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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

THE GOVERNMENT OF CANADA

Respondent/Party

STATEMENT OF DEFENCE OF THE GOVERNMENT OF CANADA

October 30, 2007

Department of Foreign Affairs
and International Trade
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STATEMENT OF DEFENCE
OF THE GOVERNMENT OF CANADA

Pursuant to Article 19 of the UNCITRAL Arbitration Rules, the Government of Canada ("Respondent" or "Canada") respectfully submits this Statement of Defence in response to the Statement of Claim submitted by Merrill & Ring Forestry L.P. ("Claimant" or "Merrill & Ring") on December 27, 2006.

PRELIMINARY STATEMENT

1. This case is about export controls applied by Canada to logs from British Columbia. Merrill & Ring is one of over 70 timber companies operating under federal jurisdiction in the province of British Columbia. It alleges that a measure introduced by Canada in 1998 governing the issuance of export permits for logs harvested in British Columbia violates the investment protections of Chapter 11 of NAFTA.

2. Merrill & Ring's Claim is untimely and unsustainable.

3. In Part I of this Statement of Defence, Canada describes the regime governing the export of logs from British Columbia. Merrill & Ring has operated in British Columbia for over 100 years, and has been subject to some form of export control for over 60 years. The export control procedures specific to logs from British Columbia have been in place since 1969.

4. The measure that Merrill & Ring claims is a breach of NAFTA is *Notice to Exporters Serial No. 102* ("*Notice 102*"). *Notice 102* establishes a domestic surplus test that is applied before issuing export permits for logs from British Columbia. *Notice 102* has been in effect and unchanged since April 1, 1998.

5. Merrill & Ring also complains about the operation of the provincial regime governing the harvest and use of logs from provincial lands, however that regime does not apply or relate to Merrill & Ring.

6. In Part II of the Statement of Defence, Canada sets out its position on the issues in dispute. Section A outlines Canada's jurisdictional objections to Merrill & Ring's Claim. The entire Claim is time barred. NAFTA Article 1116(2) bars the investor from bringing 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."[1] *Notice 102* has been in effect since 1998 and has governed the Claimant's log exports at all times. The Claimant first acquired actual knowledge of the measure and its impact on its business in April 1998. Accordingly, this Claim is time-barred by Article 1116(2) and the Tribunal has no jurisdiction over Merrill & Ring's claim.

7. Canada requests that this objection to jurisdiction be dealt with on a preliminary basis. If this objection is upheld, it would dispose of the case entirely and make it unnecessary for the Tribunal to proceed to the merits of the Claim.

8. In Section B of Part II, Canada demonstrates that there is no merit to Merrill & Ring's claim based on NAFTA Articles 1102, 1103, 1105, 1106 and 1110. Merrill & Ring cannot demonstrate and has not even alleged the nationality-based discrimination necessary to support national treatment (Article 1102) or most-favoured-national treatment (Article 1103) violations. Indeed, the measure applies equally to all companies operating in British Columbia on land subject to federal jurisdiction. Nor has the Claimant identified any treatment that falls below the customary international law minimum standard of treatment of aliens (Article 1105). The claims with respect to prohibited performance requirements are based on an interpretation of Article 1106 that cannot be supported by the plain meaning of that provision. Finally, the expropriation claim (Article 1110) seeks protection for an interest, the Claimant's so-called "right to export", that is not an "investment" as defined by NAFTA. In any event, this claim does not disclose a deprivation or a level of interference anywhere near the substantial deprivation necessary to find expropriation at international law.

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[1] *North American Free Trade Agreement Between the Government of Canada, the Government of Mexico and the Government of the United States*, 17 December 1992, Can. T.S. 1994 No. 2, 32 I.L.M. (entered into force 1 January 1994) (NAFTA), online: NAFTA Secretariat, http://www.nafta-sec-alena.org/DefaultSite/index_e.aspx?DetailID=160, NAFTA Article 1116(2) (Tab 1).

9. In Part III, Canada outlines its position on the damages sought by Merrill & Ring. The Claimant has failed to provide even a basic articulation of how it arrived at the US $25 million in damages allegedly suffered as a result of the measure in question.

10. The Claim fails for want of jurisdiction and on the merits. Accordingly, the Tribunal should dismiss Merrill & Ring's Claim and render an award in favour of Canada, with costs.

I. FACTUAL BACKGROUND

A. THE MEASURE AT ISSUE IS *NOTICE 102*

11. NAFTA Chapter 11 "applies to measures adopted or maintained by a Party relating to ... investments of investors of another Party in the territory of the Party."[2] In this case, the measure adopted and maintained by Canada which is at issue is *Notice 102.* Merrill & Ring identifies the measure in the Statement of Claim as:

> DFAIT's procedures, requirements and administrative practices in granting or denying export permits for logs [as] described in its *Notice to Exporters Serial No. 102* ('*Notice 102*').[3]

12. Since April 1998, *Notice 102* has controlled the export of logs harvested from federally-regulated private land in British Columbia, including the export of logs by Merrill & Ring.[4] Merrill & Ring complains both about the way in which *Notice 102* is administered and about the fact that a separate regime (the provincial regime that applies to land under provincial jurisdiction and does not apply to Merrill & Ring) is slightly different than *Notice 102*.

13. To assess Merrill & Ring's claims with respect to *Notice 102* in their proper context, Canada explains briefly below: the history of the timber regime in Canada and British Columbia; the division of legislative authority between the federal and provincial governments of Canada; the procedures that apply to log exports from provincial lands and those that apply to log exports from federal lands.

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2 NAFTA Article 1101 (Tab 2).

3 Statement of Claim, para. 23.

4 Notice to Exporters, Serial No. 102, made under the *Export and Import Permits Act*, April 1, 1998 (Tab 3).

B. THE HISTORICAL CONTEXT OF *NOTICE 102*

1. The distinction between federal and provincial lands

14. In the late nineteenth and early twentieth centuries, land in British Columbia was classified into three categories for forestry purposes:

(1) Crown[5] Land (Government owned). The Crown retains title to the land. Harvesting occurs under a tenure agreement, which imposes various obligations on the tenure holder. Since 1891, British Columbia has imposed a local use or manufacture requirement, whereby logs cut from provincial Crown lands must be used or manufactured locally within the province of British Columbia[6] ("provincial land").

(2) Private land acquired through Crown tenure granted after March 12, 1906. In 1906, British Columbia passed the *Timber Manufacture Act* (the "*TMA*"),[7] which extended the policy of local use or manufacture to private land transferred by Crown grant after March 12, 1906. Following the passage of the *TMA*, Crown grants disposed of the land, but maintained certain rights in the timber – including the right to tax the timber and impose domestic use or manufacture requirements ("provincial land").

(3) Private land acquired through Crown grant prior to March 12, 1906. These lands are exempt from British Columbia's local use or manufacture requirements. Merrill & Ring's land falls within this category because it was purchased before 1906[8] ("federal land").

15. The first two of these categories of land are known in the forestry industry as "provincial land" (whether privately or publicly tenured) because the province of British Columbia has jurisdiction over the use of logs harvested from the land. The third category, although in private hands, is referred to in the industry as "federal land" because Canada has exclusive jurisdiction over logs from that land. Although less than 5% of British Columbia's productive forest land is "federal land," logs originating from federal land account for over 60% of British Columbia's log exports.

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5 In this Statement of Defence, "the Crown" means the federal government or a provincial government, depending on its context.

6 By operation of an amendment to the British Columbia *Land Act*.

7 *Statutes of the Province of British Columbia,* 1906, c. 42 (Tab 4).

8 Statement of Claim, para. 13.

16. The federal government and the provincial government both have measures in place regulating the use or export of logs. These measures are described below. Logs from timber grown on federal land, like Merrill & Ring's logs, are subject only to the federal regulations. Logs from timber on provincial land are subject both to federal regulation and to a provincial regime.

2. British Columbia's local use or manufacture requirements affect provincial lands only

17. Merrill & Ring describes in detail the British Columbia regime affecting timber companies operating on provincial land, even though this regime does not apply to Merrill & Ring. As explained in Section B below, the provincial regime is not relevant to this case because it does not apply to investors in 'like circumstances' with Merrill & Ring, or offer such investors more advantageous treatment than Merrill & Ring.[9] Nor does the provincial regime discriminate against Merrill & Ring on the basis of nationality. Canada provides the following description of the provincial logging regime as context to the arguments made by the Claimant.

18. Over 90% of British Columbia's productive forest lands belong to the provincial Crown, which retains full title to the land and its resources. Investors harvest timber from these lands under tenure agreements with British Columbia. A tenure agreement is a contract between the provincial government and the tenure holder which allows the tenure holder to cut a certain amount of timber and sell those logs for profit. The tenure agreement imposes various requirements on the tenure holder.

19. Certain Crown lands and tenure agreements are managed by British Columbia Timber Sales ("BCTS"), an organization within the British Columbia Ministry of Forests and Range. BCTS does not harvest timber or export logs. It is a government agency tasked with developing Crown timber for public auction.

20. Section 127 of the *Forest Act* requires that all timber[10] from Crown land or private lands under provincial jurisdiction be used or manufactured in British Columbia. Section

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9 Statement of Claim, para. 28.

10 "Timber" is defined in section 1 of the *Forest Act* as "trees, whether standing, falling, living, dead, limbed, bucked, or peeled." In short, "timber" refers to a standing tree, while a "log" is a tree that has been harvested. R.S.B.C. 1996, c. 157, s 1, Definitions and interpretation (Tab 5).

128 of the *Forest Act* sets out three exemptions from this requirement. These exemptions are for:

(i) timber that is surplus to local manufacturing requirements (the "surplus" exemption);

(ii) timber that cannot be processed and/or transported economically by or for a facility in British Columbia (the "economic" exemption); and

(iii) cases where an exemption would prevent the waste or improve the utilization of timber cut on Crown land (the "utilization" exemption).[11]

21. Logs are considered to be "surplus" when a fair-market-value offer to purchase the logs is not received following public advertisement on the "provincial bi-weekly list". If no domestic processors place an offer, the logs are generally declared surplus and can be exported, either by sending the logs to another province or by seeking a federal export permit.

22. When "provincial" logs are found to be surplus because no fair-market-value offer is received, the exporter is required to pay a fee in lieu of local manufacture in the amount of 5% to 15% of the domestic value of the logs. The fee varies depending on the species and grade of the log. It must be paid before the logs can be removed from British Columbia.

23. When an offer is received, it is reviewed by the Timber Export Advisory Committee ("TEAC")[12] which determines whether the purchase price offered is at fair-market-value.

24. Applications for economic exemptions also go before the TEAC, which provides the British Columbia Government with its recommendation as to whether the logs in question can be harvested economically at current domestic prices, or whether they can only be harvested if international prices can be obtained. Such exemptions are granted by

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[11] R.S.B.C 1996, c. 157, Part 10, ss. 127-128 (Tab 6).

[12] A provincial advisory body that provides the British Columbia Government with recommendations on granting surplus and economic exemptions.

Order-in-Council,[13] require extensive supporting documentation, and can take up to one year to process. Exporters of logs subject to economic exemptions also pay a fee in lieu of local manufacture.

25. Finally, utilization exemptions are initiated by the British Columbia Ministry of Forests and Range and are used as a forest management tool. For example, utilization exemptions were issued on species and areas infested by mountain pine beetle to encourage the harvest of logs that would otherwise be lost to infestation. Utilization exemptions are also granted through an Order-in-Council.

26. British Columbia can initiate exemptions under the surplus and economic exemptions, as well as the utilization exemption. Such exemptions cover a geographic area and are referred to as "blanket standing exemptions." Logs subject to standing exemptions are also subject to a fee in lieu of local manufacture.

27. Anyone wishing to remove provincial logs that are exempt from local use or manufacture requirements under section 128 of the *Forest Act* must obtain an authorization from British Columbia confirming that all legal requirements of the *Forest Act* have been met.[14]

3. Federal export controls affecting logs from provincial and federal lands

28. Canada has exclusive jurisdiction to control the export from Canada of logs from both federal and provincial lands. It began exercising this jurisdiction pursuant to the *War Measures Act* in 1942. These controls were subsequently replaced by the *Export and Import Permits Act*[15] and the *Export Control List*,[16] a related regulation.

29. All federal export controls are administered by the Export and Import Controls Bureau ("EICB") of the Department of Foreign Affairs and International Trade

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[13] An Order-in-Council is a notice of an administrative decision issued by the Governor General of Canada in the case of federal matters, or the Lieutenant Governor of a province, in the case of provincial matters. Orders-in-Council originate with the federal or provincial cabinet and are approved by the Governor General or Lieutenant Governor, as the case may be.

[14] Province of British Columbia, *Procedures for Export of Timber 1999; Vancouver and Prince Rupert Forest Regions* (Tab 7).

[15] R.S., 1985, c. E-19. (Tab 8).

[16] SOR/89-202, online: http://www.canlii.org/ca/regu/sor89-202/whole.html (Tab 9).

("DFAIT"). The Minister of Foreign Affairs (the "Minister") issues export permits at his or her sole discretion. In order to provide guidance and clarity to exporters, DFAIT issues "Notices to Exporters" which set out the procedures to apply for specific types of permits and criteria which the Minister considers in exercising his discretion.

30. Export control procedures specific to logs from British Columbia have been in place since 1969.

31. Canada first introduced the surplus test for federal land in 1986 through the implementation of *Notice to Exporters Serial No. 23.*[17] Under *Notice 23*, logs originating from federal land could only be exported if they were surplus to domestic requirements. A log was determined to be surplus if no domestic processor made a fair-market-value offer to purchase the logs.

32. *Notice 102* replaced *Notice 23* on April 1, 1998, and remains in force to this day. *Notice 102* applies to the export of logs from federal and provincial land.

33. For logs originating from provincial lands, *Notice 102* provides that such logs are subject to control under the *Forest Act.* An export permit will only be issued when the exporter presents a provincial authorization[18] stating that the legal requirements for removing the logs from British Columbia have been met.

34. For logs originating from federal land, *Notice 102* establishes a surplus test similar to that administered by British Columbia under the *Forest Act. Notice 102* – like *Notice 23* before it – does not contain "standing" or "blanket standing" timber exemptions because Canada does not have legal or constitutional authority respecting timber, including timber exemptions.

35. *Notice 102* is central to the activities of any enterprise seeking to export logs from federal lands in British Columbia. It sets out in detail the procedures that an applicant must follow to apply for an export permit.

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[17] Notice to Exporters, *Export and Imports Permits Act,* Serial No. 23, January 1, 1986 (Tab 10).
[18] Form FS 34, Permit to Export Unmanufactured Timber (Tab 11).

36. Logs that are proposed for export must first be advertised on the federal bi-weekly list to allow eligible domestic offerors to bid on the logs.[19] The vast majority of log booms,[20] however, do not receive offers and DFAIT immediately invites the owner of these logs to apply for an export permit.

37. When an offer is received, the offer is referred to the Federal Timber Advisory Committee ("FTEAC") to determine if the offer reflects domestic fair-market-value for the logs.

38. The FTEAC is composed of the TEAC plus a representative of the federal government. The FTEAC and the TEAC meet together on a monthly basis and consider offers on provincial and federal logs at the same meeting. If the FTEAC finds an offer to be below fair-market-value, it will recommend to the Minister that he declare the logs surplus and eligible for an export permit. When one or more fair-market-value offers are received, the FTEAC will recommend to the Minister that the logs be declared non-surplus.

39. In determining whether logs are surplus, the Minister takes into account the FTEAC's recommendation and any other relevant considerations. Investors may make submissions to the Minister as to relevant considerations. The Minister will then decide whether the logs are surplus to domestic needs.

40. When logs are found to be surplus, DFAIT invites the potential exporter to apply for an export permit. Where the logs are not surplus, DFAIT informs the applicant and the offeror that an export permit will not be issued.

41. Although no formal appeal process is set out in *Notice 102*, an applicant can ask the Minister to reconsider his decision and investors often do so. In addition, exporters

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[19] *Notice 102* establishes eligibility criteria for domestic offerors. To be eligible, an offeror (i) must be involved in log processing, (ii) must not have directly or indirectly exported logs in the last 90 days, and (iii) must not have advertised logs on the bi-weekly list in the preceding 90 days (Tab 3).

[20] A "boom" is a method of storing or transporting a batch of logs by water. The boom consists of a line of logs chained together at each end to encircle and control the other free-floating logs.

who are dissatisfied with the Minister's decision can have that decision judicially reviewed by the Federal Court of Canada.[21]

42. Merrill & Ring has been subject to *Notice 102* since its introduction in April 1998. It has dealt with FTEAC and DFAIT officials numerous times since April 1998. In that time, Merrill & Ring has been issued hundreds of export permits for advertised log booms that receive no offers. It has also had extensive experience with the FTEAC process and ministerial decisions on export permits, including in situations where export permits have been denied.

43. Despite the fact that the procedures under *Notice 102* have been followed by and applied to Merrill & Ring since April 1998, Merrill & Ring waited until December 2006 to commence this arbitration. Merrill & Ring now complains about the *Notice 102* procedures and their impact on Merrill & Ring's business after operating under *Notice 102* for more than 9 years.

44. Canada states that this Claim is time-barred under NAFTA Article 1116(2) and that *Notice 102* does not breach NAFTA Chapter 11.

II. POINTS AT ISSUE

45. In this Part, Canada presents the jurisdictional grounds on which the Tribunal should dismiss the Claim without reaching the merits. Canada then outlines its defences on the merits of the claims under each of the relevant provisions of NAFTA Chapter 11.

A. THE TRIBUNAL LACKS JURISDICTION OVER MERRILL & RING'S CLAIMS

1. The Claim is time-barred under NAFTA Article 1116(2)

46. Canada objects to the jurisdiction of the Tribunal on the ground that the Claim before it is barred by the time limitation for submitting a claim to arbitration in Article 1116(2). Article 1116(2) provides:

> 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

[21] *Federal Courts Act,* R.S. 1985, c. F-7, s. 18.1 (Tab 12).

acquired, knowledge of the alleged breach and knowledge that the investor has incurred loss or damage.

47. The trigger for the three year time limitation in Article 1116(2) is when an investor first acquired or should have first acquired knowledge of the alleged breach and resulting loss. The Claimant served its Notice of Arbitration on Canada on December 26, 2006. Thus, the Claim is time-barred if Merrill & Ring first acquired, or should have first acquired, knowledge of the alleged breaches and resulting damages prior to December 26, 2003.

(a) Actual Knowledge of Breach or Damage Alleged

48. Merrill & Ring has had actual knowledge of *Notice 102* since 1998.

49. *Notice 102* came into effect on April 1, 1998. Canadian Federal Government officials explained the new procedures to Merrill & Ring as soon as these procedures came into effect. In addition, DFAIT applied *Notice 102* to Merrill & Ring for the first time in April 1998. In that instance it determined that three booms of Merrill & Ring's logs were not surplus to Canada's domestic needs. Merrill & Ring was informed that export permits would not be issued with respect to those booms.[22]

50. Since April 1998, Merrill & Ring has had frequent and similar interactions with DFAIT concerning the administration of *Notice 102* and its application to Merrill & Ring's operations.

51. The denial of Merrill & Ring's export permit in April 1998 is also when the Claimant first acquired knowledge of the loss or damage allegedly caused to it by *Notice 102*. The time bar in Article 1116(2) is triggered by knowledge of the fact that some loss or damage has been incurred and does not require knowledge of the precise extent or quantification of that loss or damage. Each time the Claimant was denied an export permit and required to sell its logs domestically, it would have been aware of any shortfall in price it might have achieved had it sold the logs internationally, and hence would have actual (or constructive) knowledge of loss or damage.

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[22] Letter from Lynda Watson (DFAIT) to Karen Kurucz (on behalf of Merrill & Ring LP), dated April 16, 1998 (Tab 13).

52. As *Notice 102* has not changed since its promulgation in April 1998, the Claimant first acquired actual knowledge of the alleged breach and the alleged consequences of that breach more than 5 years before the December 26, 2003 cut-off date established by Article 1116(2). This is more than 8 years before the Notice of Arbitration was filed.

53. The Claimant's interpretation of the time limitation in Article 1116(2) is untenable at international law. The limitation period in Article 1116(2) of the NAFTA is to be interpreted in good faith in accordance with the ordinary meaning to be given to its terms in their context and in light of the treaty's object and purpose.

54. The Parties to NAFTA used the words "first acquired knowledge" to establish the trigger for a time bar on claims. The words "first acquired knowledge" identify a single point in time. Regardless of whether a measure is instantaneous or continuing, knowledge of the alleged breach and resulting damages can only happen for the first time once. Knowledge cannot be acquired for the first time one day and for the first time the next day. The Claimant cannot side-step the limit clearly set forth in Article 1116(2) by relying on the artifice that the Claimant "first acquires" knowledge afresh and anew "every day that the measures remain in force."[23]

(b) Constructive Knowledge of Breach or Damage Alleged

55. In the unlikely event that the Claimant denies actual knowledge of the existence of *Notice 102* before the December 26, 2003 cut-off date, or actual knowledge that it has incurred loss or damage, the Claim would in any event be barred by the constructive knowledge provisions in Article 1116(2) ("*should* have first acquired, knowledge…").

56. *Notice 102* is central to the activities of any investor seeking to export from Canada logs originating from British Columbia. Accordingly, the Claimant must be deemed to have first acquired knowledge of any alleged breach of NAFTA and resulting damages based on *Notice 102* shortly after it came into force and clearly before December 26, 2003.

57. The Claimant cannot avoid the time limitation in Article 1116(2) by citing specific applications of *Notice 102* and subsequent actions that merely implemented,

[23] Statement of Claim, para. 8.

administered or applied *Notice 102* between December 26, 2003 and December 26, 2006. Such actions flow from and are authorized by *Notice 102*. The mere implementation of *Notice 102* does not constitute an independent basis for a claim. As the Claimant has not alleged any independent violations based on the implementation of *Notice 102*, the Claim is barred in its entirety.

2. The claims based on British Columbia's measures do not relate to Merrill & Ring, and are time-barred in any event

58. The Statement of Claim and correspondence from counsel for the Claimant[24] are unclear as to whether the British Columbia *Forest Act* is also being challenged in this arbitration. If so, Canada states that such a claim is beyond the jurisdiction of this Tribunal.

59. Chapter 11 of NAFTA applies expressly only to measures adopted or maintained by a Party relating to investors of another Party or their investments.[25] This requires a legally significant connection between the measure and the investor or the investment.

60. There is no legally significant connection between the British Columbia *Forest Act* and the Claimant. The Claimant's investment consists of lands granted prior to March 12, 1906, which are entirely exempt from the local use or manufacture requirements of the provincial *Forest Act*. Accordingly, to the extent Merrill & Ring intends to challenge the provincial measures, such claim must fail.

61. Alternatively, even if the *Forest Act* is found to relate to the Claimant's investment – which Canada denies – claims based on provisions of the *Forest Act* and its subsequent administration are time-barred by Article 1116(2). The exceptions to local use or manufacture requirements found in s. 128 of the *Forest Act* have been in place and known to Merrill & Ring since 1978.

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[24] Letter from Barry Appleton (Claimant's Counsel) to Gilles Gauthier (DFAIT), November 22, 2006 (Tab 14).

[25] NAFTA, Article 1101: Scope and Coverage (Tab 2).

B. MERRILL & RING'S CLAIMS ARE WITHOUT MERIT

62. *Notice 102* and Canada's actions pursuant to *Notice 102* do not breach any of Canada's obligations under Chapter 11 of NAFTA. *Notice 102* does not discriminate on the basis of nationality, violate the customary international law minimum standard of treatment of aliens, impose prohibited performance requirements, or expropriate the Claimant's investment. Nor does the manner in which *Notice 102* is administered violate any of these obligations. Below, Canada outlines its response to each of the alleged violations of NAFTA Chapter 11.

1. Canada has not violated its national treatment obligations under NAFTA Article 1102

63. Merrill & Ring alleges that Canada is in breach of its national treatment obligations under NAFTA Article 1102(1). Article 1102 (1) provides:

> Each Party shall accord to investors of another Party treatment no less favourable than that it accords, in like circumstances, to its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.

64. Article 1102 protects foreign investors and their investments from discrimination based on nationality. The Claimant has not pleaded any discrimination on the basis of nationality.

65. The first step in establishing a claim under Article 1102 is to identify investors of the Party (local investors) "in like circumstances." The second step is for the Claimant to show it is being accorded "less favourable treatment" than that accorded to similarly placed local investors.

(a) None of the Canadian investors identified by Merrill & Ring are in "in like circumstances" to Merrill & Ring

66. Merrill & Ring alleges that there are three categories of local investors that are in like circumstances to Merrill & Ring:

(1) The Province of British Columbia, acting through a division of the Ministry of Forests called British Columbia Timber Sales. BCTS allegedly receives additional exemptions from surplus testing.[26]

(2) Private Canadian timber companies that sell logs harvested from land that is subject to provincial regulation (as opposed to federal regulation). These provincially-regulated companies allegedly receive additional exemptions from surplus testing.[27]

(3) Owners of private forest lands in other Canadian provinces (*i.e.* outside of British Columbia), which are not subject to the Federal Surplus Test.[28]

67. Although all three "comparators" alleged above operate in the same business sector, that is where the similarities end. Each comparator suggested by the Claimant is in materially "unlike" circumstances from Merrill & Ring for the purposes of NAFTA Article 1102.

68. The Claimant is not in like circumstances with BCTS. The Claimant argues it is in like circumstances with BCTS because they both own land from which logs are harvested.[29] However, *Notice 102* applies to Merrill & Ring in its capacity as a log harvester and exporter, and not in its capacity as a landowner. BCTS does not harvest logs and it does not export logs; it merely auctions the harvesting rights on provincial Crown land. Whereas Merrill & Ring is a private forestry enterprise, BCTS is a government agency that fulfills a unique public purpose and a forest management role in British Columbia. Further, timber from the lands over which BCTS auctions harvesting rights are subject to the local use or manufacture requirements of the *Forest Act*, treatment from which the Claimant is exempt.

69. The Claimant is not in like circumstances with private Canadian timber companies whose lands or tenure agreements in British Columbia are subject to provincial regulation. The Claimant is subject only to *Notice 102*. The *Forest Act* does not apply to the Claimant's investment. These are distinct measures that address separate policy objectives. They exist for historical, legal, and constitutional reasons entirely unrelated to the nationality of the investor. Because Merrill & Ring's land is subject to

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[26] Statement of Claim, para. 35.
[27] Statement of Claim, para. 36.
[28] Statement of Claim, para. 38.
[29] Statement of Claim, para. 33.

federal regulation, it is not in like circumstances to investors (Canadian or otherwise) whose land is regulated by the province of British Columbia.

70. The Claimant is not in like circumstances with owners of private lands subject to federal jurisdiction in other Canadian provinces. Coastal British Columbia produces logs of species and sizes that are considered highly desirable internationally. This, coupled with lower transportation costs associated with its proximity to water, places British Columbia in a unique position vis-à-vis other Canadian provinces. As a result, British Columbia accounts for over 50% of Canada's log exports. Landowners in other Canadian provinces which are less accessible to coastal transport for export and which do not harvest coastal forest species, are not "in like circumstances" with Merrill & Ring.

(b) Merrill & Ring is not accorded "less favourable treatment" than Canadian investors in like circumstances

71. Merrill & Ring overlooks Canadian investors in like circumstances. Private companies harvesting timber from coastal British Columbia lands under federal jurisdiction are subject to identical treatment. The Claimant is but one of over 70 investors in British Columbia which operate solely under *Notice 102*. The vast majority of such investors are Canadian, including Timberwest and Island Timberlands – the two largest holders of private forest lands in British Columbia, which together own 75% of these lands. The Claimant has failed to identify a single entity amongst this group of investors that receives more favourable treatment than Merrill & Ring. In fact, all the investors in this group are equally affected by *Notice 102* and there is no basis to claim that Canada discriminates against Merrill & Ring by treating these Canadian investors any differently.

72. The Claimant has failed to point to any discrimination by reason of the investor's nationality. The Claimant's Article 1102 claim is without merit and should be dismissed.

2. Canada has not violated its most favoured nation treatment obligations under NAFTA Article 1103

73. NAFTA Article 1103 provides:

> (1) Each Party shall accord to investors of another Party treatment no less favourable than that it accords, in like circumstances, to investors of any other Party or of a non-Party with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.

74. The Claimant alleges that Canada has violated Article 1103 by including a more favourable Minimum Standard of Treatment provision in at least fifteen subsequent bilateral investment treaties entered into after the NAFTA.[30]

75. The Claimant fails to identify with any precision a treatment that allegedly violates Canada's MFN obligation. The Claimant's pleading of the alleged breach of NAFTA Article 1103 is so devoid of specificity that it is impossible to understand the allegation. As a result, the Claimant's allegations, even if taken on their face as true, are incapable of constituting a violation of Canada's MFN obligation and can be rejected on a preliminary basis.

76. The Claimant also fails to identify a single foreign investor in like circumstances to the Claimant who has been accorded more favourable treatment.

77. The Claimant does not show how the Minimum Standard of Treatment obligations in subsequent bilateral investment treaties to which Canada is a Party provide more favourable treatment than that provided by Article 1105.

78. Nor has the Claimant established that any loss or damage has flowed from the alleged breach of Article 1103. As a result, the Claimant's Article 1103 claim is without merit and should be dismissed.

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[30] Statement of Claim, paras 41-44.

3. Canada's export control regime for logs does not breach the customary international law minimum standard of treatment of aliens under NAFTA Article 1105

79. NAFTA Article 1105(1) provides that:

> (1) Each Party shall accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security.

The Free Trade Commission Note of Interpretation makes it clear that the treatment referred to in Article 1105 is the customary international law minimum standard of treatment of aliens. [31]

80. The Claimant makes six allegations to establish its claim under Article 1105.[32] Some of these allegations are not attributable to Canada. Others are not "related to" the Claimant or its investment. Still others allege violations of principles that do not form part of the customary international law minimum standard of treatment of aliens.

81. Canada will respond first to the allegations concerning the FTEAC process (items (a) to (d)); then to the allegations about blocking by private companies (item (e)), and finally to the allegation about exemptions under the provincially-regulated scheme (item (f)).

82. The Claimant has not proven and Canada does not admit that the legal principles alleged by the Claimant form part of the customary international law of the minimum standard of treatment of aliens.

(a) The FTEAC process does not violate the minimum standard of treatment

83. The first four alleged breaches of Article 1105 relate to the FTEAC process.[33] Despite the Claimant's conclusory allegations of "procedural unfairness", "no transparency", "fail[ure] to exercise due diligence to prevent abuses" and arbitrariness, a

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[31] Note of Interpretation of Certain Chapter 11 Provisions, *(NAFTA Free Trade Commission, July 31, 2001)*, online: http://www.dfait-maeci.gc.ca/tna-nac/nafta_commission-en.asp (Tab 15).

[32] Statement of Claim, para. 45.

[33] Statement of Claim, para. 45.

brief examination of the *Notice 102* procedures shows that they exhibit none of these characteristics.

84. *Allegation a: "The membership of FTEAC consists of primarily domestic log processors."* Canada agrees that this is a correct statement of fact but denies that the composition of the FTEAC results in procedural unfairness. The FTEAC's composition necessarily includes people who are active in the forestry industry because they are knowledgeable about current log prices. Private sector participants attend the FTEAC meetings in their personal capacity – not as representatives of a particular company or organization. Where a conflict of interest might arise regarding a particular offer or group of offers, it is FTEAC practice for that member to excuse himself or herself from the meeting while those offers are considered. Nothing about the FTEAC's composition violates the customary international law minimum standard of treatment of aliens.

85. *Allegation b: There is no transparency or legal security in the surplus testing procedure."*[34] This allegation is unfounded. *Notice 102,* including the surplus testing procedure, is applied uniformly to all log producers in British Columbia whose land is subject to federal regulation. The administration of *Notice 102* is transparent, predictable and provides legal security.

86. *Notice 102* sets out the criteria by which the Minister makes his determinations including fair-market-value offers and other pertinent factors. Investors make submissions to the FTEAC and communicate with officials. The FTEAC considers those submissions, deliberates based on the criteria in *Notice 102* and makes a recommendation to the Minister. Investors who are dissatisfied with the recommendations of the FTEAC can and frequently do make submissions to the Minister.

87. There is no formal appeal of the FTEAC recommendation because it is only recommendation. It is not binding on the Minister, who has the final say on whether to declare the logs surplus. Investors who are dissatisfied with the decision of the Minister have recourse to the Federal Court of Canada for judicial review of the decision. There is no arbitrariness or fundamental unfairness about the system.

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[34] Statement of Claim, para. 45.

88. *Allegation c: "The government fails to exercise proper diligence over the log export regime."*[35] This accusation is unfounded. DFAIT exercises due diligence to prevent abuses of the system. Complaints regarding ineligible offerors or bad faith offers are investigated by DFAIT and action is taken when warranted. The Claimant provides only one example of an alleged failure to "exercise proper diligence"[36] and that example is misrepresented. While DFAIT did receive a complaint regarding offers made on five of the Claimant's booms, the allegation that the Claimant was forced to sell the five booms to the offeror after waiting more than two months for a response to its complaint is incorrect. In fact, roughly a month after it wrote to DFAIT, the Claimant was invited to apply for export permits for three of those booms after offers on those booms were withdrawn. The Claimant sold the other two booms in British Columbia.

89. *Allegation d: "The time and sort requirements of the Federal Surplus Test are arbitrary."* The sort and time-frame requirements of the surplus test are not arbitrary. Separating logs into "sorts" in the form of "booms" is a common industry practice, whether logs are intended for domestic or export sales. The sort requirements are set out in *Notice 102* and are industry standard.

90. Nor is the time-frame for administering the test arbitrary. FTEAC meets on a monthly basis, on dates set well in advance. The vast majority of applications are dealt with expeditiously. Similarly, requests for reconsideration by the Minister are resolved rapidly, usually within one month. Even if *Notice 102* results in some delay to a log exporter or a boom being sold at the domestic rather than international price, this does not breach Article 1105.

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35 Statement of Claim, para. 45.

36 Statement of Claim, para. 48(a): "On October 11, 2005, Merrill & Ring wrote to DFAIT regarding the offers received on five hemlock booms. Merrill & Ring requested that the offers made by International Forest Products Limited should be ruled invalid as they were in bad faith and below market price. After waiting two months for a response, Merrill & Ring was forced to mitigate the water damage being caused to the logs by selling them to International Forest Products Limited."

(b) Actions of private parties are not attributable to the Canada

91. *Allegation e: "The domestic log purchasers abuse their governmental authority to block logs".*[37] This allegation relates to actions by private domestic logging companies, including C-1(b)(ii) and C-1(b)(iv) C-1(b)(ii) and C-1(b)(iv) The actions and intent of private companies making offers on advertised booms are not attributable to Canada and are therefore not measures under NAFTA Chapter 11 that can form the basis for an Article 1105 claim.[38]

92. Further, if DFAIT is notified of a bidder using abusive tactics, it conducts an investigation. If the allegation is substantiated, DFAIT will declare the logs surplus despite a fair-market-value offer.

93. Similarly, the examples of "blocking letters" received by Merrill & Ring,[39] are not attributable to Canada. Nor has the Claimant alleged that any of the offers listed were abusive or made for ulterior motives. In each case, the Claimant admits that the offer reflects the British Columbia price.

(c) Provincial measures do not relate to the Claimant and in any event do not violate the minimum standard of treatment

94. *Allegation f: "The arbitrary grant of exemptions to standing timber from provincially-regulated land."* Merrill & Ring alleges that there are exemptions available under the *Forest Act* that are not available under *Notice 102*, and that the process by which British Columbia determines whether "standing" exemptions should be approved for provincial land is "discretionary and opaque."[40]

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[37] Statement of Claim, paras 45, 50-51.

[38] Article 8 of the International Law Commission's Articles of State Responsibility provide that the conduct of a person or group of persons shall only be considered an act of a State under international law "if the person or group of persons is in fact acting on the instructions of, or under the direct control of, that State in carrying out the conduct." International Law Commission, *Articles on Responsibility of States for Internationally Wrongful Acts,* General Assembly, UN Doc. A/CN.4/L602/Rev.1 (2001) (Tab 16).

[39] Statement of Claim, paras 51-52.

[40] Statement of Claim, paras 45, 53.

95. There is nothing arbitrary at international law about the manner in which these provincial "standing" exemptions are granted. British Columbia grants exemptions from its local use requirements following a consideration of the facts of the specific case and in accordance with the *Forest Act*.

96. At the federal level, the Minister does not grant exemptions. The Minister decides whether to issue an export permit in accordance with the *Export and Import Permits Act* and following the guidelines in *Notice 102*.

97. Finally, Merrill & Ring has no standing to make this complaint as it is not subject to the provincial measures. The provincial measures do not "relate to" the Claimant's investment within the meaning of Article 1101, and Article 1116 only allows an investor to submit claims in respect of which they have incurred loss or damage. As the Claimant is not subject to the provincial regime, these allegations are outside of the jurisdiction of this Tribunal.

4. Canada has not imposed prohibited performance requirements under NAFTA Article 1106

98. The Claimant alleges that the Federal Surplus Test in *Notice 102* violates NAFTA Article 1106. NAFTA Article 1106(1) sets out an exhaustive list of performance requirements that cannot be imposed in connection with the establishment, acquisition, expansion, management, conduct or operation of an investment of an investor of a Party or of a non-Party in its territory. It prohibits a Party from requiring that an investment (a) export a given level or percentage of goods or services; (b) achieve a level or percentage of domestic content; (c) purchase or use domestic goods or services; (d) relate imports or exports to foreign exchange inflows; (e) restrict domestic sales by relating them to export sales or foreign exchange earnings; and (f) transfer technology.

99. *Notice 102* does not impose any of the enumerated prohibited performance requirements. *Notice 102* does not require Merrill & Ring to export a given level or percentage of logs or any set amount of logs (as prohibited by Article 1106(1)(a)).[41]

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[41] Statement of Claim, para. 56.

100. *Notice 102* does not require the Claimant to achieve a given level or percentage of domestic content (as prohibited by Article 1106(1)(b)). As the Claimant's product is a primary natural resource, the domestic content is necessarily 100 percent, but this does not result from any government requirement.[42]

101. *Notice 102* does not require that the Claimant purchase, use, or accord a preference to goods produced or services provided in its territory (as prohibited by Article 1106(1)(c)).[43] *Notice 102* is a measure respecting controls of log exports.

102. Merrill & Ring does not allege Canada imposed performance requirements prohibited by the remaining portions of Article 1106(1).

103. Finally, Article 1106(3) prohibits conditioning the receipt or continued receipt of an advantage, in connection with an investment in its territory on compliance with requirements set out in that Article. Article 1106(3) does not apply because no "advantage" has been granted to Merrill & Ring. Nor has Canada forced Merrill & Ring to comply with any of the requirements in Article 1106(3) (a) to (d).[44]

104. Accordingly, the Claimant's Article 1106 claim has no merit.

5. Canada has not violated the expropriation provision in NAFTA Article 1110

105. The Claimant alleges that Canada has violated NAFTA Article 1110 which provides that "[n]o Party may directly or indirectly nationalize or expropriate an investment of an investor of another Party in its territory or take a measure tantamount to nationalization or expropriation of such an investment" except where certain conditions are met, including payment of compensation.[45]

106. Merrill & Ring has failed to identify how any "investment" capable of protection under NAFTA Article 1110 has been expropriated. *Notice 102* has not deprived the Claimant of the use and enjoyment of its lands in British Columbia, nor has it deprived the Claimant of the logs produced from that land.

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[42] Statement of Claim, para. 57.
[43] Statement of Claim, para. 58.
[44] Statement of Claim, para. 59.
[45] Statement of Claim, para. 60.

107. Merrill & Ring instead alleges that its "right of access to international markets" has been expropriated. The investor has no stand-alone "right to export" or to "access international markets." Even if such a right existed, it could not be an investment within the meaning of Article 1139. The Claimant's sole investment in Canada for the purposes of NAFTA protection is its ownership of 10,347 acres of land in the coastal regions of British Columbia. This land has not been expropriated.

108. Under *Notice 102*, the Claimant has been able to obtain export permits and obtain international prices for the vast majority of the logs that it sought to export. In the nine years that the Claimant has operated under *Notice 102,* the vast majority of the Claimant's booms did not receive domestic offers and were summarily approved for export.

109. There has been no deprivation of all or substantially all of any investment owned or controlled by the Claimant. There has been no interference with the Claimant's conduct of its operations. Therefore, there is no expropriation at international law.

III. REMEDY SOUGHT

A. THE CLAIMANT HAS NOT SUFFERED THE DAMAGES IT ALLEGES

110. Merrill & Ring has not provided any grounds to support its claim for US$ 25 million. No particulars and no time frame are provided for the alleged loss.

111. Canada's export controls have not had any significant impact on the Claimant's ability to access international markets. The Claimant is asking this Tribunal to attribute all of its business woes to Canada's export controls, ignoring global economic conditions, the impact of the softwood lumber dispute between Canada and the United States, and even basic economics. NAFTA was not intended to provide foreign investors with blanket protection against such variables and nothing in its terms so provides.

112. Canada denies that the Claimant has suffered any damages caused by breach of NAFTA and puts the Claimant to the strict proof of the alleged damages.

B. AWARD SOUGHT BY CANADA

113. For the reasons outlined above, Canada respectfully requests that:

(1) the Tribunal decide that this Claim is time-barred;

(2) the Tribunal dismiss this Claim for lack of jurisdiction;

(3) If the Tribunal determines it has jurisdiction, that it dismiss Merrill & Ring's claims in their entirety; and

(4) pursuant to NAFTA Article 1135(1) and Article 40 of the UNCITRAL Arbitration Rules, the Tribunal require the Claimant to bear all costs of the arbitration, including Canada's costs of legal assistance and representation; and

(5) the Tribunal grant any other relief it deems appropriate.

October 30, 2007

Respectfully submitted
on behalf of Canada,

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