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**School of International Arbitration, Queen Mary, University of London
International Arbitration Case Law**

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Award Name and Date: Mercer International Inc. v. Canada (ICSID Case No. ARB(AF)/12/3) – Award – 06 March 2018

Case Report by: Shahmeer Naveed Arshad**, Editor: Diego Luis Alonso Massa***

Summary: Claimant brought an action for relief against Canada pursuant to North American Free Trade Agreement ('NAFTA) alleging that Canada breached, *inter alia*, national treatment, most-favoured nation treatment and minimum standard of treatment provisions in NAFTA in relation to its investment in a pulp factory plant located in British Columbia, Canada. The Tribunal considered jurisdictional objections of Canada on whether the claims were time-barred and also considered whether Canada's conduct was discriminatory or unfair.

Main Issues: the scope of time limits under Articles 1116 and 1117 of NAFTA, the meaning of discriminatory treatment under Articles 1102, 1103 and 1503(2) of NAFTA, the application of public procurement exception in Article 1108(7).

Tribunal: Mr. V. V. Veeder (President), Professor Francisco Orrego Vicuña (Arbitrator) and Professor Zachary Douglas QC (Arbitrator).

Claimant's Counsel: Mr. Michael T. Shor, Ms. Gaela K. Gehring Flores, Mr. Samuel Witten, Ms. Catherine Kettlewell, Mr. Andrew Treaster, Mr. Pedro Soto, Ms. Shepard Daniel, Mr. Claudio Matute (Arnold & Porter LLP, Washington D.C.), Mr. Harj Sangra, Mr. Kim Moller (Sangra Moller LLP).

Respondent's Counsel: Mr. Michael Owen, Mr. Adam Douglas, Ms. Krista Zeman, Mr. Andrew Mason, Ms. Lori Di Pierdomenico (Trade Law Bureau); Mr. Jonathan Eades, Mr. Bruce I. Macallum, (Legal Services Branch – Ministry of Attorney General), Ms Vicki Antomiades (Legal Services).

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Digest:

1. Relevant Facts

The Claimant, a publicly incorporated company in Washington, owns and operates a pulp mill in Castlegar, British Columbia (“BC” or “the Province”), Canada (the “Celgar Mill” or “Mill”) through Zellstoff Celgar Limited and Zellstoff Celgar Limited Partnership (“ZCL and ZCLP”), incorporated in Canada (the ‘Claimant’). The Claimant was both a producer and consumer of electricity (¶1.1, 1.2).

The dual nature of the Claimant as a producer and consumer of electricity, allowed it to sell electricity and purchase it back from the utility (¶2.3). The dispute concerned the extent to which the Claimant could engage in energy arbitrage i.e. sell electricity to the utility at higher rates and buy power at typically lower/ cost embedded rates to meet its own needs (¶2.4).

British Columbia Hydro and Power Authority (“BC Hydro”), is a provincial Crown corporation in British Columbia. The Government of British Columbia (the “BC Government”) is BC Hydro’s sole shareholder and appoints its Board of Directors and Chair. BC Hydro does not provide services in the South Central portion of the province, where Fortis BC Inc. provides electricity services (¶2.7).

The Claimant sold some of its electricity to BC Hydro under an Energy Purchase Agreement (“EPA”) entered into on 27 January 2009 (¶2.9). The Claimant filed a request for arbitration alleging that BC Hydro entered into preferential energy purchase agreements with other pulp mills in the area (¶1.12). The Claimant argued that such preferential treatment was in breach of Canada’s NAFTA obligations on the standard of treatment to be accorded to investors, namely Articles 1102, 1103, 1105 and 1503 (¶2.19, 2.20). Canada (the “Respondent”) argued that the claim was time-barred under Articles 1116 and 1117, suffered from the public procurement exception contained in Article 1108(7)(a) and was not an exercise of delegated governmental authority pursuant to Article 1503(2) (¶2.56 – ¶2.61).

2. Procedural History

On 30 April 2012 the Claimant submitted its Request for Arbitration against the Respondent (“the Request”) pursuant to Article 2 of the ICSID Arbitration AF Rules, for itself under NAFTA Article 1116 and on behalf of ZCL under NAFTA Article 1117 (¶1.12). The Request was registered by the Secretary-General of ICSID pursuant to Articles 4 and 5 of the ICSID Arbitration AF Rules on 16 May 2012 (¶1.13). ^[1]^[SEP]The Tribunal held its first session with the parties on 5 December 2012 and the parties raised no objections to the constitution of the Tribunal, this agreement was embodied in Procedural Order No.1 of 24 January 2013 (¶1.14). Claimant filed its memorial on 31 March 2014 (¶1.16). Respondent filed its Counter-Memorial on 22 August 2014, including objections to jurisdiction and admissibility (¶1.18). Claimant filed its reply on 16 December 2014 (¶1.20). Respondent filed its rejoinder on 31

March 2015, and a corrected version on 9 April 2015 (¶1.22). USA and Mexico filed their Article 1128 submissions on 8 May 2015 (¶1.25, 1.26). The parties filed their response to Article 1128 submissions on 12 June 2015 (¶1.27). The oral hearing took place at the World Bank in Washington D.C, USA from 21 to 31 July 2015 (¶1.28). Claimant filed post-hearing submissions on 7 January 2016 and Respondent on 26 February 2016. Claimant and Respondent filed their initial submissions on cost on 15 March 2016 and supplemental submissions on 3 April 2017 (¶1.32). The Tribunal closed the file on 23 December 2017 (¶1.40).

3. Positions of the Parties

3.1 Claimant's Position

Claimant submitted that the British Columbia Utilities Commission (“BCUC”) prohibited Fortis BC (the Utility in Claimant’s area of operation) from providing embedded cost of electricity to self-generators in its service territory whilst they were selling electricity, except on a “net-of-load” basis. ^[SEP]The Claimant could sell only that part of its self-generated electricity that exceeded its own load; thereby compelling the Claimant to use first its own self-generated electricity unless and until its own load was met. The net-of-load was the electricity generated over and above the Generator Base Line (“GBL”) of the particular self-generator (¶2.8).

3.1.1 The meaning of GBL

GBL is a term used by BC Hydro for electricity purchase contracts with self-generators, at the express direction of the BCUC, to delineate the level of self-generated electricity a customer must use to self-supply its own load and below which it cannot sell to any person or entity. The GBL also determines the amount of access the Claimant would have had to embedded cost of energy from its utility to meet its load (¶2.10).

3.1.2 The effect of GBL

The Respondent set the Claimant’s GBL at the Claimant’s 2007 load. The Claimant argued that the effect of setting the GBL at the 2007 level is to prohibit the Claimant from selling its biomass energy and realising commercial sales of its premium energy service, unless it is net-of-load electricity (¶2.11).

3.1.3 The effect constitutes treatment less favourable than which is afforded to Canadian pulp manufacturers

Claimant submitted that the province of British Columbia permitted other pulp mills in the area to maintain access to embedded cost of electricity – while selling a significant portion of their below-the-load electricity – in contrast to the net-of-load standard that the Claimant had to comply with (¶2.12).

3.2 The BCUC Ruling and historical standards

Claimant submitted that the BCUC ruled on 23 November 2013 that it was unduly discriminatory for utilities to hold some self-generators at a net-of-load standard and another to a GBL standard based on historical usage (¶2.16). The Claimant submitted that the

historical standards of other pulp mills were relatively lower compared to their generation and load, allowing them access to embedded cost of energy (§2.17).

3.3 BC Hydro's Load Displacement Agreements ("LDA")

Claimant argued that BC Hydro entered into LDAs with other self-generators and provided them funds or financing for construction of energy generation units. The Claimant received no such consideration from BC Hydro (§2.18).

3.4 The Respondent through its discriminatory treatment breached Article 1102, 1103 and 1503(2)

The Claimant argued that the Respondents conduct constituted treatment less favourable than that granted to Canadian self-generators and those of third countries. Hence, it is a violation of Articles 1102 (National Treatment), 1103 (Most Favoured Nation Treatment) and Article 1503(2) (Discriminatory Treatment by State Enterprise) (§2.19, 2.20).

3.5 The Respondent through its unfair and inequitable treatment breached Article 1105

The Claimant alleged that BC Hydro had no written policies or procedures for determining generator baselines, no internal controls, and no apparent mechanism for ensuring non-discriminatory treatment (§2.22). That in failing to provide reasons for its differences in treatment or any transparency in its regulatory regime for industrial self-generators, BC Hydro through its arbitrary, discriminatory and unfair actions denied the Claimant regulatory fairness. Therefore, the Respondent has breached its obligations under NAFTA Article 1105 by failing to provide fair and equitable treatment in accordance with the minimum standard (§2.27).

4. Respondent's position

The Respondent raised objections to jurisdiction and admissibility of the claim. The Respondent contended that the Claimant was unfairly trying to benefit from arbitrage of electricity by convincing Fortis B.C to provide cheap electricity to the claimant at embedded cost and then sell expensive self-generated electricity to Fortis B.C at three times the price of embedded cost (§2.29). The Respondent submitted that the arbitrage project of the Claimant would give no new electricity to BC Hydro and in effect compel BC Hydro to purchase its own electricity at higher rates (§2.41).

4.1 The Claim effectively amounts to an access percentage subsidy

In Respondent's view, the Claim is in effect a request for subsidising the Claimants use of electricity by imposing the same percentage standard on all self-generators regardless of their capacity. The access percentage subsidy that the Claimant requests would require BC Hydro to purchase the same percentage of electricity from every pulp mill in the Province regardless of whether these pulp mills have any new electricity for sale (§2.50). The regulatory policy framework required that BC Hydro issue incentives only for increased generation resources and not in a way that would be disadvantageous for BC Hydro ratepayers. Further, no other pulp mill has been provided with an incentive without complying with the policy framework (§2.59).

4.2 Setting of the GBL is outside the scope of NAFTA Article 1503(2)

The Respondent submitted that BC Hydro sets the GBL as part of its contractual negotiations with self-generators. The Respondent argued that the procurement of electricity pursuant to a competitive bidding process by a commercial enterprise falls outside the scope of Article 1503(2) of NAFTA (¶2.55).

4.3 The limitation period defined in Article 1116(2) and 1117(2) has expired

The Respondent argued that the GBL determination occurred well before the three-year limitation period set out in NAFTA Articles 1116(2) and 1117(2). The Claimant's GBL was set on 30 May 2008 and accepted by the Claimant on 10 June 2008. The Claimant thus had three years from the later date to submit a claim; *i.e.* by 10 June 2011. The Claimant, however, waited until 30 April 2012; and it is therefore time-barred (¶2.56).

4.4 The determination is within the public procurement exception contained in Article 1108

Respondent argued that Article 1108 exempts procurement of state enterprises from the scope of NAFTA. Thus, in respect of the subject transaction (setting of the GBL) the Respondent does not have any obligations under Article 1102 and 1103 (¶2.58).

4.5 Claimant's damages claim is inflated and speculative

Respondent argued that before selling any electricity the Claimant is bound to consume electricity generated from its own assets. Hence, the damages claimed are significantly inflated. There is also no mention of a competitive disadvantage suffered by the Claimant to substantiate the damages claimed (¶2.62). Further, the quantification of damages is speculative because it presumes that BC Hydro would purchase all of the Claimant's self-generated electricity (¶2.63).

5. Tribunal's analysis

The Tribunal concluded that the claim was not time-barred under Article 1116 and 1117, because the knowledge that the Claimant should have had was not the unfairness of the agreement itself, but the treatment of comparators 'in like circumstances' (¶6.25). However, the Tribunal held that the public procurement exception in Article 1108(7) applied; therefore it did not have authority to hear claims of discrimination under Articles 1102 and 1103 (¶ 6.50). The Tribunal did not explicitly find, but instead assumed jurisdiction to hear claims of discrimination under Article 1503(2) and also analysed alleged breaches of Article 1105 (¶6.58). The Tribunal found that there had been no discrimination in light of the individual circumstances of each pulp mill to which the GBL standard applied (¶7.29-7.37). Lastly, the Tribunal held that there had been no unfair or inequitable treatment under Article 1105 (¶7.83).

5.1 Whether the claim is time-barred under Articles 1116(2) and 1117(2)

The Tribunal stated that Articles 1116(2) and 1117(2) specify that an investor may not make a claim if more than three years have lapsed from the date when the investor first gained knowledge of the breach. (¶6.6). The Tribunal further noted that it was common ground that the relevant time-bar date is 30 April 2009, whereas the request for arbitration was filed on

30 April 2012 (¶6.7). The Tribunal concluded that the EPA with BC Hydro took effect on 27 January 2009, therefore the Claimant ‘should have known’ of the breach and alleged damage or loss before 30 April 2009 (¶6.16).

However, the Tribunal found that the situation was different with regard to claims of discriminatory treatment; the date depended on the Claimants knowledge of the treatment of comparators in ‘like circumstances’ (¶6.18). The Tribunal analysed the specificity of the claims in the Claimant’s request for arbitration (¶6.19). The Tribunal found that the Claimant did not have actual or constructive knowledge of the treatment of comparators before 30 April 2009 (¶6.20). The Tribunal thus decided that it had jurisdiction to hear the claims regarding the 2009 EPA and the treatment of comparators in like circumstances (¶6.25).

5.2 Applicability of the public procurement exception in Article 1108(7)(a)

The Tribunal stated that it was common ground between the parties that BC Hydro was a state enterprise (¶6.28). It noted that GBL and the exclusivity provision in the EPA were a procurement activity by BC Hydro as a state enterprise (¶6.29). The Tribunal interpreted the meaning of procurement in Article 1108 to be broad and not restrictive (¶6.34). The Tribunal rejected the Claimant’s submission that the GBL was inserted into the EPA as a matter of form only (¶6.43). The Tribunal found that the Claimant’s GBL and exclusivity provision were integral terms of the EPA and therefore they fall within the procurement exception contained in Article 1108(7)(a) (¶6.47, 49). The Tribunal decided that it had no jurisdiction to hear the Claimants claims under Articles 1102 and 1103 (¶6.50).

5.3 Claims of discriminatory treatment by a state enterprise under Article 1503

The Tribunal noted that Article 1503(2) applies only to the extent that the state enterprise exercised regulatory, administrative or other governmental authority (¶6.53). The Tribunal was divided in its view and left this jurisdictional question open to proceed to the merits. The Tribunal assumed for the sake of argument that it had jurisdiction, and moved on to analyse the claims on the merits (¶6.58).

5.4 Whether there was discriminatory treatment under 1102, 1103 and 1503

The Tribunal rejected the Claimant’s submissions that it did not have to establish discriminatory intent. The Tribunal accepted USA & Mexico’s submission that discrimination occurs when a facially neutral measure is applied in a discriminatory fashion based on nationality (¶7.8). The Tribunal made a distinction between legal and evidential burden of proof stating that the shifting of evidential burden of proof remained relevant (¶7.16).

The Tribunal relied on *Cargill v. Mexico*¹, to hold that ‘like circumstances’ was not to be interpreted in the abstract, but in light of the rationale for different measures and their policy objectives (¶7.20). The Claimant identified two pulp mills as being in like circumstances, which the Tribunal accepted (¶7.23).

¹ *Cargill, Incorporated v United Mexican States*, ICSID Case No. ARB(AF)/05/2, Award of 18 September 2009

The Tribunal agreed with the Claimant that it was entitled to treatment no less favourable than the most favourable of the more favourable treatment (¶7.27). However, the Tribunal preferred the expert testimonies adduced by the Respondent that differences in GBL was a result of different individual circumstances of those mills (¶7.29, 30).^[SEP]

The Tribunal found that GBL and LDAs were incomparable in their effect, they were independent arrangements entered into by BC Hydro (¶7.36). While BC Hydro would have been under an obligation to accord the same treatment to pulp mills that had LDAs, the Tribunal concluded that the Claimant was not entitled to the benefit of every arrangement ever agreed by BC Hydro merely because a benefit exists (¶7.37).

The Tribunal accordingly dismissed the discriminatory treatment claims under Articles 1102, 1103 and 1503 (¶7.46).

5.5 Was the treatment inequitable under Article 1105?

The Tribunal relied upon *Merrill & Ring v Canada*², stating that the minimum standard of treatment under customary international law, even in the absence of bad faith or malicious intention on the part of the State, precluded conduct “which is unjust, arbitrary, unfair, discriminatory or violation of due process. However, the Tribunal relied on *Methanex v. USA*³, to conclude that claims for discrimination cannot be advanced under Article 1105(2) (¶7.59, 60).

The Tribunal analyzed the facts surrounding the order of BCUC (“BCUC Order G-48-09”^[SEP]) that led to the Claimant being allowed to buy electricity from Fortis B.C and sell it to third parties, except the electricity that is provided to Fortis B.C by BC Hydro under the EPA of 1993 between BC Hydro and Fortis B.C (¶7.68-7.75). The Tribunal noted that BCUC Order G-48-09, nor any other aspect of the regulatory regime, breached the customary international law of the minimum standard of treatment established in *Merrill v. Canada*⁴. It concluded that the Claimant failed to establish irrationality, injustice, arbitrariness, or a violation of due process within the meaning of the customary international law standard (¶7.76).^[SEP]

With regards to the Claimant’s allegations of the lack of transparency in the regulatory regime, the Tribunal found that the customary international law standard set out in *Cargill*⁵ did not embrace a claim to transparency (¶7.77).

The Tribunal relied upon *ELSI v. Italy*⁶ to set out the standard of arbitrariness as ‘the willful disregard of due process’. The Tribunal found that willful disregard of due process by BC Hydro had not been shown (¶7.78). The Tribunal accordingly decided the Respondent’s treatment of the Claimant was not contrary to provisions of NAFTA Chapter 11 (¶7.83).

² *Merrill & Ring Forestry L.P. v The Government of Canada* (UNCITRAL) Award of 31 March 2010.

³ *Methanex Corporation v United States of America*, (UNCITRAL) Award on Jurisdiction and Merits of 3 August 2005.

⁴ *Ibid* 2.

⁵ *Ibid* 1.

⁶ *Elettronica Sicula SpA (ELSI) United States v. Italy* Judgment of 20 July 1989.

6. Costs

The Tribunal ordered the Claimant to pay legal costs of the Respondent amounting to CAN \$9,000,000 (¶9.11). The Tribunal decided that each party should bear their own arbitration costs (¶9.15).

7. Dissenting Opinion of Professor Francisco Orrego Vicuña

Orrego Vicuña opined that a broad interpretation of the exercise of state authority would transform a carve-out provision into an escape clause because any exercise of state authority would result in excluding the transaction from the jurisdiction of NAFTA (¶6.65). Hence, the concept of discrimination is broader than that set out in the award. He concluded that the different treatment is sufficient to prove discrimination (¶7.87). He further noted that the possibility of submitting a claim under Article 1105 is not limited by the issue of procurement and could also allow for claims relating to more favourable treatment (¶7.90).