CASE REPORT

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IACL International Arbitration Case Law

Academic Director
Dr. Ignacio Torterola[*]

Coordinating Editors
Farhod Sharipov & Iliana Garcia[**]

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Award Name and Date: Koch Industries, Inc. and Koch Supply & Trading, LP v. Canada (ICSID Case No. ARB/20/52) — Award — 13 March 2024

Case Report by: Dr. Anqi Wang[***], Editor Ignacio Torterola[****]

Summary: US conglomerate Koch industry and its Delaware-based energy trading subsidiary Koch Supply & Trading (KS&T) filed ICSID arbitration against Canadian government, invoking Chapter 11 of the North American Free Trade Agreement (NAFTA). The dispute arose from the latter's decision to cancel without compensation the "Cap and Trade Program" for greenhouse emissions in Ontario. ICSID tribunal decided that KS&T's emission allowance in the emission trading program does not constitute protected investment under NAFTA chapter 11. It also found that Koch industry does not have a qualifying investment under NAFTA. The tribunal rejected jurisdiction *ratione materiae* and dismissed the claimants' request for relief of over USD 30 million without considering the merits.

Main Issues: Whether Koch industry and KS&T have qualifying investment in the sense of NAFTA Chapter 11. In particular: (1) whether the emission allowance held by KS&T in Ontario constitutes "property" under NAFTA article 1139(g), and (2) whether such emission allowance qualifies as "interest" under NAFTA article 1139(h).

Arbitral Tribunal: Mr. Eduardo Zuleta (President), Professor Andrea K. Bjorklund (Arbitrator) and Mr. Henri C. Alvarez, K.C. (Arbitrator)

Claimants' Counsel: Mr. Christophe Bondy, Mr. Thomas Innes, Mr. Alexandre Genest, Mr. Emmanuel Giakoumakis, Mr. Michael Lee, Ms. Lindsey Dimond (Steptoe International (UK) LLP 5 Aldermanbury Square, London, EC2V 7HR, United Kingdom) and Ms. Chloe Baldwin,

[*] Director can be reached by email at iacl@transnational-dispute-management.com and itorterola@clarkhill.com
[**] Farhod Sharipov - International Associate at Clark Hill, arbitrator in commercial cases. sharipov.law@gmail.com. Iliana Garcia - Legal Administrative Assistant at Clark Hill, igarcia@clarkhill.com
[***] Dr. Anqi Wang is a foreign lawyer in the international arbitration team of Hogan Lovells, Munich. She has a Ph.D degree from World Trade Institute, University of Bern. Dr. Wang can be reached at: anqi.wang@hoganlovells.com
[****] Ignacio Torterola is the Academic Director of International Arbitration Case Law (IACL) and a partner in the International Arbitration and Litigation Practice at Clark Hill.

Ms. Claire Schachter (Steptoe LLP 1330 Connecticut Avenue NW Washington, D.C. 20036, United States)

Respondent's Counsel: Ms. E. Alexandra Dosman, Ms. Krista Zeman, Mr. Stefan Kuuskne, Mr. Dmytro Galagan, Mr. Brendan Robertson, Mr. Benjamin Tait, Ms. Marianna Maza Pinero (Trade Law Bureau | Direction générale du droit commercial, international – JLTB Lester B. Pearson Building, 125 Sussex Drive Ottawa, ON K1A 0G2, Canada)

Digest:

1. Relevant Facts

Koch Industries Inc. (Koch Industries) is a Kansas-based company, and Koch Supply & Trading, LP (KS&T) is its wholly owned subsidiary established under the laws of Delaware, USA (together, 'the Claimants').

The Respondent is Canada.

Ontario became one of the regional governments of the Western Climate Initiative (WCI) in 2008, the purpose of which is to design a marketed-based regional approach to reduce greenhouse gas emissions (¶ 59). In 2010, WCI introduced its cap-and-trade program among partner jurisdictions. Governments that implement the WCI cap-and-trade program would issue "emission allowances" to meet its jurisdiction-specific emissions goal, with the total number of available allowances as the "cap" on emissions. The emission allowances are tradable, i.e. they could be bought, sold, and transferred among partner jurisdictions (¶ 62). Following this, California launched its cap and trade program in 2012. The same year, KS&T registered to join the California cap and trade program as a market participant and was assigned its own California Compliance Instrument Tracking System Service (CITSS) account (¶ 65). Québec launched its cap and trade program in 2013 (¶ 66).

In May 2016, Ontario enacted its *Climate Change Mitigation and Low-Carbon Economy Act* (Cap and Trade Act) (¶ 70). Pursuant to this, Ontario commenced its cap and trade program in 2017 and held four Ontario-only auctions of emission allowances the same year. KS&T bid in all four auctions and received respective emission allowances into its Ontario CITSS account (¶ 77).

Ontario linked its cap and trade program with California and Québec in January 2018 (¶ 75). Following this, the three jurisdictions held two joint auctions in February and May 2018. KS&T bid, in both auctions and received emission allowances into its Ontario CITSS account (¶¶ 80, 85). However, before KS&T could transfer the allowances it purchased from the second joint auction to its CITSS account in California, the newly-elected Ontario government announced to cancel the current cap-and-trade system and withdraw Ontario from future auctions (¶¶ 87-90). California and Québec subsequently announced to delink their CITSS registries with Ontario. As a result, KS&T could no longer transfer its emission allowances from its Ontario account to its California account since the latter has blocked emission allowance transfer to and from Ontario CITSS accounts (¶¶ 91-93).

In July 2018, Ontario revoked its cap-and-trade mechanism and prohibited market participants from purchasing, selling, trading, or otherwise dealing of emission allowances (¶ 96). To this

end, Ontario government introduced the Cap and Trade Cancellation Act (Cancellation Act), which precludes market participants under the Ontario cap-and-trade program from receiving any compensation for unused emission allowances remaining in their CITSS accounts (¶ 97).

In its "Final Determination Notice" issued in March 2019, Ontario declined KS&T's application for compensation for the emission allowances in its Ontario CITSS account that have been cancelled by Ontario's Cancellation Act (¶ 116). The claimants then filed ICSID arbitration against the Canadian government in December 2020, claiming that the Canadian government's behavior breached *inter alia* fair and equitable treatment and expropriation under NAFTA Chapter 11.

2. Procedural History

Claimants filed their request for arbitration against Canada with ICSID on 7 December 2020 (¶ 6).

The arbitral tribunal (the 'Tribunal') was constituted on 27 April 2021 (¶ 13). Claimants submitted their Memorial on Jurisdiction and the Merits (Memorial) on 6 October 2021 (¶ 18). Respondent filed its Counter-Memorial on Jurisdiction and the Merits (Counter-Memorial) on 17 February 2022 (¶ 22). In response, Claimants filed their Reply on Jurisdiction and the Merits (Reply) on 18 July 2022 (¶ 25). On 30 September 2022, Respondent filed a Rejoinder on Jurisdiction and the Merits (Rejoinder) (¶ 28). The Hearing on Jurisdiction and the Merits was held in Washington, D.C., from December 5 to 8, 2022 (¶ 45). The Parties filed their statements of costs on 14 April 2023 (¶ 50).

3. Positions of the Parties

3.1 Jurisdiction under NAFTA Article 1139 (g)

3.1.1 Respondent's Position

NAFTA Article 1139 (g) defines "investment" as "real estate or other property, tangible or intangible, acquired in the expectation or used for the purpose of economic benefit or other business purposes," without providing an express definition of "property".[1]

Since NAFTA does not define the term "property", Respondent asserts that the existence of property in the sense of Article 1139(g) must be determined in light of relevant domestic law, i.e. the law of Ontario (¶ 131). Since Ontario law does not declare emission allowances as property, Claimants therefore do not have a qualifying investment under NAFTA Chapter 11, thus failing to establish jurisdiction for the tribunal (¶ 130).

Ontario courts have not yet considered the question of whether emission allowances constitute property under Ontario law. As such, Respondent suggests a three-stage analysis that an Ontario court typically applies in the face of a novel claim to property (¶ 132). To begin with, an Ontario court would consider "whether there is a legislative declaration or a judicial decision that adds the interest to the category of property rights." (¶ 135). The creation of a new property right

[1] NAFTA Article 1139 (g), the text of which is available at: http://www.sice.oas.org/trade/nafta/chap-112.asp

cannot be presumed. Ontario Courts normally consider the absence of property language in a statute creating a new interest as significant (¶ 136). In the current dispute, the lack of the nomenclature "property" and the non-compensable nature of emission allowances specified in the Cap and Trade Act is indicative. It shows that "the legislature did not intend to create a proprietary interest" for emission allowances (¶ 136).

At stage two, an Ontario court would "examine the nature and character of a statutory interest, considering the provisions of the statute in their entire context within the statute's object and purpose" (¶ 139). In this light, Respondent argues that emission allowances were created in the Cap and Trade Act as a compliance instrument, i.e. a non-compensable, regulatory interest conferring immunity from penalties for an amount of GHG emissions (¶ 139).

For stage three, an Ontario court would determine whether the interest at issue possesses the characteristics of common law property, most notably exclusivity (¶ 141). As such, Respondent contends that emission allowances lack exclusivity for three main reasons. First, the government retains discretion to act with respect to emission allowances and make additional regulations to achieve its policy goals (¶ 141.1). Second, holders of emission allowances do not enjoy presumptive rights against expropriation without compensation under Section 70 of the Act, thus lacking exclusive control vis-à-vis the government (¶ 141.2). Third, holders of emission allowances cannot include anyone else in their interest under Section 28.2 of the Cap and Trade Act (¶ 141.3).

Following this approach, Respondent submits that emission allowances are not considered property rights in Ontario law, and that the Tribunal does not have jurisdiction over the current dispute.

3.1.2 Claimant's Position

Claimants contend that the emission allowances at issue qualify as "intangible property for economic benefit or other business purposes" under NAFTA Article 1139 (g) (¶ 143).

Claimants agree that the Tribunal should rely on Ontario law to determine the essence of emission allowances (¶ 144). Claimants refer to prominent Canadian cases to support its argument that Ontario courts have provided "the appropriate analytical framework" to confirm that emission allowances are indeed property (¶ 146).

Most notably, the Ontario Court of Appeal in *Tucows. com v. Lojas Renner, SA* (***Tucows***) decided that exclusivity is necessary for property to exist in the sense of Ontario law (¶ 146). In this sense, Claimants believe the "exclusive control and use" has been explicitly demonstrated in the current dispute through "the many different things that a participant could exclusively do to control and use emission allowances" (¶ 147). For Claimants, these include *inter alia*, "holding, purchasing, selling, trading, and otherwise dealing with emission allowances" in the Cap and Trade Act(¶ 147). According to Claimants and contrary to Respondent's claims, the proprietary status of emission allowances is "inherent in the Cap and Trade Act", rendering an explicit legislative declaration to this effect unnecessary (¶ 148).

Moreover, Claimants contend that Respondent's position is not supported by principles of statutory interpretation or the application of the Ontario court framework (¶ 149). In this regard, Claimants believe that Respondent applied a results-driven approach by fixating on the

compliance purposes of emission allowances (¶ 149.1). By doing this, Respondent allegedly ignored Ontario's express choice of a "market mechanism", which could provide an appropriate context for interpreting the status of emission allowances under the cap and trade program (¶ 149.2).

Claimants argue that Respondent has failed to provide sufficient examples to prove the government's "absolute discretion" vis-à-vis emission allowances. Also, Section 70 as drafted supports that allowances are property. Because if they were not, an express declaration of "no compensation" would be unnecessary (¶ 149.4).

In addition, Claimants contend that the term "property" as contained in NAFTA should also be examined under international law, particularly under international case law (¶ 150). To this end, Claimants relied on the *Ainsworth* criteria adopted in *Armstrong DLW GmbH v. Winnington Networks Ltd* case *(Armstrong)*. In this case, the English High Court considered the emission allowances under the EU Emission Trading System (EUA) which is "for all purposes" the same as an Ontario emission allowance, and found them to be property under common law (¶ 150).

3.2 Jurisdiction under NAFTA Article 1139 (h)

3.2.1 Respondent's Position

Respondent contends that Claimants do not have qualifying investment under NAFTA Article 1139(h) for the purpose of jurisdiction.

NAFTA Article 1139 (h) defines interests that give rise to a protected investment, i.e. those arising from "the commitment of capital or other resources in the territory of a Party to economic activity in such territory, such as under: (i) contracts involving the presence of an investor's property in the territory of the Party, including turnkey or construction contracts, or concessions, or (ii) contracts where remuneration depends substantially on the production, revenues, or profits of an enterprise." [2]

Respondent asserts that a thorough reading of the *Chapeau* of Article 1139(h) in conjunction with sub-paragraphs (h)(i) and (h)(ii) suggests that, to qualify as an investment under Article 1139(h), an "interest" must exhibit similar features to those of the illustrative examples in the sub-paragraphs. That means a qualifying investment under Article 1139(h) should present common features including the reference to contracts, the presence of the investor's property or enterprise in the host State, and economic activities conducted within the host State's territory (¶ 320). In the current case, KS&T do not exhibit any of these features.

According to Respondent, first of all, KS&T has no physical or corporate presence in Ontario consistent with Articles 1139(h)(i) or (ii) (¶ 322). Second, its activities in the primary and secondary markets were conducted from the U.S. to support its U.S. business (¶ 323). Third, the mere expenditure of funds like the purchase of emission allowances by KS&T, even in connection with an 'interest', does not suffice to qualify as an investment under Article 1139(h). In this regard, Respondent referred to the tribunal's decision in *Apotex v. U.S* that, Article

[2] NAFTA Article 1139 (h), the text of which is available at: http://www.sice.oas.org/trade/nafta/chap-112.asp

1139(h) excludes "cross-border trade interests" as it requires more permanent presence of business activities (¶ 324).

3.2.2 Claimant's Position

Claimants challenge Respondent's use of the sub-paragraphs, and instead focus their argument on the *Chapeau* of Article 1139(h). According to Claimants, it is sufficient to prove that (i) KS&T holds an "interest" which is understood in a broad sense, and (ii) such interest arises from the commitment of capital, (iii) in the territory of Ontario (¶¶ 331-335).

According to Claimants, the emission allowances that KS&T acquired, along with its carbon trading business in Ontario, amount to interests arising from the commitment of capital and other resources to economic activity in Ontario, and therefore satisfy the requirements set out under Article 1139(h).

Claimants purport that Respondent improperly invokes sub-paragraphs 1139(h)(i) and (ii) to twist the meaning of the *Chapeau* of Article 1139 (h). For Claimants, the term "interest" carries a broad ordinary meaning. In fact, NAFTA tribunals have held that Article 1139(h) covers "anything amounting to "an actual and demonstrable entitlement of the investor to a certain benefit under an existing contract or other legal instrument". Emission allowances indisputably falls within this definition (¶ 329).

Based on the broader operational context of its engagement with Ontario's cap and trade program, Claimant disagreed that their activities should be defined as "cross-border trading". In any event, Respondent's reliance on NAFTA precedents like *Apotex v. U.S.* makes little sense as they involved substantially different facts from the current dispute. Claimant's emission allowances actually arise from the commitment of capital or other resources in Ontario. This is supported by the fact that it involves monies to purchase the emission allowances, and that KS&T gained business development and launched marketing and trading activities in Ontario over the course of several years as part of a sustained, long-term business plan (¶ 332).

Furthermore, KS&T has been trading as an Ontario-registered market participant. It built its emission allowance inventory in its Ontario CITSS account by committing capital that was intended to fund Ontario green projects (¶ 336.1). Its choice to transfer and "store" the emission allowances in California was to maximize its investment while ensuring compliance with the holding limits (¶ 336.2). Therefore, their interests arose from the commitment of capital in the territory of Ontario to economic activity in Ontario's territory. It is therefore unsupported for Respondent to contend that KS&T's business strategy merely involved purchasing emission allowances from auctions "almost exclusively for transfer to its California CITSS account…for resale in that jurisdiction." (¶ 335).

In any event, it is indisputable that Ontario received the proceeds of its emissions allowances purchased by KS&T throughout the 2017 and 2018 auctions, which constituted continuing and regular commitments of capital made directly to the Ontario government and to economic activity in the territory of Ontario (¶ 336). According to Claimants, there is sufficient territorial nexus as long as funds are made available to host States and served to finance their economy or needs (¶ 336).

3.3 Jurisdiction ratione materiae with respect to Koch Industries

3.3.1 Respondent's Position

Respondent argues that none of the alleged investments of Koch Industries is sufficient to establish jurisdiction *ratione materiae*.

First of all, the term "enterprise" as relied on by Claimants in Article 1139(a) must necessarily be an enterprise of the host State i.e. Canada, while KS&T is a partnership organized under the laws of Delaware (¶ 402).

Second, emission allowances purchased by an enterprise do not constitute interests in that enterprise. Therefore, they are not protected under Article 1139 (e). Moreover, emission allowances under Cap and Trade Act cannot be indirectly owned. In any case, whether Koch Industries indirectly holds emission allowances or not matters little, as the allowances do not qualify as investments under Article 1139(g) or Article 1139(h) in the first place (¶ 403).

Third, Koch Industries' shareholding in Canadian entities INVISTA and Georgia Pacific does not qualify as an investment under NAFTA Article 1139(a). According to Respondent, in order to ground subject-matter jurisdiction under Article 1101(1)(b) and Article 1139(a), the "enterprise" must also be the alleged "investment" in dispute. However, Claimants have not made any claims of breach or damage vis-à-vis INVISTA or Georgia Pacific under NAFTA. By the same token, whether or not Koch Industries owns real estate in Canada indirectly through its ownership of Canadian companies is not relevant unless the real estate itself is the subject of the investment dispute (¶ 405).

3.3.2 Claimants' Position

Claimants assert the Tribunal has jurisdiction *ratione materiae* vis-à-vis Koch Industries as it holds qualifying investment in Canada.

First, Koch Industries holds 100 percent shareholding in KS&T and INVISTA, which constitute qualifying investment under NAFTA Article 1139 (a)'s definition of investment as enterprise.

In addition, Koch Industries owns real estate or other property, tangible or intangible, that was acquired in the expectation or used for the purpose of economic benefit or other business purposes, which qualify as an investment in accordance with Article 1139(g). Specifically, Koch Industries held both tangible investment like INVISTA and Georgia Pacific and intangible investments. For the latter, Koch Industries indirectly hold the emission allowances acquired by KS&T due to the former's 100 percent shareholding in KS&T. According to Claimants, these are all qualifying investments under NAFTA Articles 1139(g) and/or 1139(h) (¶ 407). Moreover, interests in enterprises entitle Koch Industries to income or profits of these enterprises. This is consistent with NAFTA Article 1139 (e), which defines investment as "an interest in an enterprise that entitles the owner to share in income or profits of the enterprise" [3] (¶ 406).

[3] NAFTA Article 1139 (e), the text of which is available at: http://www.sice.oas.org/trade/nafta/chap-112.asp

4. Arbitral Tribunal's analysis

4.1 Jurisdiction under NAFTA Article 1139 (g)

The Tribunal fixates its analysis on whether the emission allowances held by KS&T constitutes property under Ontario law to find jurisdiction under Article 1139(g) of NAFTA (¶ 155). However, there is no statutory or judicial rule in Ontario that expressly provides a definition of "property" (¶ 168).

In view of this, the Tribunal turns to determine whether Ontario or Canadian courts have developed "general interpretative principles" that the Tribunal could apply in finding whether emission allowances constitute property or not. For this, the Tribunal reviewed previous Canadian court decisions as well as other international court decisions that also involve novel property claims over intangible objects. After meticulous analysis, the Tribunal reaches the conclusion that none of the reviewed cases have set out an approach for finding property under Ontario law, nor have they identified a test, general rule, or interpretative principle to determine the existence of property (¶ 238).

4.1.1 The Tribunal's findings in Canadian court decisions

(a) "Bundle of Rights" as an interpretative tool

In particular, the Tribunal reviewed "Bundle of rights" as an interpretative method adopted in *Saulnier v. Royal Bank* (*Saulnier*). The question in the *Saulnier* case was whether fishing licenses created by the Canadian Fisheries Act could constitute property (¶ 179). To answer this, the Canadian Supreme Court adopted the "bundle of rights" approach to determine if an intangible object not defined as property in the statute that created it (the Fisheries Act) fulfilled a given definition of property under another specific statute (Bankruptcy and Insolvency Act and Personal Property Security Act). Under the "bundle of rights" interpretative approach, the definition of property should be determined "in consideration of any applicable statutory definition, and the corresponding statutory context, while giving full effect to the purposes of such statute" (¶ 192). In this regard, the Canadian Supreme Court found that the bundle of rights associated with fishing licenses satisfied the statutory definition of property for the purposes of bankruptcy and insolvency laws because the "subject matter of the license (i.e. the right to participate in a fishery that is exclusive to license holders) coupled with a proprietary interest in the fish caught" bore a "reasonable analogy to a common law *profit á prendre* which is undeniably property right" and therefore could be framed within the element of "profit" found in the definition of property of section 2 of the Bankruptcy and Insolvency Act (¶ 185).

The Tribunal deems it implausible to find property based on "bundle of rights" approach. For the Tribunal, although the similarities between an intangible statutory creation and the traditionally recognized forms of property may provide indicia of the existence of property, such similarities cannot in themselves support a finding of property under general common law (¶ 242). In this regard, the Tribunal distinguishes itself with Canadian cases like *Saulnier*, where there is already a statutory definition of property, thus only "some analogy" would suffice to determine whether the bundle of rights associated with fishing licenses coupled with a proprietary interest fell within the scope of relevant statutory definitions (¶ 242). In the current case, however, neither NAFTA nor Ontario law provide a statutory definition of property.

In view of the above, the Tribunal refuses to make a finding of property solely on the basis of "some" resemblance or analogy between emission allowances and other traditional forms of property, including *profit á prendre* (¶ 194).

(b) "exclusive control" as an essential attribute to find property

For the Tribunal, the element of "exclusive control" is an essential attribute to find property under general common law in Ontario, which in turn depends on the extent of governmental discretional power over the rights of the holder of the corresponding asset (¶ 270) . To this end, the Tribunal believes the reviewed court decisions do not establish a general rule in Ontario that clearly determines the scope and extent of the rights that must be associated to a statutory creation to satisfy the "exclusive control" attribute of property under general common law.

That said, the Tribunal acknowledges that the Canadian court decisions indeed provide some common parameters in determining the level of governmental discretion to establish exclusive control. First, the express statutory recognition of "absolute" or "unfettered" governmental discretion has been deemed inconsistent with a finding of property under general common law. Second, even in the absence of "absolute" or "unfettered" discretion to the government, such discretion may still be broad enough to amount to an "interference with or appropriation of a specific legal right" or to be "inconsistent with the degree of exclusive control and use needed to have a property right. Third, the right to renewal or the predictability of allocation of a statutory creation does not fetter the government's statutory discretion, and it cannot confer property rights in itself. Lastly, the government's discretionary powers over statutory creations permitting the taking, removal or modification of rights without compensation, or the exclusion of expropriation claims, may be indicative of the absence of "exclusive control", and thus the absence of property (¶ 241).

In view of the current case, the Tribunal believes that the government's discretionary power to interfere with or appropriate the emission allowances should be an indication that the latter does not qualify as property (¶ 243).

4.1.2 The Tribunal's findings in non-Canadian court decisions

The Tribunal agrees with the parties that the submitted non-Canadian decisions could provide persuasive value, as they deal with emission allowances and cap and trade systems in other common law jurisdictions.

Among the cases reviewed, the English High Court decision in *Armstrong DLW GMBH v. Winnington Networks Ltd* (*Armstrong*) is of particular relevance. Similar to the current case, the court in *Armstrong* determined the proprietary status of European Union allowances (EUA) under the European Union (EU) cap and trade scheme, which does not define the proprietary status of an emission allowance either (¶ 252). To determine the proprietary status of EUA, the *Armstrong* court first examined the "characteristics of property" at common law defined in the *Ainsworth* case, i.e. "definable, identifiable by third parties, capable in its nature of assumption by third parties and having some degree of permanence or stability" (*Ainsworth* test)(¶ 255). It then sub-categorized EUA as an intangible property using the three-fold test from the *Re Celtic Extraction Ltd* case (*Celtic* test) (¶ 257).

Based on *Ainsworth* test, the *Armstrong* court finds EUA satisfies the characteristics of "property" in general, because "[i]t is definable, as being the sum total of rights and entitlements conferred on the holder pursuant to the ETS. It is identifiable by third parties; it has a unique reference number. It is capable of assumption by third parties, as under the ETS, an EUA is transferable. It has permanence and stability since it continues to exist in a registry account until it is transferred out either for submission or sale and is capable of subsisting from year to year" (¶ 255).

Under *Celtic* test, one should exhaust a three-layer test of (i) "a statutory framework conferring an entitlement on one who satisfies certain conditions", (ii) that "the exemption must be transferable", and (iii) that "the exemption or license have value" (¶ 257). For the *Armstrong* court, the EUA fulfilled *Celtic* test because of, first, the presence of a statutory framework which confers an entitlement on the holder of an EUA to exemption from a fine. Second, the EUA is an exemption that is transferable, and expressly so, under the statutory framework. Third, the EUA is an exemption with value (¶ 257).

The current Tribunal acknowledges that the *Armstrong* case provides guidance as it involves the same issue as to whether emission allowances constitute property in common law. However, the Tribunal found it insufficient to follow the tests adopted by the English court in order to determine that emission allowances constitute property in Ontario law. In particular, The submitted Canadian cases are not sufficient to establish that the *Ainsworth* test and *Celtic* test applied by the *Armstrong* court have been adopted by Ontario courts. On the contrary, the reviewed Canadian decisions have been reluctant to extrapolate general rules or tests from cases with specific statutory definitions and with different contexts. Therefore, it is not clear whether and to what extent Canadian courts would follow the same approach as the *Armstrong* court (¶ 262). Moreover, the value of the English court decisions for the Tribunal is essentially decimated by the fact that, none of the court decisions in *Armstrong*, *Ainsworth or Celtic* deals with the issue of exclusive control which has been identified as a core issue under Ontario law (¶ 265).

4.1.3 The Tribunal's analysis of the Cap and Trade Act

In view of the fundamental attribute of "exclusive control" to find property in Ontario law, the Tribunal proceeds to examine the purpose, context and text of the Cap and Trade Act to ascertain whether it grants the emission allowance holders like KS&T exclusive control over emission allowances against third parties, particularly against Ontario government (¶ 271).

(a) Purpose of the Cap and Trade Act

The Cap and Trade Act defines its "Purpose" in Section (2), which is further sub-categorized into Subsection (1) and (2). Based on the text of Subsection (1), the Tribunal finds it unambiguous that one of the purposes of Cap and Trade Act was to establish a regulatory scheme to reduce gas emissions, protect the environment, transit to a carbon low economy and in that regard, allow Ontario to coordinate its actions with other jurisdictions in order to ensure the efficacy of its regulatory scheme in the international context (¶ 275).

However, there exist two possible readings for Subsection (2). The text of Subsection (2) is "The cap and trade program is a market mechanism established under this Act that is intended to encourage Ontarians to change their behavior by influencing their economic decisions that

directly or indirectly contribute to the emission of greenhouse gas" (¶ 274). For the Tribunal, one can read "market mechanism" included therein as either one of the purposes of the Cap and Trade Act (¶ 276), or as a means to achieve the purpose of creating a regulatory scheme as such (¶ 277). Given the central role of emission allowances in the Act's purpose of establishing a regulatory scheme, the Tribunal decides to consider both the "regulatory scheme" and "market mechanism" as the purpose of the Act (¶ 278).

(b) The context of the Cap and Trade Act

The Cap and Trade Act creates a regulatory scheme to reduce carbon emissions via carbon-pricing policy (¶ 281). It establishes a carbon pricing market where the emission allowances represent the right to emit a certain amount of greenhouse gas for certain prescribed activities (¶ 283). Like KS&T in the current case, market participants are permitted to purchase allowances in auctions conducted by the government. The aggregate tradable emission cap is created and decided by the government and tends to decline every year until the goal of emission reduction is achieved. In other words, the government enjoys broad discretion of creating, granting, and capping the total number of emission allowances (¶ 287). Market participants like KS&T are in turn subject to significant limitations regarding their rights to use and control the allowances. For the Tribunal, this indicates the absence of exclusive control by the participants over their emission allowances (¶ 289)

(c) The text of Cap and Trade Act

The Tribunal proceeds to review the text of Cap and Trade Act to ascertain whether the emission allowances satisfy the "exclusive control" element and thus constitute property in Ontario law.

The Tribunal starts its analysis with Subsection 22(1) and 28(2) as invoked by the Claimants. Subsection 22(1) provides that emission allowances held in cap and trade accounts were "under the control" of participants, and only registered participants could purchase, sell, trade and deal with emission allowances generally on their own terms. Subsection 28(2) provides that control of the allowances in participants' accounts was exclusive to the extent that participants may not hold in their account the allowances "owned" by another person (¶ 293).

The Tribunal interprets the above provisions in the context of Cap and Trade Act. In particular, it made reference to Subsection 15(3) which forbids participants to submit emission allowances that are not in their own account to the Ministry in order to meet a participant's compliance obligations. For the Tribunal, the interpretation of Subsection 22(1) in light of Subsection 15(3) indicates that, the purpose of Subsection 22(1) is to require the participants to have their own account and reduce the possibility to participate through another entity, instead of granting participants exclusive control of the emission allowances (¶ 295).

Similarly for Subsection 28(2), the Tribunal believes that it attempts to establish a limitation of use of the allowance by participants, who cannot choose to hold the allowances in another participant's account or vice versa. For the Tribunal, the effect of the provision is to impose a limitation on the holder's rights. In addition, the term "owned" used in Subsection 28(2), when examined in context, refers to the relation of belonging between a holder of a right and the beneficial interest thereof, instead of the creation of a property right. This interpretation is consistent with common law tradition as well (¶ 297).

Notably, the interpretation of Section 70 of the Act was under contention between the Parties. Section 70 deals with remedies. It precludes the right to compensation in respect of any action for the government including the removal of emission allowances, expropriation claims arising from anything "done or not done" under the Act, and any payment regarding governmental actions including the removal of emission allowances from a participant's cap and trade accounts (¶ 305).

For the Tribunal, it is already quite telling that expropriation claims, as a typical remedy for property rights, are excluded from the Act (¶ 306). In addition, the Tribunal believes that the use of the term "removal" in Section 70 for emission allowances instead of "taking", and the use of "taking" for expropriation claims in the same provision, is indicative in determining the character of emission allowances as non-property in the Act (¶ 310). In general, statutory permission of the taking, removal or modification of rights by the government without compensation is determinative of the fact that emission allowances were not conceived as property in Ontario(¶ 311).

After a thorough review of all relevant provisions under Cap and Trade Act, the Tribunal reaches the conclusion that, the provisions of the Act represent significant limitations to participant's control and use of emission allowances. By contrast, they render the government rather broad discretionary power by *inter alia* retiring the emission allowances from circulation, cancelling them, refusing to register an application, imposing restrictions upon registered participants' accounts, and prescribing exceptions to the prohibition on dividing interest, for participants to create a trust. (¶ 302). For the Tribunal, the provisions of Cap and Trade Act serve the purpose of controlling the regulatory scheme created therein, instead of vesting exclusive control over market participants over emission allowances.

4.1.4 The Tribunal denied its jurisdiction under NAFTA Article 1139 (g)

Based on its analysis of the text, context and purpose of the Cap and Trade Act, the Tribunal is of the view that the provisions contained in the Act, in the aggregate, grant the Canadian government broad discretion over the rights conferred over the emission allowances. For the Tribunal, such discretion is broad enough to sufficiently limit or even exclude exclusive control of market participants over their emission allowances (¶ 314).

In the current case, KS&T as a holder of emission allowances does not have sufficient control over its allowances to satisfy the key attribute of exclusive control to find property under Ontario law. As a result, the Tribunal determined that it does not have jurisdiction due to the lack of qualifying investment in Canada under NAFTA Article 1139 (g).

4.2 Jurisdiction under NAFTA Article 1139 (h)

4.2.1 Tribunal's Interpretation of NAFTA Article 1139 (h)

The Tribunal interprets NAFTA Article 1139(h) pursuant to the principle of treaty interpretation embodied in Article 31 of the Vienna Convention on the Law of Treaties (VCLT). Article 31(1) requires treaty interpretation to be conducted "in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and

purpose."[4] Article 31(2) specifies that the relevant context includes the treaty's text, its preamble and annexes, and other relevant agreements or instruments.[5]

In light of this, the Tribunal determines that, the term "interests" in the *Chapeau* of Article 1139(h) cannot be construed in isolation from the sub-paragraphs (i) and (ii), which serve as integral parts of the context of NAFTA (¶ 347). To this end, the Tribunal referred to another NAFTA case *Grand River v. U.S.*, where the tribunal explained that NAFTA's Article 1139 is neither broad nor open-textured. It contains a rather exclusive list of elements or activities that constitute an investment for purposes of NAFTA (¶ 348).

The current Tribunal considers that the term "such as" contained in Article 1139(h) suggests that the examples in sub-paragraph (i) and (ii) are illustrative instead of exhaustive (¶ 348). Moreover, the Tribunal notes that Cap and Trade Act selected the term "such as" over "including", which is frequently used in legislation. This means sub-paragraphs (i) and (ii) provide more focused examples than would be provided with "including" (¶ 348). As a result, the Tribunal determined that a qualifying investment must share some resemblance to the examples listed in sub-paragraphs (i) and (ii) (¶ 351).

The illustrative examples therefore suggest that the types of arrangements that can give rise to protected interests are related to economic activities in the host state's territory that involve the presence of an investor's property or of an enterprise in that territory (¶ 362).

4.2.2 Tribunal's reasoning on whether KS&T holds protected investment under Article 1139(h).

The Tribunal determines that emission allowances are not covered under the term "interests" as outlined in Article 1139(h) (¶ 354).

The Tribunal reverts to the definition of emission allowances under Cap and Trade Act, which is essentially a permit or right granted to mandatory or voluntary participants, allowing them to emit greenhouse gases up to a specified limit (¶ 359).

In the current case, KS&T's business activities primarily involved purchasing emission allowances in the primary market in Ontario as well as transferring and reselling them in the secondary market in California. For the Tribunal, these purchase and sale transactions bear no resemblance to those described in the illustrative examples of sub-paragraphs (h)(i) and (h)(ii) (¶ 361).

In any event, even if the *Chapeau* of Article 1139(h) is examined separately from its sub-paragraphs, it still unquestionably requires economic activity in the territory of the host State i.e. Ontario. In the Tribunal's view, KS&T's activity was based on cross-border trade, which several NAFTA tribunals have determined are not protected by Article 1139(h). Also, Claimants did not submit any evidence to prove that KS&T's trading business was linked to a specific underlying economic project, operation, or activity taking place in Ontario (¶ 364).

[4] Article 31(1) of the Vienna Convention on the Law of Treaties, entered into force on 27 January 1980, the text of the treaty is available at: https://legal.un.org/ilc/texts/instruments/english/conventions/1_1_1969.pdf
[5] Ibid., Article 31(2).

This led the Tribunal to conclude that KS&T did not have any physical or corporate presence, or economic activity in Ontario (¶ 364).

The Tribunal dismisses Claimant's argument that the territorial nexus requirement is met based on the availability of funds for Ontario's economy or needs, as the international decision submitted by Claimants for its arguments are from non-NAFTA tribunals based on different treaty provisions and contexts (¶ 365).

4.3 Jurisdiction ratione materiae with respect to Koch Industries

The Tribunal determines that Koch Industries cannot establish jurisdiction based on the emission allowances it allegedly held indirectly, as emission allowances are not property in the sense of NAFTA Article 1139(g) (¶ 413).

Also, Koch Industries' ownership of the Canadian entities i.e. INVISTA and Georgia Pacific does not establish jurisdiction over this dispute. According to the Tribunal, Claimant should prove that it has suffered loss or damage arising from the alleged NAFTA breaches. However, in the current case, Claimants did not make any claims for INVISTA or Georgia Pacific, nor did it submit how the Claimants' rights in INVISTA and Georgia Pacific were inflicted due to the alleged NAFTA breaches by Ontario government.

In conclusion, the Tribunal determines that it lacks jurisdiction *ratione materiae vis-à-vis* Koch Industries. Since the Tribunal has also rejected jurisdiction *ratione materiae* over KS&T above, it finds no need to proceed with its analysis over other jurisdictional objections raised by Respondent. As a result, the Tribunal decides that it does not have jurisdiction to hear the dispute submitted by Claimants (¶ 418).

5. Costs

Article 61(2) of the ICSID Convention confers ICSID tribunals broad discretion in allocating costs of arbitration proceedings in the absence of agreement between disputing parties.[6] In the Tribunal's opinion, although the case is decided in favor of Resondent, it was nevertheless a "very close case" that involves novel and profoundly complex legal issues on emission allowances (¶ 426). The Tribunal believes that both disputing parties showcased a high level of advocacy and profession during the proceeding. Therefore, the Tribunal decides to take the "costs lie where they fall" approach, ordering each party to bear their own costs and to share in equal parts the costs of the Tribunal and the ICSID Secretariat (¶ 428).

[6] Article 61(2) of ICSID Arbitration Convention provides that "In the case of arbitration proceedings the Tribunal shall, except as the parties otherwise agree, assess the expenses incurred by the parties in connection with the proceedings, and shall decide how and by whom those expenses, the fees and expenses of the members of the Tribunal and the charges for the use of the facilities of the Centre shall be paid. Such decision shall form part of the award." The text of the treaty is available at: https://icsid.worldbank.org/sites/default/files/ICSID_Convention_EN.pdf