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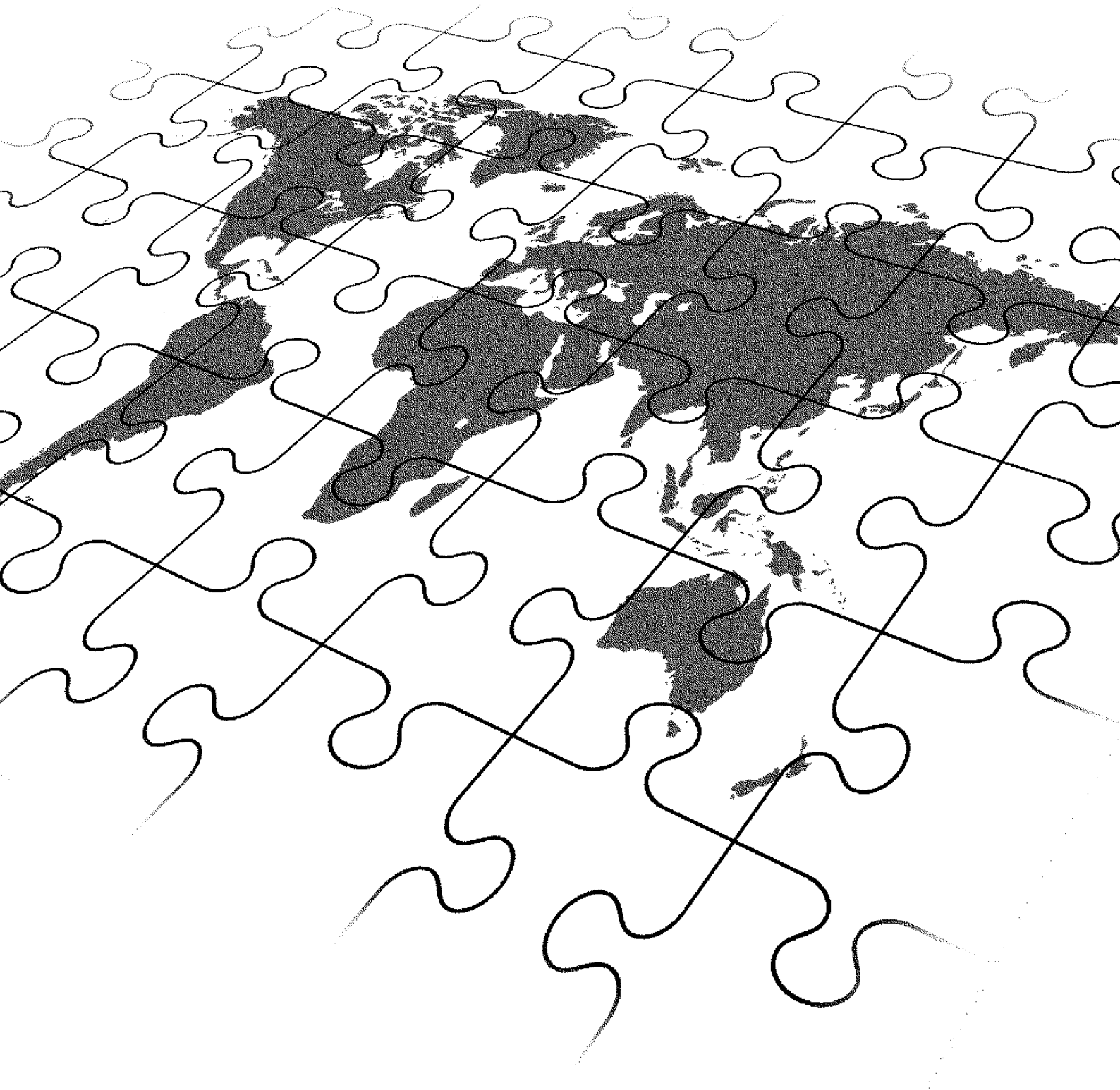

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Case summary: *Merrill & Ring Forestry L P v Canada* (NAFTA award)

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The recent NAFTA award in the *Merrill & Ring Forestry L P v Canada* case will be the subject of much debate and commentary, in particular with regard to the Tribunal's analysis of the fair and equitable treatment standard under Article 1105 of NAFTA.[1] Perhaps the most salient aspect of the award with respect to that provision is that the Tribunal was unable to agree on the threshold to be applied to establish a breach of the fair and equitable treatment standard under Article 1105(1). The Tribunal avoided a split-decision on that fundamental legal issue by instead concluding that regardless of which threshold were adopted, the investor had failed to demonstrate that it had suffered damages and, as a result, Article 1105(1) was not breached. That ultimate conclusion was based on the Tribunal's view that damages and liability are 'inextricably related'.[2] This article provides a brief summary of the award.

The parties to the dispute were Merrill & Ring Forestry L P (US), as Claimant, and the Government of Canada, as respondent. Claimant was represented by Canadian counsel Barry Appleton, of Appleton & Associates. Respondent was represented by Sylvie Tabet and Lori Di Pierdomenico, of the Trade Law Bureau, Department of Foreign Affairs and International Trade of the Government of Canada.

The Tribunal was constituted on 31 August 2007. Its members were Francisco Orrego Vicuña (President, appointed by ICSID after parties failed to agree), Kenneth W Dam (appointed by Claimant), and J William Rowley QC (appointed by respondent). The Tribunal issued its award on 31 March 2010, addressing both merits claims and jurisdictional objections.

Factual overview

This case concerned the application of Canada's Log Export Regime to Claimant's timber operations in British Columbia. Under the Regime, the removal of logs from British Columbia was governed by provincial regulations under the British Columbia Forest Act as well as by Canadian federal regulations under the Export and Import Permits Act. Both regulations included a log surplus test prior to authorisation of log removal or exports from the province, where parties interested in removing logs from British Columbia had to first allow local log processors to make offers for the purchase of the logs. Only if no offer were made, or if the offers were made at below fair market value (as defined in the British Columbia market), could the logs be deemed to be surplus and thus eligible for removal or exportation. If an offer from a local log processor were submitted, and if it were determined by the Regime's administrator to reflect fair market value, however, the logs would not be eligible for removal and would not be granted an export permit.

Claimant complained that the federal regulations were disadvantageous when compared to the provincial regulations. The federal regulations, for example, required that trees be harvested before a company could apply for an export permit, while provincial regulation could allow for the application of an export permit before harvesting. This was significant because the logs became susceptible to rot and disease after harvesting. The federal regulations also required, inter alia, that logs be scaled metrically, which meant that logs had to be re-scaled for export to markets not using the metric system.

Ultimately, according to Claimant, the cumulative effect of those measures was that Claimant was forced to sell its logs at below fair market value, as measured on the global market, with the result that Claimant subsidised the British Columbia sawmills.

Claimant's claims and Tribunal's findings

Claimant argued that the logging regulations were aimed at ensuring that log processors in British Columbia had access to logs at artificially suppressed prices; that objective, and the fact that these very log processors have

been put in charge of the administration of the regime, were alleged to breach a number of NAFTA provisions and other standards of international law. The three main provisions invoked by Claimant were NAFTA Article 1102 (National Treatment), Article 1110 (Expropriation), and Article 1105 (Fair and Equitable Treatment).

National treatment under NAFTA Article 1102

Claimant argued that it was in 'like circumstances' as compared with timber companies operating in other parts of Canada and not subject to the same federal regulatory regime. This differentiated treatment, Claimant argued, resulted in a breach of the national treatment standard under NAFTA Article 1102.

The Tribunal first defined the standard of comparison, clarifying that 'treatment accorded to foreign investors by the national government needs to be compared to that accorded by the same government to domestic investors. . . just as the treatment accorded by a province ought to be compared to the treatment of that province in respect of like investments.'[3] Claimant was thus compared to other log producers subject to the same federal regulations and not to producers in other provinces or to producers operating under provincial regulations. To the degree that Claimant's operations were located in provincially regulated lands, those were compared with operations of similarly regulated log producers. The Tribunal ultimately concluded that under these comparisons, 'the treatment the Investor is accorded is identical to that accorded to domestic investors in the same category' and thus dismissed Claimant's claims under NAFTA Article 1102.[4]

Expropriation under NAFTA Article 1110

Claimant argued that its investment included an interest in realising a fair market value for its logs in the international market, but that the Log Export Control Regime, by substituting government control for its own control over critical parts of its business, provided low cost raw material for British Columbia sawmills. Claimant reasoned that being deprived of the full control of its investment without compensation for the depressed domestic log prices at which it was forced to sell its logs constituted expropriation under NAFTA Article 1110.

The Tribunal recognised that an investment could give rise to intangible rights protected by the treaty and that these could be expropriated. The Tribunal questioned, however, whether the intangible interest at issue did in fact constitute a protected right. The Tribunal concluded that to qualify for protection under the treaty, '[t]he right concerned would have to be an actual and demonstrable entitlement of the investor to a certain benefit under an existing contract or other legal instrument. This reasoning underlies the *Feldman* tribunal's conclusion that an investor cannot recover damages for the expropriation of a right it never had. Expropriation cannot affect potential interests.'[5] In this light, the Tribunal concluded that while Claimant enjoyed a protected right to export, 'the protection against expropriation does not, and cannot, guarantee exports will be made at a certain price. Such a conclusion would transform NAFTA into an insurance policy, guaranteeing that every investor exporter will get for its products the best price available in the international market, which is a somewhat farfetched proposition.'[6]

While this conclusion was in itself dispositive as regards the expropriation claim, the Tribunal explored the same issue from a different angle, asking whether the degree of interference that Claimant complained of amounted to a taking of the (presumed) rights concerned. The Tribunal considered that Claimant's claim essentially consisted of whether it could have obtained better profits in exporting logs to the international market, and whether its inability to achieve such profits due to the federal regulations was tantamount to a taking of its profits. In addressing the issue, the Tribunal reasoned that '[l]egitimate expectations are no doubt an important element of a business undertaking, but for such expectation to give rise to actionable rights requires there to have been some form of representation by the state and reliance by an investor on that representation in making a business decision.'[7] Because the Tribunal found no evidence that Canada made representations to Claimant, the Tribunal concluded that Claimant's ownership rights had not been affected by governmental conduct so as to amount to an expropriation.

Fair and equitable treatment under NAFTA Article 1105

Conclusion in respect of liability

Claimant argued that Canada breached the fair and equitable treatment standard under NAFTA

Article 1105(1) by subjecting its operations to a complicated set of federal regulations. According to Claimant, this regime resulted in unfairness, discrimination and an unstable business environment that breached fair and equitable treatment obligations, constituted an abuse of right by Canada, and violated Claimant's legitimate expectations.

The Tribunal dismissed Claimant's Article 1105 claims, but did so on the basis of Claimant's failure to prove that it suffered damages as a result of the challenged measures.[8] The Tribunal explained that an investor's claims for damages and the breach of the fair and equitable treatment standard under Article 1105(1) are inextricably linked. It stated that 'an international wrongful act will only be committed in international investment law if there is an act in breach of an international legal obligation, attributable to the Respondent *that also results in damages*.'[9] The Tribunal cited as support for this link between liability and damages the Permanent Court of International Justice in the *Chorzów Factory* case, the 1929 and 1961 Harvard Drafts on State Responsibility, and other sources of public international law.[10]

The reason why the Tribunal relied on absence of damages to dismiss Claimant's claim under Article 1105 may be explained by the 'different views' within the Tribunal in respect of the applicable standard under Article 1105(1).[11] As a result of that divergence of views among its members, the Tribunal considered a possible breach of the protections provided by Article 1105(1) under two different scenarios. It based the *first* scenario on the view – put forth by Claimant – that the threshold to establish a breach of the fair and equitable treatment standard under Article 1105(1) is a comparatively low one, ie, the standard offers significant protections to the investors. The Tribunal based the *second* scenario on a higher threshold (but not as high as *Neer*), according to which a breach of Article 1105(1) may result from a state's wrongful conduct or behaviour that is sufficiently serious as to be readily distinguishable from an ordinary effect of otherwise acceptable regulatory measures.[12]

The Tribunal appeared to conclude – but did not say so explicitly – that if the comparatively low standard or threshold was applied to the measures complained of, at least some of Claimant's claim of breach of Article 1105(1) would prevail.[13] By contrast, the Tribunal was less tentative in its conclusion under the second scenario; it said that under that scenario it would be likely to conclude that 'Canada had *not* contravened the provisions of Article 1105(1).'[14]

Before analysing the facts under each of the scenarios, however, the Tribunal embarked on a lengthy discussion of its own understanding of the evolution of the minimum standard of treatment of aliens required by customary international law. It proffered a sixty-four-paragraph-long *obiter dictum* exploration of the meanings of the minimum standard of treatment and its possible application to the case.

As part of its musings about the minimum standard of treatment, the Tribunal noted that it was an evolving standard that needs to be interpreted in light of all available sources of international law. It also concluded that the minimum standard of treatment and the contemporary notions of fair and equitable treatment are one and the same. It explained that the 'minimum standard of treatment of investors is found in customary international law and that, except for cases of safety and due process, today's minimum standard is broader than that defined in the *Neer* case and its progeny. Specifically this standard provides for the fair and equitable treatment of alien investors within the confines of reasonableness. The protection does not go beyond that required by customary law, as the FTC has emphasised. Nor, however, should protected treatment fall short of the customary law standard.'[15]

The notion that the minimum standard of treatment of aliens under customary international law is an evolving standard is relatively uncontroversial,[16] and there is support in investment treaty jurisprudence for the Tribunal's position that the minimum treatment standard can be equated with contemporary notions of fair and equitable treatment.[17] As regards NAFTA Article 1105 and the FTC Clarification of 2001, the Tribunal's position seems to be that the Clarification may have less meaning today than it did when it was issued a decade ago, given that any gap that may have existed between the treaty standard of fair and equitable treatment and the standard of fair and equitable treatment understood as the minimum standard of treatment under customary international law, has by now narrowed. Of note, the Tribunal also applied an equitable analysis in its interpretation of the meaning of Article 1105, explaining that it would be 'countenanc[ing] an unacceptable double standard' if it were to permit NAFTA Parties to impose an (arguably higher) treaty standard

of fair and equitable treatment in their BITs with other states, while at the same time using the FTC Clarification to impose a different (relatively lower) fair and equitable treatment standard on themselves.[18]

With respect to a requirement for transparency in governmental conduct, the Tribunal stated that such a requirement is not at present part of the customary law standard, but is fast approaching that stage.[19] It is noteworthy that the Tribunal referred to transparency as a potential obligation under customary international law, but failed to note that at least one previous NAFTA tribunal, and the Supreme Court of British Columbia in its review of the award in *Metalclad v Mexico*, affirmatively held that there are no transparency obligations contained in NAFTA Chapter 11.[20] The Tribunal also considered as part of the fair and equitable treatment standard the requirement to provide a stable legal environment, in order to avoid sudden and arbitrary alterations of the legal framework governing the investment.[21]

Conclusion in respect of damages

As opposed to the applicable standard of fair and equitable treatment, there was no difference of opinion within the Tribunal concerning Claimant's claim for damages. As mentioned above, the Tribunal concluded unanimously that Claimant failed to prove damages to the satisfaction of the Tribunal. That conclusion was based on the Tribunal's finding that Claimant did not prove the existence of a legitimate interest that was affected by the governmental measures complained of.[22] Specifically, the Tribunal noted that Claimant did not have contractual rights and had not established that it could have acquired them in the near future. Any expectations that it would acquire such rights was an uncertain fact, not supported by the evidentiary record. That uncertain expectation, the Tribunal explained, 'does not appear to provide a solid enough ground on which to construct a legitimately affected interest.'[23] The Tribunal also found that Claimant had not identified an intangible interest which could be affected by the measures, and opined that Claimant's general business outlook did not constitute such an interest for the purpose of calculating damages.[24]

In the absence of damages, the Tribunal concluded that Canada 'has not been shown to have breached Article 1105(1).'[25]

Notes

1 *Merrill & Ring Forestry LP v Canada*, Award, IIC 427 (2010), 31 March 2010, Ad Hoc Tr (UNCITRAL).
2 *Ibid*, at ¶ 266.
3 *Ibid*, at ¶ 82.
4 *Ibid*, at ¶ 93.
5 *Ibid*, at ¶ 142 (internal footnote omitted).
6 *Ibid*, at ¶ 144.
7 *Ibid*, at ¶ 150.
8 *Ibid*, at ¶ 266.
9 *Ibid*.
10 *Ibid*, at ¶ 244.
11 *Ibid*, at ¶ 246.
12 *Ibid*, at ¶ 219.
13 *Ibid*, at ¶ 234.
14 *Ibid*, at ¶ 242.
15 *Ibid*, at ¶ 213.
16 *See*, eg, *Siemens AG v Argentina*, Award and Separate Opinion, IIC 227 (2007), 6 February 2007, ICSID Case No ARB/02/8, at ¶ 299; *CMS Gas Transmission Company v Argentina*, Award, IIC 65 (2005), 12 May 2005, ICSID Case No ARB/01/8, at ¶ 284; *ADF Group Inc v United States*, Award, IIC 2 (2003), 6 January 2003, ICSID Case No ARB(AF)/00/1, at ¶ 179; *Mondev International Ltd v United States*, Award, IIC 173 (2002), 11 October 2002, ICSID Case No ARB(AF)/99/2, at ¶¶ 116, 117.
17 *See*, eg, *Azurix Corp v Argentina*, Award, IIC 24 (2006), 23 June 2006, ICSID Case No ARB/01/12, at ¶¶ 364, 368-372 (stating that '[i]n holding that Article 1105(1) refers to customary international law, the FTC interpretations incorporate *current* international law, the content of which is shaped by the conclusion of more than two thousand bilateral investment treaties and many treaties of friendship and commerce.' (emphasis added)); *CMS Gas Transmission Company v Argentina*, Award, IIC 65 (2005), 12 May 2005, ICSID Case No ARB/01/8, at ¶ 284; *see* also Stephen M Schwebel, 'The Influence of Bilateral Investment Treaties on Customary International Law', 98 *Am Soc'y Int'l L Proc* 27 (2004) (stating that '[c]ustomary international law governing the treatment of foreign investment has been reshaped to embody the principles of law found in more than two thousand concordant bilateral investment treaties').
18 *Merrill & Ring* at ¶ 212.
19 *Ibid*, at ¶ 231. Although the Tribunal did not cite any support for that conclusion, there is at least one international tribunal in an investment arbitration that referred to 'the principle of transparency under international law'; *Champion Trading Company and Ameritrade International Inc v Egypt*, Award, IIC 57 (2006), 27 October 2006, ICSID Case No ARB/02/9, at ¶ 164.
20 *Feldman v Mexico, Award*, IIC 157 (2002), 16 December 2002, ICSID Case No ARB(AF)/99/1, at ¶ 133 (citing *United Mexican States v Metalclad*, Supreme Court of British Columbia, Reasons for Judgment of the Honorable Mr Justice Tysoe, 2 May 2001, ¶¶ 70-74).
21 *Merrill & Ring* at ¶ 232.
22 *Ibid*, at ¶ 258.
23 *Ibid*.
24 *Ibid*.
25 *Ibid*, at ¶ 266.