memorial, ¶ 166.

210. As explained in the Counter Memorial, Hibernia reported dramatically decreasing expenditures on R&D from 1998.<sup>294</sup> Hibernia's 2000 Benefits Report, issued in early 2001,<sup>295</sup> described those decreasing expenditures:

Year	Reported R&D Expenditure (Millions)	Percentage of Revenue <sup>296</sup>
1997	\$4.2	12.5
1998	\$2.5	0.6
1999	\$2.2	0.2
2000	\$1.5	0.06

<sup>294</sup> Counter Memorial, ¶ 88.

<sup>295</sup> CE-72, Hibernia 2000 Benefits Report (Jan. 1, 2001), p. 13.

<sup>296</sup> The expenditure as a percentage of revenue did not appear in the Hibernia 2000 Benefits Report. These percentages were produced by dividing revenue by the R&D expenditure amount. Revenues were obtained as follows: in 1997, production was 1,272,221 bbl, the average price of oil was US\$19.09, and the average exchange rate was CDN\$1.38, producing revenues of CDN\$33,515,644. In 1998, production was 23,799,349, the average price was US\$12.72, and the average exchange rate was CDN\$1.48, producing revenues of CDN\$448,037,024. In 1999, production was 36,391,620, the average price was US\$17.97, and the average exchange rate was CDN\$1.49, producing revenues of CDN\$974,396,543. In 2000, production was 52,798,403, the average price was US\$28.50 and the exchange rate was CDN\$1.49, producing revenues of CDN\$2,242,084,183. Production numbers are taken from First Expert Report of Richard E. Walck, ¶ 46 (hereinafter "Walck Report I"). Oil prices are taken from <http://www.bp.com/productlanding.do?categoryId=6929&contentId=7044622>. Exchange rates are taken from [http://www.bankofcanada.ca/en/rates/exchange\\_avg\\_pdf.html](http://www.bankofcanada.ca/en/rates/exchange_avg_pdf.html).

211. Terra Nova's 2000 Benefits Report, issued around the same time, also reported dramatically decreasing expenditures.<sup>297</sup>

Year	Reported R&D Expenditure (Millions)
1997	\$1.5
1998	\$0.45
1999	\$0.425
2000	\$0.375
2001-2003	\$0.15 – \$0.2 per year (projected)

212. As explained by Frank Smyth, “[r]eporting these [decreased expenditures] to the Board in the course of developing the White Rose Decision Report turned the Board’s mind to the need to establish guidance with respect to R&D and E&T spending ...”<sup>298</sup> Hence, the Board stated in its 2001 decision approving the White Rose Benefits Plan that it expected expenditures “consistent with national norms for such expenditures by the

<sup>297</sup> CE-87, Terra Nova 2000 R&D Report (Mar. 2001), p. 10. See also CE-88, Terra Nova 2000 E&T Report (Mar. 2001), p. 13 projecting E&T spending of only \$150,000 - \$200,000 per year in 2002 and 2003. Hence, the Claimants are wrong when they state at ¶ 167 of their Reply that “the Board’s plans to issue guidelines predated its knowledge that ... Terra Nova ... forecasted decreased expenditures for 2002 through 2004.”

<sup>298</sup> Smyth Statement I, ¶ 6. See also Way Statement I, ¶ 44 (“The reports and information filed with the Board indicated declining research and development expenditures for both Hibernia and Terra Nova. These actual and projected declines of R&D and E&T expenditures caused considerable concern within the Board about the level of future R&D and E&T spending by Operators and their commitment to the R&D and E&T requirements in their approved Benefits Plans.”).

private sector.”<sup>299</sup> In the same decision, the Board stated that it would issue guidelines to this effect.<sup>300</sup>

213. The Claimants challenge that the reports of decreased expenditures motivated the decision to issue the Guidelines in late 2001. They assert that the decision predated the Board’s knowledge of the decreased expenditures.<sup>301</sup> This is not correct. The decreased expenditures were reported in the 2000 reports, described above, which were issued in early 2001, eight months before the decision to issue the Guidelines was announced in the White Rose decision.

214. The Claimants note that “[f]or the five years up to and including 2000, Hibernia reported average R&D expenditures of approximately \$3 million per year ... [but between 2004 and 2008] under the Guidelines, the Board is requiring Hibernia to spend an average of approximately \$14 million per year.”<sup>302</sup> However, the Claimants fail to mention the difference in revenues which Hibernia was generating between 1996-2000 and 2004-2008. In the first period, production began, revenues were small and, consequently, expenditures were a large part of this revenue. Indeed, as explained above, in 1998, R&D expenditures were approximately 0.6% of revenues. The Board felt no need to intervene in response to the operators spending this percentage of their revenue on R&D. By 2000, Hibernia R&D, as a percentage of revenues, had fallen by 90%. Reports of these dramatically decreasing expenditures, together with the forecasts of the equally dramatic decreased expenditures at Terra Nova, forced the Board to intervene.

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<sup>299</sup> RE-22, White Rose Decision 2001.01, p. 18, quoted in Counter Memorial, ¶ 90. Through this decision, the Board immediately told the Hibernia and Terra Nova operators of its expectations. Thus, the Claimants are wrong when they state at ¶ 170 of their Reply that they were not immediately informed.

<sup>300</sup> *Id.*, p. 25, quoted in Counter Memorial, ¶ 95.

<sup>301</sup> Claimants’ Reply Memorial, ¶ 167.

<sup>302</sup> Claimants’ Reply Memorial, ¶ 168.

**f) Canadian Courts Confirmed What Should Have Been the Claimants' Expectations**

215. The expectations which the Claimants should have had were confirmed by Canadian courts. In rejecting the Claimants' challenge to the Guidelines, the courts held that the Guidelines were consistent with the Accord and the Accord Acts. The Trial Court held that the Board "has the authority to establish reasonable levels of expenditure required to be made for research and development and education and training as part of its ongoing monitoring and enforcement role under the Accord and the Act."<sup>303</sup>

216. The Court of Appeal stated that:

section 45(3) of the federal Act provides that a Canada-Newfoundland benefits plan *shall* contain provisions intended to ensure that expenditures shall be made for research and development to be carried out in the Province. These mandatory provisions contain no qualification entitling oil companies to refuse to expend on research and development because they are of the opinion the needs of their projects can be met with existing knowledge and technology.<sup>304</sup>

217. Both the Trial and Appeal Courts also held that the Guidelines are consistent with the decisions approving the Hibernia and Terra Nova Benefits Plans. According to the Court of Appeal, the Board:

...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 [*sic*] issued. The same rules apply today.<sup>305</sup>

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<sup>303</sup> CA-52, Trial Court Decision, ¶ 74, quoted in Counter Memorial, ¶ 135.

<sup>304</sup> CA-53, Court of Appeal Decision, Justice Barry, ¶ 130, quoted in Counter Memorial, ¶ 134. The emphasis is the court's.

<sup>305</sup> *Id.*, ¶ 135, quoted in Counter Memorial, ¶ 137. See also CA-52, Trial Court Decision, ¶ 47.

218. The Claimants curtly dismiss the court decisions as irrelevant to their legitimate expectations.<sup>306</sup> Yet, far from irrelevant to the Claimants' legitimate expectations, the decisions are fundamental. Since the Guidelines are consistent with the Accord and the Accord Acts, as held by the courts, then they cannot possibly be inconsistent with the legitimate expectations generated by the Accord and the Accord Acts. Similarly, since the Guidelines are consistent with the Hibernia and Terra Nova decisions, as held by the courts, then they cannot possibly be inconsistent with the legitimate expectations arising from those decisions.

219. In addition to dismissing the Canadian court decisions as irrelevant, the Claimants baldly assert that they are incorrect and should not be respected by this Tribunal.<sup>307</sup> The Claimants did not address the numerous cases to which Canada referred in its Counter Memorial in which NAFTA tribunals refused to reconsider the decision of a domestic court unless it was tainted by a denial of justice.<sup>308</sup> Nor did the Claimants address the decisions of the Permanent Court of International Justice or Professor Brownlie's observation that "[i]nterpretation of their own laws by national courts is binding on an international tribunal."<sup>309</sup>

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<sup>306</sup> Claimants' Reply Memorial, Annex A, ¶¶ 11-14.

<sup>307</sup> Claimants' Reply Memorial, ¶ 154.

<sup>308</sup> See Counter Memorial, fn. 479, referring to **RA-3**, *Azinian*, ¶ 97 ("A governmental authority surely cannot be faulted for acting in a manner validated by its own courts unless the courts themselves are disavowed at the international level."); ¶ 99 ("The possibility of holding a State internationally liable for judicial decisions does not, however, entitle a claimant to seek international review of the national court decisions as though the international jurisdiction seized has plenary appellate jurisdiction. This is not true generally, and it is not true for NAFTA. What must be shown is that the court decision itself constitutes a violation of the treaty."); **CA-36**, *Mondev*, ¶ 136 ("On the approach adopted by Mondev, NAFTA tribunals would turn into courts of appeal, which is not their role."); **CA-33**, *Thunderbird*, ¶ 125 ("It is not the Tribunal's function to act as a court of appeal or review in relation to the Mexican judicial system regarding the subject matter of the present claims ..."). See also **RA-132**, *Waste Management Inc. v. United Mexican States*, (ICSID ARB(AF)/00/3) Decision on Mexico's Preliminary Objection to Jurisdiction (26 June 2002), ¶ 47 (hereinafter "*Waste Management IP*") ("a NAFTA tribunal does not have 'plenary appellate jurisdiction' in respect of decisions of national courts, and whatever may have been decided by those courts as to national law will stand unless shown to be contrary to NAFTA itself.")

<sup>309</sup> See Counter Memorial, fn. 355, referring to **RA-45**, *Case Concerning The Payment of Various Serbian Loans Issued in France*, (1929) P.C.I.J. (Series A) No. 14, p. 46, **RA-5**, *Case Concerning The Payment in Gold of Brazilian Federal Loans Contracted in France*, (1929) P.C.I.J. No. 15, p. 124 and **RA-6**, Brownlie, I., *Principles of Public International Law*, 7<sup>th</sup> ed. (Oxford University Press: 2008), p. 39.

220. Instead, the Claimants refer to authorities which provide them with no support.<sup>310</sup> The Claimants rely on Article 3 of the International Law Commission's Articles on the Responsibility of States for Internationally Wrongful Acts, which states that "[t]he characterization of an act of a State as internationally wrongful is governed by international law. Such characterization is not affected by the characterization of the same act as lawful by internal law."<sup>311</sup> While this is true, it does not assist the Claimants. Canada does not rely merely on the fact that the Guidelines are consistent with domestic law to argue that they are consistent with the NAFTA. Canada simply notes that the Claimants have alleged a breach of the NAFTA *through a failure to fulfil their legitimate expectations*. Those expectations are based on domestic law. Since the Guidelines are consistent with domestic law, they cannot be inconsistent with those expectations.<sup>312</sup>

## 2. The Alleged Expectations of the Claimants Have no Basis

221. Despite the decision of the Canadian courts, the Claimants continue to maintain that they legitimately expected they could spend what they determined was necessary for the projects. They maintain that they legitimately expected that they could spend nothing on R&D and E&T if they deemed such expenditures unnecessary for the projects. The Claimants have not identified a single promise or assurance to support this expectation. Instead, they seek to draw their expectations from tangential and unrelated sources.

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<sup>310</sup> Claimants' Reply Memorial, fn. 184.

<sup>311</sup> **CA-158**, UN International Law Commission, *Draft articles on Responsibility of States for Internationally Wrongful Acts*, UN Doc. No. A/56/10 (2001), p. 36.

<sup>312</sup> The commentary to the ILC Article on which the Claimants rely recognizes the importance of domestic law in similar circumstances. **RA-16**, *Responsibility of States for Internationally Wrongful Acts 2001*, Report of the International Law Commission, Fifty-Third Session (23 April-1 June and 2 July-10 August 2001), Supp. No. 10 (A/56/10), United Nations, New York, Commentary, p. 38 ("Especially in the fields of injury to aliens and their property and of human rights, the content and application of internal law will often be relevant to the question of international responsibility. In every case it will be seen on analysis that either the provisions of internal law are relevant as facts in applying the applicable international standard, or else that they are actually incorporated in some form, conditionally or unconditionally, into that standard"). The Claimants also fail to mention that the Special Rapporteur to those Articles, Professor James Crawford, presided over the *Waste Management II* tribunal, which held that: "a NAFTA tribunal does not have 'plenary appellate jurisdiction' in respect of decisions of national courts, and whatever may have been decided by those courts as to national law will stand unless shown to be contrary to NAFTA itself." **RA-132**, *Waste Management II*, ¶ 47.

222. For the first time in this arbitration, the Claimants in their Reply seek to draw legitimate expectations from Canada's practice under the Foreign Investment Review Act. ("FIRA").<sup>313</sup> The FIRA prescribed rules for the review of the foreign purchase of Canadian businesses from 1973 until it was replaced by the Investment Canada Act in 1985.

223. First, the FIRA cannot be important if the Claimants omitted any mention of it in their Memorial. Second, the FIRA did not govern the investment in Hibernia or Terra Nova.<sup>314</sup> The Claimants cannot draw legitimate expectations from a law to which they were not subject. Third, the FIRA only obliged foreign investors to comply with the commitments that they had undertaken. By contrast, the decisions approving the Benefits Plans obliged the Claimants to comply with express obligations in the Accord Acts, including the obligation to expend on R&D and E&T. Finally, the Claimants have provided no documents to support their argument that the FIRA influenced their legitimate expectations.

224. The Claimants also seek to draw expectations from obligations imposed "in other Canadian provinces."<sup>315</sup> However, the Claimants fail to refer to a single document or witness statement to describe the content of such obligations, let alone that they influenced the Claimants' expectations concerning Hibernia and Terra Nova.

225. The Claimants also seek to draw expectations from the 1990 fiscal agreement between the operators and the federal and provincial governments.<sup>316</sup> As explained in the Counter Memorial,<sup>317</sup> this agreement was separate to the Accord Acts. It did not address

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<sup>313</sup> Claimants' Reply Memorial, ¶ 155.

<sup>314</sup> The Guidelines concerning Acquisitions of Interests in Oil and Gas Rights explain that the Claimants' investment in Hibernia fell outside the investments which were subject to review under the Act. **RA-91**, *Foreign Investment Review Act, Guidelines concerning Acquisitions of Interests in Oil and Gas Rights*, 5 January 1976.

<sup>315</sup> Claimants' Reply Memorial, ¶ 152.

<sup>316</sup> Claimants' Reply Memorial, ¶ 183.

<sup>317</sup> Counter Memorial, ¶¶ 59-60.

the Claimants' R&D and E&T expenditure obligation under those Acts and, consequently, provides no legitimate expectations concerning that obligation. Moreover, since the Board was not a party to the agreement, it cannot generate any legitimate expectations regarding the Board's future actions.<sup>318</sup>

226. Finally, the Claimants argue that their immediate response to the draft Guidelines in 2003 illustrates their expectations.<sup>319</sup> It is hardly worth stating that the Claimants' objections to the Guidelines are not evidence of the Claimants' legitimate expectations at the time of their investment.

227. Thus, the Claimants have provided no support for their alleged expectation that they could decide whether to spend on R&D and E&T in NL. The only legitimate expectations were that:

- the legal framework to govern their investment would reflect the importance of R&D and E&T to the sustainable development of NL;
- the Claimants were required to make expenditures on R&D and E&T in NL;
- these expenditures would be monitored and approved by the Board; and
- the Board had the authority to issue guidelines on the R&D and E&T expenditure requirement.

228. As confirmed by the Canadian courts, the Guidelines on R&D and E&T expenditures are perfectly consistent with these expectations.

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<sup>318</sup> The Claimants assert in their Reply at ¶ 134 that the decisions approving the Benefits Plans generated contracts between the Board and the operators. The Claimants provide no authority for this assertion and it is not correct. The decisions approving the Benefits Plans were the exercise of the Board's regulatory authority to unilaterally decide that the operators had fulfilled their obligation in section 45(2) of the Accord Acts, subject to the conditions contained in the decisions. That section states that "[b]efore the Board may approve any development plan ... a Canada-Newfoundland benefits plan shall be submitted to and approved by the Board ...". Hence, when the Claimants argued before Canadian courts that the Guidelines were inconsistent with the decisions, the Claimants followed the normal administrative law process for challenging regulatory decisions. The Claimants did not claim for a breach of contract.

<sup>319</sup> Claimants' Reply Memorial, ¶ 180.

**IV. THE CLAIM FOR COMPENSATION IS STILL UNFOUNDED**

229. In their Reply, the Claimants maintain that their damages are the difference between the expenditures on R&D and E&T required by the Guidelines and the expenditures which they would have undertaken in the ordinary course of business (“shortfall”).<sup>320</sup> However, despite recognizing the “significant factual developments since [they] filed their initial Memorial,”<sup>321</sup> the Claimants failed to re-quantify their shortfall. Instead, they propose to re-quantify that shortfall “nearer to the hearing date.”<sup>322</sup>

230. By failing to quantify their damages in their Reply, the Claimants have prejudiced Canada’s preparation of its defence. Nonetheless, even without the Claimants’ quantification, there is sufficient information to conclude that the claim for compensation remains unfounded.

231. The Claimants continue to claim damages from the time that the Guidelines were implemented in 2004 until the end of their projects in 2036. However, the NAFTA prevents the Tribunal from awarding damages incurred after the Notice of Arbitration was filed on November 1, 2007. Moreover, the Claimants’ assessment of their loss from 2004 to 2036 is exaggerated because:

- the claim for damages from 2004 to 2008 is still exaggerated;
- the claim for damages for 2009 and 2010 is premature; and
- the claim for damages from 2011 to 2036 is unfounded.
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<sup>320</sup> Claimants’ Reply Memorial, ¶ 196.

<sup>321</sup> Claimants’ Reply Memorial, ¶ 195.

<sup>322</sup> Claimants’ Reply Memorial, ¶ 195. See also ¶ 206.

**A. Damages Incurred after November 1, 2007 Cannot be Awarded****1. The Tribunal Does Not Have Jurisdiction to Award Damages Incurred After the Date of the Claim**

232. Canada explained in its Counter Memorial<sup>323</sup> that the NAFTA only allows a tribunal to award compensation for damages incurred before the date of the claim.

Article 1116(1) states:

An investor of a Party may submit to arbitration under this Section a claim that another Party has breached an obligation under [Chapter Eleven]...and that the investor has incurred loss or damage by reason of, or arising out of, that breach.<sup>324</sup>

233. The operation of Article 1116 was confirmed in *UPS v. Canada* where the NAFTA Chapter 11 tribunal held that a claimant cannot recover losses incurred after the date of the claim:

If a violation of NAFTA is established with respect to any particular claim, any obligation associated with losses arising with respect to that claim can be based only on losses incurred within three years of the date when the claim was filed.<sup>325</sup>

234. The Claimants do *not* address *UPS* in their Reply. Nor do they identify decisions which support a different interpretation. Instead they assert that Article 1116(1) “is a [...] standing provision [which] does not speak to the rules applicable to compensation.”<sup>326</sup> Article 1116(1) goes to the very issue of the Tribunal’s jurisdiction and speaks directly to what damage the Tribunal may award. It clearly limits a claim under Chapter 11 to damages that have been “incurred.” The provision does not allow a claim for loss or damages “that the investor has incurred *or will incur*.” The wording of the provision must be given effect.

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<sup>323</sup> Counter Memorial, ¶¶ 328-331.

<sup>324</sup> CA-3, NAFTA, Chapter 11. Article 1117 has nearly identical wording.

<sup>325</sup> RA-71, *United Parcel Service of America v. Canada*, (UNCITRAL) Award on the Merits, 24 May 2007, ¶ 30.

<sup>326</sup> Claimants’ Reply Memorial, ¶ 237.

235. The Claimants filed their claim on November 1, 2007.<sup>327</sup> The Tribunal does not have jurisdiction to award damages incurred after that date.

**2. Damages From Future Payments under the Guidelines Were Not Incurred When the Guidelines Were Issued in 2004**

236. As explained in the Counter Memorial,<sup>328</sup> the claim for loss until 2036 is *not* a claim for damages which the Claimants have already incurred. In some cases compensating future losses is appropriate where the damage has already been incurred. But this is not the case here. For example, this is *not* a claim for the past expropriation of an investment that requires the calculation of the investment's future profits to determine the value of the investment on the date of expropriation. Nor is it a claim for the past repudiation of a contract that requires the calculation of the lost profits under the contract. In those circumstances, the damages are incurred on the date of the expropriation or repudiation, which is in the past. Conversely, the Claimants assert that they will incur damages each year until 2036 through expenditures made under the Guidelines. This is a claim for damages not yet incurred.

237. The fact that the Claimants have not incurred all of their claimed damages is confirmed by their financial statements. International Accounting Standard 37 ("IAS 37") requires companies to record "a liability of uncertain timing or amount"<sup>329</sup> when:

- (a) an entity has a present obligation (legal or constructive) as a result of a past event;
- (b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and
- (c) a reliable estimate can be made of the amount of the

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<sup>327</sup> Notice of Arbitration.

<sup>328</sup> Counter Memorial, ¶ 326. See also Second Expert Report of Richard E. Walck, ¶ 169 (hereinafter "Walck Report II").

<sup>329</sup> **GFA-23**, International Accounting Standard 37, *Provisions, Contingent Liabilities and Contingent Assets*, ¶ 10.

obligation.<sup>330</sup>

238. In response to a request by Canada, the Claimants did not produce any document demonstrating that they have recorded a provision for all their future Guidelines expenditures.<sup>331</sup>

239. Despite this fact, the Claimants continue to allege that they have already incurred all of their damages. They argue that, the moment the Board first implemented the Guidelines in 2004, the Claimants incurred *all* of their damages, from 2004 to 2036.<sup>332</sup>

240. The only support which the Claimants provide for their interpretation of what damages “incurred” means is the NAFTA tribunal’s decision in *Grand River*.<sup>333</sup> In that case, Grand River challenged a requirement that they annually place into escrow a percentage of their revenue from selling cigarettes. However, by the time they brought their claim, it had been three years since the statutory scheme was implemented. The tribunal had to determine when Grand River had incurred loss or damage in the context of the United States’ argument that the claim was time-barred. The issue in *Grand River* was thus not whether the claimant had brought a claim under Article 1116(1) for damages incurred after the date of the claim, but whether the claimant was time-barred under Article 1116(2).

241. In any event, a proper reading of the decision does not confirm the Claimants’ expansive interpretation of the word “incurred.” To the contrary, the tribunal in *Grand River* confirms the opposite. In that case, Grand River did not incur loss or damage on the date the escrow statutes were adopted, as the Claimants seem to allege.<sup>334</sup> Rather,

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<sup>330</sup> *Id.*, ¶ 14. The requirement that the obligation arise from a *past* event is important. IAS 37 is careful to distinguish existing obligations from obligations that are dependent on future actions. Provisions are not made for obligations that are dependent on future actions. See Walck Report II, ¶ 59.

<sup>331</sup> Redfern Schedule, 24 May 2010, Document Request No. 5.

<sup>332</sup> Claimants’ Reply Memorial, ¶ 238.

<sup>333</sup> CA-95, *Grand River Enterprises Six Nations Ltd. v. United States*, (UNCITRAL) Decision on Objections to Jurisdiction, 20 July 2006 (hereinafter “*Grand River*”).

<sup>334</sup> Claimants’ Reply Memorial, ¶ 238.

Grand River incurred loss when it “became liable to” those laws; that is, when it sold cigarettes under those statutes.<sup>335</sup> Similarly, Mobil and Murphy Oil did not incur all their damages when the Guidelines were implemented in 2004 but incur damages each year that they produce oil and thereby become subject to the Guidelines in that year. Thus, *Grand River*, the sole authority on which they rely, confirms that the Claimants did not incur all of their claimed damages before the date of the claim.

242. The decision in *Grand River* is also confirmed by *Occidental*. In that case, Occidental claimed damages arising from Ecuador’s refusal to refund its Value Added Tax. The tribunal held that Occidental had incurred damages from the tax it had already paid but not from tax it might pay in the future.<sup>336</sup> By analogy, the Claimants have not incurred damages for all the oil it may produce in the future.

#### **B. The Claimants’ Loss or Damage Before November 1, 2007**

243. The Claimants maintain that their damages are the difference between the expenditures on R&D and E&T required by the Guidelines and the expenditures which they would have undertaken in the absence of the Guidelines.<sup>337</sup> This is called their “shortfall.” The Guidelines require the Claimants to spend the shortfall on further R&D and E&T. On March 31, 2010, the Claimants submitted to the Board proposed R&D and

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<sup>335</sup> CA-95, *Grand River*, ¶ 77.

<sup>336</sup> CA-39, *Occidental Exploration and Production Co. v. Republic of Ecuador*, LCIA Case No. UN3467, Final Award, 1 July 2004, ¶ 210 (hereinafter “*Occidental*”). The Claimants argue that Occidental is different because the future loss in that case “would not be incurred unless and until a future rebate was sought and then denied by Ecuador,” Claimants’ Reply Memorial, ¶ 248. The Claimants misread the case. Ecuador had issued “Denying Resolutions” that pre-emptively denied all future reimbursement applications by the Claimants (*Occidental*, ¶ 3). According to the tribunal, seeking rebates was “futile” and they awarded damages for past rebates that had *not* been requested from Ecuador (*Occidental*, ¶ 205). Thus, despite the “futility” of seeking rebates under the Denying Resolutions, the tribunal did not award VAT that was not yet due or paid. More importantly, the Claimants’ interpretation confirms that the Claimants have not incurred all future payments under the Guidelines until 2036. If loss could be incurred only after Occidental sought a rebate under the Denying Resolutions, as the Claimants allege, then Canada’s position is vindicated. Such a reading would show that, in order for an investor to incur loss, more is required than the mere promulgation of a statute, resolution, or guideline. That fact that the Claimants advocate this approach in their interpretation of *Occidental* vindicates Canada’s position.

<sup>337</sup> Claimants’ Reply Memorial, ¶ 196.

E&T expenditures that could meet their shortfall (the "Work Plans").<sup>338</sup> These additional expenditures will provide the Claimants with SR&ED tax credits, royalty payment deductions, and operational benefits that would not exist but for the Guidelines.

244. The Claimants' loss or damage is thus quantified by assessing their:

- obligations under the Guidelines;
- R&D and E&T expenditures in the absence of the Guidelines;
- SR&ED tax credits on additional spending under the Work Plans;
- royalty payment deductions on additional spending under the Work Plans; and
- operational benefits from the additional spending under the Work Plans.

#### **1. The Claimants' Obligations under the Guidelines**

245. While the Guidelines have operated since 2004, they were not enforced by the Board until their legality was confirmed by Canadian courts in late 2008.<sup>339</sup> After this confirmation, the Board assessed the Claimants' obligations under the Guidelines.<sup>340</sup>

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<sup>338</sup> **CE-212**, Hibernia R&D Work Plan; **CE-213**, Terra Nova R&D and E&T Work Plan. In their Reply at ¶ 218, the Claimants state that the expenditures proposed in the Work Plans do not indicate how they will spend their shortfall because the "proposals are dependent on the Board's own decision as to whether or not to accept them." The Board has now approved a number of these expenditures and is presently assessing the others, **GFA-46**, May 28, 2010 Letter from J. Bugden to A. Ringvee re Work Plan approval - Dual Oil Producer; **GFA-48**, May 28, 2010 Letter from J. Bugden to A. Ringvee re Work Plan approval - OLS Replacement. The Claimants also suggest that NL may not have the "capacity to absorb" the expenditures proposed in the Work Plans. However, in response to the Claimants' assertion in their Memorial that there was insufficient capacity in the province to absorb the expenditures required under the Guidelines, Canada submitted the expert report of Wade Locke and the witness statements of Charles Randall and Raymond Gosine. In their Reply, the Claimants have not addressed this report or these statements. Consequently, the evidence that the province does have the capacity to absorb the expenditures required by the Guidelines is unchallenged. In his witness statement attached to the Reply, Andrew Ringvee asserted, without support, that the province does not have capacity in the specific area of subsea engineering. Canada has attached a second witness statement of Raymond Gosine to address this assertion. Mr. Gosine, who is the Vice President of Research at MUN, describes the extensive capacity at that university in subsea engineering, Second Witness Statement of Raymond Gosine.

<sup>339</sup> Counter Memorial, ¶ 103.

<sup>340</sup> **CE-116**, Letter from F. Smyth, CNLOPB, to P. Sacuta, HMDC (Feb. 26, 2009); **CE-117**, Letter from F. Smyth, CNLOPB, to G. Vokey, Petro-Canada (Mar. 3, 2009).

According to this assessment, the Claimants' obligations under the Guidelines prior to November 1, 2007 are \$19.626 million for Hibernia and \$7.385 million for Terra Nova.<sup>341</sup>

246. The Claimants later sought approval from the Board to have the development phase credit ("DPC") from both projects apply to their Guidelines obligations.<sup>342</sup> As explained in the Counter Memorial,<sup>343</sup> the DPC is a credit for R&D and E&T expenditures during the development phase and totals 0.5% of the capital cost of the project. Applying the DPC to the Claimants' obligations prior to November 1, 2007, reduces the obligation for Hibernia to \$16.638 million and reduces the obligation for Terra Nova to \$6.341 million.

## **2. The Claimants' R&D and E&T in the Absence of the Guidelines**

247. After the Board assessed the Claimants' obligations under the Guidelines, the Claimants submitted to the Board for approval R&D and E&T expenditures they had made in the ordinary course of business. The Board's determination of eligibility reflects the Claimants' ordinary course expenditures in this arbitration,<sup>344</sup> that is, the amount the Claimants would have otherwise spent on R&D and E&T in the absence of the Guidelines.

248. In December 2009 and March 2010, the Board approved R&D and E&T expenditures prior to November 1, 2007 that total \$6.990 million for Hibernia and \$4.372 million for Terra Nova. Subtracted from the Claimants' obligations under the Guidelines, the Claimants' shortfall is \$9.648 million for Hibernia and \$1.969 million for Terra Nova.

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<sup>341</sup> Walck Report II, ¶ 125. All calculations in the Counter Memorial and Rejoinder account for the Claimants' respective ownership interests in Hibernia and Terra Nova. However, the calculations made in Walck Report II are determinative.

<sup>342</sup> CE-122, Letter from G. Vokey, Petro-Canada, to F. Smyth, CNLOPB (May 7, 2009); CE-180, Letter from J. Bugden, CNLOPB, to P. Phelan, HMDC (Jan. 8, 2010).

<sup>343</sup> Counter Memorial, ¶ 359.

<sup>344</sup> Claimants' Reply Memorial, ¶ 198; Counter Memorial, ¶¶ 309-310.

### 3. The Claimants' SR&ED Tax Credits from Additional Spending Under the Work Plans

249. As described in the Counter Memorial,<sup>345</sup> the federal and provincial governments provide a tax credit of 32% for eligible SR&ED expenditures.<sup>346</sup> If the Claimants are to be returned to their position prior to the Guidelines their SR&ED tax credits need to be taken into account.

250. The Claimants refuse to quantify any SR&ED tax credits they will receive from the proposed R&D expenditures in their Work Plans.<sup>347</sup> In their Reply, the Claimants argue that no SR&ED tax credits should be deducted because the Claimants can meet their spending obligations solely through E&T expenditures, which are not eligible for the SR&ED tax credit.<sup>348</sup> However, in reality, the Claimants' Work Plans contain more than just E&T. In fact, R&D represents approximately 82-89% of the Hibernia Work Plan's total estimated future spending.<sup>349</sup>

251. The Claimants also argue against the deduction for SR&ED tax credits because "none of [the Work Plan] spending is required by the projects themselves."<sup>350</sup> However, an R&D expenditure need not be "required by a project" to be SR&ED eligible.

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<sup>345</sup> Counter Memorial, ¶ 318.

<sup>346</sup> **CE-142**, Canada Revenue Agency, What is the SR&ED Program? (hereinafter "What is the SR&ED Program?"); **RA-17**, *Income Tax Act*, S.N.L. 2000, c. 1-1.1, s. 42. **GFA-34**, CRA *Overview of the Scientific Exploration and Experimental Development (SR&ED) Tax Incentive Program*; **RE-53**, Hibernia Frontier, "Taking Credit for R&D", (Jul./Aug. 1998).

<sup>347</sup> This refusal is most striking in light of the Claimants' consistent proposition that the Board will only accept SR&ED eligible R&D under the Guidelines (see Claimants' Memorial, ¶ 218, fn 406; Claimants' Reply Memorial, ¶ 209 ("The Board has consistently said that it will give Guidelines credit only to those projects accepted by the CRA as eligible for SR&ED tax credits.")). If this were true, then 100% of the Claimants' shortfall R&D expenditures would receive the SR&ED tax benefit. However, they still refuse to quantify this benefit.

<sup>348</sup> Claimants' Reply Memorial, ¶ 220. In a previous section, the Claimants criticize Canada for suggesting that their obligations under the Guidelines can be met through E&T, Claimants' Reply Memorial, ¶ 84.

<sup>349</sup> Walck Report II, ¶ 109.

<sup>350</sup> Claimants' Reply Memorial, ¶ 221.

252. Lastly, the Claimants argue that the SR&ED eligibility of their Work Plan R&D expenditures is uncertain and cannot be quantified.<sup>351</sup> Thus, despite their willingness to speculate on the factors which increase their damages calculation, they refuse to account for the factors which reduce that calculation. The Claimants cannot have it both ways. Moreover, they have already admitted that their calculations will be overstated if they do not deduct SR&ED tax credits from additional R&D expenditures.<sup>352</sup> Indeed, the CRA confirms that “[g]iven the extremes of the environment conditions and scale, it is not difficult to imagine that the R&D projects will involve some element of SR&ED.”<sup>353</sup>

253. The SR&ED tax credits from the additional spending for 2004-2008 can be estimated by analyzing past data. For Hibernia, Canada's damages expert, Mr. Walck, compared the costs of the R&D projects that HMDC submitted to CRA between 2004 and 2008 with the amounts the CRA ultimately approved. Finding that 77.46% of the R&D dollars that were submitted to CRA were approved,<sup>354</sup> he concludes that an offset of 20.3% to the Claimants' shortfall at Hibernia reflects the SR&ED tax credits the Claimants will receive.<sup>355</sup>

254. Mr. Walck adopted a similar approach for Terra Nova. He found that approximately 17.8% of the expenditures for Terra Nova will generate SR&ED credits

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<sup>351</sup> Claimants' Memorial, ¶ 222; Claimants' Reply Memorial, ¶ 221.

<sup>352</sup> First Expert Report of Howard N. Rosen, ¶ 56(i) (hereinafter “Rosen Report I”) (“To the extent that the ITC's which relate to Incremental Spending would be accepted by the CRA, there would be an offset to the Incremental Spending and thus the quantum of economic damages would decrease”); Second Expert Report of Howard N. Rosen, ¶ 80 (Rosen Report “II”) (“I identify the following two areas of potential cash savings, which the Claimants may realize in the course of making the additional R&D payments necessary to meet the Guidelines: the Scientific Research and Experimental Development (“SR&ED”); and, royalties”).

<sup>353</sup> GFA-43, Letter dated May 31, 2010 from J. Muir to R. Walck.

<sup>354</sup> Walck Report II, ¶ 79.

<sup>355</sup> Walck Report II, ¶ 110.

for the owners. He therefore concludes that an offset of 5.7% to the Claimants' shortfall at Terra Nova reflects the SR&ED tax credits the Claimants will receive.<sup>356</sup>

255. Hence, the Claimants' R&D shortfall should be offset by \$1.957 million for Hibernia and \$0.112 million for Terra Nova to return the Claimants to their position prior to the Guidelines.

#### **4. The Claimants' Royalty Payment Deductions from Additional Spending Under the Work Plans**

256. As described in the Counter Memorial,<sup>357</sup> R&D or E&T spending to fill the Claimants' shortfall may qualify as an "eligible cost" under the Province's royalty scheme. The R&D and E&T spending could also qualify as "research and development costs" under the royalty scheme.<sup>358</sup> These expenditures could therefore significantly reduce the Claimants' royalty payments. For example, expenditures of \$1 million could save the Claimants more than \$425,000 in royalty payments.<sup>359</sup>

257. Unlike eligibility for SR&ED, eligibility under the royalty scheme requires expenditures to be necessary for the project. The Claimants argue that the "bulk" of their Work Plan expenditures are industry-wide initiatives which are not necessary for Hibernia or Terra Nova.<sup>360</sup> However, the Work Plans include millions of dollars in expenditures for "Proposed Hibernia R&D Projects"<sup>361</sup> and "Proposed Terra Nova R&D/E&T."<sup>362</sup> These expenditures are obviously not "industry-wide initiatives" and could be necessary for the projects.

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<sup>356</sup> Walck Report II, ¶ 116. The percentage is smaller than for Hibernia because Terra Nova has historically submitted a higher proportion of E&T projects, which are not eligible for the SR&ED tax credit.

<sup>357</sup> Counter Memorial, ¶ 320.

<sup>358</sup> GFA-45, Letter dated June 1, 2010 from V. Newhook to R. Walck (hereinafter "Newhook letter").

<sup>359</sup> Counter Memorial, ¶¶ 320-321.

<sup>360</sup> Claimants' Reply Memorial, ¶ 223.

<sup>361</sup> CE-212, Hibernia R&D Work Plan, pp. EMM0003460-EMM0003510.

<sup>362</sup> CE-213, Terra Nova R&D and E&T Work Plan, pp. EMM0003529, EMM0003532-EMM0003533.

258. The Claimants argue that it is premature to calculate any royalty deductions.<sup>363</sup> Once again, despite their willingness to speculate on the factors which increase their damages calculation, they refuse to take into account factors which reduce that calculation. Yet, the Claimants have admitted they will be overcompensated if royalty savings are not deducted from their additional R&D expenditures.<sup>364</sup> Moreover, the Province has reviewed the Projects' Work Plans and confirms that "some research and development and education and training expenditures under the Work Plans could qualify as an Eligible Cost and/or a research and development cost under the Province's royalty schemes."<sup>365</sup>

259. While it is clear there should be some deduction, it is not possible to estimate the amount of royalty deductions because the Work Plans do not contain sufficient information to determine the precise eligibility of the proposed expenditures for deduction in the calculation of royalties. Moreover, unlike SR&ED tax credits, there is no past data that can be analyzed to estimate the royalty deductions.<sup>366</sup> Yet, if the Claimants are to be returned to their position prior to the Guidelines, these royalty deductions need to be taken into account. The net impact of the offset could exceed the Claimants' shortfall, in which case the Claimants' damages would be zero.<sup>367</sup>

### **5. The Claimants' Operational Benefits under the Guidelines**

260. In addition to benefits from SR&ED credits and royalty deductions, the Claimants will benefit in other ways from the expenditures they undertake to meet their shortfall.<sup>368</sup> These benefits are described in the Work Plans. For example, in addressing the value

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<sup>363</sup> Rosen Report II, ¶¶ 80, 83.

<sup>364</sup> Rosen Report I, ¶ 56(ii), fn 25 ("If Incremental Spending were to be fully deductible from pre-tax income for the purposes of computing the royalties, the Incremental Spending pertaining to Hibernia and Terra Nova would decrease by 40% and 30%, respectively.")

<sup>365</sup> GFA-45, Newhook letter.

<sup>366</sup> Walck Report II, ¶ 119.

<sup>367</sup> Walck Report II, ¶ 44.

<sup>368</sup> Counter Memorial, ¶ 322.

added from undertaking a study of iceberg impact on subsea wells, the Hibernia Work Plan notes:

- “Savings of approx. \$6-\$8 M per well – excavation & habitat compensation;
- Eliminate need for protection structures for subsea infrastructure;
- Improve economics for marginal field development;
- Allow exploration well tie-in to future field developments.”<sup>369</sup>

261. Canada asked Professor Øystein Noreng, Professor of Petroleum Economics and Management at BI Norwegian School of Management, to review the Claimants’ Work Plans. He explains:

This project aims at providing a better response to the contact of icebergs with subsea wells. Very limited knowledge exists on the response of a wellhead to iceberg contact. The R&D could eliminate the need for protection structures on subsea infrastructure. This could result in savings of approximately \$6-\$8 million per well. There is potential application of this R&D to Hibernia South Extension (“HSE”) and the Ben Nevis-Avalon (“BNA”) reservoir, which are both part of the Hibernia field. The outcome of this R&D effort would potentially be of considerable benefit to future operations in Arctic waters.<sup>370</sup>

262. Every expenditure in the Hibernia Work Plan contains a section that describes the “value added” by the project. Terra Nova’s Work Plan also lists several benefits, including from the joint industry projects (“JIPS”) and the funding of the centre for

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<sup>369</sup> CE-212, Hibernia R&D Work Plan to, p. EMM0003462. The Board has approved this expenditure under the Guidelines; GFA-47, Letter dated May 28, 2010 from J. Bugden to A. Ringvee re iceberg impact study.

<sup>370</sup> Noreng Report, ¶ 8.

Arctic Resource Development.<sup>371</sup> Moreover, the Terra Nova Work Plan states “R&D/E&T Workplan proposed will be of direct benefit to Terra Nova.”<sup>372</sup>

263. The Claimants argue that without “concrete evidence as to the net economic value of the alleged benefits...the Tribunal should simply ignore Canada’s hypotheticals.”<sup>373</sup> But, it is clear from the Claimants’ own documents that they will benefit significantly from the expenditures in the Work Plans.

264. Canada is unable to quantify these operational benefits which the Claimants will receive from the increased R&D and E&T required by the Guidelines. Yet, if the Claimants are to be returned to their position prior to the Guidelines, these operational benefits need to be taken into account. The net impact of these benefits could reduce the Claimants’ damages to zero.<sup>374</sup>

## 6. Summary

265. The Claimants’ shortfall before November 1, 2007 is \$11.617 million. However, the Claimants acknowledge that they will receive SR&ED tax credits, royalty payment deductions, and operational benefits from additional expenditures to fill the shortfall.<sup>375</sup> If the Claimants are to be returned to their position prior to the Guidelines, these factors need to be taken into account.

266. To account for the Claimants’ SR&ED tax benefits, their shortfall of \$11.617 million should be reduced by \$2.069 million. From the remaining \$9.548 million, royalty savings and operational benefits must be deducted. While these cannot be precisely quantified at this time, they could be sufficiently significant to reduce the Claimants’ damages from 2004 until November 1, 2007 to zero.

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<sup>371</sup> CE-213, Terra Nova R&D and E&T Work Plan, pp. EMM0003540-EMM0003546.

<sup>372</sup> *Id.*, p. EMM0003532.

<sup>373</sup> Claimants’ Reply Memorial, ¶ 225.

<sup>374</sup> Walck Report II, ¶ 44.

<sup>375</sup> Rosen Report I, ¶ 56.

**C. The Claimants' Assessment of Their Loss is Exaggerated**

267. The Claimants have not assessed their loss before November 1, 2007. Instead, they have assessed their damages from 2004 to 2008 and from 2009 until 2036. The Claimants' assessment of their damages in these periods is exaggerated.

**1. The Claim for Damages from 2004 to 2008 is Exaggerated****a) The Claimants Inflated Their 2004-2008 Shortfall**

268. Events since the Claimants filed their Memorial confirm that they inflated the calculation of the shortfall for the 2004-2008 period. In their Memorial the Claimants alleged damages of \$30.286 million between 2004 and 2008.<sup>376</sup> However, incorporating events since the Claimants filed their Memorial, their shortfall is now \$16.016 million. The Claimants' numbers were inflated because:

- they understated their R&D and E&T in the ordinary course of business;
- they did not deduct the remaining available development phase credit from their 2004-2008 Guidelines obligations; and
- they failed to account for Murphy Oil's decreased ownership in Terra Nova.

**i) The Claimants Understated Their R&D and E&T in the Ordinary Course of Business Between 2004 and 2008**

269. In the Memorial, the Claimants' damages calculations were based on their prediction of what the Board may find to be eligible R&D and E&T expenditures:

To calculate Claimants' net exposure under the Guidelines, Mr. Rosen next deducted a sum to represent those R&D expenditures *likely to be deemed eligible* by the Board for Guidelines credit. Mr. Rosen based that assessment on the data collected by Claimants and submitted to the Canadian Revenue Agency ("CRA") with a

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<sup>376</sup> Claimants' Reply Memorial, ¶ 199.

view to obtaining tax credits under the SR&ED incentive program during the applicable period.<sup>377</sup>

270. The Claimants predicted the Board would approve as eligible under the Guidelines ordinary course expenditures amounting to \$7.754 million between 2004 and 2008. In December 2009 and March 2010, the Board approved over \$16.151 million of the Claimants' ordinary course expenditures between 2004 and 2008 as eligible under the Guidelines.<sup>378</sup> The Claimants' prediction was incorrect because they assumed that the Board would approve only SR&ED eligible expenditures.<sup>379</sup> However, the Board approved additional R&D expenditures because R&D under the Guidelines "includes, but is not limited to" R&D which qualifies for SR&ED. Canada raised this issue in its Counter Memorial,<sup>380</sup> noting that the Claimants had inflated their shortfall by understating their R&D and E&T in the ordinary course of business.<sup>381</sup>

271. Curiously, the Claimants argue that the Board's decision "vindicates" their approach to damages.<sup>382</sup> Had the Tribunal adopted the Claimants' assessment of damages in their Memorial, the Claimants would have been overcompensated by \$8.397 million.

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<sup>377</sup> Claimants' Reply Memorial, ¶ 198, emphasis added.

<sup>378</sup> **CE-179**, Letter from J. Bugden, CNLOPB, to P. Sacuta, HMDC (Dec. 10, 2009); **CE-183**, Letter from J. Bugden, CNLOPB, to P. Phelan, HMDC (Mar. 9, 2010). The Board is still considering the eligibility of a \$521,436 E&T expenditure for Hibernia, **CE-189**, Letter from J. Bugden, CNLOPB, to G. Vokey, Suncor Energy Inc. (Dec. 15, 2009); **CE-191**, Letter from J. Bugden, CNLOPB, to K. Healy, Suncor Energy, Inc. (Mar. 8, 2010).

<sup>379</sup> Claimants' Memorial, ¶ 218, fn. 406; Claimants' Reply Memorial, ¶ 209.

<sup>380</sup> Counter Memorial, ¶ 313.

<sup>381</sup> Canada did not "predict" the Board's decision, as the Claimants allege, Claimants' Reply Memorial, ¶¶ 210-211. To the contrary, the Counter Memorial explicitly states at ¶ 310: "Canada has not made a prediction that will inevitably need to be abandoned when the Board issues its decision."

<sup>382</sup> Claimants' Reply Memorial, ¶¶ 207-215. The Claimants continue to argue that the Board "will give Guidelines credit only to those projects accepted by the CRA as eligible for SR&ED tax credits," Claimants' Reply Memorial, ¶ 209. This statement is contradicted by the Guidelines, themselves, and by the Claimants' own documents. **RE-58**, E-mail from D. Finn, PRAC, to D. Williams and R. LeDrew, Husky Energy (Sep. 6, 2007).

**ii) The Claimants Did Not Deduct the Development Phase Credit From Their 2004-2008 Guidelines Obligations**

272. In their Memorial, the Claimants did not deduct the DPC from their 2004-2008 Guidelines obligations. However, after Canada filed its Counter Memorial, the Claimants sought approval from the Board to have the DPC for Hibernia apply to their 2004 – 2008 Guidelines obligations.<sup>383</sup> The Claimants had previously sought a similar approval for Terra Nova,<sup>384</sup> which was also granted by the Board after Canada filed its Counter Memorial.<sup>385</sup>

273. For Hibernia, instead of deducting the DPC from their 2004-2008 obligations, the Claimants pro-rated the DPC over their 2009-2036 obligations, inflating their 2004-2008 shortfall. They alleged their 2004-2008 shortfall for Hibernia was \$19.829 million whereas, with the DPC applied up-front, that figure drops by \$4.012 million to \$15.817 million.

274. For Terra Nova, the Claimants did not pro-rate the DPC over the life of the projects, but applied it to their 2009 Guidelines obligations.<sup>386</sup> The Board has since applied the DPC to the Claimants' 2004-2008 obligations. By not applying the DPC to the proper time period, the Claimants inflated their 2004-2008 shortfall of \$10.455 million. With the DPC applied up-front, that figure drops by \$1.616 million to \$8.839 million.

275. By taking into account the DPC, the Claimants' shortfall for 2004 to 2008 thus drops by another significant amount. Had the Tribunal adopted the Claimants' assessment of damages in their Memorial, the Claimants would have been overcompensated by another \$5.628 million.

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<sup>383</sup> CE-180, Letter from J. Bugden, CNLOPB, to P. Phelan, HMDC (Jan. 8, 2010).

<sup>384</sup> CE-122, Letter from G. Vokey, Petro-Canada to F. Smyth, CNLOPB (May 7, 2009).

<sup>385</sup> CE-190, Letter from J. Bugden, CNLOPB, to G. Vokey, Suncor Energy Inc. (Dec. 15, 2009).

<sup>386</sup> Claimants' Memorial, ¶ 218; Rosen Report I, schedule 3.

**iii) The Claimants Failed to Account for Murphy Oil's Decreased Ownership in Terra Nova**

276. The Claimants also inflated their 2004 to 2008 shortfall by failing to account for Murphy Oil's predicted decreased ownership in Terra Nova resulting from provisions of the joint agreement between the Terra Nova owners. Murphy Oil's ownership is currently being arbitrated and is predicted by Murphy Oil to fall from 12% to 10.5%.<sup>387</sup> This decreased ownership will be retroactive to 2004, thus further decreasing the share of the Claimants' past and future damages. The quantifications made by Canada in this Rejoinder continue to reflect Murphy Oil's 12% ownership interest in Terra Nova. Should more information become available, Canada will update its quantification prior to the hearing.

**iv) Summary**

277. In their Memorial, the Claimants alleged that their shortfall for 2004 to 2008 was \$30.286 million.<sup>388</sup> However, incorporating events since the Claimants filed their Memorial reduces that figure to \$16.016 million. The table below compares the Claimants' calculation of their 2004-2008 shortfall based on their estimate of what the Board would accept with the Board's actual determination of the projects' spending shortfalls:

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<sup>387</sup> **GFA-30**, Murphy Oil Corp. Form 10-K for the Year Ended December 31, 2009 (Feb. 26, 2010), Part I, p. 2 ("The joint agreement between the owners of Terra Nova requires a redetermination of working interests based on an analysis of reservoir quality among fault separated areas where varying ownership interests exist. The operator completed the initial redetermination in 2009 and the matter is the subject of arbitration before final interests are determined. The Company anticipates that its working interest will be reduced to approximately 10.5%, subject to the results of the ongoing arbitration process between the operator and certain other owners. Upon completion of the arbitration process, the Company will be required to make a settlement payment to the Terra Nova partnership for the value of oil sold since about December 2004 related to the ultimate working interest reduction below the Company's original 12.0%.")

<sup>388</sup> Claimants' Reply Memorial, ¶ 199.

	Hibernia	Terra Nova	Total
2004-2008 Damages Calculated by Claimants	\$19.828 million	\$10.455 million	\$30.283 million
2004-2008 Damages Based on Board's Determination of Shortfalls	\$12.965 million	\$3.051 million	\$16.016 million
Claimants' Overstatement of 2004-2008 damages	\$6.863 million	\$7.404 million	\$14.267 million <sup>389</sup>

278. By calculating damages prior to having the relevant supporting facts, the Claimants have overstated their 2004-2008 shortfall for Hibernia by 52.9%<sup>390</sup> and for Terra Nova by 242.7%.<sup>391</sup> In total, the Claimants overstated their 2004-2008 shortfall by \$14.267 million, which represents a 93.8% overstatement.<sup>392</sup> The Claimants assert that their figures are “reasonable, reliable, and accurate.”<sup>393</sup> However, had the Tribunal accepted the Claimants’ quantification of their shortfall in their Memorial, the Claimants would have been significantly overcompensated. Canada’s submission in its Counter Memorial that the Claimants had inflated their shortfall<sup>394</sup> has been confirmed.

<sup>389</sup> This figure reflects the Board’s reassessment of the Claimants’ obligation under the Guidelines for Terra Nova, CE-190, Letter from J. Bugden, CNLOPB, to G. Vokey, Suncor Energy, Inc. (Jan. 8, 2010).

<sup>390</sup> Walck Report II, 39.

<sup>391</sup> Walck Report II, 40.

<sup>392</sup> Walck Report II, 41.

<sup>393</sup> Claimants’ Reply Memorial, ¶ 215.

<sup>394</sup> Counter Memorial, ¶¶ 312-316.

**b) The Claimants Still Fail to Deduct the SR&ED Tax Credits, Royalty Payment Deductions and Operational Benefits They Will Receive From Their Additional Expenditures on R&D and E&T**

279. Taking into account additional information available since the Claimants' Memorial, the Claimants' shortfall between 2004 and 2008 is \$16.016 million. The Claimants allege that, for this time period, an award representing their shortfall would wipe out the consequences of the Guidelines and would re-establish the situation that existed before the Guidelines were enforced.

280. However, as described above,<sup>395</sup> the Claimants have submitted to the Board two Work Plans that propose R&D and E&T expenditures to meet their shortfall. The expenditures will provide the Claimants with SR&ED tax credits, royalty payment deductions and operational benefits. Despite acknowledging that they will receive these benefits,<sup>396</sup> the Claimants refuse to quantify them.<sup>397</sup>

281. The Claimants' SR&ED tax credits can be quantified in the same method described above.<sup>398</sup> In short, an offset of 20.3% to the Claimants' shortfall at Hibernia<sup>399</sup> and 5.7% to their shortfall at Terra Nova<sup>400</sup> reflects the SR&ED tax credits the Claimants will receive. Applied against the Claimants' R&D shortfall expenditures for 2004–2008, an offset of \$2.632 million for Hibernia and \$0.174 million for Terra Nova should be applied against the Claimants' 2004-2008 shortfall to return them to their position prior to the Guidelines.

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<sup>395</sup> Rejoinder, ¶¶249-264.

<sup>396</sup> Rosen Report I, ¶ 56.

<sup>397</sup> Rosen Report II, ¶¶ 80, 83.

<sup>398</sup> Rejoinder, ¶¶ 253-254.

<sup>399</sup> Walck Report II, 110.

<sup>400</sup> Walck Report II, 116.

282. While it is clear the Claimants will receive royalty payment deductions and operational benefits, it is not possible to estimate these amounts. Yet, if the Claimants are to be returned to their position prior to the Guidelines, these deductions need to be taken into account. The net impact of the offset could exceed the Claimants' shortfall, in which case the Claimants' damages would be zero.<sup>401</sup>

**c) Summary**

283. Taking into account additional information available since the Claimants' Memorial, the Claimants' shortfall between 2004 and 2008 is \$16.016 million. However, the Claimants acknowledge that they will receive SR&ED tax credits, royalty payment deductions, and operation benefits from their additional expenditures.<sup>402</sup> To account for the Claimants' SR&ED tax benefits, their damages claim of \$16.016 million should be reduced by \$2.806 million. From the remaining claim of \$13.210 million, royalty savings and operational benefits must be deducted. While these cannot be precisely quantified at this time, the net impact could exceed \$13.210 million, in which case the Claimants' damages would be zero.<sup>403</sup>

**2. The Calculation of Damages for 2009 and 2010 is Premature**

284. On February 11, 2010 the Board assessed the Claimants' R&D and E&T obligations under the Guidelines for the year 2009.<sup>404</sup> That assessment totals \$7.286 million. In order to determine the Claimants' damages in 2009, we must deduct from this amount the Claimants' ordinary course expenditures in 2009 and the Claimants' SR&ED tax credits, royalty payment deductions and operational benefits.

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<sup>401</sup> Walck Report II, ¶ 44.

<sup>402</sup> Rosen Report I, ¶ 56.

<sup>403</sup> Walck Report II, ¶ 44.

<sup>404</sup> **GFA-31**, February 11, 2010 Letter from J. Bugden to P. Sacuta re Hibernia 2009 expenditure requirements; **GFA-33**, February 11, 2010 Letter from J. Bugden to G. Vokey re Terra Nova 2009 expenditure requirements.

285. On March 31, 2010, the Claimants submitted to the Board for approval a total of \$3.531 million in R&D and E&T expenditures for 2009.<sup>405</sup> However, the Board has not yet determined the amount of expenditures that will be credited toward the Claimants' requirements under the Guidelines. As Canada stated in its Counter Memorial,<sup>406</sup> until the Board issues its decision it is premature to calculate the Claimants' shortfall. Canada will update its quantification of the Claimants' shortfall for 2009 in its submission prior to the hearing and will offset that shortfall to account for the Claimants' SR&ED tax credits, royalty payment deductions and operational benefits.

286. The Claimants do not quantify their 2010 damages in either their Memorial or in their Reply. Nor do they describe their precise methodology for the quantification of those damages. However, the Claimants have indicated that they will quantify their 2010 damages in their submission prior to the hearing. It is thus premature for Canada to quantify these damages. Canada will respond to the Claimants' quantification in its submission before the hearing.

### **3. The Claim for Damages From 2011 to 2036 is Unfounded**

#### **a) The Claim for Damages From 2011 to 2036**

287. The Claimants continue to claim for damages until the end of the projects (2036 for Hibernia and 2018 for Terra Nova). The Claimants did not quantify these damages in their Reply. Canada explained in its Counter Memorial that the claim for damages from 2011 to 2036 is unfounded because:

- the Tribunal does not have jurisdiction to award damages not yet incurred;
- the award of damages not yet incurred is inconsistent with international principles of compensation; and
- such damages are unduly speculative.

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<sup>405</sup> **CE-186**, Letter from P. Phelan, HMDC, to J. Bugden, CNLOPB (Mar. 31, 2010); **GFA-44**, Suncor Energy, *Canada-Newfoundland and Labrador Benefits Annual Report 2009*.

<sup>406</sup> Counter Memorial, ¶¶ 309-310.

288. Nothing in the Reply affects this conclusion.

**b) The Claimants Have Not Proven that Damages from 2011 to 2036 Can be Awarded**

**i) The Tribunal Does Not Have Jurisdiction to Award Damages Not Yet Incurred**

289. As explained above and in Canada's Counter Memorial,<sup>407</sup> the Tribunal does not have jurisdiction to award damages incurred after November 1, 2007, let alone from 2011.

**ii) An Award of Damages Not Yet Incurred is Inconsistent with International Principles of Compensation**

**International Tribunals Have Consistently Refused to Award Compensation for Damages not yet Incurred**

290. The Counter Memorial explained that a claim for damages not yet incurred is inconsistent with international principles of compensation.<sup>408</sup> As recognized in Article 36 of the ILC Articles on State Responsibility, "the function of compensation is to address the *actual losses incurred* as a result of the internationally wrongful act... Monetary compensation is intended to offset, as far as may be, the damages suffered by the injured State as a result of the breach."<sup>409</sup> Consistent with this principle, international tribunals have constantly held that they may only award compensation for damages already incurred.

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<sup>407</sup> Counter Memorial, ¶¶ 328-331.

<sup>408</sup> Counter Memorial, ¶¶ 332-339.

<sup>409</sup> **RA-16**, *Responsibility of States for Internationally Wrongful Acts 2001*, Report of the International Law Commission, Fifty-Third Session (23 April-1 June and 2 July-10 August 2001), Supp. No. 10 (A/56/10), United Nations, New York, Commentary, p. 99, emphasis added. See also **RA-8A**, Crawford, J., *The International Law Commission's Articles on State Responsibility, Introduction, Text and Commentaries*, (Cambridge University Press, 2002), p. 219.

291. The seminal decision of the PCIJ in *Chorzow Factory* held that an award for compensation is an award for “loss sustained.”<sup>410</sup> Similarly, the *LG&E* tribunal stated that it could only award compensation for “damages actually suffered”<sup>411</sup> and applied this principle to refuse to compensate for a reduction in future dividends.<sup>412</sup> The tribunal in *Occidental* said it “will not order the payment of compensation or a refund of amounts that are not due or paid.” The tribunal applied this principle to reject a claim for damages not yet incurred, as recognized by the Claimants.<sup>413</sup>

292. Thus, international tribunals have consistently refused to award compensation for losses not yet incurred. While the Claimants challenge this conclusion in their Reply, in all the decisions on which they rely, damages were already incurred:

- *Sapphire* - damages were incurred by the termination of a contract;<sup>414</sup>
- *LIAMCO* – damages were incurred by the expropriation of concession rights;<sup>415</sup>
- *Aminoil* – damages were incurred by the expropriation of concession rights;<sup>416</sup>

<sup>410</sup> **CA-28**, *Factory at Chorzów*, 1928 P.C.I.J. (Ser. A) No. 17, Decision, 13 September 1928, p. 47.

<sup>411</sup> **RA-25**, *LG&E*, ¶ 96.

<sup>412</sup> The award 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 (Claimants’ Reply Memorial, ¶ 255). The tribunal rejected *LG&E*’s claim for lost future dividends because: (i) the impact of Argentina’s conduct on the value of investments had not yet crystallized; (ii) the lost future profits were uncertain; and (iii) compensation could only be awarded for damages actually suffered, **RA-25**, *LG&E*, ¶ 96.

<sup>413</sup> Claimants’ Reply Memorial, ¶ 258.

<sup>414</sup> **CA-111**, *Sapphire Int’l Petroleum Ltd v. Nat’l Iranian Oil Co.*, Ad Hoc Award, 15 March 1963, 35 I.L.R. 136, (1967), p. 185. The arbitrator found that NIOC was “in flagrant breach of the contract” (p. 180) and that NIOC’s actions constituted the “termination” of the contract.

<sup>415</sup> **CA-101**, *LIAMCO v. Government of Libya*, Ad hoc Tribunal (Sole Arbitrator), Award, 12 April 1977, p. 120. The tribunal found that there was the “[t]ermination of contract by nationalization” and that there was a “source of liability to compensate the concessionaire for said premature termination of the concession agreements.”

- *Amoco* – damages were incurred by the expropriation of assets;<sup>417</sup>
- *Phillips Petroleum* – damages were incurred by the termination of a contract;<sup>418</sup>
- *Amco* – damages were incurred by the breach of a contract;<sup>419</sup>
- *AGIP* – damages were incurred by the expropriation of oil distribution rights;<sup>420</sup>
- *ADC* – damages were incurred by the termination of agreements;<sup>421</sup>
- *SD Myers* – damages were incurred during the period that Canada had closed its border;<sup>422</sup>
- *SIAG* – damages were incurred by the expropriation of assets;<sup>423</sup>

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<sup>416</sup> **CA-94**, *Government of Kuwait v. Aminoil*, Award, 24 March 1982, p. 998, ¶ 109 The tribunal found that the Government of Kuwait issued a Decree Terminating the Agreement between the Kuwait Government and Aminoil. In this case nationalization “enabled an end to be put to a contractual situation.”

<sup>417</sup> **RA-77**, *Amoco*. In this case the parties agreed “that Amoco’s interest in Khemco was expropriated” (¶ 86), and the Tribunal assessed compensation on the basis of a fixed valuation date determined by expropriation measures (¶ 267).

<sup>418</sup> **CA-108**, *Phillips Petroleum*. The tribunal came to “[t]he conclusion that the Claimant was deprived of its property” (¶ 100) and that the date for determining liability is “when the interference has deprived the Claimant of fundamental rights of ownership and such deprivation is not merely ephemeral, or when it becomes an irreversible deprivation”(¶ 101).

<sup>419</sup> **CA-85**, *Amco Asia Corporation et al. v. Republic of Indonesia*, (ICSID ARB/81/1) Award, 20 November 1984, ¶ 265. The tribunal found an “infringement of a contractual obligation” and awarded compensation on the basis of that breach.

<sup>420</sup> **CA-84**, *AGIP S.p.A. v. People's Republic of the Congo*, (ICSID Case No. ARB/77/1), Award, 30 November 1979, 1 ICSID Reports, ¶ 97. The tribunal held that the case involved “not just an act of nationalization but also a series of repudiations by the Government of its contractual undertakings”.

<sup>421</sup> **CA-15**, *ADC*, ¶ 304. The tribunal found that legislation passed by the Hungarian Parliament “had the effect of causing the rights of the Project Company to disappear and/or become worthless...In the opinion of the Tribunal, this is the clearest possible case of expropriation.”

<sup>422</sup> **CA-44**, *S.D. Myers*. The tribunal determined that the respondent’s temporary ban on PCB exports to the USA had breached Articles 1102 and 1105 of the NAFTA.

<sup>423</sup> **CA-112**, *SIAG v. Egypt*, (ICSID ARB/05/15) Award, 1 June 2009, ¶ 427. In this case, “ownership in land was transferred from the Claimants to the government” and on that basis the tribunal found “that Claimants’ investment was directly expropriated by Egypt.”

- *SOABI* – damages were incurred by the termination of a contract,<sup>424</sup>
- *Siemens* – damages were incurred by the termination of a contract.<sup>425</sup>

293. Hence, the Claimants have not been able to cite a single international award for damages not yet incurred.<sup>426</sup>

### **Damages not yet Incurred are Speculative**

294. Canada explained in its Counter Memorial that underlying the refusal of tribunals to award compensation for damages not yet incurred is the principle that speculative damages cannot be awarded.<sup>427</sup> As recognized by the International Law Commission, “Tribunals have been reluctant to provide compensation for claims with inherently speculative elements.”<sup>428</sup> In *Chorzow*, the PCIJ recognized that “reparation must ... reestablish the situation which would, *in all probability*, have existed if that act had not been committed.”<sup>429</sup> Since damages not yet incurred will always be speculative, tribunals have refused to compensate them.

295. The Claimants responded that the uncertainty of their future damages is irrelevant. They argue that once the “fact of damage” is established, the “amount of damage” can be “an estimate, uncertain or inexact.”<sup>430</sup> Thus, the Claimants argue that if they can establish

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<sup>424</sup> **CA-114**, *SOABI v. Senegal*, (ICSID ARB/82/1) Award, 25 February 1988, ¶ 6.01. The tribunal confirmed that the government “not only put at end to the contract [and] its contractual relations” with the claimant, but also “the whole of the project.”

<sup>425</sup> **CA-46**, *Siemens A.G. v. the Argentine Republic*, (ICSID ARB/02/8) Award, 6 February 2007, ¶ 271. The tribunal considered legislation passed by Argentina to be an expropriatory act that “was a permanent measure and the effect was to terminate the Contract.”

<sup>426</sup> Moreover, with the exception of *SD Myers*, each of these cases involved a claim for lost future profits. However, at ¶ 294 of their Reply Memorial, the Claimants readily admit theirs is not a claim for future lost profits (“Claimants are not seeking future lost profits.”).

<sup>427</sup> Counter Memorial, ¶ 340.

<sup>428</sup> **RA-16**, *ILC Articles*, p. 104, ¶ 27.

<sup>429</sup> **CA-28**, *Chorzów*, p. 47, emphasis added.

<sup>430</sup> Claimants’ Reply Memorial, ¶ 257.

the fact of future damages with sufficient certainty, they have no evidentiary burden regarding the quantum of those damages and their best guess is sufficient.

296. The Claimants do not base this distinction on any principle.<sup>431</sup> Moreover, the distinction drawn by the Claimants is inconsistent with decisions and commentary. The comments of the PCIJ and the ILC quoted above concerning the danger of speculation did not distinguish between the fact and quantum of damages. Moreover, other tribunals have expressly stated that both the fact and the quantum must be sufficiently certain. The NAFTA tribunal in *SD Myers* stated:

[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.<sup>432</sup>

297. Similarly, the tribunal in *Amoco International Finance Corp. v. Iran* held:

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.<sup>433</sup>

298. Hence, there is no basis to the Claimants' argument that Canada should compensate their best guess of future damages. Both the fact and the quantum must be proved with sufficient certainty. Since both the fact and quantum of damages not yet incurred will never be certain, international tribunals have consistently refused to award them.

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<sup>431</sup> To support the distinction, Claimants cite the text *Recovery of Damages for Lost Profits*, which is a treatise on U.S. domestic law and is not applicable to investment treaty arbitrations. They also cite **CA-22**, *Compania de Aguas del Aconquija S.A. v. Argentine Republic*, (ICSID ARC/97/3) Award, 20 August 2007, ¶ 8.3.5. However, in that case the tribunal denied a claim for lost future profits because the claimant failed to establish, with a sufficient degree of certainty, that the concession would have been profitable.

<sup>432</sup> **RA-44**, *SD Myers*, ¶ 173.

<sup>433</sup> **RA-77**, *Amoco*, ¶ 238.

**iii) Damages From 2011 to 2036 Are Still  
Speculative**

299. Canada explained in its Counter Memorial that every element of the claim for damages not yet incurred is speculative. Nothing in the Reply affects this conclusion:

- the future exchange rate is still uncertain;<sup>434</sup>
- future oil production is still uncertain;<sup>435</sup>
- the future StatsCan Factor is still uncertain;<sup>436</sup>
- the Claimants' future SR&ED tax savings and royalty payment deductions are still uncertain.<sup>437</sup>

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<sup>434</sup> The uncertainty of the future exchange rate is explained in Canada's Counter Memorial, ¶ 351. In their Reply at ¶ 291 the Claimants argue their forecast is not uncertain because it takes into account "historical fluctuations." However, the forecast has not been accurate. For example, in 2009 the average exchange rate was \$1.14 and not \$1.20 as the Claimants predicted. In 2010, the average exchange rate on the date of this Rejoinder is \$1.03, much less than the \$1.12 rate the Claimants predicted. **GFA-53**, Oanda Historical Exchange Rates 1983-2009; **RE-61**, Oanda Historical Exchange Rates January 1, 2010- June 4, 2010.

<sup>435</sup> Historically, there has been significant fluctuation between the Claimants' oil production forecasts and the amount of oil actually produced. This was explained in Canada's Counter Memorial at ¶¶ 353-355 and Walck Report I, ¶¶ 47-49, 57, 61. The Claimants allege that Canada compared actual production with forecasts, which "were preliminary in nature," and that "most of the forecasts in Walck's comparison were created in the pre-production stage of the Projects," Rosen Report II, ¶ 29. However, many of the forecasts on which Mr. Walck relied were made after production began and these forecasts were still inconsistent with actual production, Walck Report II, ¶ 129.

<sup>436</sup> The uncertainty of the future StatsCan Factor was explained in Canada's Counter Memorial, ¶¶ 356-358. Canada asked the Claimants to provide evidence to support the argument that their projection of the future StatsCan Factor is conservative. Instead, in their Reply at ¶ 295, they argue that the future uncertainty of the benchmark is Canada's "own creation." Yet, the Claimants claim future losses and therefore have the burden of proving the future value of each of the variables that are relevant to the damages calculation, **RA-44**, *S.D. Myers*, ¶ 94. Nor is the argument true. The uncertainty of future StatsCan Factors is a product of the nature of the claim for damages.

- the Claimants' future cost savings are still uncertain;<sup>438</sup> and
- the continued existence of the Guidelines in their present form is still uncertain.<sup>439</sup>

300. Moreover, as described in more detail below:

- the future price of oil is still uncertain;
- the Claimants' future R&D and E&T in the absence of the Guidelines is still uncertain;
- the Claimants' future operational benefits are uncertain; and
- the Claimants' future ownership interests in the projects are uncertain.

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<sup>437</sup> The uncertainty of the Claimants' future SR&ED tax credits and royalty payment deductions was explained in Canada's Counter Memorial, ¶ 367. The Claimants' expert, Mr. Rosen, has now acknowledged that their future SR&ED and royalty benefits are uncertain. He states that it is "not known whether such spending will be eligible for SR&ED program and / or deductible for the purposes of the Projects' royalty payments going forward," Rosen Report II, ¶ 80, and that "[t]he most accurate way to compensate the Claimants in this case would be to wait until SR&ED eligibility is known each year," Rosen Report II, ¶ 81. He definitively concludes that "[w]ithout knowledge of how the Projects will utilize the Incremental Spending, quantifying the associated benefits, if any, would not be possible." Rosen Report II, ¶ 83. See also Claimants' Reply Memorial, ¶ 218 ("[I]t is not yet known how Claimants will meet their shortfall obligations"); Claimants' Memorial, ¶ 221 ("It therefore remains to be seen how the Hibernia and Terra Nova interest owners will manage their Guidelines expenditure obligations"); and Phelan Statement I, ¶ 29 ("Depending how we proceed, there may be different tax and royalty consequences that have yet to be fully understood.").

<sup>438</sup> The uncertainty of the Claimants' future cost savings was explained in Canada's Counter Memorial, ¶¶ 323, 367. In their Reply the Claimants argue that "this assertion is advanced without substance or specificity," Claimants' Reply Memorial, ¶ 224. However, they do not deny the possibility of these cost savings nor the future uncertainty that surrounds them. To fill their shortfall the Claimants may shift existing projects to NL from other locations. They may also undertake in NL projects which they would have undertaken elsewhere. This would save them costs. For example, if the Claimants are required to spend an additional \$1 million on R&D, they could (a) undertake a \$1 million project and claim the million in this arbitration; or they could (b) move a project that would have cost \$800,000 in another location to NL, where it costs \$1 million. In case (b), the Claimants' losses are only the additional \$200,000. The extent of these cost savings is uncertain.

<sup>439</sup> As Canada explained in its Counter Memorial, ¶ 368, the Claimants' entire damages claim for future loss is based on an assumption that the Guidelines will exist in their present form until 2036. However, any change to the Guidelines before 2036 would completely change the Claimants' future damages.

## The Future Price of Oil is Still Uncertain

301. The Claimants make annual predictions of the price of oil 27 years into the future. These predictions are highly speculative and cannot be used as a basis for compensation.

*Amoco International Finance Corp. v. Iran* stated:

The element of speculation in a short-term projection is rather limited, although unexpected events can make it turn out to be wrong. The speculative element rapidly increases with the number of years to which a projection relates. It is well known, and certainly taken into account by investors, that if it applies to a rather distant future a projection is almost purely speculative, even if it is done by the most serious and experienced forecasting firms, *especially if it relates to such a volatile factor as oil prices*.<sup>440</sup>

302. The *Amoco* tribunal applied these principles to deny a claim for future profits.<sup>441</sup>

303. The Claimants argue that their oil price forecast is more certain than the forecast rejected in *Amoco* because the structure of the oil market is different today than it was when the forecast in *Amoco* was made.<sup>442</sup> However, this does not imply that current oil price formation is predictable and stable. Moreover, that the structure of the oil market can change *increases* the uncertainty of the Claimants' forecast. As Canada's oil price expert, Mr. Davies, explains:

Future oil price formation, through to 2036, could change.  
Proposals to constrain trading in oil have recently been proposed.  
The structure of world oil consumption is shifting with oil demand

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<sup>440</sup> RA-77, *Amoco*, ¶ 239, emphasis added.

<sup>441</sup> RA-77, *Amoco*, ¶ 240.

<sup>442</sup> Claimants' Reply Memorial, ¶ 284. The Claimants also criticize the decision in *Amoco* because the tribunal's approach to lawful expropriation has been "criticized in academic writings" (Claimants' Reply Memorial, ¶ 285). The *Amoco* tribunal's approach to lawful expropriation is irrelevant to this case. On the contrary, their approach to speculative damages *is* relevant and academic writings have affirmed the *Amoco* tribunal's approach. For example, Irmgard Marboe writes: "The tribunal in *Amoco International Finance v. Iran* held in its often-quoted statement, that: '[o]ne of best settled rules of the law of international responsibility of States is that no reparation for speculative or uncertain damages can be awarded'", CA-146, Irmgard Marboe, *Methods of Valuation in International Practice*, in *Calculation of Compensation and Damages in International Investment Law* (Oxford International Arbitration Series 2009), p. 207. See also RA-134, Sergey Ripinsky and Kevin Williams "Damages in International Investment Law", (BIICL 2008), p. 281.

in China and other developing markets rising rapidly, while oil consumption in OECD countries has fallen since 2005. There is an increasing likelihood that oil consuming nations will impose some form of a cost of carbon in order to address global climate change. This would impact the cost of consuming oil and, as a result, impact the price of crude oil and products.<sup>443</sup>

304. The Claimants fail to cite any case to support their proposition that oil price forecasts can be used by a tribunal as a measure of fair compensation. Instead, they argue that “forecasting is a legitimate, necessary, and reliable exercise” often used when making “investment and financing decisions.” However, the *Amoco* tribunal explicitly rejected this proposition:

[Oil price] projections can be useful indications for a prospective investor, who understands how far it can rely on them and accepts the risks associated with them; they certainly *cannot* be used by a tribunal as the measure of a fair compensation.<sup>444</sup>

305. The Claimants also overstate the weight that oil companies give to oil price forecasts in their commercial practices. Mr. Davies, former Chief Economist of British Petroleum, explains:

At no time did I or BP rely on oil price forecasts to make decisions. I purchased the forecasts in order to access informed analysis and to understand the conclusions and assumptions made by price forecasters. As Chief Economist of BP I was explicitly not required to make oil price forecasts; it was fully understood that accurate price forecasting is impossible.<sup>445</sup>

306. The Claimants argue that forecasting the price of oil is a reliable exercise because Canada, through the National Energy Board (“NEB”), engages in the practice of forecasting the price of oil. This is false. The NEB does not make oil price forecasts. Approximately once every four years, the NEB creates hypothetical long term supply and demand trends for energy in Canada in a report called a “Reference Case Scenario.” In

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<sup>443</sup> Second Expert Report of Peter A. Davies, ¶ 38 (hereinafter “Davies Report II”).

<sup>444</sup> RA-77, *Amoco*, ¶ 239, emphasis added.

<sup>445</sup> Davies Report II, ¶ 9.

order to review possible future trends, the NEB makes assumptions with respect to the prices of a number of energy commodities including oil, natural gas, and coal. These assumptions are not forecasts.<sup>446</sup>

307. The Claimants argue that their oil price forecast is not speculative because it is conservative. To support this argument, they compare their forecast to scenario assumptions made by the NEB, the International Energy Agency (“IEA”) and the U.S. Energy Information Administration (“EIA”). However, none of these are a proper comparator because none is an oil price forecast. As explained by Mr. Davies:

Such a comparison is conceptually unsound and misleading. First, all three comparators are not forecasts but scenario assumptions. Unlike forecasts, they are not intended to be most likely outcomes. Each scenario is explicitly based upon no new oil and energy policy changes globally in the future. That is, each scenario scopes out how the world energy markets may look if no new policy measures are introduced. It thus gives decision makers a yardstick against which to consider new energy policy initiatives. This is conceptually sound and rational – but they are certainly not intended to be oil price forecasts.<sup>447</sup>

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<sup>446</sup> The NEB Reference Case Scenario in 2007 explicitly states that “[s]cenarios are not forecasts; they are descriptions of plausible alternative futures”, **RE-55**, National Energy Board, “*Canada’s Energy Future, Scenarios for Supply and Demand to 2025*”, p. 7. Mr. Davies further explains: “Scenarios are sets of consistent views of the future that are generated using differing assumptions for key uncertain variables. Scenarios do not contain and are not intended to produce point forecasts. Instead they use prices that are consistent with a particular set of economic, political and social assumptions about the future. Scenarios tend to be used where uncertainties prevail and where decision making needs to take into account the reality that forecasting cannot be accurate. To the contrary, an oil price forecast is a “most likely outcome”. It attempts to accurately predict the price of oil on a given date in the future. The two methodologies are conceptually different and the prices are likely to differ”, Davies Report II, ¶ 7.

<sup>447</sup> Davies Report II, ¶ 27. The Claimants also argue that their forecast is conservative because it is “below the IEA’s most aggressive climate change forecast”, Claimants’ Reply Memorial, ¶ 287; Second Expert Report of Sarah A. Emerson, ¶ 36 (hereinafter “Emerson Report II”). However, Mr. Davies explains: “This is a misleading comparison. The IEA addresses a potential path that could generate lower oil consumption. They include a cocktail of measures – and include the potential impact of higher crude oil prices to reduce the amount of oil consumed. This serves to highlight the magnitude of the challenge required to turn the world’s energy economy around and move towards a sustainable climate. Their focus is on the magnitude of the task and the urgency for policy measures. The IEA does not address the impact of climate change policies and lower world oil consumption on world oil prices. It remains very likely that a structural change in world energy consumption with lower world oil consumption would negatively impact upon world oil prices in the long run”, Davies Report II, ¶ 35.

308. Moreover, the Claimants' forecast is high because it was made when the price of oil was at a record high.<sup>448</sup> To prove this point empirically, Mr. Davies provided two graphs in his first report.<sup>449</sup> These graphs show that, historically, oil price forecasts reflect the recent price of oil. Ms. Emerson's forecast is not conservative because it takes *no* account of these historical price trends.<sup>450</sup>

309. In their Reply, the Claimants fail to address this critical issue. Instead, they argue they can "mitigate the uncertainty of future events" by using the most current information.<sup>451</sup> Ms. Emerson argues her forecast is not speculative because it provides "a reasonable view of expected future prices as of a specific date."<sup>452</sup>

310. This may be legitimate in a case of expropriation where the tribunal must determine the fair market value of an expropriated asset on the date of the taking. For

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<sup>448</sup> As Mr. Davies explained in his first report, oil price forecasts are cyclical; that is, that they rise when oil prices increase and decrease when oil prices decline: "Oil price forecasts have tended to follow recent price changes. For example, forecasts rose in 2006 when oil prices exceeded \$60 for the first time. A similar phenomenon occurred in the 1980s. Price forecasts were high when oil prices spiked around 1980. Forecasts then fell following the oil price collapse of 1985. Current oil price forecasts, such as Emerson's and those of the 2009 data set, reflect the price rises up to the 2008 oil price spike. Future forecasts are likely to reflect the prices that currently prevail", First Expert Report of Peter A. Davies, ¶ 40 (hereinafter "Davies Report I").

<sup>449</sup> Davies Report I, pp. 14-15. Davies Report I, pp. 14-15. The scenario assumptions produced by the NEB also follow this trend. For example, the NEB's 1999 Reference Case Scenario assumes the price of oil will be US\$18/barrel in 2025, **RE-54**, National Energy Board, *Canadian Energy Supply and Demand to 2025*, (1999), p. 4. The report also states at p. 4 that price forecasting is "hazardous." The 2003 Reference Case Scenario assumes that crude oil prices will remain constant at US\$22/barrel until 2025, **RE-55**, National Energy Board, *Canada's Energy Future, Scenarios for Supply and Demand to 2025*, (Jul. 1, 2003), p. 22. The report also states at p. 53 that "oil prices will be volatile." The 2007 Reference Case Scenario runs a number of different scenarios with future oil prices ranging from US\$35/barrel to US\$85/barrel until 2030, **RE-57**, National Energy Board, *Canada's Energy Future, Reference Case and Scenarios to 2030* (2007), p. 89. The report also states at p. 89 that oil prices are "volatile."

<sup>450</sup> Davies Report I, ¶ 55; Davies Report II, ¶¶ 21-23.

<sup>451</sup> Rosen Report II, ¶ 16 ("By considering sources which are reliable and utilizing information that is most current to the date of the analysis, the expert is able to mitigate the uncertainty associated with future events and gain sufficient certainty to arrive at a conclusion on damages. For this reason, an updated calculation will be presented closer to the hearing date.")

<sup>452</sup> Emerson Report II, ¶ 4.

example, in *Phillips Petroleum* the Iran-US Claims Tribunal considered a reasonable buyer's assessment of the future price of oil on the date of expropriation. The tribunal indicated that it would not be prepared to accept that assessment for any other purpose.<sup>453</sup>

### **The Claimants' Future R&D and E&T in the Absence of the Guidelines is Still Uncertain**

311. The Claimants estimate that their future annual R&D and E&T expenditures in the ordinary course of business will be a "normalized average" of their expenditures from 2004 to 2008, "with projected expenditures decreasing towards the end of the life of each Project."<sup>454</sup> The Claimants argue that using these past expenditures to project future expenditures is justified because "little R&D would be expected in the mature production phase of a project."<sup>455</sup>

312. However, this is not necessarily the case. Professor Noreng explains that:

R&D is useful to reduce costs at all stages of an oil project, including the production stage. The fate of an oil field is not sealed when the initial investment is completed and production commences; on the contrary, there is a potential for enhancing performance by raising extraction rates, prolonging lifetime, increasing total volumes, cutting costs and improving safety.<sup>456</sup>

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<sup>453</sup> CA-108 *Phillips Petroleum*, ¶ 125, emphasis added ("In order to estimate what revenue could have reasonably been expected in September 1979 to be received from the sales of the oil to be produced under the JSA, an assessment has to be made of what oil prices would have been foreseen in September 1979 to prevail on world markets during the remaining years of the JSA. *While experience shows that forecasting future crude oil prices is difficult and open to a high risk of being proved wrong by the subsequent realities of the actual market, the Tribunal's objective here is to determine the range of expectations that seemed reasonable in September 1979, not the accuracy of those expectations in fact.* The actual course of prices since 1979 to the date of this Award, while relevant to the present value of the property, is irrelevant to the value of the property in 1979, and it is the 1979 value which the Claimant seeks and to which it is entitled. Having determined the range of those expectations, the risk that world oil prices from 1979 to 1999 would prove to fall outside that foreseeable range will be discussed in the assessment of the risk factors affecting the value of the Claimant's JSA interests."). The Claimants ask the Tribunal to adopt its forecast as an "expectation of fact". Reliance on information that is "the most current" has no bearing on the certainty of a projection in this context. The tribunal in *Phillips Petroleum* clearly distanced itself from this approach.

<sup>454</sup> Claimants' Memorial, ¶ 218, fn. 409; Claimants' Reply Memorial, ¶ 272.

<sup>455</sup> Claimants' Reply Memorial, ¶ 272.

<sup>456</sup> Noreng Report, ¶ 22.

313. Moreover, there are three undeveloped reservoirs that are also part of the Hibernia field. As Canada explained in its Counter Memorial,<sup>457</sup> the development of these fields could result in significant R&D and E&T that could be applied against the production phase expenditure phase requirements for Hibernia.<sup>458</sup>

314. Finally, the Claimants' R&D and E&T expenditures in the ordinary course of business are not limited to expenditures that are related to the projects. The ordinary course expenditures are those that would have taken place "in the absence of the Guidelines,"<sup>459</sup> regardless of whether they are related to the projects. Indeed, many of the Work Plans expenditures are not related to the projects.<sup>460</sup> For example, the Plans identify a significant amount of R&D to advance the Claimants' general interests in

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<sup>457</sup> Counter Memorial, ¶¶ 365-366.

<sup>458</sup> The three undeveloped fields are Ben Nevis Avalon ("BNA"), the AA Blocks, and Hibernia Southern Extension ("HSE"). The Claimants acknowledge the possibility of large R&D expenditures to develop BNA in the future, Claimants' Memorial, ¶ 94. See also First Witness Statement of Edward Graham, ¶ 15. Indeed, the Hibernia Work Plan proposes a "BNA study" to help increase recovery of oil from that field, CE-212, Hibernia R&D Work Plan, p. EMM0003471. The first phase of the study could total \$5.2 million and two more phases are anticipated, CE-212, Hibernia R&D Work Plan, p. EMM0003453. Also, a study for up to \$32.5 million on the impact of icebergs on subsea wells could also be of significant benefit for the BNA field, CE-212, Hibernia R&D Work Plan, p. EMM0003462. With respect to the AA Blocks, Canada sought documents from the Claimants that identify proposed R&D expenditures but received no documents. Lastly, the HSE is a large reservoir and R&D could play a significant role in its development. The Hibernia Work Plan proposes a number of expenditures toward the development of that field. For example, the study on the impact of icebergs on subsea wells could also be of benefit to HSE, providing between \$30-40 million in savings if the 5 wells planned for HSE are built and if the study creates savings as envisaged, Noreng Report, ¶¶ 8, 21; CE-212, Hibernia R&D Work Plan, p. EMM0003462. Moreover, the arctic development roadmap study is to identify R&D needs for HSE, including a study on oil spills in ice prone waters, Noreng Report, ¶¶ 20-21, 34, 42. The tribunal ordered the Claimants to produce documents that address any specific proposals for R&D and E&T expenditures related to HSE, but the Claimants did not produce any, Redfern Schedule, 24 May 2010, Request No. 8.

<sup>459</sup> Claimants' Reply Memorial, ¶¶ 272-275.

<sup>460</sup> This is acknowledged by the Claimants at ¶ 223 of their Reply "[T]he bulk of HMDC's and Suncor's Work Plans focus on industry-wide and ownership-specific initiatives" and are not "necessary to the projects."

frontier areas, such as the arctic.<sup>461</sup> It is impossible to know which of these expenditures the Claimants would have undertaken in the absence of the Guidelines.

### **The Claimants' Future Operational Benefits are Still Uncertain**

315. Equally uncertain are the operational benefits the Claimants will receive from increased future R&D and E&T spending. Examples of the types of benefits the Claimants will receive are described in the Work Plans<sup>462</sup> and are analyzed in the report of Professor Noreng.<sup>463</sup> Canada requested documents from the Claimants that could show the economic value of the Work Plan expenditures, but received none.<sup>464</sup> The full extent of the operational benefits the Claimants' will receive from their future spending is uncertain.

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<sup>461</sup> These expenditures meet the strategic R&D interests of the Claimants. As Canada's R&D expert, Professor Noreng, explains at ¶ 46 of his report: "Production joint ventures like Hibernia and Terra Nova have motives for R&D beyond what is required to succeed in the projects in order to gain maximum economic access to further reserves. It is clear from the Work Plans that the partners in the Hibernia and Terra Nova prospects intend to expand their operations in frontier areas such as offshore NL and beyond. Even if the projects are not ongoing enterprises with a stream of future projects and investments, the partner companies are involved in future prospects. Petroleum companies can be expected to carry out R&D for new commercial processes and technologies not directly essential to the projects, through a jointly owned company like the HMDC or Terra Nova."

<sup>462</sup> CE-212, Hibernia R&D Work Plan; CE-213, Terra Nova R&D and E&T Work Plan.

<sup>463</sup> For example, Noreng Report, ¶ 21 ("The Work Plans include several projects to improve operational efficiency and cost-effectiveness. All Hibernia-specific projects have the potential of improving operational efficiency and cost-effectiveness on that field. Subsea wells could be less costly for the HSE and BNA portions of Hibernia. For example, 5 wells are planned for HSE, and the Work Plans state that successful development could yield savings of \$6-\$8 million per well. The replacement of the flexible riser in the OLS system could reduce the need for regular inspections and interventions. The annular safety valve for a dual bore gas lift could help increase reservoir productivity. The Gas Utilization Study could help access an additional 50 million barrels of oil at Hibernia through Improved Oil Recovery ("IOR") and BNA Study could help access 114 million barrels of oil in the BNA portion of Hibernia. As to joint industry projects, some appear to have potential applications to current fields in addition to their value for future developments. The advanced well design R&D has objectives similar to the Gas Utilization Study and BNA study. The rigless well intervention R&D could enhance economic viability of marginal fields since intervention systems currently do not have the ability to function year-round in the Grand Banks. Even the R&D capacity projects may have some immediate usefulness for Hibernia. The arctic development roadmap study is to identify R&D needs for the HSE.").

<sup>464</sup> Redfern Schedule, 24 May 2010, Request Nos. 3, 4.

**The Claimants' Future Ownership Interests in the Projects are Uncertain**

316. Since Canada filed its Counter Memorial, Canada has discovered that Murphy Oil's ownership interest in Terra Nova is currently being arbitrated and is predicted to fall from 12% to 10.5%.<sup>465</sup> While Murphy Oil's ownership is being arbitrated, its obligations under the Guidelines remain uncertain. Moreover, that ownership interests can change makes the Claimants' future loss uncertain.

**iv) The "Maturity" of Hibernia and Terra Nova Does not Reduce the Speculation of the Claim for Future Damages**

317. Despite the overwhelming uncertainty described above, the Claimants allege that their future damages are not speculative because they arise "in connection with long term, mature activities."<sup>466</sup> The Claimants fail to explain how that maturity affects the certainty of the elements described above. For example, the Claimants fail to explain how the operational history of the projects affects the StatsCan Factor or the future price of oil.

318. The Claimants rely on decisions that address lost profits in expropriation cases and indicate that lost profits are only awarded where there is a going-concern. They draw from this a conclusion that future losses are appropriate here. However, as explained earlier, this claim is different.<sup>467</sup> It is not a claim for the past expropriation of an investment that requires the calculation of the investment's future profits.<sup>468</sup> It is a claim for damages they have not yet incurred. The decisions on which the Claimants rely are thus irrelevant.

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<sup>465</sup> **GFA-30**, Murphy Oil Corp. Form 10-K, Part I, p. 2 ("The Company anticipates that its working interest will be reduced to approximately 10.5%, subject to the results of the ongoing arbitration process between the operator and certain other owners. Upon completion of the arbitration process, the Company will be required to make a settlement payment to the Terra Nova partnership for the value of oil sold since about December 2004 related to the ultimate working interest reduction below the Company's original 12.0%.").

<sup>466</sup> Claimants' Reply Memorial, ¶ 264.

<sup>467</sup> Rejoinder, ¶ 236.

<sup>468</sup> Claimants' Reply Memorial, ¶ 294 ("Claimants are not seeking future lost profits").

319. Moreover, international tribunals have consistently held that a historical record provides little certainty for the future. For example, in *LG&E* the tribunal rejected the claim for future lost dividends despite the claimant's payment of dividends for the past twelve years.<sup>469</sup>

320. *Merrill & Ring Forestry LP v Canada* is similar. In that case, the claimant contended that Canada's restrictions on the export of logs obliged the company to sell its products in Canada for less than the world price. The claimant sought past losses of export premiums<sup>470</sup> between 2003 and 2008 as well as future lost export premiums to 2016. The future losses were calculated by the claimant using the 2003-2008 figures. The NAFTA tribunal concluded that, even if it accepted the claimant's past loss figures, the claim for future losses was speculative:

Even if the Investor's past loss figures were accurate, there is no way of knowing whether the situation in the future will be identical or altogether different. Indeed, the fact that for the 2008-2009 period of economic crisis a different basis for estimating damages had to be used, in order to accommodate the collapse of the construction industry and the consequential demand for logs in world markets, evidences how difficult it is to make any realistic projections in this matter. What the future of such markets might be until 2016 is entirely speculative.<sup>471</sup>

**v) The Claimants' "Up-to-Date Assumptions" Do Not Reduce the Uncertainty of the Claim for Future Damages**

321. Despite the uncertainty in their claim for future loss, the Claimants argue that any prediction based on "current information" is not speculative.<sup>472</sup> However, relying on

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<sup>469</sup> RA-25, *LG&E*, ¶¶ 74, 78.

<sup>470</sup> Defined by the claimant as the higher prices the exporters of logs from Canada would receive, if they could sell like logs in the export market, rather than in the Canadian market, RA-104, *Merrill & Ring*, ¶ 248.

<sup>471</sup> *Id.*, ¶ 263.

<sup>472</sup> Rosen Report II, ¶ 16 ("Any event which is expected to occur in the future is, by definition, not certain...[However by] utilizing information that is most current to the date of the analysis, the expert is able to mitigate the uncertainty associated with future events.").

“current information” does not reduce the uncertainty of future events. For example, in their Memorial the Claimants claimed damages of \$30.283 million between 2004 and 2008. Their analysis was based on “current information” at that time. In a mere 10 months, events reduced that amount by almost half.<sup>473</sup> Similarly, Ms. Emerson used “current information” in 2004 when she forecast the price of oil for the next five years. Her forecast was incorrect by 300%.<sup>474</sup>

#### vi) Summary

322. The Claimants have failed to prove that damages from 2011 to 2036 can be awarded. Both the NAFTA and international principles of compensation prevent a claim for damages not yet incurred. Moreover, the claim for damages from 2011 to 2036 rests on a series of highly uncertain elements. When the uncertainties are compounded, the effect is overwhelming.<sup>475</sup>

323. The Claimants argue that NAFTA tribunals have “considerable discretion,”<sup>476</sup> however, a NAFTA tribunal does not have the jurisdiction to make an award for damages not yet incurred. The Claimants also argue that all doubts should be “resolved against the party in breach.”<sup>477</sup> However, NAFTA tribunals cannot award compensation that is not sufficiently certain. The Claimants have the burden of proving their alleged losses.<sup>478</sup> They have failed to satisfy this burden regarding their claim for damages from 2011 to 2036.

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<sup>473</sup> This calculation does not include deductions for SR&ED tax credits, royalty payment reductions or operational benefits.

<sup>474</sup> **Davies R1**, Energy Bulletin, “Innovation seen crucial to future energy supply”, Oil & Gas Journal Online (Nov. 22, 2004).

<sup>475</sup> Walck Report I, ¶ 154.

<sup>476</sup> Claimants’ Reply Memorial, ¶¶ 240-242.

<sup>477</sup> Claimants’ Reply Memorial, ¶ 296.

<sup>478</sup> **RA-44**, *S.D. Myers*, ¶ 94.

**c) The Claimants' Calculation of Future Damages is in any Event Exaggerated**

324. The claim for future damages is exaggerated. To determine the present value of their alleged future loss, the Claimants continue to employ a discounted cash flow method. They employ this method in two basic steps. First, the Claimants estimate the damages that they will allegedly suffer in the future. Second, they discount those alleged future damages to calculate their present value. The Claimants continue to exaggerate their damages by continuing to misapply both steps.

**i) The Claimants Continue to Exaggerate their Estimated Future Damages**

325. The Claimants exaggerate their estimated future damages through the same means that they exaggerate their past damages.

**The Claimants Still Underestimate their Future R&D and E&T Expenditures in the Ordinary Course of Business**

326. In their Memorial,<sup>479</sup> the Claimants estimate that their future annual R&D and E&T expenditures in the ordinary course of business will be a "normalized average" of their expenditures from 2004 to 2008. Subsequently, the Board determined eligible expenditures between 2004 and 2008, which the Claimants agree are their ordinary course expenditures for that period.<sup>480</sup> Hence, Mr. Rosen states in his second report:

The figures deemed eligible by the Board from 2004 to 2008 (and 2009, to the extent it is available) will be included in my updated calculation of damages prior to the hearing. My forecast of spending in the ordinary course of the Projects' operations will also be updated, in light of the Board's decisions regarding the eligibility of expenditures in the historical period.<sup>481</sup>

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<sup>479</sup> Claimants' Memorial, ¶ 218, fn. 409.

<sup>480</sup> Claimants' Reply Memorial, ¶ 198.

<sup>481</sup> Rosen Report II, ¶ 91.

327. Canada uses the Board's determinations of eligible spending for 2004-2008 to calculate an average annual "ordinary course" spending for each project. Those annual expenditures average approximately \$5 million for Hibernia and approximately \$4.2 million for Terra Nova.<sup>482</sup>

### **Future Expenditures Required Under the Guidelines are Unknown**

328. These future expenditures in the ordinary course of business, described above, must be deducted from the future expenditures required under the Guidelines to produce the future "shortfall." These future Guidelines expenditures will be the product of future oil production, the future price of oil, the future exchange rate and the future StatsCan factor. The value of each of these elements is entirely uncertain, as explained above.<sup>483</sup> However, for the purposes of producing a quantification of the Claimants' future damages for the benefit of the Tribunal, Canada has applied the Claimants' forecast for these factors (updated by the most recent information).<sup>484</sup>

### **The Claimants Have Still Not Deducted SR&ED Tax Credits, Royalty Deductions, Operational Benefits, or Cost Savings From Additional R&D and E&T Expenditures to Fulfil Future Guidelines Obligations**

329. Just as they have still failed to deduct SR&ED tax credits, royalty payment deductions, operational benefits or cost savings from the additional expenditures to fulfil the 2004-2008 shortfall, the Claimants have also still not deducted these elements from their alleged future shortfall.

330. As explained above,<sup>485</sup> the Hibernia shortfall needs to be offset by 20.3% and Terra Nova by 5.7% to account for the SR&ED tax credits the Claimants will receive. The Claimants' royalty payment deductions, operational benefits, and cost savings from their additional expenditures appear to be substantial. However, the Claimants refuse to

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<sup>482</sup> Walck Report II, ¶ 159.

<sup>483</sup> Rejoinder, ¶¶ 301-316.

<sup>484</sup> Walck Report II, ¶¶ 128, 130, 155-156.

<sup>485</sup> Rejoinder, ¶¶ 253-254.

quantify these benefits because they are uncertain. In so doing, the Claimants ask Canada to fund R&D and E&T initiatives that will significantly benefit them. While the benefits cannot be quantified, they should be taken into account should damages be awarded for the 2011-3036 period.

**ii) The Claimants Still Exaggerate the Present Value of Their Future Damages by Applying a Risk-Free Discount Rate**

331. The Claimants not only exaggerate their estimated future losses, they also exaggerate the present value of those losses by misapplying the second step of the DCF method. This step applies a discount rate, which is “[a] rate of return used to convert a monetary sum, payable or receivable in the future, into present value.”<sup>486</sup>

332. Canada explained in its Counter Memorial that an appropriate discount rate follows the financial principle that a safe dollar today is worth more than a risky dollar tomorrow.<sup>487</sup> Thus, the discount rate must reflect the value to the Claimants of receiving their future loss now instead of in the future. By receiving their future loss now, the Claimants avoid the risk that their future loss may be lower. In other words, if the Claimants receive a lump sum award today that is intended to reflect their loss for every year from now until 2036, they will no longer be exposed to the risk that their prediction of that loss will actually be lower. The avoidance of this risk has value.<sup>488</sup>

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<sup>486</sup> **GFA-26**, International Valuation Standards, 8<sup>th</sup> Ed., *International Valuation Guidance Note No. 9*, “Discounted Cash Flow Analysis for Market Valuations and Investment Analyses (Revised 2007), s. 3.1.

<sup>487</sup> Counter Memorial, ¶ 378; See also Rosen Report I, ¶ 46 (“[A] dollar received today has greater value than a dollar to be received in the future because there is typically some risk that the future dollar will not be received. The dollar received today, by definition, is not subject to this risk of realization.”). See also **GFA-9**, Sergey Ripinsky & Kevin Williams, *Damages in International Investment Law* p. 197, emphasis in original (“In addition to the time value of money, the discount rate must reflect the uncertainty and riskiness of a specific cash flow, thus responding to a second basic financial principle: *A safe dollar is worth more than a risky one.*”); **RA-135**, Mark Kantor, *Basic Valuation Approaches*, in *Valuation for Arbitration*, (Wolters Kluwer Law 2008), p. 143 (“The discount rate used in a DCF valuation is the rate of return used to convert future cash flows into a present value that reflects the risks associated with those cash flows.”); **CA-146**, Marboe, p. 245 (“In this context, the risk is defined as the degree of uncertainty as to the realization of the expected future return.”).

<sup>488</sup> Walck Report I, ¶ 134.

333. Mr. Rosen accepts that his projection of the Claimants' future loss is uncertain.<sup>489</sup> Yet, he continues to refuse to account for the significant benefit the Claimants would receive from avoiding that uncertainty. The Claimants suggest they "should not be burdened with the risks of changes in the variables"<sup>490</sup> which form the basis of their claim for damages. However, it is the avoidance of these risks that a discount rate is intended to reflect.

334. As Canada noted in its Counter Memorial,<sup>491</sup> the best indicator of the value to the Claimants of avoiding the risk that their predictions of the future are incorrect (and, thus, the best indicators of the discount rate) is the Claimants' own contemporaneous assessment of the risks inherent in the projects' cash flows. The Claimants argue that risks inherent in the projects' cash flows are only relevant to a claim for lost future profits.<sup>492</sup> Yet, the risks inherent in the projects' cash flows are also inherent in the Claimants' assessment of their future loss. Just as the projects' cash flows depend on the future production and price of oil, so too does the Claimants' assessment of their future loss.<sup>493</sup>

335. Canada requested from the Claimants documents that would show their own contemporaneous assessment of the risks inherent in the projects' cash flows. The Claimants refused to produce these documents.<sup>494</sup> In the absence of the Claimants' own project-specific assessments, Mr. Walck examined the average cost of equity for

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<sup>489</sup> Rosen Report II, ¶ 110 ("My analysis does not suggest that future Incremental Spending is free of any risk or uncertainty. As discussed previously, risk or uncertainty will be present in any future oriented information.").

<sup>490</sup> Claimants' Reply Memorial, ¶ 293.

<sup>491</sup> Counter Memorial, ¶ 382.

<sup>492</sup> Rosen Report I, ¶ 50; Claimants' Reply Memorial, ¶ 294. Canada also notes that the Claimants attempt to support the majority of their legal arguments using lost profits cases.

<sup>493</sup> Walck Report II, ¶ 190.

<sup>494</sup> In his report, Mr. Rosen argues that Mr. Walck's approach should not be adopted because the "rate of return associated with the Projects" is unknown, Rosen Report II, ¶ 104(iii). However, the only reason the rate of return associated with the projects is unknown is because the Claimants refused to produce those documents.

investments in Canada generally, which is 12.64%.<sup>495</sup> This figure is adjusted upward to reflect the greater risk of an investment in offshore oil production.

336. Mr. Walck then examined the cost of equity for oil producing companies.<sup>496</sup> For ExxonMobil, equity returns from 2000-2009 ranged from 14.8% to as high as 40%. For Murphy Oil, the range was between 6.4% and 27.7% over the same period.<sup>497</sup> Mr. Walck adjusted these figures downward to reflect the fact that the projects are in their production phases. He concludes that an appropriate discount rate is 15%.<sup>498</sup>

#### d) Quantification of the Claimants' Future Loss

337. Applying a discount rate of 15% to the Claimants' future shortfall (minus SR&ED benefits) generates the following damages for 2011-2036:

	Hibernia	Terra Nova	Total
Mobil Investments Canada Inc.	\$2.725 million	\$1.114 million	\$3.839 million
Murphy Oil	\$0.535 million	\$0.608 million	\$1.143 million
Total	\$3.26 million	\$1.722 million	\$4.982 million

338. These figures rely on the Claimants' own entirely speculative forecasts. Moreover they do not account for the Claimants' future royalty payment deductions, operational benefits, or cost savings. While these benefits cannot reasonably be quantified, they

<sup>495</sup> Walck Report II, ¶¶ 192-193. Cost of equity represents the collective risk assessment of the shareholders who provide capital to the firm – it is the return the market requires for the prospect of receiving those future cash flows. As Mr. Walck explained in his first report, “it is one indicator of the discount rate that the shareholders would apply to the firm’s future cash flows in which they have an ownership interest”, Walck Report I, ¶ 143.

<sup>496</sup> Walck Report II, ¶¶ 199-202.

<sup>497</sup> Walck Report II, ¶ 199.

<sup>498</sup> Walck Report II, ¶ 203.

could be sufficiently significant to reduce the Claimants' damages for the 2011-2036 period to zero.

#### 4. Conclusion

339. Articles 1116 and 1117 of the NAFTA prevent the Tribunal from awarding damages incurred after the date of the claim. The Claimants filed their claim on November 1, 2007 and the Tribunal does not have jurisdiction to award damages incurred after that date.

340. The Claimants' damages incurred before November 1, 2007, accounting for SR&ED tax credits but before incorporating royalty deductions and operational benefits, are:

<b>Period</b>	<b>Mobil</b>	<b>Murphy</b>
2004-2007 <sup>499</sup>	\$7.630 million	\$1.920 million

341. The Claimants have not assessed their loss before November 1, 2007. Instead, they calculate their damages as if there is no limit on the Tribunal's jurisdiction. They have divided their assessment of damages into the periods 2004-2008 and 2009-2036. It is premature to estimate damages in 2009 and 2010. The Claimants' damages for 2004-2008 and 2011-2036, accounting for SR&ED tax credits but before taking into account royalty deductions, operational benefits and cost savings, are:

<b>Period</b>	<b>Mobil</b>	<b>Murphy</b>
2004-2008	\$10.499 million	\$2.710 million
2011-2036	\$3.839 million	\$1.142 million
Total	\$14.338 million	\$3.852 million

<sup>499</sup> April 1, 2004 to November 1, 2007.

342. These figures should be reduced by royalty deductions, operational benefits and cost savings the Claimants will receive from their additional spending. While these cannot be quantified, they could be sufficiently significant to reduce the Claimants' damages to zero.

June 9, 2010

Respectfully submitted  
on behalf of Canada,

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