In The LCIA
No. 7941

THE UNITED STATES OF AMERICA,

Claimant,

v.

CANADA,

Respondent.

STATEMENT OF THE CASE

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TABLE OF CONTENTS

PAGE

TABLE OF CONTENTS

-continued-

PAGE

STATEMENT OF THE CASE OF THE UNITED STATES OF AMERICA

1. Pursuant to the Tribunal's procedural order dated October 15, 2007, ordering that proceedings in this arbitration be bifurcated, claimant, the United States, respectfully submits this statement of its case regarding liability. Because these proceedings are bifurcated, the United States does not request a determination of remedy at this time.

INTRODUCTION

2. This case concerns Canada's breach of the 2006 Softwood Lumber Agreement ("SLA" or "Agreement"), an international trade agreement between the United States and Canada, which resolved a longstanding trade dispute regarding Canadian exports of softwood lumber to the United States. See Exhibit A (SLA); Exhibit B (Amendments).[1] After years of painstaking negotiations, the United States agreed in the SLA to forgo the imposition of antidumping and countervailing duties in favor of a mechanism for Canada to impose, when certain market conditions prevail, export measures designed to avoid adverse effects to the United States from continuing Canadian lumber practices. Canada now rejects this mechanism, even though the United States already has fulfilled its obligations under the Agreement by (a) refunding to Canada approximately five billion US dollars in previously-collected duties, and (b) terminating antidumping and countervailing duty orders that had helped address these continuing Canadian practices. After extensive discussions and formal consultations did not resolve the dispute, the United States commenced this arbitration. See Exhibit C (letter from the United State to Canada requesting consultations).

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[1] The exhibits cited are attached to this statement of the case. The United States also files, separately, an appendix of authorities cited.

3. The facts of this case, as they concern liability, are not in dispute. This case is solely about whether Canada was required to apply a particular calculation set forth in the Agreement. As a general matter, Canada agreed to impose certain export measures to control Canadian exports of lumber when the United States price of lumber decreases. Because contemporaneous information about the United States market is not immediately available, Canada agreed to use an estimate of United States consumption when calculating export measures. The Agreement calls this "expected United States consumption," or "EUSC," expressly defines it, and requires Canada to correctly apply expected United States consumption in determining export measures as of the Agreement's effective date.

4. This dispute has arisen because Canada has failed to determine properly and to impose timely this calculation and, thus, has caused Canadian lumber exports to flood the United States market when that market was indisputably depressed. Specifically, Canada has applied the calculation belatedly and, then, only selectively to some exports and not to others. This constitutes a breach of the Agreement. There is no dispute that: (1) Canada is not applying the calculation to certain exports, or (2) for those exports for which it is performing the correct calculation, it is not applying the calculation as of the Agreement's effective date. Resp. ¶¶ 22-23. Accordingly, the two issues at this stage of the proceedings rest upon the correct interpretation of the Agreement to determine whether Canada has timely and correctly applied the calculation. If the Tribunal determines that the United States' interpretation of the Agreement is correct, the Tribunal should find that Canada has breached the Agreement. The only remaining question, then, will be the magnitude of the remedy that should be imposed.

5. Because these proceedings are bifurcated, the United States does not request a determination of damages at this time. However, pursuant to Procedural Order No. 1, the United States reserves the right to request an appropriate remedy, including the standard for compensation and the quantification of damages required by Article XIV of the SLA, which requires a Party to cure any breach.

BACKGROUND

I. The Historical Dispute

6. Softwood lumber is wood sawn from coniferous trees that is used primarily for home building. The United States and Canada both have significant softwood lumber industries.

7. For nearly two centuries, there has been trade in softwood lumber between the United States and Canada, as well as disputes concerning that trade. See generally SOFTWOOD LUMBER FROM CANADA, USITC PUB. 3509, I-5 - I-11 (May 2002). The most recent dispute dates back several decades, when a collapse of the United States housing market coincided with a surge in Canadian softwood lumber imports into United States.

8. In 1986, the United States Department of Commerce preliminarily found that provincial governments were providing subsidies of 15 percent ad valorem to Canadian producers.[2] See Preliminary Affirmative Countervailing Duty Determination: Certain Softwood

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[2] The United States and Canada both have laws that address injurious dumping and subsidization of imported goods. The United States trade laws provide relief to domestic producers and manufacturers by assessing duties on imports of competitive products that are sold in the United States at less than fair value (antidumping duty), or that are unfairly subsidized (countervailing duty) by the government of the exporting country, and are materially injuring the domestic industry. 19 U.S.C. §§ 1671, 1673 et seq.

Similarly, Canadian trade laws address "dumping and subsidizing." See generally Annual Report for the Canadian International Trade Tribunal ("CITT") for Fiscal Year 2007 ("CITT Report"), available at <http://www.citt-tcce.gc.ca/doc/english/Publicat/ar2h_e.pdf>.

Lumber Products from Canada, 51 Fed. Reg. 37,453 (Dep't of Commerce, Oct. 22, 1986). The United States International Trade Commission preliminarily determined that there was a reasonable indication that the alleged subsidized Canadian softwood lumber imports were threatening material injury to the United States softwood lumber industry. On December 30, 1986, the United States, Canada, and the United States industry entered into a memorandum of understanding in which Canada agreed to impose an export tax if the United States industry withdrew the countervailing duty petition.

9. Canada ultimately terminated the memorandum of understanding in 1991. In response, the United States Department of Commerce self-initiated a countervailing duty investigation. Since then, the two nations have struggled to develop a workable solution to ensure that Canada's exporting practices remained fair to the United States industry. These efforts have, at times, included a system of export charges on Canadian exports, and, at other times, have included antidumping and countervailing duty charges assessed upon Canadian exports.

10. In 1992, after the United States Department of Commerce and the United States International Trade Commission issued affirmative determinations of material injury and dumping, the Department of Commerce issued a countervailing duty order upon softwood

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Like the United States, Canada imposes duties based upon separate determinations of injury, in conjunction with determinations of dumping or subsidization, made by different tribunals. Id. Revenue Canada is the Canadian agency responsible for determining whether dumping or subsidization has occurred, and CITT determines whether an industry has been injured. Canada then imposes these duties upon United States imports. See, e.g., Revenue Canada Monthly Report for September 2007, available at <http://www.cbsa-asfc.gc.ca/sima/monthly-eng.html> (noting current duties upon United States origin corn, copper pipe fittings, potatoes, and sugar).

lumber from Canada, which Canada challenged before a US-CFTA binational panel. Canada prevailed, and the United States revoked the countervailing duty order.

11. In 1996, the United States and Canada entered into the Softwood Lumber Agreement of 1996 ("SLA 1996"), which imposed an export control regime upon Canadian softwood lumber. As part of SLA 1996, the United States industry agreed not to petition for trade remedies. SLA 1996 expired on March 31, 2001. Then, the chain of events leading to the current SLA began.

II. A Resolution: The 2006 SLA

12. After SLA 1996 expired in 2001, members of the United States softwood lumber industry filed petitions requesting antidumping and countervailing duty investigations on imports of softwood lumber from Canada. Preliminary and final investigations were conducted. The United States Department of Commerce determined that Canadian imports of softwood lumber were subsidized and sold at less than their fair value; the United States International Trade Commission determined that the Canadian imports were threatening material injury to the United States softwood lumber industry. Based upon these determinations, the United States Department of Commerce issued antidumping and countervailing duty orders. Certain Softwood Lumber Products from Canada, 67 Fed. Reg. 36,068 (Dep't of Commerce May 22, 2002) (antidumping duty order); Certain Softwood Lumber Products from Canada, 67 Fed. Reg. 36,070 (Dep't of Commerce May 22, 2002) (countervailing duty order). Canadian interests (including the Canadian federal and provincial governments and Canadian producers and exporters) and the United States industry challenged various aspects of these and other related unfair trade and injury determinations. These challenges were brought, with varying results, before the United

States Court of International Trade, North American Free Trade Agreement ("NAFTA") Art. 1904 binational panels and extraordinary challenge committee, the World Trade Organization ("WTO"), other United States courts, and other NAFTA arbitral panels.

13. Throughout this time, Canada and the United States struggled to resolve amicably these disagreements. After several years of negotiations, on September 12, 2006, the two nations signed the SLA to resolve permanently the burdensome and protracted multi-forum litigation that had persisted for two decades. Under the Agreement, the United States retroactively revoked antidumping and countervailing duty orders covering softwood lumber from Canada and refunded all antidumping and countervailing duty cash deposits on those entries, approximately US$5 billion, and agreed not to impose other trade remedies. See SLA, art. III-IV. In exchange, Canada agreed, among other things, to impose a mixture of volume restraints and export charges upon its lumber exports. See SLA, art. VII.

A. The Export Measures

14. The export measures to which Canada agreed give Canada's different lumber producing regions a choice between two options, Option A and Option B. SLA, art. VII. Both options involve export charges and volume limits. Under both options, export charges are imposed when the United States price is at or below US$355, and the charges increase as the price declines. SLA, art. VII, ¶ 2.[3] Under Option A, an additional export charge – 50 percent of the existing export charge – is imposed on all exports from that region if the region's exports

[3] The United States price, or "prevailing monthly price" is defined by the Agreement as "the most recent four-week average of the weekly framing lumber composite ("FLC") prices available 21 days before the beginning of the month to which the Prevailing Monthly Price shall be applied, as specified in Annex 7A." SLA, art. XXI, ¶ 43.

exceed the region's "trigger" volume by more than one percent. SLA, art. VIII, ¶ 1(b).[4] Under Option B, in addition to the export charge, a quota volume (or volume restraint) is applied to each region, which limits the volume that region may export.

15. Thus, Option A accommodates those Canadian regions whose producers export large volumes of lumber and would prefer to be subject to increasing export charges rather than strict volume restraints. Option B accommodates those Canadian regions whose producers export less lumber and, therefore, can easily remain within the Agreement's pre-set, proportional volume restraints as a percentage of expected United States consumption in the Agreement.

16. The Agreement provides specific direction for how to calculate export measures for both options. This direction, set forth in a series of calculations, explains how Canada agreed to determine, first, whether export measures are necessary, and second, whether the export measures need to be enhanced by imposing a trigger volume or altering a quota volume.

17. Export measures are initially imposed in accordance with the chart that appears in SLA, art. VII, ¶ 2:

Prevailing Monthly Price	Option A – Export Charge (Expressed as a % of Export Price)	Option B – Export Charge (Expressed as a % of Export Price) with Volume Restraint
Over $US 355	No Export Charge	No Export Charge
$US 336-355	5%	2.5% Export Charge + maximum volume that can be exported to the United States cannot exceed the Region's share of 34% of Expected U.S. Consumption for the month.

[4] If a region's exports exceed the region's trigger volume by less than one percent, Canada must reduce the region's trigger volume for the following month by the amount of the overage. SLA, art. VIII, ¶ 1(a).

$US 316-335	10%	3% Export Charge + maximum volume that can be exported to the United States cannot exceed the Region's share of 32% of Expected U.S. Consumption for the month.
$US 315 or under	15%	5% Export Charge + maximum volume that can be exported to the United States cannot exceed the Region's share of 30% of Expected U.S. Consumption for the month.

Additionally, as mentioned, if an Option A region exceeds its quota as determined under the Agreement (that is, the regional trigger volume), the export charges are increased by 50 percent. SLA, art. VIII. Canada is to calculate Option A trigger volumes in a manner similar to that in which it calculates the Option B quota volumes.

18. Option A trigger volumes are provided for in SLA, Article VIII:

> 1. This Article shall apply when the volume of exports of Softwood Lumber Products to the United States in any month from a Region that has elected Option A under Article VII exceeds the Region's Trigger Volume:
>
> (a) if the volume of exports from the Region exceeds the Region's Trigger Volume by 1% or less in a month, Canada shall reduce the applicable Trigger Volume for that Region during the following month by the total MBF amount of the overage (*i.e.*, the amount by which actual exports exceeded the Trigger Volume);
>
> (b) if the volume of exports from the Region exceeds the Region's trigger Volume by more than 1% in a month, Canada shall apply retroactively to all exports to the United States from the Region during that month an additional Export Charge equal to 50% of the applicable Export Charge determined under Article VII(3) for that month.

> 2. For the purposes of this Article, a Regional Trigger Volume shall be calculated in accordance with Annex 8.

19. Pursuant to Annex 8, the formula for calculating a region's trigger volume is:

RTV = EUSC x RS x 1.1.

SLA, Annex 8, ¶ 3. That is, a region's trigger volume ("RTV") is equal to expected United States consumption ("EUSC"), multiplied by the region's assigned market share ("RS"), multiplied by 1.1. Id.

20. Option B quota volumes are provided for in SLA, art. VII, ¶ 4(b):

> 4. Under Option B, Canada shall on a monthly basis:
>
> * * *
>
> (b) limit the Region's exports of those products [Softwood Lumber Products] during the month to the volume determined in accordance with Annex 7B.

21. Pursuant to Annex 7B, the formula for calculating a region's quota volume is:

RQV = EUSC x RS x PAF.

SLA, Annex 7B, ¶ 2. That is, a region's quota volume ("RQV") is equal to expected United States consumption EUSC, multiplied by the region's assigned market share RS, multiplied by an assigned price adjustment factor (PAF). Id.

22. Under the Agreement, therefore, both trigger volumes and quota volumes are obtained by multiplying expected United States consumption (EUSC) by a market share value multiplied by an adjustment factor. For Option A regions, Annex 8 instructs that expected United States consumption is "calculated in accordance with Annex 7D." SLA, Annex 8, ¶ 3. For Option B regions, Annex 7B instructs that expected United States consumption is "as

calculated in Annex 7D." SLA, Annex 7B, ¶ 2. Thus, both Option A and Option B use exactly the same calculation for expected United States consumption. See also SLA, art. XXI, ¶ 21 ("'Expected U.S. consumption' means the expected level of U.S. Consumption defined and calculated in accordance with paragraphs 12 through 14 of Annex 7D").

23. Pursuant to Annex 7D, monthly expected United States consumption is equal to the average United States consumption for the 12-month period ending three months before the month for which expected consumption is being calculated (United States consumption for the latest, available 12-month period divided by 12) multiplied by an assigned seasonal adjustment factor. SLA, Annex 7D, ¶¶ 12 and 13. Further, if actual United States consumption during a quarter differs by more than five percent from expected United States consumption during that quarter, the calculation of expected United States consumption for the following quarter for which quotas are being determined is to be adjusted to minimize any divergence between expected United States consumption and actual United States consumption:

> 14. If U.S. consumption during a Quarter differs by more than 5 % from Expected U.S. Consumption during that Quarter, as calculated under paragraph 12, the calculation of Expected U.S. Consumption for the following Quarter for which quotas are being determined shall be adjusted as follows. Specifically, the difference (in MBF) between U.S. Consumption and Expected U.S. Consumption for the Quarter shall be divided by 3 and the amount derived shall be added to (if U.S. Consumption was more than expected) or subtracted from (if U.S. Consumption was less than expected) the monthly Expected U.S. Consumption calculated under paragraph 12 for each month in the next Quarter for which quotas are determined.

SLA, Annex 7D, ¶ 14.

24. This provision is designed to prevent the calculation of expected United States consumption under the Agreement from becoming a systematically inaccurate estimate under the

circumstances of a rapid change in the level of United States consumption. In the absence of such an adjustment, the use of a 12-month moving average as the basis for the estimate would result in an estimate that lags behind such movements in actual United States consumption. In providing for the calculation of expected United States consumption, Annex 7D neither mentions nor distinguishes between Option A and Option B, or trigger volumes and quota volumes.

25. In short, the parties agreed upon an approach for calculating a fair and accurate value for expected United States consumption that provides for continual adjustment to minimize any divergence between expected United States consumption and actual United States consumption, and that approach applies equally when calculating both Option A trigger volumes and Option B quota volumes.

B. Canada's Breach

26. Beginning in January 2007, and continuing through today, Canada abandoned the position it took at the time the Agreement was signed, and has failed continually to calculate expected United States consumption in accordance with Annex 7D, including paragraph 14. As a result, Canada has failed to limit exports from some regions and failed to assess tens of millions of dollars in charges on exports from other regions. Canada's breach has disrupted the balance to which the parties agreed in the SLA.

27. In its response to the arbitration request, Canada contended that it was not required to, and therefore, did not apply adjusted expected United States consumption to Option A regions and, to the extent that it was required to apply the adjustment to Option B regions, it was required to do so only months after the Agreement's effective date. Resp. ¶¶ 5, 6, 13, 23(e), 28(a). Canada has not contested that if these adjustments were applied, it would have had to

implement Option A Measures and implement Option B measures earlier; but it did not do so. Accordingly, having conceded the factual question whether the adjustment was made, Canada's response has narrowed the issue during this liability stage to the correct interpretation of the Agreement.

SUMMARY OF THE ARGUMENT

I. Canada's Failure To Apply Timely The Calculation

28. As the calculations demonstrate, the Agreement provides for a mechanism to increase the accuracy of estimated (or expected) United States consumption. In paragraph 14 of Annex 7D, the Annex that defines expected United States consumption for all purposes, Canada agreed to adjust expected United States consumption by comparing an earlier quarter's expected United States consumption with that same quarter's actual consumption. Given its paramount importance as a variable in the calculation of export measures in response to a dynamic United States market, the parties agreed that the calculation of expected United States consumption should be as accurate as possible. This is precisely what paragraph 14 of Annex 7D accomplishes.

29. Nevertheless, Canada has ignored its agreement and applied an adjusted expected United States consumption figure to some regions but not others and has accomplished even that partial effort only belatedly. This is a breach of the Agreement. Contrary to Canada's contention, the Agreement does not entitle Canada to wait at least nine months after the Agreement's October 2006 effective date before beginning to adjust the calculation for accuracy. See Resp. ¶ 23(e). No provision of the Agreement provides for such a grace period. Rather, paragraph 14 of Annex 7D must be applied from the first month in which expected United States

consumption calculations are made. Indeed, there would be no rational purpose for a grace period in light of a primary purpose of the Agreement, which is "to ensure that there is no material injury or threat thereof to an industry in the United States from imports of Softwood Lumber Products from Canada, and to avoid litigation under Title VII of the Tariff Act of 1930 on this issue." SLA, Annex 5B.

II. Canada's Failure To Apply Accurately The Full Calculation

30. In addition, Canada has breached the Agreement by failing to apply the adjustment for expected United States consumption to calculations under both Option A and Option B. Resp. ¶ 23(e) (conceding that Canada has not adjusted expected United States consumption for Option A regions). Each Canadian region (the regions correspond to Canadian provinces with the exception of British Columbia, which is divided into the B.C. Coastal region and the B.C. Interior region under the Agreement), may choose the measures to which they prefer to be subject. For example, high volume producing regions may take advantage of Option A, which combines an export charge with what is, in effect, a soft volume cap that increases export charges when the export volume of that region exceeds a trigger amount determined under the Agreement. In turn, lower volume producing regions that can easily limit their exports are able to select export measure Option B, which assesses lower export charges in combination with a hard cap on exports.

31. Regardless of which option a region chooses, however, the substantive and central calculation remains the same — each export measure, regardless of its type, relies indispensably upon an accurate calculation of expected United States consumption. Annex 7D of the Agreement defines the only calculation of expected United States consumption, and, for

each type of export measure applied, the Agreement refers without qualification to Annex 7D. Nothing in Annex 7D refers to the two options; rather, the Agreement provides for one, and only one, calculation of expected United States consumption for determining export measures.

32. Canada has breached the Agreement by refusing to calculate and to apply the adjustment to expected United States consumption to the calculation of regional trigger volumes under Option A. Instead, Canada has selectively applied the calculation to benefit impermissibly Option A regions, thus reading into the Agreement a self-styled "bifurcation" of the calculation as between Option A and Option B. That distinction exists neither in the text of Annex 7D nor elsewhere in the Agreement. Specifically, as of the third quarter of 2007, Canada has begun to apply the full calculation to Option B regions; however, it applies only part of the calculation to Option A regions. By not applying the expected United States consumption to all exporting regions, Canada has failed to impose the required export measures. As a consequence, Canada failed to impose the required export disincentive upon Canadian producers, and Canadian lumber exports have flooded the United States market when that market has been indisputably depressed, disrupting the carefully-considered balance struck in the SLA.

33. In defense of its actions, Canada offers an unreasonable, post hoc interpretation of Annex 7D, asserting that one word – "quota" – in one sentence of one paragraph (paragraph 14), justifies this distinction between Option A and Option B, at the expense of the remainder of the provision and the Agreement as a whole. Canada suggests that the two types of export measures involve two different calculations for expected United States consumption. They do not. In fact, the Agreement provides that expected United States consumption is a universal equation that must be applied to each export measure.

34. Indeed, Canada admits that at the time the Agreement came into force in October 2006, it did not interpret the Agreement as it does now. See Resp. ¶¶5, 23(h); Exhibit D. Rather, Canada developed its current interpretation of paragraph 14 in Annex 7D some time after the parties entered into the Agreement. See id. Canada's new interpretation, however, conflicts with the ordinary meaning of paragraph 14 in Annex 7D in its context and in light of a primary object and purpose of the Agreement, which is to implement the agreed-upon mechanisms to "ensure that there is no material injury or threat thereof to an industry in the United States from imports of Softwood Lumber Products from Canada." SLA, Annex 5B.

ARGUMENT

I. The United States' Interpretation Of The SLA Is Consistent With Established Principles Of Treaty Interpretation

35. The governing law is the SLA and applicable customary international law, including customary international law applicable to the interpretation of treaties. Article 31 of the Vienna Convention on the Law of Treaties, May 23, 1969, 1155 U.N.T.S. 331 ("Vienna Convention") reflects customary international law on the interpretation of international agreements between state parties.[5]

36. Article 31(1) of the Vienna Convention provides that "[a] treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose." In discussing Article 31, the International Court of Justice and the Iran-U.S. Claims Tribunal have recognized that

[5] The International Court of Justice has determined that Article 31 is reflective of customary international law. See, e.g., Kasikili/Sedudu Island (Bots. v. Namib.), 1999 I.C.J. 1045, 1059 (Judgment of Dec. 13).

"[i]nterpretation must be based above all upon the text of the treaty."[6] Article 31 further states in relevant part:

> 3. There shall be taken into account, together with the context:
>
> . . . . (b) any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation . . . .

Vienna Convention, art. 31 (2). The Vienna Convention permits use of "supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of article 31, or to determine the meaning when the interpretation according to article 31: (a) leaves the meaning ambiguous or obscure; or (b) leads to a result which is manifestly absurd or unreasonable." Vienna Convention, art. 32.

37. As explained further below, the Agreement's provisions, read in their context and in light of the Agreement's object and purpose, clearly provide that Canada agreed to calculate the full definition of expected United States consumption as set forth in paragraphs 12 through 14 of Annex 7D, that Canada agreed to do so for both Option A and Option B regions, and that Canada agreed to do so immediately upon the Agreement's effective date. A primary purpose of the SLA is "to ensure that there is no material injury or threat thereof to an industry in the United States from imports of Softwood Lumber Products from Canada, and to avoid litigation under Title VII of the Tariff Act of 1930 on this issue." SLA, Annex 5B. Further, even if the ordinary meaning read in its context reveals an ambiguity in the language setting forth the adjustment,

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[6] Territorial Dispute (Libyan Arab Jamahirya v. Chad), 1994 I.C.J. 6, 22 (Feb. 3); see also Iran v. United States, AWD 597-A11-FT at para. 181 (April 7, 2000).

supplementary means of interpretation confirm the United States' reading. By failing to apply a fundamental calculation properly and timely to all regions, Canada has increased the threat of injury to the United States industry — a result that is inconsistent with a primary purpose of the SLA.

II. Canada Agreed To Adjust Export Measure Calculations For Accuracy As Soon As The Agreement Went Into Effect

38. The first issue in this dispute is whether the adjustment in paragraph 14 of Annex 7D is to apply to calculations of expected United States consumption from the beginning of the Agreement (as the United States contends), or nine months after the Agreement has commenced (as Canada suggests). The text of the Agreement expressly states that "[a]s of the Effective Date, Canada shall apply the Export Measures to exports of Softwood Lumber Products to the United States." To ensure that Canada timely adjusts its export measures as market conditions change, the Agreement bases the relevant calculations, in part, upon expected United States consumption of lumber. Expected United States consumption is a critical variable in the calculations of both Option A trigger volumes and Option B quota volumes. To maintain control of its exports, therefore, whether imposing what is in effect a soft cap trigger volume (to trigger a 50 percent increase in the export charge) under Option A, or a hard cap volume restraint under Option B, Canada must, at the outset of the Agreement and on a continuing basis thereafter, compare the most recent, available actual United States consumption with the corresponding estimated United States consumption. It does this to ensure that the expected United States consumption used in determining the two volume restraints accurately reflects any recent changes in the actual level of United States consumption.

39. Annex 7D of the Agreement defines expected United States consumption. SLA, art. VII, ¶¶ 12-14; SLA art. XXI, ¶ 21. Because expected United States consumption is an estimate of future consumption, the parties agreed to a mechanism to improve the accuracy of the estimate. SLA, Annex 7D, ¶ 14. This mechanism continually compares the most recently available actual United States consumption with the corresponding estimated United States consumption. If that difference exceeds five percent, Canada must adjust the expected number for future calculations. Id.

40. Canada agreed to implement this mechanism from the time the Agreement went into effect. However, it is undisputed that Canada did not implement, until the third quarter of 2007, the comparison for which the United States contends paragraph 14 provides. Resp. ¶ 23(e). Nothing in the Agreement allowed Canada to avoid adjusting expected United States consumption for accuracy for nine months after the Agreement had been in effect.

A. The Whole Of The Agreement Went Into Effect In October 2006

41. The ordinary meaning of the terms of paragraph 14 of Annex 7D, read in context, is that the provision came into effect at the time of the Agreement. The Agreement expressly provides that "[a]s of the Effective Date, Canada shall apply the Export Measures to exports of Softwood Lumber Products to the United States." SLA, art. VI; see also art. II ¶1(d) ("Canada has certified to the United States that it can administer the Export Charges and issue Export Permits as of the Effective Date"); Exhibit F (letter from Canada certifying that it was prepared to impose export measures as of the effective date). The only caveat is in footnote 2, which establishes the transition period pursuant to which the Agreement initially treated all regions as Option A regions through December 31, 2006. Id., n.2. The Agreement further provides,

however, that each region had to elect its option "[b]y the Effective Date." SLA, art. VII(1). See also SLA, art. VIII(8).

42. Thus, paragraph 14 of Annex 7D came into effect on the Agreement's effective date. There is only one ordinary meaning under these circumstances: Canada should have begun determining in October 2006 whether it was required to adjust expected United States consumption pursuant to paragraph 14 of Annex 7D. There is only one ordinary meaning under these circumstances: as of October 2006, Canada should have begun to adjust expected United States consumption pursuant to paragraph 14 of Annex 7D by applying the proper export measures. As it acknowledges in its Response (see Resp. ¶ 23(e)), it did not, and it has thereby breached the Agreement.

B. The SLA Uses Accurate Calculations To Maintain Careful Control Of Canadian Exports To The United States

43. The United States' interpretation of the mechanism provided in paragraph 14 of Annex 7D, which requires Canada to adjust expected United States consumption immediately upon the Agreement's effective date, is consistent with a primary object and purpose of the SLA. As previously explained, the SLA's provisions "ensure that there is no material injury or threat thereof to an industry in the United States from imports of Softwood Lumber Products from Canada, and to avoid litigation under Title VII of the Tariff Act of 1930 on this issue." SLA, Annex 5B. Consistent with this primary purpose, paragraph 14 of Annex 7D ensures that the calculation of expected United States consumption as applied in any given quarter is as accurate as possible, and that the export measures imposed (if any) are as fair as possible to both parties, so as to maintain a balance of Canadian exports in the United States.

44. In the absence of actual data for a quarter, the best method to ensure the accuracy and fairness of the calculation is to consider whether the most recent set of "actual data" available (which will be from the most recently completed quarter) is within five percent of the unadjusted expected United States consumption calculation for that earlier quarter. If it is not, it is clear that the market is either increasing or decreasing (as the case may be), and that the expected United States consumption for the current quarter is likely to be inaccurate unless Canada makes an adjustment to reflect this increasing or decreasing market trend. Paragraph 14 of Annex 7D requires Canada to make such an adjustment to ensure that the final expected United States consumption value Canada applies to determine the export measures is as accurate as possible.

45. The following example demonstrates how this works in practice. In the first three months of 2007, Canada made no adjustments under paragraph 14 of Annex 7D to the expected United States consumption calculations it applied to determine the export measures. As a result, the expected United States consumption exceeded the actual United States consumption for those months by the following percentages: 13.72 percent in January; 20.58 percent in February; and 11.62 percent in March. If Canada had made the required adjustments (that is, if Canada had used actual data from the third quarter of 2006 to adjust the expected United States consumption for the first quarter of 2007), the expected United States consumption calculations would have been far more accurate and would have only marginally exceeded the actual consumption by the following amounts: 0.3 percent in January; 6.7 percent in February; and 0.7 percent in March.

46. This improvement in accuracy is precisely what the adjustment mechanism was designed to achieve. Canada's application of the calculation results in estimates of expected

United States consumption that are less accurate than the parties agreed. This inaccuracy subverts the Agreement's efforts to maintain a balance of exports into the United States to avoid material injury to the United States.

C. Canada's Interpretation Of The Timing Of Paragraph 14 Is Unreasonable

47. As a consequence of Canada's failure to apply the adjustment, the United States has had to endure nine months of excess imports of softwood lumber, and Canada's softwood lumber industry has benefitted from nine months of exporting higher volumes of lumber than would have been the case if the adjustment had been applied correctly. This oversupply of Canadian lumber has disrupted the careful market balance that the SLA was designed to protect.

48. Canada's interpretation of this provision clearly conflicts with a primary object and purpose of the SLA. A primary purpose of the SLA is to "to ensure that there is no material injury or threat thereof to an industry in the United States from imports of Softwood Lumber Products from Canada, and to avoid litigation under Title VII of the Tariff Act of 1930 on this issue." SLA, Annex 5B. The purpose is not to apply a clearly inaccurate expected United States consumption calculation and expect the party suffering the detriment of the inaccuracy (in this case, the United States) to wait until the 12-month moving average catches up to actual consumption levels to correct the market imbalance, even though available market data could have made the calculation far more accurate in the first instance.

49. Canada has acknowledged that it must always apply the adjustment (if required) to each quarter, but only for the period beginning in the third quarter of 2007. Resp. ¶ 23(e). It is inconsistent with the SLA's purpose to suggest that Canada may take advantage of inaccurate expected United States consumption calculations for the first three quarters of the SLA, and only

then start to apply the provision correctly. This interpretation would, and has, resulted in over-exportation of Canadian lumber to the United States, in violation of the Agreement.

50. Finally, the parties' subsequent practice is further evidence that the United States' interpretation is correct. Canada's communications to the provincial government of British Columbia in the early months of the Agreement demonstrate that Canada understood that it was required to make the adjustments required by paragraph 14 of Annex 7D as soon as the effective date of the Agreement. Specifically, in January 2007, the provincial government of British Columbia stated, "BC calculations prior to January 2007 assumed that this adjustment [pursuant to paragraph 14 of Annex 7D] did not apply to surge limit [Option A trigger volumes] calculations. However, the federal government has stated it will apply the adjustment to surge limit calculations." Exhibit D (memorandum from BC Ministry of Forests and Range). These communications demonstrate that when the parties entered into the SLA, they intended that paragraph 14 of Annex 7D would apply to both Option A and Option B from the beginning.

51. That is, Canada began to apply paragraph 14 of Annex 7D as soon as the Agreement went into effect, October 2006. Canada informed British Columbia that the adjustment should be applied, and that although it was not required to adjust expected United States consumption for the fourth quarter of 2006, because the difference between the expected United States consumption and the most recently available actual United States consumption (from the second quarter of 2006) was less then five percent, the adjustment should be made for the first quarter of 2007. Although the SLA contemplates use of pre-SLA data to make many calculations,[7] Canada now suggests that the ordinary meaning of paragraph 14 is not workable

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[7] See SLA, Annex 7D, ¶¶ 12-13 (requiring use of 12 months of data preceding the SLA).

because it requires use of pre-SLA data. Canada should not be permitted to "blow hot and cold – to affirm at one time and deny at another."[8] Clearly, that Canada itself actually calculated expected United States consumption, including the appropriate adjustment, and showed its lumber producers how they were to be affected by the Agreement, supports the correctness of the United States' interpretation. As Canada admits in paragraph 13 of its response to the request for arbitration, the United States returned approximately US$5.5 billion to Canadian lumber producers. The United States did so in reliance upon Canada's commitment to comply with the on Agreement from its effective date.

III. The Calculation Of Expected United States Consumption Applies To All Regions

52. Not only has Canada failed to apply timely the export measures, it has applied them only to Option B regions and not to Option A regions. This selective application of correct export measures unfairly benefits certain regions and undermines the very purpose of the export measures. The Agreement's export measures require Canada, in every instance, to determine the most accurate expected United States consumption value possible for a particular region. Canada has not done so, and it thus has breached the Agreement.

A. Canada Must Apply The Full Expected United States Consumption Calculation For Option A Regions

53. The ordinary meaning of the terms of paragraph 14 of Annex 7D, read in context, require that Canada apply the defined expected United States consumption calculation to both

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[8] See Bin Cheng, GENERAL PRINCIPLES OF LAW AS APPLIED BY INTERNATIONAL COURTS AND TRIBUNALS at 141 (2006) (citing England, Court of Exchequer: Cave v. Mills (1862) 7 Hurlstone & Norman, p. 913, at 927).

Option A and Option B regions. The text of the Agreement expressly requires expected United States consumption to be "defined and calculated in accordance with paragraphs 12 through 14 of Annex 7D." SLA art. XXI, ¶ 21. In turn, expected United States consumption' is the cornerstone of determining how certain provisions of Option A and Option B are applied. Whenever a calculation of expected United States consumption is required, the terms of the Agreement require that the calculation include the adjustment required by paragraph 14. See, e.g., SLA Annex 8, para. 2 ("A Region's Trigger Volume for a particular month shall be determined by multiplying the total monthly Expected U.S. Consumption . . . .").

54. As noted above, the SLA is the result of years of painstaking negotiations aimed at finally resolving the protracted trade disputes concerning exports of Canadian lumber to the United States. The parties ultimately settled upon a combined system of export charges and volume restraints that control continually the exports of Canadian lumber into the United States. This system is intended to replace the earlier antidumping and countervailing duty assessments imposed upon Canadian lumber and to "ensure that there is no material injury or threat thereof to an industry in the United States from imports of Softwood Lumber Products from Canada." SLA, Annex 5B.

55. To address the size and variety of the Canadian lumber industry, the parties agreed to two regionally-based types of export measures. For regions choosing to be subject to a strict volume restraint, the regulation provided for in the Agreement is explicit — when United States price is at or below US$355, those regions must limit their exports (and be assessed an export charge). For regions choosing to be subject to only an export charge, the control provided for in the Agreement is more fluid — what is, in effect, a soft cap. That is, export charges rise as

United States price decreases with the goal of discouraging exports rather than explicitly limiting them to a certain percentage of the United States market. To further discourage over-exportation of Canadian lumber, this option also imposes an additional 50 percent to the existing export charge when the volume of exports exceeds the region's "trigger volume." SLA, art. VIII.

56. The calculation for both volume restraints and trigger volumes (which trigger imposition of the additional 50 percent charge) rely primarily upon an accurate estimate of expected United States consumption; that is, the volume of lumber that the United States will consume in a given month, which, in turn, is a proxy for the size of the United States market for softwood lumber at that time. For both types of export measures, Canada agreed to calculate expected United States consumption to determine whether its exports exceed a region's agreed-upon market share. The Agreement relies upon an expected number, rather than an actual number, in recognition of the unavailability of contemporaneous actual data and the need to tie monthly exports of Canadian lumber to changing market conditions in the United States. That is, the Agreement requires Canada to determine the expected United States consumption precisely to ensure that Canada's imposition of export measures tracks as closely as possible the United States market, rather than lags behind it.

57. Option A regions are subject to a trigger volume, which must be calculated using the directions set forth in Annex 8 of the SLA. SLA, art. VIII. Paragraph 3 of Annex 8 explicitly includes expected United States consumption in the calculation of regional trigger volumes. SLA, Annex 8 ¶ 3. Essentially, the trigger volume is calculated by multiplying a region's United States market share by expected United States consumption. Id. Annex 8 directs Canada to Annex 7D for the required calculation of expected United States consumption.

Expected United States consumption is defined by the SLA as the "expected level of United States consumption defined and calculated **in accordance with paragraphs 12 through 14 of Annex 7D.**" SLA, art. XXI, ¶ 21 ("Definitions") (emphasis added).[9]

58. Similarly, for regions choosing Option B, paragraph 2 of Annex 7B explicitly includes expected United States consumption in the calculation of quota volumes. SLA, Annex 7B ¶2. That is, when determining what the volume restrictions should be, Canada must again refer to Annex 7D to determine the expected United States consumption. Id. Again, the Agreement does not qualify or limit in any way the reference to Annex 7D.

59. Rather, the Agreement provides that, for each and every calculation of export measures, Canada must calculate expected United States consumption in accordance with the Agreement's definition of that term and in accordance with the Annex dedicated to the calculation. Thus, because expected United States consumption is defined as the calculation set forth in paragraphs 12 through 14 of Annex 7D, Canada must apply each of those paragraphs to each and every export measure calculation. Instead, Canada has unilaterally and belatedly determined that for Option A regions, it need only apply paragraphs 12 and 13 of the calculation, and for Option B regions, it will apply the full definition (but beginning only in the third quarter of 2007).

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[9] Article 31(4) of the Vienna Convention provides that "a special meaning shall be given to a term if it is established that the parties so intended."

B. Canada's Interpretation Ignores The Ordinary Meaning In The Context Of The Agreement And In Light Of A Primary Object And Purpose Of The Agreement

60. Rather than accept the consequences of the calculation to which it agreed, Canada has developed an exceedingly narrow, post hoc interpretation of one word of one provision in paragraph 14 of Annex 7D, to conclude that the use of the word "quota" in paragraph 14 effectively prohibits application of the calculation of expected United States consumption to Option A regions. Canada's selective implementation of the Agreement defies the provisions' ordinary meaning in their context and in light of the Agreement's object and purpose.

61. Misunderstanding that Option A regions are subject to what is in effect a soft cap on exports, Canada ignores that the SLA's definition of expected United States consumption includes paragraph 14, as well as the references to Annex 7D in the provision governing the calculation of trigger volumes for Option A regions. Canada's arbitrary reliance upon "quota" at the expense of the context of the remainder of the provision and at the expense of the Agreement's purpose, is fundamentally inconsistent with basic principles of treaty interpretation.

62. Rather than apply the ordinary meaning of the paragraph 14 adjustment – that an adjustment must be made to expected United States consumption regardless of whether the adjustment will be applied to quota volumes or trigger volumes – Canada treats it as if its application is discretionary, substantially reducing its effect. This is inconsistent with the principle of effectiveness *("*ut res magis valeat quam pereat"), "generally accepted as one of the main principles of treaty interpretation."[10] Specifically, in paragraph 14 of Annex 7D, Canada

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[10] Iran v. United States, AWD ITL63-A15-FT at 46 (Aug. 20, 1986).

agreed to adjust expected United States consumption when the current value for expected United States consumption differs from the most recent, available value for actual United States consumption by more than five percent:

> 14. If U.S. Consumption during a Quarter differs by more than 5% from Expected U.S. Consumption during that Quarter, as calculated under paragraph 12, the calculation of Expected U.S. Consumption for the following Quarter for which quotas are being determined shall be adjusted as follows. Specifically, the difference (in MBF) between U.S. Consumption and Expected U.S. Consumption for the Quarter shall be divided by 3 and the amount derived shall be added to (if U.S. Consumption was more than expected) or subtracted from (if U.S. Consumption was less than expected) the monthly Expected U.S. Consumption calculated under paragraph 12 for each month in the next Quarter for which quotas are determined.

63. The ordinary meaning of the first sentence setting forth the timing for application of the adjustment is clear: Canada is to adjust expected United States consumption for the next Quarter in which quotas are determined, that is, when the prevailing price of lumber is at or below US$355 MBF. The clause "in which quotas are determined" immediately follows, and therefore modifies, the term "Quarter." "Quarter" is a division of time. SLA, art. XXI, ¶ 44 (defining "Quarter" to mean "unless otherwise specified, the three-month periods commencing January 1, April 1, July 1 and October 1 of each Year."). Accordingly, the modifying clause is a timing clause. It merely specifies **when** Canada is to apply adjusted expected United States consumption. The modifying clause does not, as Canada now insists, dictate the "circumstances" under which Canada must make the adjustment. See Resp. ¶ 5 ("In describing the circumstances when adjustment is required, paragraph 14 uses the limiting words "for which quotas are being determined."). Canada effectively moves the modifying clause "for which

quotas are determined" backwards to modify "calculation," and there is no basis for tolerating this reading, either in isolation or in the context of the Agreement.

64. The SLA's use of "quota" to modify "Quarter" introduces no "bifurcation" between how expected United States consumption should be calculated in determining Option A regional trigger volumes and how expected United States consumption should be calculated in determining Option B quota volumes. See Resp. ¶ 27(g). Canada is required to calculate Option A trigger volumes pursuant to Annex 8, and Option B quota volumes pursuant to Annex 7B. Both annexes expressly, and without qualification, provide that Canada must calculate expected United States consumption pursuant to Annex 7D. Nothing in Annex 7D mentions or distinguishes Option A, Option B, trigger volumes, or quota volumes.

65. If the parties had wanted to limit paragraph 14 of Annex 7D to only Option B regions, they would have done so explicitly. Indeed, paragraph 14 of Annex 7D stands in marked contrast with other provisions in which the parties made explicit that only one Option was at issue. For example, in Article VI, note 5, the Agreement establishes a "transition period" and specifies that only Option A export measures shall apply during this transition period. Similarly, the Agreement states explicitly that the surge mechanism, set forth separately in Article VIII, applies only to Option A regions. Finally, there are no provisions in Annex 7D or elsewhere that allude to or even contemplate the idea that the expected United States consumption for Option A regions will ever differ from that for Option B regions. Accordingly, read in the context of the Agreement as a whole, the marked absence of any provision in paragraph 14 limiting its application to Option B regions when other provisions explicitly limit their applicability to one region or the other, confirms the United States' interpretation.

C. Canada Now Adopts A Fundamentally Different Interpretation Of Annex 7D Than It Did When It Signed The Agreement

66. As with Canada's argument on timing, and notwithstanding its current interpretation of paragraph 14 of Annex 7D as limiting its application to only Option B regions, the document attached as Exhibit E demonstrates that Canada did not perceive the so-called "limiting words" of paragraph 14 when it signed the Agreement. See Exhibit E (email from Canada to the United States regarding changes to paragraph 14); see also Resp. ¶¶ 4, 5, 23(h), 27. Instead, Canada confesses, it devised its current interpretation only when "planning for the administration" of the Agreement. See Resp. ¶¶5, 23(h). Canada's concession undermines the textual argument Canada advanced in its response to our arbitration request. See Resp. ¶¶ 5, 23(h). If the "limiting words" are as plain as Canada contends, it is unclear why Canada did not perceive them as such at the time it signed the Agreement. Further, Canada admits that the Agreement came into force in October 2006, id. ¶1, but fails to explain why it was "planning" (in a future sense) for the administration of the Agreement, when, in fact, that administration had already begun, and had been underway for months. See SLA, art. II (certifying that Canada was prepared to impose export measures as soon as the Agreement's effective date).

67. In any event, as the negotiating history demonstrates, Canada and the United States understood the implications of the calculations of paragraph 14 of Annex 7D. In discussing a previous (but very similar) iteration of the adjustment to expected United States consumption, Canada itself commented that the adjustment as worded could result in problematic calculation of **both** "surge trigger volumes" and "quotas." See Exhibit E (email from Canada to the United States regarding changes to paragraph 14). Specifically, during the negotiation of the Agreement, the parties discussed the precise wording of paragraph 14. In

response to the concern that the adjustment might have to be made three times per month, rather than just once, Canada stated that such "'triple counting' forecast errors . . . would result in quotas and surge trigger volumes that are persistently higher or lower than they should be . . . ." Exhibit E. If Canada had believed that the adjustment did not apply to trigger volumes (Option A), or even if it had not bothered to take a position on the matter, it would not have so clearly concluded that application of the provision could affect trigger volumes at all. Consideration of this history is appropriate to confirm the ordinary meaning of the provision, particularly because it so clearly reveals Canada's full understanding that the calculation of expected United States consumption includes paragraph 14 for both Option A and Option B calculations. Vienna Convention, art. 32.

68. Accordingly, for all of these reasons, Canada has breached the SLA by failing to apply timely the calculation of expected United States consumption and by failing to apply fully the calculation to Option A and Option B.

AWARD SOUGHT

The United States respectfully requests an award determining that:

(1) The SLA obligates Canada (i) to calculate expected United States consumption for purposes of determining trigger volumes of softwood lumber imports for Option A provinces pursuant to paragraph 14 of Annex 7D of the Agreement; and (ii) to make this calculation for all export measures for softwood lumber as of January 1, 2007;

(2) Canada breached the SLA by failing to make such calculation as of January 1, 2007 and is liable for the consequences of that breach; and

(3) The consequences of Canada's breach shall be determined in a second phase of this arbitration.

Respectfully submitted,

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