Exhibit H

IN THE LONDON COURT OF INTERNATIONAL ARBITRATION

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In the Matter of Arbitration :
Between: :
:
THE UNITED STATES OF AMERICA, :
:
Claimant, : No. 7941
:
and :
:
CANADA, :
:
Respondent. :
: (Amended 10/23/08)
- - - - - - - - - - - - - - - - - - - -x Volume 1

HEARING ON REMEDIES

Monday, September 22, 2008

The New York Palace Hotel
455 Madison Avenue
Stanford Conference Room
New York, New York

The hearing in the above-entitled matter came on, pursuant to notice, at 9:30 a.m. before:

PROF. DR. KARL-HEINZ BÖCKSTIEGEL, President

PROF. DR. BERNARD HANOTIAU, Arbitrator

MR. V.V. VEEDER, Q.C., Arbitrator

Also present:

MS. YUN-I KIM,
Secretary to the Tribunal

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AGENDA

ITEMS	PAGE
SHORT INTRODUCTION BY THE CHAIRMAN OF THE TRIBUNAL	6
OPENING STATEMENTS:	
ON BEHALF OF THE CLAIMANT:	
By Ms. Davidson	18
By Ms. Ewusi-Mensah	28
ON BEHALF OF THE RESPONDENT:	
By Mr. Aguilar-Alvarez	58
WITNESSES:	
JONATHAN A. NEUBERGER	
Direct examination by Mr. Schwind	93
Cross-examination by Mr. Aguilar-Alvarez	99
Redirect examination by Mr. Schwind	114
Recross-examination by Mr. Aguilar-Alvarez	119
JOSEPH P. KALT	
Direct examination by Mr. Aguilar-Alvarez	122
Cross-examination by Mr. Schwind	158

P R O C E E D I N G S

CHAIRMAN BÖCKSTIEGEL: Good morning, ladies and gentlemen. I hereby open the Hearing on Remedies in what has been identified as the Softwood Lumber Arbitration, which is the LCIA Arbitration Case Number 7941, between the United States of America as Claimant and Canada as Respondent.

Though most of us already met at the December hearing, let me first begin shortly to introduce our Tribunal. As you may have imagined by now, I'm Karl Böckstiegel, and my co-Arbitrators have agreed that I shall be the Chairman of this Tribunal.

Sitting with me are two further Members of the Tribunal, Mr. Johnny Veeder, you'll see appointed by Claimant; and Professor Bernard Hanotiau, appointed by Respondent. And, also with us is the Tribunal Secretary, Ms. Yun-I Kim, sitting over there.

On behalf of the Tribunal, may I welcome you all here. After our common experience in December, during the liability hearing, I have no doubt that it shall again be possible, despite many of the areas and high financial volume at stake here, to conduct the hearing on the side of all concerned in a professional way.

As recorded in Section 3 of Procedural Order No. 1, the Parties have agreed on a bifurcated procedure to the effect that in the first stage of the procedure the Tribunal shall

only deal with the issue of liability. After our Award on Liability has been issued in March of this year, this is now the hearing on remedies in this case.

Let me read out from the Procedural Order No. 1 what was agreed regarding hearings in this case and then, indeed, implemented. Section 6.2: It is recalled that Article 17 of the Softwood Lumber Agreement, which is the SLA, provides as follows: Hearings of the Tribunal shall be open to the public. The Tribunal shall determine in consultation with the Parties appropriate arrangements for open hearings including the protection of confidential information.

Section 6.3: The Hearing shall be simultaneously transcribed using live transcription software system with the delivery to the Parties and the Members of the Tribunal of daily transcripts each evening after the close of the hearing, and I welcome our Court reporting colleagues over here.

From Procedural Order No. 2, let me recall the following: Section 5, Evidence of Witnesses and Experts. The Witness Statements and Expert Reports shall come in lieu of direct examination of fact and expert witnesses at the hearing. The Party calling a fact witness or expert witness will be deemed to have submitted that witness's direct testimony in his or her statement or report.

Thus, absent leave of the Tribunal for reasonable cause, the direct examination of a fact witness or expert

witness will be limited to confirming his or her written testimony and comment on any new developments that have occurred after the statement or report was made, in case of several reports that will be the last report, of course.

5.8: Direct examination regarding any new developments after the statement or report was made, witnesses giving oral evidence shall first be asked to confirm that statement or report. Each fact witness and expert witness shall then be examined by counsel for the opposing Party by cross-examination and subsequently by counsel of the Party offering the witness or expert with respect to the matters that arose during cross-examination, which is, as you all know, redirect examination. The subject to a limited direct examination regarding any new developments after the statement or report was made, witnesses giving oral evidence shall first be asked to confirm that statement or report, the Arbitral Tribunal may pose questions after or during the examination of any fact or expert witness at any time.

5.9: The Arbitral Tribunal shall at all times have control over the oral proceedings including the right to limit or deny the right of the Party to examine a fact or expert witness when it appears to the Arbitral Tribunal that such examination is not likely to serve any further purpose. That has not become relevant in our context here.

Fact and expert witnesses shall be heard on

affirmation.

Number seven: Unless otherwise determined by the Tribunal, the hearing will commence at 9:30 a.m. and conclude at 5:30 p.m., with a two-hour break for lunch. On the last day this schedule may have to be modified since Members of the Tribunal will have to catch a plane that same evening.

Finally, from Procedural Order No. 3, I recall the following: According to Section 4.3 of the Order, it was agreed, in order to avoid time consuming searching for documents, that the Parties were to provide at the hearing, hearing binders to the other Party and to each Member of the Tribunal containing all documents the Party intends to rely on in its oral presentation today. And, indeed, you see behind us what the Parties have given us already in that respect.

According to Section 5.2, it was agreed that the date of the hearing shall be from September 22nd, today, to September 24th.

Again, from Procedural Order No. 3, under Section 6, taking into account the recent communications between the Parties and the Tribunal, the following agenda has been established for this hearing:

One, introduction by the Chairman of the Tribunal; that's where we are now;

Two, opening statements by the Parties are not more than 75 minutes each for the Claimant and the Respondent;

Three, examination of Dr. Neuberger, expert presented by Claimant, in the following format:

A, affirmation of expert to tell the truth;

B, short introduction by Claimant. This may include a short direct examination on new developments, if any, after the last written statement of that expert which is dated as late as September 15th, as you know;

C, cross-examination by Respondent;

D, redirect examination by Claimant, but only on issues raised in cross-examination.;

And E, remaining questions by Members of the Tribunal, even though, as I said before, we may raise questions at an earlier time, as well.

Number four on the agenda is the examination of Professor Kalt, expert presented by Respondent, and the same vice versa under A to E above as I have just read out. Respondent's direct examination may include examination of Professor Kalt regarding--I should say Kalt, I don't know whether you pronounce it the same way--that's a German word, so I tend to use the German pronunciation and not embarrass anybody. It actually means "cold" in German. Anyway, so that is Section 4. Professor Kalt will be examined in the same way as I indicated for Dr. Neuberger before.

The Tribunal has taken note of Respondent's suggestion to finish Professor Kalt's examination on Tuesday, September

23rd, and on Claimant's expectation that this may be achieved. However, as a precaution, we have invited Respondent to ensure Professor Kalt's availability also Wednesday morning, if so required.

Five, in view of the additional report by Dr. Neuberger of September 15 and the oral examination of Professor Kalt on this report of Dr. Neuberger, the Tribunal does not consider it necessary the two experts be recalled after their primary examination. However, if a Party insists on such a recall, the experts may only be recalled for rebuttal examination by a Party or the Members of the Tribunal if such intentions are announced at the time of his primary examination in time to ensure the availability of the expert during the time of this hearing.

Number six on the agenda are remaining questions by the Members of the Tribunal, if any.

Seven, closing statement, the closing statement by Claimant of not more than 60 minutes.

And eight, the closing statement by Respondent of also not more than 60 minutes.

And after that, as a final point on the agenda, we have discussion regarding possible post hearing briefs and other remaining procedural matters.

I may, perhaps, suggest, depending how the hearing goes on, that we do this already on Tuesday evening, rather

than wait until the very end of the hearing because we may be in a rush at the end and may perhaps be better to do that slightly earlier.

Return to Procedural Order No. 3, there are a few other matters we mentioned under Section 7. Unless otherwise agreed between the Parties or by the Tribunal, the experts may be present in the hearing room during the testimony of the other expert, 7.2. According to Section 7.4 of Procedural Order No. 2, when the agreement is recorded for the Tribunal to establish equal maximum time periods for the examination by the Parties, and taking into account calculation of hearing time that was attached to that order, the total maximum time available for the Parties including their introductory and closing statements for the hearing shall be as follows: five hours for Claimant and five hours for Respondent.

Except for the opening and closing statements under agenda items 2, 7 and 8, it is left to the Parties how much of their allotted time they wish to spend on agenda items 3 or 4, subsections (b, (c) and (d). The Parties shall prepare their presentations that was set in the Order and examinations at the hearing on the basis of the time limits established in that Procedural Order.

Each Party is free to use audiovisual equipment at the hearing as long as a large screen for general viewing or individual display screens are made available both to counsel

of the other Party and each Member and the Secretary of the Tribunal and that has been set up, as you can see.

This concludes what I have to recall from earlier rulings in this procedure for the benefit of the transcript, but also to ensure everybody understands clearly what has been said. Oral communications in this hearing shall be made into one of the microphones.

The end of this introduction may permit a few general remarks. Since the beginning of this arbitration, many and voluminous written submissions have been filed, including arguments and many exhibits. The procedural orders and many additional communications between the Tribunal and the Parties have provided further opportunities for the Parties to submit more arguments and more exhibits. This was done to ensure that, with regard to all issues, every Party had a full opportunity to present all factual and legal aspects of its case and answer fully to what the other Party had presented. This exchange was intended to lead to an oral hearing at which as much as possible, so to speak, all the facts and major arguments are already on the table. It is, therefore, not the intention of this hearing, nor is there obviously time in those three days, to orally repeat all the material submitted in writing.

To ensure equal opportunity for both Parties, the Tribunal has agreed with the Parties well before this hearing

on how much time they will have available at this hearing. The long and detailed procedure follows the common intention that, as much as possible, the impression and determination of this hearing shall not depend on any surprises to the other Party, but on a prepared, balanced exchange between the Parties and with the Tribunal on the facts and the law of this case.

We must also recall that we are not here under the procedure as it is viewed before our courts in our home countries, but we are here in an international arbitration procedure. As you know, the procedure shall be in accordance with the relevant provisions of the Softwood Lumber Agreement, the SLA, and the LCIA Arbitration Rules; and, lacking provisions therein in respect of a given procedural issue, the procedure shall be freely determined by this Arbitral Tribunal.

In order to have a productive hearing, the Tribunal would be grateful if we would not use a major part of this limited time on the hearing on procedural battles between the Parties, but concentrate on the factual and legal issues in this case. We managed pretty well in December; I'm sure we will be able to do that here.

In the same spirit, finally, I suggest that we give each Party time to finish their respective presentations as provided for in our agenda and within the time given for these presentations, and that only thereafter the other Party takes up procedure or substantive objections which it may have.

The same spirit, finally, we--as Members of the Tribunal, though we may raise a question at any time if we feel it is easy to fit in at that given moment--intend to normally wait with our questions until the respective presentations by the Parties are finished.

Experience of arbitration hearings of this kind shows that often a spontaneous question one may have at a given point of a Party's presentation may be answered at a later stage within the same presentation or may pose itself differently after one has heard the comments by the other Party; therefore, often the question doesn't even have to be posed anymore once the presentations are finished.

Another very logistical trivial matter is, if you have any mobile phones, which I'm sure you have, be sure you have them turned off and that they don't disturb this hearing.

This concludes all I have prepared and thought I had to say, but let me ask my colleagues whether I forgot anything.

(Pause.)

CHAIRMAN BÖCKSTIEGEL: Not yet. Okay.

About their letters of September 15 and later communications, the Parties have notified the Tribunal who is attending at this hearing from their respective side. Nevertheless, once we turn to the next side of the agenda, which are the opening presentations by the Parties, as you know, I would be grateful if each Party will shortly identify

the persons present on their side, so we can all from the very beginning connect names with faces, even though many of the faces are already known to us from the December hearing.

In that spirit, may I ask Claimant first to present the persons on that side. Please, go ahead.

MS. DAVIDSON: Yes. My name is Jeanne Davidson.

Would you like titles, also?

I'm the Director of the Commercial Litigation Section of the United States Department of Justice.

MS. EWUSI-MENSAH: Maame Ewusi-Mensah, Trial Attorney from the United States Department of Justice.

MS. BURKE: Good morning. My name is Claudia Burke, Senior Trial Counsel at the United States Department of Justice.

MS. McCARTHY: Patricia McCarthy, Assistant Director, United States Department of Justice.

MR. SCHWIND: I'm Gregg Schwind, also from the United States Department of Justice.

MS. JAMES: Tanisha James, paralegal from the United States Department of Justice.

CHAIRMAN BÖCKSTIEGEL: Would the Respondent be kind enough to do the same.

MR. AGUILAR-ALVAREZ: Yes, Mr. Chairman. I'm Guillermo Aguilar-Alvarez, from Weil, Gotshal & Manges.

MS. OSENDARP: I'm Joanne Osendarp, from Weil, Gotshal

& Manges, representing the Government of Canada.

MR. ROH: Chip Roh, also from Weil, Gotshal & Manges.

MR. RYAN: John Ryan, Weil, Gotshal & Manges.

MS. GUERRERO: Maria Isabel Guerrero, from Weil, Gotshal & Manges.

MS. WU: Kim Wu, with Weil, Gotshal & Manges.

CHAIRMAN BÖCKSTIEGEL: If there's nothing else that we have to discuss, any procedural matter, please--

MR. AGUILAR-ALVAREZ: There is one procedural issue, Mr. Chairman, I think we'll be able to settle pretty quickly.

As the Tribunal suggested in one of its Orders, the Parties exchanged demonstrative Exhibits two business days before the commencement of the hearing. One of the demonstrative exhibits submitted by the U.S. is text of a document that is not on the record.

I received subsequently a request for introduction of that document and agreed to introduction of the document subject to Canada being given the opportunity to submit rebuttal documents and argument once we hear what the argument is that the U.S. will make based on this document. And this has been discussed by counsel.

CHAIRMAN BÖCKSTIEGEL: Claimant confirms that?

MS. DAVIDSON: Yes, that would be fine with the United States if the Tribunal approves.

CHAIRMAN BÖCKSTIEGEL: I see no problem in that

regard.

MR. AGUILAR-ALVAREZ: We have not agreed on a time frame yet, and we're happy to follow your directions.

CHAIRMAN BÖCKSTIEGEL: The time frame we have is really we now have the opening statements for which you have up to 75 minutes, but you don't have to use it, of course, and we will start with the Claimant side. I don't think there's a reason to have a break now. I think we can go ahead.

OPENING STATEMENT BY COUNSELF FOR CLAIMANT

MS. DAVIDSON: Good morning. As I said, my name is Jeanne Davidson. I'm the Director of the Commercial Litigation Branch within the United States Department of Justice. I would like to welcome you all here, both the Tribunal and any visitors from Canada, to New York, the most international of cities in a very international week. I think it's appropriate we're sitting here this week for this proceeding.

We, also, on behalf of the United States, would like to thank the Tribunal for the substantial time and effort it devoted to this very important dispute between two very close neighbors. We really appreciate the time you have committed to this proceeding, and we're eager to get started with the remedy phase.

The March Award by the Tribunal resolved liability and held that Canada had violated the Agreement at least in one respect and also stated that Canada is now liable for the

consequences of its breach. Those consequences within the United States were severe.

As a result of the breach, Canadian exporters shipped approximately 200 million board feet in excess of the amount of softwood lumber that was allowed under the Softwood Lumber Agreement. 200 million board feet translates to one-and-a-half month's worth of sales of softwood lumber in the northern part of the United States and looked at another way, 3.5 months of sales in the State of Maine. So this was a substantial overshipment in a depressed market on both sides of the border.

I'm going to limit my remarks to highlight just a few aspects of the issues that are before the Tribunal today. I would like to begin by outlining what the Members of the United States team will be addressing during the next three days.

Following my brief remarks, Ms. Maame Ewusi-Mensah will provide a detailed description of the dispute resolution procedures in the Softwood Lumber Agreement and explain why they require a remedy in this case.

Then we will switch to the evidentiary phase of the proceeding, and Mr. Gregg Schwind will present the testimony of our expert, Dr. Jonathan Neuberger, and also conduct cross-examination of Canada's expert, Dr. Kalt--or Professor Kalt, excuse me.

Following the evidentiary portion of the proceeding, Ms. Claudia Burke will summarize the remedial issues and

explain why at least one of the approaches to remedy that we have presented should be adopted. And then at the end, Patricia McCarthy, who opened our proceeding here on liability, will summarize the position of the United States and address any issues that may have arisen during the proceeding that were not perhaps adequately addressed during the proceeding.

I would like to start with a very brief overview of the background of the Softwood Lumber Agreement. I recognize the Tribunal is very familiar with it already by virtue of the liability proceeding, but I want to emphasize the origins of the Agreement and the nature of the obligations, one side to the other.

The Softwood Lumber Agreement arose because the United States had imposed antidumping and countervailing duty orders on shipments of softwood lumber from Canada to the United States. Pursuant to those orders, the United States had collected approximately 5 billion USD in deposited duties, which were accruing interest because they were deposited in interest bearing accounts. So this pile of money was growing.

In the meantime, Canadian interests had launched massive litigation in the domestic courts of the United States, the WTO and before NAFTA tribunals. So we had massive litigation over the antidumping duty order and over the $5 billion in deposits that had accrued.

Ultimately, these two neighboring countries and very

strong trading partners committed to sitting down to seeing whether they could resolve their differences in a way that would get past the litigation and start afresh and allow Canada the opportunity to restrain its own exports in a way that replaced the domestic measures that the United States had imposed.

After extensive negotiations we reached the Softwood Lumber Agreement, which resulted in an exchange of promises and commitments for performance. The United States' commitments were rather front-loaded. The United States committed to vacate the antidumping and countervailing duty orders which left our domestic industry unprotected if there was any dumping of subsidized shipments into the U.S. industry.

The United States agreed to return the full $5 billion-plus interest to Canada. That was the lynchpin of the Agreement from the United States' perspective was returning the $5 million and vacating the antidumping and countervailing duty orders. What the United States retained in return was resolution of all that litigation, the litigation all was dismissed. I think there's a couple lingering ones which the Tribunal haven't gotten around to dismissing.

Essentially, the litigation was resolved, and Canada undertook a very broad series of measures to ensure that the United States would not need to invoke its domestic remedies in the future. Canada would essentially use its own enforcement

measures to regulate trade on the north side of the border rather than having the United States regulate trade from the south side of the border.

So, the United States fully performed all of its obligations under the Agreement and it was very controversial in the United States. Particularly, returning $5 billion-plus interest and vacating the antidumping and countervailing duty orders, but the United States performed because that was the commitment we made to Canada.

Now, under Canada's interpretation of the Softwood Lumber Agreement, Canada agrees that it has to comply with the Agreement, come into compliance; but if it breaches, all it needs to do is at some point before an Arbitral Panel reaches a final decision on remedy, Canada must come into compliance, then it's finished. There's no remedy for the United States, no matter how egregious the breach or how calamitous the consequences.

Therefore, in Canada's view, if the Canadian Government were to infuse an enormous one-time subsidy to its industry, which would clearly violate the Agreement and the United States were to complain or to go to a Tribunal, Canada would say, "Well, we're not doing it anymore, it's over, so there's no remedy under this Agreement. This Agreement only provides for prospective relief, so there's no remedy here."

Similarly, if Canada engaged, perhaps, in a continuing

subsidy program so it was subsidizing this industry on an ongoing basis but stopped the program one hour before the Tribunal issues a decision on remedy, Canada would say, "We ceased the violation. There's no more remedy under the Agreement."

As Ms. Ewusi-Mensah will explain, that's not the way the text of the Agreement is written, and it's counterintuitive. The United States would not and did not agree to an agreement that's so one-sided that would require the United States to perform monumental obligations with no recourse if Canada, for whatever reason, did not perform its obligations under the Agreement.

Canada attempts to analogize the Softwood Lumber Agreement to the WTO and to NAFTA and in support of its argument that the only remedies available are prospective only. But those agreements are clearly different from the Softwood Lumber Agreement. As this Panel noted in its March Award, this is a unique agreement; it's not like the NAFTA or the World Trade Organization. Those two agreements are multilateral market access agreements. The WTO has now over 150 Members. NAFTA includes our other trading partner in North America, the Government of Mexico.

Those agreements cover a vast array of industries, of subject matters, of practices affecting trade. The Softwood Lumber Agreement is industry specific, it's bilateral, it's

just between two trading partners, and it is very specific on the measures that will be filed. It is much more like a bilateral investment treaty than it is like the WTO or the NAFTA, if you were to draw comparisons. And I think that's clear from the preambles of the World Trade Organization or the NAFTA, as quoted in our submissions, and Ms. Ewusi-Mensah will talk more about that later.

The preambles of the WTO and the NAFTA make clear their purpose is to open markets and bring the member countries into compliance. The WTO especially recognizes that some Members will not be able to fully comply immediately with the full panoply of requirements under the WTO and that the codes are in a very limited sense aspirational.

The Members are committed to try to come into compliance, full compliance, with all of the codes in the WTO, but for many Members this takes time because they have domestic interests they need to resolve, and some never come into complete compliance or at all times with every aspect of the WTO. So the WTO has measures that essentially pressure Members to try to come into compliance or if they really can't, then they have to compensate for their inability to come into full compliance with all of the requirements of the WTO.

The Softwood Lumber Agreement contains no provisions like that. It's not aspirational. It's a subject of litigation in which there were very concrete requirements

imposed and commitments made for performance by the two sides, and, as Ms. Ewusi-Mensah will explain, there's a very clear dispute resolution for disposing that.

There's a dispute resolution in the NAFTA and if the Parties to the Softwood Lumber Agreement had wanted dispute resolution in accordance with the NAFTA, they easily could have specified that in the Softwood Lumber Agreement, but they didn't. They created a very specific dispute resolution system just for this Agreement.

Finally, I would just like to highlight a couple points about remedy. We will be presenting our expert, Dr. Jonathan Neuberger, and I think you'll find him very helpful in understanding the economic and damage issues, the remedial issues that are raised in this proceeding.

The United States has identified four possible approaches to remedies. We've submitted them in our briefs, and Dr. Neuberger will talk about them later. The remedy that we prefer and that we think is the most appropriate for this breach is one that would essentially treat the provinces that were the subject of the breach like the provinces that didn't breach.

As the Panel is aware, in Canada the provinces were allowed to choose between Option A and Option B in how they regulated their shipments to the United States in the Agreement. The Option A countries were subject to a 15 percent

export charge. The Option B countries were subject to only a 5 percent export charge, but they also had a quota. The breach here was the quota was not set correctly and, therefore, the Option B countries only paid a 5 percent export charge but shipped way in excess of the quota they should have been adhering to.

So, essentially, having not complied with Option B, the only alternative under the Agreement is Option A. And so our proposed and preferred remedy is to treat the Option B provinces as though they were Option A provinces for a period of time, which Dr. Neuberger will explain is commensurate is the extent of the breach.

As I said, we offer a total of four--we've identified a total of four possible remedies. Two are price-based, including the one I just outlined, and two are volume-based. Now, Canada attacks all four of our proposed remedies and doesn't offer any of its own.

Canada contends in addition to its legal argument that the Softwood Lumber Agreement simply doesn't provide for any remedy, only for prospective relief. Canada submits that it would be impossible to identify an appropriate remedy in these circumstances because the violation has been concluded, and that's counterintuitive. As all of us know who have dealt with difficult situations involving violations of commercial agreements, it's always easier to measure the harm caused by a

past breach within a confined period of time than it is to measure the effects of a continuing breach, which may last into an indeterminate point in the future. With continuing in the future breaches, there are numerous factors that may be considered that are not relevant to measuring a past breach. One has to try to imagine what the world will look like in the future, what other factors may come into play. One has to discount the present value to get to a current number.

When you're talking about a six-month period of time that concluded in June of 2007, it should not be too difficult to design a remedy. And those of us who have had the privilege of resolving numerous disputes with Canada over many years know the Canadians are well up to the task. So Canada's approach to the remedy is counterintuitive.

It would not be difficult to design a remedy for a six-month breach period that is now behind us. And the United States should be restored to the status quo ante, and that is what our proposed remedies seek to do.

With that, I will turn the microphone over to Ms. Ewusi-Mensah, who will discuss the Softwood Lumber Agreement in greater detail.

CHAIRMAN BÖCKSTIEGEL: A question has just been raised what you have in demonstratives on the screen. Would that be available in hard copy later on?

MS. EWUSI-MENSAH: Yes, Chairman. They are available

in the back of the hearing--

CHAIRMAN BÖCKSTIEGEL: Good. Please continue.

MS. EWUSI-MENSAH: Thank you, Members of the Tribunal. Thank you, Ms. Davidson.

As Ms. Davidson mentioned, I will discuss the operation of the dispute settlement provisions of the 2006 Softwood Lumber Agreement and demonstrate why the provisions require that--the ordinary meaning of these provisions, rather, is that the SLA requires a remedy for the breach Canada has committed.

First, I will walk through the operation of the SLA provisions that are triggered in the case of a finding of a breach by the Tribunal.

Next, I will show that the ordinary meaning of Paragraph 22 of Article XIV is that it is operative in the event of any finding of a breach by the Tribunal. In so doing, I will explain how Canada's arguments before this Tribunal are in truth an attempt to reargue the question of liability, which has already been determined.

Following this, I will explain the ordinary meaning of the term "cure" in--within the context of the SLA and demonstrate why "cure" requires complete reparation, including compensation.

I will then show that the ordinary meaning of "compensatory adjustments" in the SLA is that the compensatory

adjustments are to be in an amount that remedies the entirety of any breach found by the Tribunal.

And finally, I will summarize how secondary means of interpretation, including public international law principles as well as the negotiating history of the Agreement, confirm the ordinary meaning of both "cure" and "compensatory adjustments" under the SLA.

I begin by walking through the operation of Article XIV of the Softwood Lumber Agreement. Article XIV sets forth a coherent and unitary process for the resolution of disputes concerning breaches of the SLA. And consistent with the ordinary meaning of its terms, the provisions triggered after the finding of a breach apply to all types of breaches.

Now, we have provided a complete copy of the SLA in the hearing binders at Tab CR-1, and there are certain excerpted portions of Article XIV that I will discuss which will appear on the screens and which are in the demonstrative exhibits at the end of the hearing binder.

The first provision triggered by the finding of a breach by the Tribunal is Paragraph 22. As we can see pursuant to Paragraph 22, once the Tribunal finds a breach, it is presented with two tasks. First, to determine a reasonable period of time for the breaching Party, in this case, Canada, to cure the breach; and second, to identify an appropriate set of compensatory adjustments in an amount that remedies the

breach in the event that the Parties--that Canada fails to cure the breach by the end of the cure period.

Paragraph 23 specifies that the compensatory adjustments must be in an amount that remedies the breach that the Tribunal has found. Now, we know when looking at Paragraph 22 and 23 together, that there is no indication that the breach referred to in the first portion of Paragraph 22 is anything other than the breach referred to in Paragraph 22 A, Paragraph 22 B and Paragraph 23.

Following the Award by the Tribunal setting forth both the cure period and the compensatory adjustments, the work of this Tribunal on this Request for Arbitration will be complete. For simplicity's sake, I will assume a cure period of 30 days. During these 30 days, pursuant to Article XIV, no compensatory adjustments will be imposed; however, the Parties can use this period of time to come to an agreement about the nature of the cure required.

And there are three valid reasons for this cure period: First, agreement as to a cure during the cure period necessarily relieves the breaching Party of the requirement to impose compensatory adjustments at the end of the cure period.

Second, the agreement on a cure during the cure period permits the breaching Party to implement a cure of its own design rather than be subject to the compensatory adjustments that the Tribunal has determined, which may not be its

preference.

And finally, the agreement by the Parties as to a cure during the cure period permits the implementation of a cure other than something limited to the compensatory adjustments.

As described, we see that in Paragraph 23 the compensatory adjustments are limited to modifications of the Export Measures. Therefore, the Agreement by the Parties as to a cure during the cure period has the advantage of permitting a cure that is not limited to an adjustment to the Export Measures. For instance, it is possible that the Parties may agree that a form of cash compensation may be an acceptable cure to both Parties, although that would not fit within the rubric of compensatory adjustments.

Now, at the end of the cure period, pursuant to Paragraph 24, if the Parties have not agreed on a cure, then the compensatory adjustments ordered by the Tribunal must be imposed. Therefore, we see that the early determination by the Tribunal of the nature of the compensatory adjustments facilitates the negotiation of a cure during the cure period because it provides the Parties with certainty as to the consequences of not agreeing as to a cure during the cure period.

Furthermore, the compensatory adjustments serve as an effective means of policing the Agreement to which the United States and Canada have agreed. As Ms. Davidson mentioned, the

nature of this Agreement, unlike any other agreement that one can refer to or that Canada has compared the SLA to, is that the United States provided most of its consideration up front and agreed to forbear the use of its own antidumping and countervailing duty measures. Therefore, there must be a means of policing this Agreement; otherwise, it is almost illogically one-sided. We know even with respect to the forbearance of the use of United States antidumping and countervailing duty measures, the nature of these measures is that even if the United States decided at some point to cease forbearance of use of these measures, it would take months to impose new duties.

For this reason, although the compensatory adjustments began only to apply at the end of the reasonable period of time, they are retroactive to the date of the breach; that is, they remedy the entirety of the breach, not just any new portion of the breach that occurs after the end of the reasonable period of time as Canada contends.

And looking at the text at 23 and together makes this clear. The end of 23 states that the compensatory adjustments shall be in an amount that remedies the breach. As I mentioned before, there's no indication that this breach--that's referred to at the end of Paragraph 23--is only a portion of the breach; rather, it is the same breach referred to in Paragraph 22, and that is the breach the Tribunal has found.

Moving on, according to Paragraph 27, it is only at

the end of the cure period if the Parties have not agreed as to a cure--that the breaching--and the breaching Party has not imposed compensatory adjustments that the nonbreaching Party is permitted to impose its own compensatory measures. Therefore, this occurs only at the end of the cure period and only after the breaching Party has failed to impose the compensatory adjustments ordered by the Tribunal.

Moving on to Paragraph 29, it is only at this point, and if the Parties still disagree as to the nature of a cure and whether compensatory adjustments or compensatory measures should be imposed, that the Parties may again seek the assistance of the Tribunal in resolving their dispute.

I note with respect to Paragraph 29, that with respect to a dispute such as the one we're in, there are two ways it can be invoked. For instance, if the nonbreaching Party has imposed its Paragraph 27 compensatory measures and the breaching Party disagrees, the breaching Party can bring an arbitration under Paragraph 29. On the other hand, if the nonbreaching Party has decided to forego its option to impose its own Paragraph 27 compensatory measures, the nonbreaching Party can bring an arbitration itself under Paragraph 29 for resolution of this issue concerning cure and whether or not compensatory adjustments should be imposed. Then, after such an arbitration is initiated pursuant to Paragraph 31, the Tribunal is empowered to step in, resolve the dispute and

either maintain, modify, or terminate the compensatory adjustments or measures as appropriate.

According to Paragraph 32, if the Tribunal determines that the compensatory adjustments need to be modified or terminated, any such modification or termination is retroactive to the date that the compensatory measures were imposed. Clearly, it would be nonsensical to order modification or termination of these compensatory adjustments retroactive to a date prior to when they were imposed in the first place.

So, as we can see by this walk-through of these provisions, the normal operation of Article XIV, as I have just described, embodies the Parties' Agreement that an amicable resolution of any dispute concerning cure is preferred.

In the same way, we note that the earlier portion of Article XIV, the provisions that were operative before we even got to arbitration, those provisions--concerning consultations and mediation--those provisions also embody the Parties' Agreement that an amicable resolution of any dispute concerning a breach in the first place is preferred.

We fully expect, therefore, that if this Tribunal were to make a determination as to the cure period and were to select a set of compensatory adjustments as we request, that the Parties could then proceed to the next phase of what was envisioned in the Agreement and they could profitably use the cure period to agree as to a cure, and this is what we expect

will occur.

Rather than establish a system where the Tribunal's Award in Paragraph 22 comprises a final resolution of all possible disputes arising from the original breach, the Parties negotiated and drafted a two-step system where the Tribunal's Award in Paragraph 22 merely initiates the process for the Parties to resolve between them the cure of the breach the Tribunal has found. Canada, by attempting to rewrite Paragraph 22, is attempting to short circuit the careful process to which the Parties agreed. This is particularly inappropriate given that in an arbitration setting, this arbitration itself is a creature of the Parties' Agreement.

I will now discuss how Canada's attempt to short circuit this process is in effect an attempt to reargue the question of liability that has already been determined by this Tribunal. Canada even refers to this issue as a "threshold issue."

The clear and ordinary meaning of Paragraph 22 of Article XIV, as the Tribunal itself noted during the hearing on liability, is that it is mandatory. We have included an excerpt of the transcript from the hearing on liability in the hearing binder at Tab CR-31, and this reference I'm making is to Page 123 to 124 of that transcript. Paragraph 22 mandates if the Tribunal finds a breach, it is to make a determination as to compensatory adjustments and it is to set a period for

cure. It does not contain any exceptions.

During the beginning of these proceedings last fall, Canada agreed the Tribunal should be authorized to make a finding as to breach, and the Tribunal then made that finding earlier this year. Now, Paragraph 22 can only be an operative in the manner that Canada proposes if Paragraph 22 simply is not applied to this sort of breach; that is, a breach that is limited in time to a period prior to the Award. However, if Paragraph 22 does not apply to this sort of breach, then this renders the Tribunal's decision earlier this year as a nonbinding decision without any practical effect. This however would be contrary to the express text of the SLA which states at Paragraph 20 of Article XIV that any award of the Tribunal is to be final and binding.

Put another way, given the clear language of the SLA, the Tribunal is to determine compensatory adjustments in the event of a breach. The logical conclusion of Canada's position is that the Tribunal did not even have jurisdiction to find a breach in the first place, and this position virtually eviscerates the Award the Tribunal has already issued.

Now, not only does this argument strain credulity and is extremely counterintuitive, but Canada's own actions throughout these proceedings is directly contrary to this position. Had Canada, indeed, determined that Paragraph 22 would be rendered inoperative in the case of this sort of a

breach, in that it was a void in this sort of a breach, one would imagine it would have raised this as a threshold issue that would have prevented consideration of the merits of the dispute in the first place back in December. And as the Tribunal is well aware, both the Parties and the Tribunal knew at the inception of this arbitration the nature of the breach we were dealing with and the fact that it was a breach that was limited in time to a period prior to the filing of the Request for Arbitration by the United States.

Instead of raising this Paragraph 22 argument as a threshold issue regarding consideration of the merits of the liability question, Canada never asserted what it asserts now, which is that the Tribunal cannot make the mandatory determination as to compensatory adjustments that are required by Paragraph 22, nor did Canada state that Paragraph 22 was not mandatory. In fact, when the Chairman stated at the end of the liability hearing that the Chairman views Paragraph 22 as mandatory, Canada did not raise any concerns at all.

Now, Canada asserts it has maintained this position concerning Paragraph 22 throughout these proceedings, but a close reading of its submission shows this is simply not true. I would point the Tribunal to Canada's response to the Request for Arbitration, which is found at Tab CR-32 of our hearing binder. In that submission, at Paragraph 28(f), Canada raises several objections, and throughout the submission Canada raises

several objections to the remedies proposed and sought by the United States. Specifically, in Paragraph 28(f), it raises--it states no compensatory adjustments can be imposed because Canada had already cured its breach.

What is important to note, though, is that Canada did not state at that time or any other time during the Award is that Paragraph 22 as a whole would be rendered inoperative. It merely stated no compensatory adjustments can be imposed presumably at the end of the cure period.

Now, although Canada has acknowledged, for instance, it acknowledged this in its Statement of Defence on remedy at Paragraph 2 that it is, quote, "common ground" that the powers of the Tribunal are set forth in Paragraph 22. Canada now turns Paragraph 22 on its head and states, contrary to the ordinary meaning of the paragraph, that the paragraph requires the Tribunal to make a finding on cure at this time, and it states, even though this is the central question for the Tribunal to determine and Canada will use, that Paragraph 22 prohibits the Tribunal from making a determination at this time as to compensatory adjustments, which is directly contrary to the ordinary meaning of the language and the clear text.

I will now turn, however, to the ordinary meaning of the term "cure" which Canada states is the central question, showing that the ordinary meaning of the term "cure" is that cure requires complete reparation.

Now, Canada points out in its rebuttal Memorial at Paragraph 79 that the meaning of "cure" depends upon what is being cured. We do not object to this at all. This is correct. Here, what is being cured is the breach the Tribunal found. And the breach the Tribunal found, as we well know is--was Canada's failure to timely perform its time-sensitive obligations under the Agreement.

As both dictionary definitions of "cure" will show, and as legal authorities on "cure" show, cure in these circumstances requires compensation for Canada's failure to timely perform its time-sensitive obligations. For instance, in the dictionary, "cure" is defined as "to remedy, to rectify, to heal." Now, to remedy, rectify or to heal Canada's failure to timely perform calculations in January through June, Canada must do more than properly perform calculations in July.

And I would just remind the Tribunal, as the Tribunal already knows, the nature of these calculations are--they are unique to each month of the Agreement. Therefore, it is almost illogical for Canada to argue its timely and proper calculation of calculations in July of 2007 with respect to shipments in July 2007 could in any way remedy, rectify or heal the improper calculation in January of 2007 of quotas and Expected U.S. Consumption concerning January 2007.

The meaning of "cure" as used in the legal context and particularly in contractual situations is consistent with this

common-sense meaning, which is: To cure, there must be a complete reparation. In fact, in our brief, we explain this is an axiomatic principle of United States contract law.

Now, of course, we understand that the United States domestic law does not control the interpretation of cure in this Agreement, nevertheless, we suggest that it is persuasive. In fact, it is highly persuasive in the circumstance we are in here, where Canada has not provided any legal authority that sets forth an alternative definition of the term "cure." It merely attacks our use of legal authority preferring to use portions of dictionary definitions or analogies to other situations such as medical situations.

However, it seems to us that given that the Softwood Lumber Agreement is an agreement, it's a contract between two Parties, the use of the term "cure" in the legal context with respect to contracts is highly relevant and should be persuasive to this Panel.

We note that Canada also points to the use of other terms, which it argues are the true definitions of "cure" that the Parties intended. It refers to the term "remove." It also refers to the term "eliminate." And it states that these are terms which only contemplate prospective relief and because this was the definition that the Parties intended--that cure only contemplate prospective relief.

However, if we contend with this for a moment, the

nature of the breach is such that even if you were to define "cure" as "to remove" or "eliminate," it does not change the nature of the remedy required. To remove or to eliminate the breach of miscalculation for January 2007 shipments, Canada cannot perform in July proper calculations with respect to July shipments. It must, therefore, compensate for the effects of the breach which occurred in January through June of 2007.

Now, on this issue of effects, Canada chides us in its briefs for attempting to remedy the effects of the breach, presumably on the understanding that the remedy is only to be directed directly at breach and the effects of the breach should not be considered. However, it seems there is no true dispute between the Parties on this. We note in Paragraphs 40 and 44 of Canada's rebuttal Memorial, it too points to the fact that the remedy contemplated by the paragraphs on the compensatory adjustments are directed at the effects of the breach.

Now, Canada also states in support of its arguments concerning the prospective-only nature of cure is that, had the Parties intended for cure to have the retrospective interpretation which the United States posits, that the Parties would not have included a cure period at all. One of Canada's primary arguments with respect to the cure period is that the cure period should be serving as a grace period, and if the cure period cannot serve as a proper grace period if

compensation is continuing to increase and accrue during the course of the cure period.

So, according to Canada, the cure period really serves no purpose under retrospective system and is actually incompatible with retrospective system since it doesn't give the Parties the benefit of a grace period.

However, as discussed earlier, as I walked through the provisions of the Agreement, the cure period serves several valid purposes in a retrospective system. It permits the Parties to agree as to a cure which preserves the Agreement's preference for Party-directed solutions. It also permits the breaching Party to implement a cure of its own devising rather than face the imposition of compensatory adjustments. And it also permits the breaching Party and the nonbreaching Party to agree to implementation of a cure which is not limited to modification of the Export Measures.

Now, Canada's contrary assessment of the cure period and its belief that it is incompatible with retrospective system derives primarily from its comparison of the cure period under the SLA with what it considers to be analogs under the WTO and the NAFTA systems.

Now, I will be making reference to the dispute settlement provisions of both of those agreements. We also provided copies of these in the hearing binder. The WTO Dispute Settlement Understanding is at CR-24 of the hearing

binder and the NAFTA dispute settlement provisions are at CR-25 of the hearing binder.

This comparison that Canada seeks to make under the SLA and what it considers analogs under the WTO and NAFTA systems are not useful because a close examination of these various periods of time under these various agreements shows the WTO and NAFTA periods are almost unrecognizable from the SLA cure period.

CHAIRMAN BÖCKSTIEGEL: Now, if you were to refer to NAFTA in general, I take it you actually refer to the trade provisions and not the investment provisions.

MS. EWUSI-MENSAH: Right. I'm specifically refer--at this point, I'm referring to Article 2018 of the NAFTA provisions. Thank you for that clarification.

With respect to the period of time that Canada considers to be an analog under the WTO system, that period of time is 15 months and that is providing for solely prospective compliance. This is very different from the SLA period of time, which can be no more than 30 days. Similarly, both WTO and NAFTA contemplate further involvement of the deciding panel in the process of bringing what are termed "inconsistent measures" into compliance.

Under the WTO Article 22, Paragraph 8, which again as I mentioned is found at CR-24, the dispute settlement body maintains surveillance over the adoption of its rulings. To

contrast, as this Tribunal well knows, after the Award on Remedy in this case, the Tribunal does not monitor the Parties' Agreement as to cure or the imposition of compensatory adjustments. Similarly, under NAFTA Article 2018, the Parties report back to the Panel as to its final resolution of the dispute after receiving the panel's report, whether or not they have agreed to nonimplementation or to removal of the inconsistent measure.

Now, the fact that these periods of time are so different from the SLA periods of time, both in length and in what is to occur during the period of time, the fact the SLA contemplates no surveillance by the Tribunal suggests it's not reasonable to assume that the cure period is meant to serve the same purposes as the--as these alleged analogs under the WTO and NAFTA systems, and it's certainly not reasonable to conclude that the cure period must be simply for prospective compliance only.

Moreover, the WTO and NAFTA systems, their language itself is very different from the language of the SLA. We highlighted that in the briefs, but I will reiterate the WTO and NAFTA systems discuss what are termed "inconsistent measures," and they discuss compliance with these inconsistent measures and nullification or impairment by the nullification systems.

SLA uses the term "cure" and the term "breach" which

are very different. Not only could the Parties have used the language of the WTO and NAFTA if they wanted the same meaning of WTO and NAFTA--that is prospective-only remedies--they could have done that. Similarly, as Ms. Davidson mentioned, if they wanted to merely utilize the already robust and sophisticated dispute resolution systems of WTO and NAFTA to resolve any disputes under the SLA, they could have merely provided for that. However, they specifically excluded the WTO and NAFTA. The use of WTO and NAFTA systems for use--for resolution, excuse me, of disputes under this Agreement.

Now, just to reiterate the ordinary meaning of "cure," as the dictionary definitions and legal authority show, is that it involves complete reparation including retroactive relief, retrospective relief is needed.

I now turn to the ordinary meaning of the term "compensatory adjustments." Paragraph 23 limits the compensatory adjustments in only two ways. They must consist of adjustments to the export measures and they must be in an amount that remedies the breach the Tribunal has found. That's the portion concerning remedying of the portion at the end of Paragraph 23.

As I mentioned before, Article XIV discusses only a single breach throughout the entire article. The first reference to the breach is the reference to the Tribunal's finding of a breach at the beginning of Paragraph 22. There's

no indication that the references to breach in A, in 22 B and in 23 are anything other than the breach the Tribunal found. And in this case, the breach the Tribunal found was Canada's failure to make the calculation adjustment at issue as of January 1, 2007. We've also provided for the Tribunal's convenience a copy of the Award in our hearing binder and that's at Tab CR-30. In particular, we are pointing to Paragraph 2 of Page 97 of that Award which sets forth the Tribunal's finding as to breach.

Now, because the compensatory adjustments, as reflected in Paragraph 23, must be an amount that remedies the breach and we know from the--this is reference to the breach--the Tribunal found the ordinary meaning of "compensatory adjustments" is they must remedy the entirety of the breach the Tribunal has found. That is Canada's failure to make the calculation as of January 1, 2007. There is no part of Article XIV, certainly no part of Paragraph 22 or Paragraph 23 that indicate that this remedy is limited to what Canada terms as "ongoing breaches" or that there is only a portion of the breach which is to be remedied by the compensatory adjustments. Canada responds, however, that the fact that the SLA limits the form that the compensatory adjustments can take means that these are also limits on the breaches to which the compensatory adjustments can apply.

But the language of the SLA simply does not support

this reading. It does not even suggest that the compensatory adjustments are not meant to remedy all breaches and the entirety of all breaches. Canada sets forth three reasons for its reading that the Paragraph 23 reference to the breach is only some breaches or portions of some breaches.

First, it contends that compensatory adjustments only apply to, quote, ongoing breaches or new portions of breaches because they are intended to be virtually identical to the suspension of benefits concept under the WTO dispute settlement understanding and the NAFTA Chapter 20 dispute resolution provisions. Second, Canada contends that for the compensatory adjustments to apply to a past breach, such as the breach we have at issue in this case, would be inherently punitive. And third, Canada contends, as Ms. Davidson mentioned, that to use these limited compensatory adjustments to try to remedy a past breach is actually not feasible.

Now, this third reason will--and our response to this third reason will be discussed in detail during the presentations by the expert witnesses. I will focus on the first two reasons.

With respect to the WTO and the NAFTA, again, the SLA differs substantially from the WTO and NAFTA specifically with respect to the determination of remedies which is the issue for which Canada seeks to use those two agreements. As I mentioned, neither of these agreements make any reference to

cure or make any reference to breach. Nevertheless, Canada strenuously argues that the compensatory adjustments under the SLA are the equivalent of the suspension of benefits in the WTO and NAFTA Chapter 20 systems. It does so even though the WTO and NAFTA systems contemplate suspension of benefits, other than those at issue, where it is beyond dispute that with respect to the compensatory adjustments, they apply to the very same products at issue; that is softwood lumber and the very heart of the dispute.

Now, Canada explains that it believes the compensatory adjustments are to work as an offset on a going-forward basis of the ongoing portion of the breach, but the SLA language does not discuss that the compensatory measures are meant to offset the breach on an ongoing basis. Rather, it states the compensatory adjustments are to remedy the breach and we would posit that both the use of the term "compensatory" and the use of the term "remedy," both of which have retroactive and retrospective connotations, suggest that Canada's approach is simply wrong.

Now, with respect to the question of whether or not the compensatory adjustments are meant to serve as an offset, we note the WTO and NAFTA systems are explicit, that the suspension of benefits are to work as an offset on a going-forward basis. In fact, rather than discussing the concept of remedying a breach under the WTO and NAFTA systems,

both of those agreements make clear that the level, and they use the term "level" of suspension of benefits should be equivalent to the "level," again to the term "level" of nullification or impairment used by the inconsistent measure and we find this language in the WTO at Article 22, Paragraph 4, that's at Tab CR-24 and NAFTA Chapter 20, Article 2019, Paragraph 3.

The SLA doesn't refer to inconsistent measures and it doesn't refer to offsets or levels. It only refers to the remedy of the breach and this language we would posit is inherently retrospective, particularly given this situation where the breach the Tribunal found is a past breach.

Now, with respect to the idea compensatory, the use of compensatory adjustments to remedy past breach will be inherently punitive, this is also incorrect. This misconstrues the nature of the compensatory adjustments and cure. All of the compensatory adjustments that we are proposing in this proceeding have a foreseeable end point.

The end is when compensation has been accomplished because with respect to this breach, at least when compensation has been accomplished that is when cure has been accomplished. And, therefore, all of these proposals are consistent with the language of Paragraphs 22, 23 and 24 concerning the length of time that the compensatory adjustments should apply.

Therefore, since all of the compensatory adjustments

we have proposed would cease as soon as complete compensation is reached, these adjustments are not punitive. They do nothing more than provide the compensation that is the remedy to which the United States is entitled in Paragraphs 23, 24 and 24.

Now, although Article XIV covers all, it must cover all possible breaches of the Agreement, Canada's interpretation of the compensatory adjustments applies to almost none of them.

First, imagine if the breach consisted of a breach of the Export Measures. And let's assume even an ongoing breach of the type that Canada chooses to focus on. If it is true the compensatory adjustments are to be prospective only and if we're dealing with a breach by Canada of the Export Measures, compensatory adjustments would be nothing more than simply a requirement that the Party come into compliance with the original Export Measures, and this seems nonsensical that there would be this whole system of compensatory adjustments and cure when all the Tribunal is going to do in the compensatory adjustment is say Canada must come into compliance. There would be no difference between the--asking the Party to come into compliance and seeking compensatory adjustments, in the case of an ongoing breach of the export measures.

Second, another example is the example of a breach consisting of a one-time payment by Canada to its lumber producers. This would contravene the anticircumvention

provisions of the Agreement. This, like any other breach, would have to be remedied by the compensatory adjustments and the limited form they take.

Now, given a one-time subsidy or ongoing subsidy, the idea of prospective only offset is also nonsensical given you have a one-moment-in-time subsidy and you're trying to remedy that with only a forward going offset. The sense of offset is not meaningful in the case of a subsidy. Third, if we imagine that the breach consisted of a violation of Canada's retroactive obligations under the agreement--and Canada makes much of the fact that it has certain retroactive obligations under the agreement--then Paragraph 22 is also rendered nonsensical.

I will give one specific example if the Tribunal looks at Article VIII(1) B of the SLA, this concerns the surge mechanism which was discussed at some length during the breach-liability hearing. The operation of the surge mechanism involves retroactive action by Canada. However, a prospective-only interpretation of the compensatory adjustments would have no meaning with respect to a retroactive obligation of Canada. Now, given that there are at least these three major situations where a prospective-only compensatory adjustment system would have no meaning, we posit that it's not reasonable to read the compensatory adjustments as being prospective-only.

First, as I mentioned, there's a simple breach of the export measures, all the compensatory adjustments would be--would be a reminder to comply. Then, second, there is the issue of a one-time subsidy payment. And third, there's this issue if Canada breaches retroactive obligations.

For the Tribunal's reference, I point to other retroactive obligations that would raise this problem. Article XII(2)(b)(i) and Article XVII(5). In addition, the fact that Paragraph 22 would be rendered inoperative in the case of a breach of Canada's retroactive obligations, also points to a flaw in Canada's textual arguments concerning Paragraphs 31 and 32.

With respect to Paragraph 32, Canada argues that the use of the term "retroactive" in Paragraph 32 means that the absence of the term "retroactive" in Paragraph 22 is meaningful. But this cannot be given that this reading of Paragraph 22 renders it inoperative in the case of a breach of Canada's retroactive obligations. Therefore, we would posit the various examples of Canada's retroactive obligations call into question the prospective-only reading of compensatory adjustments as well as the determination that the absence of the term "retroactive" means prospective only.

Now, for the reasons I have just explained, therefore, the fact the compensatory adjustments are limited to the export measures does not mean they are prospective only. To the

contrary, there is good reason for the limitations on the compensatory adjustments within the Article XIV process for resolving disputes concerning cure. We must recall that the Agreement operates exclusively via export measures. Therefore, to limit the Tribunal's determination as to compensatory measures at this time, to limit those to adjustments to the export measures appropriately cabins the Tribunal's role at this early stage rather than having the Tribunal determine at this early stage what the cure should be or to order a specific cure. This preserves the Party's preference they develop their own resolution to any such dispute and given the delicate balance of export measures in the Agreement, it would likely be untenable for the Parties to have the Tribunal introduce a cure outside of the export measures at such an early stage.

Now, certainly, after the Parties have attempted to come to an agreement as to cure and have gone through the steps set forth in Paragraphs 24 through 28, that is an appropriate time for the Tribunal to step in and assist on the determination of the question of cure, and we posit that is precisely what Paragraph 29 provides for.

Now, I will briefly discuss how secondary means of interpretation confirm the ordinary meaning of "cure," which I have discussed, includes complete reparation and the ordinary meaning of "compensatory adjustments" that I discussed must remedy the entire--of any breach the Tribunal has found. The

ILC Articles and the Chorzów Factory case, both of which we discussed in our briefing and copies of which were provided in the hearing binder, embody the public international law principle that reparations are required under international law for breaches of international obligations.

Now, Canada responds this is a violation of principle or points to the principle of lex specialis, stating that the SLA provides for a specific dispute resolution system and, therefore, to use public international principles, public international law principles such as the ILC Articles or Chorzów Factory to elucidate the meaning of "cure," is clearly inappropriate.

Nevertheless, this would only be true if Canada could show that retroactive relief is indeed precluded in the SLA. It is not precluded in the SLA, therefore, the SLA is not inconsistent with the ILC Articles and Chorzów Factory. And for lex specialis to be triggered it could only be triggered if the SLA was inconsistent with these broader principles of public international law.

As we have explained in detail in our briefs, these principles of public international law merely confirm what the ordinary text of the Agreement says, which is that complete reparation must be required--a complete remedy for the breach.

Now, although Canada raises this idea of lex specialis, it seeks, however, to use and rely heavily on the

WTO and NAFTA Chapter 20 agreements to explain the meaning of cure and compensatory measures, despite the fact the language of these agreements are very different than the language of the SLA, and despite the fact the SLA uses the term "cure" and the term "breach," terms which are peculiarly commercial terms which have retroactive and retrospective meaning.

Now, we do wish to clarify for the Tribunal an issue raised by Canada in its Rebuttal Memorial concerning bilateral investment treaties and this is the subject of the demonstrative that Mr. Aguilar-Alvarez made reference to.

Now, in Paragraph 77 to 78 of Canada's Rebuttal Memorial, it makes an argument concerning the bilateral investment treaties. First, it points out that in a 2001 arbitration under the 1996 SLA, there was an award issued. Now, this Award is found at Tab RA-1 in the hearing binder. And the portion that Canada quotes on Page 60 of that Award. In that Award, the Tribunal states that the Parties have agreed that they would not seek remedies after the termination because of the 1996 SLA was on the eve of termination.

Now, Canada argues because bilateral investment treaties provide for retrospective relief and because Parties can seek these remedies after termination, the fact that the Parties to the 1996 SLA agreed not to seek remedies after the termination of that agreement means that somehow the 1996 SLA also did not include retroactive relief.

Now, this ignores the fact that the ability to seek relief after termination of a bilateral investment treaty derives from the language of the Treaty.

So, for this reason, we have introduced as a new exhibit the Model United States Bilateral Investment Treaty, which is found at Tab CR-33 of the hearing binder. And one of the slides which is up on the screen is Article 22 of that Agreement. Now, this Agreement, Paragraph 3 of Article 22, constitutes what is known as the tail of the BIT. And it's the tail which states that certain provisions including those provisions concerning the seeking of relief continue, even after the termination of the Agreement. So we just wanted to clarify that.

It's not, the question of whether or not the Parties to the 1996 SLA thought they could or wanted to seek relief after termination does not bear on the question of whether or not the relief could be retroactive. It's rather a function of whether the Agreement provided for seeking of relief after termination. The model U.S. BIT for one example does provide for the seeking of remedies after termination, whereas the 1996 SLA did not.

Now, finally, we don't accept that we need to resort to negotiating history to resolve this dispute, but the negotiating history does show that Canada was well aware of the United States definition of "cure" at the time of the

negotiation of the 2006 SLA; and neither objected to it, nor were the Parties--nor did the Parties negotiate some different meaning of "cure" that we can see in the text.

During the 1998 arbitration under the 1996 SLA, and we discussed this at Paragraphs 45 through 48 of our Reply Memorial, the United States explained in that 1998 arbitration its belief that the term "cure" had the same meaning as it did under United States domestic law, which is the meaning I had discussed earlier in my presentation to remedy, to rectify, to heal in a retrospective way. Even Canada states that, in its Statement of Defence at Paragraph 76 that it did not set out its views on cure.

And if it did not set out its views on cure, it certainly did not set out a contrary view on cure. Nevertheless, at the time of negotiation, at the time of the 2006 SLA, Canada specifically chose as it alleges to use the word "cure" again, despite the knowledge of the United States understanding of the term "cure."

In conclusion because the Tribunal has already found that Canada has breached the SLA by failing to timely perform its time-sensitive calculations as of January 2001 and because the--as the Tribunal found, Canada is liable for the consequences of that breach and because the Tribunal has determined its tasks under Paragraph 22 are mandatory, we ask that this Tribunal set a cure period of 30 days for Canada to

cure its breach, and we ask the Tribunal at this time to select one of the four remedies we have proposed as the compensatory adjustments to be applied if the Parties do not agree as to cure during the cure period.

Thank you very much.

CHAIRMAN BÖCKSTIEGEL: Thank you very much.

I take it the presentation will continue.

MS. DAVIDSON: That concludes our opening statement.

CHAIRMAN BÖCKSTIEGEL: Good. I was worried about the timing. So the other colleagues you mentioned, they come up at a later stage.

MS. DAVIDSON: Right. They're going to participate at a later stage.

CHAIRMAN BÖCKSTIEGEL: All right. I think that's an appropriate time for a coffee break or whatever.

Is 15 minutes okay, Mr. Aguilar?

MR. AGUILAR-ALVAREZ: Can we make it 20?

CHAIRMAN BÖCKSTIEGEL: 20. 11:20. Right. We meet again at 11:20.

(Whereupon, at 11:20 a.m., a recess was taken to 11:40 a.m.)

OPENING STATEMENT BY COUNSEL FOR RESPONDENT

MR. AGUILAR-ALVAREZ: Thank you, Mr. Chairman.

The Arbitral Tribunal found in March that there had been a breach, but its March Award appropriately takes no

position on remedy or appropriate remedy or the interpretation of remedy under the SLA. That discussion is appropriately before the Arbitral Tribunal today.

Canada has cured and its position that it has cured has been known to the United States since the answer to the Request for Arbitration, long before the Tribunal was even constituted. We've heard a lot this morning, and I plan to return to some of the points that were raised, including with respect to the U.S. Model BIT in our closing argument.

I don't believe that Canada will require time after the hearing to reply to that or to some of the other points we heard this morning.

Following your admonition, Mr. Chairman, I don't intend to, rest assured, to repeat every argument that has already been presented by Canada in its written submissions. What I would like to do, and I hope this will be useful for the Tribunal, is to identify where there is common ground between the Parties. Where we disagree and why we believe applying the interpretive principles of the Vienna Convention, the areas of disagreement regarding the central issues in this dispute must be resolved in Canada's favor.

Let me again begin with some common ground. The Parties' agreement on some fundamental points. First, we both agree the text of the SLA is critical in determining whether a particular agreement contains a remedy that contemplates

reparation. It is undisputed there is no mandatory rule of international law which requires any particular consequences to flow from a sovereign's breach of a Treaty obligation and that states, therefore, are free to craft whatever special regime they wish to address the consequences a breach.

The commentary to Article 55 of the ILC Draft Articles explicitly recognizes this principle, "When defining the primary obligations applied between them, States often makes special provision for the legal consequences of breaches of those obligations." That is what Canada and the United States did when they drafted the dispute settlement provisions of the SLA. Article XIV of the SLA establishes what the U.S. has characterized as "a comprehensive remedy regime." This is U.S. Reply, Paragraph 14. Canada agrees with this characterization. The implication of this fundamental point is clear and it is very significant. When answering the central questions in this proceeding, the Tribunal's focus must be on the remedy regime the Parties established in Article XIV of the SLA, in particular, paragraphs 22 to 32 and not on general principles of international law.

The ILC Articles serve only a residual or gap-filling role. A purpose that is not necessary in this case given the acknowledged comprehensive nature of the SLA remedy regime.

Another area of common ground is that the WTO and Chapter 20 of the NAFTA, the two largest trade agreements to

which the United States and Canada are Parties, establish remedy regimes that are directed at prospective compliance and do not provide for monetary damages or other compensation for past breaches. As the commentary to ILC Article 55 observed "for WTO purposes compensation refers to future conduct not past conduct." This is a comment specifically addressed at WTO dispute settlement. NAFTA Chapter 20 reflects the same principle. Canada and the U.S. both agree the dispute settlement regimes of the WTO and NAFTA Chapter 20 are prospective in design and application.

In this way, there can be no dispute that trade agreements differ from bilateral investment treaties and commercial contracts that typically provide for monetary damages to make the Claimant whole for the damages it may have suffered because of the Respondent's breach.

While the Parties disagree on the remedies generally available in the event of breach in these different contexts, they fundamentally disagree on where the SLA falls between these two alternative approaches. It is Canada's position that the rules and structure of the remedy regime established in the SLA, again an international trade agreement, not surprisingly follow the same prospective model found in the WTO and the NAFTA Chapter 20.

The U.S., in contrast, is approaching this phase of the proceeding--we heard it again this morning--as if it were a

damages assessment under a bilateral investment treaty or commercial contract, arguing that it or its lumber producers are entitled to be compensated for the effects of Canada's breach, both past and future.

The problem for the U.S. is that the text of the dispute settlement provisions of the SLA does not look anything like the remedy regimes in typical bilateral investment treaties. With the Tribunal's indulgence, and before I turn to the language the Parties did choose when they drafted the SLA, I would like to pause and consider language the Parties could have drafted but chose not to.

Let's begin with the language of Article 1135 of the NAFTA, which you now see before you on the screen, and this is Exhibit RRA 15. This is the provision of NAFTA Chapter 11 that sets forth the consequences if a Tribunal finds that a state has breached its investment protection obligations. Subparagraph 1A of Article 1135 provides--you can see it on the screen--where a Tribunal makes a final award against a Party, the Tribunal may award separately or in combination only monetary damages and any applicable interest or restitution of property. And you can see in Paragraph B that the Tribunal must also indicate a cash alternative to restitution.

Let me now pull up on the screen Article 1116 and Article 1117 of the NAFTA. These are the provisions that govern who gets to bring a claim against the State for breach

of Chapter 11. This is also RRA 15. These two provisions establish that an investor, to bring a claim to arbitration, must allege that there has been a breach and that it has incurred loss or damage by reason of or arising out of that breach.

Now, similar language can be found in many bilateral investment treaties including the model U.S. BIT we saw this morning, and Canada's Model Foreign Investment Protection Agreement.

Let's take a look at the model BIT that the U.S. introduced into evidence today. Let's look at Article 34. Article 34 of the U.S. Model Bilateral Investment Treaty is a verbatim of Article 1135 of the NAFTA. Just as with NAFTA Article 1135 in subparagraph B directs the Tribunal to indicate a cash alternative to restitution, Article 24 of the model BIT that the U.S. introduced into evidence this morning is also verbatim, NAFTA Articles 1116 and 1117. Nothing prevented the U.S. and Canada from using similar language if they wanted to compensate for past breaches of the SLA by way of monetary damages or its equivalent.

Let's now review the remedy provisions in the Treaty underlying the two arbitrations the U.S. cited for the unremarkable proposition that state to state disputes arising from bilateral agreements do not necessarily require prospective only regimes. Canada has never disputed this

proposition for the reasons I just noted. International law lets states craft reparations based on prospective remedy regimes or anything in-between. The key as the U.S. acknowledges is how they express their choice in the text of the Treaty.

On the screen is an excerpt from the Treaty at issue in the Gabcikovo arbitration between Hungary and Czechoslovakia. This is RRA 16. As you can see, Article 25(2) provides that Parties are jointly liable. They must jointly and in equal measure make compensation for damages resulting from acts giving rise to their joint liability and pay the costs arising from such compensation.

The Parties' intent to provide reparations for a tort, this Treaty--this case is not about a breach of Treaty, it is about a tort--can scarcely be more evident on the face of the Treaty.

And, again, there was nothing to prevent the U.S. and Canada from using comparable language in the SLA if their intent had been to provide compensation for damages that were caused by a breach of the SLA.

Finally, let's examine the Convention on International Liability for Damage Caused by Space Objects. And this is Exhibit CR-16. This is a multilateral treaty to which both the U.S. and Canada are Parties. Article II, which is now on the screen states that, "A launching state shall be absolutely

liable to pay compensation for damage caused by its space object on the surface of the Earth or to aircraft in flight." It should come as no surprise that Canada claimed the monetary damages for the effects of Russia's tort in that case. The language of the Treaty expressly authorized this.

If the SLA contained language like that we just reviewed from the NAFTA or either of these two treaties, I wouldn't be standing here debating whether Canada was required to compensate the U.S. for a past breach. My focus instead would be solely on whether the U.S. had satisfied its burden of establishing a nonspeculative basis for the relief it was seeking, a burden, by the way, that the U.S. has not met in this case, as I will explain in the latter portion of my presentation this morning.

The SLA does not contain language resembling even remotely the language found in the text of the regimes we just examined. You will search Article XIV of the SLA in vain for the words "damages," "monetary damages," "paid compensation for damages" or anything akin to the phrases common to the reparations-based treaties with which both the U.S. and Canada were intimately familiar.

What you will find instead in the SLA are phrases and concepts that are wholly alien to reparations-based regimes, for example, the authorization of compensation if and only if a cure is not achieved by expiration of the reasonable period of

time and only until the breach remains uncured. A reasonable period of time not to exceed 30 days in which to cure the breach.

Finally, the use of trade measures, not cash damages, as the chosen instrument of compensation if a breaching Party fails to cure its breach. These are the tools that the SLA makes available to you for the determination in the second phase of the arbitration. I will talk more about each of these concepts shortly.

As Canada has established, these concepts are found only in prospective compliance regimes of international trade agreements like the WTO, like NAFTA Chapter 20. In our last submission, we asked the U.S. to identify a reparations-based treaty incorporating any of these concepts. The U.S. has failed to respond, and the reason for the U.S.'s silence is obvious: No such treaties exist.

On balance, it isn't a close call on the law. If the Parties had intended the SLA to provide for full reparations in the case of breach, they easily could have accomplished that intent by adopting language comparable to any of the Treaty language we just reviewed. They didn't choose that course. Instead they adopted the prospective compliance approach of other international trade agreements, other international trade agreements like the WTO and NAFTA Chapter 20, to which they are both Parties.

We are confident that you will conclude that by applying the Expected U.S. Consumption adjustment properly since July 1st of 2007, Canada has cured the breach within the meaning of Article XIV of the SLA and that no compensatory adjustments are required or allowed under Article XIV to compensate for the effects of its breach.

Why are you deciding this issue now? In this phase of the proceedings? You will recall that, at the time the Parties agreed to bifurcation of these proceedings, two challenges were before this Tribunal: Canada's decision not to apply U.S. adjustments of Option B Regions limited to the period of January to June of 2007 and Canada's decision not to apply the adjustment for Option A Regions, which was ongoing. In the case of the breach with respect to Option B Regions, Canada had already cured the breach, if any existed, in fact, about a month before the Request for Arbitration was even filed. While adjudicating the Option B issue seemed pointless as a practical matter, it is well established in prospective only dispute settlement systems--it happens in trade-related settlement disputes--that there is a right to adjudicate cases even where the breach has ended and there can be no further relief.

The nature of these proceedings, therefore, compels us to respond even to U.S. arguments whose premises, in Canada's view, are fatally flawed. For this reason Canada, aided by its experts Professor Kalt and Dr. Reishus, has shown that even if

the SLA were interpreted to provide compensation for past breaches, none of the alternatives advanced by the United States is justified, either legally or economically.

You will hear much over the next day or so from the economic experts but in reality, this dispute can and should be resolved without them. Their principal value will be to reinforce the lesson apparent from the text of the SLA. If the Parties intended to create a reparations based regime, it is difficult to imagine them having established a more ill-equipped vehicle to accomplish that purpose than what you find in Paragraphs 22 to 32 of Article XIV.

Much of my statements this morning will be devoted to reviewing the reasons why, applying the principles of the Vienna Convention, Article XIV is properly interpreted to provide prospective-only relief.

I will deal with the issues in the following order. First, I will show that the ordinary meaning of "cure the breach" and "compensate for the breach" in their context make plain that they are prospective only. Secondly, I will look at trade agreements to which Canada and the U.S. are Parties as relevant rules of international law under Article 31(3) of the Vienna Convention.

As I just noted, this is important because the standard approach to remedies in trade agreements like the SLA is that remedies should be prospective only. Trade agreements

focus only on cessation. In the context of discussing these trade agreements, I will explain why the U.S. efforts to apply Article 31 of the ILC Articles must fail. In Canada's view, the matter should end there, with a finding that Canada cured the breach in July 2007 when it ended the contested practice. But since the U.S. has argued for various remedies, I will briefly address these remedy proposals at the end of my presentation.

I would like to turn now to the text and context of Paragraphs 22 through 24 of Article XIV of the SLA.

Both Parties agree that the interpretation of the SLA is governed by Article XIV of the Vienna Convention. The ordinary meaning of the text of Article XIV within its context, in light of its object and purpose, makes clear that "cure the breach" on the one hand and "compensatory adjustments" on the other are prospective obligations only.

You have up on the screen and in your hearing binders the text at Paragraphs 22 to 24 of Article XIV. The first thing I will say is these three paragraphs operate together, and together they establish the rules of the road for a finding with respect to the consequences of a breach. These rules function smoothly under Canada's interpretation.

Under the U.S. interpretation, they make no sense. Let's look at Paragraph 22. If the Tribunal finds that a Party has breached the SLA, it has to do two things. First, it must

identify a reasonable period of time to cure the breach.

And second, it must determine the appropriate adjustments to the export measures that are applied if that Party fails to cure the breach within the reasonable period of time.

The word "if" in Paragraph 22 B is critical. It makes clear that "cure" means something different from compensatory measures. The obligation to impose compensatory adjustments is triggered only if the breaching Party fails to cure the breach by the end of the reasonable period of time established in Paragraph 22 A. "Curing the breach" and "compensatory adjustments" are plainly different concepts. This conclusion, by the way, is reinforced by Paragraph 24, which provides that the adjustments may be applied from the end of the reasonable period of time until the breaching Party cures the breach--until the breaching Party cures the breach. "If" in Paragraph 22. "Until" in Paragraph 24.

Paragraph 23 provides that the compensatory adjustments must be in an amount that remedies the breach. Thus, under Paragraph 23, the amount of compensatory adjustments must remedy the breach for the period between the end of the reasonable period of time and the cure of the breach. The U.S--we heard it again this morning--tries to find support in the wording of the last sentence of Paragraph 23 to argue that cure and compensatory adjustments are equivalent

concepts. There is no support for the U.S. position. The word "amount" in Paragraph 23 modifies adjustment.

All this sentence does, therefore, is tell the Tribunal that the compensatory adjustments that apply to the end of the reasonable period of time forward, if a Party fails to cure, are to be in an amount that remedies the breach. Let's move away from the text and look at a different way of representing this.

Here's how the process works up on the screen. Under Paragraph 22, the Tribunal establishes a reasonable period of time to cure the breach. Not more than 30 days. And it determines compensatory adjustments if there is no cure.

If the breaching Party has not cured by the end of the reasonable period of time, those days right there, compensatory adjustments in the amount determined by the Tribunal are triggered. The compensatory adjustments remain in place until the breaching Party during this period, until the breaching Party cures.

Compensation, therefore, comes into play if only there is no cure during the reasonable period of time and is applied to compensate for the ongoing breach only until the breaching Party cures the breach. To take an example, assume the U.S. was found to have been breaching the Agreement by imposing, let's say, for a period over the last eight months, a prohibited unilateral restriction on imports of softwood lumber

from Option B Regions. This is an obligation that exists under the SLA and was not front-loaded. Now, the Tribunal finds and determines that this measure, this, that the U.S. took reduced allowable imports from Canada by, say, 5 percent--5 percent per month--and assume this is an ongoing practice.

Let me tell you how Canada interprets the Agreement. As Canada interprets Article XIV the compensatory adjustment that the Tribunal should establish is obviously a 5 percent increase in the quota for Option B Regions and that is what the U.S. took away. And that quota would apply if the U.S. does not stop breaching by the end of the reasonable period of time and up and until such time as we can see here as the U.S. does stop the practice and thus cures the breach.

In other words, Canada would be entitled to impose the compensatory adjustments beginning on day 31 by adjusting upward, volumes upward by 5 percent until such time the U.S. has cured the breach. This is how the breach gets compensated. The adjustment cancels out the ongoing effects of the breach on the export measures but no more. There is no distortion, there is no need to make provision for changing the level of the adjustment in the future. The adjustment continues properly, so long as the breach continues uncured.

Now, let's consider how the U.S. will say the Tribunal should deal with the same example. The U.S. would require the Tribunal to order a monthly compensatory adjustment that does

two things. First, offset the effect of the continuing breach moving forward, therefore, the 5 percent increase that Canada's interpretation would require but the U.S. is asking the Tribunal to do one more thing. It is asking the Tribunal in addition to compensate for the effects on the Canadian industry caused by the breach from its inception several months ago, eight, in my example, up to the end of the reasonable period of time.

With due respect, this is an impossible task for this Tribunal. While this Tribunal may be able to calculate the 5 percent monthly adjustment that will offset the ongoing breach and what amount will offset the amount of the past breach, it will not know how long it will be before the U.S. cures the breach. The Tribunal will, therefore, not be able to calibrate with any accuracy the proper level of monthly adjustment.

Trying to translate effects on export measures into effects on the U.S. industry as the U.S. now urges would add still more complexity and uncertainty.

Let me now turn to the reasonable period of time that's provided under Paragraph 22 for a Party to cure the breach. As I said in my introduction this concept is nowhere found in reparations-based regimes. And the U.S., we saw again this morning, is having great difficulty why it is in the SLA. The U.S. has not attempted in its memorials and, again, this morning to deal with the disconnect between the concept of a

reasonable period of time to cure a breach and a reparations-based regime.

It makes no sense to allow for a reasonable period of time to cure the breach if there will be compensation back to the date of the breach. The cure period would only add time to the time for which compensation must be paid. By contrast, a reasonable period of time is built into prospective systems to provide an incentive, that is the explanation, to provide an incentive for the breaching Party to stop more quickly whatever conduct has been found to be in breach. If a Party stops the breach by the end of the reasonable period of time determined by the Tribunal, then no compensatory adjustments are applied.

The 30-day maximum for the reasonable period also cannot be reconciled with the notion that the breaching Party not only must stop the--stop breaching the Agreement but must, in addition to that, compensate for the past breach. A 30-day maximum is reasonable in most circumstances if as Canada contends eliminating the breaching conduct will cure the breach. However, compensation for past harms or any other form of undoing a past breach is likely to be much more complicated and to require more time-consuming legislative or administrative processes.

The U.S. appears to have realized its interpretation was untenable and could result in draconian effects. Fix everything in 30 days. In Paragraph 17 of its reply, it

offered a novel explanation that we heard again this morning. According to the U.S., a Party is not necessarily required to cure the breach within the reasonable period of time, but rather can within a reasonable period of time propose a plan to cure it, acceptable to both Parties.

This is a rewrite of Paragraph 22 and it has no support in the text. Another powerful indication that the SLA provides prospective only remedies with no compensation for past breaches, is the fact that the compensatory adjustments applied when the Party fails to cure are limited to increases in export volumes or export taxes. Those are the tools that the SLA gives this Tribunal. This is not cash compensation. Cash compensation is normally, we will hear that from the economist, the most efficient way to compensate those harmed as a consequence of a breach and, as the Tribunal is aware, the common remedy in private commercial arbitration or investment arbitration.

I refer you back to NAFTA Chapter 11 and the U.S. Model BIT provisions we looked at earlier, there's no need repeating that now. By contrast, adjusting import and export measures is a very inefficient way of trying to make whole the U.S. industry for any harm it might have suffered as a consequence of past breaches.

Awards under trade agreements are meant to apply at a macro industry wide level. They are not intended to provide

compensation to individual persons or companies. This is why remedies under trade agreements are used to encourage a breaching Party to stop the breach and are applied only for so long as the breaching measure remains in place.

If the Parties really intended compensation for past breaches, why is their only tool so poorly suited for this task? There are effective remedy mechanisms for past damages. Those mechanisms were well known to the Parties. Why didn't they use them? The answer is obvious. The Parties never intended to provide compensation for past damages. They provided a tool that is suited only to offset the effect of an ongoing breach.

That provision becomes all the more compelling when you consider that when the Parties wanted a provision to have retroactive effect, they were very clear about it. The best example of this is Paragraph 32 of Article XIV where the drafters made explicit that the action ordered by the Tribunal in the context of a remedial measures review has retroactive application. This is further contextual evidence, that no retroactive cure or compensation can be read into the silence of Paragraph 22 on that point.

Let's look at how Paragraph 32 works, and I will use a similar drawing.

For hypothetical purposes, again, let's consider an ongoing breach by the United States. The Tribunal, if you look

at the left-hand side of the drawing, the Tribunal under Paragraph 22, identifies a reasonable period of time for the U.S. to cure the breach. Let's say the 30-day maximum. And two, the second thing the Tribunal does is it determines compensatory adjustments if the U.S. fails to cure the breach within a reasonable period of time. Let's assume for purposes of our hypothetical example that the compensatory adjustment determined by the Tribunal is a 10-percent increase in export volumes that Canada is then applying. If on day 31 immediately after expiration of a reasonable period of time, the U.S. has failed to cure the breach. Under Paragraph 32, Canada could begin applying the 10-percent increase in export volumes determined by the Tribunal at this point in time.

If the U.S. believes it has cured the breach or that the 10-percent increase in export volumes is not consistent with what the Tribunal determined under 22 B, the U.S. could bring a new arbitration under Paragraph 29.

In that new arbitration, the Tribunal would determine whether the U.S. has cured the breach or whether the compensatory adjustments supplied by Canada, the compensatory adjustment singular was consistent with the original award and the extent to which the adjustment should be modified or whether it should be terminated, and that is at Paragraph 31.

The Tribunal's Award in that second arbitration would be effective as of the date that the compensatory adjustment

was imposed.

Now, let's go back to my hypothetical. Assume that the Tribunal finds that the U.S. had, in fact, cured the breach, under Paragraph 32, the Tribunal would direct Canada to stop allowing the increased exports and to impose additional export volume restraints to compensate for the excess export volumes that Canada had allowed. And that order of the Tribunal would be retroactive to day 31. That outcome in 32, that retroactive compensation is expressly mandated by Paragraph 32. And it is mandated in the very same provision in the very same provision Article XIV that includes Paragraph 22, but there is no language in Paragraph 22 that specifies a similar retroactive application of the Tribunal's determination on compensatory adjustments.

If we go back to the Paragraph 22 demo, in fact, Paragraph 24 indicates quite the opposite. It provides that an adjustment may only be applied from the end of the reasonable period of time until the breaching Party cures the breach, or on a prospective basis only, in other words.

Let me finish the discussion of step one under the Vienna Convention by going back to the term to cure. We heard a little bit about that this morning. The ordinary meaning of "cure" in its context is plainly to eliminate or remove the breach. Although the U.S. seeks to characterize remove as the narrowest interpretation of "cure," it offers no credible basis

for rejecting it. None of the alternative definitions it offers can plausibly be interpreted to mean compensation for the consequences of a past breach when it is used in the context of curing the breach and the procedures set forth in Paragraphs 22 to 24 of Article XIV of the SLA.

The U.S. tries to disguise the fact that the ordinary meaning of the cure does not support its position by reading additional words into Paragraph 22 that are simply not there. It argues Canada's interpretation of proper quotas beginning on July 1st of 2007, did not remedy, rectify or heal the effects of the overshipment.

In discussing its remedy proposals, the U.S. goes even further, cure the breach becomes cure the breach, cure the effects of the breach on U.S. lumber producers. Paragraph 22 does not require that a Party cure the effects of the breach. It requires that a Party cure the breach. "Cure" means to remove or to stop without any implication that redress for past effects is also required.

The extra words the U.S. is arguing for aren't there and they can't be read into the text to radically change the meaning of Paragraph 22.

Let me move on to the next step under the Vienna Convention. Article 31(3). This provision requires taking into account, together with context relevant rules of international law applicable in the relations between the

Parties. This includes other trade agreements to which Canada and the U.S. are Parties, such as WTO and the NAFTA.

As I said in my introduction, the fact that WTO and Chapter 20 of the NAFTA are prospective remedy systems is really not in dispute. It is evident and scarcely surprising that the trade negotiators for the U.S. and for Canada structured the dispute settlement provisions of the SLA after those of the WTO and Chapter 20 of NAFTA. All the elements of Article XIV that I just went through with you demonstrate that prospective-only nature of Paragraph 22, and they are all modeled after the rules of the WTO and NAFTA Chapter 20. The U.S. has put forward various arguments to attempt to distinguish Article XIV of the SLA from the NAFTA Chapter 20 and the WTO. Canada has shown that none of these arguments has merit.

First, the U.S. points to Article XIV(2) as proof that the SLA explicitly rejected the WTO and NAFTA as models. Let's take a look at Article XIV(2). Even a brief examination of this provision demonstrates that it contains no such rejection. Simply, this paragraph provides that for as long as the SLA is in effect, the Parties will not litigate any disputes arising out of the SLA using any other dispute settlement process, including those of the WTO or NAFTA. This rejection of all other fora for the settlement of disputes does not mean that the U.S. and Canadian negotiators were rejecting their dispute

settlement model.

Second, the U.S. asserts that the differences in terminology among the WTO, NAFTA, and the SLA imply substantive differences in their meaning. Well, the agreements do use different terminology. The U.S. fails to show any material difference in substantive intent of the respective rules of each of these dispute settlement systems. As I said earlier, NAFTA and the WTO do not share between themselves the same terminology, and yet Canada and the United States agree they're both prospective.

The U.S. has also argued that the SLA is unlike the dispute settlement provisions of the WTO and NAFTA because it does not contain a reference to or draw a distinction between prospective and retrospective remedies. But neither the WTO nor the NAFTA uses the terms "retroactive" or "prospective" in reference to the remedies they provided.

In this respect, all three agreements are precisely the same. In fact, the language of Article XIV of the SLA, if anything, more clearly demonstrates the prospective-only intent of Paragraph 22 because of the contrast we just discussed between Paragraph 22 and Paragraph 32.

NAFTA Chapter 20 and the WTO dispute settlement rules simply do not use the terms "retrospective" and "prospective," even though everyone agrees these are prospective-only systems.

Canada noted other elements of similarity in its

Statement of Defence. Let me be clear on this. Our point is not that each element on its own makes our view right and the U.S. interpretation impossible.

Rather, Canada's position is that if you look at these similarities collectively and you contrast them with the provisions common in investment treaties, you'll see the SLA tracks the NAFTA, WTO model. If the Parties intended to create a dispute settlement system that was consistent with retrospective-based regimes, the Agreement would have looked very different.

The U.S. is also wrong in trying to apply Article 31 of the ILC Articles to this dispute. When you look at the text of the ILC Articles and Commentary, you see that the ILC Articles play a residual role only. This is clear from the text of Article 55 which confirms Canada's interpretation. Up on the screen you have that text, and that is Exhibit RR-26.

What does Article 55 tell us? It says that the ILC Articles do not apply where a breach of an obligation is governed by special rules of international law. And the Commentary to ILC Article 55 gives further explanation.

When drafting the primary obligations that apply between them, states often make special provision for the legal consequences of breaches of those obligations. Here, the SLA, like the WTO and the NAFTA, has special dispute settlement rules. Indeed, Article XIV of the SLA, which sets out these

rules in 32 paragraphs, is the longest provision of the SLA with the exception, of course, of the definitions provision, Article XXI.

On to remedy. I would like to turn now to the four alternative U.S. proposals for compensatory adjustments. Let me start by saying this is an issue that you do not need to reach. The U.S. is demanding remedies for a breach that no longer exists. Compensatory adjustments are applied only if the breaching Party continues to breach beyond the reasonable period of time, and then only until it has cured the breach. Canada has already cured the breach, and the matter is done.

Even assuming that the SLA requires compensation for past breaches, the compensatory adjustments proposed by the U.S. are not justified. They are complicated and may lead to uncertain results. They employ inconsistent means. They even have inconsistent goals. They bear little relationship to the actual breach and they are disproportionate.

These difficulties tell a story. They demonstrate that none of this was intended by the Agreement. Where the SLA provides for compensation, it is on the one-for-one basis with respect to the measure itself, not the effects of the measure.

You'll recall from our discussion of Paragraph 32 a few minutes ago that the retroactive compensation provided under that paragraph is a simple one-for-one offset of the export or import measure at the border.

Five percent too little quota, 5 percent more. Five percent more, 5 percent less. The remedy is a reduction in quota to compensate for every unit of quota overshipment regardless of the effects of that measure or whether the original unjustified action reviewed by the Tribunal had any market effect.

The U.S. wants you to take this mechanism and stretch it far beyond its intended scope. The U.S. wants you to decide who within each country is supposed to pay and who was supposed to benefit. They stretch it in two ways. First, they stretch it back into the past. They ask you to apply compensatory adjustments after the breach has stopped to compensate for the consequences of that past breach.

As I have discussed, a compensatory adjustment should only stay in place until the breaching Party has cured the breach. Second, they stretch it for different purposes. They don't just ask you to offset a continuing breach. They ask you to do other things, to calculate consequential damages and award reparations or to recapture in some way supposed benefits.

Trying to stretch the mechanism like this, confronts immediate problems. A future export restriction is not designed to address the past. This is why the U.S. has been unable to show you any agreement where a future export restriction is used in this way, and the SLA provides no

guidance on how to do it because it is not supposed to be done. Stretching the mechanism to different purposes not only violates the Agreement, it introduces a whole new set of distortions. Having abandoned the SLA's only goal for a compensatory adjustment, the U.S. waivers from one newly invented goal to the next. At one point, it suggests recapturing benefit supposedly enjoyed by Canadian producers.

Then it tries reparations for consequential damages supposedly suffered by U.S. producers. After that, it proposes an extraordinary reduction and export quota to make the quota binding at a time when the market is slack. The U.S. proposes all of these things, but it doesn't even attempt to address their own inconsistencies. As I walk you through these issues, and later as you hear testimony from the expert witnesses, I urge you to ask yourselves, is there any basis for this in the SLA? The answer is no.

Let me look at some of the specifics. The first remedy proposal attempts to stretch the Agreement's remedy to a new purpose. The U.S. proposes to recapture a benefit that Canadian producers supposedly enjoyed during the breach. Everything about this proposal is fictional. The U.S. suggestion that lumber exporters in Quebec, Ontario, Manitoba, and Saskatchewan shipped unlimited amounts while evading the export tax is false. It is uncontested those procedures limited their exports to the quota that was imposed at the

time. Dressing the proposal is an economist's report is also false. There is not even an attempt to measure any economic gain from the breach. And the proposal departs utterly from the goal of the SLA. If a province ships a single piece of wood more than its quota, the U.S. would have you impose an export tax on all of its exports.

How do you find authority for this in the mechanism that imposes compensatory adjustments until the breach is cured? Let's move to the second proposal. Here the U.S. heads off in a totally different direction. It drops the pretense of recapturing a benefit and pursues a different goal.

Reparations for consequential damages of the breach. I have already shown that there is no damages mechanism in the SLA. There is no authority to award reparations. But let's look also at the practical problems.

First, is the calculation of consequential damages. In the damages agreement, the burden of proving damages falls squarely on the Claimant. We all know that. The U.S. would have to prove its damages with concrete evidence, and it is well established that damages must be proven. They cannot be speculative. But look at the U.S. case. How far short it falls of a concrete damages measure. There is not a clear concept of whose damages should be measured, nor is there an agreed measure. Supposedly distorted prices? Supposedly lost volumes? Lost profits? And there is no concrete evidence of

any harm. No evidence of sales lost. No evidence of contracts broken. Just an economist's simulation based on highly speculative assumptions. Even if there were damages in the SLA, the U.S. case would fail because the most elemental burden of proof has not been met.

Second, how do you provide reparations? In a damages determination in commercial arbitration or investment arbitration, the loser writes a check. It's pretty easy but the SLA provides no such remedy. The U.S. presses into service the only tools provided under the Softwood Lumber Agreement, an export tax or a volume restraint to be applied in the future. Think of the complexity this involves. The market is very different today from 2007. It may change again.

If you impose a restriction, how long do you keep it in place? Do you make a guess now and just hope it's right? Do you try to measure the effect as the market changes and modify the measure over time? What are you measuring? Prices, volume, profit? Whose profits? Do you have a measurement tool that is not speculative? Importantly, do you have continuing jurisdiction to use it?

We could spend a lot of time arguing about each of these points, and I'm confident that I could show you that the U.S. proposal is both speculative and unworkable, but we believe that you should discard the second proposal by asking a much simpler question: Where is the authority for this in the

SLA? This whole complicated business has no grounding in the Agreement. If the Parties had intended to provide reparations for consequential damages, they would have said so, and they would have adopted a straightforward process to award damages. They did not do that, and the Tribunal should rule accordingly.

That brings us to the third proposal. Here, the U.S. confronts the problem of stretching a future remedy to address the past. The concept is simple--reduce export volumes by the amount of the breach--but the breach occurred in the past when quotas were binding. Current conditions are very different. The market now is weak and the quotas are not binding, so the U.S. is asking this Tribunal to artificially recreate the conditions of the past. It is asking you for an extraordinary intervention to reduce the export quota to make them binding. It then asks you to adjust that new fictional quota to impose the remedy. There is no authority for this in the SLA. You are being asked to predict markets and set quota levels based on economic projections. That is not how the Parties agreed to set quota. The Parties agreed on a very different and detailed mechanism. In fact, the mechanism is the mechanism that you examined in the liability phase of this arbitration. There is no authority to intervene in that mechanism and change it.

Now, that brings me to the final U.S. proposal. The final U.S. proposal asks the Tribunal to intervene in the quota calculation itself, adjusting Expected U.S. Consumption in the

future.

Again, there is no authority for this in the SLA. There is no basis in economics. Indeed, the U.S. proposal starts with the false assumption that Canada had filled its quotas in recent months, when, in fact, shipments fell far below the quota amounts.

You can discard this proposal very quickly. The Tribunal has authority only to order export taxes and volume restraints. It does not have authority to intervene in the workings of the Agreement and alter the mechanism agreed to by the Parties.

Let me return to our starting point. What matters in this debate about compensatory adjustments is not economic models and data. What matters are the provisions of the SLA. I have walked you through some aspects of the U.S. remedy proposals, not to debate them, but to show you how far they stray from the provisions of the Agreement. The goal of the SLA, like other trade agreements, is to have the breaching Party stop the breach, and failing that, to offset the ongoing breach. It does not seek to correct past effects or to recreate past conditions. It does not call for the recapture of benefits or for the reparation of consequential damages.

This dispute can and should be decided based on the text of the Agreement. Soon, we will examine the Parties' expert witnesses. For the reason I just mentioned, I intend to

keep our cross-examination of Dr. Neuberger short. This Tribunal should not be distracted from the real issue in this proceeding. Canada is confident that when you have heard the legal argument and have examined the many problems raised by the U.S. proposals, you will agree that the SLA provides no remedy for a breach that has been fully stopped.

Thank you very much.

CHAIRMAN BÖCKSTIEGEL: Thank you very much indeed.

I will take it that this is the appropriate time for the lunch break. We would restart again at 2:30. The question is can we have a little bit of what the Parties expect in the examination of the first expert, Dr. Neuberger. The question is should we plan to end the afternoon session at 5:30 or would it be helpful if we go slightly beyond that just to make up some time. We are flexible as far as that is concerned.

Are the Parties in any position to make a comment on that right now or would they like to consider that over lunch?

MS. DAVIDSON: We're here for this purpose, Mr. Chairman. So, if the Panel would like to go this evening, would like to continue, we'll continue until the Panel would like to break.

MR. AGUILAR-ALVAREZ: That is also agreeable to Canada, Mr. Chairman, and as I said, our cross-examination of Dr. Neuberger will not be long.

CHAIRMAN BÖCKSTIEGEL: I see. It obviously depends

how you deal with Dr. Neuberger or that we have redirect and at which length and so on. I will take it Professor Kalt will come up tomorrow morning.

MR. AGUILAR-ALVAREZ: Professor Kalt is here.

CHAIRMAN BÖCKSTIEGEL: That's good to know anyway, but that probably would be too much, but let's see how we go on. We take it--so we take it that we have some flexibility to go beyond 5:30 this afternoon, and we'll see how it goes, and we will not go into really the evening, obviously, but 5:30 is rather early. So maybe we can add a half hour or even an hour if that is helpful just to get some order in the proceedings.

Okay, have a good lunch. See you at 2:30.

(Whereupon, at 12:24 p.m., a luncheon recess was taken until 2:30 p.m.)

AFTERNOON SESSION

CHAIRMAN BÖCKSTIEGEL: All right. If we are ready to start, we might as well. Our next point on the agenda, as you know, is the examination of Dr. Neuberger. We will start with an introduction, but first I would like Dr. Neuberger, perhaps, to come up and sit at the table.

Welcome, sir.

MR. AGUILAR-ALVAREZ: Mr. Chairman, can I raise two quick procedural questions?

CHAIRMAN BÖCKSTIEGEL: Go ahead.

MR. AGUILAR-ALVAREZ: First one is just a point of clarification Procedural Order 3 states that direct examination is limited to confirmation of the written reports, unless there are new developments as of September 15th, and second, to confirm that we are ready to put Professor Kalt up for testimony tomorrow morning.

CHAIRMAN BÖCKSTIEGEL: Great. Great. Wonderful. I think our ruling was that anybody can take ten minutes for an introduction anyway, but beyond that, only if there are new developments, which I think is the idea.

Now, we are very fortunate in this case that both experts have had--actually, you have had three opportunities to submit something in writing. Professor Kalt has had two opportunities, but will have an opportunity to rebut your third report tomorrow. So, we have heard a lot from the experts

already in advance of this hearing. And that, of course, is extremely helpful, I'm sure, for the Parties and the Tribunal; and it will shorten the examination, I would imagine, because many questions that originally one had probably have been answered by now or responded to, at least, even though I'm sure differences of opinion remain.

All right. Dr. Neuberger, if you would be kind enough to look at the statement in front of you and if you agree, read it out loud.

JONATHAN A. NEUBERGER, CLAIMANT'S WITNESS, CALLED

THE WITNESS: I am aware that in my testimony I have to tell the truth and nothing but the truth. I am also aware if I do not comply with this obligation, I may face severe legal consequences.

CHAIRMAN BÖCKSTIEGEL: Thank you very much indeed.

Would you like to introduce Dr. Neuberger.

MR. SCHWIND: Thank you, Mr. Chairman.

DIRECT EXAMINATION

BY MR. SCHWIND:

Q. Good afternoon, Dr. Neuberger.

A. Good afternoon, sir.

Q. You prepared three Expert Reports in this arbitration; correct?

A. That's correct.

Q. Could you direct your attention to the hearing binder

in front of you.
A. I have it.
Q. If you could turn to Tab CR-3.
A. Yes, I'm there.
Q. You recognize this document as your May 29, 2007, report bearing your signature on Page 30?
A. May 29, 2008, yes.
Q. 2008. If you could please turn forward to the document behind Tab CR-13?
A. Yes, I'm there.
Q. Again, do you recognize this as your rebuttal Expert Witness Report, dated July 21, 2008, with your signature on Page 30?
A. Yes, that's correct.
Q. All right. If you could please turn forward to the Tab CR-29.
A. Yes.
Q. And you recognize this document as your September 15th, 2008, second Rebuttal Expert Witness Report bearing your signature at Page 13?
A. Yes, that's correct.
Q. And, Dr. Neuberger, you've had a number of days since you prepared your second rebuttal report; correct?
A. It's been a week, yes.
Q. And during that time, have you become aware of any

corrections or clarifications to any of the information contained in any of the three reports that you identified?

A. There is one clarification that's not specifically addressed in the second rebuttal report, and then I also have a correction to one of the footnotes in that report, in that second rebuttal report.

Q. First, Dr. Neuberger, what clarification do you refer to?

A. The clarification I would like to make refers to the issue of contemporaneous data versus revised data in computing the magnitude of the violation by the Option B Regions.

In my Expert Report, I used revised data to compute the extent of the overage during the first six months of 2007. Dr. Kalt used contemporaneous data, that is to say, data that were available contemporaneous to the violation. I used revised data largely because I did not have available to me a consistent set of contemporaneous data. I tried on several occasions to reproduce what I felt was a consistent representation of the data that were available in the first half of 2007, and I was never able to satisfy myself that the data that I did have access to satisfied a criterion that it really did represent the contemporaneously available data. Accordingly, I used the revised data, data that had become available at a later point in time and revised by the issuing agencies.

Dr. Kalt used contemporaneously available data, which I understand his client provided to him. Again, I did not have access to those, that particular data set and based on the data that I did have available to me, I just could not convince myself that I had been able that I had data that were truly contemporaneous.

In the first report, I discussed why I thought revised data might be more appropriate, depending upon the situation, in the last couple of days conversations with counsel have convinced me that the contemporaneous data are more relevant or more appropriate to use for this purpose. And the reason I say that is RQVs, regional quota volumes, once they are computed using contemporaneously data, are never revised.

Even though the export data might reflect how much over those RQVs the exports from Option B Regions were during the first half of 2007, the RQVs themselves do not change, and the data I used was very much involved in computing those RQVs.

So I now believe, based on the information that's become available to me since I wrote my second rebuttal report, that the contemporaneous data are more appropriate.

Q. Dr. Neuberger, what is the significance of this clarification to your calculations of the overshipments during the first half of 2007?

A. In my reports, as described in my reports using the revised data, I quantified the extent of the overage during the

first six months of 2007 as approximately 182 million board feet. If you use the contemporaneously available data, that number is higher, about 216 million board feet.

Q. Thank you, Dr. Neuberger. You mentioned you had a correction to make or something to your report?

A. Yes. If you look at Footnote 11 in my September 15th report, the second sentence needs to be revised and I can read what's there, and then the revision, or if you prefer, I can read the revision.

The revised sentence should read, "Estimates in the economics literature of export supply elasticities for Canadian softwood lumber fall in the approximate range of 0.6 to 1.0 with sensitivity analyses as low as.4 and as high as 1.4." That's the only change I would make.

CHAIRMAN BÖCKSTIEGEL: What's the original version? Do we have that there?

THE WITNESS: I do. The approximate range I identified is 0.4 to 1.1. I would change that to 0.6 to 1.0 with evidence in the literature that sensitivity analyses have been conducted on export supply elasticities as low as.4 and as high as approximately 1.4.

MR. SCHWIND: Thank you, Dr. Neuberger.

Mr. Chairman, that's all we have at this time.

CHAIRMAN BÖCKSTIEGEL: Thank you.

Now we come to cross-examination by the Respondent,

then.

Excuse me.

ARBITRATOR VEEDER: Sorry for intervening. I didn't quite catch the correction to your Footnote 11. You corrected the figures in the approximate range of 0.4 to 1.1 as 0.6 to 1.0; is that right?

THE WITNESS: Yes.

ARBITRATOR VEEDER: What happens to the next sentence?

THE WITNESS: The figure I use, 0.57, is near the bottom end of the range of typically observed or typically estimated elasticities. It is within the range of the sensitivity analyses that have been performed in various economic studies.

ARBITRATOR VEEDER: So that sentence stays as it is?

THE WITNESS: It should probably be changed to what I just said, which is at the bottom of the range of observed or estimated values and within the range of the sensitivity analyses that have been performed.

ARBITRATOR VEEDER: Thank you very much.

THE WITNESS: Thank you, sir.

CHAIRMAN BÖCKSTIEGEL: Respondent, please.

MR. AGUILAR-ALVAREZ: Follow-up clarification, if you could read how the last sentence should read.

THE WITNESS: The figure I used, 0.57, is at the bottom of the range of estimates in the literature and within

the range of sensitivity analyses conducted in that literature.

CROSS-EXAMINATION

BY MR. AGUILAR-ALVAREZ:

Q. Thank you, Dr. Neuberger.

A. Yes, sir.

Q. My name is Guillermo Aguilar-Alvarez, and I'll be asking you questions this afternoon.

Dr. Neuberger, you are an economist by training, are you not?

A. I am.

Q. And your testimony in this arbitration is as an economist; correct?

A. Yes, sir.

Q. You are not a lawyer, Dr. Neuberger, are you?

A. I am not.

Q. So, you are not qualified to provide expert testimony on the proper legal interpretation of the SLA, are you?

A. I am not, nor have I attempted to do so.

Q. Is this the first time, Dr. Neuberger, that you have testified in a trade dispute between two sovereigns?

A. Yes.

Q. Let's go to one of your calculations. You have calculated the amount of lumber overshipped by Option B exporters during the first six months of 2007, haven't you?

A. Yes.

Q. And using data available to you at the time of the first report I just heard your clarification, but at the time of the first report, your calculation during this period is of an overshipment of roughly 182 million board feet; correct?

A. That's correct.

Q. You have also testified, haven't you, that these overshipments caused prices in the U.S. to drop in this period relative to what they would have been in the same period absent the overage? Correct?

A. Based on the economic simulation underlying my second remedy, I found that that economic model, those economic simulations revealed or identified an almost $2 drop in the average price per thousand board feet in the United States.

Q. Everyone selling lumber in the U.S. market would have experienced the lower price; is that correct?

A. That's correct.

Q. Including Option B exporters; is that correct?

A. Yes.

Q. Can I ask you to take a look at Footnote 13 of your first report, Dr. Neuberger. We should have it up on the screen in a minute. I think there's an issue with audiovisual. Bear with me. There it is.

Could you please highlight the first sentence in the footnote? You testified here, Doctor, that Canadian Option B exporters benefited because they exported more softwood lumber

to the U.S. during the first six months of '07; correct?

A. That's what the footnote says, yes.

Q. Then you go on to say--right under the footnote--that Canadian exporters earned incremental profits from their conduct to the detriment of U.S. producers; right?

A. Yes. In the last sentence?

Q. Yes. Yes, thank you. Your reports don't consider the lower

Price you calculated would have the effect of reducing profits, do they?

A. Are you referring to profits of Canadian producers?

Q. Option B exporters, that's the subject--

CHAIRMAN BÖCKSTIEGEL: Can you speak up a little bit more, or go closer to the mike?

MR. AGUILAR-ALVAREZ: Yes.

BY MR. AGUILAR-ALVAREZ:

Q. The object of the last sentence in your report is to state that Canadian exporters earned incremental profits so, yes, the question relates to Canadian Option B exporters specifically?

A. I did not specifically analyze the impact of Option B producers on their own profits. What I did do was infer from the behavior of exporters in those regions that assuming they were acting rationally, that it was in their economic best interest to exceed or ship the amounts that they did. If it

had not been in their economic best interest to do so, they would not have done it, but I have not specifically analyzed the profits of Canadian exporters.

Q. Your reports do not calculate the net effect on Canadian exporters; correct?

A. That's correct.

Q. Could you please turn to Paragraph 58 of your second report, Dr. Neuberger.

A. Could you remind me which?

Q. Paragraph 58, second report. Yes, I can help you. I think it will be CR-4, if I'm not mistaken.

A. It's 13. I have it.

Q. I specifically want you to focus on the sentence starting with "my analysis."

"My analysis shows that the overages had a significant price effect on the U.S. market that should be remedied." That is your testimony; correct?

A. It is, yes.

Q. And we just heard that you estimated the price effect of the overshipments as a decrease of a $1.94, didn't you?

A. That is correct.

Q. Could we go to Paragraph 59, again, but this time of your first report. Towards the bottom of the paragraph, Dr. Neuberger, you indicate that the average U.S. price of lumber during the breach period was $290.66; isn't that right?

A. Yes.
Q. And you also have the $1.94 in that same paragraph; correct?
A. I do.
Q. And $1.94 is less than 1 percent than 290, if my math is correct?
A. That is correct.
Q. Let me take you to another one of your calculations. I would like you to please take a look at Paragraph 13 of your third report, the report of September 15, if you may, please?
A. What was the paragraph number again, sir?
Q. Thirteen.
A. Yes, I'm there.
Q. In this paragraph, again, towards the end you testified that U.S. producers were harmed by Option B exporters by an amount that you calculated, $34 million; correct?
A. That is the lost producer surplus according to the economic model I used for my second remedy, yes.
Q. And if not money damages were possible here, Doctor, this is the amount you would say Respondent should pay; correct?
A. I would certainly consider this figure as a potential remedy. I have certainly been involved in other cases where other remedies, other potential measures were used. But certainly, and as I indicate in this paragraph, using the

standard of economic harm that Dr. Kalt puts forward in his second--or actually both of his reports, the loss in producer surplus to U.S. producers was $34 million, yes.

Q. Put simply, that means they made $34 million less than they would have but for the decrease in price; correct?

A. I think you have to be careful about defining your terms. We're talking about economic profit here. Accounting profit and economic profit are not the same concepts.

Q. Which profit did you calculate, Doctor?

A. This figure represents economic profits.

Q. Now, you are aware, aren't you, that the SLA does not provide for payment of monetary damages? Right?

A. As you yourself pointed out, sir, I'm not a lawyer, so I don't know whether the provisions of the SLA can be interpreted to require or allow for such compensation or not.

Q. Does the SLA, Doctor, direct the arbitrators to use export measures?

A. It does.

Q. And you say, don't you, that--well, let's turn to Paragraph 16 of your third report now. Specifically to the passage where you discuss the 86.7 million figure that has to be collected.

A. Yes, I see that.

Q. You say here, don't you, that use of export measures requires a collection of $86 million to return $34 million to

U.S. producers? Correct?

A. Based on the economic model I used in my second remedy, that's correct.

Q. Okay. Towards the end of that paragraph--let me take you exactly. At the beginning of Paragraph 17 in that same third report, the very first sentence, you indicate that this amount, the 86 million, by which the additional export charges exceeded or exceed the lost U.S. producer surplus overstates any purported punitive aspect to this remedy because Canada itself will collect the export charges. Your point here is that there is no punishment because the money is going to the Canadian Treasury; correct?

A. I don't say that there's--I don't say here there's no punitive point here. I mean, all of the remedies I attempted to construct in this case were intended not to be punitive. There was never any punitive aspect to the calculations that I performed. The point I'm making here is that you can't just look at the difference between the additional export charges that I'm recommending and the lost producer surplus and say that represents some punitive amount. It does not. It does not because, in part, Canada is the entity collecting the tax.

And I would also point out that the intended effect of the remedy is to raise prices in the U.S. and that those same Option B producers will enjoy that benefit. They will be able to sell at a higher price. So, again, just looking at the

difference, naively between the total amount of the tax and the estimation of producers, lost producer surplus is not an indication of the punitive nature of these remedies, which I have attempted to make not punitive at all.

Q. And that is the difference between the million and the 86 million; correct?

A. I'm not sure what this is, but the difference between the total estimated tax, which is $86 million and the estimate of lost producer surplus, which is $34 million.

Q. Let me ask this as an economist, Doctor. You have estimated damages in commercial litigation, haven't you?

A. I have.

Q. And you have never been involved in a case where the breaching Party receives compensation for the breach, have you?

A. I don't believe so, unless there were counter charges.

Q. You use an economic model to measure the effect on the U.S. lumber market of Option B overshipments, don't you?

A. In part, yes.

Q. And your economic model simulations are described in Appendix A to your first written report; correct?

A. That's correct.

Q. And your model uses elasticities of supply and demand; correct?

A. It does.

Q. Isn't it basic economics, Doctor, that a change in

supply of exports to the U.S. in response to a policy intervention that affects the price in the U.S. will be more responsive to that price change than the response of total production inside Canada?

A. There are several elements to that question. I think if your question is will export elasticities, export supply elasticities for Canadian softwood lumber, to make it very specific, exceed those of general supply elasticities of Canadian softwood lumber, then my answer would be, in general, yes.

Q. You testified that you reviewed the literature for export supply elasticities, didn't you?

A. Yes.

Q. And you provide a range that you found in the literature. We just looked at your footnote and how you modified that; correct?

A. That's correct.

Q. And your footnote now reads that the .57 is at the bottom of a range, the bottom of which is .6; correct?

A. Yes.

Q. Wouldn't you say that it's below the bottom?

A. Again, I've seen a fair bit of literature that attempts to estimate these elasticities, the lowest value I saw was approximately .6, yes. 0.57, if not rounded to 0.6, is below 0.6.

Q. And 0.57 is not within a range of .6 to 1.0, is it?
A. It is not. I would note that it's in the range of export supply elasticities that have been tested in models and--I'll stop there.
Q. Could I ask you to, please, take a look at Exhibit 2 of your first report. This is the exhibit to your report where you list the documents that you have reviewed for preparation of your report.
A. Yes.
Q. And in that list, at number nine, appears a work with the title "Economic Impact of the Expiration of the SLA," expert study of Robert Stoner, Henry McFarland, and Stuart Gurrea, Economists Incorporated, October 6, 2004. You're familiar with that piece of literature, Doctor, aren't you?
A. I am.
Q. Let me now ask you to look at Page 2 of your first report. I'm sorry. Actually, I misspoke. It's Page 2 of your model, so that would be the appendix, Appendix A, to your first report.
At the middle of the page there is a paragraph that starts with that one right there, these equations can be restated in terms of percentage, and the paragraph goes on.
A. Yes.
Q. Do you remember whether this paragraph was lifted verbatim from the McFarland literature that we just saw in Item

9 of the documents that you reviewed, Doctor?

A. I don't recall that. It's pretty much a paragraph--excuse me, defining certain terms. If it were identical, I wouldn't find that terribly remarkable or terribly revealing.

Q. Do you remember drafting this paragraph, Doctor?

A. I work with staff on the development of all of my reports, and the initial drafting of this appendix may have been assigned to one of my colleagues, and I believe that's the way the initial draft of this paragraph was produced. I certainly reviewed every word in every paragraph of all three of my reports, but if this came word for word out of the paper that you cited a moment ago, I wouldn't find that particularly unusual, especially, since it's primarily a definitional paragraph.

Q. But you are familiar, aren't you, Doctor, with that "Economic Impact of the Expiration of the SLA" study by Stoner, McFarland and Gurrea?

A. I am.

Q. And isn't it true that paper runs sensitivities on a range of .7 to 2.0 on elasticities?

A. I recall that.

Q. And you still believe that the range of elasticities that you have included in Footnote 11 of your third report is a better range?

A. I believe so, yes.
Q. Could you explain why, Doctor?
A. There have been several articles in the literature that have described export supply elasticities of Canadian exports to the U.S. I can think of a number of them off the top of my head. There's a paper by Boyd and Krutilla. There's a paper by Zhang. There's a paper by Kinnucan and Zhang. And all of those--there's a paper by Haynes and Adams. All of those papers dealt specifically with export supply elasticities and typically measured those export supply elasticities in the range of 0.6 to 1.0. So that's why I made the recommendation or the clarification that I did to the footnote that I did. It is entirely possible that other researchers have considered other ranges, but based on my review of the literature, that range that I gave you earlier, 0.6 to 1.0, is the range that I believe most researchers have agreed upon.
Q. Footnote 11 acknowledges that you used a general supply elasticity, didn't you?
A. Footnote 11 of which report?
Q. Of report three?
A. That was the footnote I revised a moment ago, was it not?
Q. Yes.
A. Correct.
Q. And you have said in your testimony today that as a

general matter, export supply elasticities are higher than general supply elasticities; correct?

A. Yes. At least as high as general supply elasticities.

Q. And you have also acknowledged that .57 is not only at the lower end of your new range but below that; correct?

A. Yes.

Q. And wouldn't it be lower, even lower if this is a general supply elasticity than what is called for in terms of economic science in export supply elasticities?

A. I agree with the proposition that an export supply elasticity is relevant in this context. I would note the 0.57 was taken from a paper written by two Canadian economists who produced a recent study that I reviewed for purposes of my analyses and which produced--or which provided a fairly extensive literature search and also a consistent estimate of the relevant elasticities. Those are the elasticities that I adopted for the model that I used. I acknowledged based on Dr. Kalt's critique and also my further review of the literature that in this context an export supply elasticity may be more appropriate in this setting. I would note that among the papers that I did review the 0.57 was at the high end of general supply elasticities and, as I mentioned, at the bottom end of the range of the export supply elasticities that I've observed.

So, while there may be a theoretical issue here, I

think, as a practical matter, the 0.57 I used is a pretty reasonable number under both ranges and is a potentially reasonable export supply elasticity. Are higher numbers possible in the range I identified? Yes, they are.

Q. Thank you, Professor--thank you, Doctor. I misspoke.

I would like to ask you about your calculation of the overshipments now. I would ask you to please go to Footnote 28 of your second report.

If I could have the first sentence highlighted, please. For the record, that first sentence reads as follows: "According to the Annex 7B, Paragraph 7, regions can carry forward, carry back between two months only if the region was subject to a volume restraint in both months."

Doctor, is this your understanding or was this represented to you by counsel for the United States?

A. I certainly read the relevant paragraph in the annex and understood it in a particular way in the way that I described here. Obviously, I ran that interpretation by my client and discussed it with Department of Justice attorneys and others, and I stand by the interpretation. I realize ultimately it may be a legal issue how to interpret that statement, but from my nonlegal perspective, this is what I took it to mean.

Q. You say here also that, according to an annex a little later in that footnote, you say that it is your understanding

that there was no volume restraint from October to December of '06, even for regions that elected to be Option B; is that correct?

A. It is. As I understand it, there was a transition period setup in the last quarter of 2006 when the SLA was first getting started and that both Option A and Option B Regions were treated largely as Option A Regions during that period and that volume restraints did not apply to the Option B Regions until January, 2007.

Q. And you base your understanding on Article VI, Footnote 5 of the SLA. I would represent to you that Article VI of the SLA just has two footnotes that appears to be a typo. I believe you were referring to Footnote 2, but I'll be happy to show you a copy of the SLA made available so that you can take a look and verify for yourself.

Maybe if we could put the SLA up on the screen and go to Footnote 2 of Article VI.

Is this the footnote, Doctor, you were testifying about in Footnote 28 of your second report that we were just looking at?

A. I believe it is, and I thank you for the clarification for finding the typo.

Q. Could you please read the last sentence of Footnote 2 that's just been highlighted, Doctor?

A. Would you mind if I stood? I can't see it because of

the lamps on the table.

Q. I can read it. That's okay. The last sentence reads, "In determining the volume restraint levels which would have applied to an Option B Region during the transition period, the carry forward and carry back rules laid out in Annex 7B shall be taken into account for all of the months of the transition period."

Do you see that, Doctor?

A. I do.

Q. Does this cause you to modify your understanding of the SLA?

A. It does not.

MR. AGUILAR-ALVAREZ: I have no further questions, Mr. Chairman.

CHAIRMAN BÖCKSTIEGEL: Thank you very much.

Do we have redirect questions?

MR. SCHWIND: Yes, Mr. Chairman.

CHAIRMAN BÖCKSTIEGEL: Okay.

REDIRECT EXAMINATION

BY MR. SCHWIND:

Q. Dr. Neuberger, you were asked about the supply, export supply elasticities you chose to use in your model. Do you recall that?

A. I do.

Q. And you chose--you used a figure of approximately 0.57

in your model?

A. That's right.

Q. And in your testimony you spoke of a lower end of a range for approximately 0.625 for export supply elasticity?

A. That was the elasticity, the export supply elasticity, that was identified in the paper by, I believe, Haynes and Adams.

Q. Then you mentioned there were some sensitivity analyses done in the scientific literature; correct?

A. Yes.

Q. Could you explain the relationship between the range between elasticities and the sensitivity tests done on those ranges?

A. Numerical estimation of a particular elasticity will provide a point estimate. I would say most economists recognize that each elasticity is an important parameter in an economic model and frequently will test that model to see the impact of alternative estimates.

And so what I've seen in some of these papers is that sensitivity tests attempting to discern the impact of alternative values. So, even though a particular researcher may identify a value of .7 or .8 or .9, they would want to see what the impact on the predictions of the model, depending on what purpose they develop the model for, to see how those differing values affect the outcome of the model, and that's a

sensitivity analysis.

Q. If we--well, back up.

Using the 0.57 figure you used in your model, what did you calculate to be the additional export charge required to bring U.S. prices up by the desired $1.94?

A. $39.65.

Q. And that's per thousand board feet of lumber; correct?

A. Per thousand board feet of lumber, yes.

Q. In your analysis, you multiply that by the volume of lumber in the first half of 2007; correct?

A. I did, yes.

Q. What does the total export charge then rise to, as extrapolated from that volume of lumber?

A. Approximately $87 million.

Q. If we were to use--instead of .57 if we were to use an export supply elasticity of, let's say, .625, what does that do to your ultimate figure of 86 or $87 million?

A. I haven't estimated the exact effect. A higher export supply elasticity will reduce the per MBF charge, and since the volume of shipments in the first half of 2007 doesn't change, it will similarly reduce the total amount of additional export charges that are collected.

Q. Will it reduce that figure down to zero?

A. It certainly will not bring it down to zero. I would say an estimate or export supply elasticity of .625 would

probably reduce that number to the low 80s.

Q. So, we're still somewhere around $80 million as an additional export charge that would be required to raise U.S. prices by the desired $1.94; correct?

A. That's correct.

Q. Mr. Alvarez also asked you about a report or a paper authored by Stoner and McFarland; do you recall that?

A. Stoner, McFarland and Gurrea, yes.

Q. Was that a paper prepared for Economists Incorporated?

A. All three of those people are economists at Economists Incorporated, the firm I work at.

Q. So what is your response to the suggestion that it was cribbed from a prior paper?

A. A couple of staff members that I asked to help me in this particular case also worked in that prior case, so both Dr. Stoner and Dr. McFarland were part of the staff, a team I put together for this assignment, and I think the first draft of the appendix in question was drafted by one of my colleagues.

As I said, I wrote all of the reports, I reviewed every word that went into every report, but it's entirely possible that one of my colleagues used the same language describing the definitions of elasticities that appeared in that earlier paper.

Q. Essentially, your colleagues took that paragraph--if

what Mr. Aguilar is saying is true--took that paragraph from their own report?

A. I believe that's correct.

Q. Now, Mr. Alvarez also asked you to confirm that the $1.94 reduction in price caused by overshipments by the Option B Regions into the United States translates into approximately or less than 1 percent of the lumber prices that you used at that time; correct?

A. The average during the relevant metric was the average price observed during the first six months of 2007 and yes, the $1.94 was less than 1 percent of that average price?

Q. Dr. Neuberger, less than 1 percent, is this in your professional opinion a de minimis effect of Canada's breach?

A. It is not.

Q. Why do you say that?

A. The economic model I developed to study this question identified a distinct discernible quantitative impact, and that impact was $1.94 per thousand board feet during the first half of 2007. I don't consider that to be de minimis or an annoyance.

MR. SCHWIND: Your Honor, that concludes the redirect we have. I add there's some confusion on our side as to the meaning of the Procedural Order No. 3 as far as what we're supposed to do at this time.

CHAIRMAN BÖCKSTIEGEL: Can you get closer to the mike?

MR. SCHWIND: Yes, Mr. Chairman, I apologize for that. To the extent we need to do so now under the Tribunal's Procedural Order No. 3, we reserve the right to call Dr. Neuberger in response to anything Dr. Kalt testifies to at a later point in this proceeding.

CHAIRMAN BÖCKSTIEGEL: I believe that's a correct interpretation of the Order. If you do so now, that will be admissible.

Okay. Any recross from Mr. Aguilar?

MR. AGUILAR-ALVAREZ: Couple of questions, Doctor.

RECROSS-EXAMINATION

BY MR. AGUILAR-ALVAREZ:

Q. You just testified, Dr. Neuberger, that McFarland, Stoner and Gurrea study you took was, in fact, a study of your colleagues within your same firm; correct?

A. That is correct.

Q. And you also indicated in answering my questions that you rejected the range of export supply elasticities in that report; is that correct?

A. I don't think it was a conscious rejection. One of the things that became available subsequent to the production of that report was the study by Stennes and Wilson, which I mentioned was a fairly comprehensive literature review and provided a consistent set of supply elasticities that our team, my team determined was an improvement over the existing

literature at the time. And so we drew the elasticities that we used in my report, my reports here, from that study. That was not a study that was available at the time the earlier report was prepared.

Q. But you ignored the export supply elasticities in your own firm's study, didn't you?

A. I wouldn't say I ignored them. I adopted a different range and drew different conclusions about the relevant elasticities.

Q. Did you even refer to those elasticities your firm developed in your report, Doctor?

A. I don't specifically refer to them in my report.

Q. Your footnote says that sensitivities have been run on .4 to 1.4 in the literature; is that correct?

A. Yes.

Q. Isn't it true that Stoner, McFarland and Gurrea run on sensitivities on 2.0?

A. I believe they did. It's not a published study. It didn't appear in a peer-reviewed journal. The criteria when I refer to the literature, I'm referring generally to peer-reviewed economics articles.

MR. AGUILAR-ALVAREZ: I have no further questions, Mr. Chairman. Thank you.

CHAIRMAN BÖCKSTIEGEL: That concludes the questioning from the Parties?

MR. SCHWIND: Yes, Mr. Chairman.

CHAIRMAN BÖCKSTIEGEL: I ask my colleagues, do we have any questions?

ARBITRATOR VEEDER: No.

ARBITRATOR HANOTIAU: No.

CHAIRMAN BÖCKSTIEGEL: Neither do I.

We have had these several exchanges in written reports. So that has concluded the first examination of Dr. Neuberger very soon.

Do I understand you want to make a procedural--

MS. DAVIDSON: Mr. Chairman, we're prepared to proceed with Professor Kalt, if you'd like to continue.

CHAIRMAN BÖCKSTIEGEL: So are we. It's early in the afternoon. It's the same subject, so I don't see any reason why, after a short break, we shouldn't do that. Thank you for the time being, but you'll stay available, please.

Dr. Neuberger, let me say this, as well--this is on the record--you should not discuss your testimony with either of the Parties until you are called back.

THE WITNESS: I understand.

CHAIRMAN BÖCKSTIEGEL: We'll have a 10-, 15-minute break--we never manage ten minutes anyway--and then we'll have Professor Kalt called.

(Whereupon, at 3:21 p.m., a recess was taken to 3:35 p.m.)

CHAIRMAN BÖCKSTIEGEL: Okay. I take it we may continue now?

JOSEPH P. KALT, RESPONDENT'S WITNESS, CALLED

CHAIRMAN BÖCKSTIEGEL: I've now learned that we are together with Professor Kalt. Have you got the statement?

Would you be kind enough to read it out.

THE WITNESS: I'm aware that in my testimony I have to tell the truth and nothing but the truth. I'm also aware if I do not comply with thes obligations, I may face severe legal consequences.

CHAIRMAN BÖCKSTIEGEL: Thank you very much.

Now, we know the Respondent may not only introduce Professor Kalt, but there's also room for rebuttal to the last report by Dr. Neuberger.

MR. AGUILAR-ALVAREZ: Thank you, Mr. Chairman.

On the issue with which we concluded before the break, Canada was not planning to recall Professor Kalt on recall testimony; however, if the U.S. recalls Professor--Dr. Neuberger, we will have to recall Professor Kalt, as well.

CHAIRMAN BÖCKSTIEGEL: I'm not surprised to hear that.

DIRECT EXAMINATION

BY MR. AGUILAR-ALVAREZ:

Q. Dr. Kalt, you have a hearing binder on the desk. If you could go to Tab Number 2 and please tell me whether that is your first report in this matter, dated June 27, 2008.

A. Yes, this is my first report.
Q. Could you now please turn to Tab Number 4, and there you should find your rebuttal report of August 11, 2008.
A. That's correct.
Q. For the record, the first report is Exhibit Number RR-2, and the Rebuttal Expert Witness Statement is RR-27.
Dr. Kalt, could you briefly introduce yourself, please.
A. Yes, I'm Professor Kalt, Ford Foundation Professor of International Political Economy at the John F. Kennedy School of Government at Harvard University. A Ph.D. in economics. I'm a Senior Economist with Compass Lexecon, an economics consulting firm.
Q. What does it mean to be a professor of international public policy?
A. Political economy. Kennedy School of Government in Harvard is Harvard graduate school for Master's in Public Administration, Public Policy, and Ph.D. programs and public policies and public administration. Many of us carry these titles or some version of "political economy" in our titles.
As economists, we not only study economics, but we study application directly to economics to public policy problems to the structuring of laws, regulations, public policy in general.
Q. Professor, have you studied the softwood lumber

industry?

A. Yes, I began doing research in the mid 1980s on the softwood lumber industry. Published research, I think first in 1988 on softwood lumber dispute which you know in the long run is quite famous. Beginning in early 1990s, I was asked by the Government of Canada and some of the provinces to work on some of the disputes and filed testimony, I believe for the first time in 1992. I can't remember what round--lumber one, lumber two, lumber three--but in 1992 I filed my first testimony and worked extensively then for at least the last years or so on softwood lumber dispute in the softwood lumber industry.

Q. Have you ever been an arbitrator, Professor?

A. Yes, I have. I've been both a selected--party arbitrator, whatever they call it, as well as a chair or neutral arbitrator.

Q. What is your role in this proceeding?

A. I've been asked as an economist to examine the dispute between the Parties, in particular the economic analysis of Dr. Neuberger with respect to remedies that the United States has set forth as possible remedies to the breach.

Q. Professor, let's now turn to Dr. Neuberger's report of September 15, which is the object of your direct examination today.

Have you read Dr. Neuberger's report of September 15?

A. Yes, I have.

Q. And you witnessed his testimony here today; correct?
A. Yes, I did.
Q. Could I ask for the Paragraph Number 5 of Neuberger, Dr. Neuberger's third report to be put up on the screen.
Professor, in this paragraph, Dr. Neuberger quotes you as saying, "In the case of a breach"--I will have that language highlighted--"In the case of a breach that has a continuing effect on market outcomes, undoing the ongoing breach through imposition of an offsetting market restriction on the breaching Party can restore the market equilibrium to that which would have occurred absent the breach."
What did you mean by that language, Professor?
A. Here what I was discussing was the difficulties of trying to provide after the fact reparations retroactively through the use of export measures, taxes or quotas and pointing out on a going-forward basis if that were the problem, one could, if one Party had in some way, say, decided to limit--say the U.S. decided to limit quota, you could offset them by increase quota for Canada, for example. What I'm talking about here it's much more difficult to do that, categorically, more difficult to do that when you're trying to do it after the fact or retroactively.
Q. That is an issue that is raised in Paragraph 6. Let me go to Paragraph 6 because in this paragraph Dr. Neuberger doesn't--fails to or claims that you fail to explain why this

same logic does not apply to using export measures to compensate for past breaches.

Could you respond to these--to this, Professor, please?

A. Sure. Obviously, you all have had a very crisp distinction going on between the Parties as to their legal interpretation but what I'm saying as an economist is the attempt to restore Parties through reparations achieved through export measures, applying those export measures going forward for damages that occurred in the past, is subject to a number of difficulties which make that a highly uncertain and speculative effort. On a going-forward basis when you try to use export measures, if you're trying to use those export measures to compensate someone for past damages, if that's the legal position, that is appropriate. You run into the difficulty the market has changed, the Parties have changed, and in this context the size of the target that you're trying to hit is quite small amidst a lot of movement and uncertainty in the parameters of the appropriate model and the movement of the marketplace.

That's what I'm trying to describe here. This is, indeed, a complex effort, and it's made particularly complex under the circumstances we confront here.

Q. In Paragraph 8 of his report, if we can turn to that, Dr. Neuberger states that the fact that a remedy is complex

does not mean that you should eschew altogether remedying a breach. It starts with "it is true." Until the fourth line.

Do you agree with this statement, Professor?

A. Well, I think from an economic perspective, you have to ask yourself whether you can get reliable nonspeculative results. And if you cannot get reliable nonspeculative results, then that's a principled reason you wouldn't want to do this. And for the reasons I just noted, when you're trying to intervene in the market, rather than a direct cash payment, for example, in a more conventional damages context, when you're trying to achieve reparations in the past by intervening in the market that's moving and changing on you, and you're trying to hit a small target, then you're going to be faced--and I laid out in my reports the reasons why I believe you're faced with difficulty of finding a reliable nonspeculative answer to the challenge the U.S. legal position puts to the Panel.

Q. Would cash compensation be a complex remedy, Doctor?

A. No, well, I'm sure we'll probably have a hearing and the economists will go back and forth, but in principle, it's a matter of calculating as you heard what economists call producer surplus. This is a standard measure of lost economic profit. Our distinction between economic and accounting profit here deals with--fundamentally with sunk costs. If you're really trying to restore someone to a particular position via a

cash payment, you would ignore the sunk costs and just ask what's their net economic change in their net economic well being, and that's what we call producer surplus. And it's a very common concept applied in commercial litigation, even antitrust damage matters, where someone writes a check for the lost producer surplus.

Q. From an economic perspective why is it more complicated to apply adjustments to export measures as opposed to cash compensations?

A. The adjustment measures fundamentally alter the equilibriums in the marketplace going forward. If you use export measures of a tax or a quota, what you're doing is altering the fundamental supply and demand balances in the marketplace. And if you have in mind that you were under the U.S. legal position, that you're trying to hit a particular target of reparations, then you have to account for the fact that you're not just writing a check for the amount of the lost producer surplus; but, in fact, you're going to be altering supply and demand in the marketplace in complicated ways in a changing environment. In that situation, then, you're going to have this issue of can you get a reliable, nonspeculative approach, and it's fundamentally that's the difficulty, you're trying to tweak the market equilibrium to hit a small target in a changing world.

Q. Let me turn your attention to Paragraph 7, Doctor, of

Dr. Neuberger's third report where he again quotes you. If you could take a look at that paragraph, Professor, and explain to us what you were referring to in the quoted language that is being highlighted.

A. This paragraph says that, what I've said is a significant concession. By concession, I would say what I'm describing here is, again, if one thought the appropriate legal position was one of reparations for past damages, then the most direct mechanism for doing so is nondistortive cash compensation, writing a check to a particular subset of damaged Parties. So all I'm pointing out here is this issue that I think is central from an economist point of view with regard to the dispute between the Parties here.

My understanding is that it seems to be the Parties' understanding that the SLA does not provide cash compensation. That puts the Panel, then, in a situation with the U.S. legal theory of trying to use export measures in the future in a changing world.

Q. Right after the quoted language, Professor, Dr. Neuberger claims you have made a significant concession and he goes on to explain why. Is this an accurate description of your opinion?

A. I think Dr. Neuberger was trying to say that I was conceding that some kind of reparation was necessary. No, I'm trying to provide information for the Panel that, from an

economist's perspective, bears on the dispute between the two Parties here. If it's the case that reparations for past damages are appropriate, is the appropriate legal standard, then the most basic way that that can be done in a nondistorted way is through direct cash payment.

Q. What are the economic implications of this distinction between cash compensation and the use of export measures?

A. The export measures, as I've said, alter the underlying supply and demand. Quota restricts physically; in the sense in our language, it cuts off the supply curve. A tax raises the supply curve, makes supply coming from Canada more expensive. That will alter the equilibriums in the marketplace.

On a going-forward basis, that will occur in a market in which there have been dramatic downturns in the size of the market, fundamentally, that is, the collapse in the U.S. housing market, softer prices in the market. So any change that would be implemented under that kind of approach would be implemented in a world considerably changed from the world in the first half of 2007 when the breach occurred.

Q. Now, from an economic perspective, are there other examples of standards of remediation that might be relevant?

A. As an economist, I can't obviously answer the legal dispute between the Parties in how to interpret these paragraphs, but certainly we recognize in public policy that

under certain circumstances we do see, indeed, cash payments for damages, reparations for past damages, but we also see people held liable for the consequences in the form, for example, of cease and desist orders.

If I could provide you with one example I studied and had occasion to teach about, most developed nations in the world have adopted laws, regulations, Court rulings, holding airliners, airline companies for, liable for noise damage, harm done to people around airports. In that approach, for the most part, there was no payment for past damages, but what the world did was essentially cease and desist and hold people liable for the noise, which compelled the airlines to basically retrofit all airliners and build new engines that weren't as noisy as they were before. So, there are these examples that we see; I see them in trade, NAFTA and WTO, clearly has the prospective flavor to them from what I can tell.

Clearly, we see different approaches for different circumstances. The cash damage approach is the basic approach. The most common approaches that I've seen for past damages where reparations are appropriate.

Q. Let's turn now to the core of Dr. Neuberger's report in terms of economics and economic remedies. Could you please turn to Paragraph 12 of Dr. Neuberger's third report.

And if we could put that up on the screen.

Dr. Neuberger claims here that his remedies, "are

closely related to a remedy concept that Kalt endorses." Do you see this, Professor?

A. Yes.

Q. Do you agree with Dr. Neuberger?

A. No. Again, what I've said is, it's an if-then statement. If this table is right, then a producer surplus measure of past damages is appropriate. In most cases if that's the case, my experience has been damages are paid with cash payments. On the other hand, if that table is correct, if Canada is correct in its legal interpretation, my understanding is you wouldn't be coming up with a reparation based remedy.

Q. What do you understand, Dr. Neuberger, to be trying to do with his four proposals?

A. The four proposals, each has--I think it's useful to think of it as, somewhat different targets. Dr. Neuberger has two tax-based or price-based proposals and two-volume based proposals.

The first of the tax-based proposals, under that proposal when Dr. Neuberger's proposal is--and the United States indicated today, it's their preferred remedy. That proposal says fundamentally that the breach constituted Option B producers becoming like Option A producers; and hence, says Dr. Neuberger, the remedy should be the imposition of the Option A tax on Option B producers so long as necessary to collect an amount of tax equal to the tax not paid under this

option back in 2007. So it's essentially treat them like Option A producers, ask what tax they should have paid if they were Option A producers in the first half of 2007 and target that.

The second proposal from Dr. Neuberger targets the price effect that he calculates with a simulation model that you heard earlier. The $1.94. And that approach asks during the first half of 2007 what export tax would have had to be imposed on the Option B producers to change the price in the North American market by $1.94, to raise it back up and have offset back in 2007, first half of 2007 the $1.94.

The third proposal is a quantity-based approach from Dr. Neuberger, and that proposal says adjust the RQVs, the regional quota volumes, to account for the breach or the overage, but because in recent months, and hard to predict but perhaps in the future, the quotas as calculated will not be fully utilized. In our language we will say the quota is not binding.

Under this third proposal, Dr. Neuberger will first reduce the RQV by any amount by which the actual RQV and the forecasted, if you will, need for the RQV, by that difference, make the RQV binding, and then subtract the overage. So it essentially tightens the export controls, tightens the RQVs, and then subtracts further the overage.

The fourth option proposed by Dr. Neuberger would

recalculate, essentially adjust the EUSC, Estimated U.S. Consumption, for the amount of the overage on some going-forward basis.

So the first one targets tax collections as if the Option B producers were Option A producers, during the first half of 2007.

Second one says what tax collections would we have had to make in the first half of 2007 to have raised the price $1.94 in the North American market.

The third one says cut the RQVs after you adjust it to make it binding, cut it by the overage.

And the fourth says adjust the EUSC for the overage.

Q. Now, notwithstanding their complexity, as you testified in the third report, Dr. Neuberger nonetheless believes the proposed remedies are both appropriate and reliable. Do you agree with this statement, Professor, as a matter of economics?

A. No, I don't.

Q. Can you tell me why.

A. Sure. I think it's--may I write a few words on the board here?

CHAIRMAN BÖCKSTIEGEL: Yes.

THE WITNESS: Thank you.

MR. SCHWIND: Mr. Chairman, at this point we'd like to point out this is just a general critique now of Dr.

Neuberger's remedies. This is not responsive to anything that's presented as new in Dr. Neuberger's third report.

MR. AGUILAR-ALVAREZ: If I may, Dr. Neuberger has testified in the third report he has acknowledged that his remedies are complex, but that nonetheless they should be applied because they're reliable and they're appropriate. This goes to the problem of complexity and appropriateness in the light of his testimony in the third report.

MR. SCHWIND: He said that exact same thing in his first two reports, as well.

CHAIRMAN BÖCKSTIEGEL: But he confirmed it in a different way.

I think we can let that go.

Professor Kalt, whatever you write down there you will have to read out for the record at a later stage.

THE WITNESS: Sure.

CHAIRMAN BÖCKSTIEGEL: Don't make it too complex; we're just lawyers.

THE WITNESS: Let me point out--I'm sorry--four problems of this complexity that introduce this lack of reliability and speculativeness to the remedies being proposed.

ARBITRATOR HANOTIAU: Can you speak in the microphone?

CHAIRMAN BÖCKSTIEGEL: Yes.

THE WITNESS: As I see it, the problem you're presented with has sort of difficulties on this complexity

question at two levels. One is the overall approach, and the second is the specifics of the model, which I'll talk about in a minute. From the perspective of the overall approach, you have the following difficulties. Number one, Dr. Neuberger's remedies actually don't target the standard that is implied by a U.S. position which says the purpose of Article XIV Paragraphs 22, 23, et cetera, the purpose of that is the U.S. says is to put the U.S. producers in the position they would have been in but for the breach a reparations standard.

Number one, you have this difficulty that that is not what's targeted by Dr. Neuberger's proposed remedies. The first remedy doesn't even try. All it does is turn Option B producers into Option A producers for tax purposes and targets a tax amount, a tax amount that Option B producers would have paid had they been Option A producers in the first half of 2007. That's not tied conceptually to the producer surplus.

Secondly, as I've stressed, you can only do this now in a going-forward basis. At this point, from this day forward if one intervenes with export measures, you face the problem those would be implemented in changing supply and demand conditions.

Let me go back and say one word. The first alternative doesn't even try to target producer surplus. The second alternative that Dr. Neuberger puts forward targets a $1.94. But a $1.94, if that's what you were trying to target,

doesn't apply to the tax collections in 2007 that would have produced $1.94 price offset, doesn't imply the same producer surplus in a dramatically changed market where the industry is much smaller, for example, Canadian share of the market is much smaller.

The third option, this RQV option, again doesn't really target producer surplus or what the economists agree is the right standard. It just targets a quantitative restriction in a different market.

And the fourth has some of the same difficulties of targeting something other than reparations to U.S. producers, which is what the U.S. position is, and all that would be done under conditions of changing supply and demand. And those are substantial changes. Importantly intervening in a market when one goes in and messes with the equilibrium, intervenes and alters those equilibriums--you have collateral effects. That is under the various proposals; for example, they would raise the price, U.S. consumers would pay much higher prices.

Under the tax proposals, the Canadian Government would collect tax revenues. Option B producers would pay large amounts of tax. Option A producers under some of the options would benefit as the market expanded. You have all kinds of collateral effects independent or different from the target ideally if one adopted the U.S. position of reparations for U.S. producers.

Lastly--I think this is important in any agreement like this--there's implicitly or explicitly a going-forward equilibrium under the undistorted Agreement. The Parties could reasonably anticipate the way this Agreement was written. There are times when quotas weren't binding, for example.

When you go in and use Export Measures to try to provide past reparations, you're distorting that going-forward equilibrium. From a public policy perspective one of the reasons we have public policies which support cash payments for past reparations is those don't distort the going-forward equilibrium, although they can provide reparations. So, these are the kinds of problems that arise in terms of the overall approach of the Neuberger remedies.

BY MR. AGUILAR-ALVAREZ:

Q. Thank you, Professor.

Please turn your attention to Paragraph 6 of Dr. Neuberger's September 15th report. In this paragraph, Professor, Dr. Neuberger has you saying remedying a past breach is only possible "when the remedy is applied to the exact same market conditions in which the breach occurred." You see that highlighted up on the screen. Are you arguing for a standard of perfect accuracy, Professor?

A. No.

Q. Why not?

A. The issue here is not one of perfect accuracy. The

issue is that you're trying to hit small targets that are moving as a result of change in supply and demand conditions. The issue is one of reliability and nonspeculative results.

In addition, as I've stressed, you have the difficulties that I just put up on the board that arise when you try to use export measures on a going-forward basis; that is, you have collateral effects, you distort the going-forward equilibrium among the Parties, and all of those create then this difficulty as I've stressed, difficulties for the proposed remedies that the United States has put forward.

Q. How do you establish that the target is small?

A. Well, when you look at the data and the way it's modeled in Dr. Neuberger's model as one U.S. market, the overages we're talking about amounted to about 1 percent of one day's worth of consumption. The price effects that he estimates that are less than 1 percent of the price. So these are in a very large U.S. market, these are quite small effects, and you can see that in the data; I've prepared data on that.

Q. And that data is in your reports?

A. Yes.

Q. Where?

A. I think it's my Figure 1.

Q. Figure 1?

A. Of my first report.

Q. Do we have Figure 1? Is that it?

A. Yes.

CHAIRMAN BÖCKSTIEGEL: That's on Page 7, is it? I can't see from here.

MR. AGUILAR-ALVAREZ: I don't have it.

THE WITNESS: Yes, it's Page 7.

BY MR. AGUILAR-ALVAREZ:

Q. I don't see the target there, Professor.

A. I can see the target, but it's quite small. That is, it goes to this issue of complexity that the Panel is being presented with. You're faced now, this whole discussion of complexity has joined the issues between the economists and the point I'm stressing here. If you look at that chart, the little black dots in the middle of those bars in the first half of 2007 represent the monthly amount of the overages that have been calculated, and these overages amount to, as I said, quite small amounts both in terms of their quantity and in terms of the price effects that Dr. Neuberger finds in the simulations.

These are quite small amounts and you're trying now--probably be a year, year-and-a-half later; more than that, I guess, maybe two years later--trying to offset those small effects in the marketplace with export measures under the U.S. proposals.

Q. Could we take a look at Paragraph 9 of Dr. Neuberger's report of September 15.

You have made the point in your written reports,

Professor, and again, here this afternoon of the changing market conditions. In this paragraph, Dr. Neuberger contends that he has designed his proposals to account for changing market conditions.

Do you agree with his statement, Professor?

A. I don't think that's accurate for the issue at hand. It is true that the remedies do change in terms of, for example, in a lower-priced market, the first option put forward by the United States, a 10 percent ad valorem tariff. With lower prices, 10 percent ad valorem is 10 percent of a lower price. It would take longer to collect that amount, but as I have stressed, those are not the targets that the U.S. theory of reparations implies. So there's adjustment for market conditions, but not adjustment to keep the remedy focused on the target of proposed reparations that the U.S. says is appropriate.

Q. Going back to your chart, Professor, what do you mean by number three, "collateral effects"?

A. By "collateral effects," I mean when you intervene in the market, in economist language, we say that you start shifting surpluses around. By that I mean if you go into a market, for example, one of the first, the first two remedies proposed by the U.S. by Dr. Neuberger would impose a tax. For example, the Option B producers who Dr. Neuberger's model showed did not benefit from the overage, nevertheless, for

example, would pay very large tens of millions of dollars of this additional tax that would be imposed under any of his tax-based remedies, the first and second alternatives, even though the Option B producers were roughly a wash with respect to the overage. The U.S. consumer in all of these, although the U.S. consumer did not breach, would pay the higher prices. Whatever would result under any of the four alternatives, the U.S. consumer would pay more.

Under the first two alternatives, the Canadian Government collects tax revenues. Under the quantitative alternatives, Option B producers and Option A would see a tighter quota, higher prices under the Neuberger model, as a result of that quota, and would realize benefits as a result of this purported remedy. So you get all kinds of other Parties beyond those who are the target of the proposed reparations under the U.S. approach that would see either pluses or minuses as a result of any of the remedies.

Q. Thank you.

What do you mean by "distortions going forward"?

A. The reason this seems to me to be a problem, as I said, any agreement like this embodies, implicitly or explicitly, a statement by the Parties how they wanted the world to work at the time they started their agreement. To an economist, that's an agreement on a certain kind of equilibrium in the relationship going forward. After the fact,

intervention on a going-forward basis through export measures to provide reparations for retroactive harm, as under the U.S. theory, distorts that going-forward equilibrium.

For example, think of the third alternative Dr. Neuberger puts forward, where you would essentially tighten down the RQV first to make it binding, then subtract the overage and further tighten it. Well, there would be times in our relationship going forward where the quotas wouldn't be binding; that's fine, that's what we agreed to, but now as a remedy you come in and alter that going-forward equilibrium.

To me, what this means as an economist--I can't make the legal decisions at all, obviously--is that the use of export measures by having these effects and difficulties, they point the arrow away from the U.S. interpretation. I can't make the legal interpretation, I'm saying you--economically when you want to pay past reparations, the common thing we will see that economists see in our work is cash damages.

Q. Could I please have Paragraph 16 of the third report of Dr. Neuberger on the screen. And towards the middle of the paragraph, Professor--I have it printed here--Dr. Neuberger testifies that he calculates precisely the export charge that is needed to return $34 million in producer surplus to U.S. producers.

Do you agree with this, Professor?

A. No, I don't think that that's accurate.

Q. Why not, Professor?

A. Two primary reasons: First, what Dr. Neuberger actually calculates--and this is under his second alternative--what he actually calculates is within the context of his model, the export charge that would have been needed to offset that $1.94 that his model predicts. $1.94 reduction that his model predicts the overage caused, but none of the alternatives. Alternative two here is imposed back in 2007. It would be imposed in the future, probably sometime in 2009 or something like that.

The world has changed, and so this statement is not true. The proposed export charge under alternative two. In fact, under his model it looks like it returns about 35 percent more than the 34 million he says there, so his actual remedy is overcompensation, even under the U.S. standard modeling.

The second reason this is inaccurate is important. All of those results are in the context of his model, and that model is very sensitive, and hence, you have questions of reliability, very sensitive to the parameters like the supply elasticity discussion you've heard so much about today.

So, the model is highly sensitive, and it doesn't have the tools to go back and do that, which is the exact targeting on a going-forward basis.

Q. I guess this brings me to a footnote which has been the object of much focus this afternoon and this morning. I

refer to a footnote of Dr. Neuberger's third report. That footnote, as it appears on the screen is the footnote as it stood until this morning.

The footnote has been modified by Dr. Neuberger, and if my notes serve me well, the way it is modified is the last sentence would read: Estimates in the economics literature of export supply elasticities for Canadian softwood lumber fall in the approximate range of.6 to 1.0 with sensitivity analyses as low as .4 and as high as 1.4.

And the last sentence would read--the figure I used .057--0.57, I'm sorry, is at the bottom of the range and in the range of sensitivity analyses conducted in that literature.

In testimony this morning, Dr. Neuberger confirmed that that .57 is a general supply elasticity and not an export supply elasticity.

Is that an error, Professor Kalt?

A. Yes, yes, that's an error.

Q. In Dr. Neuberger's model?

A. Yes.

Q. Why, Professor?

A. If I could draw a few supply and demand curves, I'll try to explain this issue of supply elasticity he has in his Footnote 11.

CHAIRMAN BÖCKSTIEGEL: I think it would be preferable if you try to do it orally; that way, we have it on the

transcript.

THE WITNESS: The issue you have here--

BY MR. AGUILAR-ALVAREZ:

Q. If I might interrupt, I believe the supply elasticity charts, Mr. Chairman, are in Professor Kalt's report, and we can put them up on the screen, and he can speak to them.

CHAIRMAN BÖCKSTIEGEL: Indeed.

BY MR. AGUILAR-ALVAREZ:

Q. It's Page 30 of the first Kalt-Reishus report, Figure A-1. That's it.

A. The issue you see being batted back and forth in this discussion of Dr. Neuberger Footnote 11 is the following.

MR. RYAN: Excuse me. I wanted to provide him a pointer, to point to the chart.

THE WITNESS: Thank you.

In doing analyses of international trade, we draw distinction quite appropriately between what was referred to by counselor and Dr. Neuberger earlier as a general supply elasticity. We would usually say a home country, a home region supply elasticity of the industry which is the elasticity of its production. We draw a distinction between that and elasticity of export supply, the difference being all of your production is total supply. Some of that gets consumed at home in Canada, and what's left over gets exported. So the home production supply is a different concept. That's the total

production supply in a region. It's different than what's left over to be supplied as exports. And what we tried to explain before and what is being discussed here today in Dr. Neuberger's September 15th report is exactly that. I forget how to use this thing.

ARBITRATOR VEEDER: Close your eyes.

THE WITNESS: On the left hand side you see a Canadian region domestic market. And I won't teach all of supply and demand, but you see there a supply curve, the upward sloping line that says "SCA Region." That's the supply curve. The elasticity of that supply curve describes how much supply responds to a change in price. That's what supply elasticity is about.

When price changes, how much does supply change? The export supply elasticity and the export supply curve reflect the willingness in this case of the Canadian region to export after it has satisfied whatever domestic consumption would arise at a given price.

So, for example, if you look at that picture up there on the far left at a price of P sub Naught, P0, at that point if you go over, if you look at that point on the left-hand graph, the amount produced in the Canadian region exactly equals the amount consumed, so there's nothing left to export. The Canadian supply curve, then when you go over to the right, supply of exports comes out from that point. There's no supply

of exports below a price of P. Naught because in P. Naught, everything consumed in the Canadian--everything produced in the Canadian region is consumed.

So the export supply elasticity is the difference between that horizontal bracket you see. The export supply is the difference between total domestic production and domestic consumption, and you only export when you have more production than what you consume.

That's the structure of the analysis is you're trying to find what's left over after your domestic consumption. And it's a basic proposition that in this kind of situation where you have a region that consumes some but not all of its production, its export supply will be more price responsive, more supply elastic than its home production. And the reason is straight forward. When the price rises for exporting region, two things happen. Yes, you get more production at home, but you also get reduction in demand, and that's the gap that's widening between the supply and demand curve on the left-hand side. So you get more supply response for the export market when price rises because you both get more domestic production and you reduce the domestic consumption.

So, the bottom line is export supply elasticities in the context relevant to this case are always going to be higher, greater than--more price responsive than the home production supply elasticities. Dr. Neuberger in his modeling,

and he acknowledged it today, used essentially the supply elasticity for the supply curve on the left-hand graph when he should have been using the supply elasticity for the curve on the right-hand graph. He now responds in the new Footnote 11 by saying that the number that he selected essentially was selected for the wrong supply curve, but it happens to fall within a range that he can find in the literature or at least a range that's been tested in sensitivity analysis.

That, however, doesn't solve the problem for two reasons. Selection of a supply elasticity of .57 comes from a study that was looking at eastern Canada's home production, the left-hand side, supply. One needs to be internally consistent with one's data sources. It can't be the case if he says or his data sources say the .57 is the proper number for the left-hand side. It literally mathematically cannot be the case in these situations that that's the right number for the curve he was really looking for, which was the supply elasticity.

Be that as it may, the fundamental problem is the following: You heard discussion today. There's not tight agreement on what these numbers should be, even if you start focusing on the correct supply elasticity, and the results of his modeling are highly sensitive to the selection of the supply elasticities.

In particular, the different ranges one might do sensitivity analysis on is presenting you as panelists with the

difficulty of choosing a number within a range that is creating highly sensitive results in which there is not agreement in how to narrow down that range. So you're left with no nonspeculative basis for picking a particular number or particular value ultimately for the kinds of remedies Dr. Neuberger proposes.

CHAIRMAN BÖCKSTIEGEL: May I ask a question in that context. I'm not sure whether that's relevant, but it may be, perhaps. You've several times said, Professor Kalt, that the supply that is left over from the Canadian consumption is then exported.

Now, is it factually the case that a producer in Canada will first try to sell as much as possible on the domestic market and then only export the rest? Isn't it sometimes more profitable to export, and doesn't that make a difference?

THE WITNESS: Yes. The phrase "left over," we mean if you look at the left-hand side, that given any price in the market, actually the Canadian consumer will select how much to buy, and the total production, the price will also signal to the producer the total amount produced, and the reason that price holds is because there are foreign buyers and the price settles down, so that adjusted for transportation costs, the price in the equilibrium will have Canadian consumers consuming less and Canadian exporters anxious to go pursue sales in the

U.S. market.

So, the price is sort of arbitrating between whether to sell at the margin inside Canada or externally outside Canada. So the phrase "leftover" is perhaps confusing.

CHAIRMAN BÖCKSTIEGEL: So, there's no preference, really.

THE WITNESS: At the margin, when the market settles down at equilibrium, you're going to be indifferent. That's how markets adjust. In the margin, you're going to say I'm indifferent between the Canadian price and the U.S. price.

CHAIRMAN BÖCKSTIEGEL: Thank you.

MR. AGUILAR-ALVAREZ: Thank you, Mr. Chairman.

BY MR. AGUILAR-ALVAREZ:

Q. In Footnote 11, as we were just looking at, as modified by Dr. Neuberger, he is still standing by .57 as the right supply elasticity as used in his model.

Have you looked at the literature and identified other ranges?

A. I've looked at these ranges that Dr. Neuberger talks about. You can find some of them in the literature. You can find others in the literature. I looked at how sensitive his results are to these ranges.

Q. How sensitive are the results to the elasticities?

A. Dr. Neuberger today said he finds an upper range in the literature of 1.4. Under his alternative two, Dr.

Neuberger proposes a remedy that embodies supply elasticity for exports incorrectly applied, but that's how he uses it, of .57, and he produces this proposed remedy of a tax; I think it's $39.65 under his alternative two.

If we go to the upper end of his range, for example, the 1.4 that he now says he sees in the literature that cuts that $39.65 to $15.99 in his model--just about $16. It cuts it by more than half. That study you mentioned and which Dr. Neuberger talked about, the Stoner, McFarland, Gurrea study, it actually looked at sensitivities at .7 to 2.0. And at 2.0 you cut--Dr. Neuberger's model cuts the alternative two tax from roughly $40 to just under $12. The point of that is whether it's one literature's range or another, you have results that are highly sensitive to the selection of these elasticities. This introduces for a panel the difficulty of how to select a single number as one being more reasonable than another. There's no basis for doing that on the basis of the evidence I've seen.

Q. Does economics provide some standard methods for assessing the accuracy, the results that are generated by these economic models?

A. They can, yes.

Q. Has Dr. Neuberger provided any analysis of the range of potential error in his estimate?

A. Number one, while he has indicated that the literature

shows a range, I do not find his work the actual calculation of how sensitive the results were. Secondly, from a statistical point of view, particularly when you're using the simulation models to try to target a very finely tuned matter, a $1.94, one day's worth of consumption and its impact on the market, to have reliability under that situation, one would both have liked to do sensitivity analysis as well as test the confidence bounds, the statistical confidence, and that has not been provided.

Q. Can Dr. Neuberger's model reliably assess the effect of the export overshipments and his proposed remedies?

A. No. I've tried to stress while this--take one example. While the debate over supply elasticity sounds like technical arguments about fine tuning a number, it turns out the literature is telling us that within the range the literature looks at, Dr. Neuberger's results are highly sensitive to that, and I think what that means is that if one were trying to target the reparations standard put forward by the U.S., one does not have a reliable nonspeculative basis for doing so within this form of modeling.

Secondly, as I've stressed, goes back to my point about the wrong targets, you're trying to hit very small targets in a changing world on a going-forward basis using market interventions rather than cash payments, and that creates this added problem of a small target that's moving.

And I conclude, I think that you do not have remedies that provide you with a reliable basis for picking particular values for the models or remedies or alternatives to follow from those models.

Q. Does Dr. Neuberger's model account for adjustment of inventories?

A. No. I stressed, and he talked about it in his September 15th report, Dr. Neuberger's model when you're down at this level of change, you quite appropriately have to worry that there are other, if you will, participants in the market and other sources of supply and demand response in the market.

For example, a change in the volume of exports as a result of the overage might be responded to somewhere in the chain by someone, for example, in the United States of merely absorbing that overage into inventory and not fundamentally altering the price and the purchases from the demand seen by U.S. procedures. So, when you're down at this level of detail, things like inventory behavior are critical to be analyzed, as I pointed out in my reports.

Q. Do models typically account for inventories?

A. It depends on what you're modeling. If one is trying to--typically, if one is trying to model the long-term effects of a sustained change in a market, for example, one wants to model the long-term price of oil resulting from the major discovery in the Middle East or something like that, generally,

one wouldn't build a model that would finally have detailed numbers about month-to-month inventories, for example.

On the other hand, when you're trying to find those little black dots you can see as the overage, then it's appropriate you would have to fine tune your model to capture such effects; otherwise, you can't claim to have reliable, nonspeculative results.

Q. In his third report, Dr. Neuberger claims that Option B exporters breached the Agreement, benefited from the breach and should pay the consequences of that breach. As a matter of economics, did Option B exporters benefit from the overshipments?

A. No. At least under Dr. Neuberger's model, when you look at that model, the Option B producers were roughly a wash. Depending on how I model or handle some of the parameters in his model, it looks like they were probably a slight negative from the overage, slightly worse off, and there's a fundamental reason.

The overage allows the Option B Regions to export more. That's a source of higher income. But in the model, that higher level of exports causes prices to go down by $1.94. Option B exporters suffered a lower price of a $1.94 on everything that they exported, including what was consistent with no breach. And when you look at the net effect then of additional exports but a lower price on everything you

exported, what you find is within Dr. Neuberger's model is it's a slight negative, approximately a wash for Option B producers. There is no evidence, nor do the economics indicate that Option B producers were beneficiaries in any material or substantial way of the overage.

MR. AGUILAR-ALVAREZ: Can I have just a minute, Mr. Chairman?

CHAIRMAN BÖCKSTIEGEL: Yes.

(Pause in the Proceedings.)

BY MR. AGUILAR-ALVAREZ:

Q. Professor, you spoke a minute ago about testing for the accuracy of the model.

A. Yes.

Q. If you applied standard testing for that accuracy, is the statistical significance of the $1.94 that Dr. Neuberger calculates different from a penny?

A. Based on the information before us, we don't have a basis for saying whether the $1.94 is statistically different from a penny or statistically different from $4. We don't have a reliable nonspeculative number.

In addition, as I pointed out, we don't even have a basis for saying it's statistically different from zero. The reason for that is because of the missing parts from the model, things like inventory adjustments, for example. Based on the evidence we have here, we do not have a basis for saying a

$1.94 is statistically different from 1 cent, $4; there's no basis here.

MR. AGUILAR-ALVAREZ: Thank you.

We have no further questions, Mr. Chairman.

CHAIRMAN BÖCKSTIEGEL: Thank you very much.

May I take it that, before we enter into cross, you would like to have a short break?

MR. SCHWIND: Yes, Mr. Chairman. But we are at least prepared to begin with cross today.

CHAIRMAN BÖCKSTIEGEL: Right away?

MR. SCHWIND: After a short break.

CHAIRMAN BÖCKSTIEGEL: I thought so.

So we'll try ten minutes this time. Thank you.

And, of course, you should not talk to the attorneys.

(Whereupon, at 4:38 p.m., a recess was taken to 4:48 p.m.)

CHAIRMAN BÖCKSTIEGEL: All right. We've come to cross-examination.

MR. AGUILAR-ALVAREZ: Mr. Chairman, sorry to interrupt for a procedural point. We confirm we are ready to go as late as possible, and we feel very strongly that Professor Kalt's examination or cross-examination shouldn't be interrupted.

CHAIRMAN BÖCKSTIEGEL: We'll have to see. We'll leave it to the Claimant how long they take. There's some stage, of course, time to break; and, if it goes into the next morning,

that can be dealt with, as well, so let's see how we go on. Why don't you get started.

As I said we can go beyond 5:30, but let's see how we go on.

CROSS-EXAMINATION

BY MR. SCHWIND:

Q. Good afternoon, Dr. Kalt.

A. Good afternoon.

Q. You stated on direct examination that you're a professor at Harvard University; is that right?

A. Yes.

Q. Isn't it also true for the past years you've been a professional consultant?

A. I've been consulting for at least years.

Q. In that capacity you worked for various companies and industries in this country?

A. Governments, industries, all types of clients over 30 years. Sure.

Q. Would you agree, from a review of your résumé, the majority of your work as an expert witness or as a consultant relates to the energy sector and, in particular, to the oil and gas industry?

A. Probably by number of matters that I've worked on, yes. I don't know about time allocation, but by number of matters, sure.

Q. We had, of course, you're probably aware, a prior hearing in this matter back in December 2007. Are you aware of that?

A. Sure.

Q. And I believe your partner in the report, Dr. Reishus, was present at that hearing; is that right?

A. I believe he was, yes.

Q. Now, had you at that time been hired by Canada to participate in the arbitration?

A. I believe I had a meeting back in the fall of '07 sometime, maybe late summer of '07 where I recall beginning some work on this matter.

Q. Now, were you also consulted with respect to providing input on the filings that Canada has made in this arbitration?

A. Not really, no. I mean, I guess my reports are filings, but I think you mean the things they write.

Q. Right. Their briefs, for lack of a better word?

A. I don't believe so.

Q. Now, have you--we have, of course, your two reports in this case and your testimony today.

Have you performed any work for Canada related to the Softwood Lumber Agreement that is not reflected in your two Expert Reports?

A. Well, certainly as I indicated, I first filed testimony in the softwood lumber dispute back in 1992, and I

listed each time for you in my curriculum vitae I provided testimony related to softwood lumber.

Q. I think you misunderstood my question. I apologize for that. My question related to the 2006 Softwood Lumber Agreement.

What other work have you performed for Canada related to that Agreement that's not reflected in either of your two Expert Reports?

A. I'm trying to remember the timing. I listed some other matters. I don't recall specifically any other matters. This is the main thing I've been working on with respect to the 2006 Agreement.

Q. Let's look back at some of your other work briefly. Of course, as you say you provided the Tribunal and the Parties with your résumé, your CV in this case. It's an attachment to your first report; correct?

A. Yes.

Q. And if you could find that résumé in front of you, please, it would be your Attachment A to your first report.

A. Okay.

Q. Of course if we look through your CV, we can see a number of entries related to your work that you performed through the last 23 years or so on behalf of Canada or one of its provinces related to softwood lumber; correct?

A. No. I believe the first work I did was in the early

1990s, and the first testimony I filed was 1992. My first work on this matter was the academic research. It wasn't done for anybody other than academic research.

Q. Well, we see, for example, let's talk about your 1992 work, the page marked 68 of your résumé. We see you authored four reports for Canada and testified at least twice in 1992 as part of the Department of Commerce investigation into the Canadian stumpage programs. Do you recall that?

A. Yes.

Q. I believe your first report reflected on your résumé was January 1992; is that correct?

A. I think it's February. It looks like statements of February, March, and April 1992. Do you see that?

Q. All right. Is it fair to assume that you had been consulted at least back in 1991 by Canada with respect to that matter?

A. Yes.

Q. So we have at least from 1991 to the present that you have Canada as a client with respect to the softwood industry, or the softwood lumber dispute; correct?

A. Since 1991, I have had Canada as a client on a number of aspects of the softwood lumber dispute as it has gone on through the decades.

Q. Look at Page 67 of your résumé, another report, for example, in 1994 prepared for Canada?

A. What page?
Q. Sixty-seven.
A. Yes. That's softwood lumber dispute again, yes.
Q. And Page 62, two more reports for Canada, testimony for Canada in 2000 as part of the NAFTA arbitration, I believe?
A. Yes.
Q. And Page 56 of your résumé, an entry for the ten reports that you prepared for British Columbia between 2001 and 2005; is that right?
A. Which page?
Q. Page 56.
A. Yes. That's correct.
Q. And these have always been in matters not only working for Canada but in matters against the United States; right?
A. These are all dealing with the softwood lumber dispute, which has been between yourself and Canada and the provinces.
Q. So, essentially, your work over the years, is it fair to say it consisted of providing economic analyses and critiques to justify the legal positions of either Canada or British Columbia, its largest exporting province?
A. No, I don't think that's fair to say. I started the work as an academic, I did reach conclusions that turned out to be consistent with the Canadian position, but I never met anyone on the Canadian side when that happened.

Since that time I provided analyses. I know they've agreed with me sometimes in Canada, and sometimes they haven't, but I provided analyses to the best of my professional ability.

Q. Is it fair to assume, Dr. Kalt, the reports that you've prepared for Canada have been consistent with their legal positions?

A. Not in all instances, no.

Q. Can you give a specific example right now of a report that you filed whose bottom line conclusion was not consistent with Canada's legal position?

A. I think in the discussion of log exports, for example, I found analyses to basically describe the situations under which log exports could have an effect on the market, might not have an effect on the market, and my understanding was that that wasn't the desired position of the Canadians, but that's the position I took.

Q. Ultimately, you agreed with Canada, though, with respect to the log export restraints; correct?

A. No, I filed my economic analysis and put it out there.

Q. In addition, you also worked for the British Columbia Lumber Trade Council; correct?

A. Yes.

Q. If we look again at Page 56, your work for British Columbia and those ten reports, they were not only for British Columbia, but they were for British Columbia Lumber Trade

Council from 2001 to 2005; correct?

A. I'd have to go back and check on that. There were two parties. I don't know if they were Respondents or Claimants in that case. I can't recall if I was retained by one or both.

Q. Can you look at your résumé. Your résumé says you were retained by both?

A. No, that's, that tells me who the parties were, but I'm not sure I was necessarily retained by both parties.

Q. You're saying there is a chance you were retained by both?

A. Yes.

Q. You're just not sure?

A. Yeah.

Q. Would you agree that the British Columbia Lumber Trade Council is the voice what is by far of the largest provincial lumber industry in Canada?

A. Some people might characterize it that way. I don't have a basis for agreeing or disagreeing with you.

Q. Dr. Kalt, if we stay on that entry on Page 56, who shortened this entry on your résumé in order to make it seem less prominent than it really is?

A. The characterization--I understand why you're doing it, but it's not accurate. The résumé has been shortened through all my resumes in all these cases, tightening them up so they didn't take up so many pages. I can write a long title

of every one of these cases, but we shortened those up on every case.

Q. Who shortened this entry, Dr. Kalt?

A. I believe I shortened every entry about six months ago. Every entry--there are about 20 pages of entries here.

Q. You shortened your résumé approximately how many pages would you say?

A. Well, it's still--

Q. Still about 42 pages; right?

A. Still pretty long, yeah. It was getting up around 60.

Q. So you made the changes to the résumé yourself?

A. Uh-huh.

Q. And, in fact, with respect to this entry--well, first of all, are you aware that your other employer Lexecon or Compass Lexecon posts a copy of your résumé on its website?

A. I believe they do, yeah.

MR. SCHWIND: Mr. Chairman, if I may approach, I would like to show the witness a copy of that résumé. It's been marked CR-49, and I'm prepared to give copies to the Tribunal and to counsel.

CHAIRMAN BÖCKSTIEGEL: Is it a new exhibit?

MR. SCHWIND: It is a new exhibit.

CHAIRMAN BÖCKSTIEGEL: Any objections?

MR. AGUILAR-ALVAREZ: It's Professor Kalt's--

CHAIRMAN BÖCKSTIEGEL: It's his own résumé. As long

as we all see it, it should be all right. And it's certainly not new to him.

BY MR. SCHWIND:

Q. Dr. Kalt, do you recognize the document I've marked as CR-49 as a copy of your résumé dated September 2007 that's available on the Compass Lexecon website?

A. Certainly it's dated December 2007. I'll accept that you've downloaded it from the website, sure.

MR. SCHWIND: Can we have the ELMO, please?

BY MR. SCHWIND:

Q. If you turn to Page 8 of that résumé, please.

Do you recognize this entry, Dr. Kalt, as the entry describing your work for British Columbia and the British Columbia Trade Council between 2001 and 2005?

A. Sure.

Q. And this is the entry you shortened in your résumé provided in this arbitration; correct?

A. No, I shortened it in my résumé for all things I'm doing, not only this entry but many, many other entries. I was tightening up my résumé. It didn't have anything to do with this proceeding.

Q. Are you aware this is the résumé that's still currently on the Compass Lexecon website?

A. No.

Q. Do you have any explanation as to why these

corrections to your résumé would not be reflected by your employer?

A. Sure the Webmaster hasn't put it up. I've been using this résumé for quite some time. The one you have for this report, it wasn't prepared especially for this report.

Q. Would you agree this résumé is 40 pages long?

A. That's correct.

Q. If we look at your résumé, we see you note you authored a paper in 1988 titled, "The Political Economy of Protectionism, Tariffs and Retaliation in the Timber Industry"; is that correct?

A. Yes.

Q. And that was--correct me if I'm wrong. I believe it was published in a text that was titled, "Trade Policy Issues and Empirical Analysis"; do you recall that?

A. I think that's accurate, yes. You're talking about this one on Page 41 of my résumé.

Q. Yes, the fourth entry down from the top of the page.

A. Yes, on Page 41.

MR. SCHWIND: Mr. Chairman, again, I would like--I'm going to use this for several lines of questioning in the cross-examination. Maybe we can give the witness his 1988 paper that he himself authored.

MR. AGUILAR-ALVAREZ: If it's not in the record--this is unlike the résumé--we would object to its introduction.

MR. SCHWIND: Mr. Chairman, this is cross-examination. This is the witness's own--

CHAIRMAN BÖCKSTIEGEL: We have a general rule: No new documents. And that was in Procedural Order No. 1, I think. Is there any reason why you could not have produced that document before?

MR. SCHWIND: Well, we could have produced all the papers that Dr. Kalt had noted on his résumé.

CHAIRMAN BÖCKSTIEGEL: That's not my question. I'm referring to the new document you're bringing in now.

MR. SCHWIND: I understand, Mr. Chairman. Our understanding is for cross-examination, if we were using the witness's own materials, that there was no ambush or surprise or any reason that he couldn't answer questions about his own writings or his own past résumé that we just looked at.

CHAIRMAN BÖCKSTIEGEL: Well, there is an element of surprise. He has published, obviously, many things, and if you come with one article in a long list and ask him something which he could not look at before, I think there is an element of surprise. If--

MR. AGUILAR-ALVAREZ: Mr. Chairman, for that very reason we had available the McFarland literature that I questioned Dr. Neuberger about. We deliberately did not attempt to introduce it because it was not in evidence.

CHAIRMAN BÖCKSTIEGEL: If you feel strongly about

this, I think I'll just retire with my colleagues and talk about this.

MR. SCHWIND: We do feel strongly about it, and to make sense, we can ask several questions without giving him the papers. Perhaps he'll recall his statements. If he's unable to do that, perhaps he can do it tonight in anticipation of tomorrow's questioning.

CHAIRMAN BÖCKSTIEGEL: Will there be other documents of that kind you're bringing? Yes.

MR. SCHWIND: Depending on his answers, again, as to papers he cited in his papers that he cited in his reports provided to the Tribunal, we may. If he says I don't recall something from that paper, we may need to refresh his recollection with the paper he cited. That will be the only other incidence of this.

MR. AGUILAR-ALVAREZ: Mr. Chairman, I confirm my objection. Canada prepared for the hearing on the basis of the rules set out by the Tribunal.

CHAIRMAN BÖCKSTIEGEL: I have some sympathy for that. This is why exactly early on in the proceedings we said no new documents--actually, no new documents at a certain stage after the hearing. I mean, we all have published a lot, and if you're confronted with a long article off the long list suddenly and asked about that, you actually need to be fair. You need to give the time to read your own article fully, and I

don't see how this can be done during the hearing.

MR. SCHWIND: We may be able to accommodate everyone at this point. If we could, Mr. Chairman, I would like to see how far we can get without the document.

CHAIRMAN BÖCKSTIEGEL: Okay. Go ahead.

BY MR. SCHWIND:

Q. Dr. Kalt, you referred to your 1988 paper, previously, as far as I believe you identified as the first work you've done related to the softwood lumber industry dispute; correct?

A. When you asked me earlier today, yes, I referred to it, yes.

Q. Do you recall your paper presented and analyzed the origins and, in certain respects, the economic consequences of the U.S.-Canada lumber dispute?

A. I focused primarily on the so-called stumpage subsidy question and analyzed the economics of the stumpage subsidy dispute between the two countries.

Q. Do you recall that your paper followed the phase of the dispute where in late December 1996 the United States was essentially on the verge of imposing a 15 percent duty on softwood lumber exported from Canada into the United States?

A. That wouldn't have been right. Not 1996. Do you mean 1986?

Q. 1986, yes.

A. I'd have to go back and look but that might have been

the case. It's more than 20 years ago. That might have been the case.

Q. Do you recall that that dispute was resolved by a memorandum of understanding between the Parties, between Canada and the United States?

A. I don't recall specifically right now. I recall something about the U.S. Secretary of State going to Canada on New Year's Eve, but I don't recall beyond that.

Q. Do you recall as a result of the Parties' Agreement that Canada began collecting a 15 percent duty on exports to the United States?

A. I don't recall it's 15 percent. I believe there was a duty collection by Canada. I don't recall the magnitude.

Q. Do you recall that in your paper you reached a conclusion that the United States in this case, the International Trade Commission, had incorrectly ruled that the Canadian timber pricing system constituted an export subsidy to the lumber industry that warranted countervailing U.S. duties?

A. I'm sure I didn't pass a legal judgment. I did not find evidence in my research that the stumpage subsidy was altering Canadian production and hence was not altering Canadian lumber exports, but I'm sure I didn't draw a legal conclusion.

Q. Well, you found there was no economic justification for imposing a countervailing duty on Canadian lumber; correct?

A. I found that the central proposition of the United States that, that is the stumpage subsidy was distorting Canadian production of lumber by causing there to be greater production, and hence greater exports, I did not find evidence of that.

Q. It was sometime after you published this paper that Canada began, began I guess entered into a consulting relationship with you; correct?

A. I believe this was sometime in 1991, probably something like that. I was contacted by either Canada or one of the provinces about the disputes that were going on, the overall softwood lumber dispute as of that time period, and that led to that 1992 filing you see me making in my CV in my résumé.

Q. Now, do you recall that in your paper you concluded that if the United States had collected that 15 percent duty, there would have been a net benefit to the U.S. national welfare?

A. I believe I talked about the so-called large country import tariff and reached the conclusion that if the United States collected the tariff, there would have been a net wealth transfer to the United States, yes.

Q. And you also concluded that because Canada would be the collector of the 15 percent tax, essentially the tax collected in that fashion by Canada would produce a net gain to

Canadian national welfare?

A. I believe that's accurate. I would have to go back and look at the tables, but I know there were tables to that effect.

Q. If we move forward to 1996, do you recall the 1996 Softwood Lumber Agreement?

A. Not in any detail.

Q. Now, do you recall that you prepared an Expert Report for either Canada or one of its provinces related to--I believe it was for whether British Columbia's adjustment to its stumpage program somehow violated the 1996 Softwood Lumber Agreement?

A. I don't recall specifically. I'd have to go back and look. You phrase it like a lawyer, and I'm sure I didn't talk about whether it violated it or not. That's a legal conclusion. I'm sure I didn't do that.

Q. Do you recall preparing a lengthy report for British Columbia related to allegations of the United States that British Columbia's--some aspect of British Columbia's stumpage program violated the 1996 Softwood Lumber Agreement?

A. Do you know what year you're talking about? Is it '98 or something like that? Are you talking about the entry on Page 63, Government of Canada Arbitration Panel?

Q. Yes, it would have been in 2000.

A. No, 1999, March 1999, that one. Page 63 on my CV.

Third from the bottom.

Q. Yes.

It refers, in fact, to what you've written here, Softwood Lumber Agreement?

A. Yes. I don't recall how long that report was.

Q. Do you recall that work related to the 1996 Softwood Lumber Agreement?

A. I think so, but I'd have to go back and check. It may have.

Q. Do you recall that under the 1996 Softwood Lumber Agreement, similar to the prior understanding reached between Canada and the United States, Canada collected the permit fees that were imposed under that Agreement?

A. I think that's accurate, yes.

Q. And then, of course, are you familiar with the 2006 Softwood Lumber Agreement?

A. Yes, of course, we're talking about it here.

Q. Are the export charges assessed--you'll confirm the export charges imposed under the current Softwood Lumber Agreement are collected by Canada, as well; correct?

A. We already talked about that today with counselor for Canada.

Q. So, in at least one of your reports you talk about the gains to U.S. national welfare; correct?

A. If the U.S.--in that 1988 article, if I recall, again,

it was if the U.S. were the collector of the tariff duty, as I recall it, I found a net benefit to the United States, but that wasn't the case. Canada was the collector of those revenues.

Q. So Canada got the benefit; correct?

A. As I recall--again, I have to go back, look at the tables, but as I recall, yes.

Q. In your first Expert Report provided in this arbitration, do you recall your discussion of benefits to the U.S. national welfare?

A. Yes. Yes.

Q. And you omit any discussion at all about the Canadian national welfare, don't you?

A. The focus there was the impact of the effects on the United States, and that's what I talked about. I think we do talk about the effect, that what I referred to today as collateral effects, and that does deal with Canada.

Q. And vis-á-vis Canada, the collateral effects, do you refer to a benefit of Canada?

A. Of what?

Q. Of collecting the export charges.

A. No. Here we're analyzing the proposed remedies of Dr. Neuberger, and as I pointed out in answering questions today, yes, Canada would collect those revenues. All else equal, that's a benefit to Canada.

Q. Your opinion is that--

A. Under Dr. Neuberger's first two tax alternatives. Under the quantitative alternatives, those revenues don't go to the Government of Canada. Under his alternatives three and four, there's no tax to collect by the Government of Canada is what I'm telling you.

Q. But the U.S. isn't collecting any taxes here; right?

A. None of these remedies do I understand him to be proposing that the U.S. collect taxes.

Q. But your opinion, as I understand it, is that with respect to Dr. Neuberger's first two remedies, the additional export charges, your opinion is that these remedies are potentially punitive because they may harm Option B producers more than the Option B producers benefited from the overshipments; correct?

A. Yes. As I said, they didn't benefit from the overages. I know you'll assert that, but look at the data in Dr. Neuberger's model. They didn't benefit, and they would bear the taxes in the first two alternatives.

Q. What analysis have you done, Dr. Kalt, with respect to the benefits realized by the Option B producers from the overshipments found in this case?

A. I've analyzed Dr. Neuberger's model and saw what it says about those benefits.

Q. Have you performed any independent analysis yourself?

A. I haven't tried to build a separate model, no. I've

been analyzing Dr. Neuberger's model and its reliability.

Q. You could have built such a model; right?

A. I might have for some other purpose, but you all came in and said you have this legal theory, your Witness put forth a model, and I analyzed it.

Q. Would you agree that even if the Option B producers gained relatively little from the breach of the Softwood Lumber Agreement but nonetheless caused significant harm to U.S. producers, it would be perfectly equitable to hold Option B producers accountable for that harm?

A. I can't express legal opinion, but I can say my understanding was that it wasn't the Option B producers that created the breach. It was the Government of Canada in the way it calculated the EUSC during the first half of 2007. So it wouldn't have been the Option B producers. They got a quota, my understanding, to a hard cap. They went up to the hard cap, they followed the quota that was available to them. Your claim has been there was too much quota created by the Government of Canada.

Q. Dr. Kalt, my question was this--it goes to your opinion of who is responsible for the breach--as a result of the breach, the Option B producers gained relatively little?

A. They didn't gain. They didn't gain in Dr. Neuberger's model. You can't say that.

Q. But you've done no analysis of that yourself, correct,

Dr. Kalt?

A. I looked at his model analyzed what it says and the net effect is approximately a wash. If you use constant elasticity assumption, it's a slight negative for the Option B producers. I've done that analysis.

Q. Using someone else's model; right?

A. I used Dr. Neuberger's model, yes.

Q. That's the model you say is wrong; right?

A. It is not reliable for the purposes of creating these remedies.

Q. So you went ahead and used a model you think to be unreliable to form an opinion that there's no net benefit to Option B producers in this case?

A. No. I said under the model that you all have presented, you don't have any basis for saying the Option B producers benefited.

Q. Let's go back to your opinion that somehow the price-based or the export charge-based remedies are punitive. Does your opinion as to whether the remedies are punitive change if we focus not only on Option B producers but we focus on Canada more broadly, that is we look at total Canadian welfare?

A. I have not tried to add up the total Canadian welfare, but my opinion is not punitive as related to the Option B producers. They would bear this very large tax along with U.S.

consumers.

Q. So, it may change your opinion of whether the remedies are punitive, may change if we look at total Canadian welfare?

A. It wouldn't change my opinion with respect to analyzing U.S. consumers and Option B producers. I told you the Canadian Government collects net tax revenues under the first two alternatives.

Q. Let's talk about under your first report. I believe you say the total national welfare we're talking about that looks at the economic benefit or harm to Canada as a whole, not just Option B producers; correct?

A. No. In my report we talk about the United States and--since you claim the reparations for the United States, at least in your initial briefs, we looked at that claim--the net welfare effect of the United States of the overage.

Q. But if I ask what is the definition of total national welfare vis-á-vis Canada, it's all the same things just from a Canadian perspective; correct?

A. In principle, yes.

Q. In fact, your 1988 paper looked at gains to total national welfare of Canada; correct?

A. Yes.

Q. Again, look at under total welfare effects or impacts on Canadian producers, Canadian consumers and the Canadian Government; correct?

A. For what purpose?
Q. For purpose of assessing Canadian national welfare effects of a particular remedy?
A. For what purpose?
Q. Unfortunately, I have to ask the questions, Dr. Kalt.
A. If you want to do that, yes, you would look at basically all the participants in Canada, including the Canadian Government, sure.
Q. You would agree that a matter of basic fundamental economics that if an additional tariff--if additional export charge is assessed on the Option B producers, all other things being equal, that would lead to a greater supply of lumber in Canada; correct?
A. If I understand, you mean you're imposing an additional tariff on Option B producers?
Q. Yes, sir.
A. You mean produced in Canada--I'm sorry, staying in Canada?
Q. You're saying you're making it more expensive for Option B producers to ship their lumber into the United States because you're assessing an additional export charge?
A. Yes.
Q. Would you agree that you would expect as an economist that would lead to a greater supply of softwood lumber in Canada?

A. The total supply would be reduced. The remaining supply after exporting would go up, if I understand your question correctly.

Q. So, with the greater supply in Canada, you would expect to see--again basic economics--we got greater supply in Canada, you'll have lower prices in Canada; correct?

A. If I understand correctly, you're driving a tariff wedge between the U.S. and Canadians; is that what you're asking? A tariff. Is that what you're doing?

Q. I'm talking either of Dr. Neuberger's first two remedies that assess an additional export tax on Option B exports to the United States.

A. It would tend to discourage exports and tend to hold down the price in Canada.

Q. And by holding down the price in Canada, that would be a benefit to Canadian consumers under your standard national welfare analysis; right?

A. Sure.

Q. And then, of course, if there's an additional tax collected by the Government of Canada, this would be of benefit to the Canadian Treasury; right?

A. They would certainly collect more revenue, yes.

Q. So, if we look at Canadian national welfare as you've looked at U.S. national welfare, it could very well be that there really are no punitive effects on Canada if the Tribunal

orders either of Dr. Neuberger's first two remedies; correct?
A. Under the first two remedies, there would be strong punitive effects on Option B producers. Some others, such as the Canadian Government would benefit. These are the collateral effects I was talking about.
Q. And, of course, we actually forgot another player in the Canadian--there's Option A Regions; correct?
A. Yes.
Q. And Option A Regions include British Columbia, the largest exporter in Canada; correct?
A. Yeah, they're the largest, yes.
Q. In fact, the Option B Regions including British Columbia, would benefit from the lower prices--I'm sorry, would benefit from the higher prices in the United States that would be produced by either of Dr. Neuberger's first two remedies; correct?
A. That would be a source of benefit, I'm sure.
Q. That would be another gain to the Canadian welfare; correct?
A. No, that would be a gain to Option A producers.
Q. But you would include that if we're assessing the effect on total national welfare, wouldn't you?
A. If you wanted to calculate the total national welfare, you would include that, yes.
Q. We would even include the gains to the maritime

provinces, wouldn't we, Dr. Kalt?

A. If you wanted to calculate that, sure.

Q. Who would also benefit from the higher prices in the United States?

A. I believe that's accurate. I haven't looked at that in detail.

Q. Would you agree then, Dr. Kalt, that considering total Canadian welfare, the overall effect on Canada of ordering additional tax on Option B exports, in contrast to your opinions, could very well likely be positive, that has a net positive effect on Canadian welfare?

A. I'm sorry. You said in contrast to my opinions?

Q. In contrast to your opinions that there's some punitive aspect?

A. There are punitive aspects, for example, Option B producers pay heavy tax, others in Canada gain. These are the collateral effects I'm talking about.

Q. In your 1988 paper, you also concluded in your study that the 15 percent duty resulted in a marginal reduction in Canadian imports to the United States. Do you recall that?

A. I believe so, yes.

Q. Now, would you agree as a general proposition basic economics here that the larger the export charge on Canadian lumber, the greater the reduction in lumber exports in the United States we should expect to see?

A. If I understand your question correctly, yes.

Q. And you would agree that--again, basic economics--that an additional export charge imposed on Option B Regions would be expected to alter the marginal incentives of those producers?

A. Certainly, sure. If you put a tax on them, it could have that effect. In this case as we state in my report with a temporary charge, and with ability for others to adjust in the markets other layers of the industry, inventories and so forth, it may not have any effect at all on Option B producers. But as a general theoretical matter as you're asking it now, it it could have that effect, but not for the remedies you proposed, for the reasons I set out in my report.

Q. Let's break that down a bit. Basic economics would say additional export charge leads to marginal reduction in exports to the United States; correct?

A. No. It depends. You say it as a general matter. You asked about the 1988 paper. Yes, that was a large tariff put on as stated clearly in my reports here. If you have a small short-lived export charge, it doesn't necessarily have that effect.

The reason is exactly what I said in answers to the Government of Canada. When you're looking at these small changes, you have to build a model, you have to consider the missing parts that are not in Dr. Neuberger's model--treatment

of inventories, other layers of the industry. Small changes like that are different than the types of things I looked at in my 1988 paper.

Q. You didn't build or attempt to construct any other model that would dispute Dr. Neuberger's results, did you?

A. No, I didn't try to build a different model. I examined his model for its reliability and accuracy.

Q. You talk about the possible effects of the inventory behavior of Option B producers as well as producers in the U.S.; correct?

A. Yes.

Q. Did you conduct any type of analysis of that inventory behavior and how it might play out it if the Tribunal orders a particular remedy in this case?

A. Yes. As we state in my second report, we talk about the levels of inventories that are held in Canada, for example, since the September 15th report, and Dr. Neuberger raised this. I've gone again and looked at the U.S. data. For example, the wholesale segment of the U.S. industry seems to hold about a month's--at least a month's worth of inventories on average. Those are quite large relative to the overage and the kinds of remedies that Dr. Neuberger is setting out. So yes, I have looked at that.

Q. I wanted to distinguish it. Did you conduct any formal economic analysis of the inventory effects that you

might or might not anticipate?

A. I described analysis in examining that data. Did I build another simulation model? No, I was analyzing whether that issue would be important, but I've not tried to build a different model. I've examined Dr. Neuberger's model.

Q. Well, your conclusion is that given the inventory behavior you've seen in some of the data, that the Option B producers may simply hold more in inventory for shipment later; is that your opinion?

A. That's certainly one possibility, sure.

Q. Isn't that exactly what Dr. Neuberger--well, isn't that exactly what the intent of the remedy is?

A. No. As I understand Dr. Neuberger, he's trying to alter prices in his second alternative via a tax. And in his third alternative, he's trying to effectively alter prices by changing quantities and fundamentally changing the demands seen by U.S. producers.

Q. Your opinion, Dr. Kalt, is that in response to either the additional--either the first two remedies that assess an additional export charge, Option B producers may try to avoid the charge by holding more in their inventories; right?

A. What I indicated is by holding more in the inventories, which could be a rational response, then you're not changing the fundamental supply going to the United States and you don't have price effects.

Q. If they're holding more in their inventories, they're not sending it across the border, right, Dr. Kalt?

A. But you have other inventory holders in the marketplace.

Q. All other things being equal, if Option B producers, are holding more of their production in inventory as opposed to shipping across the border, that would lead to less supply in the United States and higher prices, which are the exact effects that are sought by Dr. Neuberger's remedies; correct?

A. Not quite. Your first part of the statement is right. If they hold more in inventory and don't ship, that leads to less shipments, but you have other inventory holders in the model, so you can't conclude necessarily the price goes up. If you have U.S. wholesalers, for example, holding a month's worth of inventory--this happens all the time in the American industry and Canadian industry as well. One response to less shipments during that period from Canada is, well, I'll draw down my current inventories and put the supply into the market, out of current inventories, and so there's no change in the price. And most fundamentally, there's no measurement in these models and in these remedies for what that price change would be. There's no reliability, you're speculating there would be a price change.

Q. But, again, you decided not to do a model yourself; right, Dr. Kalt?

A. I've again not tried to build a model for the U.S. remedies, no.

Q. I want to get back to your opinion as far as the inventory behavior on both sides of the border. It sounds like what you're saying is because of possible inventory behaviors in Canada and the United States, the remedies imposed by Dr. Neuberger may be insufficient to produce the price increase in U.S. lumber industry that he seeks to achieve?

A. Well, I'm saying two things. And I said to counselor for Canada, you can't predict what price effects would occur. It does depend on inventory behavior. You also can't assert, as I said in sort of the last line of questioning for Mr. Alvarez, you cannot say that there was a price effect of $1.94 during the first half of 2007 because you haven't built a model to measure that effect, that could measure that effect.

Q. You understand Dr. Neuberger's model did produce the result of $1.94 price reduction in the United States?

A. That's what we've been talking about, yes, that model did do that.

Q. And you've produced no model that gives rise to a different result, have you?

A. Well, in a sense I have. As I said, I've run these different elasticities through, and you cut the price effects by two or three quite quickly if you use different supply elasticities, and that was my analysis looking at the

sensitivity. Dr. Neuberger didn't do that, as far as we know.

Q. Did you discover any evidence--in conducting your 1988 study that led to your 1988 paper, did you adduce any evidence suggesting that inventory behavior in Canada or the United States would somehow dampen the effects of the 15 percent, 15 percent duty that was at issue at that time?

A. Sure the analysis of supply and demand that you and I have been talking about produces that result. The failure to analyze it means that the results of the models don't give us a reliable basis for the $1.94 or projected price increases for the purported remedies, so I've done that analysis.

Q. I'm talking about your 1988 study?

A. And your question is.

Q. My question is: In carrying out that study that looked at Canadian welfare, U.S. welfare and even got into some export supply elasticities that we're going to talk about shortly, did you see any evidence that essentially Canadian or Canadian producers could avoid the 15 percent duty simply by manipulating their inventories?

A. That wasn't part of that imposition of export duties at that time. I was looking at a large impact on the market of a new tariff, and that's what I looked at.

Q. In fact, your conclusion was that tariff would, in fact, reduce Canadian supply, Canadian exports, to the United States?

A. As I said in answer to counselor from Canada, if you have a permanent large change like that, you expect those changes. You have to build a model to fit what you're analyzing. My 1988 model was not analyzing the dispute between the Parties here in 2008, which has to do with $1.94 effect in the market. My analysis there dealt with the underlying softwood lumber dispute at the time.

Q. You built a model back then?

A. I built a model back then to analyze the stumpage subsidy question that was at the heart of the softwood lumber dispute.

Q. According to your June 2008 report in this arbitration, you state that you were asked by the Government of Canada to do three things.

A. Where are you reading?

Q. Page 3.

A. The first report?

Q. Your first report.

A. Okay.

Q. Reading from the top of that page, you were asked to analyze the harm to the United States and the principles of compensation; is that right?

A. In the remedies proposed by the U.S.

Q. And the remedies. You were asked to review Dr. Neuberger's calculations of overshipments; is that right?

A. Yes.
Q. And to provide an economic analysis, you say, of the U.S. remedy proposals, including the extent to which they are consistent with the principles espoused by the U.S. and the Neuberger report. Do you see that?
A. Yes.
Q. Did you understand in any way that your task in this arbitration was to assist the Tribunal in crafting an appropriate remedy for Canada's breach of the SLA?
A. Since you state it that way, I don't think I took that as my task, no.
Q. That's because your client, Canada, never asked you to assist the Tribunal in crafting an appropriate remedy, did they?
A. Well, that's not the way it occurred. Their legal position as you know is different. It's a fundamental dispute between the Parties in some sense, the use of the word "remedy"--as I understood the Canadian position, they did not think that the SLA called for the calculation of some ex post, after-the-fact reparations. So there was nothing for an economist to craft. I don't know how to say it more bluntly.
Q. So you--in this case, your role essentially is to criticize as opposed to affirmatively offer a remedy for the Tribunal's consideration; correct?
A. I have analyzed the remedies that have been

forward--put forward. The question of the remedy turns on a legal matter, which I'm not expert.

MR. AGUILAR-ALVAREZ: Mr. Chairman, I'm very sorry to interrupt, but as I said in our opening statement this morning, Canada views the issue of burden of proof as lying with the U.S. It is not Canada's burden to craft what counsel believes to be an appropriate remedy, and we have consequently not asked Mr. Kalt to do that, if that is useful to the Tribunal.

CHAIRMAN BÖCKSTIEGEL: I quite understand, and you may come back to that in your closing remarks, of course. It's a legal matter, procedural legal matter in that case, but I don't think we should stop the questioning for that reason.

The expert is, of course, free to say as he has said that his mandate has been limited to these three questions and that's what he responded to and about due to tell us what Canada should have done.

BY MR. SCHWIND:

Q. You're not a robot, though; right, Dr. Kalt?

A. That's a deeply metaphysical question, as you know.

Q. In your role of critiquing Dr. Neuberger, did it at any time dawn on you there were any approaches that were better, more preferable than those proposed by Dr. Neuberger?

A. I certainly set out, I believe, that the appropriate target under your theory is a producer surplus target certainly, and I talk about that in my reports.

Q. Again, explain what's the remedy that's implicit in there.

A. Well, you start with a target. I haven't tried to go build a model for your legal theory. I haven't tried to do that. That was beyond my task and, frankly, that's not been my task as I lay out here. These are my tasks. This is what I set out to do, what I was asked to do.

Q. I understand what you were asked to do. But while you were going forward with that task, did you at any time conceive of any approaches to remedy that were in your view preferable than those that were proposed by Dr. Neuberger?

A. Well, I have not tried to build a model, so I can't speak to whether it would be preferable in some reliability sense. I laid out principles that are, with which Dr. Neuberger's approaches are inconsistent: failing to target producer surplus, failing to account for the multiple layers in the market and multiple prices in the market at those different layers, the inventory behavior you and I talked about, the appropriate use of supply elasticity. If one wanted to build a better model, I am providing you there with principles you ought to adhere to.

Q. So, again--

A. Whether that would produce a reliable result for such a small target is another question. That's one of the difficulties of using export measures after the fact to hit a

small and moving target. So you can't even say what would be preferable at the end, if you tried to do that.

Q. Is it possible in this case, Dr. Kalt, to conceive of--

CHAIRMAN BÖCKSTIEGEL: Can you get slightly closer to the microphone. It's difficult to understand.

MR. SCHWIND: Thank you.

BY MR. SCHWIND:

Q. Is it your testimony, Dr. Kalt, that it is impossible as an economist to construct, to design a remedy using export measures to compensate for the harm caused by the breach found by the Tribunal in this case?

A. And to do it with export measures the way you all propose?

Q. Yes.

A. And your question is do you mean do something reliable, nonspeculative, something to rely on and recommend it to the Panel they would rely on? Is that what you're asking, or just produce any result?

Q. Is it possible as an economist to construct a remedy using export measures to compensate for the harm caused by the breach found by the Tribunal in this case?

A. It may not be possible to do it with reliability and nonspeculative results in the context of this case. It may not be possible.

Q. You're not sure whether it's possible or not?
A. That's correct, because you're shooting at a small moving target using after-the-fact interventions into the marketplace where supply and demand are changing, even if you tried to build a model that was analytically correct in the sense of accounting inventories, multiple layers in the market, the appropriate supply elasticities and so forth. As you can see in the literature, there's still tremendous uncertainty among things like these export supply elasticities.
In any model, when you have that kind of range and you're trying to target something like $1.94, you may not be able to get reliable results. It's one of the reasons why I said earlier the arrow of these economics point away from your interpretation because these are the problems you run into if you try to use ex-post, after the fact, export measures to provide for retroactive reparations.
Q. Dr. Kalt, you seem in that answer to agree or at least your opinion is that using the target of producer surplus is appropriate; correct?
A. Your legal theory implies. I'm trying to be honest, I don't have a legal opinion on the fight between the two of you.
Q. I'm not asking you about your legal opinion.
A. Your legal theory definitely implies, particularly your legal theory in your Reply Memorial where you say you're not focusing on the impacts of the United States--you're

focusing solely on the impact on U.S. producers, your legal theory implies to economists that you would want to look at producer surplus, yes. I've been as clear about that in my reports as I can.

Q. Would you also agree if the correct target is producer surplus in your view that the remedy--or I should say it would be appropriate using export charges to design them in a way that would raise U.S. prices in order to return the lost producer surplus to U.S. producers?

A. No, you would have to--if you're going to use export measures, you would have to find some way to raise producer prices if you were trying to target producer surplus.

Q. Using export measures, what other ways can you conceive of to do that, other than what Dr. Neuberger has proposed?

A. Cash compensation.

Q. I just said using export measures?

A. I thought you said other way besides export measures.

Q. Using export measures.

A. The other way besides export measures would be cash compensation.

Q. Correct, but if we're restricting ourselves to the imposition of export measures, either by adding or assessing an additional export charge on Canadian lumber or reducing quotas that are going to bind Option B Regions, what other means are

out there, other than what Dr. Neuberger has proposed?

A. You just constrained it to two things. You have export measures or tax measures. Your question, I'm sorry, was tautologic, I think.

Q. You understand that Canada--it's more of a legal position?

(Pause in the Proceedings.)

Q. Now, let's talk briefly about your calculations of the overshipments in this case, Dr. Kalt.

You would agree that, during the six-month period January through June 2006, given the Tribunal's prior Award, that the Option B producers shipped a certain volume of softwood lumber into the United States that they were not entitled to under the Softwood Lumber Agreement?

A. My general understanding is that the Award indicated there were overages as a result of the way figures were calculated.

Q. And, in fact, you and Dr. Reishus went about calculating or quantifying exactly what that overage was during the first half of 2007; correct?

A. We provided calculations to that, yes.

Q. And you used what Dr. Neuberger referred to as contemporaneous data; correct?

A. That's correct.

Q. By "contemporaneous data"--correct me if I'm

wrong--we're looking at the data that was available to Canada in the first half of 2007 at the time that it was calculating what RQVs, what quotas would be in effect?

A. Basically, that's correct.

Q. Do you agree that it is more appropriate to use the contemporaneous data in order to calculate the RQVs that would have been in effect in the first half of 2007?

A. Sure. That's what I state in my first report.

Q. Do you also believe--you also agree with Dr. Neuberger that we should nonetheless use revised data as far as the quantity of lumber that the Option B Regions ultimately shipped into the United States?

A. It depends on for what purpose.

Q. Well, did you use revised data for that purpose at least for exports from the Option B Regions?

A. Yes.

Q. So you would agree then?

A. Yeah.

Q. Do you have the green binder up there, Dr. Kalt? That's the one. There's a tab there, CR-48, if you could turn to that, please.

CHAIRMAN BÖCKSTIEGEL: That's your hearing binder, the Claimant's hearing binder?

MR. SCHWIND: Yes, sir.

CHAIRMAN BÖCKSTIEGEL: CV-48, you say?

MR. SCHWIND: CR-48.

CHAIRMAN BÖCKSTIEGEL: Yes, it's at the very end.

BY MR. SCHWIND:

Q. The first two pages, Dr. Kalt, are a cover letter from your attorney Mr. Alvarez. And he's enclosing--correct me if I'm wrong--tables showing your calculations of the overshipments during the first half of 2007. Do you see that?

A. Yes.

Q. And, in fact, those would be the first two pages behind the cover letter; correct?

A. You're talking about these tables?

Q. Yes.

A. Yeah.

Q. So, if we look, for example, you calculate that in Saskatchewan there are at the end of the day no shipments in excess of the correctly calculated quotas; correct?

A. Yes.

Q. Manitoba, we have a little over 154,000 board feet of lumber?

A. Yes.

Q. And we turn the page. We see Ontario, 92, almost 93 million board feet in excess of correctly calculated quotas.

A. Yes.

Q. Quebec, the final Option B province, about 49 million board feet of lumber?

A. Yes.
Q. Now, your total, we see--if you go to the first page in the upper right, we see your total, just under 142 million board feet of lumber shipped in excess of the correctly calculated quotas; correct?
A. Yes.
Q. And your calculations also reflect that you took into account what is referred to as "carry forward" and "carry back"?
A. Yes.
Q. And would you agree that your carry forward and carry back reduces the total overshipment volume from 216 million board feet to your figure of 142 million board feet of lumber?
A. No, I think it reduces it by the difference between 142 and 106, I think, if I understand your question correctly.
Q. Okay. Well, your--if we look at your total is one, again, the 142 million board feet correct?
A. Say again.
Q. Your total for the overshipments was 142 million board feet?
A. Accounting for both contemporaneous data and the--that accounts for using the contemporaneous data, as I recall, correctly.
Q. Did you prepare these tables or is this Dr. Reishus's bailiwick?

A. The tables were prepared under our direction by our research assistant entering the data under my direction.

Q. In Dr. Neuberger's second report, he pointed out that using your data, the contemporaneous data he now agrees with, but not allowing for carry forward, carry back as you have, that the overshipment amount from the Option B Regions during the first half of 2007 rises to 216 million board feet. Do you recall that?

A. Yeah, right.

Q. Do you recall that in your second report you did not disagree with Dr. Neuberger's observation?

A. That's right. Yeah. If you accept his assumptions about contemporaneous data and his treatment of carry forward to carry back.

Q. Let's talk about your treatment of carry forward and carry back. How did--what did you rely upon to decide that it was proper to reduce the overshipments for carry forward and carry back during the first half of 2007?

A. The attorneys told me that was the appropriate treatment. It's a legal matter.

Q. So they just told you to do it and you did what they said?

A. No. They told me it was a legal matter and they thought that was the legally proper decision.

Q. Did you investigate that in any way?

A. It was a legal matter. It wouldn't have done much good if I did. It was a legal matter.

Q. Did you look at the SLA and requirements of the SLA in calculating the quotas when you were calculating the quotas as part of your work?

A. I looked at the SLA. But I understand you're disputing this treatment of carry forward, carry back. I'm not in a position to read the SLA and make a legal determination as to which one of you is right.

Q. Are you aware--I mean, did you consider that the--under the SLA, no quota volume may be carried back or carried forward between two months unless the region's exports were subject to a volume restraint in both of those months?

A. I recall reading something like that. I don't recall specifically that passage, but I recall reading that.

Q. What--and, of course, subject to a volume restraint. That means subject to a quota; right?

A. When I say I read something like that, it sounded like your legal position, but I'd have to go back and look at everything where you all are tussling over this legal.

Q. Did you have any evidence that Canada--well, I should say, did you have any evidence that Option B Regions were subject to a quota, to a volume restraint, in December 2006?

A. I didn't find it necessary to investigate that. It dealt with a legal dispute between the Parties.

Q. Would you agree that if the Tribunal finds that Canada was not entitled to carry forward from December 2006 to January 2007, your estimate of the overshipment rises by 38 million board feet of lumber?

A. That sounds about right, sure.

MR. SCHWIND: Mr. Chairman, this may be a good time to break. I do have approximately an hour left of cross-examination.

CHAIRMAN BÖCKSTIEGEL: Okay. I think that will be too much for this evening. So maybe this is indeed the time to stop.

Dr. Kalt, I have to tell you, as well, that you should not discuss the matter with either one of the Parties. You have to spend a quiet evening as far as that is possible in New York, of course, and we will resume the examination, and we take it that you are in the range of about one more hour to go tomorrow.

MR. SCHWIND: Yes, sir.

CHAIRMAN BÖCKSTIEGEL: Having heard that, I'm aware that both Parties have reserved the right to call back the Experts, and I suppose that would happen after that tomorrow without a long interruption.

MR. SCHWIND: We requested, Mr. Chairman, approximately an hour in our comments on your proposed Procedural Order No. 3. We understand you did not grant that

hour in the final procedural Order, but we would make that same request, that we be allowed one hour to prepare for that examination.

CHAIRMAN BÖCKSTIEGEL: Do you have any comments?

MR. AGUILAR-ALVAREZ: Question, Mr. Chairman, what is the purpose exactly of the recall? Is it just for direct examination or--

CHAIRMAN BÖCKSTIEGEL: For what?

MR. AGUILAR-ALVAREZ: The recall of the witnesses?

CHAIRMAN BÖCKSTIEGEL: It is really a continuing of cross. I would have to look at the Order, but I think it says only in rebuttal to what has been said before. Now, of course, if you start with cross, the other side may want to come in. So, basically, it's going back and forth if the Parties so wish, as we have done that today.

MR. AGUILAR-ALVAREZ: Just a point of clarification. Again, we see no need for recall because we will, as you say, keep going back and forth with what the witnesses have already testified, and if the Tribunal wants to eliminate the recall of witnesses, we are satisfied that that is a good procedural decision.

Now, if there is a recall of witnesses, we would like to know if the witness is recalled for direct examination or cross or both.

CHAIRMAN BÖCKSTIEGEL: Well, I'll consult with my

colleagues in a second, but let me say we indicated from our side, it is not necessary to recall because we feel already now in the examination that basically everything has been said and already said twice or three times now. I'm slightly exaggerating, but you know what I mean.

Now, let me consult my colleagues. Just give us a second.

(Tribunal conferring.)

CHAIRMAN BÖCKSTIEGEL: All right. The mike is on again? Yes.

We have just made sure that we read our own Orders, and it is actually section--is it five on the agenda?--agenda item 5. That is where we deal in our newest version with recalling, and it confirms what I have just said. It can only be done in rebuttal of things that were happening in examination today, but that would be possible.

Both Parties have announced in time that they consider this option and would like to reserve that position. It's hard to distinguish between direct and cross, then, because basically both Parties, that would then have a chance to examine both experts again but only in rebuttal to things that were said today. That is the strict rule. So it can't be very long, and there's no reason to repeat questioning that has been done today, as well.

On the other hand, the Parties have time overnight to

consider whether there's really anything left. Obviously, we have some further cross-examination tomorrow morning which you don't know yet, but would be my feeling. I mean we are well in time that after we are finished cross-examination and perhaps redirect from your side, so we are finished the primary examination of Professor Kalt, then we give the Parties if they still feel they want to call the experts, say about an hour--certainly not more--to think about that, unless they can tell us at an earlier stage whether they want to use the right to recall; and if they do, then they would be able to do so and the limits that I've just identified.

So it would be my expectation that this probably could be done still tomorrow morning. Is that clear enough?

MR. AGUILAR-ALVAREZ: It is. Yes.

MS. DAVIDSON: Yes, thank you, Mr. Chairman.

CHAIRMAN BÖCKSTIEGEL: So we will proceed that way.

Now if we do finish the examination of the experts tomorrow morning, the question is do you need tomorrow afternoon for any preparation. It's a long time for preparation until Wednesday morning, of course, or would you be in a position later on in the afternoon to do the two hours, one hour each for the final statements.

It's a bit hard to say now, but on the other hand we all want to plan a little bit how things go on. How would you feel?

MS. DAVIDSON: Well, Mr. Chairman, we're here at the Panel's disposal, and I think we can make every effort to present our closing statements tomorrow afternoon. Perhaps, if we finish at a reasonable time in the morning, we could have a slightly longer lunch break and come back. And I believe that the last Procedural Order allotted one hour to each side for closing, so we only need two hours.

CHAIRMAN BÖCKSTIEGEL: How do you--

MR. AGUILAR-ALVAREZ: Let me--at the risk of repeating myself, we don't think a recall of witnesses is necessary. I've made that point clear, and let me say that to the extent there might be a recall, then I would request the Chair to admonish Dr. Neuberger not to confer or speak with counsel for the U.S. tonight in preparation for the continuation of cross-examination of Professor Kalt tomorrow.

On the issue of timing, closing argument Wednesday morning works out well for us, Mr. Chairman.

CHAIRMAN BÖCKSTIEGEL: I'm sorry. That would be okay for tomorrow morning.

MR. AGUILAR-ALVAREZ: For closing argument?

CHAIRMAN BÖCKSTIEGEL: That's why I didn't hear it. Say it again, please.

MR. AGUILAR-ALVAREZ: Our preference would be Wednesday morning; but again, we're in the Tribunal's hands.

MS. DAVIDSON: Mr. Chairman, no one needs to be

admonished. We have no intention of talking to Dr. Neuberger about his testimony, and he has no intention of discussing it with us.

CHAIRMAN BÖCKSTIEGEL: That's good to hear. Let's see how we get along tomorrow morning. Then we make up our mind with the Parties actually about the timing of the closing statements. Thank you. And both experts will have a quiet evening and that's part of your--okay. Would it help if we start at 9:00 instead of 9:30? Or do you find that too unpredictable?

MS. DAVIDSON: That would be fine with the United States.

MR. AGUILAR-ALVAREZ: That would be fine with Canada, too.

CHAIRMAN BÖCKSTIEGEL: Okay. So we'll make it 9:00 tomorrow morning. That gives us a bit more time to deal with.

(Whereupon, at 6:10 p.m., the hearing was adjourned until 9:00 a.m. the following day.)

CERTIFICATE OF REPORTER

I, John Phelps, RPR-CRR, Court Reporter, do hereby certify that the foregoing proceedings were stenographically recorded by me and thereafter reduced to typewritten form by computer-assisted transcription under my direction and supervision; and that the foregoing transcript is a true and accurate record of the proceedings.

I further certify that I am neither counsel for, related to, nor employed by any of the parties to this action in this proceeding, nor financially or otherwise interested in the outcome of this litigation.

_____

JOHN PHELPS

IN THE LONDON COURT OF INTERNATIONAL ARBITRATION

In the Matter of Arbitration Between:	:	
THE UNITED STATES OF AMERICA,	:	
Claimant,	:	No. 7941
and	:	
CANADA,	:	
Respondent.	:	
	:	(Amended 10/23/08)
	:	Volume 2

HEARING ON REMEDIES

Tuesday, September 23, 2008

The New York Palace Hotel
455 Madison Avenue
Stanford Conference Room
New York, New York

The hearing in the above-entitled matter came on, pursuant to notice, at 9:00 a.m. before:

PROF. DR. KARL-HEINZ BÖCKSTIEGEL, President

PROF. DR. BERNARD HANOTIAU, Arbitrator

MR. V.V. VEEDER, Q.C., Arbitrator

Also present:

MS. YUN-I KIM,
Secretary to the Tribunal

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AGENDA

ITEMS	PAGE
WITNESS:	
JOSEPH P. KALT	
Continued cross-examination by Mr. Schwind	215
Redirect examination by Mr. Aguilar-Alvarez	253
Recross-examination by Mr. Schwind	258
Questions from the Tribunal	261
CLOSING STATEMENTS	
ON BEHALF OF THE CLAIMANT:	
By Ms. Burke	277
By Ms. McCarthy	296
ON BEHALF OF THE RESPONDENT:	
By Mr. Aguilar-Alvarez	312

P R O C E E D I N G S

CHAIRMAN BÖCKSTIEGEL: All right. Are we ready to start? It's two minutes early, I'm quite aware.

All right. We resume the hearing and continue with the cross-examination of Professor Kalt.

MR. SCHWIND: Thank you, Mr. Chairman.

CONTINUED CROSS-EXAMINATION

BY MR. SCHWIND:

Q. Good morning, Dr. Kalt.

A. Good morning.

Q. I have several questions about just general economic principles that you observe in your work, and then move on to the topic of elasticities that you spoke of at some length yesterday.

First of all, as an economist you assume that producers and consumers act rationally; correct?

A. In most contexts, sure, yes.

Q. And so in this case, for example, you would assume that producers, lumber producers on both sides of the border, are rational, profit-seeking companies; correct?

A. Certainly.

Q. And, as you say, rational, self-interest is the engine of the world to an economist; correct?

A. That's a little bit of an artful way of saying it, but certainly we focus on producers and their profit-seeking

behavior, sure.

Q. Let's move to the topic of elasticities. Yesterday, you made a number of criticisms of Dr. Neuberger's choice of elasticities he used in his model; correct?

A. Yes.

Q. And before we get into those criticisms, would you agree that the issue of elasticities has no bearing on either the first remedy that's been proposed by the United States; that is the Option A remedy?

A. That's true. As Dr. Neuberger says that first remedy is not anchored, he says, in economics.

Q. It's not anchored to his model; correct?

A. Not anchored to his model, not anchored in economics.

Q. It's anchored more in the Agreement and the legal interpretation of that Agreement; correct?

A. No. It's anchored, it's created by this assertion that the overages should be treated as if Option B producers were converted to Option A producers. I'm not aware of that in the Agreement, but I understand that's what Dr. Neuberger says.

Q. The notion that the Option B producers were acting like Option A producers during the breach period; right?

A. I understand that's the notion, but as I said yesterday, my understanding is the Option B producers, in fact, did not act like Option A producers. They went up to the hard cap which included the overages, but they stopped at that cap

is my understanding.

Q. But you agree they did overship their quotas by 216 million board feet of lumber; correct?

A. I understand there was an overage depending on the treatment of carry back and so forth. I understand there was an overage, and I understand you're all saying 216; I understand you're saying that. All I'm telling you is my understanding is they behaved like Option B producers. They went up to the hard cap. That cap was excessive according to the Panel's Award, but they didn't behave like Option A producers.

Q. I'm not going to argue with that, but you understand the ramifications of Dr. Neuberger's Option A remedy; correct?

A. Yes.

Q. And you agree that the issue of which elasticity he chooses or you choose has nothing to do with the validity of the Option A remedy; correct?

A. Well, it does only in the sense that Option A is designed according to Dr. Neuberger to have a positive price effect on U.S. producers, and as we discussed at length in our reports and you and I discussed yesterday, one can't conclude that remedy would have such an effect or what effect it would have in terms of monetary value.

Q. If we look at the third remedy, and you described the third remedy yesterday during your direct examination; correct?

A. Yes.
Q. We'll talk later about that third remedy, but, generally, it reduces the Option B Regions volume restraints, their quotas, twice, in order to compensate for the breach, would you agree?
A. Twice, if it's the case that you're in market conditions, in which the RQVs would not be binding otherwise.
Q. Would you agree this issue of which elasticity we choose, whether it's your choice or Dr. Neuberger's choice, essentially has no bearing on the validity of the--of that remedy, either?
A. Well, it does have bearing on the question of the impact of the proposed reduction in RQVs in the third option in terms of whether and how much it would affect the price. That depends on elasticities out there in the world. I didn't--it's not derived from his model, if that's what you're asking.
Q. Right. The remedy has nothing to do with Dr. Neuberger's model, does it?
A. Not the specific supply and demand model. It does have to do with the elasticities, though.
Q. Dr. Kalt, do you understand the third remedy is not derived from Dr. Neuberger's model?
A. That's what I just told you, yeah.
Q. And, of course, the fourth remedy which is also a volume-based remedy that is going to seek to reduce Option B

Regions' exports to the United States during the remedy period is also--also does not emanate from Dr. Neuberger's model; correct?

A. It does not numerically emanate, but again the role of elasticities is present because all four of his remedies are designed to cause a change in price. The change in price depends on the elasticities.

Q. Okay. If we look at the second remedy that does relate to Dr. Neuberger's model, just to recap, Dr. Neuberger calculates that the impact of the overage--

A. I'm sorry, I should say something back on his third remedy, you asked about. It does depend on his model in the sense the second of the reductions in RQVs is tied to hit a particular target, as I understand it.

Q. Well, the second reduction is simply for the overshipments that occurred during the first half of 2007; correct?

A. That's correct.

Q. And the calculation of the overshipments during the first half of 2007 has nothing to do with elasticities, does it?

A. The calculation of the overages doesn't but the price effects do.

Q. Okay. Well, in the remedy that Dr. Neuberger asserts price effects, the second remedy he calculates as a result of

the overshipments, U.S. lumber prices were depressed by approximately $1.94 per thousand board feet of lumber; correct?

A. His model predicts that as the price effect.

Q. And he uses that to calculate an additional charge of approximately $40 per thousand board feet on the same volume of lumber in order to bring up U.S. prices by the same amount; correct?

A. Well, he calculated--I don't know what you mean by "same volume." He calculates an export charge based on first half 2007 data as to what the export charge would have been to raise the price $1.94, but as I stressed yesterday, that export charge will be applied in today's world, or actually the world in the future, and those volumes are not the same as the volumes contained in his model's calculations.

Q. He does then take that volume for the first half of 2007 and the additional export charge of the $39.65, and he calculates an additional export tax of approximately 87 million, in his view. I understand you don't agree with this, but in his view, an additional charge of 87 million would, again, bring up the prices by the $1.94 they were depressed?

A. No. He doesn't say that. If you look at the paragraphs we looked at yesterday from his report, he recognizes that if the world were as it was in 2007, his model would predict that export charge would raise prices $1.94, but he recognizes the world has changed and that would imply

directly, he could not predict that it would produce $1.94.

Q. But the intent, though, is to bring up prices in the U.S. market; right?

A. There's no question that's his intent, yes.

Q. Now, of course, yesterday we spoke--or you spoke at length on direct as far as the elasticity of export supply, that is export supply elasticity; correct?

A. We did talk about that, yes.

Q. And, generally, just in laymen's terms, if export supply elasticity is low, that is the market is generally inelastic, then producers up in Canada are not very sensitive to price changes in the United States and essentially they continue to sell into the U.S. market even at higher prices, would you agree?

A. If supply elasticity is relatively low, their export supply is not particularly price sensitive, and that makes quantities less sensitive and elasticity is higher. It--it's a continuum.

Q. Right. If they're not particularly price sensitive, then these Option B producers, say, would be less likely to alter their exports to the United States in response to small price increases?

A. No, that's not quite the way to say it. If the elasticity is low, then all else equal, there will be less of a price response--I'm sorry, supply response than if the

elasticity was higher for any given price change.

Q. Right. Less of a supply response means less exports to the United States; correct?

A. No. It means less reduction in exports to the United States, all else equal, for given reduction in price than if you had higher elasticity.

Q. Correct. Would you agree that in some of the literature we see the term "import supply elasticity"?

A. Sure.

Q. That's the same thing as export supply elasticity. Just depends on which side of the border you're looking at it from; right?

A. If you mean an importing country's import supply elasticity that they're facing? Yes. If you mean import elasticity the demand they're showing the world, no.

Q. I'm talking about if--would you agree that in the literature when we're talking about export supply elasticity from Canada, that sometimes the researchers refer to it as "import supply elasticity"?

A. Yes, that can be done.

Q. So, in fact, as a general matter, economic studies, including your own in 1988, concluded that Canadian export supply elasticity was very low, would you agree?

A. I don't recall very low. I don't recall the specific numbers. They are what they are, but I don't recall what

number I calculated.

Q. Well, less than one generally means inelastic; correct?

A. We generally label elasticities less than one as the word "inelastic."

Q. In fact, if we have an export supply elasticity of less than one from Canada, that would suggest a very high degree of market power for the United States vis-á-vis Canada; correct?

A. It's again on a continuum. At lower elasticities than the U.S. is less--I'm sorry more of a price maker than a price taker than higher elasticities.

Q. And, in fact, you refer to, at least in your 1988 paper, as this monopsonistic power. Do you understand that term, Dr. Kalt?

A. Sure.

Q. Again, just trying to get this down to laymen's terms, but a low export supply elasticity means that more of an increase in prices in the U.S. is necessary in order to get Canadian producers to export less to the United States?

A. No, if you talk about, you're talking about imposition of an export charge or something?

Q. Yes.

A. No, a larger export charge is needed to achieve any given volume reduction from Canada.

Q. But your criticisms, I understand, is you don't think Dr. Neuberger needs as much of the increase in price that he's calling for. Much of the increase in export charges that he's calling for on Option B exports in order to bring about the desired increase in U.S. prices?

A. No, that's not what I've said. What I've said is the results are highly sensitive to the elasticities that are selected.

Q. All right. But you would agree--

A. Hence, there's no reliable basis for picking a particular single number when you're trying to hit such a small target.

Q. Is the logical extension of that criticism what I just said, essentially, Dr. Neuberger may not need the additional export charges he's calling for in order to bring about the desired price increase in the United States?

A. No. What it means is, first, what you're calling the desired price effect is inaccurate. The $1.94 is not reliable because that depends on supply elasticities and the model that predicted the $1.94.

Given $1.94 or given any target, the greater the elasticities, the less of an export charge is needed to hit any given target.

Q. Well, in your first report, Dr. Kalt, you looked at essentially how much of an additional export charge would be

required in order to produce the $1.94 increase using various export supply elasticities; correct?

A. What we showed was the sensitivity of Dr. Neuberger's model to those elasticities in my Table A2.

Q. Can you find that table, please. It is as you say Figure A2 to your June 30th--or I should say your June 29th, 2008, report. Got a shadow of the lamp there.

What I've put on the ELMO is your Figure A2 in your first report, right, Dr. Kalt?

A. Yes.

Q. And in this table, you show a range of export supply elasticities. You show a range of export supply elasticities in the corresponding additional tax. You call it the penalty amount, that would be required to bring U.S. prices up by the $1.94 that Dr. Neuberger calculated; correct?

A. No. We're calculating given those elasticities what the price effect would be. If you look at the opening sentence Paragraph 10 on Page 32 of my report we're both calculating what the price effect would be given those elasticities and then applying essentially his alternative number two methodology to find the offsetting export charge.

Q. Are you aware, Dr. Kalt, that the $1.94 does not depend on the export supply elasticity from Option B Regions?

A. I'm aware that it depends upon the way he hits the demand curve, and so we do that methodology. I believe that

turns out to be the $1.94, but I'm saying we reproduced his methodology.

Q. My question was, Dr. Kalt, are you aware the $1.94, as in Dr. Neuberger's calculations of the $1.94 price effect, does not depend on which export supply elasticities we use?

A. It depends on underneath the model of the demand elasticities model, as I recall. I believe it also depends on the Option A producers' elasticity.

Q. These are elasticities you haven't disagreed with, correct, Dr. Kalt?

A. That's correct, but I'm just telling you how the model works.

Q. Again, understanding $1.94 does not depend on export supply elasticities, would you agree. At least in your table here. You're essentially trying to shoot for the same $1.94 price increase of Dr. Neuberger?

A. Mathematically, that's accurate, yes.

Q. So we see, for example, Dr. Neuberger's use of supply elasticity of .57. Then he calculates that out to the right of the 86.7 million; right?

A. Yes, and the export charge of $39.65.

Q. Correct. Then you apparently took it upon yourself to take his 0.57 supply elasticity and convert that into an export supply elasticity; correct?

A. I'm in the second row. What I've done is recognize

that what he used was actually a home production elasticity of Eastern Canada, and I've applied the appropriate mathematical formulas to derive the export supply elasticity associated with that.

Q. Right. So, you say that using his 0.57 general supply elasticity, that translates into, using your equations, the 1.17 export supply elasticity?

A. Using everybody's equation, that's a basic equation that we all use.

Q. According to your table if we do that, the ultimate export charge, the additional export charge that's needed is only $44.4 million; correct?

A. On a per unit basis it's $20.31, and added up in the way he does it's $44 million.

Q. So it's significantly less than the $87 million he believes is appropriate; correct?

A. Well, whether he still believes it's appropriate, you have to ask him, but yes, it's less than what he originally reported.

Q. You also posed an intermediate case in this table; right?

A. Yes.

Q. Here you choose an export elasticity of 2.9; correct?

A. We look at supply elasticities and derive from that an export supply elasticity of 2.9.

Q. Using export supply elasticity of 2.9, you then calculate the additional export charge required is only what, that 20--

A. No, it's $8--I'm sorry, $9. I can't read it either.

Q. The additional export charge, the total is 20.5 million, correct, Dr. Kalt?

A. That's correct.

Q. So we're down from 87 million now down to 20-and-a-half million; right?

A. Yes.

Q. Then you say--let me ask you this: Do you think an export supply elasticity of 2.9 is a reasonable figure for export supply elasticity that this Tribunal can rely upon?

A. Certainly, if you look at the range of general or home supply elasticities that's been used, we see this range, for example, in that study we're all talking about yesterday, the so-called Stoner, McFarland, Gurrea study looks at .2, that's where the 2.9 comes from. I believe it's in the range of what people had looked at.

Again, what I'm trying to convey to all of you is that there's tremendous sensitivity to these elasticities, and we have no strong basis for picking one elasticity over another within these ranges.

Q. The question was, "Do you believe your 2.9 figure is a reasonable export supply elasticity"?

A. I think it's reasonable for showing the sensitivity of these results, yes, it is reasonable for showing the sensitivity.

Q. Is it reasonable for anything else?

A. Sure. That's within the range of the kind of numbers that people looked at.

Q. And can you cite any study where a researcher has used or has found an export supply elasticity of 2.9?

A. I began, I believe you've seen estimates people talk about .7 to 2 for Canadian; whether that holds, when you run it through the math, whether it's 2.9, I'm not sure. Look at the first column. You see the first column, that's what I'm referring to.

Q. So you see .7 to 2 is what you see?

A. Certainly in that Stoner, Gurrea study, and as we see here in my report, when you look at the elasticities from the sources relied upon from Dr. Neuberger, you get ranges as you see on the cases I've shown you there.

Q. If we look at the table, you've also come up with what you call a "high case"; correct?

A. Yes.

Q. In this high case, you offer an export supply elasticity of 11.26; right?

A. That's a number we calculate, yes.

Q. In this figure, you say exports essentially are so

sensitive to price that the only additional export charges required is $8.4 million; right?

A. No. I'm saying that Dr. Neuberger's model implies that these kinds of high cases export a charge of $3.85, totalling 8.4 million, produces the result he's trying for in his model.

Q. And you don't believe, Dr. Kalt, that 11.26 is a plausible value for export supply elasticity that the Tribunal can rely upon, do you?

A. No, I said there isn't a single number they can rely upon. That's the point. These results are highly sensitive to these elasticities.

Q. Again, the number that you--the 11.26, is that plausible to you at all?

A. Certainly, if you look at the data sources I cite for this, it's been--it's the number that is implied by, for example, my Footnote 64, but I've not said that's the number the Panel should pick.

The point here is that these numbers are highly sensitive to the particular elasticities that any Party selects, and the Panel is being asked implicitly by the United States to pick a particular supply elasticity.

Q. Dr. Kalt, you've had an occasion in the past to yourself choose what you believe to be a reliable export supply elasticity; correct?

A. I believe in my 1988 study, I looked at various supply elasticities and employed them, sure.

Q. In fact, in your 1988 study, you yourself felt the most reasonable aspect of export supply elasticity was .9; correct?

A. I don't recall the specific number I used, but I wouldn't be surprised at that.

Q. Why wouldn't you be surprised at that?

A. Because 20 years ago I was doing research in trying to find figures that reflected the market to model what I was marketing, modeling which was essentially the overall change in the market implied by the softwood lumber dispute.

Q. Again, in your 1988 study, do you recall that you noted in the literature the estimates of .917 by Adams, McCarl and another writer whose name begins with H, that I can't pronounce?

A. No, I don't recall that. It seems plausible I did. I recall the names, but I don't recall what I cite.

Q. Do you also recall you cited another study by Boyd and Krutilla where they found an export supply elasticity of .89?

A. Possibly. But, again, that's been years since I did that research--more than years.

Q. Do you recall using your calculations, you yourself calculated an import supply elasticity of .9 which you noted was consistent with what you'd seen in the literature?

A. I wouldn't be surprised at all. That would be perfectly reasonable.

Q. And, in fact, if we look at the .9 figure you used in your paper, even your intermediate case of using 2.9 is more than three times than what you yourself felt was a reasonable figure for your export supply elasticity in your own paper; right?

A. I said I felt the .9 number was consistent with what I've seen in the literature. That's not to say, when an economist says it's consistent, he's saying there's a range.

Secondly, we're talking about the market as it exists more than 20 years later. That research I was citing was done in the early 1980s. Both the milling industries on both side of the borders changed dramatically. I wouldn't be relying on data from the early 1980s or the first half of the 1980s for the purposes here.

Q. We'd have to look at the more recent papers, wouldn't we?

A. That would be appropriate.

Q. In fact, in your same report you provide a list of papers that you read presumably and relied upon in writing your report; right?

A. Relied upon for making this point that there's a range of estimates out there, and the results of Dr. Neuberger's models are highly sensitive to that range.

Q. In fact, one of the papers that you cite, and this is at Appendix B, materials reviewed, one of the papers, number 11 is a paper by a gentleman named Zhang, Z-H-A-N-G; correct?

A. Yes.

Q. Did you read that paper, Dr. Kalt?

A. I believe I read it at some point, yes.

Q. Are you aware that in this paper--first of all, it's a 1996 paper; correct?

A. Yes.

Q. And this paper Dr. Zhang--I'm sorry, 2001 paper; correct?

A. It's a 2001 paper, yes.

Q. In fact, in this paper, Dr. Zhang reports a range of export supply elasticities of .625 all the way up to the .9 that you yourself used in 1988. Were you aware of that?

A. Well, I'd have to look at the study again to confirm that, but implying as you did in your question that it's the same number I used isn't accurate. I was describing an earlier market than I understood him to be examining, as I understood that paper focussed on the 1996 SLA and beyond.

Q. Again, do you have any reason to doubt my assertion that in the 2001 paper that you relied upon, the authors reported a range of export supply elasticities from .625 up to .9?

A. No, that seems consistent.

Q. Another paper you cite at number 13 is even more recent from 2004. You see that, Dr. Kalt?
A. Yes.
Q. Did you read this paper as part of preparing your--
A. I believe I've seen this Kinnucan and Zhang paper, yes.
Q. Do you recall from your use of the paper in preparing your report that Kinnucan and Zhang in this, again, 2004 paper use an export supply elasticity of .9?
A. They may have. I don't recall.
Q. Do you, Dr. Kalt, have anything more recent than these papers that you cited in your report suggesting export supply elasticity or finding export supply elasticities are as high as something in the range that you've offered the Tribunal 2.9 or 11.26?
A. More recent, is that what you're asking?
Q. Yes.
A. I don't recall the exact date, but the Latta and Adams report we cite is what produces those high ranges. I'd have to go back and look specifically at the data, but I don't recall the date exactly of that study.
Q. Well, Latta and Adams was back when, in the 1980s, around the time when you published--
A. I don't recall specifically.
Q. So my question to you is: Are you aware of anything

more recent than the 2001 and 2004 studies that came to the conclusion that export supply elasticities should be higher than the .625 or the .9 range that these two papers used?

A. I don't recall the specific sources, but you'll notice that the--as we say in my Paragraph 10 of my report, the first report, this appendix, the data sources relied upon by Dr. Neuberger generate this intermediate case, which is higher than the .9 you're now keying on, so I've given you those sources.

Q. Would you agree that as far as you know, Dr. Kalt, the current state of the scientific literature, the economic literature is that the most reliable range for export supply elasticities is somewhere between .625 and .9?

A. No, I don't think that's right.

Q. But you have nothing in the scientific literature or anything more recent than these sources showing otherwise; right?

A. Well, again, if you go back and look at the Stoner, Gurrea and McFarland paper, there they examine a report that resembles the ITC staff looking at their information, looking at a range of .7 to 2. So, professionals in the field are looking at a range. You attempt to pin it down as an accurate representation--as an inaccurate representation of the issue before us.

Q. In the published scientific literature, you mean you're aware the Stoner, McFarland paper was not published;

correct?

A. It was a sworn submission to the ITC. I don't believe it was published unless it was published at some output of the ITC.

Q. So, in the published scientific literature, the best estimates we have for export supply elasticities would be between .6 and .9; correct?

A. No, that's not accurate. If you look at data sources I relied upon for my intermediate and higher cases, you get higher numbers than your range. And Dr. Neuberger yesterday said he was seeing numbers at 1.4, not .9.

Q. Again, the most recent scientific literature is .6, between .6 and .9?

A. No, I don't believe that's accurate.

Q. All right. In fact, in your 1988 paper, do you recall that--saying or writing that North America is virtually a closed market. The United States annually buys more than 60 percent of Canadian lumber production, and other outlets for Canada are subject to very high transportation costs and tend to be restricted to specialty products. Moreover, the elasticities of Canadian lumber supply both for total production and exports are quite low?

A. It sounds like you're reading from my report, it seems reasonable I would have written that.

Q. Dr. Kalt, I would like to talk now about the third

remedy that the United States had proposed for the Tribunal.

CHAIRMAN BÖCKSTIEGEL: Did you turn this the wrong way?

MR. SCHWIND: Mr. Chairman, I'm about to draw something.

BY MR. SCHWIND:

Q. The third remedy in this case is the first volume-based remedy, as we said earlier, and as you said yesterday, reduces the quotas, the volume restraints for the Option B Regions during a period of time we refer to as the "remedy period"; correct?

A. Yes.

Q. And so, for example, if I use this to represent the quotas available to the particular Option B Regions, in a particular month, we'll call--that region is RQV; you understand what that means?

A. Yes.

Q. And down here is, of course, zero?

A. Yes.

Q. This region can ship up to the RQV in a particular month?

A. That's my general understanding.

Q. Under the SLA?

A. Yes.

Q. In the third remedy, what we do is we forecast; right?

We attempt to forecast exports during a particular month in the remedy period, and the first reduction essentially corresponds to that forecast; right?

A. You mean the first reduction you're proposing?

Q. Right.

A. If I understand your proposal if you forecast that the RQV isn't going to be binding, you would reduce the RQV by an amount to make it binding.

Q. Let's say if we have to do that this month, we put this down here, the forecast amount and, of course, the difference between the RQV and the forecast, the first reduction; correct?

A. You're calling it "first reduction," but I understand what you mean, yes.

Q. And then we, the remedy proposes a second reduction for the amount of the overshipment; correct?

A. As I understand it, under the--your third proposal you target a change in exports that's equal to the volume of what you calculate as Option B overages.

Q. Let's say we're in Ontario and Ontario overshipped a total of 120 million board feet of lumber. We look at the remedy period, six months, and say we want to take out 20 million board feet in a particular month as part of the second reduction in this remedy; correct?

A. That's what you're proposing. If that's what you're

proposing, I'll accept that.

Q. We take that down to the second reduction that we'll call the "final reduction"; correct?

A. It's correct you've called it that.

Q. Well, is it correct, this is your understanding how the third remedy works?

A. This is my understanding, basically, of how it works.

Q. One of the criticisms you and Dr. Reishus make or assert in your--

CHAIRMAN BÖCKSTIEGEL: Try to get as close as possible to the mike.

MR. SCHWIND: Yes, Mr. Chairman.

BY MR. SCHWIND:

Q. One of the criticisms in your report is that the application in this remedy is going to produce a biased result; is that right?

A. That's correct.

Q. And, in fact, it's your opinion that this bias result is so because the likely effect is as a result of this remedy, we may get too large a reduction in Option B exports, that is, we may get a reduction that exceeds the reduction we want?

A. Well, what we're saying is that the direction of error in the way the model or method is set up runs in only one direction. That is if your method overforecasts the amount of what you call the "first reduction," then you have an

overtightening under your own methodology that only goes in one direction. That is, it only has the effect of further tightening, and so you miss the actual level of your first reduction needed to produce binding export controls.

Q. Dr. Kalt, you gave us a hypothetical example how this bias works in your second report in Page 13, 14. Would you go to that, please. You see on Page 13 you say--

A. Where are you reading?

Q. Paragraph 29, sir. In your second report.

A. Second report, I'm sorry. I thought you said first. Sorry. Okay.

Q. And you say if we--under the U.S. third option, if the forecasts level of exports were exactly correct, then the targeted reduction for that region, say 50 million board feet in exports, would be as desired. Do you see that?

A. As desired under the method, that is, obviously, under Dr. Neuberger's desires, if you will, yes.

Q. Would you agree that, in your hypothetical example, that 50 million board feet is going to correspond to the second reduction?

A. As I understand it, that's what Dr. Neuberger's methodology would be doing.

Q. In your hypothetical, you say that, well, suppose, however, the forecast is correct on average, but it's too high half the time and too low by the same amount the other half,

when the forecasted level of exports is below that which would actually have occurred, you say, by a hundred million board feet; right?

A. Yes.

Q. Essentially we have a hundred million board feet of error on both sides of our forecast in your hypothetical; right?

A. Yes.

Q. So, we use the diagram here. Here's our forecast. You're saying if the error is either a hundred million board feet in that direction or it's a hundred million board feet in this direction, then we're going to see how this bias works; right?

A. Okay.

Q. And you say, well, if our forecast was too low and Canada really, what it would have shipped up to this level hundred million board feet above our forecast, then the total forced reduction on Canada is 150 million board feet, hundred to get to our forecast and the 50 down to final reduction; right?

A. The assumption is you forecasted the need for a hundred reduction, then you put in what you call the second adjustment of 50.

Q. All right. So, in your example here, would you agree the reduction of Canadian exports is 150 million board feet?

A. If I understand the hypothetical, the way you're drawing your pictures, if I understand your question correctly, you're saying that you forecast a reduction--I'm sorry, I see what you're drawing. Yes, that's what you're drawing, yeah.

Q. And then if we look at the other range, if Canada really only shipped this much down here, essentially, our forecast was too high. There's no reduction in exports because they weren't going to ship to the final reduction anyway; right?

A. I'm sorry, say again.

Q. If we look at the other end of your error spectrum here and, essentially, our forecast was a hundred million board feet too high, your conclusion in your hypothetical is there's no reduction in Canadian exports, put a zero there, because they were never going to ship up to their final production; right?

A. The problem is we're forecasting a reduction here. So what we're saying is if the forecast overestimates the level of shipping so that the forecast needed for the reduction is smaller than what would--what actually turns out to have been needed to make the--back up.

What we're saying is you're trying to forecast first what level of reduction in the RQV is needed to make the exports binding. If you overforecast, you estimate too large an amount to make it binding, then you're causing a tighter

quota than was needed to actually implement Dr. Neuberger's proposal.

On the other hand, if you forecast a smaller amount, then you are underforecasting the amount to make the stage one, or "step one" as you've called it, to make the system binding. And then on top of that, if you apply your second reduction, it may or may not be binding, depending how large it is.

Q. Again, in your hypothetical, we see that on average the expected reduction in actual exports--reading from the bottom of Page 13, your Paragraph 29, the expected reduction in actual exports in this case would be 75 million board feet, which you say is the average from 150 and zero; right?

A. In this hypothetical, yes.

Q. Correct.

So, again, the 150 is the forced reduction. If our forecast is too low, Canada gets reduced by 150 million board feet of lumber; right?

A. In this hypothetical, yes.

Q. It's your hypothetical; right?

A. Yes.

Q. In the second example where the forecast is too high, Canadian exports are not reduced at all; right?

A. No, that's not true. You can't conclude that.

Q. Your hypothetical averaged 150 to zero; correct?

A. Well, the average from 150 and zero is 75, yes.

Q. How did you get to zero?
A. It's a hypothetical.
Q. Tell me, am I illustrating your hypothetical incorrectly?
A. I never looked at it quite this way, so I'm trying--struggling to see it in this format. I'm not sure. You're drawing a particular picture that you came up with, not me.
Q. Sir, you would agree in your Paragraph 29, when the forecast is too high, as in our second example here in your hypothetical, exports would be unaffected as the misforecast amount 100 million board feet misforecast exceeds the target reduction, it's 50, and, again, in that case as you say here exports are unaffected. You agree?
A. Yes, in this hypothetical, sure.
Q. So, again, this is the source of your average of 150 and zero; right?
A. When I'm doing a case, if you look at the last sentence of 13, spills over to 14, I'm saying the 75 arises as 50 percent of the time, 150 million board feet reduction; and 50 percent of the time, no reduction.
Q. Right. Now, in fact, when Canadian exports aren't reduced at all, would you agree the United States essentially does not get its remedy?
A. No, I don't think that's right.

Q. Canadian exports weren't reduced at all that month; right?

A. Under your theory of remedy in other months, you were getting an extra effect when you go the other direction.

Q. I understand other months--but again, in this example--

A. But the target wasn't a monthly target; it was a total target, so it's relevant in other months. That's the point.

Q. We'll talk about other months in a minute, but in your hypothetical month where you say--I'll read it to you--Canadian exports are unaffected by the misforecast; correct?

A. That's correct.

Q. And if Canadian exports are unaffected, that means the United States didn't get anything out of its remedy; right?

A. Not in this month in the sense of a reduction in exports since that what you were seeking, but--I'm sorry, Dr. Neuberger's methodology has this built into it that there would or could be months of that type and that would be part of your remedies in that month you didn't get a reduction in exports.

Q. So, for that month, if our target reduction was 50, Canada, essentially, the United States doesn't get that 50 in some other month; right?

A. No. It depends in a sense on your forecast errors in other months in going in the other direction.

Q. Would you agree, Dr. Kalt, that in this situation

where the Canadian exports are unaffected, which you counted as a zero, the United States doesn't get its remedy, and the reality is that Canada is actually getting 50 million board feet to its benefit?

A. No. What you're describing is a situation which built into Dr. Neuberger's approach are months in which this would happen, in which there would be no forced reduction in exports. That's part of your proposed remedy. It's the nature of the process of forecasting RQVs. That's part of the way the system works in Dr. Neuberger's third proposal.

Q. Dr. Kalt, would you agree, again, in your example, your hypothetical, you counted as a zero what actually should be counted as a plus 50 because Canada is getting that to its benefit because its exports have not been reduced by the 50 million board feet the remedy calls for?

A. No. I think you're playing a semantic game there.

Look, you're in a situation with Dr. Neuberger's proposals, this third methodology, in which these kind of months, just because of those forecast errors, that's what we're pointing out and the forecast in this direction, there's no forced reduction for the overage. That's a necessary characteristic of what you're proposing as your third remedy.

You do not propose a makeup in later months, so I presume that zero is, in fact, an intended or at least a recognized consequence of forecast errors that run in

particular months in particular directions.

Q. Dr. Kalt, would you take the average--if you look at what happens to Canada in your hypothetical, at one end of your spectrum Canada, their reductions are reduced by 150 million board feet; correct?

A. In the way you would apparently run the system, yes.

Q. And at the other extreme, if I'm correct, that Canada is actually gaining 50 million board feet of lumber because the United States is not getting the reduction the remedy calls for. The average of my negative 150 and positive 50 is 50 million board feet, which is exactly the targeted reduction we're trying to achieve?

A. No. Your proposal for number three produces as the outcome for that particular situation a zero reduction and produces that result. That's what your proposal produces.

Q. You disagree Canada gains that 50 million board feet--is that right?--in this situation where it doesn't have to reduce its export--

A. It may gain relevant to what you want in some sense, but it doesn't gain relevant to Dr. Neuberger's proposal. This is built into the proposal.

Q. In this situation, let's say your top forecast error where the forecast is too low, the United States--from a U.S. perspective, the United States essentially got 100 million board feet of reduction that it essentially was not entitled

to; correct?

A. Sorry, I lost you.

Q. Using your hypothetical, you say when the forecast is too low, Canadian exports are reduced too much; right?

A. When the forecast is too low, yes. Your stage one imposes an RQV reduction, which is more than was needed in stage one to bring export quotas into a binding situation.

Q. In that situation, the United States got 100 million more board feet of remedy than it should have; right?

A. It got a larger reduction, but I don't know what you mean by "should have." This is a necessary result of Dr. Neuberger's proposal. So, in some sense, by the proposal that's what it should have gotten. I'm just saying it results in this excessive tightening of export controls in that situation.

Q. In this second situation where Canadian exports aren't reduced at all, would you agree if I say the United States essentially got zero, nothing of its remedy, that is, if the remedy is the targeted 50 million board feet of lumber that was supposed to be part of the remedy?

A. If you wanted 50, you would not have gotten 50 in that month. That's the necessary result of Dr. Neuberger's analysis.

Q. What's the average between a hundred and zero, Dr. Kalt?

A. It's 50.
Q. Which is exactly the target reduction in your hypothetical that we want to get over the remedy period, isn't it?
A. In your hypothetical that's the--you've said that's what you were targeting. That's an average, yeah.
Q. So, even using your hypothetical, there's no bias at all because we're getting even with your error range, we're getting on average exactly the 50 million board feet of lumber export reduction that's targeted; right?
A. No. There is a bias in the sense that your stage one imposes an extra condition of excessive bindingness relative to the stated goal in your third alternative.
Q. Sometimes it's high; sometimes it's low. Right?
CHAIRMAN BÖCKSTIEGEL: Would you go back to the microphone because others in the room may not be able to understand you.
THE WITNESS: The bias arises because, for example, the desired overage still does not bring the import controls into bindingness, then you end up with a situation that the remedy you were seeking would have resulted in nonbinding results. If you misforecast, the binding export controls would stay in your step one, as you called it.
BY MR. SCHWIND:
Q. You spoke yesterday about--on your chart that's behind

you, the flip chart that's still there, you say that the imposition of a remedy, either additional export charges or a quota reduction, was problematic because it would disturb what you called the going-forward equilibrium under the Agreement; correct?

A. Yes.

Q. Your--essentially, additional export measures might interfere with the Parties' ongoing expectations under the Agreement; right?

A. No, I think what I said was at the time of their agreement--I think I used an exact phrase, but their explicit or implicit understanding would be that they were setting up a system that would govern market equilibriums going forward and after the fact, intervention with export measures to achieve retroactive reparations to a particular subgroup of the market, U.S. producers, would distort that anticipated equilibrium under the Agreement, or those anticipated equilibria under the Agreement.

Q. Your testimony--I think you said this yesterday, as well--if Canada would simply provide cash compensation for its breach--again, write a check, as you say--this would not disturb the going-forward equilibrium under the Agreement?

A. That's correct.

Q. At a risk of pointing out the obvious, wouldn't you agree it was Canada's overshipment of approximately 200 million

board feet of lumber into the United States that it was actually that which disturbed the going-forward equilibrium in the first place?

A. No. That disturbed the equilibrium, if you will, whatever the amount of the overage was in some way during the period of the overage.

MR. SCHWIND: If I can have one minute in place, Mr. Chairman.

(Pause in the Proceedings.)

BY MR. SCHWIND:

Q. Dr. Kalt, you also talked about collateral effects yesterday of the potential remedies.

A. Yes.

Q. Just to confirm, the collateral effects you mentioned were higher U.S. consumer prices?

A. Yes. In Dr. Neuberger's model, yes.

Q. And also a benefit to Option A Canadian producers who could benefit from the higher U.S. prices?

A. Yes.

Q. So, in fact, all the collateral effects you talked about yesterday were either harmful to the U.S. or beneficial to Canada; correct?

A. No, because Option B producers under your first alternatives, for example, pay very sizable taxes.

Q. So, aside--

A. They're not commensurate with the impact of the overage on them.

Q. So, aside from the effect as you see it on the Option B producers, all of the collateral effects that you identify, again, are either harmful to the United States or beneficial to Canada?

A. Except for that part of Canada made up by Option B producers; is that what you mean? You want me to ignore them? I'm happy to. It's true, Option A producers would tend to gain; and, under your first two alternatives, the Canadian Treasury would gain.

Q. Dr. Kalt, what notes are you looking at up there? Were you looking down at some notes you brought with you?

A. Not during today. Yesterday I did, yeah. I looked at those notes, and I looked at this calculation we gave you of the implications of Dr. Neuberger's new range from his Footnote 11. I told that to you yesterday.

MR. SCHWIND: Okay. Thank you.

That's all we have, sir.

CHAIRMAN BÖCKSTIEGEL: Thank you very much.

It's a bit early for a coffee break, I would think. Do you have some redirect questions on the Respondent's side?

MR. AGUILAR-ALVAREZ: Yes, I do, but it would be useful if we could take a break.

CHAIRMAN BÖCKSTIEGEL: Okay. We will take a break.

Ten minutes sufficient?

MR. AGUILAR-ALVAREZ: Yes.

(Whereupon, at 9:57 a.m., a recess was taken to 10:07 a.m.)

CHAIRMAN BÖCKSTIEGEL: Can we continue?

We'll resume the hearing, and the Respondent has the floor for redirect.

MR. AGUILAR-ALVAREZ: Thank you, Mr. Chairman.

REDIRECT EXAMINATION

BY MR. AGUILAR-ALVAREZ:

Q. Professor Kalt, counsel for the U.S. asked you a number of questions on the elasticities and whether the $1.94 was relevant to all the options or not. We have heard testimony from Dr. Neuberger that the $1.94 is the price effect that the overages had in the U.S. market and that this is the damage to U.S. producers.

How does Professor Neuberger calculate the $1.94?

A. The $1.94 is calculated in a model that employs these measures of supply and demand elasticity, calculates the amount of the overage and essentially reverse-engineers the actual data by saying what would a reduction of exports in the amount of the overage from Option B producers produce in terms of a new supply and demand equilibrium.

Q. And having calculated that this is the price effect and that this is the damage, does he then proceed to target

that with his four proposals?

A. No, he does not.

Q. How many of his proposals don't even target that?

A. The only one that essentially even tries is the second alternative. The first alternative targets a tax collection amount. Even under his second alternative, it's really a tax collection amount that is targeted under the theory that, had that tax been collected back in the first half of 2007, it would have produced this $1.94 result. But options three and four don't target the $1.94 at all, either.

Q. Thank you, Professor.

In response to one of counsel's questions, you mentioned something about Option A, the first proposed alternative remedy that Dr. Neuberger explores, that it was not anchored in anything. I would like to show you Dr. Neuberger's report to determine whether that is what you were referring to. If we could turn to Dr. Neuberger's first report, Paragraph 57, please.

Could you read that.

A. What I was referring to was in particular the very first sentence. You'll see what Dr. Neuberger says about the first alternative, which I understand from the opening yesterday was the U.S. preferred alternative. While--I'm quoting now--While the approach described above is both straightforward and practical, it fails to provide an economic

anchor to the effects of the overexporting, in quotes, by Option B Regions had on lumber markets in both the U.S. and Canada.

Q. Could I then put up on the screen Paragraph 29 of Dr. Neuberger's third report.

Does Dr. Neuberger make the same point here?

A. Yes. In the--the lamp is partly excluding the quote but--thank you. First, the additional tax to be collected under the Option A remedy remains the same because the remedy is not tied to the mechanism of the overage, whatever it says, to the magnitude of the overage, yes. He seems to be making the same basic point.

Q. Thank you, Professor.

Is the use of domestic supply elasticities for export supply elasticities a fundamental error in economics?

A. Yes.

Q. What is the range of elasticities in the McFarland, Stoner, Guerra study that was discussed yesterday?

A. In that study, the study notes, the ITC staff had used a range of .7 to 2.0, I believe, and I believe Stoner, McFarland and Guerra then go on to say they do sensitivities on 2.0 export supply elasticity, as I recall.

Q. Now, assuming, Professor, that we fix the elasticities in Dr. Neuberger's model, does it become a reliable model?

A. What do you mean, "fix" them?

Q. If you choose the right export supply.
A. Conceptually.
Q. Elasticity?
A. No.
Again, the point I'm trying to make to all Parties is that the kind of sensitivity we see to the selection of the particular number for the export supply elasticity, in other words, you choose the correct conceptual thing that is export supply elasticity rather than general home production supply elasticity. Even if you do that, the results are highly sensitive to that selection of a particular number.
That sensitivity is saying, number one, even in the context of Dr. Neuberger's model for any target that you think you're trying to hit, you can't reliably hit it because you have a range out there in the export supply elasticity.
Q. Let me ask you one final question using the example that was put to you--using the example that was put to you in discussing alternative three. In counsel's example, the forecast is always the same. You always hit the forecast. What happens if this point moves?
A. If the point moves--that is if, for example, it moves down relative to actual--then what happens is, under this option three, the first step of the process--as counsel for the U.S. said it, the first step of the process would have a larger reduction in RQV in the first step of the process, relative

to--the actual one, the actual reduction RQVs that one would get if you had an accurate forecast.

So, the issue here is that as the forecast varies from the actual, you get in some situations excessive tightening, and you get tightening in situations where the market wasn't going to be tight, even with the overage as we pointed out, overage in the second step accounted for, as we point out in my first report.

Q. What was your--what was the purpose of your analysis of Dr. Neuberger's elasticities, Professor?

A. Again, I tried to assess the reliability of the proposed remedies in providing what the U.S. asserts as the proper legal position, which is this after-the-fact reparations through going-forward export measures interventions into the marketplace.

And my purpose there is to understand whether the methodologies or remedies that are proposed would have the effect that the U.S. asserts through its legal theory as the appropriate effect. In doing that, I ended up with kind of two purposes: One was checking, if you will, the internal correctness of the model. This mathematical error arises around the choice of the home production elasticity, rather than the export supply elasticity.

Secondly, my purpose was to examine the sensitivity of results to those elasticities within his model and obviously to

point out those results are highly sensitive to the selection of elasticities; and, hence, when you're trying to hit a small target, even apart from the other difficulties with his modeling, I conclude you end up with a model that's not reliable and approaches that aren't reliable for hitting the targets that are asserted.

MR. AGUILAR-ALVAREZ: Thank you, Professor.

I have no further questions, Mr. Chairman.

CHAIRMAN BÖCKSTIEGEL: Okay. Anything from Mr. Schwind?

MR. SCHWIND: Yes, Mr. Chairman. Briefly.

RECROSS-EXAMINATION

BY MR. SCHWIND:

Q. Once again, you spoke to the Stoner, McFarland paper; is that right?

A. Yes.

Q. I assume you reviewed or you read that paper at some point prior to today; right?

A. Yes.

Q. You're aware that in that paper the authors write, Kinnucan and Zhang use supply elasticity of .9, which will be used for all imports in the base case. Do you recall that?

A. Yes.

Q. So, the authors of this paper used an export supply elasticity of .9, the same export supply elasticity that you

arrived at in your 1988 paper; correct?
A. It's not quite the same as being applied to a different market. It's numerically the same number.
Q. And, in fact, you mentioned sensitivities that the ITC had tested sensitivities from .7 to up to 2; is that right?
A. I believe that's what it says.
Q. You tested sensitivities in your 1988 paper; correct?
A. I believe so, yes.
Q. In fact, I'll read what you wrote: "To provide some indication of the sensitivity of welfare implications to the import supply elasticity"--and you've already agreed import supply elasticity is the same as export supply elasticity; right?
A. Conceptually, the way I was using it there, yes.
Q. --"the figure below graphs the net national U.S. welfare gains from an optimal tariff over alternative values of the import supply elasticity."
You say cutting the import supply elasticity to .5 would imply an increase in the U.S. monopsonistic power, and the net gain from an optimal tariff would exceed $700 million annually. Do you recall that?
A. No, but that sounds like what I wrote.
Q. So, you tested sensitivities for export supply elasticities all the way down to .5, didn't you, Dr. Kalt?
A. Sure. I was pointing out the sensitivity of these

results to these elasticities; same point I'm making here.

Q. With respect to counsel's diagram, is your point that sometimes the forecast is too high, sometimes the forecast is too low?

A. By its very nature, forecasts can be too high or too low, yes.

Q. Sometimes the U.S. gets more than the targeted remedy, sometimes the U.S. would get less than the targeted remedy?

A. Sometimes you would have overtightening, sometimes you would have undertightening in your stage one as part of your remedy proposal.

Q. And you would agree, for example, just trying to tie this to your hypothetical that you spoke of earlier, in that hypothetical, at one end of the misforecast, would binding the U.S. got 100 million board feet of reduction more than the targeted remedy; correct?

A. In that hypothetical, as I understand what you were trying to do, the way you were drawing it, you were trying to say that there was a misforecast that resulted in undertightening, if you will.

Q. No overtightening in that case?

A. Both.

Q. On one hand in your hypothetical, the United States got 100 million board feet too much; the other end of your example, the United States got no remedy at all. Right? Zero?

A. In that particular hypothetical, if you mean by "remedy" hitting the target as if there were no error, yes, but there's error in the world; that's the point. There's inherent error in trying to forecast these things.

MR. SCHWIND: Thank you.

That's all we have.

CHAIRMAN BÖCKSTIEGEL: Thank you.

QUESTIONS FROM THE TRIBUNAL

CHAIRMAN BÖCKSTIEGEL: Professor Kalt, I have one question coming back to the long discussion Mr. Schwind had with you yesterday and let me say, first, we have been discussing for hours is really on the basis of the presumption that on the primary legal question one would come to a retroactive compensation system. So, I don't want to give the impression that we have pre-judged that, but I want to follow-up on that presumption. And we have heard a number of reasons, read them and heard them again, why you think Dr. Neuberger's four approaches are not really correct to calculate what they're supposed to achieve.

We have also seen that in terms of reference of your report, so to speak, there were the three questions that counsel for Respondent raised with you and that's what you tried to answer, and none of them asked for a Kalt model, and you explained this was not your function. And we also are aware, of course, I think Mr. Aguilar mentioned there's a

question of burden of proof legally involved in that context.

Nevertheless, let me ask you this: Having heard all the difficulties that you find with the different--with the four Neuberger models--and you explained that for many reasons the moving target idea, so on; it's extremely difficult to really find a good solution--would you think that it is possible, impossible or extremely difficult to come up with a model that would satisfy your criteria?

THE WITNESS: I think it would be extremely difficult to come up with a model that provided you with stable or, if you will, insensitive results. And let me briefly explain why. As I indicated yesterday, as the way cross-examination goes, you start down a theme, and it doesn't get completed, but as I indicated appropriate measure of reparations implied by the United States legal theory, this concept of producer surplus or net economic lost profit, and in order to target that in a reliable way, one would have to build a model that reflected underlying supply and demand conditions, but also reflected, because of the temporary nature and the small nature of what you're doing here, such things as the way the market responds.

I used the phrase yesterday "missing parts" in Dr. Neuberger's model. You have to explicitly model, I believe, inventory behavior, for example. You would also have to explicitly model the fact there are layers in this industry. If wholesalers, for example, altered their inventory behavior

or didn't, you might change the price at the wholesale level, but not for the producer, so you're not hitting any target. Such models are in theory constructible, so I'm trying to explain why now it's so difficult. It's in theory possible to construct such models where you have the explicit modeling of the inventory behavior, as well as the behavior of the different stages of the industry heading back from retail to producer.

In doing that, however, you would still face this difficulty of the sensitivity of the results to some of these underlying parameters or supply and demand elasticities; and, when you're trying to apply this on a going-forward basis using market interventions of export measures, my sense is if one were to do that, you would still be hearing a discussion here of how sensitive the modeling is to the selection of particular elasticities and other parameters in the model, and so you'd be left with this, what's a reliable number for U.S. panelists to pick. You would have a very difficult time doing that.

CHAIRMAN BÖCKSTIEGEL: What you really would be looking for is not a perfect solution, but the best you can do under the circumstances.

THE WITNESS: The best you can do without having to speculate in the technical sense of speculating. You can see within this model it's kind of a sensitivity where you can derive export measures, export charges from $40 to one-third of

that very easily. Yeah, you have a difficult time when you have the sensitivity of saying what's the best you can do in a nonspeculative way.

CHAIRMAN BÖCKSTIEGEL: Whoever would come up with the model might be subject to discussion by peers, would that be in your speculation?

THE WITNESS: If someone came up with a model, such as Professor Kalt, and said this is the most reliable number, I think, yes, we'd be subject to a kind of peer review, which says "Professor Kalt, how did you pick that as the single value in this context?"

CHAIRMAN BÖCKSTIEGEL: I'm glad to hear that. It happens to lawyers all the time.

Now, is it too naive to think that since we're only talking about a six-month period and we're talking about it in hindsight, and we do have as, I understood yesterday, the contemporaneous figures pretty well available, wouldn't that make it easier?

THE WITNESS: If you were trying to provide reparations for producer surplus, use of the contemporaneous data here is being used to calculate the amount of the overage. Given whatever that amount is, that would drive what you calculate as the past lost producer surplus, but that doesn't help you in any particular way with the challenge you and I were just discussing of producing at least a theoretically

sound model or an analytically correct model.

All the difficulties I just laid out for you in my previous answer would still be present. In other words, you might get a more accurate measure of the lost producer surplus you're trying to target, but hitting the target is the challenge when you have to apply as you do here--if you adopt the U.S. legal position, you have to apply export measures going forward. Your job is not made easier by the use of that contemporaneous data, even with a theoretically sound model.

CHAIRMAN BÖCKSTIEGEL: Thank you very much.

My colleagues have any questions?

ARBITRATOR VEEDER: I have one minor question.

If you could look at your first report.

THE WITNESS: I might have a little difficulty. My glasses just broke.

ARBITRATOR VEEDER: If you could turn to Figure A-2 that you were referred to earlier this morning, on Page 33.

THE WITNESS: Yes.

ARBITRATOR VEEDER: You were asked about the export elasticity figures in the second column.

THE WITNESS: Yes.

ARBITRATOR VEEDER: I wanted to ask you about the high case that you get to the figure of 11.26. Now, you refer to a Paragraph 10 and I went to the wrong paragraph, but Paragraph 10 on the previous page is it. Elasticity estimates.

THE WITNESS: Yes, that's correct.

ARBITRATOR VEEDER: If you look down four lines, you'll refer to the primary sources for the figures used by Dr. Neuberger in Footnote 64.

THE WITNESS: Yes.

ARBITRATOR VEEDER: Latta and Adams.

If we turn to Tab D, is that the reference you make in that footnote, an article by Latta and Adams?

THE WITNESS: Yes, I believe it is.

Let me doublecheck the date. Yes, I believe that's accurate.

ARBITRATOR VEEDER: Table 4 to which you refer Page 1423 of that article, this is where I need your help. In your Paragraph 10, you refer to a range of estimates for Eastern Canada from 0.49 to 11.90; and in this Table 4 we see 11.90 under the fourth column east, three lines down, Baker 1990 Ontario. Is that the figure to which you're referring?

THE WITNESS: I believe that's accurate, yes.

ARBITRATOR VEEDER: If you look at text which begins on the previous page in the last paragraph up to the first sentence, estimates of unconditional elasticities are limited, the largest number coming from two studies by Baker 1989 to 1990. The Baker 1990 study yielded elasticities far higher than any reported elsewhere in the literature for either the United States or Canada.

Now, given the date of this paper which seems to be 1990 and the fact that it seems to be an outlier, how reliable is that as a guide?

THE WITNESS: I think as you go farther out, the reliability goes down, but it doesn't change the point about sensitivity even within the range we've done them for 1.1, we've done them for two. The farther out you go, while the numbers exist in the literature, you say, well, I'm less likely to go out that far; that's why I call it a "high case."

ARBITRATOR VEEDER: What about the date, the fact this was done in 1990, perhaps different working conditions? Would that affect its reliability, too?

THE WITNESS: Well, its usability, yes. Sure.

ARBITRATOR VEEDER: Thank you very much.

CHAIRMAN BÖCKSTIEGEL: Okay. That seems to conclude your examination, Professor Kalt. You've been very patient, as Dr. Neuberger was before. I assume that's part of the game.

Let me now ask the Parties whether they have decided on the question of recall. Do they want to recall one of the experts, or do you reserve your position on that? You may do so within the limits I described yesterday, obviously. So I ask Claimant first, you want to recall--Professor Kalt was just finished, so we're really talking about Dr. Neuberger now.

MR. SCHWIND: Thank you, Mr. Chairman.

If we could we would request a short break, ten

minutes, to discuss this with--amongst counsel. Right now I'd say we're leaning towards recalling Dr. Neuberger to respond to Dr. Kalt, but we'd like a short break to discuss it, whether that's completely necessary.

CHAIRMAN BÖCKSTIEGEL: Would you like to make a comment at this stage?

MR. AGUILAR-ALVAREZ: I would reserve our comment, Mr. Chairman.

CHAIRMAN BÖCKSTIEGEL: We'll have a 10-minute break. We'll start again quarter to 11:00.

MR. SCHWIND: Thank you.

(Whereupon, at 10:34 a.m., a recess was taken to 10:45 a.m.)

CHAIRMAN BÖCKSTIEGEL: All right, Mr. Schwind.

MR. SCHWIND: Thank you, Mr. Chairman.

We decided after discussion--we're still waiting--

CHAIRMAN BÖCKSTIEGEL: I'm sorry.

MR. AGUILAR-ALVAREZ: A truncated Tribunal.

MR. SCHWIND: We do have one housekeeping matter--

CHAIRMAN BÖCKSTIEGEL: Why don't we wait.

(Pause in the Proceedings.)

CHAIRMAN BÖCKSTIEGEL: All right. No truncated Tribunal anymore.

Mr. Schwind?

MR. SCHWIND: Thank you, Mr. Chairman.

One housekeeping matter. I drew an exhibit with Dr. Kalt when he was on the stand. We intend to have it marked and included in our hearing binder today, copies made for everyone.

Secondly, we had, after some discussion, decided not to recall Dr. Neuberger to the stand. And, therefore, of course, the one remaining--assuming the Tribunal has no further questions of the experts, the one remaining aspect of the hearing is the closing arguments, and we would request that the Parties reconvene at 3:30 this afternoon for that purpose.

CHAIRMAN BÖCKSTIEGEL: Thank you.

Now we'd like to hear the comment from Respondent's side. Do you plan to recall one of the experts?

MR. AGUILAR-ALVAREZ: We have not been fond of recall, so no.

CHAIRMAN BÖCKSTIEGEL: I noticed that.

So, there will be no recall.

As you know, we didn't feel it was necessary, but let me add right away we will discuss further procedure in due time, but let me say that anyway, in the Post-Hearing Briefs, that we feel we need from the Parties, you will have not only ample opportunity, but we would ask to evaluate very carefully the examination of the experts to translate the economic wisdom that has been brought forward here into the concrete relevance for the issues that we have to decide legally. We definitely need the Parties' help on that, so that will give you an

opportunity to do just that, and we would actually ask you to do that. So, not recalling does not mean you don't have an opportunity to deal with the matter anymore.

Very good.

Now, the next thing is then what we have before us is still the closing statements and the short discussion on the further procedure which will not take very long. I had--I've heard what you said, 3:00 or 3:30 this afternoon. Yesterday, I was under the impression Respondent preferred to do it tomorrow morning.

What is your comment?

MR. AGUILAR-ALVAREZ: Well, we planned for worst-case scenario and didn't sleep, so today is fine.

CHAIRMAN BÖCKSTIEGEL: Today is fine?

MR. AGUILAR-ALVAREZ: Yes.

CHAIRMAN BÖCKSTIEGEL: Then 3:30 would be fine, too?

MR. AGUILAR-ALVAREZ: 3:30 would be fine, Mr. Chairman.

CHAIRMAN BÖCKSTIEGEL: That would mean we start at 3:30. You have up to an hour, as you know, which would lead us up to 4:30; short break; then we have an hour for Respondent. Since it's still quite early, perhaps we can do the procedural discussion now rather than doing it later in the afternoon. There's not much to discuss. I will make a few closing remarks at the end of the hearing, obviously.

The only thing that I can imagine we have to discuss right now is really the Post-Hearing Briefs. We intend to issue a short order about the contents of the Post-Hearing Briefs. It will be what I already told you a minute ago, but we may have a couple of issues or questions of a specific kind which we would like you to address, in addition to the general evaluation of the hearing. And we may also try to find out an appropriate language that the evaluation of the hearing should particularly focus on the economic discussion that we have had.

We feel we have from the Parties really sufficient input on the legal questions, both in writing and what we've heard yesterday already, and I'm sure we will hear some more this afternoon, but--so we feel the evaluation of the hearing should particularly deal with the economic side and what it means for the relief sought in this arbitration. But we will try to put that in appropriate wording, and the Order will reach you shortly after that, but this is the idea.

So, the transcripts are available, so you don't have to wait for that, so we can count from now, basically. What would be an appropriate period for you to have sufficient time to do the Post-Hearing Briefs? I would not want to limit them by pages. Sometimes we do that, but in this situation here, I don't think we need a page limit. It doesn't mean you should send several hundred pages because then best ideas get lost in those 200 pages, of course. We're not trying to tell you to

make it long, but I don't think we should limit it.

The other question that comes up in that context normally is, what about further exhibits? We have said no new documents, basically. We feel we don't need any more documents and, therefore, that should be excluded except perhaps legal authorities, if you have something, if you have not submitted yet that could be done, but even there, I think we are fully briefed from the Parties' side. I would suggest no exhibits whatsoever at this stage because the Parties have been supplying really whatever they consider relevant at an earlier stage.

Well, that's about it. So, our suggestion would be no new documents, no limitation on pages, and the contents being what I just described in a general way. Now, having heard that, what would you think is a reasonable period? We are not trying to press you; rather, we should take a realistic period and not an ambitious one and later you come up and say "We can't make it" because that changes plans at a time when it's much more difficult.

MS. DAVIDSON: Thank you, Mr. Chairman, and thanks to the entire panel for the time and attention you've devoted to the hearing.

We would respectfully ask for a period of four weeks, perhaps. We haven't had a chance to discuss this with Canada, so we don't know what their views are. Three to four weeks, I

think, at a minimum, given other commitments we have with other Tribunals.

MR. AGUILAR-ALVAREZ: Mr. Chairman, four weeks is fine, although in going through the transcript last night, it needs to be corrected; and if there is dispute as to how to correct it, perhaps the time should start running when we have a transcript that will be useful for you if we--if we quote it in the Post-Hearing Briefs.

CHAIRMAN BÖCKSTIEGEL: Let me give the following input. We shortly discussed when we could meet for our first deliberations, and before that I have to count a certain period when we have to prepare our deliberations, especially on my side, obviously.

So, as far as we are concerned--we are now in the middle of September. As far as we are concerned, if you go to the end of October, that would still be okay, but it would be better to have a fixed time now, and then you include in that the consideration you have just raised about the transcript. Would that be an agreeable way?

MS. DAVIDSON: That would be fine.

Mr. Chairman, also, is there a preferred procedure for submitting corrections to the transcript? Would you like the Parties to try to stipulate?

CHAIRMAN BÖCKSTIEGEL: I would suggest that the Parties try to do that and then perhaps directly contact the

Court Reporter. I must admit we discussed that shortly, and I have been in one case, and that's why I learned a lesson in a way wherein The Hague it was not to the--but a commercial arbitration that happened to be in the Peace Palace. It was an important arbitration, but this is as well, and we agreed as suggested by the Parties, if I recall correctly, that the Parties should in a formal procedure meet with the Court Reporters and try to agree on a text of the transcript. That took them two weeks, and it was still not an agreed text. I'm hesitant to get the Tribunal involved. I think at some stage it's a fact question, really.

So, really the Tribunal has not much to contribute whether something was said or not said or was intended but nevertheless--my suggestion would be--we haven't discussed it here, but it would be the two Parties get together first and, if they have a problem factually, go back to the Court Reporter. Do you have a tape or something? So that could be checked. And just at some stage we all receive an agreed final text of the transcript.

MS. DAVIDSON: If there are disagreements, a few disagreements, then those would have to be submitted to you, I assume. We hope there won't be.

CHAIRMAN BÖCKSTIEGEL: Obviously, we can't exclude that something arises where we are asked to deal with that, even though as you say we would hope not, and it's hard to say.

Hard to see how we can be better informed than what was said than the Parties with all their teams and the Court Reporters.

So, anyway, we'll give you the time for that, but if you have until the end of October for your Post-Hearing Briefs, that would include that effort. Is that okay?

MS. DAVIDSON: That would be fine.

MR. AGUILAR-ALVAREZ: Thank you. Mr. Chairman, that is fine.

The Post-Hearing Briefs will be simultaneous?

CHAIRMAN BÖCKSTIEGEL: Yes. I took that for granted. I'm sorry, I should have mentioned that. And I don't think we need the second round. Okay.

ARBITRATOR HANOTIAU: I would like to elaborate a little bit on what our Chairman said. Following the discussions we had together, we have heard very eminent testimony by very eminent experts. Sometimes, you know, it's not always easy to understand what we would like to ask you is try to make, you know, your Post-Hearing Briefs written in a way that really expresses in more simple terms what has been testified by the experts.

CHAIRMAN BÖCKSTIEGEL: Digestible for lawyers.

All right. Anything from your side? No?

We just saw that the 31st of October is a Friday, so that would be a good date to pick, and you will find that in the Order.

MS. DAVIDSON: That would be fine, Mr. Chairman.

CHAIRMAN BÖCKSTIEGEL: All right. That's all we can do right now, I suppose.

So, you have lunch and preparation on both together, I'm sure, and we'll meet at 3:30 for the closing statements. Thank you very much.

MR. AGUILAR-ALVAREZ: Thank you, Mr. Chairman.

(Whereupon, at 1:30 p.m., the hearing was adjourned until 3:30 p.m., the same day.)

AFTERNOON SESSION

CHAIRMAN BÖCKSTIEGEL: All right. I take it we have come to the next and final session of this hearing, which is, as we all know, the closing statements by the parties.

Let's start with the Claimant.

CLOSING STATEMENT ON BEHALF OF THE CLAIMANT

MS. BURKE: Members of the Tribunal, my name is Claudia Burke. I and my colleague, Patricia McCarthy, will be presenting the United States' closing remarks.

On behalf of the United States, we thank you very much for your time and attention you have given to this proceeding, particularly to the expert testimony provided by both Parties. We also thank you very much for the opportunity to present additional briefing on the economics questions raised during this proceeding.

I will begin by addressing the question of remedy which, of course, is the purpose of this hearing. And, in particular, I will discuss the nature and the magnitude of Canada's breach. I will then discuss the task before the Tribunal, which is to determine appropriate compensatory adjustments to the export measures and the ways in which Dr. Neuberger's proposed remedies squarely address this task. Finally, I will discuss Canada's various criticisms of the United States' proposed remedies. Ms. McCarthy will then conclude by responding to Canada's arguments on the proper

interpretation of the SLA's dispute resolution provisions.

The Tribunal determined that Canada breached the SLA by failing to apply the adjustment to EUSC, Expected United States Consumption, in a timely manner, then found that Canada is liable for the consequences of that breach.

The consequence of that breach was the overshipment of 216 million board feet of lumber. I refer the Tribunal to the chart on the screen which shows the regions with the largest overshipments. In particular, as the chart demonstrates, Ontario and Quebec demonstrably, and significantly, exceeded their quotas in all months of the breached period.

CHAIRMAN BÖCKSTIEGEL: May I ask, will we be able to get those later?

MS. BURKE: I believe they are attached at the very end of our hearing binder under the tab labeled "Demonstratives."

MR. AGUILAR-ALVAREZ: Mr. Chairman, we have received a copy of the demonstrative exhibits as we previously agreed. We verified the data which this chart was prepared, and I believe there's a mistake on the chart in that the red part should be within the green, should be below and not put on top, but we can address this in more detail.

CHAIRMAN BÖCKSTIEGEL: Okay. Then why don't you.

MS. BURKE: And if I can just make a correction. Actually, it's the case where copies were just handed out to

the Tribunal.

CHAIRMAN BÖCKSTIEGEL: That's what we have here?

MS. BURKE: Yes.

And we provided them to Canada last week.

MR. AGUILAR-ALVAREZ: An hour ago.

CHAIRMAN BÖCKSTIEGEL: Whatever.

MS. BURKE: Anyway, the purpose of this proceeding, despite Canada's attempts to obfuscate the issue, is to determine the appropriate compensatory measures to remedy the breach. The SLA directs the Tribunal how to do this. The Tribunal shall determine appropriate adjustments to the export measures to compensate for the breach. These can be in various forms: They can be an increase in the export charges and/or they can be a reduction in export volumes. But in any case, they must be in an amount that remedies the breach.

Now, Canada questions the Tribunal's authority to determine a remedy in this way. Assuming Canada is incorrect in its interpretation of the SLA's dispute resolution provision, as we must in order to reach the question of remedy, Paragraphs 22 and 23 indisputably provide the Tribunal with the authority and, indeed, the obligation to determine appropriate export measures.

Canada resists this framework provided in Paragraphs 23 and 23 at every turn, arguing in one way or the other that the breach cannot be remedied by an adjustment to the export

measures. Canada never proposes an alternate adjustment to the export measures. In contrast, Dr. Neuberger tackles head-on the task before the Tribunal.

As Dr. Neuberger demonstrated in his submitted testimony, his proposed remedies all satisfy the SLA's requirement to determine appropriate adjustments. Each remedy is comprised only of adjustments. Each remedy is directly tied to the overshipments, and each remedy offsets the effects of the breach in different ways and most importantly each remedy attempts to restore the integrity of the Agreement by requiring Canada to compensate for the breach; no more than compensation, and no less.

Although the SLA's parameters require only that a remedy must be in the form of adjustments to export measures, Dr. Neuberger makes several additional and basic common-sense assumptions, all of which refine and narrow the scope of his proposed remedies, all to Canada's benefit. He assumes that any remedy must be commensurate with the breach, must be economically meaningful, must not be punitive, and must be easily enforceable. Canada, of course, does not disagree with these assumptions.

Because Canada is currently shipping under its quota volumes, simply recouping the overshipment from the breach period will not be commensurate with the breach, nor will it be economically meaningful. And this conclusion makes sense. The

volume of lumber agreed to is an economic effect of the SLA; therefore, any breach that disrupts the balance of volume agreed to by the Parties should be remedied by an equal and opposite restoration of that agreed-upon volume.

Dr. Neuberger proposes multiple remedies in recognition of the different needs, but the equally valid ways of viewing Canada's breach. In fact, Dr. Kalt conceded that the different remedies have different targets and has offered no reason why it isn't reasonable to offer different proposals that address different aspects of the breach.

Now, I would just like to go through Dr. Neuberger's proposals one by one. Dr. Neuberger's preferred remedy, which is also our preferred remedy--we call it Remedy Number 1; we also call it the Option A Remedy--views the breach in terms of the benefits experienced by Option B, and that benefit is the avoidance of the Option A export charges.

Dr. Neuberger suggests this is the most appropriate remedy because it easily accomplishes the tasks required by the SLA. In effect, it treats the breaching regions the way they would have been treated under Option A until the effects of the breach are neutralized.

As the Tribunal is well aware from the liability phase of these proceedings, the SLA recognizes only two categories of exporting Regions A and B. It does not provide a third category for regions that wish to exceed their correct quota

restrictions but still wish to pay lower export charges. And the fact is, although Option B Regions generally stayed within their incorrectly calculated RQVs, they did not stay within their correctly calculated RQVs. This preferred remedy acknowledges that Option B Regions benefited from getting to act outside the confines of the SLA.

Dr. Neuberger prefers this remedy because it recognizes that Option B Regions enjoined the benefits of Option A, but endured none of its burdens. In fact, Dr. Kalt concedes that Option B producers are rational profit-seeking entities.

The remedy is particularly attractive because it is entirely governed by the SLA itself. It does not require any determination of outside market forces, nor does it require the Tribunal to make any assumptions about the economic effects of the breach. Rather, it just calls upon mechanisms that are already in place and, in fact, mechanisms that were already negotiated and agreed to by the Parties.

For example, it treats Option B Regions the same way Option B Regions were treated during the transition period during the first three months of the Agreement; that is, like Option A Regions. During the first three months of the Agreement, the Parties saw nothing punitive about this approach.

And Dr. Kalt has identified nothing inappropriate

about the remedy, other than to say it is not tied to any economic effects of the breach. Dr. Neuberger admits that his preferred remedy is not necessarily tied to the economic effects of the breach; it is tied to the SLA and to what the SLA requires compensatory measures to look like. As long as compensatory measures are appropriate, they satisfy the SLA requirements. Dr. Kalt does not explain--Dr. Kalt does not explain why a remedy that is tied to a benefit as opposed to an economic effect is not an appropriate remedy, particularly when the remedy looks to the SLA and only the SLA for guidance.

As an alternative, Dr. Neuberger suggests a second price-based remedy, one that is tied to the economic effects of the breach. As Dr. Neuberger concludes, the overshipment affected price, which is most definitely a primary ingredient of the SLA. It lowered the price by $1.94 cents to get back that $1.94. Dr. Neuberger opines that an export charge of approximately $39 per thousand board feet should be assessed on the same amount of lumber we ship during the breach period.

Our third and fourth proposed remedies view the breach in terms of the direct effect that the breach had upon the volume. Remedy Proposal Number 3 decreases the regional quota volumes. As the Tribunal can see on the chart that's currently on the screen, the current regional volumes of RQVs are much higher than what Canada is exporting, merely reducing the RQVs. What they should have been reduced by would not result in any

change in behavior or any reduction in the actual shipments. So, the proposed remedy would be two reductions for RQVs instead of one. First, it would predict or forecast future levels of unused quota volume, or as the chart refers to them, "The Water." It would then reduce RQVs by that amount.

Second, the remedy would further reduce RQVs by the reduction in volume which should have taken place during the breach period. This approach constitutes an adjustment to export measures and is directly tied to the breach. And it makes practical sense because the quota volumes are currently exceeding shipments; therefore, a meaningful remedy must somehow eliminate the excess volumes, so the Canadian exporters are encouraged to ship less, which will restore the Parties to their pre-breach positions.

In our final proposal, we propose adjusting EUSC downward during the next quarter in which quota are in effect, which will effectively result in two EUSC adjustments. This remedy acknowledges the very nature of the breach found by the Tribunal; that is, Canada failed to timely address the EUSC.

Under the final proposed remedy, Canada would first apply the adjustments to EUSC that should be made during the quarter that we're in, and then apply the adjustments that should have been applied during the breach period. In response to Dr. Neuberger's attempts not only to adhere to the confines of the SLA, but also to provide the Tribunal with a range of

options, Dr. Kalt declines to propose any remedy at all. Rather, Dr. Kalt opines that it is not feasible to compensate for the breach or it may not be feasible to compensate for the breach. To support this conclusion, Dr. Kalt claims that Dr. Neuberger's preferred remedy and all of our other proposed remedies fail to adequately address certain issues, and as a result all four remedies are speculative and unreliable.

For each response to our proposed remedies, instead of trying to determine whether a remedy is appropriate which, of course, is the standard prescribed by the SLA, Dr. Kalt assumes his conclusion that the breach can't be remedied by any adjustments to the export measures. We heard many times yesterday that the only appropriate and nondistortive way in which to remedy the breach under the SLA is through a cash payment to the United States or to the United States industry. Anything other than a cash payment, according to Dr. Kalt, is punitive. Anything other than a cash payment assumes the incorrect target or, according to Dr. Kalt, causes adverse collateral effects or distorts the Agreement going forward.

These categories of consideration which Dr. Kalt has drawn on his flip chart are unresponsive to the remedies proposed and are really masking his true position that the SLA simply doesn't provide a desirable system for compensation.

First, Dr. Kalt seems to be saying, seemed to be saying, during Canada's submissions, it is never feasible to

compensate for any past breach because it is simply too difficult to craft compensatory measures. Of course, today in his cross-examination he conceded that compensatory measures are feasible, just very difficult to craft. Perhaps paying lip service to the SLA's requirement, and the Tribunal's task, Canada finally concedes that there can be compensatory export measures, but only on a "one-for-one basis."

Dr. Kalt's one-for-one approach may be or may seem rhetorically appealing, but as a practical matter it is incorrect. First, there can never be a true one-to-one remedy. Even if Canada continued to breach a quota volume, the breach itself would not necessarily be predictable or steady. Rather, in every month, Canada may, until it cured its breach, continue to breach its quota volume in distinct and unpredictable ways, each time creating a market disruption that could not be remedied until at least the next month when, as Dr. Kalt explains, the market would necessarily be different.

Therefore, even in a continuing breach situation, if there is a market disruption in, say, month one, the soonest this disruption can be corrected would be in month two and likely even later.

Dr. Kalt provides no analysis why market changes on a monthly basis are not difficult to predict, while market changes in trying to--in trying to compensate for a past breach a year ago, or however much time ago, are difficult to predict.

Additionally, Dr. Kalt's one-for-one approach is too simplistic. To the extent its simplicity is appealing, it is appealing only because it assumes a hypothetical breach that can always be addressed by a one-for-one approach. During our opening remarks, Ms. Ewusi-Mensah provided several examples of breaches that do not lend themselves to a simple one-for-one remedy, but still the SLA must be remedied by compensatory adjustments. Canada failed to respond to any of these examples. Take, for example, a breach of the SLA that involves Canada providing to its lumber industry a large subsidy.

Now, let's assume Canada stopped providing the subsidy or any future payments much in the same way Canada stopped failing to perform, stopped failing to miscalculate the EUSC here. How would Dr. Kalt craft a compensatory export measure for this breach? Perhaps he'd say the task is impossible because it's too difficult.

But then let's say the breach is continuing, that Canada is providing ongoing subsidies to its lumber industry, and let's assume we don't necessarily know the amount month to month, nor do we know how the subsidy is being administered.

Dr. Kalt would have to agree that the SLA requires a remedy for such an ongoing breach. And would also have to agree that constructing a one-for-one remedy for this kind of a breach would be impossible. In fact, determining compensatory export measures would be quite complex for this kind of a

breach, indeed much more complex than what the Tribunal is asked to do here. It could involve a combination of export measures and volume restraints, which is obviously not what we're asking the Tribunal for here.

So, can it be this breaching cannot be remedied, even though it's ongoing? If this is the case, then Paragraphs 22 and 23, under Canada's view, are rendered meaningless. Dr. Kalt appears to have created a framework in which the determination of remedy is made on an ad hoc basis. This is, obviously, contrary to the SLA which discusses only one category of breach and requires that they all be remedied in precisely the same way.

To the extent that Dr. Kalt does engage the Tribunal on the question of remedying the breach, he does nothing to aid the Tribunal in crafting a remedy, an appropriate remedy. Again, he provides no proposal of his own. He merely offers insignificant criticisms of Dr. Neuberger's second remedy and only the second remedy he provides no real substantive criticism of the other proposed remedies. He spends probably 90 percent of his testimony talking about Dr. Neuberger's second proposed remedy. And, confusingly, he applies some of his criticisms regarding Dr. Neuberger's second proposed remedies, remedy to other of our proposed remedies, which, as Dr. Neuberger explained in his report, and as we have explained are only considering the effect upon pricing, each remedy

considers a different target as Dr. Kalt actually, I think, understands.

With respect to our preferred remedy, Remedy Number 1, Dr. Kalt calls it punitive because it only considers the Canadian producer. But Canada concedes that an additional export charge on Option B benefits the Canadian consumer. It benefits the Government of Canada, it benefits Option A Regions. In fact, it practically benefits everybody except the Canadian producer. Conversely, Canada would have to concede paying fewer export charges would necessarily benefit the producer. If Canada maintains the illogical position that, during the breach period, Option B exporters received no benefit for their behavior, this conclusion effectively assumes Option B exporters acted irrationally by continuing to ship at lower export charges. This defies common sense. There is nothing punitive about the Option A remedy. Canada has already conceded that Option B producers are harmed when they pay more tax, the remedy does nothing more than assess additional export charge, that other regions have, in fact, chosen for themselves.

Canada responds also that the remedy is punitive and arbitrary because it has the same result regardless of whether the overshipment is one board foot or 200 million board feet. Of course, Canada fails to acknowledge this is the very nature of the quota system to which the Parties agreed. For example,

if Option A Regions triggered the surge mechanism, they automatically pay 50 percent more in export charges, and they pay that on their entire shipment, regardless whether it is one board foot over the surge mechanism, or 200 million board feet.

That said, Dr. Neuberger's preferred remedy takes into account the specifics of the breach, offering modifications for those regions that did not breach or that did not breach the entire time; and, for this reason alone, Dr. Neuberger's preferred remedy cannot be considered punitive.

Again, Dr. Kalt has identified nothing inappropriate about the remedy, other than to say that it is not tied to any economic effect of the breach. Dr. Kalt never explains why remedies with different targets are per se inappropriate or why remedies with different targets cannot remedy the breach equally well.

The only remedy Dr. Kalt takes on substantively is Dr. Neuberger's second proposed remedy. Dr. Neuberger and Dr. Kalt actually agree that to determine the effect of the breach price, which, of course, is the purpose of the second proposed remedy, you have to determine the effect on the producer. They also agree that this is an important consideration to the model. But again, Canada resists the terms of the SLA and says only that a cash payment and not export measures can adequately address the loss.

We agree that a cash payment could potentially effect

a cure of the breach and by cash payment--I mean a cash payment to the United States or to the producers--but in crafting a compensatory measures as opposed to a cure, additional steps must be taken to recover that lost surplus.

Dr. Kalt does nothing to refute that conclusion. If Canada really wanted to engage on the question of the second remedy, the question is--and, again, this is the standard prescribed by the SLA--whether the second remedy provides an appropriate compensatory measures to remedy the breach. And, of course, it does.

The ordinarily meaning of the SLA changes the behavior of producers based upon U.S. price. If the SLA were intended to benefit only the consumer, it would not discourage overshipment at all; rather, it would encourage lower lumber prices at any cost to producers. And you can tell this on the face of the Agreement, which restricts volume as the price drops. This means the Agreement discourages price depression that results from overshipment.

In contrast, Dr. Neuberger's remedy encourages restoring the pre-breach price through additional export charges. Dr. Kalt does not respond to this point, but instead testified yesterday that it is too difficult to determine the effect upon price because producers could potentially change their inventory, thus undermining any price effect or at least slowing down any price effect. But this comment implicitly

acknowledges Dr. Neuberg's second proposed remedy would discourage shipments and, of course, as Dr. Neuberger has explained, the ultimate goal of any compensatory export measure here to discourage Option B from shipping.

Even if Dr. Kalt does not accept the price effect is a worthy target at the very least, he and Canada must agree the volume restriction itself is at least a major effect of the SLA. Since that was disrupted, there must be a remedy. But Canada and Dr. Kalt misunderstand the disruption or, as they call it, the market distortion. Dr. Kalt contends that any remedy will distort the equilibrium of the export measures. Of course, there is no current equilibrium, that equilibrium has already been disrupted, as I believe Dr. Kalt finally conceded during his cross-examination testimony.

And our proposed remedies correct for that disruption as best they can within the framework provided by the SLA. Dr. Kalt's refusal to acknowledge this, preferring instead to operate outside the context of the SLA in a world where compensatory measures are not required.

In any event, Dr. Kalt's fears of a market disruption are belied by his assumption that the effects of the breach are very minimal. If the effects of the breach are as minimal as Dr. Kalt says, then the remedy should have the equally minimal effect.

Finally, with respect to our volume based remedies, we

actually think that Canada should appreciate these remedies because more than our first preferred remedies, our volume based remedies actually approximate a one-for-one approach.

Dr. Neuberger's third remedy proposes adjustments to RQVs to meaningfully reduce exports during the remedy period to compensate for the overshipments. The only concrete criticism Dr. Kalt offers is the remedy is somehow biased. Dr. Kalt claims in his hypothetical that the remedy is biased because sometimes the forecast is too high to Canada's benefit and sometimes the forecast is too low to Canada's detriment.

But the chance of the forecast being too high is the same as the chance of the forecast being too low; therefore, there can be no bias. Of course, the question of bias is merely hypothetical. Dr. Neuberger's proposal for how to forecast does not produce unreliable predictions. In Dr. Neuberger's most recent report at Exhibit 1, he shows that the forecasting method has proved quite accurate for the most recent six-month period. Dr. Kalt does not respond to this.

Finally, with respect to the carry forward/carry back issue, using the overshipment number of 216 million board feet and assuming no carry forward/carry back, the carry forward/carry back provision appears in Annex 7B of the SLA. It allows regions to borrow up to 12 percent of its shipments from future months or carry forward the same percentage from prior months without exceeding quotas. Dr. Neuberger assumes

Canada would not have benefitted from carry forward, carry back, first, because Canada stated no intention to do so, even though Canada was required by one of the side letters attached to the SLA to do so and that side letter appears at Exhibit CR-4.

Canada, of course, states in its most recent brief in a footnote unsupported by affidavit or any other documentation that it did so inform the United States. Obviously, an unsupported statement of counsel cannot satisfy the SLA's side letter requirement. Second, we know that Canada could not have benefited from carry forward, carry back between December and January. And the difference between Canada's calculation with December and January and without December and January is 40 million board feet, which is quite significant.

The SLA requires Canada to carry forward from one month to the next, but only if there are volume restraints in both months. Here, there was no volume restraint in December 2006. And we have the language of the provision on the screen.

We know there was no volume restriction in December 2006 because December 2006 was still part of the transition period during which all regions were treated by Option A Regions until the Option B system could be implemented. Of course, as the slide projected demonstrates the SLA also states that carry forward/carry back rules shall be taken into account for all months of the transition period. And that language

appears at the bottom of Footnote 2. However, carry forward/carry back shall be taken into account for all months of the transition period, only for purposes of determining whether Option B Regions get retroactively treated as Option B Regions for the transition period. It does not transform the transition period into a regular period for determining whether volume restraints apply.

Clearly, volume restraints did not apply in 2006. In fact, Canada itself conceded this in several of its filings during the liability stage of proceedings. For example, in its Statement of Defence at Paragraph 105, Canada stated that the transition period deferred the operation of Option B. Then, in Paragraph 115 of that same filing, Canada stated that there were no quotas in effect between July 1st and December 31, 2006.

Finally, in Canada's Rebuttal Statement on Liability, Canada states that the first quarter in which quotas were in effect, the first quarter of 2007. Canada simply cannot have it both ways.

In conclusion, Dr. Kalt essentially has one response to all of Dr. Neuberger's proposed remedies, and that is there can't be any remedy for this breach.

Canada then uses this conclusion to bolster its remarkable assertion that the Tribunal lacks authority even to consider what the appropriate compensatory measures are.

Dr. Kalt refuses to offer a remedy proposal of his own, even though he concedes it is possible in the case of a continuing breach, and he makes insignificant criticisms of Dr. Neuberger's second proposed remedy. The Tribunal is, in fact, both authorized and obligated in these proceedings to determine adjustments to the export measures that compensate for the breach. Canada offered no competing adjustments, nor has it acknowledged that the task is possible. We, therefore, respectfully urge the Tribunal to adopt Dr. Neuberger's preferred remedy which is rooted in the SLA itself and requires no additional complex considerations. Alternatively, we urge the Tribunal to adopt one of our other proposed remedies in the order in which we presented them.

And I ask the Tribunal to call upon Ms. McCarthy to provide our final remarks.

CHAIRMAN BÖCKSTIEGEL: Ms. McCarthy, please.

MS. McCARTHY: Thank you, Mr. Chairman.

Members of the Tribunal, I'm Patricia McCarthy. It's an honor to be back before the Tribunal. Last December, we thanked the Tribunal for accommodating the expedited time frame of the SLA, and we again thank the Tribunal for expediting this hearing itself, compressing it from three days to two days. We appreciate the efficiency of the Tribunal and its time and attention.

We reached these closing statements in this final

hearing on remedy, and Canada has failed to acknowledge, much less refute, many of our principal contentions made either in the written submissions made by us prior to this hearing or at this hearing these past two days. Instead, Canada has advanced an interpretation of the SLA that defies the text, defies common sense and defies the reality of the Parties' longstanding relationship. Canada has not refuted our demonstration that the SLA is an agreement to satisfy massive and protracted litigation arising from Canadian exports of softwood lumber into the United States. As such, retrospective relief in this settlement agreement as in any settlement agreement is the norm; and, indeed, it's required. No rational nation would agree, first, to refund retroactively $5 billion in collected duties; second, to vacate retroactively antidumping and countervailing duty orders; third, to refrain from imposition of domestic remedies, the institution of which would consume at a minimum several months all in exchange for an agreement with no policing mechanism; no effective recourse for breach of an agreement and no remedy for market distortions caused by the breach.

The United States never agreed to this bargain. Simply put. Although the SLA is technically a bilateral agreement, it is not, contrary to Canada's repeated assertions, a comprehensive agreement governing the trade between the two nations. It in no way covers the importation of American

products into Canada of lumber or any other product. It is simply a settlement agreement. It has no intention to liberalize trade as do the WTO or NAFTA agreements. To contend the SLA is intended to liberalize trade between the two nations defies reality.

As the Tribunal found the SLA is a unique agreement and Canada's dependency on the WTO and NAFTA to establish remedy for breach of a settlement agreement, which is more akin to the exceptional and unusual prospective-only remedies that are found in multinational agreements, and some multinational trade agreements for the liberalization of trades among numerous nations simply doesn't have any basis in reality or common sense.

If the Parties had intended for this settlement agreement to provide for prospective-only relief, they would have said so in the Agreement. There's nothing in the text of the SLA that provides for prospective-only relief.

Indeed, in analogizing to other sorts of types of trade agreements, Canada has never identified the settlement agreement that provides for prospective-only relief. There isn't any basis in the text for Canada's reading of the Agreement as providing for only prospective relief in the case of a breach. It's offered no response to our demonstration that the language in Paragraph 22 simply did not allow the exception that Canada reads into the Agreement.

The Agreement, Paragraph 22 of Article XIV, as we've discussed at length, is mandatory in it prescribes two tasks for the Tribunal and there's no exception to these tasks. Canada contends there is an exception built in or implied that allows the Tribunal to, before applying these provisions, consider whether Canada has cured the breach in the first instance.

If Paragraph 22 had, in fact, provided this exception, then it would include language similar to that found in Paragraph 29(c) of Article XIV, which states quite clearly the Party--if the Party complained against considers that it has cured the breach in whole or in part such as compensatory adjustments or measures should be modified or terminated and the complaining Party does not agree, then the Party may commence a new arbitration to address the matter.

There's nothing--there's no language like that in Paragraph 22 because, as we've demonstrated at length, Paragraph 22 is part of a long and comprehensive process that's by design intended to facilitate the Parties' amicable resolution between themselves and upon the finding of, first, there's a process for consultations; and, if that fails, then there's arbitration. Upon a final award, then the Parties are given a time within a reasonable period of 30 days to negotiate their own cure. Failing that, the compensatory measures that are prescribed by the Tribunal will facilitate, presumably

facilitate the Parties negotiation of the settlement. If that doesn't occur, then there are other provisions by the Tribunal at later stages in the proceeding can address the issue of cure. But at no point does Paragraph 22 contemplate that kind of activity by the Tribunal.

If Canada--as Ms. Ewusi-Mensah explained yesterday, if Canada is attempting to short-circuit the careful, deliberate process to which the Parties agreed in Article XIV, and if Canada is so impatient that it cannot wait until Paragraph 29 for the actions that it asks of the Tribunal right now, then it should not have agreed; it shouldn't have entered into the Agreement.

Canada further, it simplifies the language of the Agreement, desires a summary ruling from this Tribunal that has no obligation whatsoever to remedy the market distortions caused by established breach of this Agreement for six consecutive months in 2007. Accordingly, Canada has not responded to our demonstration that the cure contemplates a wide panoply of relief, including a direct cash payment. Where the compensatory measures assume or conform to the framework, which is the very heart of the substitute regime for duties that the Parties agreed to in the Agreement, there's nothing unusual or explaining about the fact that adjustments to export measures would be the form for compensation under this Agreement. Export measures are the heart and soul of this

Agreement.

Canada continues to maintain at this hearing that we maintain that cure and compensatory measures are the same. We never said that. We had said consistently that compensatory measures are one possible cure, but a cure can be anything to which the Parties agree, including as Dr. Kalt testified yesterday, a cash payment could provide a reparation for a past breach. So although--so cash payment would be an entirely permissible cure under the Agreement if the Parties agreed to it.

As Ms. Burke noted, Canada has no answer for our demonstrations that its interpretation of export measures is pertaining only to continuing breaches of export measure provisions, make no sense. Canada apparently posits it can implement a one-time subsidy or intermittent subsidy in clear contravention of anticircumvention provisions of the SLA, but the USA would have no remedy because export measures would be too speculative or unreliable. Canada has no response to our demonstration that, under Canada's view, the United States has no means to enforce even retrospective adjustments to export measures which the Agreement provides which Canada itself highlights to support its interpretation of the Agreement as providing for only prospective relief.

Under Canada's view, all those provisions for retroactive adjustments to export measures would be illusory

because they would be too speculative and too difficult. Because it reads, frankly reads Paragraph 22 as prohibiting prospective relief--retroactive relief despite the fact there's no language in Paragraph 22 that precludes retroactive adjustments to export measures.

Let's be clear: This is an agreement to settle litigation that concerned, among other things, Canada's subsidization of its own softwood lumber industry. The Tribunal is not interpreting Article XIV in a vacuum. Our references in this proceeding to anticircumvention provisions are not hypothetical. There is another--currently there is another proceeding before the LCIA in which the United States is alleging that Canada has violated the anticircumvention provisions of this, of the SLA.

So, a coherent interpretation of the phrase "cure the breach" has to include, has the conduct, in order to be plausible, has to contemplate all possible breaches in the Agreement. To interpret the cure provision as prospective-only would suggest to the public there's simply no remedy for a wide range of current and possibly future breaches of the SLA.

In fact, the hypothetical that Canada provided yesterday strains credulity. Yesterday, Canada contended that if the United States were to shut down Canadian imports by 5 percent at the border in violation of the Agreement, that it would be content with mere cessation of this practice going

forward. The idea that Canada would not ask for compensatory measures to remedy the harm suffered by Canadian interests as a result of this breach is absurd. It's simply not the relationship between the parties. Taken to its logical contention Canada's interpretation of the Agreement would tolerate, Canada cannot believe the Parties agreed to tolerate repeated short-term violations of the SLA on both sides. This is untenable. The purpose of this Agreement is to provide a replacement regime for antidumping/countervailing duties.

Canada has no response to our demonstration that contrary provisions in Paragraph 20 of Article XIV, that it does not regard the Tribunal's March 2000 or the Award is final and binding and enforceable only through this article. Paragraph 20 provides explicitly that the Tribunal's Award shall be final and binding and not subject to any appeal or other review.

An award may be enforced solely as provided in this Article. Contrary to Paragraph 20, Canada contends that the March 2008 finding of breach was of no moment, was of no purpose, not even enforceable through Article XIV. Canada questions the Tribunal's very authority to impose compensatory adjustments in an amount that remedies the breach in Paragraphs 22 and 23 of Article XIV.

Now that I've listed the points that Canada has failed to respond to, I'll briefly address the few points that Canada

has made in the affirmative sense. First, Canada has relied heavily upon the secondary rules of interpretation of the Vienna Convention to justify its heavy reliance on the WTO and NAFTA agreements. We, in contrast, rely on the primary rule of interpretation, which is the ordinary meaning of the text of the SLA read in its context in light of the object and purpose of the SLA.

In Canada's opening statement yesterday presenting its own threshold contention that the Agreement provides for only prospective relief, Canada addressed the WTO and addressed NAFTA Chapter 20 and addressed the model the United States Model BIT. It addressed NAFTA Chapter 11 and addressed the Convention on International Liability for Damages Caused by Space Objects. It addressed all of these agreements before addressing itself to the text of the SLA. And so, in order to justify its interpretation of the Agreement as providing for prospective-only relief, it seems to take a rather roundabout way to get into the text. In addition, yesterday, Canada repeatedly challenged the Tribunal yesterday to find authority for the Award for compensatory measures. The source for the authority is not too hard to find: It's found in Paragraphs 22 and 23 of the Agreement.

The Parties explicitly agreed to authorize the Tribunal to identify reasonable period of time for the Parties to cure the breach, and there's an express authorization to

determine appropriate adjustments to the export measures to compensate for the breach, if that Party fails to cure the breach within the reasonable period of time. That's the authority that--the source of the authority that the Parties granted this Tribunal.

In addition, the authorities--the Parties authorized the Tribunal to prescribe adjustments that are in an amount that remedies the breach. It's not that hard to find the source of authority for this Tribunal to prescribe compensatory measures.

Canada has also contended that the Tribunal's authority is limited to prescribing compensatory measures that address the breach itself, but not the effects of the breach but Canada, the inconsistent position of Canada, because Canada itself concedes the compensatory adjustments necessarily address the fact of the breach, not the breach itself.

In Paragraph 40 of Canada's rebuttal Memorial, it was analogizing the SLA to the WTO and NAFTA paradigm of prospective-only relief, and it was contended in Paragraph 40 that this structure is logical and harmonious as in the case of retaliation or compensation and disputes under the WTO and NAFTA if the adjustment is in an amount equivalent to the effect of the ongoing breach.

So, as Ms. Burke has explained, Canada's position is that the only room for compensatory measures is to address

ongoing or continuing breaches, but even Canada itself concedes that the limited room that allows for compensatory measures address, in fact, the effect of the ongoing breach that there's no requirement that the compensatory measures address the breach itself. And as we've demonstrated here, the effect of the breach found by this Tribunal was that Canada overshipped lumber into the United States, 216 million board feet of lumber into the United States, for a six-month period in 2007.

As Ms. Ewusi-Mensah described yesterday, Canada's view of Paragraph 22 is providing for compensatory measures only for continuing breaches is really a tautology because, under Canada's view of the breach, cure can only mean cessation of the breaching practice, which itself equals the compensatory measures. Although Canada says that we say that cures and compensatory measures are the same thing, if anyone is saying that, it appears to be Canada, and the only possible cure would be cessation of the breaching activity. Because the compensatory measures are only allowed as an offset, basically, it's all the same thing. That's really not a workable solution for an Agreement of this nature.

Canada is also permitting the wrong standard in these proceedings. The standard is not--for determining a remedy--is not one of finding--is not mathematical certainty, it's not perfection, it's not one that satisfies the subjective requirements of Dr. Kalt.

The Tribunal is authorized explicitly in Paragraphs 22 and 23 to award appropriate compensatory measures. Canada itself contends that the SLA is lex specialis. Accordingly, the authorities and standards in granting a remedy under this Agreement derives from the Parties' own agreement.

If Canada didn't wish to grant the Tribunal this authority, then it shouldn't have signed the Agreement and accepted the enormous consideration including the return of $5 billion in duties up front that the United States provided at the onset of the Agreement. Canada really does not address the definition of "cure." The substance of the definition of "cure." Yesterday, it presented a demonstrative providing for timetables for the cure. Paragraph 22, this provides the procedural outline of the timing of the way the cure, the timing of the cure provision when the compensatory measures would take effect and when they would cease to be implemented.

And then they also had--Canada also presented another demonstrative similarly outlining the latter stages of Article XIV, which provides for potentially a second arbitration to determine the substance of the cure. We don't disagree with any of these timetables, but Canada spends a lot of time talking about the timetable. It doesn't--it deflects attention, but what is the actual substantive meaning of "cure"?

We can tell the purpose of these demonstratives is

merely to show its own peculiar definition of "cure" is not precluded by these timetables, but there's never an affirmative demonstration of Canada to support its somewhat counterintuitive interpretation of cure as precluding any sort of retroactive or reparation.

In our submissions to this Tribunal, we cited legal authority to support the notion that cure--as Ms. Ewusi-Mensah was explaining yesterday, the purpose of a cure is to provide retroactive relief--is to repair the harm caused by the breach. Canada to this day has not provided any affirmative legal authority to support its somewhat idiosyncratic view of cure.

For instance, in our submissions we cited a decision of the United States Court of Appeals for the Seventh Circuit. It's a matter called "Matter of Clark," and we cited it in a footnote at Page 24 of our Reply Memorial. In that case, the Seventh Circuit Court of Appeals stated quite clearly it defined "cure" to mean to remedy or to rectify the default to "restore matters to the status quo ante." Although the Court of Appeals for the Seventh Circuit is an esteemed court in the United States, as Ms. Ewusi-Mensah said yesterday, we never pretended or represented that its views are binding on this Tribunal, but it's certainly persuasive authority.

Canada took enormous umbrage at our citation to this Matter of Clark, among other legal authorities we cited in Paragraph 79 of its rebuttal Memorial. But has Canada

identified any countervailing authority to suggest the Matter of Clark is aberrational or unreasonable? No. Has it cited authority that stated Matter of Clark defies common-sense interpretation of "cure"? No. Interestingly, Canada has not identified a single treatise, case, book, article, any sort of legal authority whatsoever to support its interpretation of "cure" as precluding retroactive relief.

Similarly, Canada contends that the export measures are inherently rigid and inflexible. There's also no support in the Agreement for even that assertion. There, Paragraph 23 allows for maximum flexibility to the Tribunal in identifying export measures that would be an amount that remedies the breach. 23(a) provides quite explicitly in the case of a breach by Canada an increase in the export charge and/or a reduction in the export volumes permitted under volume restraint that Canada is not applying; or, if no export charge and/or volume restraint is being applied, the imposition of such export charge and/or volume restraint is appropriate.

These provide the Tribunal with maximum flexibility in identifying a remedy. Canada is simply fighting the text to the Agreement when it says this is too hard or too difficult or too speculative. This is what the Parties agreed. This is the framework to which the Parties agreed.

In summary, having been found to commit a breach, Canada should be held liable for the consequences of that

breach. In Paragraph 22, the Tribunal is now to determine the appropriate remedy for Canada's overshipment of 216 million board feet of softwood lumber into the United States. We've demonstrated that when interpreting the ordinary meaning of the terms of the SLA in context, and consistent with the object in purpose of the Agreement, our interpretation is perfectly reasonable and textually permissible. There is no reason why Canada should avoid correcting the distortions in the market caused by the breach which its expert, Dr. Kalt, admitted occurred today.

We've also established that the overshipment of lumber to the United States caused a distortion in the market in 2007, and each of the four proposed alternative remedies are appropriate measures that would adjust the export measures in an amount that would remedy the breach. Canada agreed to these export measures as remedially a vehicle, and attacking them as blunt instruments does not avoid its obligation to honor its commitment to impose compensatory measures pursuant to the Agreement.

And we respectfully request the Tribunal determine compensatory measures in the amount that remedies the breach.

Thank you very much.

CHAIRMAN BÖCKSTIEGEL: Thank you.

That concludes the closing statements.

MS. BURKE: Actually, Mr. Chairman, we have one

procedural matter to raise.

CHAIRMAN BÖCKSTIEGEL: Yes.

MS. BURKE: The very first demonstrative I used during my comments, we inadvertently provided the incorrect exhibit, and we have now copied the correct exhibit, and we will distribute them to the Parties and to the Tribunal. We apologize for the mistake.

CHAIRMAN BÖCKSTIEGEL: Thank you very much.

MS. BURKE: Thank you.

CHAIRMAN BÖCKSTIEGEL: Shall we now have a 15-minute break?

MR. AGUILAR-ALVAREZ: Thank you, Mr. Chairman; yes.

CHAIRMAN BÖCKSTIEGEL: We start again at quarter to 5:00.

(Whereupon, at 4:27 p.m., a recess was taken to 4:45 p.m.)

CHAIRMAN BÖCKSTIEGEL: All right. Are we ready to go?

MR. AGUILAR-ALVAREZ: Yes, sir.

CHAIRMAN BÖCKSTIEGEL: Okay. Then we turn to the Respondent's closing statement.

Mr. Aguilar, please. I like the system with the box.

ARBITRATOR HANOTIAU: But you're making some publicity, also.

MR. AGUILAR-ALVAREZ: I guess so. I'll do it this way.

CLOSING STATEMENT ON BEHALF OF THE RESPONDENT

MR. AGUILAR-ALVAREZ: Thank you, Mr. Chairman, Members of the Tribunal.

Let me begin with a point that I made yesterday morning. I suggested to you that what matters in this debate is not economic models and data. What matters are the provisions of the Agreement. No roundabout here.

I also urged you, as you listened to the testimony of the economists, to ask yourselves whether there is any basis in the text of the SLA--again, no roundabout--for the reparations-based remedies the United States has proposed in the text of the Agreement. We have now heard from the economists, and let me take a few moments to review their testimony.

There is nothing in the Agreement, as I said earlier, to support these U.S. proposals, but let's see what the economist's testimony has given you. Let's take the first U.S. proposal. This proposal is based on two premises, and both premises are inaccurate: First, the U.S. asserts that its first proposal is intended to recapture a benefit that was gained by Canadian exporters as a result of Canada's failure to calculate EUSC in the first half of 2007.

In my opening yesterday, I pointed out the SLA provides no authority to recapture any such benefit; and, of course, there is no guidance for this in the SLA, not even in

the most basic question about how to measure that benefit. But even more fundamentally, yesterday, I asked Dr. Neuberger if he had measured whether Option B exporters, in fact, earned the increased profits from their shipments that he claimed in his report. Let me read you his response: "I did not specifically analyze the impact of Option B producers on their own profits. What I did do was infer from the behavior of exporters in those regions that, assuming they were acting rationally, that it was in their best economic interests."

So, he conceded that he did not investigate or make any attempt to measure the supposed benefit Option B producers obtained.

CHAIRMAN BÖCKSTIEGEL: Could you just give us the reference where you read that from?

MR. AGUILAR-ALVAREZ: Transcript at 125 (amended transcript page 121).

CHAIRMAN BÖCKSTIEGEL: Thank you.

MR. AGUILAR-ALVAREZ: So, he conceded he did not investigate or make any attempt to measure the supposed benefit that Option B producers obtained. In fact, it was a mere assumption by Dr. Neuberger. You heard Dr. Kalt. Professor Kalt told you, using Dr. Neuberger's own model, the effect of the overshipment was, at best, a wash for Option B producers and may even have caused a diminishment in their profitability. So, economic testimony offers the Panel no support for the

first U.S. proposal.

Equally important, the second fundamental premise of the first U.S. proposal is wrong. Dr. Neuberger claims that it is appropriate to treat Option B producers as if they were Option A producers for purposes of remedy.

And he says that, because during the breach period, they were acting supposedly like Option A producers unrestrained by quota. There is no basis whatsoever for this premise. It is undisputed that Option B producers were at all times subject to a quota calculated by the Canadian Federal Government. In the first six months of 2007, every Option B Region shipped with the constraints of the quota. Option A producers, in contrast, were not constrained by any quota during that period. And you find that in the transcript at 216 and 217 (amended transcript pages 177). So, Dr. Neuberger's first proposal rests upon two key premises, neither of which have any factual or economic basis.

Let's move to the second proposal. Here, the United States seeks reparations for consequential damages. I noted yesterday that there was no authority for reparations of this kind in the SLA. What did we learn from the economic testimony? Yesterday, Dr. Neuberger admitted that he used a general supply elasticity instead of an export supply elasticity in his model. He conceded export supply elasticities are higher than general supply elasticities.

Transcript at 136 (amended transcript pages 110-111). Dr. Kalt then demonstrated this mistake, the confusion of general supply elasticity with export supply elasticity is a fundamental error. I refer the Panel to 181 to 183 (amended transcript page 148) of the transcript.

Counsel for the U.S. tried to minimize this error in redirect. He asked Dr. Neuberger to estimate how changes in elasticity would effect his conclusions. His testimony should not surprise anyone. He asserted that a small change in the elasticity would lead to a small change in the results. I refer the Panel to Page 143 (amended transcript pages 116-117).

But that was a discussion of a very small change indeed. Dr. Kalt testified to the change that might result over the full range of elasticity estimates in the literature. He testified that just by moving to 2.0, not the 2.9 discussed this morning nor the 11.26 outlier, just by moving to 2.0, Dr. Neuberger's results would be cut by two-thirds. I refer the panel to Page 186 (amended transcript page 152).

Finally, you heard testimony yesterday from Dr. Kalt regarding Dr. Neuberger's price estimates. Dr. Neuberger concluded that the breach reduced U.S. prices by $1.94. Dr. Kalt told you there is nothing in Dr. Neuberger's analysis that permits an economist to conclude that the estimate of $1.94 is statistically different from a penny or from $4. I refer you to Page 191 of the transcript (amended transcript page 156).

Dr. Kalt explained that the effect to be measured is very small. Remember the chart with the little black dots.

The target is very small, and the model has missing parts. It simply is not equipped to produce results that are reliable and not speculative. And this is in the transcript at 189 (amended transcript page 155); Kalt first report, Figure 1.

I will say again that it is not Canada's burden to prove the U.S. damages. It is not Professor Kalt's job to produce a model that calculates any damages. What does this economic testimony tell you? It tells you the United States has not even met the most elemental burden of proof in proving damages. Its case is entirely speculative. We started into the economics with the conclusion that there is no authority for reparations in the Agreement.

Having seen the economics, we now know that the United States cannot prove damages in any event. The U.S. case fails to meet the most elemental burden of proof of damages.

Finally, the third and fourth proposals. Yesterday, I pointed out that this is where the United States is trying to stretch the SLA mechanism back into the past. I noted that the United States is asking you to intervene in the quota mechanism to recreate past conditions. I also asked you to question seriously this approach. It is premised on the assumption that quotas are not binding now. But no one in this room knows whether or when they will be binding in the future.

You cannot devise a remedy to recreate the past, and you should not create a remedy that assumes the present will continue unchanged. There is no way the United States can overcome this fatal flaw. All that was from a legal standpoint.

And what you heard from the economists showed no grounding for these proposals in economics. Dr. Kalt testified that the normal mechanism that economists see for past damages is a cash payment. And Dr. Kalt also pointed out, as an economist, that proposals three and four would disturb the equilibrium that was negotiated by the Parties. I refer the Panel to the transcript at 174 and 175 (amended transcript page 142). I think it is fair to say the economic testimony offered no support for these proposals.

The United States advanced a number of legal arguments in this hearing. Let me respond to some of them now. Yesterday, the U.S. argued that Paragraph 22 of Article XIV is mandatory. But there is no disagreement that Article XIV is mandatory. The issue is how the Tribunal properly implements this mandate in this dispute. Paragraph 22 requires the panel to identify a reasonable period of time to cure the breach. Canada and the United States agree on that.

Paragraph 22 also requires the panel to identify compensatory adjustments to be applied if there is no cure. Canada and the United States agree on that, also. But the

panel cannot answer either of these questions unless it first decides what a cure would be.

Canada stopped breaching the cure--the breaching conduct in 2007. We believe that Canada thereby cured the breach. The United States disagrees. The Panel must decide this point under Paragraph 22. If the Panel agrees with us, it will have fulfilled its obligations under Paragraph 22. It will have found that a cure has been made. It will find that no reasonable period of time is needed, and it will find that no compensatory adjustments are in order. Canada joins the United States in urging that the Panel reach a decision on this issue under Paragraph 22.

I would like now to turn to the text of Paragraph 22. And I would like to begin with a key vulnerability in the U.S. position, the explanation the United States offered yesterday for why the Parties provided in Paragraph 22 for a reasonable period of time to cure the breach. In Canada's view, the U.S. arguments on this point illustrate just how far the U.S. is forced to abandoned the actual text of the SLA in order to convince the Tribunal that its interpretation should prevail. Before I respond to the U.S. arguments, I would like to clarify once again what Canada believes is common ground between the Parties.

First, there is no dispute that the phrase "reasonable period of time" originated in Article 21 of the WTO Dispute

Settlement Understanding which both Parties agree is a prospective-only remedy regime. To Canada's knowledge, there is not another treaty in the world that uses that same phrase in the context of dispute settlement. Whether you characterize the SLA as a trade agreement or as a settlement agreement as we just heard, this fact remains true.

The United States has not identified any treaty in its written submissions or over the course of its presentation these past few days. Both Parties also agree that, in the context of the WTO, the concept of a reasonable period of time is designed to allow the breaching Party to stop the offending conduct within a set period of time and to thereby avoid the imposition of any remedial measures. And the Parties also agree that, if the breaching Party does not stop the offending conduct within the reasonable period of time, then, and only then, is compensation allowed; and the compensation is limited to offsetting the ongoing effect of the breach.

When the ILC Articles characterized compensation in the WTO context as future conduct, this is what they mean. The Parties also agree that this reasonable period of time concept is embodied in another prospective-only regime. NAFTA Chapter 20. Although using a different language in the briefer period of time to cease the offending conduct. Only 30 days, the very same period that the SLA authorizes.

In our briefs, we noted that the U.S. had great

difficulty explaining why this concept of a reasonable period of time also makes sense in the context of a reparations-based regime. You will recall that in their briefs, the U.S. had been forced to rewrite Paragraph 22 by suggesting that it didn't really require a completed cure within the reasonable period of time, but merely a plan to cure. Yesterday, the United States continued its redrafting of Paragraph 22 by suggesting that the reasonable period of time serves several purposes that are consistent with the U.S. interpretation.

I would like to focus the Tribunal's attention on two of these alleged purposes: First, the U.S. now states that the reasonable period of time was designed to permit the Parties to agree on a cure that does not constitute an adjustment to the export measures. The U.S. goes so far as to suggest that the 30-day time period exists so that the Parties could agree on a form of cash compensation as a cure. This is a remarkable assertion, and one for which they offer you no support whatsoever in the Agreement. In fact, this is complete speculation. There is nothing in the SLA or its negotiating history to support this.

As I pointed out in my opening statement yesterday, the U.S. and Canada were intimately familiar with the text of reparations-based damages regimes, and there is no question that the Parties knew how to create a cash payment mechanism in the SLA if they wished to do so. The U.S. will now have you

consider the absence of any remotely similar language in the SLA as a meaningless--as meaningless because the Parties accomplished that same goal by providing for a reasonable period of time to cure.

Think about the consequences of this. In other words, the United States would have you believe that the Parties intended the 30-day period of time to permit the negotiation of a cash--the U.S. would have you believe that the Parties intended these 30 days to permit the negotiation of a cash payment, and they reflected that intent in language allowing 30 days to "permit the breaching Party to cure the breach." With respect, there is no support for this in the text of the SLA.

Second, the U.S. argues that the "early determination by the Tribunal of the nature of the compensatory adjustments facilitates the negotiation of a cure during the cure period." Transcript at 37 (amended transcript page 31).

The U.S. goes even further and says that, in Paragraph 22, "The Parties negotiated and drafted a two-step system where the Tribunal's Award in Paragraph 22 merely initiates the process for the Parties to resolve between them the cure of the breach the Tribunal has found." Transcript at 42 (amended transcript page 35).

Once again, this is entirely a fiction that lacks any support in the language of the SLA or its negotiating history. If the Parties had intended the reasonable period of time to be

a period for consultations or negotiations to achieve agreement on a cure, Article 22 would look much different. It might resemble, for example, Paragraph 4 of Article XIV where the Parties agreed that, at the outset of any dispute, they "shall make every attempt to arrive at a satisfactory resolution of the matter through consultations." Paragraph 22 contains no such language and instead states unequivocally that the reasonable period of time is to cure the breach. Not negotiate about a cure of a breach or consult on measures to compensate for the breach, but achieve a cure. Period.

The United States cannot explain why the terms of the Agreement don't fit at all with the U.S. demand for retroactive compensation. To try to get around the problem, the United States now argues that all these irrational and inexplicable consequences of the U.S. reading of Article XIV aren't really a problem because they are just an incentive for the Parties to agree on a more sensible remedy, maybe even cash compensation, so that the United States will agree not to impose the compensatory adjustments that the Tribunal has ordered.

The United States cannot explain away the fatal flaws in its interpretation of Article XIV by saying the Parties can avoid them by coming to a sensible negotiated settlement outside the terms of Article XIV. It is also no coincidence that this interpretation puts all the leverage in the hands of the United States in these negotiations, since it is the U.S.

who decides whether the deal offered by Canada is acceptable or whether the compensatory adjustments must be imposed. None of this is in Article XIV, and none of it justifies the erroneous U.S. interpretation of that Article.

Let me turn now to another argument you heard from the United States yesterday: That Canada's interpretation of Article XIV should not be adopted because it would deprive the United States of a remedy in the case of a one-time payment to lumber producers and in the case of an ongoing breach of the export measures where the breach was cured prior to the end of the reasonable period of time. This point is made by the U.S. at paragraph--Page 26 of the transcript (amended transcript page 22).

The U.S. objections ring hollow when you consider that this is the norm in international trade agreements. Under prospective systems like the SLA, the WTO and Chapter 20 of the NAFTA, member countries are not held to account for past breaches. And compliance within the reasonable period of time set for this compliance will mean that there is no compensation or retaliation.

There have been many cases in the WTO where the breaching conduct was terminated before a final decision in the case was rendered, and in these cases there were no consequences--no consequences--following the Award because the breaching conduct had stopped. The United States has never

questioned the prospective-only operation of the WTO and NAFTA dispute settlement systems. In fact, it noted in Footnote 6 to its Reply that it is "a Party to numerous agreements with prospective systems, including the WTO and NAFTA Chapter 20, and has never suggested that the systems are particularly open to abuse."

In that same footnote, the United States noted that "an obligation of good faith attends participation in all these agreements." Canada agrees a trade agreement relies on the good faith of sovereigns to proceed appropriately in the future. This is recognized by the Governments as having great value, and valuable prospective compliance is undertaken all the time.

The Tribunal need not be concerned that it might leave a past breach unremedied. This is the Agreement that the U.S. and Canada negotiated in this case, and it is the same bargain that the United States, Canada, and over 140 other countries agreed to in the WTO. Canada feels strongly that the Tribunal rather should be concerned with the attempts by the U.S. to rewrite the bargain that it struck at the negotiating table. The U.S. also claimed that a prospective-only remedy "would have no meaning" with respect to the operation of the Article VIII surge mechanism that was the subject of the earlier liability of this proceeding. And that's at Page 63 of the transcript (amended transcript page 51).

But the U.S. is simply wrong. This example, in fact, proves the contrary. Had Canada lost the Article VIII surge mechanism issue in the liability phase of this arbitration, then a prospective remedy would have required Canada for the remaining seven years of the SLA to calculate the surge level based on the adjusted EUSC rather than the unadjusted EUSC.

The next point I would like to address is the U.S. argument that U.S. commitments under the SLA were front-loaded and now Canada has all the obligations. The United States claims "it fully performed all of its obligations under the Agreement by returning 5 billion plus interest in vacating the antidumping and countervailing duty orders." This is in the transcript at 24 and 25 (amended transcript page 20). This is a very important point, and it must be clarified.

The impression the United States seeks to leave is that accepting Canada's position that the SLA established a prospective-remedy regime would lead to a one-sided bargain that must necessarily disadvantage the United States. Canada respectfully must disagree with this entire line of reasoning. The 5 billion that the United States returned was not a gift to Canada. It consisted of duty deposits that a NAFTA panel ruled the United States had unlawfully collected. The United States nonetheless refused to revoke the illegal orders or to refund the deposits based on a novel legal theory that a three-judge panel of the U.S. Court of International Trade unanimously

rejected. The United States agreement to revoke the orders and return the $5 billion was nothing more than what its own laws compelled. It is true that further appeals by the United States would have tied up Canada's money for perhaps another two years, but the United States is wrong that repayment of that 5 billion, 1 billion of which Canada returned to the United States, was contract consideration for the Softwood Lumber Agreement.

But even more fundamentally, the United States is wrong in suggesting that only Canada has ongoing obligations under the SLA. The SLA imposes obligations on each country on an ongoing basis. That is why sections A and B of Paragraph 24 of Article XIV provide for the case of a breach by Canada or the United States respectively. I illustrated some examples of potential U.S. breaches in my opening statement.

It is also important that the United States did not address certain issues in its oral presentation yesterday. Fundamentally, the United States still cannot explain why the United States and Canada, if they had intended to provide compensation for the consequences of past breaches, would have limited the form of compensation to adjustments for export measures.

Dr. Kalt yesterday explained in economic terms the collateral damage uncertainty and excesses of using adjustments to export measures to redress past breaches.

Yesterday, we also reviewed the language of Chapter 11 of the NAFTA and the U.S. Model Bilateral Investment Treaty, all of which showed the Parties knew perfectly well how to craft sensible provisions for retroactive remedies if that is what they wanted to do.

Likewise, the United States has no explanation why the drafters of the SLA would be so explicit throughout the SLA whenever there was an intent to be retroactive. Most notably, why--if Paragraphs 22 to 24 of Article XIV were supposed to be retroactive, why did the drafters leave this to be implied from terms and rules that fit so poorly with retroactivity? The United States had no explanation why Paragraphs 22 to 24 say nothing about retroactivity while the drafters spelled out retroactivity in such detail for the subsequent phase of the proceedings described in Paragraphs 26 to 32, all of this within Article XIV.

Mr. Chairman, I could go on, as you might imagine, but I think I will stop here. Canada, of course, stands behind our written submissions and what we have said here, and we will be providing a post-hearing brief, as you request. You have received five Expert Reports. You have heard expert testimony for two days now. We would like our proposed hearing submission to be of help to the Tribunal. And, therefore, we are grateful to the Tribunal for its announced Procedural Order directing the Parties to address specific issues of particular

interest to the Tribunal. I do announce, however, in our brief we will also address what we believe to be the mischaracterization of testimony as we heard in the U.S. closing statement today.

In the end, we think that it is apparent that Canada's interpretation of the Agreement is firmly grounded in the terms of the Agreement itself in their context and in the light of the object and purpose of the SLA. The U.S. reading, by contrast, requires straining the ordinary meaning of some words, reading in terms that aren't there and ignoring those that are inconvenient. The economic testimony has shown the economic irrationality of the U.S. interpretation. In short, the U.S. case does not add up on legal or economic grounds.

In closing, Mr. Chairman, Members of the Tribunal, Secretary of the Tribunal, on behalf of the Government of Canada, we'd like to thank you for the conduct of this hearing.

Thank you very much.

CHAIRMAN BÖCKSTIEGEL: Thank you very much, Mr. Aguilar.

We now come to the end of this hearing. We already agreed earlier today on the further procedure of the Post-Hearing Brief after October, and our Procedural Order will come out as soon as possible, but you have an idea what will be in there. We will define the issues a bit more precisely that we would like you to address, but you can expect the Order

certainly sometime next week, so that should be ample time.

Are there any other outstanding procedural matters we still have to discuss beyond that? No?

MR. AGUILAR-ALVAREZ: No, Mr. Chairman. Thank you very much.

MS. DAVIDSON: No, Mr. Chairman.

CHAIRMAN BÖCKSTIEGEL: Let me ask the usual question: Have the Parties any objection to the manner in which this Tribunal has conducted the proceedings?

MS. DAVIDSON: No, Mr. Chairman. The United States has no objection to the manner of the proceedings.

MR. AGUILAR-ALVAREZ: Canada has no objection either, Mr. Chairman.

CHAIRMAN BÖCKSTIEGEL: Thank you very much, indeed.

While at the end of this hearing, let me on behalf of my colleagues and myself for the Tribunal thank the Parties and their counsel for most efficiently dealing with this procedure both in their submissions and in this hearing. It has again, as in December, been a very civilized procedure; and it is, of course, extremely helpful for a Tribunal if counsel is in a position to not only know how international arbitration of this kind works, but also to bring over the ideas and opinions that they consider relevant in such a way that we poor arbitrators have a chance to understand. So, it has really been very helpful the way the Parties have conducted this procedure, and

we would like to thank you all.

Let me also thank the two experts who have very patiently suffered the examination, but, of course, they are used to that, so let me just say that it was helpful. And, to some extent, we still hope for some further clarification from the Post-Hearing Briefs, and we will address that issue in our Hearing Order to make sure that we did not misunderstand what they have told us.

Further thanks should go to the logistics staff. This has, again, been very well setup; the equipment worked very well and we did not have any problems, and from the very beginning we all could rely on the equipment that helped very much. I apologize a little bit for the chairs you all had, but this was beyond our capacity; that's as far as the Tribunal is concerned.

Let me also thank Yun-I Kim, our Secretary of the Court, who has been very helpful behind the scenes more than you can imagine, and we would like to put that on record, as well.

And, of course, let me express my usual admiration to the Court Reporters. Whenever I see them, I can't stop telling them that I will never understand how they do this. I'm very impressed how this is done.

And the transcript is available. We have a procedure for correction. I know it hasn't been agreed on, but it has

been, again, a very helpful measure.

That's all I think I can say. Thank you all, again, and have a good journey home, insofar as you have to go far, and have a good evening.

MS. DAVIDSON: Thank you, Mr. Chairman.

MR. AGUILAR-ALVAREZ: Thank you.

(Whereupon, at 5:20 p.m., the hearing was adjourned.)

CERTIFICATE OF REPORTER

I, John Phelps, RPR-CRR, Court Reporter, do hereby certify that the foregoing proceedings were stenographically recorded by me and thereafter reduced to typewritten form by computer-assisted transcription under my direction and supervision; and that the foregoing transcript is a true and accurate record of the proceedings.

I further certify that I am neither counsel for, related to, nor employed by any of the parties to this action in this proceeding, nor financially or otherwise interested in the outcome of this litigation.

_____

JOHN PHELPS