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UNDER THE UNCITRAL ARBITRATION RULES AND THE NORTH AMERICAN FREE TRADE AGREEMENT

INVESTOR'S REPLY MEMORIAL (DAMAGES PHASE)

BETWEEN:

POPE & TALBOT, INC.

Claimant / Investor

- and -

GOVERNMENT OF CANADA

Respondent / Party

1140 Bay Street, Suite 300, Toronto, Ontario M5S 2B4 Tel. (416) 966-8800 Fax. (416) 966-8801 www.appletonlaw.com

816 Connecticut Avenue, NW. 12th Floor, Washington DC 20006 Tel. (202) 293-0900 Fax. (202) 293-0988

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REPLY MEMORIAL ON DAMAGES

PART ONE: INTRODUCTION

1. The Investor submits this Reply Memorial (Damages) in response to Canada's Counter-Memorial (Damages). The Tribunal stated in its *Award on the Merits of Phase 2* (the "*Award*") that Canada is liable for the "resultant damages" arising from the denial of fair treatment by the Canadian Softwood Lumber Division ("SLD") officials during the "Verification Review Episode".[1] The Tribunal has also stated that the actions of Canada related to the Verification Review Episode resulted in harm to the Investment. The Investment was harmed by:

   - being subjected to threats;
   - being denied reasonable requests for pertinent information;
   - being required to incur unnecessary expense and disruption in meeting SLD's requests for information;
   - being forced to expend legal fees; and
   - probably suffering a loss of reputation in government circles.[2]

2. Accordingly, the Investor has claimed for damages to its Investment for losses arising from this harm, such as management time, and legal and expert expenses that would not have been expended but for the threats, disruption and unreasonable conduct of SLD officials during the Verification Review Episode.

3. Despite breaching its NAFTA Chapter 11 obligations, Canada continues to deny that this Tribunal has jurisdiction, Canada continues to deny its liability and that it must compensate the Investor for the damages caused to it and its Investment. The Investor submits that Canada is required by the terms of the NAFTA and the *Award* of this Tribunal to fully compensate the Investor for the damages caused to it and its Investment arising out of the Verification Review Episode.

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[1] *Award* at para. 181. The "Verification Review Episode" is outlined in detail by the Tribunal in its *Award* as beginning in January, 1999 and concluding with the Interim Measures Motion hearing in January, 2000. See: *Award* at para. 156-170.

[2] *Award* at para. 181.

Summary

4. There are three central questions at issue that will need to be resolved by this Tribunal for it to make a finding in favour of the Investor regarding the damages caused to it and its Investment by the illegal conduct of Canada. These three questions are with respect to: (i) burden of proof, (ii) causation, and (iii) valuation.

Burden of Proof

5. The first issue that must be resolved by the Tribunal is: Has the Investor met its burden of proof regarding the damages claimed - in particular, management time, and legal and expert expenses - regarding the Verification Review Episode? The Investor submits that Canada has proposed an inappropriate burden of proof that makes it virtually impossible for Pope & Talbot to receive compensation for the harm that it has incurred. The appropriate standard is the "balance of the probabilities" and not a higher, more onerous standard appropriate to criminal cases. Canada has suggested that since the Investor has not met its excessively onerous standard that the Investor should receive no compensation. This position is simply not reasonable and does not accord with the substance, and spirit, of this Tribunal's own *Award.*

Causation

6. The second question for the Tribunal is - did the events surrounding the Verification Review Episode cause the Investment to take down-time during December 1999? In its Counter-Memorial, Canada has ignored the most important event in its "but for " analysis of the damages incurred by Pope & Talbot. Canada has ignored, and attempted to moderate, the events surrounding the Verification Review Episode itself. Canada identifies numerous factors that could account for the downtime taken by Pope & Talbot, but avoids addressing the events of the Verification Review Episode as the proximate cause of the damages incurred by the Investor and its Investment. The Investor submits that Canada's arguments be rejected and that this Tribunal award the Investor for harm caused to it and its Investment by the Verification Review Episode.

Valuation

7. Finally, if the Tribunal concludes that the Verification Review Episode caused the incremental losses claimed and other damages, the appropriate assumptions regarding the calculation of the incremental losses must also be resolved. The Investor has agreed with the minor calculation adjustment proposed by Canada, thus increasing the claim of damages with respect to the incremental revenue claim from US$1.08 to US$1.191. The two remaining methodological issues relate to assumptions made regarding the

appropriate softwood lumber prices and at what time these prices should be applied. The assumptions made by Canada inappropriately understate the damages incurred by the Investor, and, accordingly, the Investor submits that the Tribunal adopt the conclusions of its expert as the appropriate resolution of these issues.

PART TWO: BURDEN OF PROOF

1. Canada has argued that the Investor has not met its burden of proof in this claim and the Tribunal should dismiss its Damages Claim.[3] Canada has been provided with all documents that are relevant and necessary to the quantification of damages. The Investor submits that the level of detail that Canada has argued is required for the Investor to meet its burden if proof is unreasonable. In effect, Canada's standard would make it impossible for an investor, such as Pope & Talbot, to ever be compensated for such harm caused to it from an illegal government action. The Investor rejects Canada's unfounded assertion of such an unreasonable burden of proof in this phase of the arbitration.

2. This Tribunal has decided in its *Award* that Canada has breached its international obligations and is required to compensate the Investor for damages incurred. The Tribunal has characterized and described the offending actions of Canada in detail in its *Award*. As summarized above, the main harm to the Investment of the Investor that arose from the Verification Review Episode was that Pope & Talbot was subject to threats and forced to incur unnecessary expense and disruption in meeting SLD's requests for information, and being forced to expend legal fees. This harm resulted in loss of incremental revenue from the December 1999 downtime, and out of pocket damages related to management time and legal and expert expenses.

A. The Appropriate Standard is the Balance of Probabilities

8. Canada relies upon a respected arbitration text to argue that, while the ordinary degree of proof in an arbitration is based on a "balance of probability", this Tribunal should impose a higher standard on matters that are "improbable, far-fetched, or unsupported by evidence, where the Investor is in exclusive control of the evidence"[4]. The Investor can only conclude that Canada is suggesting by these submissions that the Tribunal adopt a criminal standard of proof of "beyond a reasonable doubt." The Investor rejects Canada's submission as misguided and unacceptable.

9. Firstly, Canada has misconstrued the text it cites in support of this proposition as nowhere in the cited portion of the treatise does such a proposition appear. Moreover, to even describe that the Investor's claims for damages related to the Verification Review Episode as "improbable" or "unsupported by evidence" flies directly in the face of the findings of fact by the Tribunal in its *Award*.

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[3] Counter-Memorial (Damages) at para. 19-29.

[4] Counter-Memorial (Damages) at para. 21. Canada cites Redfern and Hunter, and Kazazi, neither of which support Canada's proposition of a higher standard of proof.

10. The Redfern and Hunter text does, however, provide an example of the type of issue that tribunals may apply a more rigorous application of the burden of proof. For instance, the authors provide the example of cases where startling propositions relating to fraudulent activity of company officials are alleged.[5] This is a far cry from the only issue that remains to be resolved in this phase of the arbitration --the quantum of compensation owing to the Investor arising out of Canada's breach of its NAFTA obligations.

11. Moreover, it should be noted that Canada, through its officials at the SLD, have previously made similar allegations in briefing documents to the Minister of International Trade alleging criminal activity by the Investor and its Investment. This Tribunal found these allegations to be completely misleading and false.[6] The Investor submits that the Tribunal should similarly reject Canada's submission that standard of proof be a criminal standard for this damages phase of the arbitration.

B. Document Production Issues

12. All of Canada's concerns recited in its Counter-Memorial (Damages) regarding production matters have been addressed by the Investor. Canada argues that the evidence tendered by the Investor does not support the assumptions made in its Memorial (Damages) or in its *Independent Valuators' Report.* In light of the strong evidence provided to this Tribunal, the Investor respectfully disagrees with Canada on this issue and reiterates that there is more than sufficient evidence provided upon which this Tribunal can find in favour of the Investor's position on the quantum of damages.

13. Canada argues at paragraph 28 of its Counter-Memorial that it has been prejudiced in its preparation of its Counter-Memorial due to the Investor's production of materials shortly before Canada filed its Counter-Memorial. The Investor contends that this position is simply hyperbole. This material produced by the Investor was merely backup material supporting amounts that were disclosed to Canada in the Investor's Memorial. For Canada to claim that this material somehow prejudiced their preparation is absurd considering that it consists of back up documentation for disbursements incurred by the Investor's legal counsel consisting mainly of taxi chits, meal receipts, and other disbursements.

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[5] Redfern & Hunter, *Law of Practice of International Commercial Arbitration* (3rd ed.,) at 315.

[6] *Award* at 178.

C. Application of the Standard to the Facts of this Case

14. At paragraph 25 of its Counter-Memorial, Canada states that it sought documents regarding "time spent" by management, counsel, experts and others related to the Verification Review Episode. In the case in which documents do not exist, or are not in the possession of the Investor even if they do exist, the mere fact that Canada requested these documents cannot result in such claims being refused.

(i) Management Time

15. For example, with respect to management time, the senior management of Pope & Talbot, unlike service providers such as lawyers, do not docket their time or keep time sheets, nor is this standard industry practice.[7] For Canada to state that Pope & Talbot management are required to produce such documents, which do not exist, is simply unreasonable. The amounts claimed are not large and conservatively reflect the fact that Pope & Talbot expended management resources to respond to conduct of Canadian SLD officials that has been found by this Tribunal to violate NAFTA Chapter 11. To suggest that such a claim should be rejected, on the argument that evidence which does not exist has not been produced, is untenable.

16. These claims for management time rely on the best estimates of management as to the time they spent addressing these issues. Mr. Rosen has relied on management representations with regard to this claim. The Investor is credible and there is no reason that this Tribunal should not give due weight to its representations. The Investor submits that this is entirely appropriate in the context of this arbitration for this Tribunal to accept the Investor's claim with respect to management time.

17. Moreover, Canada argues that management salaries would have been paid irrespective of the verification review episode so therefore they are not compensable.[8] The Investor disagrees. The question is not whether the costs are a fixed expenditure that would have been incurred irrespective of the breach, but the opportunity cost of management time expended to deal with the improper Verification Review Episode. Clearly, the cause of the wasted time by management was the Verification Review Episode which would have otherwise been devoted to the operation of the company. It is not the normal expected operations of Pope & Talbot management to have to deal with the events that occurred during the relevant period. The Verification Review Episode was at the instigation of Canada and management had no choice but to respond. This opportunity cost is entirely

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[7] Supplementary Statement of Howard Rosen, September 17, 2001, at para. 4.

[8] Counter-Memorial (Damages) at para. 62-66. 105-113.

recoverable and could be considered to be an "unnecessary expense"[9], or unnecessary waste of company resources, resulting from the Verification Review Episode.

(ii) Legal Fees and Disbursements

18. With respect to legal expenses, the Investor makes its damages claim with respect to legal fees and disbursements covering the whole Verification Review Episode, including the Interim Measures Motion. Although the Tribunal has explicitly stated that being forced to expend legal fees was part of the harm that Pope & Talbot incurred as a result of the Verification Review Episode, Canada denies that the Investor should be so compensated.[10]

19. With respect to the question of lawyer fees and dockets, and the Investor's claim of lawyer-client privilege, the Investor had requested the Tribunal by letter to assist to reconcile the two values of providing documents and the privilege. The Tribunal concluded in its letter of September 10, 2001 that "it is for the client and attorney to decide whether and to what extent to waive that privilege in order that the damages claimed can be established." Accordingly, in the interest of resolving this issue the Investor provides these documents to the Tribunal and Canada at this time in support of its claims regarding legal costs related to the Verification Review Episode. See these documents attached at Appendix B of this Reply Memorial.

20. Canada has further suggested[11] that many of the invoices submitted do not relate to the verification review and bear no connection to the breach found by the Tribunal and that "the documents do not prove that the verification review caused the damages." As stated by the Tribunal in its *Award*, the Investor was harmed by "being required to incur unnecessary expense",[12] so the Investor is not required in this Phase to prove that the verification review caused unnecessary expense. The Investor is only required to show that, on the balance of probability, the expenses incurred resulted from the Verification Review Episode. During the period from April 1999 to January 2000, the Investor incurred substantial out of pocket expenses (legal and otherwise) and had its business disrupted in relation to the Verification Review Episode. This is the finding of the Tribunal, and Canada is estopped at this late date from challenging that finding.

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[9] *Award* at para. 181.

[10] Counter-Memorial (Damages) at para. 116-124.

[11] Counter-Memorial (Damages) at para. 26.

[12] *Award* at para. 181.

21. Canada has also made submissions regarding legal disbursements in a document titled "Schedules Relating to Investor's Productions received August 14, 2001 - Explanatory Notes." In this document, Canada implies that each and every legal disbursement must be accompanied by a detailed explanation of the reason for its expense, and whether it applies to the Verification Review Episode. Although this may be standard practice in government when demanding that service providers document each and every dollar billed to the government, it is an unreasonable exercise in the context of a valuation of damages. In effect, Canada is suggesting that the standard of proof that should be applied is that the explanation of a disbursement must, "beyond a reasonable doubt", show its relation to the Verification Review Episode, or be excluded from the Claim. This position is simply excessive and unreasonable.

22. In addition, it is unreasonable to suggest that, during the Verification Review Episode, the Investor and its service providers should have anticipated that it would be required to segregate their disbursements to the level of detail suggested by Canada. As Canada shows in its summary of disbursements, Canada is unable to assess a large portion of the disbursements in the amount of $14,654.86. Disbursement amounts were segregated in the Investor's *Independent Valuators' Report* for those periods in which the events of the Verification Review Episode took place - the April to July 1999 and December 1999 to January 2000 periods. It is reasonable to assume that all, if not a high proportion, of the remaining disbursements are related to the Verification Review Episode.

23. It should be highlighted that the Investor has not claimed disbursements during the months of August to November 1999 as this period did not include high levels of legal activity related to the Verification Review Episode. Canada is again incorrect in its exaggerated statement that "the Rosen report assumes that predominantly all costs incurred between April 1999 and January 2000 were verification costs."[13]

24. Furthermore, Canada has argued that legal disbursements related to the Interim Measures Motion should not be recoverable by the Investor.[14] Canada has confirmed that at least $6,726.46 relates to the Verification Review Episode, and that $18,212.60 relates to the Interim Measures Motion. The Investor argues that because the Interim Measures Motion was initiated in direct reaction and response to the Verification Review Episode, it is only appropriate that expenses for the Motion be included in the heads of damages claimed. As the Tribunal has stated in its *Award*, the Investor is to be compensated for the harm of

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[13] Counter-Memorial (Damages) at para. 96.

[14] Schedule Relating to Investor's Productions Received August 14, 2001 - Explanatory Notes at para. 12.

"being forced to expend legal fees."[15] The Interim Measures Motion clearly relates to, and is a critical part of, the "Verification Review Episode" as described in the Tribunal's *Award*.[16] Accordingly, the Investor submits that at least $25,000 in disbursements, plus a high proportion, if not all, of the "non-assessable" costs of $14,654 relate to the Verification Review Episode, and should be payable to the Investor in compensation for the harm Canada caused to it and its Investment.

25. Canada also makes a general challenge that many of the out of pocket expenses claimed, in particular legal expenses, relate to the NAFTA arbitration generally and should not be allowed.[17] It should be reiterated that the Investor has segregated a large amount of expenses incurred in 1999 already in its submissions and not claimed these as damages related to the Verification Review Episode.[18]

(iii) Out-of-Pocket Expenses

26. Canada argues that the claim for US$12,295 for out of pocket expenses lacks support, in particular with respect to the $10,000 charged by "AA Co."[19] The Investor has located the missing document, which was excluded in error, and provides it in this Reply Memorial (Damages)[20]. The remaining expenses largely relate to the Interim Measures Motion hearing and the Verification Review in July 1999 by company management and are entirely reasonable and, accordingly, recoverable by the Investor.

(iv) Experts Fees

27. As confirmed by Mr. Rosen in his Supplementary Statement, Mr. Rosen was involved directly in advising the Investor and its counsel on audit matters during the Verification Review Process from April 1999 through to the Interim Measures Motion hearing in January, 2000. Mr. Rosen appeared at the January Hearing to give expert evidence on proper audit procedure. The only services Mr. Rosen provided during April 1999 to January 2000 for Pope & Talbot file related to the Verification Review Episode and were

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[15] *Award* at para. 181.

[16] *Award* at para. 169-170.

[17] Counter-Memorial (Damages) at para. 27.

[18] See Memorial (Damages), *Valuators' Scope of Review Documents* at Tab 11.

[19] As noted in the Schedule in the Valuators' scope of Review Documents at Tab 13.

[20] As provided in the Supplementary Statement of Howard Rosen, September 17, 2001.

in addition to his general retainer to conduct the valuation of damages in this arbitration for the Investor.[21]

28. With respect to the fees charged by Davis & Co., Mr. Rosen has confirmed that those fees do not relate to Mr. Mitchell, but mainly to the assistance that Mr. Dean Crawford provided the Investor with respect to Government Relations issues and with respect to a possible judicial review concerning the cancellation of Pope & Talbot's quota allocation. Mr. Crawford ceased to perform that function and act as a lobbyist when Mr. Mitchell began to assist the Investor.[22]

29. Similarly, APCO provided government relations services and only a portion of their fees from May 1999 have been accounted for with respect to the Verification Review Episode. Contrary to the submission of Canada,[23] fees from APCO related to February, March and April have not been claimed by the Investor with respect to the Verification Review Episode. With respect to Barnes & Thornberg, contrary to Canada's argument,[24] dockets were provided. These time entries clearly indicate activity related to government relations directed at building support in the US government concerning the NAFTA arbitration. At the time of this work, since Pope & Talbot was on the verge of having its quota reduced or cancelled, it is clear that this activity was in response to the Verification Review Episode.

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[21] Supplementary Statement of Howard Rosen, September 17, 2001, at para. 6.

[22] Supplementary Statement of Howard Rosen, September 17, 2001, at para. 7.

[23] Counter-Memorial (Damages) at para. 129.

[24] Counter-Memorial (Damages) at para. 132.

PART THREE: THE VERIFICATION REVIEW EPISODE CAUSED DAMAGES TO THE INVESTMENT

30. The main question for this Tribunal in this Phase of the arbitration is about accountability - at what point will a breach of an international obligation to treat an investment fairly attract damages? NAFTA Article 102(1)(c) provides that one of the objectives of the NAFTA is to "increase substantially investment opportunities in the territories of the Parties". To breach NAFTA obligations in the manner that Canada has in this case, and not be liable for damages, would be clearly inconsistent with the objectives of the NAFTA. This cannot be the intent of the NAFTA Parties.

31. Canada seeks in its Counter-Memorial to avoid its responsibility to compensate the Investor for the damages occasioned to it by Canada's illegal conduct. First, Canada sets a standard of proof so high that it would be impossible for any investor to ever receive compensation. Then, Canada attempts to minimize the conduct of its officials in the SLD to the point that its states that the harm found by this Tribunal, and the damages claimed by the Investor, are "exaggerated, excessive and unreasonable".

32. The Investor submits that the damages claimed by the Investor are reasonable and that the Tribunal should find in favour of the Investor and award the damages claimed.

A. Downtime Was Caused by the Verification Review Episode

33. The disputing parties agree that the damages claimed must occur "by reason of, or arising out of" the breach of NAFTA Article 1105 with respect to the Verification Review Episode. Canada has outlined a number of potential reasons for a softwood lumber company such as Pope & Talbot to take downtime - exhaustion of quota, reaching a quota speed bump, low prices, or holiday down time. In normal cases in which the Investment took downtime, one , some or all of these reasons may have been sufficient for the company to take downtime. There are two main reasons that these were not the causes for Pope & Talbot taking downtime in December 1999.

34. The first reason why the December 1999 downtime was caused by the Verification Review Episode is that the President of the Investment Mr. Friesen, who made the downtime decision, has confirmed his recollection of the events of November 1999. Canada's argument that Mr. Friesen is not credible and that his statements are "self-serving"[25] is simply unsupported and wrong. This Tribunal had the opportunity to question Mr. Friesen themselves in January 2000 and is in a position to confirm that Mr. Friesen is a credible witness.

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[25] Counter-Memorial (Damages) at para. 68. 69.

35. In November 1999, the single largest and overwhelming concern of the company was that its quota was going to be reduced or taken away. As Mr. Friesen states in his most recent Statement, the threats from Canada made the company feel "very beat up"[26] and Canada's letter of November 10, 1999, again threatening unilateral revision regardless of whether further information was provided, made the decision to take downtime inevitable. The fact that the Investor initiated the Interim Measures Motion demonstrates the company's anxieties.

36. Secret SLD memoranda only identified through cross-examination on the second last day of the November 2000 NAFTA Tribunal hearings confirmed that SLD officials were misleading the Minister of International Trade to force a decision to strip the Investment of its quota.[27] As the Tribunal stated, "the SLD was more devoted to catching the Investment in further errors than its professed aim of assuring that accurate data be used by the SLD in administering the Regime."[28] These misleading memoranda confirm Mr. Friesen's fears that the SLD was bent on harming the Investment.

37. The second reason is that, in light of the extreme conduct of Canada's officials, it is reasonable to conclude that the Verification Review Episode was the proximate cause for the Pope & Talbot decision to take downtime. The other factors enumerated by Canada, which in previous testimony company officials such as Mr. Friesen and Mr. Gray referred to generically as the operation, or "impact" of, the "softwood lumber agreement", were certainly part of the atmosphere surrounding Mr. Friesen's decision to take downtime. Both Mr. Gray and Mr. Friesen have acknowledged that these factors could lead to taking downtime, and did so in other instances. But in this case, because of what can only be termed to be an attack by Canada on Pope & Talbot, one could say it is surprising that the company did not experience more extensive damage.

38. Canada incorrectly states that Kyle Gray told Douglas George that he expected only a 1 to 2 % loss in quota.[29] In his Statement of December 7, 1999, Mr. Gray responded that he had a very different recollection of that conversation stating that:

> At paragraph 110 of Mr. George's affidavit, he states that I believed that "the allocation level of the company would only have to be reduced by 1-2% as a result of the verification." I do not agree

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[26] Statement of Abe Friesen (Damages Phase) at para. 5.

[27] As recounted in the *Award* at para. 178 -179.

[28] *Award* at para. 179.

[29] Counter-Memorial (Damages) at para. 70 and 14.

with Mr. George's view of our conversation. it was my recollection that I stated that there might be a one to two percent error. I did not admit to Mr. George that Pope & Talbot should have its quota allocation revised on the basis of a one to two percent error. I noted to Mr. George that, in light of the almost three months it took Mr. George to respond on the results of the verification review, it would also be difficult for Pope & Talbot to meet his schedule.[30]

39. Canada argues that Mr. Friesen was aware that Pope & Talbot's quota would only be reduced by 5% when the downtime decision was made.[31] Since the letter stating the 5% figure was dated November 19th, and Mr. Friesen made the downtime decision before November 15th, this conclusion is misleading and, in fact, impossible. Canada also states that a 5% reduction in quota was "far from substantial", suggesting that such a quota reduction would not be a proper reason for taking downtime. This argument by Canada demonstrates a complete lack of knowledge about the economics of the softwood lumber industry.

40. Moreover, at the time of the Verification Review Episode, Mr. Friesen described the effect of a 5% reduction, in support of the Interim Measures Motion in December 1999, stating that:

> 10. The five percent reduction of the company's softwood lumber quota would be a serious disruption of our Canadian operations resulting in economic harm to the Investor and the Investment decreasing the value of the Investor's investments in Canada.
>
> 11. If such a reduction were to occur, it is likely that the company would be in a position of reducing its employment at our three mill facilities in the interior of British Columbia and there is even a chance that we would be forced to close down a facility entirely.[32]

41. Canada points out that Gary McGrath, Manager of the Grand Forks Facility, had calculated that the Investment had exceeded its quota and was required to shutdown for 24 days.[33] This shutdown calculation reflected the use of quota and the remaining quota available. It did not reflect other factors, such as price or the illegal actions of Canada during the Verification Episode, that may be part of a decision to shutdown.

42. These documents cited by Canada are consistent with the June 15, 2001 Statement of Abe Friesen who said that the two main factors in determining whether it was economical to

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[30] Statement of Kyle Gray, December 7, 1999 at para. 26.

[31] Counter-Memorial (Damages) at para. 70.

[32] Supplementary Statement of Abe Friesen, Interim Measures Motion, December 7, 1999 at para. 10-11.

[33] Counter-Memorial (Damages) at para. 72.

operate or not were usually the requirements of the Export Control Regime (such as the quarterly speed bump or utilization, which Mr. McGrath's calculations identified) and the status of softwood lumber prices.[34] With these factors in mind, at the time the decision was made to shutdown softwood lumber prices were such that the Investment was on a "price bubble" and could have continued to operate or not. The likelihood that SLD officials would make good on their repeated threats of reducing Pope & Talbot's quota allocation convinced Mr. Friesen to avoid the risk of producing more softwood lumber than could economically be sold.[35]

43. Canada suggests that since other softwood lumber companies took downtime in December 1999[36], and were not subject to a verification review, that this is proof that the verification review was not the reason for Pope & Talbot's downtime. The fact that these companies were not subject to the unfair conduct and threats of SLD officials makes this an unhelpful and inappropriate comparison. Furthermore, every company has a different point at which they can no longer operate due to efficiency and other operating conditions. It is possible to say that another company faced with the same circumstances might have taken even more downtime than was taken by Pope & Talbot. Since no other companies had the same experience, the experiences of these companies cannot be a useful comparison.

44. Similarly, Canada relies on the fact that the Investment took downtime at Christmas in the previous year and the year after the verification review. Since the Investment was not under the threat of its quota being eliminated or reduced in either of those two years, it is also not appropriate to make such a comparison. Moreover, it is quite likely that had the threat of its quota being cancelled or reduced existed in other years, the Investment would likely have taken even more downtime in reaction to such uncertainty.

45. Canada also relies on the fact that the Investor made no public statements that it was taking downtime in response to the SLD's conduct during the Verification Review Episode. It should be noted that the Tribunal confirmed that the verification review process is part of Canada's implementation of the *Softwood Lumber Agreement*, through the "Export Control Regime".[37] During the time in question, the Investor was directly

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[34] Statement of Abe Friesen, June 15, 2001 at para. 4.

[35] Statement of Abe Friesen, June 15, 2001 at para. 10.

[36] Counter-Memorial (Damages) at para. 84.

[37] In the *Ruling by the Tribunal On Claimant's Motion for Interim Measures*, January 7, 2000, the Tribunal dismissed the motion on the grounds that the verification review was part of the measure in question and that the Tribunal did not have the jurisdiction to enjoin the measure.

involved in the motions process. It is reasonable to conclude that, apart from general references to the "impact of the Softwood Lumber Agreement", the Investor was not prepared to announce to the public that it was being threatened and unfairly treated by the Government of Canada through a verification process. This question was before the Tribunal to determine and was not an appropriate public comment for a public company to make. The Tribunal vindicated the conduct of the Investor and its Investment during the Verification Review Episode and made the finding of fact that "the verification review and the report thereon were seriously flawed and are not a reliable basis for further action".[38] At that point in time, the damage to Pope & Talbot was done and any question of damages were to be addressed in the arbitration process.

(i) Foreseeability

46. Canada attempts to read in a subjective test for forseeability of damages.[39] The key issue is not whether damages were in contemplation of the Parties at the time of the verification review, but rather whether the Verification Review Episode caused the Investor to take downtime in December 1999. The Investor's Memorial and evidence from the Investment's Canadian President, Mr. Abe Friesen, confirms that the corporate decision to take downtime was caused by the cloud of uncertainty created by the Verification Review Episode.

47. Moreover, this Tribunal has confirmed in its *Award* that the Verification Review Episode was linked to the NAFTA case.[40] Correspondence to Canada from the Investor during the Verification Review confirms that Canada had been advised repeatedly that the conduct of its officials was jeopardizing the jobs of the employees at Pope & Talbot's Canadian mills and the communities of which they are a part, and that such conduct could result in damages being assessed against Canada for such conduct.[41]

48. For example, in a letter written by Mr. Appleton to Douglas George on May 3, 1999 the Investor made it clear that Canada's actions were unfair and likely violated the NAFTA. Specifically, with respect to the verification review episode the letter stated:

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[38] *Ruling by the Tribunal On Claimant's Motion for Interim Measures*, January 7, 2000.

[39] Counter-Memorial (Damages) at para. 46.

[40] *Award* at 156, footnote 157.

[41] Investor Memorial (Damages) at para. 9 and 10, regarding letters to Canada dated April 29, May 3 May 11, 1999.

> Such conduct may not only warrant an award of censure or additional damages against Canada but also places at risk, unfairly, the hundreds upon hundreds of jobs in British Columbia's Southern Interior of those who rely upon Pope & Talbot.[42]

49. Being threatened by a government is not an ordinary occurrence for most foreign companies. It makes a foreign company feel extremely vulnerable.[43] This is especially so when the entire livelihood of the company is at stake through a specific government program administered by those same officials who are making the threats. Pope & Talbot at all times acted in good faith while the Canadian SLD officials did not. To suggest that Pope & Talbot's decisions to minimize harm and to protect itself are "not credible", "speculative" or "remote", severely and unreasonably minimizes the impact of Canada's illegal acts.

(ii) NAFTA Articles 1116, 1117 & 1105

50. Canada argues that an "investor" that brings a claim under NAFTA Article 1116 for a breach of NAFTA Article 1105 cannot be compensated.[44] Canada's novel theory simply does not accord with the plain meaning of NAFTA Articles 1116, 1117 and 1105. The Investor owns and controls its subsidiary in Canada, Pope & Talbot, Ltd. Canada has not raised this presumably jurisdictional issue until now. Canada does not suggest that damages are not payable, only that the Investor ought to have brought its Claim under NAFTA Article 1117 not 1116 and, accordingly, this Tribunal does not have the jurisdiction to make an award of damages at this time. Even if Canada's novel theory (which prefers form over substance) that the Investor is not entitled to damages because this arbitration was brought under NAFTA Article 1116 instead of NAFTA Article 1117 is accepted by this Tribunal, this would be a jurisdictional concern that is not arbitrable after an award has been issued.

51. This Tribunal has found Canada's conduct towards the Investor and its Investment during the Verification Review to violate NAFTA Article 1105 and that the losses occasioned by Canada's breach to both the Investor and its Investment are compensable. NAFTA Article 1116 makes it clear that losses to the Investor are compensable. Specifically, NAFTA Article 1116 and 1120 permits an **Investor** of a Party to submit a claim to arbitration and requires that the Investor be compensated if it "has incurred loss or damage by reason of, or arising out of, that breach."

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[42] Letter from Barry Appleton to Douglas George, May 3, 1999.

[43] Investor's Memorial (Damages) at para. 6, citing Testimony of Abe Friesen at the Motion for Interim Measures Hearing, Transcripts January 7, 2000, Vol. II at 331.

[44] Counter-Memorial (Damages) at para. 49-58.

52. Canada has made a fundamental error in its arguments when it states that "The drafters of NAFTA included Article 1117 to provide a remedy for injuries to enterprises that would otherwise be barred from bringing a claim by the customary international law rule prohibiting claimants from filing international claims against their own governments."[45] Not only does Canada not cite any support of the intent of the NAFTA drafters, but NAFTA Article 1120(1) makes it clear that only a "disputing investor" may submit a claim to arbitration. There is no provision in the NAFTA for investment "enterprises of another Party" to bring claims on their own behalf as Canada suggests. Accordingly, this cannot possibly be the intent of the NAFTA drafters.

53. Moreover, Canada has misconstrued the objectives of NAFTA Articles 1116 and 1117. In most, if not all, cases in an Investor State dispute an investor will experiences injury if its investment experiences losses. By definition, an "investor" must have "investments" - it is not an investor in the absence of "investments" as defined by NAFTA Article 1139. If an Investor experienced any harm, it would be irrational for an Investor to only make a claim under NAFTA Article 1117.

54. Accordingly, NAFTA Article 1116 will cover all damages incurred by an investor and its investment. NAFTA Article 1117 is more restrictive and applies to those losses experienced by the enterprise only. Note that NAFTA Article 1117 does not apply to the broader definition of "investment" under NAFTA Article 1139 nor to the Investor's losses. From a practical business perspective, it would be a rare situation in which an investment experiences damages and its investor does not. Harm to an investment by definition reduces the value of that investment to its investor. The main effect of making a claim under NAFTA Article 1117 would be to limit compensation to those damages only incurred by the enterprise affected. Presumably this would cover situations in which the enterprise had changed ownership and the new investor could not establish that it had incurred harm apart from the investment.

55. Furthermore, the NAFTA does not impose any territorial limitation upon an award of damages made to a foreign investor for damage caused to it through a breach of treatment in accordance with international law (NAFTA Article 1105). It only provides in NAFTA Article 1101(1), that as a threshold issue, NAFTA investors may allege that a breach of the Chapter's obligations has occurred with respect to an investment made in the territory of another NAFTA Party.

56. NAFTA Article 1101 says nothing about limiting the availability of damages caused to an investor, in its own territory, as a result of a breach of NAFTA Party. NAFTA Article

[45] Counter-Memorial (Damages) at para. 52.

1101(1)(a) indicates that NAFTA Chapter 11 applies to measures adopted or maintained relating to investors of another party, regardless of whether those investors are present in the territory of another NAFTA Party when the breach occurred.

57. The text of NAFTA Article 1105 clearly covers breaches occasioned to "investments of investors". This Tribunal has found that Canada breached its obligations toward the Investment of the Investor in this case with respect to the Verification Review Episode. The enabling provision that permits the Investor to bring a claim under NAFTA Chapter 11 is contained in NAFTA Article 1116 so long as there has been a breach of an obligation contained under Section A and that the Investor has 'incurred loss or damage by reason of, or arising out of, that breach'. The *Award* in this case is contrary to Canada's novel theory. The Tribunal stated as follows:

> In its totality, the SLD's treatment of the Investment during 1999 in relation to the verification review process is nothing less than a denail of the fair treatment required by NAFTA Article 1105, and the Tribunal finds Canada liable to the Investor for the resultant damages.[46] [emphasis added]

(iii) Mitigation

58. Canada argues that the Investor had various options in order to mitigate its losses.[47] Canada suggests that the Investor could have challenged the verification review process in domestic court or could have sold its lumber to countries other than the US. These suggestions by Canada are not only unfounded they are naive to the realities of the softwood lumber industry that the Investor operates in.

59. Canada argues that the Investor should have worked around Canada's unlawful act by restructuring its business to reduce its losses. Canada suggests that the Investor should have opted to export to countries other than the US. To expect the Investor to change its business plan and stop exporting to the North American market is absurd. It is unreasonable for Canada to expect the Investor to change its entire business plan to mitigate the losses inflicted on it by Canada's own acting. Canada relies upon its own breach of its NAFTA obligations in an attempt to reduce damages payable to the Investor.

60. Canada argues that the Investor ought to have pursued local remedies before bringing this NAFTA Claim. The Investor submits that this Tribunal should explicitly reject this proposition in its Final Award, for it is clearly contrary to the intent of the NAFTA Parties.

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[46] *Award* at para. 181.

[47] Counter-Memorial (Damages) at para. 59-60.

61. While the obligation to exhaust local remedies is a well-known principle of international law,[48] this principle has been replaced in Chapter 11 of the NAFTA by a claims initiation procedure that specifically does not require the exhaustion of local remedies. All that is required is that a claimant meet the requirements of NAFTA Articles 1116 and 1120. This purpose of this procedure was to provide speedy determinations of disputes between foreign NAFTA investors and NAFTA governments.

B. The Independent Valuators' Report

62. Canada has attempted to characterized the *Independent Valuators' Report* as "fundamentally flawed" and "not a reliable basis" for the Tribunal to make its award.[49] What Canada mischaracterizes as "flaws" are mainly disagreements between the experts as to methodology and presumptions. Mr. Rosen has examined Mr. Harder's report and, in the continuing process of narrowing the issues in this phase of the arbitration, agrees with some of Mr. Harder's analysis on some issues and disagrees on the remaining issues.

(i) Loss of Incremental Revenue Claim

63. Mr. Rosen has conceded that there a minor calculation error should be corrected which increased the basic amount for the claim related to the loss of incremental revenue from US$1.08 to US$1.191 million.[50] This results in the Investor increasing its claim of damages to US$2,319,982.

64. On the remaining issues, Mr. Harder has taken a different methodological approach, making different assumptions than Mr. Rosen that has the effect of reducing the valuation amount.[51] The Investor disagrees with Mr. Harder's assumptions. The issues of disagreement on assumptions relate to (1) the appropriate softwood lumber prices, and (2) when is the appropriate time for these prices to be applied.

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[48] It is to be noted that Whiteman's *Law of Damages* (the very source relied upon by Canada for its exhaustion argument) reports that exhaustion of remedies as an element of mitigation applies only to cases of denial of justice: Whiteman. *The Law of Damages*, vol III at 1558 - 1559. This NAFTA Claim is not about denial of justice in its traditional legal form, for the Investor is not claiming damages for an improper Canadian judicial decision.

[49] Counter-Memorial (Damages) at para. 88-94.

[50] Supplementary Statement of Howard Rosen, September 17, 2000 at para. 8.

[51] Counter-Memorial (Damages) at para. 93.

(1) Softwood Lumber Prices

65. Mr. Rosen has relied on the industry standard *Random Lengths* SPF prices, while Mr. Harder has attempted to use actual average monthly prices.

66. Mr. Rosen confirms that the use of the *Random Lengths* industry prices are an appropriate benchmark in these circumstances to calculate the loss sustained by Pope & Talbot. Because Pope & Talbot is a price taker, in a commodity market where individual companies do not set prices, *Random Lengths* is the best benchmark to reflect the industry and the marketplace. To determine weekly prices is neither practical nor helpful. Pope & Talbot uses *Random Lengths* to set its prices, and as a matter of consistency, it is more appropriate to apply a weekly selling price to weekly production, as well as accounting better for exchange rate fluctuations.[52]

67. The Investor submits that the use of average monthly prices, as proposed by Mr. Harder, is not appropriate in this case as it understates the amount of loss sustained by Pope & Talbot. The use of monthly prices may not appropriately account for a number of factors, such as: fees paid under the Export Control Regime, sales and inventory adjustments, exchange factors and fluctuations in weekly selling prices.[53]

(2) Four week delay in sales

68. Mr. Rosen made the assumption that the sales in question occur at the same time as the lumber produced. Mr. Harder uses the average monthly prices realized in the month subsequent to production. The approach of Mr. Harder is not appropriate because it includes the effect of the ending of the *Softwood Lumber Agreement*, and the Export Control Regime, on prices in the softwood lumber market. Mr. Harder's own calculations reflect this and unnecessarily diminish the valuation. To remove the effect of the post-*Softwood Lumber Agreement* period, it is necessary to make the assumption that sales occurred at the time of production.[54]

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[52] Supplementary Statement of Howard Rosen, September 17, 2001, at para. 12.

[53] Supplementary Statement of Howard Rosen, September 17, 2001, at para. 10. The Investor contacted Canada by letter on September 7, 2001 to further request information regarding Canada's calculation Pope & Talbot's actual realized selling prices. The Investor made this request so that its valuators could understand how Mr. Harder calculated these values and to be able to verify the process. The Investor has not received a response from Canada to its request to be able to further address those issues.

[54] Supplementary Statement of Howard Rosen, September 17, 2001, at para. 13.

PART FOUR: INTEREST AND COSTS

A. Interest

69. Canada cites domestic Canadian court practice for the award of interest in this international arbitration. The governing law of this arbitration is international law. The use of municipal law with respect to the awarding of interest is simply irrelevant to this proceeding. In order to provide integral reparation so as to make the Investor "Whole", a rate of interest must be awarded that reflects the most reasonable benefit or use the Investor/Investment would have experienced.

70. The Investor continues to rely upon its Memorial (Damages Phase) in seeking compound interest on the damages payable by Canada in this arbitration.[55]

B. Costs

71. Canada argues, at paragraph 166 of the Counter Memorial (Damages), that it will be seeking costs for the Interim Measures Motion both because Canada was successful on that motion and because it was clearly a futile motion beyond the jurisdiction of a Chapter 11 Tribunal. While the Investor's motion was not successful on technical terms, the Tribunal made a finding of fact admonishing Canada and its officials for their conduct during the verification review process. Specifically, this Tribunal ruled:

> However the Tribunal feels compelled to state that the verification review and the report thereon were seriously flawed and are not a reliable basis for further action. Nevertheless, there were also admitted errors by Pope & Talbot Inc. But the Tribunal finds these to be immaterial in the context of Pope & Talbot's total quota and past action by Canada in implementing the measure.[56]

72. The circumstances underlying the Interim Measures Motion were essentially forced upon the Investor through a series of threats from the SLD officials that the Investor's quota would be reduced or cancelled. This Tribunal has found that the conduct of Canadian officials during the Verification Review Episode constituted a breach of international law under NAFTA Article 1105. As the Tribunal has ruled in its *Award on the Merits of Phase 2*:

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[55] Investor's Statement of Claim and Memorial (Damages Phase), paras. 18-20.

[56] *Pope & Talbot Inc. and the Government of Canada*, Ruling on Interim Measures, January 7 2000.

> ...the end result for the Investment was being subjected to threats, denied reasonable requests for pertinent information, required to incur unnecessary expense and disruption in meeting SLD's requests for information. forced to expend legal fees and probably suffer a loss of reputation in government circles.[57]

73. The fact that this reduction did not take place, despite causing other harm such as the December 1999 shutdown, is due to the decision of the Tribunal with respect to the Investor's Interim Measures Motion. Canada should therefore bear the full cost of the Interim Measures Motion and all legal, expert and Tribunal costs related to the Verification review Episode.

[57] *Pope & Talbot Inc. and the Government of Canada*, Award on the Merits of Phase 2, April 10, 2001 at para.181.

PART FIVE: SUBMISSIONS

In view of the facts and arguments set out in this Reply Memorial (Damages) and the Investor's Memorial (Damages). may it please the Tribunal to declare and adjudge the following:

> Canada be hereby ordered to pay compensation to the order of the Investor in an amount NOT LESS THAN US$2,319,982, including the appropriate pre and post-judgement interest on these amounts at a commercial rate of interest.

Submitted this 17th day of September, 2001

per
Barry Appleton
for APPLETON & ASSOCIATES INTERNATIONAL LAWYERS
Counsel for the Investor, Pope & Talbot, Inc.

1140 Bay Street, Suite 300
Toronto, Ontario M5S 2B4