IN THE MATTER OF AN ARBITRATION UNDER CHAPTER 11 OF THE NORTH AMERICAN FREE TRADE AGREEMENT AND THE UNCITRAL ARBITRATION RULES

BETWEEN:

MERRILL & RING FORESTRY L.P.

Claimant/Investor

And

GOVERNMENT OF CANADA

Respondent/Party

CANADA'S REPLY TO THE INVESTOR'S MOTION TO ADD A NEW PARTY

(January 2, 2008)

Department of Foreign Affairs
and International Trade
Trade Law Bureau/JLT
Lester B. Pearson Building
125 Sussex Drive
Ottawa, On K1A 0G2
Canada

TABLE OF CONTENTS

A. OVERVIEW

1. Canada submits this Reply further to the Arbitral Tribunal's letter dated December 17, 2007, and in response to Claimant's motion dated December 12, 2007, attempting to add Georgia Basin Holdings L.P. ("Georgia") as a party-investor to this arbitration.

2. Claimants' motion is without merit and should be rejected, above all because Claimant has not met the test under Article 20 of the UNCITRAL Arbitration Rules. Georgia never applied for an export permit under Notice 102 nor was Georgia ever refused a permit to export lumber from British Columbia under Notice 102. Accordingly, Claimant has failed to prove that the measures at issue in this arbitration in any way related to Georgia, or that Georgia suffered loss or damage arising out of the challenged measures. Claimant's amendment is therefore necessarily excluded under Article 20 of the UNCITRAL Rules, as it is beyond the scope of the arbitration.

3. Other reasons seriously undermine Claimant's motion to add a party. Claimant has known of Georgia's existence at all relevant times and has no reasonable excuse for its delay in bringing this motion. Claimant's tactical move to add a stranger to these proceedings is merely the latest of Claimant's attempts to re-invent its case.

4. Moreover, to accept Claimant's motion at the present stage in the proceedings would cause Canada substantial prejudice. It would allow Claimant to: circumvent express safeguards negotiated by the State Parties to NAFTA; introduce a vague and speculative claim that on its face does not arise out of the measures at issue; double the amount of damages sought for no apparent additional breach; and potentially cause substantial procedural disruption to the ongoing arbitration.

5. If Georgia has a valid claim, it can pursue it in the normal course under NAFTA Chapter 11. Claimant should not be permitted to abuse the device of amending its

pleadings to avoid the safeguards in NAFTA. Similarly, the Tribunal should respect those safeguards and allow normal process to proceed.

6. For all of the above reasons, Canada asks the Arbitral Tribunal to dismiss Claimant's motion, with costs.

B. CLAIMANT HAS FAILED TO ADD NEW FACTS JUSTIFYING THE ADDITION OF GEORGIA

1) Claimant Bears the Burden of Proof

7. Pursuant to Article 20 of the UNCITRAL Rules, Claimant bears the burden of alleging the relevant facts and legal basis demonstrating that its amendment falls within the scope of the arbitration clause. Claimant's Draft Amended Statement of Claim ("DASC") fails this test, providing no facts confirming that Georgia's claim falls within the scope of the arbitration or indeed that Georgia has any claim at all. Claimant's motion fails on this basis alone.

2) Claimant Has Failed to Justify its Amendment to Add Georgia at This Stage or at All

8. In Canada's view, Claimant has failed the relevant test justifying the addition of Georgia at this stage of the proceedings, as neither its DASC nor its Motion to Add a Party demonstrate that Georgia has any claim within the scope of the arbitration clause, or at all. If Georgia has no stand-alone claim, it cannot be added as a party to this arbitration.

9. Claimant's motion includes virtually no new facts and virtually nothing concrete about the proposed added party or its relationship to the measures at issue and the loss claimed in this arbitration. The sum total of information concerning Georgia in the proposed DASC is the following:

- *Georgia is a limited partnership constituted under the laws of Washington state.* (para. 2 of DASC);
- *Georgia Basin is an affiliate of Merrill & Ring's, but it is a legally distinct entity that is not controlled by Merrill & Ring.* (para. 4 of DASC);

- *Georgia Basin owns certain lands granted before March 12, 1906 in the province of British Columbia. Georgia Basin owns these timber lands and has been growing timber upon them for eventual harvest and sale. These lands are located near Squamish and Menzies Bay. Since 2007 Georgia Basin has harvested a small amount of timber from these lands. It intends to harvest greater amounts from these lands for export in the near future.* (para. 5 of DASC); and

- *Georgia Basin owns certain timberlands in the Province of British Columbia. Since 2007, Georgia Basin has also contracted for the sale and harvest of timber from its lands.* (para. 22 of DASC).

10. Moreover, Claimant leaves unamended paragraph 31 of the DASC, confirming that Claimant's investments, and not Georgia's investments, are subject to Notice 102.

11. Claimant's Motion to Add a Party further states that Claimant had the right to harvest Georgia's timber until 2007, and thereafter Georgia had the right to harvest its own timber:

    - *During the relevant period of this claim, Georgia Basin owned certain timber properties over which Merrill [...] had a right to harvest timber. From the year 2007 and following, the rights to harvest timber from these lands reverted to Georgia Basin. Since 2007, Georgia Basin commenced harvesting timber from these properties. Georgia Basin intends to harvest timber for export from these lands in the future.* (Para. 3 of the Motion to Add a New Party)

    The assertion that Georgia harvested timber from its lands since 2007 (para. 3 of the Motion to Add a New Party; para. 5 of DASC) contradicts the statement that Georgia contracted for the sale and harvest of timber from its lands (para. 22 of DASC).

12. With regard to breach of the substantive obligations of NAFTA, the DASC simply pluralises the word "investor" (to "investors") and pluralises the word "investment" (to "investments"). The Claimant fails to plead any breach of NAFTA relating to or affecting Georgia.

13. With regard to damages, Claimant fails to provide a single example of an alleged breach of the NAFTA causing loss to Georgia (DASC paras 39 – 70). Indeed,

Claimant's original damage claim is simply repeated at DASC paragraph 74. DASC paragraph 75 claims an additional US $25 million "jointly" between Georgia and Claimant. Claimant leaves the meaning of this "joint" claim, or the basis thereof, wholly unexplained.

14. Similarly, Merrill & Ring and Georgia purport to "jointly accept" the respondent's offer to arbitrate under Article 1122 of NAFTA. The meaning of a joint acceptance, or the basis thereof, is wholly unexplained.

15. With regard to its delay in bringing this motion, Claimant merely states that:

    - *The investor submits this motion shortly after discovering this information so as to minimize any potential for delay in the making of this application.* (para. 11, Motion to Add a New Party)

16. Claimant's DASC and Motion to Add A Party therefore fail to establish:

    - the nature of the affiliation between Georgia and Claimant;
    - that Georgia at any point exported logs from its timber lands (and therefore, that Georgia is or was subject to Notice 102);
    - that any of the cited harvest rights relate to exported logs subject to Notice 102;
    - that Georgia was in any way affected by an alleged breach of the NAFTA, or suffered any loss or damages by reason of that breach;
    - the factual or indeed legal basis for its new 'joint' claim of US$ 25 Million; or
    - when Claimant allegedly 'discovered' that harvest rights it thought it owned were in fact owned by Georgia, much less why this alleged fact was not discovered earlier, or whether it could have been discovered sooner with the exercise of due diligence.

17. In sum, neither the Motion to Add a Party nor the DASC demonstrate any nexus between Georgia and the measures allegedly violating the NAFTA or between Georgia and any loss or damage arising out of an alleged breach. Accordingly, Claimant has failed to provide facts demonstrating how its amendment falls within the scope of the present arbitration.

3) Claimant Has Omitted Key Facts

18. In addition, Canada understands that Georgia never applied for an export permit under Notice 102. In fact, Canada's records disclose that Georgia has never been subject to Notice 102.

19. Tab 2 to this reply is an affidavit of Ms. Lynne C. Sabatino, Deputy Director of the Export Controls Division at the Department of Foreign Affairs and International Trade. Her affidavit explains that a diligent search of the records of the Export Controls Division disclosed that Georgia has never applied for a permit to export logs or to have its logs considered surplus pursuant to Notice 102 (Sabatino Affidavit, paras 3-4).

20. Since Notice 102 never applied to Georgia, Georgia was *a fortiori* never denied a permit by Canada under Notice 102, nor could Georgia have suffered any loss or damage whatsoever by reason of that Notice.

21. Claimant should in all events have pleaded such facts if they existed (which Canada denies). It has failed to do so.

22. In summary, Claimant has failed to establish a basis for any claim by Georgia or that Georgia was affected by or suffered loss arising out of any measures at issue in this arbitration. Its motion should be rejected for this reason alone.

C. LAW

23. There is no debate between the disputing parties about the law applicable to amendment of pleadings. Pursuant to the second sentence of Article 20 of the UNCITRAL Arbitration Rules, an amendment must be rejected if it would cause the claim to fall outside the scope of the Tribunal's jurisdiction under the arbitration clause.

24. In their treatise on the UNCITRAL Arbitration Rules, Caron, Caplan and Pellonpää note that the second sentence of Article 20 imposes a *prima facie* absolute limitation on the right to amend a pleading. While the authors concede

that it is possible to bring a new party into proceedings by way of amendment, such amendment must be within the limits of the arbitration agreement. The authors urge particular caution in this situation, noting that,

> ...where the arbitral tribunal has doubts about the compatibility of the purported amendment with the arbitration clause or agreement, it should proceed with caution before accepting amendments, despite the generally liberal spirit of Article 20.[1]

25. If the proposed amendment is within the scope of the arbitration clause, the Arbitral Tribunal has discretion to allow an amendment unless it considers the amendment inappropriate having regard to: (1) the delay in requesting the amendment; (2) the prejudice occasioned to the other party by the amendment; or (3) any other circumstance.

26. The Arbitral Tribunal should dismiss this motion for an amendment because it does not meet the criteria in UNCITRAL Article 20. Specifically, the proposed amendment:

    1) falls outside the scope of the arbitration clause;
    2) was requested after a delay that has not been explained and is unjustifiable in the circumstances;
    3) occasions substantial and unwarranted prejudice to Canada; and
    4) is so vague and incomprehensible that it is virtually impossible for Canada to respond to the DASC.

D. CLAIMANT HAS FAILED TO MEET THE TEST UNDER ARTICLE 20

1) The Proposed Amendment Falls Outside the Scope of the Arbitration Clause

27. Claimant's proposed amendment adding Georgia as a party falls outside the scope of the arbitration clause in this matter, and should therefore be rejected under UNCITRAL Rule 20.

---

[1] Caron, David D., Lee M Caplan & Matti Pellonpää, THE UNCITRAL ARBITRATION RULES, A COMMENTARY, (Oxford University Press, 2006) at 468-469 (Tab 3).

28. In the present case, the arbitration agreement is NAFTA Chapter 11 and the relevant arbitration clauses are NAFTA Articles 1101 and 1116.

29. Article 1101 provides that Chapter 11 applies to "measures adopted or maintained by a Party *relating to*" investors of another Party and their investments (*emphasis* added).[2]

30. Article 1116 entitles an investor to submit a claim "on its own behalf" under Section B of Chapter 11 of NAFTA, alleging that another Party "has breached" an obligation under Section A, and that the investor "has incurred loss or damage by reason of, or arising out of that breach."[3] The claim sought to be submitted by Georgia is a claim "on its own behalf" pursuant to NAFTA Article 1116(1) (para. 1 of DASC).

31. The impugned "measure" in the present case, pursuant to NAFTA Article 1101, is Notice 102. Claimant has to date in this arbitration alleged that Notice 102 breaches NAFTA Articles 1102, 1103, 1105, 1106 and 1110.

32. To be included within the scope of the arbitration, Georgia would therefore have to have been affected by Notice 102, and would have to demonstrate pursuant to NAFTA Article 1116 that it had personally incurred loss or damage by reason of the measure, understood as a breach of Canada's obligations under Section A.

---

[2] Article 1101 of NAFTA is titled "Scope and Coverage" and reads: 1. 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. 2. A Party has the right to perform exclusively the economic activities set out in Annex III and to refuse to permit the establishment of investment in such activities. 3. This Chapter does not apply to measures adopted or maintained by a Party to the extent that they are covered by Chapter Fourteen (Financial Services). 4. Nothing in this Chapter shall be construed to prevent a Party from providing a service or performing a function such as law enforcement, correctional services, income security or insurance, social security or insurance, social welfare, public education, public training, health, and child care, in a manner that is not inconsistent with this Chapter.

[3] Article 1116 of NAFTA is titled "Claim by an Investor of a Party on Its Own Behalf" and reads: 1. An investor of a Party may submit to arbitration under this Section a claim that another Party has breached an obligation under: (a) Section A or Article 1503(2) (State Enterprises), or (b) Article 1502(3) (a) (Monopolies and State Enterprises) where the monopoly has acted in a manner inconsistent with the Party's obligations under Section A, and that the investor has incurred loss or damage by reason of, or arising out of, that breach. 2. An investor may not make a claim if more than three years have elapsed from the date on which the investor first acquired, or should have first acquired, knowledge of the alleged breach and knowledge that the investor has incurred loss or damage. See also, *Methanex Corp. v. United States*, First Partial Award, August 7, 2002, 2002 WL 32824210 (APPAWD), para. 120 (Tab 4).

33. Yet Claimant's motion never addresses how Notice 102 relates to Georgia, or to Georgia's investments in Canada. To the contrary, Canada has demonstrated based on the Sabatino affidavit that the impugned Notice 102 neither applied, nor related to Georgia. Georgia therefore could never have sustained any loss by reason of, or arising out of, Notice 102, as required by NAFTA Article 1116.

34. To the extent the DASC suggests Georgia may in future harvest timber for export (and thus, possibly, become subject to Notice 102), this claim is entirely speculative and hypothetical. In any event, this allegation fails to make out a *prima facie* claim under NAFTA Article 1116, which applies to past rather than to future breaches.

35. In summary, Claimants' motion proposes amendments that do not comply with Articles 1101 and 1116 of NAFTA. The proposed amendment raises claims falling outside of the scope of this arbitration. As a result, Article 20 of the UNCITRAL Rules mandates dismissal of this motion.

2) The Proposed Amendment is Inappropriate Due to Claimant's Delay

36. Claimant's delay in this case is inappropriate under Article 20 of the UNCITRAL Rules because it was caused by its own negligence. Claimant knew of Georgia at all relevant times. Had Claimant exercised due diligence, it would have been aware of Georgia's ownership of timber lands at the outset of this case.

37. As Claimant's own submissions confirm, the same individual – Richard E. Stroble – was simultaneously President of Claimant's general partner, Merrill & Ring Family Corporation (Statement of Claim, para. 14 and FN 5; Notice of Arbitration, Schedule A) and President of Georgia Basin's General Partner, Georgia Basin Ventures, Inc. (Motion to Add a Party, Tabs B & F). It lacks credibility to suggest that "affiliated" companies sharing a senior corporate officer would not have been aware of commercial arrangements between themselves. It also lacks credibility to suggest that the ownership structure of relevant timber properties could not be determined until 15 months after filing Merrill's Notice of Intent.

38. Had it exercised due diligence, Claimant would have uncovered this interlocking ownership well before the current stage of proceedings, when the disputing parties are preparing their memorials and after several important procedural and preliminary decisions have been issued. In the circumstances, Claimant's conduct constitutes considerable and unjustifiable delay, and its motion should be rejected pursuant to Article 20 of the UNCITRAL Rules.

3) Prejudice

39. Claimant's motion should further be rejected under Article 20 of the UNCITRAL Rules because its inclusion at this stage would cause substantial prejudice to Canada.

40. If admitted into this ongoing proceeding, Georgia will avoid compliance with the requirements of NAFTA Articles 1119 and 1120 and circumvent the procedural safeguards negotiated by the State-Parties for NAFTA Chapter 11 investor-State arbitrations.

41. Claimant suggests its avoidance of Articles 1119 and 1120 are mere technical breaches, citing *Ethyl* and *Mondev*. Canada disagrees. The characterisation of the preconditions to commencement of a claim under NAFTA as "mere technicalities" ignores the express wording of NAFTA Article 1122(1), which states, "Each Party consents to the submission of a claim to arbitration *in accordance with* the procedures set out in this Agreement." (*emphasis* added). The Articles in question are mandatory requirements of the treaty, upon which consent to arbitrate has been expressly conditioned. As noted by the Arbitral Tribunal in *Methanex v. United States*,

> In order to establish the necessary consent to arbitration, it is sufficient to show (i) that Chapter 11 applies in the first place, i.e. that the requirements of Article 1101 are met, and (ii) that a claim has been brought by a claimant investor in accordance with Articles 1116 or 1117 (and that all pre-conditions and formalities required under Articles 1118-1121 are

satisfied). Where these requirements are met by a claimant, Article 1122 is satisfied; and the NAFTA Party's consent to arbitration is established.[4]

42. Articles 1119 and 1120 play a pragmatic role in the operation of Chapter 11. They put the respondent State on notice of a would-be (valid) claim (Article 1119); provide a cooling-off period (Article 1120); and allow the respondent State to attempt resolution of the matter during the cooling-off period if appropriate. In return, a claimant meeting these preconditions benefits from the respondent's advance consent to arbitrate in Article 1122. The amendment proposed in this motion would upset the balance between the disputing parties negotiated in NAFTA and affirmed in Article 15 of the UNCITRAL Arbitration Rules by depriving Canada of the procedural filters in Articles 1119 to 1121, yet preserving the advance consent to arbitration enjoyed by Claimant under Article 1122.

43. Nor is there a valid policy rationale for allowing Claimant to circumvent Articles 1119 and 1120 in this case. Indeed, the practical impact of eviscerating NAFTA Articles 1119 to 1121 is well illustrated by Claimant's motion. Claimant's proposed amended pleading is so vague that Canada cannot even identify the event(s) on which Georgia bases its claim of breach and damages. Fulfillment of NAFTA Articles 1119 and 1120 would have allowed Canada to know these basic facts. UNCITRAL Article 20 was not designed to permit future claimants to avoid treaty requirements, clearly prejudicing states such as Canada.

44. The result of ignoring Articles 1119 and 1120 in this instance would be to introduce an entirely new claim that:

- is incomprehensible and vague;
- is unsupported by salient facts;
- bears no relation to the measures at issue;
- is hypothetical and speculative;
- claims future breach and hypothetical loss; and

[4] *Methanex Corp. v. United States* at ¶ 120 (Tab 4).

- is necessarily outside of the scope of Notice 102.

45. Such deficiencies may oblige Canada to challenge the jurisdiction of the Tribunal to hear the claim on behalf of Georgia. It would in any event raise entirely new issues concerning the scope of the arbitration clause and whether Georgia met the threshold test in NAFTA Articles 1101 and 1116. None of these issues are raised by the current arbitration.

46. In this respect, Canada rejects Claimant's argument that refusing to add Georgia would necessarily engender a further separate proceeding. Contrary to Claimant's assertions (paras 13 & 14 Motion to Add a Party), as suggested above, Georgia has entirely failed to demonstrate that it has a viable "stand-alone" claim that might be pursued in a separate arbitration.

47. Nor does Georgia have a claim that is ripe for consolidation under NAFTA Article 1126. Consolidation of claims is discretionary under Article 1126. Consolidation of Georgia's claim with that of Claimant assumes the existence of two claims that are *prima facie* within the jurisdiction of a Tribunal, and that could be heard together to consider a common question of fact or law. There can be no consolidation of a claim that is beyond the scope of NAFTA Chapter 11, as with Georgia's current claim.

48. In any event, if Georgia truly has a valid, stand-alone, claim, Georgia should initiate that claim and pursue it in the usual fashion, in accordance with the procedures negotiated and agreed by the State Parties to the NAFTA. In this way, questions such as jurisdiction could be addressed in an orderly fashion in accordance with the applicable arbitration rules. The present arbitration would in the meanwhile proceed in an orderly fashion, without prejudice to Claimant or respondent.

4) Other Circumstances

49. In exercising its discretion under Article 20 of the UNCITRAL Rules, a Tribunal may consider "any other circumstances." A relevant circumstance in this

arbitration is that the basis for adding Georgia is, as Canada has demonstrated, *prima facie* unsustainable. Claimant has presented a vague and confused motion that makes it virtually impossible to respond to in a meaningful way. Canada should not be required to assume relevant facts or to guess the Claimant's theory of its new case adding Georgia. This is the position Canada will be in if this amendment is allowed.

E. CONCLUSION

50. There is no basis upon which to allow the proposed amendment to add Georgia as a disputing party. Claimant has failed to meet its burden of proof under Article 20 of the UNCITRAL Rules. To the extent that any facts are known, they suggest that Georgia's claim bears no relation to the measures at issue or to the losses claimed and that it exceeds the scope of the arbitration clause. Claimant has also failed to establish a valid reason for its delay. Finally, the amendment would prejudice Canada, unbalanced by any prejudice to Claimant or Georgia if the amendment is refused. It will also unduly complicate and possibly delay the current arbitration for no valid reason. The Tribunal should therefore reject Claimants motion and allow NAFTA procedures to advance in the usual manner negotiated by the NAFTA Parties.

F. RELIEF REQUESTED

51. For all of the above reasons, Canada asks that the Tribunal dismiss this motion to add a party.

52. In the alternative, if the Tribunal allows Claimant's request, thereby adding a new party with as yet an unsustainable claim, Canada asks for 30 days from the date of the Tribunal's order to amend its Statement of Defence accordingly.

53. Canada also asks that it be awarded costs of this motion, regardless of the outcome of this motion or the arbitration on the merits. This is a further example of Claimant constantly reinventing and changing the case that the respondent

must meet. It has put the Arbitral Tribunal and respondent to unnecessary expense and inconvenience for no valid reason.

The whole respectfully submitted
this 2nd day of January, 2008

Meg Kinnear
Lori Di Pierdomenico
Raahool Watchmaker