Before the Additional Facility of the

INTERNATIONAL CENTRE FOR SETTLEMENT OF INVESTMENT DISPUTES (ICSID)

MERCER INTERNATIONAL INC.,
Claimant,

v.

GOVERNMENT OF CANADA,
Respondent.

ICSID CASE NO. ARB(AF)/12/__

REQUEST FOR ARBITRATION

April 30, 2012

Michael T. Shor
Jean E. Kalicki
Mallory Silberman
ARNOLD & PORTER LLP

Kim Moller
SANGRA MOLLER LLP

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Pursuant to Articles 2 and 4 of the Additional Facility Rules, Articles 2 and 3 of the Arbitration (Additional Facility) Rules ("Arbitration Rules"), and Articles 1116, 1117, and 1120(1)(b) of the North American Free Trade Agreement ("NAFTA"), Mercer International Inc. ("Mercer"), hereby respectfully requests approval of access to the Additional Facility and institution of arbitration proceedings concerning the claims discussed herein. Mercer submits this Request for Arbitration both under NAFTA Article 1116 (on its own behalf), and under Article 1117 (on behalf of Mercer's wholly-owned Canadian subsidiary, Zellstoff Celgar Limited, hereafter "Celgar"). In accordance with Article 3 of the Arbitration Rules, this Request is accompanied by five additional signed copies and the $25,000 lodging fee prescribed by Administrative and Financial Regulation 16.[1]

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[1] Exhibit 6, Wire Transfer Order, Demonstrating Payment of Lodging Fee.

I. INTRODUCTION

1. Mercer, through its direct investments in Celgar and as represented by its partnership units of Zellstoff Celgar Limited Partnership (the "Celgar Partnership"), owns and operates an industrial plant consisting of a northern bleached softwood kraft ("NBSK") pulp mill and a biomass-based electricity generation facility, situated in Castlegar, British Columbia (the "Celgar mill" or the "Mill"). In addition to improving pulp operations, Mercer has invested heavily in clean energy production at the plant. By burning the "black liquor" residue of the pulp manufacturing process and other wood residue as biofuel, the Celgar mill generates both: (i) thermal energy to support its pulp manufacturing; and (ii) electricity. The electricity produced by the Celgar mill can be utilized to power pulp operations (which impose a base-load electricity requirement of around 43.5 megawatts ("MW")) and/or be sold to the British Columbia Hydro and Power Authority ("BC Hydro") and others to meet the growing energy demands of both the Province of British Columbia and other adjacent jurisdictions.

2. The Government of the Province of British Columbia (the "Province") regards the Mill's energy production to be both clean and renewable. The Celgar mill produces energy derived from wood chips produced as byproducts of sawmill lumber production and wood residues from logs. Approximately 80 percent of the Mill's fuel is sourced from within the Province with the remaining imported from U.S. sawmills. Because timber is harvested on a sustainable basis in British Columbia and in the United States, the Mill's fuel source is renewable. The biomass fuel source is also carbon neutral.

3. This claim arises from the Celgar mill's role as both a producer and user of electricity in light of the market for electricity in British Columbia. In simplest terms, the Province regulates the rates BC Hydro and utilities operating in the Province charge for power

based on historical cost. The overwhelming majority of supply comes from hydroelectric generating assets built long ago, which entail low embedded costs. Incremental supply comes from more expensive generating assets and from purchases on wholesale power markets, the prices for which reflect market supply and demand factors, rather than embedded costs. The "market" rate for power is typically several times higher than the embedded cost-based rates at which BC Hydro and utilities operating in the Province supply power to their customers. At issue is the extent to which the Celgar mill, like other BC pulp mills and industrial power users with self-generating capacity, is permitted to sell its own cogenerated power at market-based rates while simultaneously purchasing power at embedded cost based rates to meet its own mill needs.

4. In recent years, numerous other pulp mills operating in British Columbia also have invested in biomass generation capacity, including the Skookumchuck mill owned by Tembec, Inc. ("Tembec"), the Prince George mill owned by Canfor Pulp Limited Partnership ("Canfor"), the Kamloops mill owned by Domtar Corp. ("Domtar"), the Port Mellon mill owned by Howe Sound Pulp and Paper ("Howe Sound"), and, as recently announced, the Nanaimo mill owned by Nanaimo Forest Products Ltd. ("Nanaimo"). With the approval of the British Columbia Utilities Commission (the "Commission"), BC Hydro has entered into various preferential deals with these and other mills. These deals have included direct subsidies or low interest rate loans to finance construction of new or additional generation turbines, and/or agreements to purchase some or all of the power generated at favorable, market-based rates. For example, BC Hydro has provided in excess of $175 million in cash subsidies or interest-free loans to such plants to increase their energy production, and to displace purchases of embedded cost energy the mills otherwise would have made from BC Hydro. BC Hydro also has increased

the competitiveness of these pulp mills, and effectively increased the value of their subsidized generation assets, by buying power from the subsidized mills at negotiated, market-based prices, while simultaneously selling embedded cost power to these mills. In all cases, the negotiated BC Hydro purchase price significantly exceeds the embedded cost of power being consumed at the mill.

5. These mills, as well as certain others within the Province that have not received direct cash subsidies, are also able to profit, to varying degrees, from buying low-priced, embedded cost power for their pulp operations from BC Hydro while simultaneously selling power from their energy operations to BC Hydro at higher, market-based rates. As contemplated in the Province's various Energy Acts and its so-called "Heritage Contract" (discussed further below), these mills share in the benefits of electricity generated from BC Hydro's historical low-cost hydroelectric energy assets ("Heritage Power"), as do all industrial users and consumers in the Province.

6. However, both the Province — through various actions of the Commission as well as directly through the Ministry of Energy and Mines and its predecessor entities (the "Ministry") and otherwise — and BC Hydro (to which the Province has delegated governmental authority) treat the Celgar mill differently. The Mill was not eligible for any direct subsidies, low-interest loans or other financial incentives in connection with its investments in generation assets. More critically, the Celgar mill is the only pulp mill in British Columbia that has been prohibited for several years from buying any embedded cost power, and that still remains prohibited from buying any Heritage Power, to meet the needs of its pulp operations, while simultaneously selling power to BC Hydro or the market. In fact, if the Celgar mill were to sell its self-generated electricity, as it has sought to do, its access to Heritage Power will be entirely

cut off while doing so, even though the benefits of low-cost Heritage Power ostensibly are available to all British Columbians, and remain available to the Celgar mill's competitors. The Province has failed to implement any uniform policy to protect the Celgar mill from such less favorable treatment, and both the Province and BC Hydro have actively intervened in various proceedings before the Commission to support this discriminatory result.

7. The actions of the Province, the Commission, and/or BC Hydro cannot be explained by the fact that, for electricity supply purposes, the Province consists of two separate service territories, one of which is supplied by BC Hydro and one of which is supplied by a private utility, FortisBC Inc. ("FortisBC"). Although the Celgar mill is located in FortisBC's service territory, it should still have access to BC Hydro Heritage Power, because FortisBC in turn has access to Heritage Power through a Power Purchase Agreement ("PPA") with BC Hydro. Moreover, as recently as December 1, 2011, the Commission reaffirmed the right of another forest products company with self-generating capacity in the FortisBC service territory — Tolko Industries Ltd.'s Kelowna sawmill — to access BC Hydro Heritage Power simultaneously while conducting its own power sales.

8. In failing to implement a uniform policy concerning access to embedded cost power (including Heritage Power) either specifically for pulp mills with self-generating capabilities or more generally for a broader class of industrial power users with self-generation capabilities, while such users simultaneously are selling self-generated power to the market, the Province, the Commission and/or BC Hydro *de facto* have discriminated against Mercer and its investment in Celgar and the Celgar mill, in violation of NAFTA. Under NAFTA and applicable principles of international law, Canada is responsible for the actions of all such entities. Accepted principles of State responsibility under international law deem Canada directly

responsible for actions taken by local or provincial authorities like the Province and the Commission. In addition, Article 1503(2) of NAFTA obliges Canada to "ensure, through regulatory control, administrative supervision or the application of other measures" that BC Hydro, as a State enterprise within the meaning of Annex 1505(a), "acts in a manner that is not inconsistent with [Canada's] obligations under Chapter Eleven . . . wherever such enterprise exercises any regulatory, administrative or other governmental authority that the Party has delegated to it." The relevant actions of BC Hydro clearly reflect the exercise of delegated governmental authority, since the legislation establishing BC Hydro on its face declares it to be "for all its purposes an agent of the government."[2] Accordingly, all actions described in this Request as having been taken by the Province, the Commission, and/or BC Hydro implicate Canada's responsibility under NAFTA, either by virtue of Canada's having constructively taken the action, or having failed to ensure that the action was not taken.

9. Notwithstanding the fact that the Celgar mill is the most energy efficient, lowest carbon footprint, pulp mill in British Columbia, and generates more electricity than any other BC pulp mill, it is able to capture far less of the economic benefit of its power generation than any other comparable mill in the Province. The Province, the Commission, and/or BC Hydro have treated the Celgar mill, and thus Mercer's investment in Celgar, in a way that is arbitrary and discriminatory, and unfair and inequitable. The unfairness and inequity of this treatment is compounded by the fact that their actions effectively have taken much of the return from Celgar's investment in clean energy technology for the direct benefit of BC Hydro (and thus the Province) and/or the benefit of BC Hydro's ratepayers, without any compensation.

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[2] The Hydro and Power Authority Act [RSBC 1996], Chapter 212, Section 3(1), *available at* http://www.bclaws.ca/EPLibraries/bclaws_new/document/ID/freeside/00_96212_01#section 1.

II. NAMES AND ADDRESSES OF THE PARTIES

A. <u>The Investor and its Investment</u>

10. Mercer submits this Request for Arbitration both under NAFTA Article 1116 as an investor on its own behalf, and under NAFTA Article 1117 on behalf of Celgar, its wholly-owned Canadian subsidiary.

11. Mercer is a limited liability company organized under the laws of the State of Washington, United States of America, and is thus is an "enterprise" and an "investor" of a Party (the United States) pursuant to NAFTA Article 1139. Mercer is a public company that is traded on both the NASDAQ global market under the symbol "MERC" and on the Toronto Stock Exchange under the trading symbol "MRI.I." Its registered address is as follows:

14900 Interurban Avenue South
Suite 282
Seattle, WA 98168
United States of America

Phone: 206-674-4639
Fax: 206-674-4629

12. Celgar, Mercer's wholly-owned subsidiary, is a corporation incorporated under the laws of the Province of British Columbia, Canada. It is "an enterprise of another Party that is a juridical person" within the meaning of NAFTA Articles 201, 1117, and 1139. Mercer directly owns and controls this enterprise. Celgar has been operating in Canada since February 2005. Its registered address is as follows:

1000 Cathedral Place
925 West Georgia Street
Vancouver, BC
V6C 3L2
Canada

13. Celgar is the entity whose rights have been directly affected by acts for which Canada is internationally responsible. Celgar owns all of the assets of the relevant pulp and energy businesses, in trust for the benefit of the unit holders in the Celgar Partnership organized under the laws of British Columbia. The Celgar Partnership was formed pursuant to a Limited Partnership Agreement dated January 10, 2006 between Mercer and its 100 percent owned subsidiary, Celgar. Celgar is the general partner of the Celgar Partnership and owns a residual 0.1 percent economic interest in that limited partnership, with Mercer as the limited partner owning the remaining 99.9 percent economic interest. The Celgar Partnership has its head office at the following address:

Suite 1120, 700 West Pender Street
Vancouver BC
V6C 1G8
Canada

Phone: 604-684-1099
Fax: 604-684-1094

and has its registered office at:

1000 Cathedral Place
925 West Georgia Street
Vancouver, BC
V6C 3L2
Canada

14. Celgar owns and operates an industrial plant which consists of an NBSK pulp mill and electric power generation assets currently capable of generating 100 MW, situated in Castlegar, British Columbia. It produces both market pulp and electricity. This dispute concerns

discriminatory limitations the Province, the Commission, and/or BC Hydro individually and collectively have placed on the Celgar mill's ability to access embedded cost power, including its access to Heritage Power, while selling electricity.

15. Mercer acquired the Mill, and its then roughly 52 MW electric power generation plant, by purchasing these assets, through Celgar, from a bankruptcy receiver on February 14, 2005. The assets were reorganized into the current limited partnership structure (described in paragraph 13 above) in March 2006. The Mill had been thoroughly modernized in 1993, at a cost of approximately C$800 million, by prior owners.

16. In addition to its initial investment in acquiring the Mill, Mercer to date has made more than C$102 million in additional capital investments to upgrade the Mill. In 2005, it began a C$28 million capital investment program aimed at increasing both pulp and energy production while reducing operating costs, which it completed in 2006. In 2008, it began a C$62 million program to add a 48 MW condensing turbine, thereby increasing its electricity generation capacity. The new turbine became fully operational in September 2010. Mercer also invested C$12 million beginning in 2008 to upgrade the wood chipping plant at the Mill.

17. Neither Mercer, Celgar, nor the Celgar Partnership has received any subsidies or financial incentives from the Province, including from BC Hydro, in connection with the acquisition of the Mill or the improvements to and expansion of the Mill's electricity generation capacity.

18. This dispute involves the following types of investments, within the meaning of "investment" defined in NAFTA Article 1139:

a. an enterprise;

b. an equity security of an enterprise;

c. an interest in an enterprise that entitles the owner to share in income or profits of the enterprise;

d. an interest in an enterprise that entitles the owner to share in the assets of that enterprise on dissolution, other than a debt security or a loan;

e. real estate or other property, tangible or intangible, acquired in the expectation or used for the purpose of economic benefit or other business purposes; and

f. interests 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.

B. The Respondent

19. Canada is a sovereign State and a Party to NAFTA.

20. Pursuant to Article 1137(2) of NAFTA, delivery of notices and documents to the Government of Canada shall be made to the following address:

Office of the Deputy Attorney General of Canada
Justice Building
284 Wellington Street
Ottawa, ON K1A 0H8

III. THE RELEVANT NAFTA OBLIGATIONS

21. As discussed further below, the Government of Canada has breached its obligations under Section A of Chapter 11 of NAFTA, including the following provisions:

a. Article 1102 — National Treatment

b. Article 1103 — Most Favored-Nation Treatment

c. Article 1105 — Minimum Standard of Treatment

22. Canada has also breached its obligations under NAFTA Article 1503(2) (State Enterprises).

23. The applicable provisions of NAFTA are as follows:

Article 1102: National Treatment

1. Each Party shall accord to investors of another Party treatment no less favorable than that it accords, in like circumstances, to its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.

2. Each Party shall accord to investments of investors of another Party treatment no less favorable than that it accords, in like circumstances, to investments of its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.

3. The treatment accorded by a Party under paragraphs 1 and 2 means, with respect to a state or province, treatment no less favorable than the most favorable treatment accorded, in like circumstances, by that state or province to investors, and to investments of investors, of the Party of which it forms a part.

4. For greater certainty, no Party may:

   (a) impose on an investor of another Party a requirement that a minimum level of equity in an enterprise in the territory of the Party be held by its nationals, other than nominal qualifying shares for directors or incorporators of corporations; or

   (b) require an investor of another Party, by reason of its nationality, to sell or otherwise dispose of an investment in the territory of the Party.

Article 1103: Most-Favored-Nation Treatment

1. Each Party shall accord to investors of another Party treatment no less favorable than that it accords, in like circumstances, to investors of any other Party or of a non-Party with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.

2. Each Party shall accord to investments of investors of another Party treatment no less favorable than that it accords, in like circumstances, to investments of investors of any other Party or of a non-Party with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.

Article 1105: Minimum Standard of Treatment

1. Each Party shall accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security.

2. Without prejudice to paragraph 1 and notwithstanding Article 1108(7)(b), each Party shall accord to investors of another Party, and to investments of investors of another Party, non-discriminatory treatment with respect to measures it adopts or maintains relating to losses suffered by investments in its territory owing to armed conflict or civil strife.

3. Paragraph 2 does not apply to existing measures relating to subsidies or grants that would be inconsistent with Article 1102 but for Article 1108(7)(b).

Article 1503: State Enterprises

1. Nothing in this Agreement shall be construed to prevent a Party from maintaining or establishing a state enterprise.

2. Each Party shall ensure, through regulatory control, administrative supervision or the application of other measures, that any state enterprise that it maintains or establishes acts in a manner that is not inconsistent with the Party's obligations under Chapters Eleven (Investment) and Fourteen (Financial Services) wherever such enterprise exercises any regulatory, administrative or other governmental authority that the Party has delegated to it, such as the power to expropriate, grant licenses, approve commercial transactions or impose quotas, fees or other charges.

3. Each Party shall ensure that any state enterprise that it maintains or establishes accords non-discriminatory treatment in the sale of its goods or services to investments in the Party's territory of investors of another Party.

IV. THE FACTUAL BASIS FOR THE CLAIM

A. Introduction

24. This claim arises out of several "measures," within the meaning of NAFTA Article 201, adopted or maintained through the auspices of entities in the Province for which Canada is ultimately responsible. The entities are: (a) the Province itself, including but not limited to the Ministry and its predecessor entities, which is responsible for implementing uniform and nondiscriminatory energy policies within its territory, (b) the British Columbia

Utilities Commission, which is a government regulatory body made up of Provincial appointees charged with administering the Utilities Commission Act, subject to the direction of the Lieutenant Governor in Council, and (c) BC Hydro, which is a wholly-owned Provincial Crown Corporation expressly deemed by its establishing legislation to be "for all its purposes an agent of the government."[3] As stated above, Canada is obligated under Article 1503(2) of NAFTA to ensure BC Hydro's compliance with Chapters 11 and 14 of the Treaty; Canada is made directly responsible for the actions of the Province and the Commission through the accepted rules of State responsibility under international law.

25. Taken together, these measures and the manner in which they have been implemented have had the effect of depriving Mercer, through Celgar and the Celgar mill, of much of the economic benefit of its considerable investment in electricity generation facilities, while the Mill's competitors — other pulp mills in the Province that have invested in electric generation — continue to enjoy more favorable treatment that enables them to reap substantially more of the economic benefits of their own investments. As a result of the challenged measures, which are described further below, until November 2011 the Celgar mill was the only pulp mill with self-generation capacity in the Province of British Columbia that was restricted from accessing *any* electric power from its local electric utility company while selling to the market any of its self-financed, self-generated electric power. As of November 2011, the regulatory landscape changed somewhat, but the Celgar mill remains the only pulp mill with self-generation capacity in the Province of British Columbia that is restricted from accessing (directly or indirectly) any BC Hydro Heritage Power while selling any such self-generated power.

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[3] *Id.* The Act establishes BC Hydro as a provincial agency with a board of directors appointed by the provincial government by Order in Council.

26. The Province does not apply this power sale policy to all pulp mills with generation capacity in the Province, but instead (through its actions and those of the Commission and BC Hydro) has applied its policy selectively and unfavorably against the Celgar mill. The measures have placed the Celgar mill in a uniquely disadvantaged position vis-à-vis its competitors. Indeed, notwithstanding the fact that the Celgar mill is the most energy efficient, lowest carbon footprint pulp mill in British Columbia, and generates more electricity than any other BC pulp mill, it is able to capture far less of the economic benefit of its power generation than any other comparable pulp mill in the Province. The inconsistent treatment of similar investors within the same industry within the Province is arbitrary, discriminatory, unfair and inequitable. It interferes with the legitimate expectations upon which Mercer reasonably relied in investing in the Province, particularly in the expansion of the Mill's generation capabilities. The measures also divert much of the economic benefit of Mercer's investment to BC Hydro, a State-owned enterprise within the Province, and/or to its customers, without any compensation to Mercer. These measures violate Canada's obligations to U.S. investors under relevant provisions of NAFTA.

B. The Relevant Background

(1) Pulp Mill Generation

27. NBSK pulp mills purchase wood chips and pulp logs (which they then chip) as the principal raw material inputs in their manufacturing process. The kraft process converts wood chips into paper pulp by removing lignin and other substances from the wood to free the cellulose fibers, through processes involving cooking the chips with chemicals in a digester. The pulp is then washed, screened, bleached, and machined to produce sheets of market pulp.

28. The lignin in the wood (black liquor) retains a high energy content, making pulp mills ideally suited to also produce energy in the form of both heat and electricity by using this biofuel that is a co-product of kraft pulp production. Black liquor contains spent cooking chemicals from the kraft process and an aqueous solution of lignin residues, hemicellulose from the wood chips. The black liquor contains more than half of the energy content of the wood fed into the digester. It is concentrated, through evaporators reducing the amount of water, and can be burned in a recovery boiler both to create the heat required in the pulp mill and to power steam turbines to generate electricity. (The recovery boiler during the combustion of the black liquor also recovers chemicals used in the kraft process, which then are recycled back into the pulping process.)

29. As a result of its 1993 modernization, the Celgar mill has a modern recovery boiler relative to other older British Columbia mills, and, due to technical advancement, the Mill is able to operate more energy efficiently than most pulp mills in British Columbia. It can extract heat energy to meet the steam needs of its pulp operations from its recovery boiler without significant use of its power boiler. Approximately 93 percent of all heat energy used at Celgar's pulp mill comes from the recovery boiler. Most British Columbia pulp mills require significant steam generation from power boilers and fossil fuels to meet internal steam needs. By mass, roughly 47 percent of the wood chips consumed in the Celgar mill are converted to pulp; the remaining 53 percent constitutes the woody residuals in the black liquor which are burned for energy production. Of the energy produced, approximately 50 percent is used as heat in the Mill, approximately 36 percent is converted to electricity, and the remainder reflects efficiency losses.

30. Through cogeneration, the Celgar mill achieves energy efficiencies, and reduces total fuel consumption by some 30–40 percent and greenhouse gas emissions by up to 50 percent over conventional separate generation facilities. As a result the Celgar mill has the lowest carbon intensity of any kraft pulp mill not only in British Columbia, but also in all of Canada. In general, pulp mills are able to achieve these efficiencies because steam turbines do not convert all of the energy in steam into electricity. (Pressurized steam contains kinetic energy and thermal energy, and the turbine utilizes mainly the kinetic energy.) The pulp mill is able to utilize much of the remaining thermal energy in its pulp manufacturing process.

31. The Mill's generation plant and infrastructure not only achieve energy efficiencies, reducing overall energy consumption, but produce renewable, clean energy. The wood chips that are the primary base source of the plant's energy production are largely a by-product of lumber production occurring at numerous sawmills located in the British Columbia Interior. The timber used by the sawmills, as well as pulp grade logs that are chipped for mill use, is harvested in a sustainable manner, and provincial stumpage tenure holders must reforest areas that they cut. In addition, approximately 20 percent of the Mill's fiber supply is imported from U.S.-based sawmills. Wood chips, moreover, are a clean energy source because they are carbon neutral due to the life cycle of the forests where they originate.

(2) Clean Energy Investment and Capacity at the Celgar Mill

32. As constructed by a subsidiary of the Celanese Corporation of America in 1959, the Mill originally included a 3.5 MW steam turbine. However, this turbine failed in 1993 and was permanently decommissioned. In 1993, as noted above, the Mill was completely rebuilt at significant cost by its then-owner, a joint-venture of the Chinese International Trust and Investment Corp (CITIC) and Stone Container Corp. In 1994, the joint-venture completed the

installation of a new, 52 MW biomass turbine at the Mill site. Unfortunately, due to a period of low pulp prices and the impact of the high debt incurred in the modernization, the Mill's owners sought bankruptcy protection in 1998, and the Mill ultimately was put into receivership.

33. Mercer acquired the Mill in February 2005, from the bankruptcy receiver. Mercer then embarked on a series of capital investments, totaling over C$102 million, as described above. These investments enhanced the Mill's operating efficiency and increased the Mill's power generation capacity from 52 MW to 100 MW.

34. Mercer's investment in Celgar and the Celgar mill since 2005 has been based on the understanding that the Mill had two separate but complementary business activities — not only its traditional pulp production operations, but also its operations as a producer and seller of clean, renewable energy. Mercer's business strategy has involved maximizing returns from each of these business activities, with a particular emphasis on expanding the Mill's energy production and maximizing its sale of electricity to the market.

(3) The British Columbia Regulatory Framework

35. Because the manufacture of kraft pulp is an energy-intensive process, the Celgar mill, in addition to being a large producer of electric energy, is also a large consumer. While its native load fluctuates, the Mill typically requires roughly 43.5 MW of capacity to meet its base load. The Mill physically is capable of meeting its power needs by purchasing power from its local utility, like other industrial users and retail consumers, or it can utilize its own, self-generated power. The only constraints are those imposed by the Province, directly or indirectly, through its energy regulatory regime.

36. For purposes of the retail distribution of electric power, the Province of British Columbia consists of two distinct geographic service territories. The electricity needs of roughly 90 percent of the Province are supplied directly by BC Hydro. A smaller service area, in which the Celgar mill is situated, is served by FortisBC, a privately-owned, regulated utility. The Celgar mill is the only pulp mill within the FortisBC service area and the only pulp mill and generation facility operator in British Columbia that is not a BC Hydro customer. Under the regulatory regime in the Province of British Columbia, for practical purposes, the Celgar mill can only receive access to embedded cost electricity, that includes Heritage Power, through FortisBC. While in theory the Celgar mill could purchase electricity directly from BC Hydro, BC Hydro has no obligation to serve the Mill or to make Heritage Power available to the Mill and, in fact, has actively opposed the Mill's having any access to Heritage Power while selling any of its self-generated electricity.

37. Even within the FortisBC service area, BC Hydro plays a critical indirect role in the provision of electric power. FortisBC has its own generating assets, but it also relies upon BC Hydro for a significant portion of its power. Under the terms of a 1993 PPA between FortisBC[4] and BC Hydro (generally known as the "3808 Agreement"), FortisBC is entitled to purchase continuously up to 200 MWh of power generated from existing resources in the BC Hydro service area (including existing hydroelectric facilities), priced on a rolled in or "embedded cost" basis, referring to BC Hydro's embedded cost.

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[4] The original agreement was with FortisBC's predecessor, West Kootenay Power.

38. By statute, the Heritage Contract,[5] and regulatory decisions, BC Hydro is obligated to provide energy to its ratepayers based on cost of service, not market prices. The stated policy goal is to ensure that all British Columbians have continued access to supplies of dependable low-cost electricity. Because BC Hydro's embedded costs include relatively low, historical costs for its very large older hydroelectric assets, and because they mainly reflect BC Hydro's large hydroelectric generating facilities, the price of embedded cost Heritage Power is significantly lower than the "market price." To meet incremental growth, BC Hydro purchases incremental power at current market prices to meet its load. These current market prices are rolled into the embedded costs to service incremental load growth, including from new customers and existing customers, at a rolled in or embedded cost rate. Market prices reflect, in part, the utilities' own marginal generation costs, which would include fuel and other costs associated with their least efficient fossil fuel burning plants, as well as the market prices paid to independent suppliers and the current costs of new generation installations.

39. As a matter of overarching Provincial public policy, low-priced, embedded cost Heritage Power is to be made available, on a non-discriminatory basis, to support the needs of all

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[5] The Province's 2002 Energy Plan ("Energy For Our Future: A Plan for BC") was predicated on the notion of "low electricity rates and public ownership of BC Hydro." 2002 Energy Plan, *available at* http://www.google.com/url?sa=t&rct=j&q=&esrc=s&frm=1&source=web&cd=1&ved=0CDwQFjAA&url=http%3A%2F%2Fwww.bcenergyblog.com%2Fuploads%2Ffile%2F2002%2520BC%2520Energy%2520Plan.pdf&ei=CxCYT-4swp7oAeek7f4G&usg=AFQjCNHI_NSTyBKusZfBwIhATM3ggd2spQ. The 2002 Energy Plan stated that: "BC Hydro ratepayers will benefit from a legislated heritage contract that locks in the value of existing low-cost generation (heritage energy), and from the continued use of trading revenues to supplement domestic revenues. The BC Utilities Commission will conduct an inquiry and recommend the terms and conditions of the heritage contract legislation. To benefit ratepayers and taxpayers alike, public ownership of BC Hydro generation, transmission and distribution assets will continue." 2002 Energy Plan, p. 7. Based on the Commission's recommendations, the Provincial Government thereafter established a "Heritage Contract" between BC Hydro's generation line of business and its distribution line of business, pursuant to Special Direction No. HC2 issued under the BC Hydro Public Power Legacy and Heritage Contract Act, enacted in November 2003. The Heritage Contract states at the outset that the Province's underlying policy goal is "to ensure *British Columbians* have continued access to sufficient supplies of dependable low-cost electricity . . . ." Exhibit 7, Heritage Contract (emphasis added). The reference to "British Columbians" reflects an intention that all users in the Province should have access to "sufficient supplies of dependable low-cost electricity," not just users in BC Hydro's direct service area.

customers within the Province, including industrial users. The 3808 Agreement thus prohibited FortisBC from using the Heritage Power purchased from BC Hydro for any purpose other than meeting its service area load requirements, such as by reselling such power on the open market outside its service territory. It did not, however, restrict FortisBC's customers with cogeneration capacity, such as the Celgar mill, from selling their own generated electricity while purchasing power that included Heritage Power.

40. Because the Celgar mill is not a regulated utility, it is permitted, under certain circumstances, to sell energy at market rates rather than cost-based rates, as are all other pulp mills in British Columbia and all other independent power producers. On the other hand, when the Mill purchases energy, like all other pulp mill and industrial users in the Province, it wishes to purchase electricity at regulated, lower, cost-based rates. The existence of this pricing differential creates a policy issue for the Province concerning the extent to which it permits self-generators of clean, renewable energy to sell that energy while simultaneously purchasing utility-generated energy at a lower price. On the one hand, the Province has indicated its interest in encouraging investment in the production of clean, renewable energy, and must recognize the energy efficiencies obtained through cogeneration. On the other hand, the supply of cheap hydro power is limited, and insufficient to meet the Province's total energy needs. The Province must decide how to allocate that resource, as well as how to allocate the costs of power that must be bought at higher cost-based and market-based prices.

41. Mercer recognizes that NAFTA does not dictate any particular set of policy choices for the Province. The Province is free to decide that self-generating electric customers may only sell energy "net of" their own load, just as it is free to decide that such energy producers may sell all energy they produce at market rates. The Province is also free to allow

access to embedded cost power, that does or does not include Heritage Power, to self-generating electric customers, or not. Alternatively, it may draw the line somewhere in between. As discussed below, however, Mercer's complaint is that the Province has failed to implement any uniform line, and thus does not *de facto* apply any uniform policy. As a result, through *ad hoc* decisions and measures, including those of the Commission and BC Hydro, the Province now *de facto* treats the Celgar mill in a worse fashion than all other similarly situated pulp mills with cogeneration.

42. As discussed further below, from May of 2009 until November of 2011, the Province applied a "net of load" requirement only to the Celgar mill, which was thereby required to meet its own electricity needs first, and permitted to sell at market rates only excess power, after fully satisfying its own Mill load. Commencing in November 2011, the Province appears to have relaxed the net of load criteria as it applied to the Celgar mill (though the practical workings of the new regime have not been formalized or implemented). However, having done so, the Province has blocked Celgar's access to the benefits of Heritage Power through a different mechanism by: (i) directing that FortisBC establish a notional matching method to match sales of non-Heritage Power from its supply sources to the Celgar mill while the Mill sells power, and to submit such methodology to the Commission for its approval by March 31, 2012 (later extended to April 13, 2012); and (ii) directing that the rate the Mill pays to purchase electricity from FortisBC while it exports self-generated electricity that is not net of Mill load will specifically exclude from its calculation the benefits of Heritage Power. To the extent that the Mill will be entitled to purchase electricity in such circumstances from FortisBC, it will do so for a certain (to be determined) amount of electricity, at a specially established (to be determined) "made-for-Celgar-only" embedded cost rate, modified in its calculation expressly to

exclude Heritage Power. While the matching methodology has now been submitted to the Commission, it has not been approved. The Celgar mill thus effectively remains blocked from access to <u>any</u> embedded cost power while it sells power that is not net of load.

43. This discriminatory treatment reduces the Mill's actual profitability relative to its projected profitability in the absence of such discrimination, and relative to all other pulp mills in the Province, as: (i) in the past and for the time being, the Celgar mill's access to embedded cost power has been and remains blocked; (ii) the level at which the Mill theoretically may be able to purchase any embedded cost power in the future has not been established, and once established may not approximate the levels established for the Mill's competitors; and (iii) all other pulp mills in the Province have access to Heritage Power, while the Celgar mill does not, and will not, while selling any power not in excess of load. Moreover, it replaces what should be the Mill's competitive advantage in energy production and efficiency with a competitive disadvantage. In a down market for pulp, the Celgar mill will be among the first to be squeezed and potentially rendered unprofitable and in a worst-case scenario, forced to shut down. Its break-even price as a purchaser of wood chips will be lower than that of its competitors — not because of inherent competitive factors, but solely due to the Province's less favorable regulatory treatment of the Mill's energy production.

44. At the time Mercer invested in Celgar, the regulatory treatment of energy sales by co-generators was different in the Province's two service territories. Within BC Hydro's service area, the issue has, since April 5, 2001, been governed by Commission Order G-38-01,[6] which provided the basis for a series of agreements that BC Hydro thereafter entered into with its pulp mill customers. Order G-38-01 directed BC Hydro:

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[6] Exhibit 8, British Columbia Utilities Commission, Order G-38-01 of April 5, 2001 ("Order G-38-01").

> to allow [its] customers with idle self-generation capability to sell excess self-generated electricity, provided the self-generating customers do not arbitrage between embedded cost utility service and market prices. This means that B.C. Hydro is not required to supply any increased embedded cost of service to a . . . customer selling its self-generation output to market.[7]

The Commission explicitly "recognize[d] that considerable debate may ensue over whether a self-generator has met this principle," but it directed BC Hydro to make "every effort to agree on a customer baseline" for affected customers, in order to define for each the notion of "idle" and "excess" capacity (*i.e.,* the amount of electricity that customers could sell directly to the market, after self-supplying a certain portion of their own mill needs). The Commission authorized BC Hydro to base these customer baselines "either on the historical energy consumption of the customer or the historical output of the generator."[8]

45. While this policy on its face may appear close to a "net of load" standard, that is not how it in fact has been implemented within BC Hydro's service area. Moreover, pulp mills in BC Hydro's service area have been compensated financially even for the less onerous restrictions imposed on them as a consequence of Order G-38-01. First, at most of these facilities, BC Hydro subsidized a significant portion of the cost of installing new generation equipment, through a series of development subsidies it made available only within the BC Hydro service area. In exchange for large financial subsidies, the customers then agreed partially to displace mill load with self-generated electricity, in "load displacement agreements" that were incorporated into the same broader transactions as the development subsidies. In other words, BC Hydro compensated these pulp mills generously for using their own self-generated power for some portion of their internal needs.

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[7] *Id.* at § 1.

[8] *Id.*

46. For example, BC Hydro contributed C$18 million towards a C$34.8 million 30 MW generation project at Weyerhaeuser's (now Domtar's) Kamloops pulp mill provided that that the first 20 MW of energy produced would be committed to displace the mill's domestic load for a period of ten years. BC Hydro likewise provided Howe Sound with a C$108 million interest free loan in 1990 in connection with its installation of an 86 MW turbine. BC Hydro also provided Canfor with a C$49 million subsidy in connection with the installation of a 49 MW turbine at Canfor's Prince George pulp mill, in exchange for the plant agreeing to use 390 GWhrs per year to displace energy purchases from BC Hydro, for a period of 15 years.

47. BC Hydro also agreed with the pulp mills in its area that the "customer baselines" referenced in Order G-38-01 — referred to in the load displacement agreements and hereafter as "generator baselines," or "GBLs" — need *not* be set at the level of actual, current mill needs, but rather could be set at much lower levels linked to *original generating capacity prior to the installation of new generating facilities*. The Commission approved these agreements, in its capacity as regulator of "rates" set by utilities in the Province.

48. As a result, to Mercer's knowledge, there is no pulp mill in the BC Hydro service area with a GBL set at actual, current mill usage. Correspondingly, there is, and has historically been, no pulp mill in the BC Hydro service area that is permitted to sell energy <u>only</u> in excess of its current mill load. All such mills purchase energy to service mill load (while selling self-generated electricity) at rates that include the benefit of the Heritage Power denied to the Celgar mill. And all mills in BC Hydro's service area that face GBL restrictions agreed to the restriction and were paid for it.

49. Until recently, none of these practices had any bearing on the Celgar mill, because Order G-38-01 applied only within BC Hydro's service area. No similar restriction applied

within the FortisBC service area in which the Mill was located. As noted above, the 1993 3808 Agreement between FortisBC and BC Hydro, which agreement provided up to 200 MW of BC Hydro power to FortisBC at embedded cost rates, did not prohibit FortisBC from selling to its customers low-cost Heritage Power obtained from BC Hydro, even if those customers had self-generation capabilities. Indeed, it did not require FortisBC to impose any restrictions on its customers' use of such power. Because there was no legal restriction on self-generators in the FortisBC service area, there was no need either for FortisBC to offset the financial impact of restrictions, by offering compensation for load displacement agreements or by negotiating GBLs at any particular level, historic or otherwise. Notably, all of the Mill's current generating turbines were installed after 1993, after the Commission approved the 3808 Agreement.

50. In reliance on the regulatory framework applicable to the FortisBC service area, Mercer through Celgar and the Celgar Partnership developed a business and investment strategy which, in pertinent part, focused on maximizing the Mill's return as a producer and seller of clean energy, as well as from traditional pulp production operations. Mercer had no intention of the Mill's trading in energy products, such as by moving in and out of the spot energy market depending upon pricing, but rather simply sought to operate two distinct and equally legitimate business lines through its investment in British Columbia. First, the pulp production line would purchase power needed for its manufacturing operations, in the same fashion as all other industrial users in the Province. The Celgar mill would *never* draw power from FortisBC in excess of the actual usage of its pulp plant and machinery. Second, the Mill's energy production line would draw upon the "black liquor" produced as a byproduct of its pulp operations, and burn this input, in part, to create clean energy for sale to third parties at commercial prices.

51. The company took several important steps to implement its business plan. First, following the acquisition of the Mill and energy generation facilities, it made strategic capital investments totaling approximately $102 million, focusing to a large extent on increasing energy production. This included the Celgar Green Energy Project, which — at a capital cost of $62 million — involved adding 48 MW of capacity, thereby nearly doubling the Mill's generation capacity to 100 MW. The Celgar Green Energy Project was approved on May 2, 2008, and immediately after approval the company committed to long-lead equipment orders in support of the Project.

52. Second, on August 21, 2008, the Celgar Partnership concluded negotiations and executed a Power Supply Agreement with FortisBC (the "2008 PSA") pursuant to which FortisBC agreed to supply all of the Celgar mill's load (*i.e.,* its energy requirements for pulp manufacturing) at FortisBC's average embedded cost of energy. This would consist of costs attributable to FortisBC's energy resources which include its own generation assets, a number of long term power purchase agreements, and the 3808 Agreement that FortisBC utilizes for both baseload and incremental energy purchases. This 2008 PSA would have enabled the Celgar mill, pursuant to the applicable business strategy, to sell its self-generated clean biomass energy at market prices, thus obtaining a competitive return on its investment in its separate energy business line, while continuing to operate its pulp production business line using energy inputs obtained on the same basis applicable to other industrial users in the Province. The Celgar Partnership and FortisBC filed the 2008 PSA with the Commission.

53. Third, on January 27, 2009, the Celgar Partnership finalized an energy sales agreement with BC Hydro (the "Celgar EPA"), under which BC Hydro became the primary purchaser of a portion of the Mill's energy production. The Celgar EPA was negotiated pursuant

to one of BC Hydro's public calls for proposals (the "Bioenergy Call for Power (Phase I)"), initiated in February 2008, as part of the Province's policy to promote green energy. Under the Celgar EPA, once the Celgar Partnership's Green Energy Project adding the new 48 MW turbine was completed, and the newly-installed generation assets achieved commercial operation, the Celgar mill would sell to BC Hydro all energy it produced above an established baseline. That baseline was set on a seasonal basis, but translated to roughly 40 MW on an hourly basis. Notably, this baseline was not intended as a GBL, as in the power displacement agreements BC Hydro had implemented in its own service territory, but rather simply as a point of demarcation establishing the parties' purchase and sale obligations.

54. Celgar and the Celgar Partnership had wished the Mill to be able to sell *all* of its energy production to BC Hydro, but BC Hydro declined to purchase any electricity below the 40 MW baseline. The understanding, set forth in a Side Letter, was that the Celgar mill could still sell energy below the 40 MWh baseline to other purchasers, provided that the Commission ultimately approved the Celgar-FortisBC plan reflected in the 2008 PSA, or a similar arrangement under which the Celgar Partnership proposed that the Mill purchase all or a portion of its electricity needs from FortisBC while selling self-generated electricity.

C. <u>The Challenged Measures</u>

55. These plans all were frustrated, however, by the measures challenged in this case. On May 6, 2009, the Commission issued Order G-48-09 and an accompanying Decision,[9] granting an application made by BC Hydro to amend the 3808 Agreement between FortisBC and

[9] Exhibit 10, British Columbia Utilities Commission, Order Number G-48-09 of May 6, 2009 ("Order G-48-09"); Exhibit 11, British Columbia Utilities Commission, *In the Matter of British Columbia Hydro and Power Authority and Application to Amend Section 2.1 of Rate Schedule 3808 Power Purchase Agreement*, Decision of May 6, 2009 ("Decision Accompanying Order G-48-09").

BC Hydro.[10] That proceeding addressed actions already being undertaken by the City of Nelson opportunistically to vary its purchases of embedded cost power from FortisBC (which FortisBC would obtain in part from BC Hydro under the 3808 Agreement), moving in and out of the market in order to benefit at particular times from selling self-generated power at market prices. All parties understood, however, that any ruling in the proceeding would also affect the 2008 PSA with FortisBC, pursuant to which the Celgar Partnership had agreed to purchase on a firm and consistent basis all of the Mill's needs from FortisBC, while selling all of the Mill's self-generated power (BC Hydro's application to amend the 3808 Agreement was filed with the Commission just three weeks after FortisBC filed the 2008 PSA with the Commission for its approval). The Celgar Partnership was a party to the proceeding as it explicitly addressed the Mill's situation as well as that of the City of Nelson.

56. The express purpose of the amendment was effectively to bar FortisBC from proceeding both with its existing sale of embedded cost power to the City of Nelson, and its planned sale of such power to the Celgar Partnership under the 2008 PSA, unless and until those self-generating customers first fully supplied their own power needs (their "load") through self-generation. The Commission expressly acknowledged that the then-existing legal framework did not bar FortisBC's sale of Heritage Power to meet the operating needs of customers with cogeneration capacity, while selling self-generated electricity, but it ordered that the 3808 Agreement be amended to add such a restriction. Under Order G-48-09, the 3808 Agreement was amended to state that "[t]he electricity purchased [by FortisBC from BC

[10] The Province of British Columbia, through the Ministry, another government entity for which Canada is internationally responsible, sought and received standing in the proceeding, and argued in favor of BC Hydro's position. *See* Exhibit 9, Final Argument of the Ministry of Energy, Mines and Petroleum Resources, *In the Matter of British Columbia Hydro and Power Authority and Application to Amend Section 2.1 of Rate Schedule 3808 Power Purchase Agreement*.

Hydro] under this agreement . . . shall not be sold to any FortisBC customer when such customer is selling self-generated electricity which is not in excess of its load."[11]

57. The effect of this measure was twofold. First, it blocked directly the Celgar mill's access to any BC Hydro Heritage Power while it was selling any of its self-generated electricity, to BC Hydro under the Celgar EPA, or to others. Second, it blocked indirectly the Mill's access to *any* embedded cost power from FortisBC, including power FortisBC generated from its own hydroelectric assets. FortisBC took the position that, because it was unable physically to segregate BC Hydro power from the other power sources making up its resource stack, the only way it could ensure that it was not transferring BC Hydro Heritage Power to the Celgar mill when the Mill was itself selling power was to refuse to supply *any* power to the Mill at those times.

58. The Commission made clear in the Decision accompanying Order G-48-09 that the self-generation requirement newly imposed on the Mill ("not in excess of its load") would apply to all of its *actual* Mill needs, as measured currently, and not simply to amounts set by reference to historic generating capacity. The Celgar mill was permitted to sell to the market only "power generated net of load on a dynamic basis."[12] In effect, Order G-48-09 required complete mandatory load displacement by the Mill. The order effectively permitted the Celgar mill only to sell energy "net of load," such that it was required entirely to self-supply the power needs of one of its business lines (the pulp operation) before it could offer the products of its second business line (clean power) for sale to the market. If it failed to do so, access to power from FortisBC would be cut off, leaving the mill stranded, subject only to its right to purchase

[11] Exhibit 11, Decision Accompanying Order G-48-09, at 31.

[12] *Id.* at 28, 29.

and wheel electricity to the mill through the open market — a scenario that would eliminate access to embedded cost power, including Heritage Power, and drastically reduce the value of the investment in generation assets and the profitability of energy sales. Because the Celgar mill is the only pulp mill in the FortisBC service area, the effect of the Commission's order was to impose this severe restriction only on one British Columbia pulp mill — Celgar's.

59. The limitation differed substantively from the far less restrictive limitations the Commission had imposed *de fact*o in the BC Hydro service area. There, as noted, the Commission had previously permitted and approved compensation to co-generators for load displacement agreements, as well as flexibility in establishing GBLs, while permitting such mills continued access to Heritage Power while they sold electricity. The only limitation they face is that they must use their own power to meet their mill load *only up to the amount of their historic GBL* — a restriction for which many received compensation. The Celgar mill, unlike the pulp mills in BC Hydro's service area, received no compensation for its mandatory load displacement, and no subsidy for its investment in clean biomass energy generation. The Mill also received, *de facto*, the most restrictive GBL possible — one tied to its current, actual mill load — whereas other pulp mills throughout the Province were less severely restricted.[13] Other pulp mills instead enjoy the benefits of GBLs set at generating capacity levels predating their incremental investment in expanded generating capacity, and that are significantly below their actual mill loads, while also enjoying access to low-cost Heritage Power.

[13] The Commission expressly acknowledged that its decision raised issues about whether there was a "level playing field" between self-generating utility customers in the FortisBC service territory and those in the BC Hydro service territory under Order G-38-01. Nevertheless, it expressly declined in that proceeding to impose a uniform policy applicable to all self-generators in the Province, or to initiate a new proceeding for such purpose. Exhibit 11, Decision Accompanying Order G-48-09, at 14–16, 21–22.

60. For example, BC Hydro's 2009 EPA with Tembec sets the GBL for its Skookumchuck mill at 14 MW, which coincides with its historical generation capacity from the 1990s. Although Tembec's actual mill load is 28 MW, it is permitted to sell all generation over 14 MW to the market, while making purchases of embedded cost power, that include Heritage Power, from BC Hydro, to service the (14 MW) balance of its actual mill needs. Similarly, under the terms of a 2008 agreement, Domtar's Kamloops mill is obligated to self-supply only 20 MW, based on its historical generating capabilities from the 1970s. The Domtar mill's current load is 50 MW. Thus, Domtar is permitted to sell to the market all generation above 20 MW, while making purchases of embedded cost power that include Heritage Power, from BC Hydro, to service the 30 MW balance of its mill load. The Port Mellon mill owned by Howe Sound apparently has a similar arrangement, in which it will self-supply only about 20 percent of its mill load requirements, purchasing far in excess of 400 GWh/year from BC Hydro to service its load while at the same time selling 400 GWh/year of its own generation output to BC Hydro. Canfor's Prince George mill apparently also is able to sell a portion of its self-generation that was previously used to supply mill load, while purchasing embedded cost power that includes Heritage Power from BC Hydro to satisfy an increased portion of its load requirements. Under the recently-announced (January 4, 2012) agreement between BC Hydro and Nanaimo, Nanaimo (it appears, based on publicly disclosed information) will be obligated to self-supply slightly less than 50 percent of its mill load while selling power in excess of such amount to BC Hydro. In each case, the mill receives the benefit of Heritage Power denied, in similar circumstances, to the Celgar mill.

61. Order G-48-09 thus altered the regulatory landscape that applied to the Mill's energy sales. It did so in a way that placed the Mill in a uniquely disadvantaged position in the

Province. It enjoyed none of the benefits the BC Hydro had agreed to provide, and the Commission had authorized it to provide, to competing pulp mills in the BC Hydro service area, such as development subsidies for expanding cogeneration capability and compensation for load displacement. Under Order G-48-09, the Commission took away the one benefit that the Celgar mill enjoyed to the exclusion of BC Hydro's customers — the ability to sell self-generated energy without limitation — and replaced that benefit (at BC Hydro's and the Province of British Columbia's urging) with an actual "net of load" restriction more severe than it required from any pulp mill in BC Hydro's service area. Thus, the Celgar mill became the only pulp mill in the Province effectively required by Commission Order to apply all of its self-generation to mill load before being able to sell any electricity in the market.

62. Following the Commission's issuance of Order G-48-09, the Celgar Partnership commenced a second proceeding requesting that it remedy just this last difference in regulatory treatment. It reminded the Commission of BC Hydro's practice of establishing GBLs for its customers at historic generation levels well below actual mill load. Because FortisBC considered itself constrained by Order G-48-09 from voluntarily agreeing to any GBL for the Celgar mill that was below actual Mill load, the Celgar Partnership requested that the Commission determine a GBL for the Mill on a basis that would be comparable to the GBLs the Commission had previously approved for mills in BC Hydro's service area — namely, a GBL based on an historical generation capacity level. On October 19, 2010, the Commission refused to establish a GBL for the Celgar mill, suggesting in Order G-156-10 and an accompanying Decision[14] that any GBL was a matter for FortisBC's discretion. The Commission later denied

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[14] Exhibit 12, British Columbia Utilities Commission, Order Number G-156-10 of October 19, 2010 ("Order G-156-10"); Exhibit 13, British Columbia Utilities Commission, *In the Matter of FortisBC Inc. 2009 Rate Design and Cost of Service Analysis*, Decision of October 19, 2010 ("Decision Accompanying Order G-156-10").

reconsideration of its ruling, through Order G-3-11 and an accompanying Decision issued on January 12, 2011.[15] The Commission thus firmly relegated the Celgar mill to being the only pulp mill with self-generation capacity in the Province that lacked a GBL, much less one using an historical reference point, and that could only sell energy "net of load."

63. By virtue of the mandatory load displacement measure ordered by the Commission at BC Hydro's request, and the Commission's subsequent refusal to establish any GBL for the Celgar mill comparable to those it approved for mills in BC Hydro's service area, the Mill's sales of electricity were significantly more limited than they otherwise would have been, and the profitability of its energy operations was much reduced. Indeed, much of the benefit of Mercer's investment in cogeneration facilities at the Celgar mill was diverted to others, without any compensation to Mercer.

64. In particular, BC Hydro could continue to offer to the market (at higher rates) the power that it otherwise would have been required to sell to FortisBC at embedded cost rates, for FortisBC to cover the Mill's energy needs. The Commission has itself acknowledged that BC Hydro was the immediate economic beneficiary of its measures,[16] stating in the Decision accompanying Order G-156-10 that had the Mill been able to purchase its mill load at embedded

[15] Exhibit 14, British Columbia Utilities Commission, Order Number G-3-11 of January 12, 2011 ("Order G-3-11"); Exhibit 15, British Columbia Utilities Commission, *In the Matter of an Application by Zellstoff Celgar Limited Partnership for Reconsideration of Commission Order G-156-10 and the Reasons for Decision regarding the FortisBC Inc. 2009 Rate Design and Cost of Service and Analysis Application*, Decision of January 12, 2011 ("Decision Accompanying Order G-3-11").

[16] It is a factual question, potentially relevant for later proceedings, whether BC Hydro passes through to its ratepayers *all* of the benefits it gains from being able to sell (at export prices) the additional energy it otherwise would have had to supply to the Celgar mill through FortisBC (at embedded cost rates). BC Hydro claimed, in the proceedings before the Commission, that its motivation at all times was to protect the interests of its other ratepayers. However, whether the benefits of Mercer's investment in cogeneration at the Mill have been diverted simply to BC Hydro, or ultimately to BC Hydro's other ratepayers, is not critical. The relevant point is that those benefits have been diverted from Mercer — which made the underlying investments that made self-supply of power possible in the first place — in violation of the investment protection principles of NAFTA.

cost rates the way other industrial facilities in FortisBC's region are permitted to do for their power needs, this "would oblige BC Hydro to pay incremental prices for the power or lose export opportunities."[17] In other words, BC Hydro gains export opportunities (at commercial rates) that are directly proportionate to the Celgar mill's loss of export opportunities, for power generated as a result of an entirely self-financed investment in new generating capacity.

65. The Celgar Partnership continued to fight against the discriminatory and unfair treatment it was receiving from BC Hydro and the Commission. On March 25, 2011, the Celgar Partnership filed a Complaint before the Commission against FortisBC, asking the Commission to establish terms for a general services agreement between the Celgar Partnership and FortisBC. The proceeding raised several issues concerning the terms and rates under which the Celgar mill could obtain power from FortisBC, and thus afforded the Commission an opportunity to revisit its earlier Orders insofar as FortisBC was constrained by those Orders. On November 14, 2011, the Commission issued Order G-188-11 and an accompanying Decision,[18] which further modified the energy regulatory regime applicable to the Mill. The Commission continued the absolute ban on the Mill's access to any Heritage Power from BC Hydro under the 3808 Agreement, while it was selling any power net of load. However, it opened the door for the Mill to obtain "some" amount of FortisBC's own embedded cost power, from other power resources available to FortisBC *other* than BC Hydro Heritage Power. Yet the company was not permitted to negotiate such an agreement directly with FortisBC, in the same manner as the owners of

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[17] Exhibit 13, Decision Accompanying Order G-156-10, at 103. In addition to BC Hydro's role as the largest electrical utility in the Province and often the supplier of last resort, it buys and sells power on domestic and international markets through its subsidiary, Powerex. BC Hydro books substantial revenues as a result of its export sales.

[18] Exhibit 16, British Columbia Utilities Commission, Order Number G-188-11 of November 14, 2011 ("Order G-188-11"); Exhibit 17, British Columbia Utilities Commission, *In the Matter of Zellstoff Celgar Limited Partnership,* Decision of November 14, 2011 ("Decision Accompanying Order G-188-11").

other pulp mills had been able to negotiate similar agreements for access to embedded cost power with BC Hydro. Instead, the Commission set some directives for determining Celgar's entitlement to non-PPA embedded cost power and ordered FortisBC first to consult with "all classes of its customers to determine guidelines for the level of non-PPA embedded cost power to which eligible self-generation customer should be entitled," before returning to the Commission with a proposal by March 31, 2012[19] (a deadline that was later extended to April 13, 2012).

66. Specifically, the Commission first resolved FortisBC's concern that supplying any power at all to the Celgar mill when it was selling its own cogenerated power would put FortisBC automatically in violation of its amended 3808 Agreement with BC Hydro. The Commission determined that FortisBC could establish and apply a "notional matching" method that would involve FortisBC purchasing *non*-Heritage Power on the open market, in amounts that would need to coincide with the Mill's sales of self-generation. In other words, FortisBC, for example, could sell 10 MW hours of electricity to the Mill if it could establish a methodology to evidence that it made a notional purchase of energy from a non-Heritage Power source, and thereby "demonstrate" that it was not drawing the power from BC Hydro under the 3808 Agreement to serve the power needs of the Mill. Second, the Commission determined that the Celgar mill was entitled to "some amount of FortisBC's non-BC Hydro PPA embedded cost power when selling power."[20]

67. The effect of Order G-188-11 was twofold. First, it provided for a notional matching mechanism through which FortisBC will be able to segregate Heritage Power from its

[19] Exhibit 17, Decision Accompanying Order G-188-11 at 38.

[20] *Id*.

resource stack, so as to enable FortisBC to sell electricity to the Celgar mill while it exports self-generated electricity. Secondly, it recognized an entitlement in favor of the Mill to receive "some amount" (not determined under the Order) of electricity from its utility when selling its own power, at a "made-for-Celgar" embedded cost rate that excludes all benefits that would otherwise be derived from the hived-off Heritage Power.

68. This decision did not resolve the Province's unduly discriminatory treatment of Mercer's investment in British Columbia. It only further complicated it. Alone among pulp mills with self-generating capacity in British Columbia, the Celgar mill still is denied any access to Heritage Power from BC Hydro while it also is selling power. And while the Mill nominally will be permitted to buy "some" power from FortisBC, it can do so only under a made-for-Celgar scheme whereby FortisBC first is required to go out and buy the equivalent notional amount of power on the open market, to establish that it can sell power to the Mill without drawing on PPA power acquired from BC Hydro under the 3808 Agreement. This scheme necessarily will increase FortisBC's costs and thus the price to be paid by the Mill. Finally, the Mill was subjected to a discriminatory process whereby FortisBC was required first to consult with its other customers, to determine their views of any impact, before proposing how much power it can sell to the Celgar mill.

69. Admittedly, FortisBC reported to the Commission earlier this month that following its consultation process, it had concluded that "in light of the Fair Treatment and Re-Entry provisions of the Access Principles," it has an obligation to serve up to 100 percent of Celgar's expected plant load with non-PPA embedded cost power.[21] It remains to be seen

[21] Exhibit 22, FortisBC, Inc., *Guidelines for Establishing Entitlement to Non-PPA Embedded Cost Power and Matching Methodology, Order G-188-11 Compliance Filing*, April 13, 2012, at 9.

whether the Commission actually will accept this conclusion. Even if it does, however, the conclusion does not remove the inherent unfairness of the "specially made-for-Celgar" process, restore any access whatsoever to Heritage Power, or begin to remedy the substantial harm Mercer already has suffered through discriminatory treatment of its investment.

70. The fact remains that both the substantive and procedural regulatory regime by which the Mill will obtain power is exclusive to it among all pulp mills in British Columbia. While uncertainty still remains, under any interpretation the regime ensures that: (i) the ability to purchase electricity to meet the needs of the Celgar mill while it is selling self-generated electricity has been limited, and will continue to be limited, in a way that applies to Celgar alone among pulp mills in British Columbia; and (ii) the price the Mill will pay for such power is higher than if it were afforded similar access to embedded cost power including Heritage Power as is every other pulp mill in British Columbia. The current regulatory regime continues to deprive Mercer of much of the benefit of its investment in self-generation at the Celgar mill, by effectively limiting to date its access to embedded cost power, and by permanently cutting off the Mill's access to BC Hydro Heritage Power made available to its competitor pulp mills.

71. Moreover, this forced diversion of the benefits of the investment to BC Hydro (a provincial Crown corporation expressly deemed an agent of the government) has been implemented without any consideration of principles of equal treatment. As discussed above, the approach that BC Hydro and the Commission have adopted vis-à-vis the Celgar mill is fundamentally inconsistent and irreconcilable with the more favorable practices adopted vis-à-vis other similarly situated investors in pulp mills in the Province. It is based on the imposition of selectively restrictive policies on the Celgar mill (which is not BC Hydro's customer), without

any attempt to impose similar policies on the Mill's direct competitors (who are BC Hydro's customers).

72. This unequal treatment cannot be rationally explained by the fact that the Celgar Mill is located outside BC Hydro's service territory. Indeed, the Commission continues to discriminate against the Mill even *within* FortisBC's territory. This is confirmed by a new Commission decision issued on December 1, 2011 involving the Canadian-owned company Tolko Industries Ltd., which operates a sawmill that includes a biomass plant in Kelowna, BC. The power plant includes a turbine that generates electricity both for operating the sawmill and for sale to third parties. Following the Commission's issuance of Order G-48-09, Tolko in March 2011 sought affirmation from the Commission of an October 25, 2001 Order[22] that had established a 2 MW GBL for its power plant, allowing it in principle to sell all of its generated power above that GBL — even though such power had previously and up to such date been utilized to supply its own load — while simultaneously accessing Heritage Power from BC Hydro through the City of Kelowna. As a practical matter, Tolko never availed itself of this opportunity, so its March 2011 application essentially sought confirmation that it now could begin selling its self-generated power, based on the 2001 Order. It was clear that the previously approved GBL of 2MW did not represent Tolko's actual net load, which was significantly higher.

73. The Celgar Partnership participated in the Tolko proceeding, and explicitly urged the Commission to use that proceeding to ensure equal treatment. For example, the Celgar Partnership stated as follows:

[22] The Commission's favorable 2001 Order followed a Provincial Order in Council specifically issued on Tolko's behalf, providing policy direction to the Commission. The Province's past intervention on behalf of Tolko stands in further stark contrast to its treatment of the Celgar mill.

> Celgar submits that if the net of load criteria applies to Celgar it must also apply to Tolko. Conversely, if the net of load criteria does not apply to Tolko then it should not apply to Celgar. Celgar further submits that if a GBL is available to Tolko it must also be available to Celgar.[23]

74. BC Hydro, in turn, noted that Tolko's application necessarily would have an impact on BC Hydro, albeit indirectly:

> Tolko has acknowledged that if it does begin to sell its Incremental Power, that has to date been used to first serve its load, then it assumes it will need to increase its energy purchases from the City of Kelowna. If these increased energy requirements would be ultimately sourced from the PPA [through FortisBC], then BC Hydro's energy requirements would increase. The consequence of Tolko's change in use of its generation and increased purchase requirements would, in that case, impact BC Hydro and its ratepayers.[24]

75. The requested (re)approval of Tolko's entitlement to sell power not in excess of its own operating requirements, while replacing such power with electricity from FortisBC, inclusive of Heritage Power, would have the same effect (other than as to magnitude) as that of a similar approval granted to the Celgar mill. Nonetheless, in an Order and accompanying Decision dated December 1, 2011,[25] the Commission granted Tolko's application, without imposing any of the special requirements (non-BC Hydro sources, notional matching, consultation with other ratepayers, etc.) that it had imposed on the Celgar mill.

76. The Commission's decision in the Tolko case reveals the true depth of the unequal treatment to which Mercer's investment in British Columbia has now been relegated.

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[23] Exhibit 18, Final Submission of Zellstoff Celgar Limited Partnership, June 17, 2011, *Re: An Application by Tolko Industries Ltd. — Kelowna Division for Reaffirmation of its Ability to Sell Power Generation In Excess of the First 2MW of Generation,* at ¶ 7.

[24] Exhibit 19, Final Submission of BC Hydro, June 17, 2011, *Re: An Application by Tolko Industries Ltd. — Kelowna Division for Reaffirmation of its Ability to Sell Power Generation In Excess of the First 2MW of Generation,* at page 3.

[25] Exhibit 20, British Columbia Utilities Commission, Order Number G-198-11 of December 1, 2011 ("Order G-198-11"); Exhibit 21, British Columbia Utilities Commission, *Re: An Application by Tolko Industries Ltd. — Kelowna Division for Reaffirmation of its Ability to Sell Power Generation In Excess of the First 2MW of Generation,* Decision of December 1, 2011 ("Decision Accompanying Order G-198-11").

This discriminatory treatment has been applied on a Province-wide basis, in both BC Hydro's service territory and now within FortisBC's territory. The effect is to seriously harm the Mill's competitive position vis-à-vis other pulp mills in British Columbia. As a direct result of these measures, the Celgar mill has moved from being first overall to being in the bottom third, on a competitive cost curve, amongst pulp mills in British Columbia with self-generation capacity.

V. NAFTA VIOLATIONS

A. <u>Canada's Responsibility under NAFTA</u>

77. Under NAFTA and applicable principles of international law, Canada is responsible not only for the actions of central government officials, but also by officials in the Province of British Columbia. This accepted rule of State responsibility clearly extends to provincial governments and ministries including but not limited to the Ministry, and to provincial regulatory entities like the Commission.

78. Canada also is responsible for the actions of BC Hydro, which qualifies as a "state enterprise" under Article 1505 of NAFTA. Article 1503(2) of NAFTA confirms that Canada has a direct responsibility to ensure that state enterprises like BC Hydro act consistently with Chapter Eleven obligations "wherever such enterprise exercises any regulatory, administrative or other governmental authority that [Canada] has delegated to it." In this case, at relevant times, BC Hydro specifically claimed to be acting in the interest of its ratepayers as a whole when it sought a Commission order amending the 3808 Agreement knowingly and intentionally to the detriment of the Celgar mill, while simultaneously according more favorable treatment to other pulp mills in the Province with respect to a resource over which BC Hydro exercises monopoly power. By its own statements, therefore, this action was governmental rather than private in nature. Indeed, as previously noted, the legislation that establishes BC Hydro (the Hydro and

Power Authority Act) explicitly states, in Section 3(1), that "[t]he authority is for all its purposes an agent of the government and its powers may be exercised only as an agent of the government."[26] Further, and as previously noted, the Province also directly argued in favor of the disputed measure.

79. As discussed more fully below, the actions of the Province, including directly as well as through the Commission, constitute breaches of Canada's obligations under Section A of Chapter Eleven, and the actions of BC Hydro denote a breach of Canada's obligation under Article 1503(2) of NAFTA. By reason of Canada's breach of its obligations, Mercer, an investor of a Party as defined in Section C of NAFTA Chapter Eleven, has incurred damages in relation to Celgar, an investment of Mercer as also defined in Section C of Chapter Eleven. Hence, Mercer is entitled to compensation for Canada's failure to comply with its obligations.[27]

80. The particular NAFTA breaches are detailed below.

B. <u>Canada's Breach of Obligations Under Article 1503(2) — State Enterprises</u>

81. First, Canada is directly responsible for its own breach of obligations under Article 1503(2) of NAFTA. Article 1503(2) requires Canada to "ensure, through regulatory control, administrative supervision or the application of other measures, that any state enterprise that it maintains or establishes acts in a manner that is not inconsistent with [Canada's] obligations under Chapter Eleven . . . wherever such enterprise exercises any regulatory, administrative or other governmental authority that the Party has delegated to it."

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[26] The Hydro and Power Authority Act [RSBC 1996], Chapter 212, Section 3(1), *available at* http://www.bclaws.ca/EPLibraries/bclaws_new/document/ID/freeside/00_96212_01#section 1.

[27] In Articles 1116(1) and 1117(1) of NAFTA, Canada has consented to arbitration of any claims that it has breached an obligation under Section A of Chapter Eleven, or Article 1503(2).

82. BC Hydro qualifies as a State enterprise in the Province, and it has expressly been deemed to be an agent of the government for all of its actions. As discussed below, its actions vis-à-vis the Celgar mill have been fundamentally inconsistent with the obligations established in Chapter Eleven of NAFTA, and Canada is directly responsible for failing to ensure that BC Hydro acted in a manner that was not inconsistent with such obligations.

C. Canada's Breach of Obligations Under Articles 1102 and 1103 — National Treatment and Most-Favored Nation Treatment

83. NAFTA Article 1102, in subsections (1) and (2), obligates Canada to accord to Mercer and its investments in Canada "treatment no less favorable" than that it accords to investors of Canadian nationality and to their investments, "with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments." The NAFTA Parties explicitly confirmed, in Article 1102(3), that constituent provinces (such as British Columbia) are required to honor these obligations, providing foreign investors and their investments "treatment no less favorable than the most favorable treatment accorded, in like circumstances, by that . . . province" to national investors.

84. Similarly, Article 1103 in subparagraphs (1) and (2), obligates Canada to accord to Mercer and its investments in Canada "treatment no less favorable" than that it accords to investors that are nationals of any other State or to their investments. In essence, this most-favored nation requirement requires that Canada treat investors from the United States as well as it treats investors from any other country.

85. In effect, these NAFTA provisions make it illegal for Canada to discriminate against a U.S. investor's activities in Canada, in comparison with any other investor (whether a Canadian national or a national of another State) that is in "like circumstances." For purposes of

this standard, the relevant comparator is investors in the same economic or business sector as the Celgar mill, who serve as its market competitors. That includes without doubt all other pulp mills in British Columbia with electricity co-generation facilities, that also purchase electricity; the Celgar mill competes directly in the sale of pulp and in the purchase of pulp logs and wood chips with pulp mills throughout the Province. Arguably, the comparator might also include other industrial users that also self-generate electricity in the Province.

86. A measure need not be discriminatory on its face (*de jure*) to violate Articles 1102 and 1103. These NAFTA provisions may be violated by measures that are neutral on their face but that have a discriminatory effect, either as a natural consequence of their terms or because of the particular way they have been implemented. The key inquiry under NAFTA is into the impact of the measures, *i.e.,* whether they effectively have altered competitive relationships by treating a particular foreign investor or investment less favorably than similarly situated investments owned by nationals or investors of other States.

87. Here, as discussed above, the actions (and failures to act) of the Province, the Commission, and/or BC Hydro clearly violated Articles 1102 and 1103. They have singled out the Canadian operations of Mercer, a single U.S. investor, for treatment regarding the sale of self-generated energy that is far more restrictive than that afforded to all other pulp mills with cogeneration capacity in the Province. These other pulp mills have been permitted to obtain significant value from their investment in increased cogeneration, both: (i) directly through development subsidies and as compensation for load displacement agreements; and (ii) indirectly by allowing them to service a portion of their actual mill loads with Heritage Power purchased at regulated, embedded cost rates, while simultaneously selling at higher market rates all of their co-generated power above GBLs set at historic load or generation levels that are significantly

below current mill loads. By contrast, BC Hydro affirmatively intervened to request, and the Commission thereafter ordered (by Order G-48-09), an amendment of BC Hydro's 3808 Agreement with FortisBC for the express purpose of preventing FortisBC from selling embedded-cost Heritage Power to the Celgar mill, unless and until it has actually satisfied its entire Mill load (measured on a current, dynamic basis rather than utilizing any historic GBL) with its own co-generated energy. Moreover, the Province, represented by the Ministry, registered as a party (intervener) in the proceeding and argued in support of BC Hydro's position.[28]

88. Commission Order G-48-09: (1) restricted the amount of energy the Celgar mill can sell at market rates to a greater extent than could be sold by other pulp mills, and (2) restricted access to embedded cost power, through restricting access to Heritage Power generated by BC Hydro, in a different manner and to a greater extent than such access afforded to other British Columbia pulp mills. Commission Order G-188-11 then subjected the Mill to a requirement to undergo a discriminatory process (which to date has not been fully completed) as a mechanism for determining the amount of non-BC Hydro embedded cost power it may in the future obtain, including a discriminatory notional matching mechanism and a discriminatory requirement that its utility first invite comment on the Mill's service from other ratepayers. (As this process unfolds, there may well be additional discriminatory impacts on Mercer's investment in the Celgar mill, as to which it reserves its rights.) Individually and in combination, since May of 2009 these measures have prevented and will continue to prevent Mercer from

[28] Exhibit 9, Final Argument of the Ministry of Energy, Mines and Petroleum Resources, *In the Matter of British Columbia Hydro and Power Authority and Application to Amend Section 2.1 of Rate Schedule 3808 Power Purchase Agreement*.

obtaining the same kind of value from its investment in increased co-generation at the Celgar mill as has been possible for all other pulp mills in the Province.

89. The Province, the Commission, and BC Hydro all have expressly acknowledged this differential treatment. BC Hydro has admitted in filings in regulatory proceedings that there are several other industrial customers in the Province with self-generation capacity who are being permitted to sell self-generated power and purchase embedded cost power that includes Heritage Power on a basis that is inconsistent with the treatment being applied only to the Celgar mill. Some of these competitors are Canadian-owned (such as Tembec, Canfor and Tolko), while others are owned by investors of other nationalities (such as Howe Sound, which is currently controlled by a Dutch company). Another competitor (Domtar) is U.S.-owned, but has been granted more favorable treatment than the Celgar mill without rational distinction. The Commission also expressly acknowledged, in its Decision accompanying Order G-48-09, that the resulting legal framework does not necessarily supply a "level playing field" within the relevant industry segment,[29] but considered that "the issue of equity between pulp mills in BC falls outside the Commission jurisdiction."[30] The Province recognized in its argument filed in the G-48-09 proceedings that in certain cases "it may be appropriate for self-generating customers to sell to market electricity that is in excess of its historical generation baselines,"[31] as opposed to energy net of load.

[29] Exhibit 11, Decision Accompanying Order G-48-09, at 14–16, 21–22.

[30] Exhibit 13, Decision Accompanying Order G-156-10 at 115; *see also* Exhibit 17, Decision Accompanying Order G-188-11 at 25.

[31] Exhibit 9, Final Argument of the Ministry of Energy, Mines and Petroleum Resources, *In the Matter of British Columbia Hydro and Power Authority and Application to Amend Section 2.1 of Rate Schedule 3808 Power Purchase Agreement*.

90. The impact on Mercer of this admittedly "less favorable treatment" of its investment in Canada has been considerable. Canada is thus directly liable for compensation for the Province and the Commission's violation of Articles 1102 and 1103 of NAFTA, and indirectly liable — through Article 1503(2) — for BC Hydro's violation of Articles 1102 and 1103.

D. Canada's Breach of Obligations Under Article 1105 — Minimum Standard of Treatment

91. NAFTA Article 1105(1) obligates Canada to accord to Mercer's investments in Canada "treatment in accordance with international law, including fair and equitable treatment and full protection and security." The notion of "fair and equitable treatment" has been interpreted to bar irrational, arbitrary or discriminatory changes in legal framework, particularly those that are contrary to reasonable investment-backed expectations.

92. In this case, Mercer was entitled to expect that it would be able to receive the economic benefits of its investment (through Celgar and the Celgar Partnership) in green cogeneration facilities in the Province. As the Commission expressly acknowledged in its Decision Accompanying Order G-48-09, the 3808 Agreement between FortisBC and BC Hydro — which was in place at the time of the investments in incremental energy production — did not prohibit FortisBC from selling low-cost power to the Celgar mill to service its load, while the Mill was separately selling its own self-generated power to others.[32] Mercer reasonably relied on this pre-existing legal framework in making its various investments in Celgar, and in reaching agreement (through the Celgar Partnership) with FortisBC in the

[32] Exhibit 11, Decision Accompanying Order G-48-09, at 19 (finding that "the provisions of the [3808 Agreement] do not specifically address the kinds of transactions now before it," and therefore that Order G-48-09 cannot be seen as involving simply "clarification" of the prior legal framework, but rather involves new action changing the preexisting legal framework).

2008 PSA to proceed with core elements of its business plan. Mercer also reasonably relied on the notion (reflected in NAFTA) that any changes in policy or legal framework that the Province later might implement would be applied on a fair and equitable basis, and not selectively to disadvantage its investment, particularly vis-à-vis its competitors.

93. The Commission's subsequent decision to amend the 3808 Agreement effectively to *block* the proposed FortisBC-Celgar transactions, and instead to require the Celgar mill to self-supply its entire load, was contrary to Mercer's legitimate investment-backed expectations. As discussed above, it also effectively diverted a significant portion of Mercer's investment for the benefit of others, and drew distinctions among pulp mills in the Province that are arbitrary, irrational and discriminatory. These measures violated not only Mercer's legitimate expectations of a stable business and legal environment but also its legitimate expectations of fair and equitable treatment vis-à-vis its competitors. All of this constitutes a clear violation of the fair and equitable treatment obligation incorporated explicitly into Article 1105 of NAFTA.

94. The Commission's subsequent decision to allow FortisBC effectively to segregate Heritage Power within its resource stack so as to deny the Mill access to such Heritage Power, did not correct the prejudice being suffered. It only compounded it by subjecting the Celgar mill to unfair and inequitable notional matching requirements, and "made-for-Celgar" consultation requirements to determine the amount of non-BC Hydro embedded cost power it will be permitted to purchase in future.

VI. ISSUES RAISED

95. Has the Government of Canada, through entities for which it is internationally responsible, taken measures inconsistent with its obligations under Articles 1102, 1103, 1105, or 1503(2) of NAFTA?

96. If the answer to this question is yes, what is the quantum of compensation to be paid to the Investor as a result of the failure of the Government of Canada to comply with its obligations under NAFTA?

VII. RELIEF SOUGHT AND APPROXIMATE AMOUNT OF DAMAGES CLAIMED

97. Because these issues have not been resolved through amicable consultations, Mercer requests the following relief:

(a) Damages for the full measure of direct losses and consequential damages sustained as a consequence of the measures that are inconsistent with Canada's obligations contained within Part A of Chapter Eleven and Article 1503(2) of NAFTA, which have been accruing at a rate of **C$ 19 million per year** to date, and, should the *status quo* remain unchanged, would total **C$ 250 million** on a net present value basis;

(b) The full costs associated with these proceedings, including all professional fees and disbursements, as well as the fees of the arbitral tribunal and any administering institution;

(c) Pre-award and post-award interest at a rate to be fixed by the Tribunal;

(d) Payment of a sum of compensation equal to any tax consequences of the award, in order to maintain the award's integrity; and

(e) Such further relief as the Arbitral Tribunal may deem just and appropriate.

VIII. THE AGREEMENT TO ARBITRATE

98. The text of the agreement to refer this dispute to arbitration under the Additional Facility Rules is set forth in Chapter 11 of NAFTA, wherein Canada made a unilateral offer to submit to arbitration claims for breaches of a substantive obligation of that Chapter and of

Article 1503(2). Mercer hereby accepts Canada's offer, thus forming the agreement to arbitrate between the parties to the dispute. NAFTA entered into force on January 1, 1994, and remains in force between Canada and the United States. In accordance with Article 4(a) of the Additional Facility Rules, a copy of NAFTA is attached to this Request for Arbitration as Exhibit 1.

99. Article 1122(1) sets forth Canada's "consent[] to the submission of a claim to arbitration in accordance with the procedures set out in this Agreement." Article 1122(2)(a) clarifies that "[t]he consent given by paragraph 1 and the submission by a disputing investor of a claim to arbitration shall satisfy the requirement of . . . the Additional Facility Rules for written consent of the parties."

100. Articles 1120(1)(b), 1116(2) and 1117(2) impose certain temporal limitations on the submission of a claim to arbitration. Pursuant to Article 1120(1)(b), an investor may bring a claim only once "six months have elapsed since the events giving rise to a claim." In accordance with Articles 1116(2) and 1117(2), however, an investor may not make a claim "if more than three years have elapsed from the date on which" the investor or its enterprise first acquired actual or constructive knowledge of the NAFTA breach and the fact that the investor has incurred loss or damage as a result. Provided these conditions are met, Article 1120(1)(b) the disputing investor may "submit the claim to arbitration under . . . the Additional Facility Rules of ICSID, provided that either the disputing Party or the Party of the investor, but not both, is a party to the ICSID Convention."

101. In addition to the temporal limitations, Articles 1119 and 1121 place two further conditions upon the submission of a claim: (1) in accordance with Article 1119, an investor must "deliver to the disputing Party written notice of its intention to submit a claim to arbitration

at least 90 days before the claim is submitted;" and (2) pursuant to Article 1121, the investor and its enterprise must provide certain consent and waivers.

102. Mercer has satisfied each of the requirements for submission of its claims to arbitration.

103. With respect to the temporal requirements, more than six months have elapsed from the May 6, 2009 issuance of Order G-48-09, which is the earliest date on which Mercer and Celgar first could acquire knowledge of the claims articulated in this Request. Mercer submits this Request on April 30, 2012 — *i.e.*, within the three-year deadline contemplated by Articles 1116(2) and 1117(2).

104. Mercer also has satisfied the other conditions for submitting this claim to arbitration, having delivered in writing to Canada on January 26, 2012 — more than 90 days before the filing of this Request — notice of its intent to pursue its claims through arbitration. A copy of the Notice of Intent, along with a letter from the Government of Canada confirming receipt of the Notice of Intent on January 26, 2012, is submitted herewith as Exhibit 2. The parties have engaged in certain discussions regarding the issues raised in the Notice of Intent, but have failed to resolve the issues in dispute.

105. Mercer, Celgar, and (for the avoidance of doubt) the Celgar Partnership have each provided the requisite consent to arbitration under the Additional Facility and waiver in the form contemplated by Article 1121 of NAFTA. Executed declarations of consent and waivers in accordance with Article 1121(3) are attached to this Request for Arbitration as Exhibit 3. Each entity has taken all necessary internal actions to authorize this Request for Arbitration and the accompanying consent to arbitration and waiver. The corresponding Board Resolutions of Mercer and Celgar that contain such authorization are attached as Exhibit 4.

106. Specifically, in the documents attached as Exhibit 3, Mercer, Celgar, and (for the avoidance of doubt) the Celgar Partnership, consent to arbitration in accordance with the procedures set out in NAFTA. Each entity also waives its right to initiate or continue before any administrative tribunal or court under the laws of any Party, or any other dispute settlement procedures, any proceedings with respect to the measures of the Government of Canada and/or the Province of British Columbia alleged to be breaches of NAFTA obligations referred to in Articles 1116 or 1117 of NAFTA, except for proceedings for injunctive, declaratory or other extraordinary relief, not involving the payment of damages, before an administrative tribunal or court under the laws of Canada and/or of the Province of British Columbia.

107. Mercer has duly authorized the following law firms to represent it in this matter and, in particular, to submit this Request for Arbitration. A Power of Attorney confirming this authorization is attached to this Request as Exhibit 5. Correspondence should be served upon counsel at the addresses listed below:

a. ARNOLD & PORTER LLP
555 Twelfth St., N.W.
Washington, D.C. 20004
United States of America
Phone: 202-942-5000
Fax: 202-942-5999

Michael T. Shor	michael.shor@aporter.com
Jean E. Kalicki	jean.kalicki@aporter.com
Mallory Silberman	mallory.silberman@aporter.com

b. SANGRA MOLLER LLP
1000 Cathedral Place
925 West Georgia Street
Vancouver, British Columbia
Canada V6C 3L2
Phone: 604-662-8808
Fax: 604-669-8803

Kim Moller	kmoller@sangramoller.com

IX. APPROVAL FOR ACCESS TO THE ADDITIONAL FACILITY

108. Though the Secretary-General has not yet formally approved the parties' agreement to arbitrate under the Additional Facility Rules, Mercer hereby requests such approval. Each of the requirements of Articles 2(1) and 4(2) of the Additional Facility Rules has been satisfied in this case.

109. Pursuant to Article 2(1)(a), the Secretariat of the Centre is authorized to administer arbitration proceedings between a State and a national of another State "arising directly out of an investment which are not within the jurisdiction of the Centre because either the State party to the dispute or the State whose national is a party to the dispute is not a Contracting State . . . ." As demonstrated throughout this Request, the dispute is a legal one arising out of Mercer's investment in Celgar and the Celgar mill. While Mercer is a limited liability company organized under the laws of a Contracting State Party to the ICSID Convention (the United States), and is thus an "enterprise" and "investor" of a Party pursuant to NAFTA Article 1139 and a "national of another State" within the meaning of the ICSID Convention, Canada has not yet deposited an instrument of ratification, acceptance, or approval of the Convention. It is therefore appropriate to initiate arbitration proceedings under Additional Facility Rule 2(a).

110. For the avoidance of doubt, and in the unlikely event that Canada ratifies the ICSID Convention so that the jurisdictional requirements of Article 25 of the Convention are met at the time when proceedings are initiated, Mercer hereby consents to the jurisdiction of the Centre under Article 25 of the Convention.

X. AGREED PROVISIONS REGARDING THE NUMBER OF ARBITRATORS AND THE METHOD OF THEIR APPOINTMENT

111. Pursuant to Article 1123 of NAFTA, Mercer proposes that this dispute be decided by three arbitrators, with one arbitrator appointed by each of the disputing parties. Mercer proposes that the third (presiding arbitrator) be appointed by agreement of the parties, or failing such agreement, by the two party-appointed arbitrators in consultation with the parties themselves.

Respectfully submitted,

Michael T. Shor/JEK

Michael T. Shor
Jean E. Kalicki
Mallory Silberman

ARNOLD & PORTER LLP
555 Twelfth St., N.W.
Washington, D.C. 20004
United States of America
Tel. +1 202 942 5000
Fax + 1 202 942 5999

Kim Moller

SANGRA MOLLER LLP
1000 Cathedral Place
925 West Georgia Street
Vancouver, British Columbia
Canada v6C 3L2
United States of America
Tel. 604 662 8808
Fax 604 669 8803

April 30, 2012

SERVED TO:

Office of the Deputy Attorney General of Canada
Justice Building
284 Wellington Street
Ottawa, Ontario
K1A 0H8
CANADA