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Arbitration – North American Free Trade Agreement (NAFTA) Chapter 11 – UNCITRAL arbitration – Investor commencing arbitration proceedings under NAFTA Chapter 11 – Whether Canada violating NAFTA Articles 1102, 1105, 1106 and 1110

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S. D. MYERS INC. *v.* GOVERNMENT OF CANADA[1]

NAFTA Arbitration Tribunal under the UNCITRAL Rules[2]

Procedural Orders Nos. 10 and 18

First Partial Award on Liability. 13 *November* 2000

Second Partial Award on Damages. 21 *October* 2002

Final Award on Costs. 30 *December* 2002

(*Arbitration Tribunal*: Hunter, *President*; Schwartz and Chiasson, *Members*)

SUMMARY: *The facts*: — The Claimant, S. D. Myers Inc. ("SDMI"), was a United States corporation based in Akron, Ohio, approximately 100 kilometres south of the border between Canada and the United States of America. At the relevant time, SDMI specialized in the process of polychlorinated biphenyl remediation ("PCB remediation"), which involved the extraction of PCBs from oil and equipment which had become contaminated. As part of this process, it was necessary for the contaminated oil and equipment and PCB waste products to be transported to SDMI's facility in Akron. From the early 1970s the environmental dangers of PCBs became apparent and manufacture decreased, causing SDMI's market in the United States of America to decline. Beginning in the early 1990s, SDMI therefore sought to obtain PCB waste in Canada for processing at its Akron facility. To that end, the Myers family who controlled SDMI incorporated a Canadian company, S. D. Myers Canada Inc. ("Myers Canada"). Most of Canada's PCB stock at that time was located in parts of Canada which were far closer to SDMI's facility in Akron than to the only facility in Canada, where the hazardous waste industry was less developed.

Canada was a party to the Basel Convention on the Control of Transboundary Movements of Hazardous Wastes and Their Disposal, 1989. The Basel Convention required that transboundary movement of hazardous wastes be reduced to a minimum consistent with the environmentally sound and efficient management of such wastes. It prohibited the export to, or import from, a State not party to the Convention on hazardous wastes unless there was in force a bilateral or other agreement whose provisions were no less stringent than those of the Convention. The United States of America had signed but not ratified the Basel Convention. The Canada–United States Transboundary Agreement on Hazardous Waste, 1986, recognized that hazardous waste located near the border might sometimes be more appropriately disposed of by operators on the other side of that border. Nevertheless, between 1990 and 15 November 1995 the United States closed the border between

[1] The names of the parties' representatives appear at para. 79 of the First Partial Award. The decision of the Federal Court of Canada on Canada's application to set aside the First Partial Award can be found at p. 194 below.

[2] The arbitration was constituted under Chapter 11 of the North American Free Trade Agreement. The Claimant elected to submit its claims under the UNCITRAL Rules. The seat of the arbitration was Toronto, Canada.

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Canada and the United States of America to the transport of PCBs. The declared policy of the Canadian Government at the same time was that hazardous waste originating in Canada should be processed in Canada by Canadian entities.

Following representations by SDMI, the United States Environmental Protection Agency issued an enforcement discretion which permitted SDMI to import PCBs and PCB waste from Canada. The enforcement discretion was valid from 15 November 1995 to 31 December 1997. The Canadian Government responded by banning the export of PCBs and PCB waste from Canada by means of an Interim Order adopted on 20 November 1995 and a Final Order adopted on 26 February 1996. Canada opened the border in February 1997 but in July 1997 it was closed once again as a result of a court decision in the United States of America.

SDMI claimed that Canada's actions violated Article 1102 of the North American Free Trade Agreement (NAFTA),[3] because they discriminated against United States waste disposal companies, Article 1105 of NAFTA,[4] because Canada had failed to accord SDMI fair and equitable treatment and full protection and security, Article 1106 of NAFTA,[5] because they involved the imposition of prohibited performance requirements, and Article 1110 of NAFTA,[6] because they constituted measures tantamount to expropriation.

In the course of the proceedings, Canada claimed Crown privilege in respect of certain documents.[7]

First Partial Award (Award on Liability): 13 November 2000

Held: — The Interim Order and the Final Order were in breach of Articles 1102 and 1105 of NAFTA but were not in breach of Articles 1106 or 1110. Canada was required to pay SDMI compensation, to be assessed in later proceedings, for such economic harm as SDMI could establish had been the direct result of the breach of Articles 1102 or 1105.

(1) The Interim Order and the Final Order favoured Canadian nationals over non-nationals. Their practical effect was that SDMI and its investment were prevented from carrying out the business which they had planned to undertake. The evidence showed that the Canadian Government had been motivated primarily by the desire to protect the Canadian PCB disposal industry from United States competition. There was no legitimate environmental reason for the ban. Any genuine environmental objective could have been achieved by other measures (paras. 161–95).

(2) The specific provisions of NAFTA should be interpreted in the light of the following principles:

(a) the parties to NAFTA had the right to establish high levels of environmental protection and were not obliged to compromise their standards merely to satisfy the political or economic interests of other States;
(b) the parties should, however, avoid creating distortions in trade; and
(c) environmental protection and economic development could, and normally should, be mutually supportive.

[3] See paras. 238–9 of the First Partial Award.
[4] See para. 258 of the First Partial Award.
[5] See para. 271 of the First Partial Award.
[6] See para. 305 of the First Partial Award.
[7] See Procedural Order No. 10 at p. 13 below.

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Those principles were consistent with the express provisions of the Transboundary Agreement and the Basel Convention. The logical corollary of them was that, where a State could achieve its chosen level of environmental protection through a variety of equally effective and reasonable means, it was obliged to adopt the alternative which was most consistent with open trade (paras. 196–221).

(3) SDMI was an "investor" and Myers Canada an "investment" within the meaning of NAFTA Chapter 11. The fact that Myers Canada was owned by members of the Myers family, rather than SDMI, was not decisive. An otherwise meritorious claim should not fail solely by reason of the corporate structure adopted by a claimant in order to organize the way in which it conducted its business (paras. 222–32).

(4) The Interim Order and the Final Order related to the investor and its investment, as required by Chapter 11, and were not barred by other provisions of NAFTA relating to trade in goods and services (paras. 233–7 and 289–300).

(5) The Interim Order and the Final Order violated Article 1102 of NAFTA. That provision required Canada to accord to investors and investments of other NAFTA parties treatment no less favourable than it accorded, in like circumstances, to its own investors and investments. In assessing whether that requirement had been met, it was relevant to take account of whether the practical effect of the measure was to create a disproportionate benefit for nationals over non-nationals and whether, on its face, it appeared to favour nationals over non-nationals. In the present case, Canada was concerned to develop the PCB processing industry in Canada. While this was understandable, the method adopted was discriminatory and contrary to Article 1102 (paras. 238–57).

(6) (by two votes to one, Mr Chiasson dissenting) By issuing the two Orders Canada had violated Article 1105 of NAFTA. There was a breach of Article 1105 when an investor was treated in such an unjust or arbitrary manner that treatment rose to a level that was unacceptable from the international perspective. That determination had to take account of the high measure of deference which international law traditionally accorded to the right of domestic authorities to regulate matters within their own borders and any specific rules of international law applicable to the case. While a discriminatory measure would not necessarily violate Article 1105, in this case the breach of Article 1102 also entailed a violation of Article 1105 (paras. 258–69).

(7) (by two votes to one, Professor Schwartz dissenting) There had been no violation of Article 1106. No requirements, as defined in Article 1106, were imposed upon SDMI (paras. 270–8).

(8) The present case was not one of expropriation and there was therefore no violation of Article 1110. Regulatory action was not generally treated as amounting to expropriation in international law. Expropriation generally involved a lasting removal of the ability of an owner to make use of its economic rights, although it could not be ruled out that there might be circumstances in which a partial or temporary deprivation amounted to an expropriation. The reference in Article 1110 to acts "tantamount to expropriation" was intended to encompass the concept of "creeping expropriation", not to expand the internationally accepted scope of the term (paras. 279–88).

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(9) SDMI was entitled to compensation for the economic harm which it could demonstrate was a direct result of Canada's violation of Articles 1102 and 1105. In accordance with general principles of international law, the purpose of reparation was, so far as possible, to wipe out all the consequences of the illegal act and re-establish the situation which would, in all probability, have existed if that illegal act had not occurred. These principles were applicable here, notwithstanding that the present case was not one of diplomatic protection. The amount of compensation would be assessed in later proceedings, where the burden would be on SDMI to prove the quantum of its loss and to demonstrate a sufficient causal connection with the violations of NAFTA. Although Canada had been held to have violated two provisions of NAFTA, SDMI was not entitled to recover twice in respect of the same heads of damage (paras. 289–319).

Separate Opinion of Professor Schwartz: (1) The Canadian Government did not have legitimate public policy, including environmental reasons, to treat SDMI and its affiliate less favourably than their Canadian competitors. There were no "unlike circumstances" which warranted differential and adverse treatment (para. 162 of Opinion).

(2) The export ban should also have been held to violate Article 1106, although this would not affect the question of compensation, since SDMI would not be entitled to any compensation for this violation over and above what it should receive for the breaches of Articles 1102 and 1105 (paras. 199–201 of Opinion).

(3) While an export ban was capable of constituting expropriation, it did not do so in this case (para. 222 of Opinion).

(4) In determining the scope of NAFTA Article 1105, it was necessary to take into account the provisions of widely accepted international agreements, like the World Trade Organization agreements, as well as bilateral investment treaties (para. 256 of Opinion).

(5) The framers of NAFTA had left a tribunal a wide measure of discretion in determining what was appropriate compensation. The basic principle was that SDMI should be compensated for economic losses resulting from the export ban (paras. 265–300 of Opinion).

On 8 February 2001, Canada notified the Tribunal that it had filed an application to the Federal Court of Canada to set aside the First Partial Award.[8] Canada's application to suspend the arbitration until judicial review of the Tribunal's award on liability had been completed was denied.[9]

Second Partial Award (Award on Damages): 21 October 2002

The Tribunal proceeded to the quantum stage of the arbitration against the background of findings contained in its First Partial Award.

Held (unanimously): — Canada was to pay SDMI compensation for the loss or damage suffered as a result of Canada's breaches of its obligations under Chapter 11 of NAFTA in the amount of CAN $6,050,000, excluding interest.

[8] See p. 194 below. [9] See Procedural Order No. 18 at p. 15 below.

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(1) Since punitive damages could not be awarded under NAFTA, the compensation to be awarded to SDMI for the proximate result of Canada's measure was to be assessed. Certain principles, such as undoing the material harm inflicted by a breach of an international obligation and no "double recovery", were to be adopted. The assessment of damages was not a precise science but depended upon appropriateness in this case based upon the evidence and applicable law. Article 1116 was relevant to the scope of recovery (paras. 6, 94, 141–3).

(2) The appropriate loss to be addressed in this particular case was the lost net income stream suffered by SDMI. While not attempting to enunciate any general principles that might serve as precedents in other cases, this conclusion recorded the view that neither the return of the money that SDMI had invested in Canada nor the payment of interest on that investment was an appropriate measure of compensation on the facts of the case (paras. 95–100).

(3) It was necessary to review some principles concerning the assessment of compensation before quantifying the lost net income stream suffered by SDMI.

(a) Compensation had to be based on breaches of specific NAFTA provisions. The existence of an investment was a threshold to maintaining a Chapter 11 claim. The First Partial Award had established that Articles 1102 and 1105 of NAFTA had been breached and that SDMI was an investor with an investment, Myers Canada, in Canada. There had to be a sufficient causal link between damages sustained and interference with an investment in Canada contrary to the provisions of Chapter 11. Compensation was to be awarded for the overall economic losses sustained by SDMI that were a proximate result of Canada's measure, not only those that appeared on the balance sheet of the investment (paras. 102–22).

(b) The fact that SDMI might have recourse to the dispute provisions of Chapter 12 as a cross-border service provider did not deprive it of the right to claim as an investor under Chapter 11. The cumulative principle applied since there was no conflict between the provisions of Chapters 11 and 12 and no specific treaty provisions to the contrary (paras. 123–39).

(c) The authorities were clear that claims for loss of profits were recoverable. The damages recoverable were those that would put the innocent party into the position it would have been in had the interim measure not been passed. As with ascertaining damages for a tort or delict, the focus was on causation and the issue remoteness. To discuss whether damages were direct or indirect was inappropriate and unnecessary (paras. 140–60).

(d) SDMI's claims for lost opportunity failed because, *inter alia*, such claims were speculative and remote (paras. 161–2).

(e) Out-of-pocket expenses were subsumed in an award that compensated SDMI for its lost and deferred net income streams (para. 163).

(f) Mitigation was not an appropriate term with reference to activities of SDMI subsequent to the re-opening of the border. The issue was the measure of compensation (paras. 164–7).

(g) It was not necessary to determine whether goodwill could constitute an investment in its own right within the terms of Chapter 11 (paras. 168–72).

(4) The quantification of loss of future profits claims could present special challenges. The lack of a track record meant that SDMI's success in the United States

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had to be acknowledged alongside the fact that the Canadian market had distinctive features. Given the significant disparities in the positions of the parties, it was necessary for the panel to perform its own analysis of facts and figures, guided by the experts and overall evidence (paras. 173–5).

(5) SDMI was disadvantaged in the Canadian market as a result of Canada's measure. Although SDMI lost the advantage of a head start which would have put it in a better position than its competitors for several months, there was no evidence that SDMI's position was destroyed completely. The extent to which SDMI's first-mover advantage was eroded by the Canadian closure was incapable of precise assessment on the available evidence (paras. 176–215).

(6) SDMI's facility in Tallmadge could have processed all of the PCB-contaminated materials it could have acquired in the Canadian market without investing significant sums in new plant or equipment (paras. 216–19).

(7) The fact that prices for remediation of that part of the inventory destroyed by Canadian operators were higher than the prices that would have prevailed if SDMI and the other US operators had been in the market was relevant to consideration of the quantification analysis. Also relevant was the fact that the quotations forming the basis of the Claimant's calculation were conservative (paras. 220–1).

(8) The Canadian closure adversely affected SDMI's investment because (i) part of the total available inventory was irretrievably lost to others, (ii) part of the inventory that remained unprocessed after the border re-opened was lost to others, and (iii) another part was delayed or lost because SDMI could not obtain the orders and export the material before the United States closed the border (para. 222).

(9) While Canada should compensate SDMI for the net income streams that it lost, for the abridgement of time available to SDMI and the value of income delayed by the Canadian closure, Canada's liability ended when it re-opened the border. The ongoing effect on SDMI's competitive position had been taken into account. Canada was not responsible for SDMI's inability to remediate Canadian PCBs after the United States' closure or any other consequences of the closure by the United States (paras. 223–8).

(10) Steps 1–12, which can be found in para. 229 at p. 159, were used to assess the compensation due to SDMI:

Income stream lost to others during the closure period (steps 1–6)

(a) *Step 1* The realistic value of SDMI's relevant orders and quotations was assessed at CAN $50,294,735. Post-July 1997 quotations were excluded because they related to the United States' closure of the border for which Canada was not responsible. The remaining CAN $8.4 million of the post-February 1997 quotations was relevant. CAN $11,880,000 relating to large soil contracts, SDMI's claimed amount of CAN $19,800,000 with respect to the bid for the Public Works Department's contract, CAN $7,600,000 with respect to Canadian Federal Government PCBs, CAN $3,000,000 for miscellaneous items and CAN $8,400,000 for post-closure bids were to be deducted from the CAN $101,774,735 total (paras. 230–48 and 300).

(b) *Step 2* The price degradation that would have occurred through the operation of competitive pricing by others if the border had remained open from November

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1995 to February 1997 was assessed at 15 per cent: this percentage applied to the value assessed in step 1 was CAN $42,700,000 (paras. 249–57 and 300).

(c) *Step 3* The success rate was assessed at 44 per cent. Since there was no scientific method of ascertaining a value, the judgment was based on the relevant evidence as a whole (paras. 258–72 and 300).

(d) *Step 4* The 44 per cent success rate applied to the value obtained in step 2 was CAN $18,800,000 (para. 300).

(e) *Step 5* The gross income stream lost by SDMI to others during the closure was calculated (applying 50+ per cent) at CAN $9,700,000 (para. 300).

(f) *Step 6* The remaining gross income stream from the pre-closure inventory available after Canada re-opened the border was CAN $9,100,000 (para. 300).

Income stream lost to others during the post-closure period (steps 7–8)

(g) *Step 7* To this figure was added the realistic value of SDMI's post-closure quotations, giving a total gross income stream available to SDMI when the border re-opened assessed at CAN $11.9 million (paras. 274–81 and 300).

(h) *Step 8* The post-closure gross income stream that was, or would have been, lost to others by reasons of the closure was assessed at CAN $2.1 million (paras. 274–81 and 300).

Income stream not lost to others, but which would have been processed by SDMI during the nineteen-month "window of opportunity" (step 9)

(i) *Step 9* The remaining pre-closure income stream was assessed at CAN $7.5 million (para. 300).

Net income stream (steps 10–11)

(j) *Step 10* The lost net income streams (45 per cent of gross) were calculated at CAN $4,400,000 (during closure), CAN $900,000 (post-closure) and CAN $3,400,000 (remaining pre-closure). The conclusion that SDMI's net income stream would have been 45 per cent of the gross income stream was reached having reviewed the specific areas of difference between the experts and having taken into account that an amount had to be deducted from the gross income stream to reflect the cost of the Canadian operation and the treatment of a discretionary employee profit sharing plan (paras. 282–300).

(k) *Step 11* The compensation to be awarded in respect of the shortened time period available to SDMI to process the remaining pre-closure inventory, and for the time value of delay, was assessed at CAN $750,000 (para. 300).

Total recovery for SDMI (step 12)

(l) *Step 12* The total lost net income plus compensation for the abridged opportunity and delay was assessed at CAN $6,050,000 (para. 300).

(11) The rate of interest was closely connected to the question of currency of account in which the award of compensation was made. The currency of compensation awarded in the Second Partial Award was Canadian dollars because, on balance, the currency of account of the lost income stream was more closely

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connected with the loss and damage suffered by SDMI than the working currency of SDMI in Ohio (paras. 302–8).

(12) Canada was to pay SDMI interest, compounded annually, for the period starting at the date of the notice of the arbitration, 30 October 1998, until the date of the payment of the award calculated at the Canadian prime rate plus 1 per cent (para. 312).

(13) All questions with respect to costs, and if necessary the calculation of interest, were to be postponed to the Final Award under Articles 38 and 40 of the UNCITRAL Arbitration Rules (paras. 309–10 and 313).

Final Award (Award on Costs): 30 December 2002

The Tribunal then proceeded to fix the costs of the arbitration in accordance with Article 38 of the UNCITRAL Rules.[10] SDMI contended that Canada should bear the arbitration costs and the costs of legal representation and assistance. Canada submitted that the arbitration costs should be borne equally between the parties and that each party should bear its own costs of legal representation and assistance.

Held (by two votes to one, Professor Schwartz dissenting): — Canada was to pay SDMI CAN $350,000 in respect of the arbitration costs and CAN $500,000 in respect of costs of legal representation and assistance, with interest.

(1) Both paragraphs of Article 40 of the UNCITRAL Rules[11] conferred a wide discretion on a tribunal in respect of its award on costs. A subtle difference of approach was, however, required between the "arbitration costs" contained in Article 38(a)–(d) and (f), which were to be borne "in principle" by the "unsuccessful party", and the costs of "legal representation and assistance" referred to in Article 38(e), which were to be apportioned after "taking into account the circumstances of the case" (paras. 8–10).

(2) Although Article 40(1) of the UNCITRAL Rules placed emphasis on "success" as a significant element in the consideration of the apportionment of arbitration costs, success was rarely an absolute commodity. SDMI succeeded on liability but not to the full extent of its pleaded case. In the quantum stage of proceedings, SDMI might fairly be considered to be the unsuccessful party since the award was a small percentage of the amount claimed. Since neither party achieved absolute success, some apportionment was necessary (paras. 15–19).

(3) As a matter of broad judgement, applying the guidance given in the relevant UNCITRAL provisions and taking into account the circumstances of the case, SDMI was entitled to recover a significant proportion of its arbitration costs, but not all of them. SDMI had established liability and was awarded some compensation. Canada's contribution, which was almost three times greater than SDMI's contribution to the total amount deposited, was a fair reflection of the relative "success" of the disputing parties (paras. 19–30).

[10] For the text of Article 38 of the UNCITRAL Arbitration Rules, see para. 8, p. 173 below.
[11] For the text of Article 40 of the UNCITRAL Arbitration Rules, see para. 9, p. 174 below.

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