School of International Arbitration, Queen Mary, University of London

International Arbitration Case Law

Academic Directors: Ignacio Torterola
*Loukas Mistelis**

MOBIL INVESTMENTS CANADA INC. & MURPHY OIL CORP.
V.
CANADA
(ICSID CASE NO. ARB(AF)/07/4)

DECISION ON LIABILITY AND ON PRINCIPLES OF QUANTUM

Case Report by Charles B. Rosenberg**
Edited by Ignacio Torterola***

In its Decision of May 22, 2012, the majority of the Tribunal held that Canada had violated the performance requirements protection in Article 1106 of the NAFTA and that the Claimants were entitled to recover damages incurred as a result of Canada's breach.

Main Issues:	treaty obligations – performance requirements; treaty obligations – international law standard; remedies – damages
Tribunal:	Professors Hans van Houtte, Merit E. Janow, and Philippe Sands QC.
Claimant's counsel:	Mr. David W. Rivkin, Ms. Sophie Lamb, Ms. Jill van den Berg, and Ms. Samatha J. Rowe of Debevoise & Plimpton LLP and Mr. Barton Legum of Salans.
Defendant's Counsel:	Mr. Nick Gallus, Mr. Mark Luz, Mr. Adam Douglas, and Mr. Pierre-Olivier Savoie of Foreign Affairs and International Trade Canada.

* Directors can be reached by email at ignacio.torterola@internationalarbitrationcaselaw.com and loukas.mistelis@internationalarbitrationcaselaw.com

** Charles B. Rosenberg is a Legal Adviser at the Iran–United States Claims Tribunal.

*** Ignacio Torterola is Co-Director of International Arbitration Case Law (IACL).

Digest

1. Facts of the Case

Mobil Investments Canada Inc. and Murphy Oil Corporation (the "Claimants") were minority shareholders in the Hibernia and Terra Nova petroleum development projects (the "Projects") off the coast of Newfoundland and Labrador in Canada. Hibernia was the first and largest offshore oil project in Newfoundland and Labrador.

The Canada-Newfoundland Offshore Petroleum Board (the "Board") regulates oil development projects in the Province of Newfoundland and Labrador. Operators of offshore oil projects wishing to exploit a field in the area must submit proposals subject to approval by the Board, which consist of: (i) a Development Plan concerning the general approach of developing an oil field; and (ii) a Benefits Plan explaining the process by which benefits would accrue to Canada and Newfoundland and Labrador. A Benefits Plan must contain a proposal for research and development ("R&D") and education and training ("E&T") expenditures to be carried out in Newfoundland and Labrador.

The Board is authorized to adopt guidelines with respect to the application and administration of the Benefits Plan requirement. In 2004, the Board issued the Guidelines for Research and Development Expenditures ("2004 Guidelines"), which were the first guidelines to directly address R&D expenditure at the production phase of a petroleum project and to require fixed amounts of expenditures to be made. The required amount of R&D expenditures for a specific period is determined on the basis of a benchmark derived from Statistics Canada reports on R&D spending by oil and gas companies in Canada.

The Claimants allege that the 2004 Guidelines are more restrictive and onerous than the provisions of existing agreements requiring the Claimants to undertake certain minimum R&D expenditures.

2. Legal Issues Discussed in the Award

(a) Liability

(i) Minimum Standard of Treatment (Article 1105)

The Tribunal held that there was no violation of the minimum standard of treatment protection in Article 1105 of the NAFTA because: (i) there was an absence of evidence indicating that the Claimants were "induced to make their investments by clear and explicit representations" in relation to any future

change to the regulatory framework or the Benefits Plans; and (ii) the Respondent's behavior was not "arbitrary, grossly unfair, unjust or idiosyncratic, or discriminatory, or involved a lack of due process leading to an outcome which offends judicial propriety." (¶¶ 170-71).

The Tribunal was unable to find that any promises were made by the federal or provincial governments or the Board either expressly or by a pattern of behavior such as to give rise to a representation that there would not be changes to the regulatory regime. The Tribunal rejected the Claimants' argument that the 1986 and 1987 Benefits Plans amounted to agreements in the nature of a contract, and that it was implicit in those agreements that there would be no changes to the Benefits Plans of the kind that were later adopted. After noting that "the Claimants are prudent and experienced investors . . . [and therefore] must have carefully considered the regulatory framework before proceeding," the Tribunal ruled that the Claimants were unable to show that in some way they were induced into making the investment by certain promises. (¶ 158).

(ii) Performance Requirement (Article 1106)

The Tribunal held that the spending on R&D and E&T pursuant to the 2004 Guidelines are performance requirements within the meaning of Article 1106 of the NAFTA, which prohibits the imposition of certain performance requirements in connection with the establishment, acquisition, expansion, management, conduct or operation of an investment.

As a preliminary matter, the Tribunal found that R&D and E&T constitute "services" within the meaning of Article 1106(1)(c) of the NAFTA even though Article 1106 does not refer specifically to R&D and E&T. The Tribunal reasoned that the ordinary meaning of the term "services" is broad enough to encompass R&D and E&T. The Tribunal rejected the Parties' references to U.S. and Japanese BITs, UNCTAD reports, the draft Multilateral Agreement on Investment, and the Canada-U.S. Free Trade Agreement, reasoning that such texts "are in some instances of only limited relevance, and in other instances, are of no relevance for the purpose of interpreting or confirming the NAFTA text:" (¶ 232)

> These agreements and sources are not the NAFTA, they did not involve entirely the same parties to the negotiation, at times raised inter-temporal discontinuities, and the extent to which they did or did not influence the NAFTA parties in the preparation of the NAFTA text is not well established. Moreover, the purposes of these agreements are not identical to that of the NAFTA, for

> example, BITs are focused on investment related matters, while the NAFTA's performance requirements in Article 1106 are part of a larger treaty that is focused primarily on international trade. (¶ 230).

The Tribunal also rejected Canada's argument that the 2004 Guidelines do not contain the requisite compulsion to run afoul of Article 1106, which refers to a "*requirement* to purchase, use or accord a preference to goods produced or services provided in its territory or to purchase goods or services from persons in its territory." The Tribunal found ample evidence of the requisite degree of compulsion for the purposes of Article 1106, concluding that "the 2004 Guidelines are designed to ensure that expenditure for R&D and E&T services occur in the Province, and thereby implying a legal requirement for the purposes of Article 1106." (¶ 242). The Tribunal reasoned that it is difficult "to see how the operators could, in reality, be required to spend millions of dollars on R&D and E&T in the Province without in practice being required to purchase, use, or accord a preference to domestic goods or services." (¶ 238).

Accordingly, the Tribunal held that, subject to the requirements of Article 1108 of the NAFTA, the R&D and E&T requirements of the 2004 Guidelines constitute a prohibited performance requirement under Article 1106 of the NAFTA.

(iii) Reservations and Exceptions (Article 1108)

Having found that the requirements imposed by the 2004 Guidelines are performance requirements subject to Article 1106(1), the Tribunal proceeded to determine whether these non-conforming measures are exceptions covered by Article 1108(1), which provides that Article 1106 does not apply to certain non-conforming measures. The majority concluded that in the context of the NAFTA reservation, the 2004 Guidelines are inconsistent with the Canada-Newfoundland Atlantic Accord Implementation Act (the "Federal Accord Act"), the Hibernia and Terra Nova Benefits Plans, and related Board Decisions.

As a preliminary matter, the Tribunal noted that it was guided by the principles of interpretation set forth in Articles 31 and 32 of the Vienna Convention on the Law of Treaties ("VCLT"). The Tribunal deemed it necessary to carefully examine the scheme established by NAFTA with regard to two distinct types of instruments: "measures" and "subordinate measures," as reflected in Article 1108, Annex I, and Canada's Article 1108 reservation.

The Tribunal noted that Article 1108(1)(a) excludes from the application of

Article 1106 any "existing non-conforming measure," which in this case is the measure maintained by Canada at the federal level as at 1 January 1994: the Federal Accord Act, which requires in Section 45(3) that "benefits plan[s] . . . ensure that . . . expenditures shall be made for research and development to be carried out in the province, and for education and training to be provided in the Province." The Tribunal recognized that Section 45 of the Federal Accord Act is an "existing non-conforming measure" within the meaning of Article 1108(1)(a). However, with respect to Section 151.1 of the Federal Accord Act, which addresses the publication of guidelines (including the 2004 Guidelines), the Tribunal held:

> If the Board issues an instrument called 'guidelines', then in the Tribunal's view, the threshold evaluation will be as to whether those particular guidelines are actually designed to give effect to Sections 45, 138 or 139 of the Federal Accord Act, as stated in Section 151.1. If the content and subject matter of any such guideline is directed to the application and administration of Section 45, including the expenditure requirement contained in Benefits Plans, the Tribunal is of the view that such guidelines are covered by the reservation.
>
> To say that a new subordinate measure, taken in the form of guidelines, to further implement Section 45, is subject to the reservation does not however insulate it from review and challenge. Importantly, whether a *particular* set of guidelines are covered or not by the reservation and consistent with the NAFTA, will require an evaluation to determine whether those particular guidelines meet the legal standards articulated in Annex I. (¶¶ 280-81).

The Tribunal then found that a "subordinate measure" forms part of a reservation made by a NAFTA Party with respect to existing measures that do not conform with obligations imposed by Article 1106. The Tribunal agreed with the Parties that the Hibernia and Terra Nova Benefits Plans were "subordinate measures adopted or maintained under the authority of and consistent with the [Federal Accord] Act." (¶ 286). The Tribunal clarified that a "subordinate measure" that has been "adopted" within the meaning of Paragraph 2(f) of Annex I refers to a subordinate measure adopted *before or after* the NAFTA came into force.

The Tribunal next addressed whether the 2004 Guidelines constitute a "new subordinate measure" that is covered by Canada's reservation, with the

consequence that the obligations set forth in Article 1106 do not apply to them. The Tribunal assessed whether "the measure" referenced in Paragraph 2(f)(ii) of Annex I means for purposes of this dispute: (i) the Federal Accord Act; or (ii) the Federal Accord Act together with existing and new "subordinate measures" that meet the conditions of paragraph 2(f)(ii) (i.e., the Hibernia and Terra Nova Benefits Plans). According to the majority of the Tribunal:

> [T]he ordinary meaning of these words is quite clear; a measure (in this case the Federal Accord Act) includes a subordinate measure that meets certain criteria, namely, that it is adopted or maintained under the authority of, and is consistent with, the measure.
>
> In this dispute, the measure cited in the Measures element is the Federal Accord Act, which contains the existing non-conforming provisions, most specifically the provision that Benefits Plans shall ensure that expenditures will be made for research and development to be carried out in the Province, and for education and training to be provided in the province. The Hibernia and Terra Nova Benefits Plans and the Board Decisions adopting those Benefits Plans are subordinate measures introduced for particular investment projects and adopted pursuant to the reserved measure, the Federal Accord Act. The 2004 Guidelines are a new subordinate measure that introduced further spending requirements with respect to research and development and education and training in the Province. In our view, under a proper interpretation of paragraph 2(f) of the interpretative note, the new subordinate measure, the 2004 Guidelines, is to be textually and logically evaluated with respect to the reserved measure and the existing subordinate measures that meet the criteria of paragraph 2(f). (¶¶ 324-25).

The Tribunal continued by determining the meaning of the phrase "under the authority of . . . the measure" in Paragraph 2(f)(ii). The majority concluded that this phrase "requires consideration of the subordinate measure with the reserved measure [and] [w]hether it also requires consideration of other subordinate measures with the reserved measure turns on the facts of the case." (¶ 331). The majority reasoned:

> On the facts we have before us, the Hibernia and Terra Nova Benefits Plans and related Board Decisions are "under the authority" of the Federal Accord Act. The 2004 Guidelines are also issued pursuant to the Federal Accord Act. It clearly makes no

> sense to suggest that the 2004 Guidelines, which are measures of general application, have to be "under the authority" of the Hibernia and Terra Nova Benefits Plans and Board Decisions, which are subordinate measures that apply to particular investment projects. Both sets of subordinate measures are authorized separately by the Federal Accord Act in a vertical relationship to that Act, but are not in a vertical relationship with each other. (¶ 330).

The majority further clarified that once a subordinate measure meets the test of authority and consistency under paragraph 2(f), it then can become part of the legal framework of "the measure" for purposes of evaluating new subordinate measures. Accordingly, the majority determined that for purposes of this dispute, in order to determine whether the 2004 Guidelines are covered by Canada's Annex I reservations, the Tribunal shall examine whether the 2004 Guidelines were adopted under the authority of and consistent with the Federal Accord Act, as well as the subordinate measures in this case (i.e., the Hibernia and Terra Nova Benefits Plans and related Board Decisions).

The Tribunal next turned to the application of the standard to the 2004 Guidelines. First, the Tribunal held that whether a "subordinate measure" has been adopted under "the authority of . . . the measure" is a matter of domestic law (in this case, Canadian law). The Tribunal concluded that the 2004 Guidelines were adopted under the authority of the reserved non-conforming measure, namely Sections 45 and 151.1 of the Federal Accord Act. The Tribunal did not question the 2008 ruling of the Court of Appeal of the Supreme Court of Newfoundland and Labrador that had held that as a matter of Canadian law the Board had acted reasonably in exercising its authority to apply the 2004 Guidelines to the Projects. The Tribunal then turned to the issue of consistency with the measure, finding that "consistency" cannot be determined exclusively by the national law of the Party adopting the subordinate measure. The criterion "consistent with" is set forth in a treaty and must be determined with reference to the rules of international law. In other words, the determination of consistency must be by reference to both the national law governing the measure and the NAFTA.

Against this backdrop, the majority addressed whether the 2004 Guidelines are "consistent with" the Federal Accord Act and the Board Decisions, with respect to the Hibernia and Terra Nova Benefits Plans, within the meaning of the NAFTA. The majority explained that it must compare two sets of measures: on the one hand, the reserved measure (the Federal Accord Act) and the existing subordinate measures (the Hibernia and Terra Nova Benefits Plans and related

Board Decisions) and, on the other hand, the new subordinate measures (the 2004 Guidelines).

The majority clarified that the dispute between the Parties is whether the additional requirements that were introduced in the 2004 Guidelines alter the expenditure requirements such that the 2004 Guidelines are not consistent under the NAFTA with the reserved measure and the existing subordinate measures. The majority first remarked that it was unable to conclude that a mere change of methodology is *per se* inconsistent with the Federal Accord Act:

> Instead, one must evaluate whether and how the 2004 Guideline methodology differs from the approach outlined in the reserved portion of the Federal Accord Act . . . and whether those changes are imposing such additional burdens that are of an inhospitable, inharmonious, incompatible, contradictory nature, and are otherwise inconsistent with the existing legal framework. (¶ 394).

The majority then noted that unlike earlier guidelines that identified particular projects or priorities, the 2004 Guidelines introduced a specific formula to determine the target amount of expenditure that must be spent on R&D and E&T in the province. This formula is based on an average level of spending in the industry in Canada and is not based on the particular needs or history of the Projects. According to the majority:

> The particular approach contained in the 2004 Guidelines has introduced expenditure requirements, reporting requirements, and financial administrative adjustments that result in a set of additional obligations with respect to the Hibernia and Terra Nova projects that are different in nature and degree than those previously applied to these investment projects. Examining all of these attributes together, the Majority is of the view that the changes that have been introduced and applied to Hibernia and Terra Nova amount to more than mere changes in the methodology, but in fact reflect a fundamentally different approach to compliance, compared to the Federal Accord Act and the Hibernia and Terra Nova Benefits Plans. (¶ 398).

The majority next found that the mere fact that additional expenditures may be imposed does not make the 2004 Guidelines inconsistent with the reserved and subordinate measures for purposes of the NAFTA since there is no specific benchmark against which to evaluate the required expenditures; the Federal Accord Act is silent as to the amounts that are to be expended in relation to a

Benefits Plan. However, after noting that the task of the Tribunal is to evaluate the nature of the reserved measure in light of the subsequent measure and come to a judgment as to whether the burden introduced by the new subordinate measure is of such a degree as to make it incompatible with the reserved measure, the majority held:

> In our view, the additional spending requirement . . . involves expenditures of millions of dollars beyond that which would have likely been spent but for the 2004 Guidelines. This additional financial burden *taken in combination* with the other new reporting, pre-authorization requirements, and new funding mechanisms of the 2004 Guidelines, amount to substantial adjustments to the regulatory framework, as compared with the framework that was in place pursuant to the Federal Accord Act, the Hibernia and Terra Nova Benefits Plans and related Board Decisions. Thus the Majority is of the view that the effect of the 2004 Guidelines bespeaks a set of requirements to purchase, use or accord a preference to local goods and services that have undergone a substantial expansion as compared with the earlier legal framework. (¶ 401).

Accordingly, the majority concluded that "the 2004 Guidelines render the local content regime that arises, more non-conforming with Article 1106 than was the case when the measures that applied to the Projects were defined by the Federal Accord Act, the Hibernia and Terra Nova Benefits Plans, and related Board Decisions." (¶ 409). In other words, the 2004 Guidelines as applied to the Projects significantly alter the legal obligations required of the Claimants in such ways as to render the local content regime more contradictory and incompatible with Article 1106. However, the majority clarified that its conclusion was only with respect to the Claimants' interests in the Projects: "[w]e have not been asked to address the implications for other investors in these projects . . . which could have a different set of applicable measures, and hence we do not do so." (¶ 412).

(b) Damages

The majority then proceeded to examine the Claimants' claim for compensation for incremental expenditures that will arise as a result of the introduction of the 2004 Guidelines and their application for the period from 2004 until 2036.

As a preliminary matter, the majority observed that a breach giving rise to future and prospective damage may, in general terms, fall within Article 1116. The

majority thus concluded that Article 1116(1) does not as a jurisdictional matter preclude the Tribunal from deciding on appropriate compensation for future damages.

The majority further clarified that the Claimants do not have to prove the quantum of damages with absolute certainty: a "sufficient degree" of certainty or probability is sufficient. The majority held that it shall apply the standard of "reasonable certainty" to determine whether the Claimants have established their case with respect to the amount of damages incurred as a result of the 2004 Guidelines. For the purposes of determining the quantum of damages, the majority will consider that "actual damages occur when there is a firm obligation to make a payment and there is a call for payment or expenditure, or the occurrence of payment or expenditure has transpired." (¶ 440).

The majority concluded by inviting the Claimants to submit further evidence on any "actual" damages incurred because of the application of the 2004 Guidelines.

(c) Partial Dissenting Opinion

Professor Philippe Sands QC dissented from certain paragraphs in the Award in relation to Article 1108, as well as from the entire section on damages. In short, Professor Sands concluded that the 2004 Guidelines and their application to the Projects are to be assessed for consistency and lawfulness under the NAFTA exclusively by reference to the Federal Accord Act. Accordingly, since they are consistent with the requirements of the Federal Accord Act, they are covered by Canada's reservation to Article 1106.

The primary issue of disagreement between the majority and the dissent was the meaning of the phrase "the measure" in Article 1108(1), which provides that Article 1106 does "not apply to (a) any existing non-conforming measure that is maintained by (i) a Party at the federal level, as set out in its Schedule to Annex I or II." The dissent was unable to agree that the phrase "the measure" should encompass the totality of a legal framework that applies to a project at the moment before a new subordinate measure is adopted.

The dissent criticized the majority's approach for necessarily leading to the result that the identification of the "measure" by reference to which an assessment as to "authority" and "consistency" is to be made will not be a constant or fixed point. Instead "authority" and "consistency" are to be assessed under the majority's approach by reference to a continually evolving standard as new subsidiary measures are adopted. The dissent predicted that "[o]ver time it is inevitable

that this will give rise to significant practical difficulties: since there is no NAFTA

requirement that subordinate measures must be published . . . how is an investor to ascertain the standard for determining 'authority' and 'consistency'?" (¶ 36). The dissent noted that this also raises transparency issues, even though transparency is "one of the key objectives of NAFTA," as reflected in Article 102 of the NAFTA. (¶ 36).

The dissent further criticized the majority's approach for elevating the status of "subordinate measures," giving them the same quality and effects as acts of primary legislation. The dissent pointed out that the NAFTA Parties are entitled to list a reserved measure, which sets a ceiling that remains in place indefinitely unless it is subject to a commitment to liberalize over time in accordance with a specified phase out. However, the majority's approach rewrites this regulatory approach: "It means that every time a NAFTA Party adopts a new subordinate measure, it in effect lowers the ceiling, by constraining the right of a NAFTA Party to adopt . . . [a new] subordinate measure. The consequences of such an approach are far-reaching." (¶ 37).

Finally, the dissent remarked that if a new subordinate measure (e.g., a new Benefits Plan applied to a new investor) can give effect to the 2004 Guidelines, then there would be no level playing field in the application of subordinate measures as between new and old projects. This would give rise to potential discrimination between new and new investors.

3. Decision

The Tribunal, by a majority, held that the 2004 Guidelines as applied to the Projects violate Article 1106 of the NAFTA and that the Claimants are entitled to recover damages incurred as a result of the Respondent's breach.