

Case summary

Pope & Talbot Inc. v Canada

Year of the award: 2000-2002

Forum: *Ad hoc* tribunal (UNCITRAL arbitration rules)

Applicable investment treaty: NAFTA

Arbitrators	Timeline of the dispute
The Hon. Lord Dervaird – President	24 December 1998 – Notice of Arbitration
The Hon. Benjamin J. Greenberg	19 August 1999 – Arbitral Tribunal constituted
Mr. Murray J. Belman	26 June 2000 – Interim Award (on Merits)
	10 April 2001 – Award on Merits Phase 2
	31 May 2002 – Award on Damages
	26 November 2002 – Award on Costs

Table of contents

I. Executive Summary.....	2
II. Factual Background and Claims of the Investor.....	2
III. Findings on Merits.....	3
A. Minimum Standard of Treatment.....	3
B. Other claims.....	4
IV. Findings on Damages.....	4
A. Law Applicable to the Determination of Damages.....	4
B. Relationship between NAFTA Articles 1116 and 1117.....	4
C. Heads of Damages.....	5
1. Heads of damages rejected.....	5
2. Heads of damages awarded.....	5
D. Interest.....	6
E. Costs.....	6
V. Implications / Initial Analysis.....	6

I. Executive Summary

Pope & Talbot, Inc. (the “Investor”) was a U.S. company with a Canadian subsidiary, which operated three sawmills in Canada and exported to the U.S. most of the softwood lumber it produced. The dispute arose out of Canada’s actions in the implementation of the 5-year Softwood Lumber Agreement (“SLA”) concluded by Canada and the U.S. in 1996. The SLA established a limit on the free export of softwood lumber into the U.S. and required Canada to collect a fee for export of softwood lumber in excess of certain established quantities. Each year Canada allocated export quotas among its softwood lumber producers in accordance with the developed procedures and criteria (Export Control Regime).

The Investor claimed that certain aspects of Canada’s Export Control Regime and its application by the Canadian authorities violated Canada’s obligations under NAFTA Chapter 11. The majority of Investor’s claims (in particular, those relating to expropriation, national treatment and performance requirements) were dismissed by the Tribunal. Only in relation to the minimum standard of treatment claim, the Tribunal found violation of NAFTA Article 1105 in one out of the seven episodes alleged by the Investor. With regard to that episode, the Tribunal established that Canada’s Softwood Lumber Division treated the Investor in an unfair way subjecting it to threats, denying reasonable requests for pertinent information, requiring to incur unnecessary expense and disruption.

Addressing the issue of compensation, the Tribunal determined that NAFTA Article 1116, under which the claims were brought, did not limit recoverable damages to damages of the Investor itself but also allowed to claim damages suffered by the Investor’s Canadian subsidiary. The Tribunal awarded US\$ 461,600 in compensation for out of pocket expenses borne by the Investor and its Investment as a result of Canada’s wrongful conduct. The Tribunal denied the claim for compensation of lost profits allegedly suffered as a result of the 7-day closure of the Investor’s production facility, because the Claimant had not shown that the closure had caused any loss of profit. The Tribunal also awarded interest at a rate of 5% p.a. compounded quarterly.

II. Factual Background and Claims of the Investor

Pope & Talbot, Inc. (the “Investor”) was a U.S. company with a Canadian subsidiary, Pope & Talbot Ltd. (the “Investment”), which operated three sawmills in British Columbia and exported to the U.S. most of the softwood lumber it produced.

The dispute arose out of Canada’s actions in the implementation of the 5-year Softwood Lumber Agreement (“SLA”) concluded by Canada and the U.S. in 1996. The SLA established a limit on the free export of softwood lumber into the U.S. and required Canada to collect a fee for export of softwood lumber in excess of the established quantity. There were three levels in the fee scale. For the quantities up to the Established Base (“EB”) level, set out in the SLA, export was free of charge. The Lower Fee Base (“LFB”) of U.S.\$50 was applied to exports from the EB level and up

to a certain benchmark. On all exports exceeding that benchmark, Canada had to levy the Upper Fee Base (“UFB”) of U.S.\$100.

The SLA determined the export quantities and applicable fees in relation to the whole of Canada (not to exports by individual producers). Each year Canada allocated the EB and the LFB quotas for that year among its softwood lumber exporters. For this purpose, Canada adopted requirements and procedures for issuing permits to export softwood lumber to the U.S. and the method of quota allocation (Export Control Regime). The process was based on the exporters’ recent export shipments, and on special criteria in the case of new entrants. The Investment fully utilized its EB and LFB quotas in all of these years. In each of years 1, 3 and 4 it exported in excess of these levels.

The Investor claimed that certain aspects of Canada’s implementation of the SLA via its Export Control Regime constituted a breach by Canada of the following provisions under NAFTA Chapter 1:

- (1) Article 1102 “National Treatment”
- (2) Article 1105 “Minimum Standard of Treatment”
- (3) Article 1106 “Performance Requirements”
- (4) Article 1110 “Expropriation”

The Investor originally sought US\$ 508 million in compensation to cover damages resulting from Canada’s breaches. This amount was reduced to approx. US\$ 2.2 million in the damages phase.

III. Findings on Merits¹

A. Minimum Standard of Treatment

NAFTA Article 1105(1) provides:

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 Investor maintained that Canada had acted in violation of its minimal standard of treatment obligation in seven distinct episodes. Only in relation to one of them, the so called “*Verification Review Episode*”, the Tribunal held that Canada was in breach of Article 1105(1). This episode concerned the actions of Canada’s Softwood Lumber Division (“SLD”) in the course of the procedure initiated by the SLD to verify certain information provided earlier by the Investor. Without going into details of the factual analysis, suffice is to note that the Tribunal held the SLD responsible for making the relations between the SLD and the Investor “more like combat than cooperative regulation”. In particular, the Tribunal found that as a result of SLD’s actions, “the Investment was being subjected to threats, denied its reasonable requests for pertinent information, required to incur unnecessary expense and disruption in meeting SLD’s

¹ Before proceeding to the merits of the dispute, the Tribunal addressed certain procedural issues which are not covered in this summary.

requests for information, forced to expend legal fees and probably suffer a loss of reputation in government circles.” (Award on Merits, para. 181)

The Tribunal held that SLD’s treatment of the Investment in relation of the verification review process constituted a denial of the fair and equitable treatment required by the Article 1105 and found Canada liable to the Investor for the resultant damages.

B. Other claims

The Tribunal dismissed Investor’s claims relating to:

- minimum standard of treatment (six episodes out of seven);
- national treatment;
- performance requirements; and
- expropriation.

IV. Findings on Damages

A. Law Applicable to the Determination of Damages

The Tribunal did not discuss the issue of applicable law. It applied NAFTA as a primary source and, where necessary, referred to international law as a supplementary source (as mandated by NAFTA Article 1130).

B. Relationship between NAFTA Articles 1116 and 1117

The Investor submitted its claim under Article 1116, which concerns claims brought by investors on their own behalf and provides, at first glance, for compensation of loss or damage, incurred only *by the investor*. Article 1117 concerns claims, brought by an investor on behalf of its subsidiary (the enterprise of another Party that is the juridical person that the investor owns or controls directly or indirectly), and provides for compensation of damage, incurred *by this enterprise*.

Canada argued that since the Investor based its claim solely on the Article 1116, it was not entitled to the recovery of loss or damage, incurred by the Investment. Thus, in Canada’s view, any elements of the claim arising from injuries suffered by the Investment must be disallowed.

The Tribunal rejected Canada’s contentions with reference to the Article 1121(1), which provided:

A disputing investor may submit a claim under Article 1116 to arbitration only if

(a) ...

(b) the investor and, where the claim is for loss or damage to an interest in an enterprise of another Party that is a juridical person that the investor

owns or controls directly or indirectly, the enterprise, waive their right to initiate or continue [any other dispute settlement procedures].

In the Tribunal's view, the text of this Article expressly admitted that claims could be brought under Article 1116 by an investor who was claiming for loss or damage to its interest in the relevant enterprise, which was a juridical person that the investor owned. The Tribunal also noted that it was for the Investor to prove that loss or damage had been caused to its interest in the subsidiary. (Award on Damages, paras.74-80)

C. Heads of Damages

1. Heads of damages rejected

The Tribunal rejected two heads of damages, claimed by the Investor as resulting from the "Verification Review Episode":

1) The value of management time devoted to the relevant claim. The Tribunal reasoned that salaries of the management staff were fixed and did not depend on the amount of work done; thus, no additional costs were incurred by the Investor even if those employees had to work more hours because of that episode. (Award on Damages, para.82)

2) Alleged lost profits flowing from the seven-day shutdown of the Investment's three mills as a result of Canada's wrongful conduct. Although the Tribunal found that the shutdown was indeed caused by Canada's breach of Article 1105(1), it held that the Investor failed to prove the damages; the evidence showed that the Investment had inventory sufficient to meet all its sales requirements at all times, notwithstanding the shutdown, thus the Investment suffered no loss of profits. (Award on Damages, paras.83-84)

2. Heads of damages awarded

The Tribunal made an award on two heads of damages (both – out of pocket expenses):

- 1) Out of pocket expenses relating to the "Verification Review Episode", including:
 - accountants' and legal fees;
 - fees and expenses incurred by the Investor in lobbying efforts to counter the actions of the SLD.

- 2) Out of pocket expenses directly incurred by the Investor with respect to the Interim Hearing held by the Arbitral Tribunal in January 2000 (this hearing related to the "Verification Review Episode").²

² It is not clear what kind of expenses these were and, assuming that they represented legal fees, why the Tribunal awarded these expenses as damages and not as costs.

Both parties submitted their calculations of these two categories of out of pocket expenses. They were reviewed and approximated by an independent expert, appointed by the Tribunal, and on this basis the Investor was ultimately awarded US\$ 407,700 as the principal amount of damages.

D. Interest

The Tribunal awarded interest on the principal sum at the rate of 5% per annum compounded quarterly, starting from 1 December 1999.³ On the date of the Award of damages, the principal amount plus interest was calculated by the Tribunal to be US\$ 461,600.

E. Costs

Taking into account the mixed results of the arbitration, the Tribunal held that each party had to bear its own costs. Concerning the costs of the Tribunal, the Tribunal awarded to the Claimant its share (US\$ 120,000) of the Tribunal's expenses relating to the Review Verification Episode (in particular, the hearings held in January 2000) – the only episode on which the Claimant was successful. The rest of the Tribunal's costs were to be borne by the parties in equal shares.

V. Implications / Initial Analysis

- This is a non-expropriation case but the Tribunal did not face (and did not touch upon) the issue of **standard of compensation**. This is probably because the standard of compensation is relevant mostly where valuation of damage is required, whereas in this case only out-of-pocket expenses were awarded, which were monetary in nature and did not require valuation.
- Under **NAFTA Article 1116**, investors may claim the damages, incurred by themselves as well as by their subsidiary enterprises. Article 1117 does not necessarily have to be invoked to recover damages suffered by a subsidiary enterprise. However, under Article 1116, the investor will have to show that the loss of a subsidiary enterprise damaged *its interest* in this enterprise.
- Expenses can be recovered as damages only if they were *additional*, that is, if they would not have been incurred without a breach (**incidental expenses**). In this case, the value of management time was not recoverable because these expenses would have been borne by the Claimant regardless of the breach.
- A **temporary shutdown** of a production facility does not necessarily entail a loss of profits. In this case, despite the 7-day facility shutdown, the Investor at all relevant times had inventory to meet all its sales requirements, thus the Tribunal concluded that the Investor had not suffered any lost profits.

³ The reason for having 1 December 1999 as a starting date was not discussed. The Tribunal only stated that it was the date sought by the Investor.