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Can Governments require foreign investors to invest a specific amount in research and development on an annual basis? A first look at Mobil Investments Canada Inc. and Murphy Oil Corporation v. Government of Canada

Rachel Bendayan · Thursday, September 13th, 2012

Mandatory research and development investment requirements (hereinafter 'R&D Requirements') may be prohibited under Chapter 11 of the North American Free Trade Agreement ('NAFTA'). A decision in *Mobil Investments Canada Inc. and Murphy Oil Corporation v. Government of Canada* ('*Mobil v. Canada*') is highly anticipated after a U.S. website leaked the fact that Canada had lost this arbitration against the two U.S. based oil companies on June 1, 2012.[1)] On the same day, a spokeswoman for the Canadian Department of International Trade confirmed that the Tribunal had found, by a 2-1 majority, that Canada had breached the performance requirements in Article 1106 of NAFTA by issuing provincial guidelines providing R&D Requirements.[2)] The NAFTA proceedings were administered under ICSID's Additional Facility rules NAFTA, with a Tribunal composed of Prof. Hans van Houtte (President), Prof. Merit Janow and Prof. Philippe Sands. While we await publication of the Tribunal's award, this piece will analyse the parties' principal submissions on the issue of the legality of R&D Requirements under NAFTA.

At the origin of the conflict is the Canada-Newfoundland Offshore Petroleum Board's adoption of new guidelines in 2004 that required investors in offshore petroleum projects to, *inter alia*, invest specific amounts in research and development on an annual basis. This annual investment or R&D Requirement was necessary in order to obtain and maintain the required authorizations for oil production operations. At the time that these new guidelines where enacted, the Claimants already operated the Hibernia and Terra Nova oil fields in the Province of Newfoundland and Labrador, the two largest oil fields off of Canada's east coast. The Claimants had also already collectively invested 163.7 million dollars in research and development in the Province in order to address the projects' many environmental and technological challenges in the absence of any formal R&D Requirements. In 2001, the Claimants reduced their investment by 50% because less research and development was needed at the production stage of their operations. According to the Respondent, the province's Petroleum Board had the right to require specific levels of annual investment, not considered necessary until then because the Claimants' reported levels of expenditures had been satisfactory. [3)]

The principal question at issue was whether the R&D Requirements constituted prohibited 'performance requirements' under NAFTA and if they were covered by the definition of 'goods

produced or services provided' under Article 1106(1)(c). No NAFTA tribunal had had the occasion to consider this problem before. On its face, Article 1106(1) prevents the distortion of free trade by limiting the conditions for allowing foreign investment into a country. According to the Claimants, it also prevents the entrepreneurship of foreign investors from being subjugated to the development goals of the host State. It is recalled that NAFTA Article 1106(1)(c) provides as follows:

> 1106 (1). No Party may impose or enforce any of the following requirements, or enforce any commitment or undertaking, in connection with the establishment, acquisition, expansion, management, conduct or operation of an investment of an investor of a Party or of a non-Party in its territory:
>
> […]
>
> (c) to purchase, use or accord a preference to goods produced or services provided in its territory, or to purchase goods or services from persons in its territory; [4)]

Although not the only contentious issue between the parties, the interpretation of NAFTA Article 1106(1) was the subject of much debate. The Claimants argued that R&D Requirements of 'expenditures in the Province in excess of what investors would otherwise spend' clearly constituted a prohibited performance requirement within the meaning of Article 1106(1). [5)] This argument was supported by reports from the United Nation Conference on Trade and Development ('UNCTAD') which had classified R&D Requirements as performance requirements. [6)]

The Respondent, relying on decisions such as *S.D. Myers* [7)] and *Pope & Talbot*,[8)] argued that Article 1106(1) should be interpreted restrictively and that a performance requirement not falling squarely within the listed examples must not be read into the agreement.[9)] Canada further alleged that any prohibition of R&D Requirements would have to be declared explicitly, as in many bilateral investment treaties signed by the U.S.[10)] The Respondent also submitted reports, notably, from the UNCTAD and from the Agreement on Trade Related Investment Measures which explained that R&D Requirements were not prohibited by most trade agreements, including NAFTA. In interpreting a 2001 UNCTAD report on Host Country Operational Measures, Canada underlined the importance of distinguishing between sourcing/local content performance requirements, which are aimed at protecting a domestic market, and R&D Requirements or training requirements, which are aimed at strengthening the knowledge capacity of the host State and promoting sustainable development.[11)] Canada argued that the R&D Requirements in question did not breach Article 1106(1)(c) because they did not 'necessarily compel the purchase, use or accordance of a preference to local goods or services' like a sourcing/local content performance requirement normally would.[12)]

Submissions were also made on the interpretation of Canada's reservation at Annex I to NAFTA. When Canada signed onto NAFTA, it had carved out certain R&D Requirements in a reservation to Article 1106. The Claimants alleged that this reservation demonstrated that Canada recognized that R&D Requirement constitute a breach of Article 1106.[13)] Canada argued that the reservation concerned other non-conforming legislative measures. For example, Canada alleged that the

reservation was necessary in order for it to require foreign investors to give 'first consideration' to local goods/services where they are competitive, claiming that any reference to R&D Requirements in the description of the reservation was made 'out of an abundance of caution'.[14)]

The validity of R&D Requirements is obviously politically sensitive and highly controversial. Certain stakeholders, like the Council of Canadians, have taken this opportunity to again question the reasonableness of NAFTA Chapter 11. According to the press release issued by the Council of Canadians at the end of June, judicial review of the decision in *Mobil v. Canada* (once published) should be sought by the province's premier.[15)]

Interestingly, this decision also comes at a time when a Comprehensive Economic and Trade Agreement ('CETA') between Canada and the EU is being negotiated. In June 2012, the Canadian Union of Public Employees issued a legal opinion stating that 'while CETA rules are similar to those of NAFTA and the General Agreement on Trade in Services, they will have far broader application because Canada proposes to abandon most of the reservations that have until now sheltered sub-national governments from the full application of such international rules'.[16)] It also wrote an open letter to all provincial premiers in Canada, warning of the potential effects the agreement would have on exclusive provincial powers, especially with respect to natural resources, citing the decision of *Mobil v. Canada* as a prime example of how investment agreements can limit legitimate areas of government regulation.[17)]

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References

?1 See ‘Canada Loses NAFTA Claim; Provincial R&D Obligations Imposed on US Oil Companies Held to Constitute Prohibited Performance Requirements’, *Investment Arbitration Reporter* (1 June 2012) online: IAReporter.

?2 See ‘Oil companies win NAFTA fight over local investment’, *CBC News* (1 June 2012) online: CBC News.

?3 See *Mobil Investments Canada Inc. and Murphy Oil Corporation v. Canada* (ICSID), Counter Memorial of December 1, 2009 at paras 71-73, online: Foreign Affairs and International Trade (Respondent’s Counter Memorial).

?4 *North American Free Trade Agreement Between The Government of Canada, the Government of Mexico and the Government of the United States*, 17 December 1992, Can TS 1994 No 2, 32 ILM 289, Article 1106(1)(c), online: NAFTA Secretariat.

?5 See *Mobil Investments Canada Inc. and Murphy Oil Corporation v. Canada* (ICSID), Claimant’s Memorial of August 3, 2009 at para. 151, online: Foreign Affairs and International Trade (Claimant’s Memorial).

?6 UNCTAD, Foreign Direct Investment and Performance Requirements: New Evidence from Selected Countries, (UNCTAD/ITE/IIA/2003/7) at pp 28-29, online: UNCTAD.

?7 *S.D. Myers Inc. v. Government of Canada* (UNICTRAL), Partial Award of November 13, 2000 at para. 275.

?8 *Pope & Talbot Inc. v. Government of Canada* (UNICTRAL), Interim Award of June 26, 2000 at para. 70.

?9 See Respondent’s Counter Memorial, *supra* note 3 at paras 144-154.

?10 See Respondent’s Counter Memorial, *supra* note 3 at paras 172-176; see e.g. *Treaty Between the Government of the United States of America and the State of Bahrain Concerning the Encouragement and Reciprocal Protection of Investment*, United States and Kingdom of Bahrain, 29 September,1999 (entered into force May 31, 2001) at Article 6 (a) and (f).

?11 See Respondent’s Counter Memorial, *supra* note 3 at paras 168-178.

?12 *Ibid* at para. 183.

?13 See Claimant’s Memorial, *supra* note 5 at paras 154-155.

?14 See Respondent's Counter Memorial, *supra* note 3 at paras 203-213; *Canada-Newfoundland Atlantic Accord Implemantation Act*, SC,1987,c 3 s 45(3)(b); *Canada-Newfoundland and Labrador Atlantic Accord Implementation Newfoundland and Labrador Act*, RSNL 1990, c C-2 s 45(3)(b).

?15 The Council of Canadians, Media Release, 'Dunderdale urged to challenge NAFTA ruling in Exxon-Murphy dispute; companies can afford R&D payments, says Council of Canadians' (28 June 2012) online: Council of Canadians.

?16 *Ibid*.

?17 See Canadian Union of Public Employees, Media Release, 'Legal opinion urges provinces to put brakes on secret CETA talks' (10 July 2012) online: Canadian Union of Public Employees.

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