**In The London Court Of International Arbitration**

**THE UNITED STATES OF AMERICA,**

**Claimant,**

**v.**

**CANADA**

**Respondent.**

# STATEMENT OF DEFENCE ON REMEDY OF THE RESPONDENT CANADA


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## STATEMENT OF DEFENCE

In accordance with Article 15(3) of the London Court of International Arbitration ("LCIA") Rules, the Government of Canada ("Canada") respectfully submits this Statement of Defence in response to the Statement of Case filed on May 29, 2008 by the United States ("the Statement of Case") under the 2006 Softwood Lumber Agreement between Canada and the United States (the "Agreement" or the "SLA").[1]

## INTRODUCTION

1. This second phase of the arbitration is to determine what measures, if any, are the appropriate consequences under the SLA, in light of the Tribunal's Award on Liability of March 3, 2008.[2] In the liability phase, the United States challenged Canada's compliance with the SLA 2006 on the grounds that Canada (1) did not apply the adjustment factor in Annex 7D of the SLA with respect to Option A regions (a practice that was and is ongoing); and (2) did not apply the adjustment to Option B regions (a practice limited to the period January 1 – June 30, 2007, after which Canada did apply the adjustment to Option B regions). In its Award on Liability the Tribunal determined that Canada had not breached the SLA with respect to the first U.S. claim, in that Canada had no obligation under the SLA at any time to apply the adjustment factor to Option A regions. However, the Tribunal determined that Canada had breached the SLA 2006 by failing to adjust "Expected United States Consumption" ("EUSC") with respect to regions operating under Option B during the period January 1, 2007 to June 30, 2007.

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[1] 2006 Softwood Lumber Agreement between the Government of Canada and the Government of the United States of America, Sept. 12, 2006 ("SLA 2006") (Ex. RR-1).

[2] The United States of America v. Canada, Case No. 7941, LCIA, Award on Liability, Mar. 3, 2008 ("Award on Liability").

2. It is common ground that the Tribunal's powers upon finding a breach of the SLA are set out in Article XIV, paragraph 22 which provides:

> If the tribunal finds that a party has breached an obligation under the SLA 2006, the tribunal shall:
>
> (a) identify a reasonable period of time for that Party to cure the breach, which shall be the shortest reasonable period of time feasible and, in any event, not longer than 30 days from the date the tribunal issues the award; and
>
> (b) 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.[3]

3. In its Statement of Case, the United States asserts that Canada has not cured the breach,[4] but the United States is silent as to what the United States would consider "cure the breach" to be. Instead, the United States seizes a single line from the Tribunal's Award on Liability to assert that the Tribunal has already decided that Canada bears additional responsibility for the consequences of its breach beyond its action in applying the adjustment in Annex 7D since July 1, 2007. Seeking to avoid the central issue as to what "cure the breach" means, the United States argues that the only issue before the Tribunal is to determine "appropriate adjustments to the export measures to compensate for the breach" under paragraph 22(b).[5] The United States then proposes four alternative adjustments, all premised on the assumptions that: (1) Canada has not cured the breach in this dispute, and (2) compensatory adjustments are authorized and

[3] SLA 2006 Art. XIV(22) (Ex. RR-1). *See also* Art. XIV(19), which provides that Art. XIV provides the exclusive means to enforce the obligations of the SLA.

[4] Stmt. of Case ¶ 30.

[5] Stmt. of Case ¶ 26.

appropriate to compensate for effects or consequences of breaches occurring prior to the end of the reasonable period of time for cure.[6]

4. Both U.S. assumptions are false. The SLA is a "prospective" remedy dispute settlement system like that of the World Trade Organization ("WTO"), Chapter 20 of the North American Free Trade Agreement ("NAFTA") and other similar intergovernmental trade agreements. Prospective systems are those that impose no penalty and require no compensation for infringement of obligations that occur prior to a dispute settlement decision, plus some reasonable period of time to comply with a panel's ruling. Retaliatory or compensatory measures imposed under prospective systems are authorized to compensate for the continuation of a breach past the reasonable period of time and until such time as the breaching measures are terminated or brought into compliance with the obligations of the agreement. Unlike most commercial arbitrations and investor-state arbitrations under bilateral investment treaties or Chapter 11 of the NAFTA, there are no "retroactive" or "retrospective" remedies intended to compensate for past breaches.

5. Canada has cured the breach within the meaning of the SLA by applying the adjustment provided in Annex 7D since July 1, 2007 and therefore no compensatory adjustments are required or authorized by the SLA.[7] Like its counterparts in other international trade agreements between sovereigns, Article XIV of the SLA provides for countermeasures only if the breach is not cured by the end of the reasonable period of time identified in paragraph 22(a), and compensatory adjustments are not authorized for prior breaches under the SLA unless specifically so stated. There is no need for the

[6] Stmt. of Case ¶¶ 48-64.

[7] SLA 2006 Art. XIV(22)(b) (Ex. RR-1).

Tribunal to consider the alternative theories and rationales presented by the United States to justify the imposition of severely intensified export restrictions to compensate for a breach long cured.

6. In Part I of this submission, Canada will show, applying the interpretive provisions of the Vienna Convention on the Law of Treaties ("Vienna Convention"),[8] that ceasing the breach of the Agreement constitutes a "cure," and that paragraph 22(b) does not contemplate or authorize compensatory measures for past breaches. It is not necessary to resort to negotiating history, but that history also confirms Canada's position.

7. In Part II of the submission, Canada explains why, even if the SLA were interpreted to require, as part of a cure, some compensatory action for past breaches, the U.S. proposals are unjustified. First, no further action is warranted in the circumstance of this proceeding because the "excess" of lumber exported by Option B regions to the United States as a consequence of the breach has already been more than offset by the degree to which those regions exported less than their full quota entitlements in the period since July 1, 2007.

8. Second, even if Article XIV(22)(b) authorized a compensatory adjustment in the circumstances of this dispute, and even if Canada's undershipments since that period were disregarded, there still would be no justification for the alternative measures proposed by the United States. Canada will show that none of the four alternatives presented by the United States provide a justifiable form or quantum of adjustment under the SLA. Indeed, the muddle of different rationales and speculations contrived in

[8] Vienna Convention on the Law of Treaties, May 23, 1969, 1155 U.N.T.S. 331 (RRA-14).

the four alternatives, and the wide range of effects they could have, only provide further evidence to reject the U.S. assumption that a right to compensation for past breaches can or should be implied under the Agreement. Canada attaches the expert report of Joseph P. Kalt and David Reishus (the Kalt/Reishus Report) which provides an economic analysis of the four alternatives proposed by the United States and its expert Jonathan Neuberger.[9]

## ARGUMENT

### PART I. CANADA HAS CURED THE BREACH, AND THE SLA DOES NOT PROVIDE FOR COMPENSATORY ADJUSTMENTS FOR PAST BREACHES

9. It is common ground that the interpretive principles of the Vienna Convention should be applied in interpreting the Agreement.[10] Article 31(1) 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." Although the United States claims that it is following the Vienna Convention, applying its principles to the text of the Agreement it is evident that the United States' argument fails.

10. Attempting to find in Article XIV a requirement to redress past breaches, as the United States seeks to do, requires the reader either to strain severely the ordinary meaning of the terms, given their context, or to ignore those terms altogether. The U.S. argument assumes that the drafters of the Agreement intended to establish a dispute settlement and remedy system modeled after the typical commercial arbitration

[9] Expert Witness Report of Joseph P. Kalt and David Reishus (June 27, 2008) (Ex. RR-2).

[10] Award on Liability ¶ 46.

or investor-state system, where the remedy is monetary damages sufficient to compensate the claimant for past harms as a consequence of the violation of the contract or agreement. However, Article XIV is not constructed to achieve such a result. The natural interpretation of the rules of Article XIV supports the view that this is a prospective system, modeled after the government-to-government dispute settlement systems of the WTO, NAFTA and other international trade agreements, which have long been properly interpreted, including by the United States and Canada, to provide for only prospective compliance and prospective remedies.

## A. THE ORDINARY MEANING OF ARTICLE XIV WITHIN ITS CONTEXT INDICATES THE SLA PROVIDES FOR A PROSPECTIVE REMEDY ONLY

11. Article XIV(22) provides that if a tribunal finds that a Party has breached an obligation of the SLA, the tribunal shall:

> (a) identify a reasonable period of time for that Party *to cure the breach*, which shall be the shortest reasonable period of time feasible and, in any event, not longer than 30 days from the date the tribunal issues the award; and
>
> (b) 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.
>
> (emphasis added.)

12. The ordinary meaning of the term “to cure the breach,” as used in Article XIV(22), and elsewhere in Article XIV, is to eliminate or remove the breach. Ironically, each of the three dictionary definitions invoked by the United States supports this view. The United States suggests that cure means “to subdue or remove by remedial means;

remedy; remove; heal" or "to remedy, rectify, remove;" and "to remove or rectify."[11] The common thread in each of these definitions is their express equating of "cure" and "remove." This is consistent with the common understanding of what a "cure" ordinarily entails in the context of its normal usage. The word cure is most often associated with disease or illness, and in common parlance, a disease or illness is "cured" when it is removed or eliminated. There is no implication or understanding that the cure also compensates for the past consequences of the disease, such as discomfort, lost days of work, or missed social engagements.

13. Curing a breach is closely akin to curing a disease, and therefore likewise must mean removal or elimination of the breaching practice, and nothing more. As shown below, the Parties' intent that "cure the breach" would have this ordinary meaning is made clear by the context of Article XIV and the Agreement as a whole, and the prospective nature of remedies in other international trade agreements to which Canada and the United States are parties. That "cure" should have its ordinary meaning in Article XIV is confirmed by the negotiating history of that provision, which shows that the Parties used the words "cure" and "eliminate" interchangeably, without any hint that a cure would entail anything beyond removing or ceasing the offending practice.

14. The context of the Agreement strongly reinforces the conclusion, suggested by the ordinary meaning, that "curing the breach" requires ceasing the breaching practice, but does not imply any requirement to undo or redress the consequences of the past breaching practice. The context in Article XIV also makes clear that adjustments to compensate for the breach logically can only be to compensate for the ongoing breach, not past breaches, as the United States assumes.

[11] Stmt. of Case ¶ 31.

15. First, the language of Article XIV, and the SLA as a whole, shows that when the drafters intended measures to apply retroactively, they did so specifically. Paragraph 32 of Article XIV provides:

> An award under paragraph 31 shall be effective as of the date that the compensatory adjustments or measures were imposed and, accordingly, shall provide that:
>
> (a) Canada shall collect any Export Charge that the tribunal finds it should have imposed and the United States shall refund any customs duties that the tribunal finds it should not have collected, *retroactive* to that date; and
>
> (b) Canada shall impose additional export volume restraints to compensate for any excess export volumes that the tribunal finds that Canada has allowed and Canada may increase the export volumes permitted under the export restraints to compensate for any excess import restraints the tribunal finds that the United States has imposed since that date, with these adjustments to be applied to exports from the pertinent Region or Regions in equal monthly amounts during a period following the award as determined by the tribunal.
>
> (emphasis added.)

16. Paragraph 32 provides for retroactive correction of unilateral measures authorized under paragraphs 26 and 27 of Article XIV. Paragraphs 26 and 27 have slightly different rules for Canada and the United States, but both authorize a successful claimant to impose specific remedial measures if a defending party neither cures the breach nor imposes compensatory adjustments as ordered by the Tribunal under paragraph 22. If the defending party thinks that those measures are excessive or insufficient, the measures can be challenged in an expedited proceeding, preferably before the same Tribunal, under paragraphs 29 to 32 of Article XIV. Paragraph 32 provides that, to the degree that the Tribunal finds that the measures were insufficient or excessive, not only must the export measures be adjusted to conform from the date of

the award, but there must be additional adjustments to make up for the excess or insufficiency from the moment the measures were imposed.

17. There would have been no need in paragraph 32 to provide for retroactive remedies or compensation for past effects in the case of a remedial measures review if, as the United States contends, those concepts are embraced implicitly in the terms "cure" and "compensate." Paragraph 32 could have been written simply to say that the adjustment should "cure" the excess or insufficiency.

18. In addition to the explicit use of the term "retroactive," the chapeau of paragraph 32 expressly provides that an award under paragraph 31 "shall be effective *as of the date that the compensatory adjustments or measures were imposed*…" (emphasis added). This language is telling for two reasons. First, had the Parties not used the word "retroactive" specifically in paragraph 32(a), the chapeau also establishes that an award under paragraph 31 is retroactive to the date compensatory measures were imposed. Second, the language stands in sharp contrast to the language in paragraph 24, which provides that compensatory adjustments "may be applied *from* the end of the reasonable period of time until the [cure]" (emphasis added). This illustrates that the Parties knew how to express an intent to make a remedy retroactive.

19. Other provisions in the Agreement also indicate that the drafters knew how to specify retroactive effect when retroactivity was intended. In addition to its express use in paragraph 32, the term "retroactive" is explicitly included in four other provisions of the Agreement, all of which relate to application of the Export Measures in situations where softwood lumber shipments have exceeded those permitted under the Agreement or where data sources on which the calculation of Export Measures rely have been proven biased or unreliable. Article VIII(1)(b) requires Canada to "apply

retroactively" an additional Export Charge if an Option A region exceeds its Trigger Volume by more than 1% in a month. Also, Article XII(2)(b)(i) and Article XVII(5) require Canada "to impose retroactively" a charge on exporters when shipments from provinces exempt from the Export Measures or the Maritimes, respectively, exceed the specified threshold. In addition, Article XV(19)(c) requires Export Measures to be "re-adjusted on a retroactive basis" when "historical data is shown to be biased or unreliable" and to have "materially affected" the application of the Export Measures. These examples underscore that where the Parties intended to provide for retroactive or retrospective analysis, they included specific text to make that intent explicit. By omission of any reference to retroactivity in paragraph 22 of Article XIV, it is apparent that the drafters chose *not* to make the "cure" and "[compensatory] adjustments" provided under that paragraph retrospective.

20. Second, paragraphs 22, 23 and 24 of Article XIV provide rules that function logically for a prospective remedy system, but that are inconsistent with a system intended to remedy past breaches. Paragraph 22(b) states explicitly that compensatory adjustments may be applied only "if [the breaching] Party fails to cure the breach within the reasonable period of time" established under paragraph 22(a). Paragraph 22 makes clear that a cure must mean something different from compensatory adjustments. This conclusion is reinforced by paragraph 24, which provides that compensatory adjustments may be applied "from the end of the reasonable period of time until the Party Complained Against cures the breach." Paragraph 23 provides that the compensatory adjustments "shall be in an amount that remedies the breach." Thus, under paragraph 23, the amount of monthly compensatory adjustments established by the Tribunal under paragraph 22(b) must remedy the breach for the

period between the end of the reasonable period of time and the cure of the breach, if any occurs.

21. These provisions function perfectly if curing the breach is given its natural meaning of ceasing the breaching conduct, and if compensatory adjustments are understood to be compensating for the current effects of the ongoing breach. Cure and compensatory adjustment are separate concepts in line with the terms of paragraphs 22 and 24 of Article XIV. If the Party ceases the breach (cures) before the end of the reasonable period of time, there are no compensatory measures. If the Party does not, the Party compensates for the continuation of the breach via adjustments to export measures. Those adjustments cease on the day that the Party cures by complying with the obligation in question. The Tribunal's task under paragraphs 22(b) and 23, while not always simple, is relatively straightforward: to establish the monthly compensatory adjustment that will remedy the ongoing effects of the breach, whether the breach is cured shortly after the end of the reasonable period of time, a few months later, or not at all.

22. By contrast, paragraphs 22 through 24 must be ignored or severely strained to reach the position advocated by the United States. While the United States never explains its view of the meaning of curing the breach, the U.S. denial that Canada has cured the breach indicates that the United States thinks that a cure does not exist without compensation for past breaches.

23. The distinction between cure and compensatory adjustment is essentially obliterated under the U.S. theory, since both cure and compensatory adjustment involve compensating for past breaches in some way. The U.S. theory makes punitive damages seemingly inevitable, in any circumstance where the defending Party does not cure

immediately. According to the United States, the Tribunal's job in the case of an ongoing breach is to order a monthly adjustment that will compensate for the past effect and the ongoing effects of the continued violation. This task is impossible, however, because the Tribunal will not know whether the defending Party will comply with the Tribunal award, and if so, how long compliance might take.

24. Thus, punitive damages result both because of uncertainty with respect to how long compensatory adjustments will continue under paragraph 24 and because the cure involves redressing the same past breaches at which the compensatory adjustments will be aimed. It is not surprising that the United States has avoided any examination of the terms of the Agreement; those terms simply do not fit with the theory now espoused by the United States that a Party that has been found to have breached the Agreement must be required to pay in some way for past breaches.

25. A third critical element of context is that Article XIV limits the form of compensation that may be awarded to adjustments of export measures; a form that is ill-suited to remedy past breaches, as even the United States implicitly acknowledges.[12] By contrast, adjustments to trade measures are well suited to encouraging prospective compliance and hence are routinely used as a remedy in agreements with prospective remedy systems. Under the SLA, Canada alone imposes export restrictions, in the form of either export charges or a combination of export quotas and export charges. Under paragraph 23 of Article XIV, the form of compensatory adjustments the Tribunal may order in the event of an uncured breach can only be an adjustment of the export charges

[12] In paragraph 63 of its Statement of Case, the United States acknowledges that "the unique provisions of the SLA do not allow the Tribunal merely to order Canada to compensate the United States through direct payment. Instead, a remedy should encourage Canada to export less lumber in order to restore the United States to the position it would have been in absent the breach." Stmt. of Case ¶ 63. Canada would observe that providing only for adjustments to trade measures would be "unique" in a system intended to compensate for consequences of prior breaching conduct, but it is perfectly logical for the SLA with its system requiring the elimination of the breach, but not compensation for past effects.

collected or the export quotas imposed by Canada. In the case of an uncured breach by Canada, the Tribunal is restricted to directing Canada to collect a greater charge on exports to the United States, or impose tighter export quotas, or some combination.

26. In dispute settlement systems focused on making whole a claimant who suffers injury as a consequence of breach, such as in the investor-state arbitration system typical of bilateral investment treaties, the normal remedy is cash compensation paid to the claimant to make the claimant whole. Monetary damages is generally the most efficient compensation where the intent is to compensate for past harms. Monetary damages, among other things, avoids the market distorting consequences of attempting to provide compensation for the past through measures that interfere in current market forces. Article XIV does not allow for cash compensation.

27. Fourth, interpreting the term "cure the breach" to require action to undo or compensate for past breaches also makes nonsensical the provision that allows a reasonable period of time no more than 30 days to cure the breach. There would be no reason to provide for *any* "reasonable period of time" to cure the breach if the breaching Party was required to compensate for the breach from the time it started. Any delay would be increasing the compensation owed for past breaches. The concept of a "reasonable period of time" was created in the WTO prospective remedy system, to encourage compliance with WTO rules as the solution to disputes, rather than retaliation or compensation in the form of other trade measures. Allowing some reasonable period of time to cease the violation, before retaliation would be authorized, makes it more likely that the breaching party will make the effort to comply with its obligations, rather than accept retaliation as an alternative.

28. In addition, the provision of only 30 days to cure the breach is not compatible with an interpretation that cure requires action to undo breaches, since it is almost always more complicated and time-consuming to try to undo or compensate for past effects than simply to cease non-conforming conduct. By advancing the concept of "cure" that it has, the United States would have the Panel believe that the Parties intended that six months of quota overshipment could regularly be compensated for by restrictions on exports imposed for a 30 day period – a "cure" that would require nothing short of draconian border measures, even if it were possible. The U.S. proposed definition of "cure" simply does not fit within a 30-day box.

29. Finally, making future adjustments of export measures to compensate for past effects would have an erratic and distortive effect on market conditions, as is evident even in the economic report of the United States' own expert.[13] The United States agreed during the liability phase of this proceeding that the SLA was designed to have export measures follow market conditions, as evident from the fact that quotas and charges are most restrictive when U.S. prices are lowest, and less restrictive or non-existent when U.S. prices are higher. Requiring the application of a remedy to redress the consequences of a past breaching practice would result in changes in exports that are likely to be contrary to what is intended by the Agreement. The greater or lesser degree of restriction may occur at a time totally inappropriate to the market conditions at the time.

30. There is no comparable distortion if, as Canada contends, the compensatory adjustments authorized under paragraph 22(b) are properly interpreted to mean adjustments that compensate for the failure to comply with the SLA prospectively.

[13] Kalt/Reishus Report ¶ 38 (Ex. RR-2).

Compensation limited to offsetting the effect of continued non-compliance corrects the distortion caused by the continuation of the breach, without introducing a new distortion by limiting or allowing exports greater than otherwise contemplated by the SLA in the particular market conditions, as they may change. Thus, the requirement that any compensation take the form of adjustments to export measures, reinforces the conclusion that Article XIV does not authorize any compensation in these circumstances where the breach has been eliminated.

## B. THE STRUCTURE OF ARTICLE XIV OF THE SLA SHOWS THAT IT WAS MODELED AFTER THE PROSPECTIVE REMEDY DISPUTE SETTLEMENT SYSTEMS OF THE WTO AND NAFTA

31. Article 31(3) of the Vienna Convention provides that, together with the context, there shall be taken into account "any relevant rules of international law applicable in the relations between parties." International agreements can provide such relevant rules. In interpreting the SLA, a trade agreement between Canada and the United States, it is relevant to consider the WTO[14] and NAFTA,[15] the two most important international trade agreements to which both Canada and the United States are Parties.[16]

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[14] Understanding on Rules and Procedures Governing the Settlement of Disputes, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 2, Legal Instruments – Results of the Uruguay Round, 33 I.L.M. 1125 (1994) ("DSU") (RRA-10).

[15] North American Free Trade Agreement, Institutional Arrangements and Dispute Settlement Procedures, Dec. 17, 1992, 32 I.L.M. 693 (1993) ("NAFTA, Ch. 20") (RRA-7).

[16] Recent bilateral free trade agreements signed by the U.S. and Canada adopt the same prospective approach embodied in the WTO (and its precursor the GATT), and the NAFTA. For the U.S., *see, e.g.*, U.S.-Colombia Trade Promotion Agreement, U.S.-Colom., art. 21.17, Nov. 22, 2006, *available at* http://www.ustr.gov/Trade_Agreements/Bilateral/Colombia_FTA/Final_Text/Section_Index.html (Ex. RR-3); U.S.-Australia Free Trade Agreement, U.S.-Austl., art. 21.3, May 18, 2004, 43 I.L.M. 1248 (Ex. RR-4); U.S.-Chile Free Trade Agreement, U.S.-Chile, art. 22.17, June 6, 2003, 42 I.L.M. 1026 (Ex. RR-5). For Canada, *see, e.g.,* Canada-Israel Free Trade Agreement, Part Five, Chapter Eight (Jan. 1, 1997) *available at*

32. An examination of the dispute settlement provisions of those agreements demonstrates first that they are prospective systems, with very similar structures compatible with and supportive of prospective-only systems, and second that Article XIV of the SLA, not surprisingly, closely follows the structure of the WTO and NAFTA. That similarity provides additional strong confirmation of the prospective-only nature of the dispute settlement system of the SLA. We will examine these two points in turn.

33. Remedies provided under the WTO, and other trade agreements such as the NAFTA, have consistently been interpreted as being prospective only.[17] The WTO and NAFTA rules, in many senses, were an evolution from those of the General

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http://www.international.gc.ca/trade-agreements-accords-commerciaux/agr-acc/israel/index.aspx?lang=en (Ex. RR-6); Canada-Chile Free Trade Agreement, Part Four, Chapter N, Section II (Jul. 5, 1997) *available at* http://www.international.gc.ca/trade-agreements-accords-commerciaux/agr-acc/chile-chili/index.aspx?lang=en#01 (Ex. RR-7); Canada-Costa Rica Free Trade Agreement, Part Six, Chapter XIII, Section II (Nov. 1, 2002) *available at* http://www.international.gc.ca/trade-agreements-accords-commerciaux/agr-acc/costarica/Costa_Rica_toc.aspx?lang=en&menu_id=2&menu= (Ex. RR-8); Canada-European Free Trade Agreement, VIII (Jan. 26, 2008) *available at* http://www.international.gc.ca/trade-agreements-accords-commerciaux/agr-acc/efta-agr-acc.aspx?lang=en (Ex. RR-9); and Canada-Peru Free Trade Agreement, Chapter 21 (May 29, 2008) *available at* http://www.international.gc.ca/trade-agreements-accords-commerciaux/agr-acc/peru-perou/peru-perou-table.aspx (Ex. RR-10).

[17] *See, e.g.*, Report of the Panel, *India – Measures Affecting the Automotive Sector*, WT/DS/146/R (Dec. 21, 2001), at para. 6.57 ("The Panel has not sought, in its analysis, to determine the nature or modalities of remedies to be provided by India, beyond determining *whether* there was still a need to make a recommendation to the DSB in order to remedy an identified violation. What the Panel has sought to address in this section is what remains as of *today* of a measure found to be illegal. The Panel has said nothing of any *past* fulfillment of export obligations or of any need to compensate manufacturers for any such *past executions* of illegal obligations.") (emphasis in original) (RRA-6); Report of the Panel, *United States – Import Measures on Certain Products from the European Communities*, WT/DS165/AB/R (Jul. 17, 2000), at para. 6.106 ("The United States did not request retroactivity, and retroactive remedies are alien to the long established GATT/WTO practice where remedies have traditionally been prospective.") (RRA-12); Report of the Panel, *European Communities – Regime for the Importation, Sale and Distribution of Bananas, Recourse to Arbitration under Article 21.5 of the DSU by Ecuador,* WT/DS27/RW/ECU (May 6, 1999), at para. 6.105 ("In framing this issue for consideration, we do not imply that the European Communities is under an obligation to remedy past discrimination. Article 3.7 of the DSU provides that '… the first objective of the dispute settlement is usually to secure the withdrawal of the measures concerned if these are found to be inconsistent with the provisions of any of the covered agreements.' This principle requires compliance *ex nunc* as of the expiry of the reasonable period of time for compliance with the recommendations and rulings adopted by the DSB.") (RRA-2).

Agreement on Tariffs and Trade (GATT) 1947, whose provisions are now subsumed in the WTO through incorporation of the GATT 1994, which established the early practice that the objective of dispute resolution was withdrawal of offending measures and that compensation was appropriate, if at all, only for the purpose of obtaining withdrawal of the offending measure.[18] By way of example, in *Norway – Procurement of Toll Collection Equipment for the City of Trondheim* a GATT panel rejected a U.S. request for retrospective relief and issued a recommendation that Norway cease the offending practice and conform its procurement going forward.[19]

34. The prospective approach to the resolution of trade agreements under the GATT was adopted and enshrined in the World Trade Organization (WTO) Agreement. The terms of the WTO's Understanding on Dispute Settlement ("DSU") speak for themselves:

> In the absence of a mutually agreed solution, the first objective of the dispute settlement mechanism is usually to secure withdrawal of the measures concerned if these are found to be inconsistent with the provisions of the covered agreements. The provision of compensation should be resorted to only if the immediate withdrawal of the measure is

[18] Understanding Regarding Notification, Consultation, Dispute Settlement and Surveillance, 1/4907, Annex ¶ 4 (Nov. 28, 1979) ("The aim of the CONTRACTING PARTIES has always been to secure a positive solution to a dispute. . . . In the absence of a mutually agreed solution, the first objective of the CONTRACTING PARTIES is usually to secure the withdrawal of the measures concerned if these are found to be inconsistent with the General Agreement. The provision of compensation should be resorted to only if the immediate withdrawal of the measure is impracticable and as a temporary measure pending the withdrawal of the measures which are inconsistent with General Agreement.") (RRA-11).

[19] ¶ 4.21, GPR.DS2/R (May 13, 1992), ("Moreover, the Panel observed that, under the GATT, it was customary for panels to make findings regarding conformity with the General Agreement and to recommend that any measures found inconsistent with the General Agreement be terminated or brought into conformity from the time that the recommendation was adopted. The provision of compensation had been resorted to only if the immediate withdrawal of the measure was impracticable and as a temporary measure pending the withdrawal of the measures which were inconsistent with the General Agreement") (RRA-8).

> impracticable and as a temporary measure pending the withdrawal of the measure which is inconsistent with a covered agreement.[20]
>
> . . .
>
> Compensation and the suspension of concessions or other obligations are temporary measures available in the event the recommendations and rulings [of the dispute panel] are not implemented within a reasonable period of time. However, neither compensation nor the suspension of concessions or other obligations is preferred to full implementation of a recommendation to bring a measure into conformity with the covered agreements.[21]
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> . . .
>
> The suspension of concessions or other obligations shall be temporary and shall only be applied until such time as the measure found to be inconsistent with a covered agreement has been removed . . .".[22]

35. Unlike in commercial arbitration, or general international law, compensation under the WTO and other trade agreements, therefore, is not a payment to repair the damage or harm caused by the breaching action. Rather, it offers relief from the harm that the complaining party will suffer due to the defending party's failure to conform or withdraw the breaching action. There is no pretense of making a complaining party whole for past damages it or its constituents may have suffered as a consequence of the breaching conduct prior to the end of the reasonable period of time allowed for compliance. Remedies prescribed in NAFTA Chapter 20 cases have been prospective as well. Of the three cases brought pursuant to Chapter 20 that resulted in final panel reports, only two found a party to be in breach of its obligations under the NAFTA.[23] In both of these cases, the remedies were limited to the panels'

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[20] DSU, art. 3(7) (RRA-10).

[21] *Id*., art. 22(1).

[22] *Id*., art. 22(8).

[23] *See In the Matter of Tariffs Applied by Canada to Certain U.S.-Origin Agricultural Products*, CDA-95-2008-01, Final Report of the Panel (Dec. 2, 1996) (RRA-4); *In the Matter of the U.S. Safeguard Action Taken on Broom Corn Brooms from Mexico*, USA-97-2008-01, Final Report of

recommendations that the breaching party take appropriate steps to bring its conduct or practice into compliance with its obligations under the applicable provisions of the NAFTA.[24]

36. The relevant rules on the resolution of disputes under these agreements have a structure and terms that support the prospective-only nature of the dispute settlement system. These rules are set out in the DSU in the case of the World Trade Organization (WTO), and in Chapter 20 of the NAFTA.

37. In both systems, only governments can be parties to disputes. The DSU and NAFTA Chapter 20 begin with bilateral consultations to try to achieve a diplomatic solution, followed by examination of the Parties' respective legal argument by a neutral panel or tribunal which provides a reasoned decision to the Parties.[25] These and other phases of the dispute settlement process are subject to overall and internal time limits to promote prompt resolution of disputes, in recognition that relief, where warranted, comes only prospectively and at the end of the dispute settlement process.

38. Those elements of bilateral consultations and examination by a neutral panel or tribunal are not unique to trade agreements or even to prospective-only dispute settlement systems. What distinguishes prospective systems from those such as investor-state arbitrations under bilateral investment treaties or Chapter 11 of the NAFTA, besides the time limits and the fact that only governments are parties, is the

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the Panel (Jan. 30, 1998) ("*Broom Corn Brooms*") (RRA-5); and *In the Matter of Cross-Border Trucking Services*, USA-MEX-98-2008-01, Final Report of the Panel (Feb. 6, 2001) ("*Cross-Border Trucking*") (RRA-3).

[24] *See Broom Corn Brooms* ¶ 78 (RRA-5); *Cross-Border Trucking* ¶¶ 295-99 (RRA-3).

[25] *See* DSU, art. 4 (RRA-10); NAFTA, Ch. 20, art. 2006 (RRA-7).

remedial provisions that follow the award of the panel or Tribunal. Under prospective systems, in the event a breach is found, the breaching party is permitted a period of time (a "reasonable period of time" under the WTO and 30 days under the NAFTA) to bring the measure into conformity with the agreement (or withdraw the measures found to be in breach).[26] This generally means removal or non-implementation of the measure not conforming with the agreement.[27] If the breaching party fails to remove the offending measure, the claimant has the right to retaliate (in the form of suspension of equivalent concessions) to the degree that the violation continues.[28] The suspension of equivalent trade concessions or other benefits remains in effect until the parties have resolved the dispute.[29]

39. The suspension of concessions or benefits serves the purpose of addressing the harm caused by the continuing breach of the agreement (from the date of

[26] *See* DSU, art. 22 (RRA-10); NAFTA, Ch. 20, art. 2019 ("If in its final report a panel has determined that a measure is inconsistent with the obligations of this Agreement or causes nullification or impairment in the sense of Annex 2004 and the Party complained against has not reached agreement with any complaining Party on a mutually satisfactory resolution pursuant to Art. 2018(1) within 30 days of receiving the final report, such complaining Party may suspend the application to the Party complained against of benefits of equivalent effect until such time as they have reached agreement on a resolution of the dispute.") (RRA-7).

[27] *See* DSU, art. 3(7) ("In the absence of a mutually agreed solution, the first objective of the dispute settlement mechanism is usually to secure the withdrawal of the measures concerned if these are found to be inconsistent with the provisions of any of the covered agreements. The provision of compensation should be resorted to only if the immediate withdrawal of the measure is impracticable and as a temporary measure pending the withdrawal of the measure which is inconsistent with a covered agreement") (RRA-10); NAFTA, Ch. 20, art. 2018 ("[w]henever possible, the resolution shall be non-implementation or removal of a measure not conforming with this Agreement . . . or, failing such a resolution, compensation." (RRA-7).

[28] *See* DSU, art. 22(4) ("The level of the suspension of concessions or other obligations authorized by the DSB [Dispute Settlement Body] shall be equivalent to the level of nullification or impairment.") (RRA-10); NAFTA, Ch. 20, art. 2019 (RRA-7).

[29] *See* DSU, art. 22(4) (RRA-10); NAFTA, Ch. 20, art. 2019(1) ("…such complaining Party may suspend the application to the Party complained against of benefits of equivalent effect until such time as they have reached agreement on a resolution of the dispute.") (RRA-7).

expiration of the reasonable period of time forward), rather than as compensation for the past breach, and is allowed only so long as the party continues not to comply with the obligation at issue.[30] The DSU and the NAFTA also permit a form of compensation as an alternative to compliance or retaliation, but this compensation is generally the offer by the defending party to provide more beneficial treatment of some other product, which is supposed to offer a trade benefit to the complaining party equivalent in degree to the ongoing harmful consequence of the breaching conduct that the defending Party has been unwilling or unable to cure.[31] Again, compensation is considered only temporary, pending removal or withdrawal of the breaching action or measure.

40. The dispute settlement mechanism under the SLA tracks closely the structure and process of the DSU and NAFTA Chapter 20. The SLA process also begins with consultations between the Parties, following which either Party can request arbitration.[32] In the event that the Tribunal finds that a Party has breached the Agreement, that Party is required to "cure the breach" within a reasonable period of time, and in no event longer than 30 days. Should the defending Party fail to cure the breach, the complaining Party may impose compensatory measures in the form of adjustments

[30] *See* DSU, art. 22(8) ("The suspension of concessions or other obligations shall be temporary and shall only be applied until such time as the measure found to be inconsistent with a covered agreement has been removed, or the Member that must implement recommendations or rulings provides a solution to the nullification or impairment of benefits, or a mutually satisfactory solution is reached.") (RRA-10); NAFTA, Ch. 20, art. 2019(1) ("…until such time as they have reached agreement on a resolution of the dispute") (RRA-7).

[31] *See* DSU, art. 22(1) ("Compensation and the suspension of concessions or other obligations are temporary measures available in the event that the recommendations and rulings are not implemented with a reasonable period of time. However, neither compensation nor the suspension of concessions or other obligations is preferred to full implementation of a recommendation to bring a measure into conformity with the covered agreements. Compensation is voluntary and, if granted, shall be consistent with the covered agreements.") (RRA-10).

[32] *See* SLA 2006 Art. XIV(4) (Ex. RR-1); DSU, art. 4 (RRA-10); NAFTA, Ch. 20, art. 2006 (RRA-7).

to volume restraints and/or export charges. Paragraph 24 of Article XIV provides that these measures may be "applied from the end of the reasonable period of time until the Party Complained Against cures the breach." As in the case of the WTO, NAFTA Chapter 20 and other bilateral agreements, the compensatory measures serve the purpose of addressing the harm caused by the continuing breach and remain in place only until the breach is cured.

41. The structure of the dispute settlement provisions under these trade agreements, including Article XIV of the SLA, therefore, make clear that the objective of dispute settlement under them is preserving future trading opportunities, not redressing past injuries or making the prevailing party whole.[33] The agreements call for a timely elimination or bringing into conformity of the breaching measure, and provide for "compensation" only as an alternative temporary remedy to offset the imbalance created by continued non-compliance.

42. There is a further point of similarity between the SLA and the WTO and NAFTA Chapter 20. Because only sovereigns can be parties to the dispute settlement proceedings, this means that disputes arising under these international trade agreements involve breaches resulting from government, not private, actions. Although the government actions at issue may have an effect on private companies, these companies are not parties to the arbitration. As a result, the arbitrators are not in a position to determine with confidence whether private parties have suffered damages, or if government conduct may be the proximate cause of any such damage. State-to-state arbitration proceedings under trade agreements like the SLA are not designed to put the

[33] *See, e.g.*, DSU, art. 3(2) ("The dispute settlement system of the WTO is a central element in providing security and predictability to the multilateral trading system.") (RRA-10).

arbitrators in a position to assess the existence of damages specific to a company or industry, or proximate causation. These critical features for the adjudication of contractual or investment disputes are not operative in international trade arbitration.[34]

## C. NEGOTIATING HISTORY CONFIRMS CANADA'S INTERPRETATION THAT THE SLA PROVIDES A PROSPECTIVE REMEDY

43. The application of Article 31 of the Vienna Convention supports Canada's interpretation of Article XIV(22), without recourse to supplementary means of interpretation. Nonetheless, the negotiating history of Article XIV provides insight into the U.S. understanding of the meaning of "cure the breach." It also indicates that the concept of retroactive application of remedies was not raised at any time by either Party, except in the context of negotiating the provisions related to Tribunal review of remedial measures.

44. The United States tabled its first full draft of the Agreement on May 24, 2006.[35] Article IX(I) of that draft provided:

> If in its award the tribunal finds that a Party has breached an obligation under this Agreement, the tribunal shall make a separate finding of compensatory measures the complaining Party may take until the breach is *eliminated* (emphasis added).

45. The draft is telling for two reasons. First, it indicates a recognition by the United States of a distinction between the act of eliminating the breach and the compensatory measures to be taken until the breach is eliminated. Second, it uses the

[34] In an investor-state arbitration under a bilateral investment treaty, a tribunal does determine whether there has been a breach of a treaty by the respondent government, and, if so, the consequences of that breach for the investor claimant. However, the investor claimant is arguing only for its own damages, and is a party whose claims can be fully tested in the proceeding.

[35] SLA U.S. Text Draft (May 24, 2006) (Ex. RR-11).

word “eliminate” to describe the action to be taken by the defendant party to address the breach. The Shorter Oxford English Dictionary defines “eliminate” as “remove; get rid of; do away with; cause to exist no longer.”[36] “Eliminate” consistently is defined using the same word – “remove” – that is the common meaning ascribed to the word “cure” in the dictionary definitions discussed above. “Eliminate” as used by the United States in this context therefore must be viewed as having had the same meaning as “cure.” The United States thus could not have contemplated that the “cure” called for in paragraph 22 went beyond removal of the offending measure or breaching action – and most certainly could not have contemplated that it would compensate for the harm caused by the breach, as it is now claiming.

46. Each text tabled by the United States from May 24, 2006 until June 12, 2006 contained the same phrase “until the breach is eliminated” to indicate the time up until when the complaining Party could apply compensatory measures.[37] None of the texts contained language that could in any way be interpreted as proposing remedies that go beyond (1) removal of the offending measure when a breach is found, and (2) application of compensatory adjustments, on a prospective basis, from the date that the reasonable period of time expires until the date that the breaching conduct has ceased.[38]

47. Canada, in the draft texts which it tabled in the same period of time, used the phrase “cure the breach” to describe the action that had to be taken by the defendant

[36] Shorter Oxford English Dictionary 812 (6th ed. 2007) (Ex. RR-12).

[37] *See, e.g.*, SLA U.S. Merged Text, 6:00 p.m. (June 3, 2006) (Ex RR-13); SLA U.S. and CDA Merged Text, 10:45 a.m. (June 5, 2006) (Ex. RR-14); SLA U.S. Merged Text, 8:00 p.m. (June 8, 2006) (Ex. RR-15).

[38] On June 12, 2006, the United States exchanged a text that adopted Canada’s version of paragraph 29 (which eventually became paragraph 22) and Canada’s use of the word “cure.” SLA U.S. Text Draft (June 12, 2006) (Ex. RR-16).

party to address the breach.[39] Canada borrowed the phrase from the SLA 1996, the Softwood Lumber Agreement that had been concluded between the Parties 10 years earlier.[40] By the end of June, the Parties were using the two phrases – "cure the breach" and "eliminate the breach" – interchangeably.[41] By mid-July, the Parties had moved exclusively to the phrase "cure the breach." The texts that were exchanged during the legal review of the agreement in July suggest that this was done to make the terminology consistent throughout the dispute settlement article.[42]

48. Of particular note is the fact that neither Party during this period proposed language regarding retroactive effect, or even considered the concept of "retroactivity" in relation to the Tribunal's original award respecting breach. This stands in contrast to a different situation where the concept of "retroactivity" was raised – and was provided for explicitly – in the context of the Tribunal's review of remedial measures imposed by a

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[39] *See, e.g.*, SLA Canada Text Draft, 5:00 p.m. (May 24, 2006) (Ex. RR-17); SLA U.S. and CDA Merged Version, 8:20 p.m. (June 4, 2006) (Ex. RR-18); SLA Merged Text Draft, 6:00 p.m. (June 6, 2006) (Ex. RR-19).

[40] The Parties understandably drew from the provisions of the former agreement, where possible, at the outset of negotiations and when texts were initially being prepared. This is confirmed by the texts themselves. Paragraphs 20 and 21 of Art. V SLA 1996 – the article dealing with dispute resolution – provided that if the arbitral panel found that either Canada or the United States had breached the agreement and that the breach had not been *"cured",* the complaining Party could suspend its obligations under the agreement (Ex. RR-20). Canada is not aware of any negotiating history related to the dispute settlement provisions of the SLA 1996. The one arbitral panel decision under the SLA 1996 – Report of the Panel, Canada-United States Softwood Lumber Agreement, In the Matter of the U.S. Customs Services Revocation of Ruling Letters Relating to the Tariff Classification of Drilled Studs and Notched Lumber on July 1, 1998 and June 9,1999 respectively (Mar. 29, 2001) – did not address the issue of what constituted a "cure" (RRA-1).

[41] For example, paragraph 21(a) of the merged June 26 text, agreed upon by both Parties, required the Tribunal, upon finding that a Party had breached an obligation under the Agreement, to "identify a reasonable period of time for that Party to *cure* the breach" (emphasis added). Paragraph 25(c) of that same text provided an opportunity to the defending Party to initiate a new arbitration if it considered that the breach had been "*eliminated,* in whole or in part, such that the compensatory adjustments or measures should be modified or terminated" (emphasis added). SLA Canada Text Draft (June 26, 2006) (Ex. RR-21).

[42] SLA Revised Scrub with U.S. (July 17, 2006) (Ex. RR-22).

Party for consistency of those measures with the original award (this is the review provided for in paragraphs 29 through 32 of Article XIV), discussed above in section A.[43]

## D. RESPONSE TO U.S. ARGUMENTS

### 1. CANADA HAS CURED THE BREACH BY STOPPING THE BREACHING PRACTICE

49. As noted previously, the United States provides virtually no explanation for its assumption that ceasing the breaching conduct is not sufficient to "cure the breach." It offers two summary explanations for its interpretation. First, it argues that Canada could not be considered to have cured the breach merely by stopping the practice, because that would mean that Canada had suffered no consequences from its breach.

50. Canada acknowledges that an aspect of prospective systems such as those of the SLA and the WTO and NAFTA is that member countries are not held to account for past violations, and prompt compliance will mean that there is no retaliation or compensation. There have been cases in the WTO, in which, as in the present SLA dispute, the breaching conduct was terminated even before the final decision against the defending party.[44] In such cases, as here, there were no consequences following the

[43] Canada, on June 26, 2006, tabled a dispute settlement text that proposed the addition of two paragraphs relating to the application of the award to be issued by the Tribunal in the event that it found that the remedial measures imposed by a complaining Party following failure of the defending Party to cure the breach were inconsistent with the Tribunal's original award. SLA Canada Text Draft (June 26, 2006) (Ex. RR-21). They contained language that made application of the Tribunal's award retroactive to the date the compensatory adjustments were imposed. In a covering e-mail Canada explained that it was proposing the language "to respond to concerns regarding the self-adjudicating nature of compensatory adjustments/measures under paragraphs 23 and 24 [current paragraphs 26 and 27]." Email from Matthew Kronby to Jeff Weiss (June 26, 2006) (Ex. RR-23). The U.S. acceptance of this proposed language is reflected in the merged text of June 27, 2006. SLA Merged Text Draft (June 27, 2006) (Ex. RR-24).

[44] *See, e.g.*, Report of the Panel, *United States – Prohibition of Imports of Tuna and Tuna Products from Canada*, L/5198-29S/91 (Feb. 22, 1982) (RRA-13). In that case, Canada

award, because the non-conforming conduct had ceased. The United States implies that a prospective system is open to abuse, but the central agreements that address both U.S. and Canadian international trade operations set forth good faith as the cardinal principle. Canada also notes that in this particular proceeding the Tribunal recorded that Canada's "arguments were manifestly advanced in good faith and, moreover, were not devoid of merit."[45]

### 2. THE DRAFT ARTICLES ON THE RESPONSIBILITY OF STATES FOR INTERNATIONALLY WRONGFUL ACTS (2001) AND THE CHORZÓW CASE ARE NOT APPLICABLE BECAUSE ARTICLE XIV CONSTITUTES LEX SPECIALIS

51. The United States also suggests that the International Law Commission's Draft Articles on the Responsibility of States for Internationally Wrongful Acts (2001) ("ILC Articles") are binding rules of international law applicable to this current dispute under the SLA 2006.[46] Contrary to the U.S. suggestion, the ILC Articles are not applicable to this arbitration because Article XIV of the SLA, in general, and paragraph XIV(22), in particular, clearly establish a *lex specialis* regime for dispute resolution under the SLA. These rules replace the more general rules of remedy with a "prospective" remedy regime.

52. The maxim of *lex specialis derogat legi generali* suggests that where two parties have agreed to specific principles to govern a certain relationship, these should prevail over other more general international obligations. Article 55 of the ILC Articles

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challenged a U.S. ban on imports of Canadian tuna. The United States lifted the ban while the case was being argued. The arguments were concluded and the Panel ruled against the United States. However, the measure having been terminated, there were no issues of compensation or retaliation.

[45] Award on Liability ¶ 196.

[46] Stmt. of Case ¶ 31, n.9.

and the Commentaries indicate that the articles are secondary obligations, applicable only in the absence of *lex specialis*.[47] State responsibility acts as a "residual law" or a "law of the gaps."[48] Thus, where, as here, the parties have agreed to *lex specialis* as they have in the dispute resolution mechanism contained in Article XIV, including specific rules concerning the remedies for breach, the more general "rules" on State responsibility are inapplicable.

53. The Commentary to Article 55 of the ILC Articles explains that, where it is clear from the language of a treaty that only the consequences specified are to flow, such consequences will be determined by the special rule, and not by the ILC Articles.[49] The Commentary further cites to Article 3(7) of the DSU of the WTO as an example of this kind of special rule.[50] Article 3(7) of the WTO DSU provides for compensation ". . . only if the immediate withdrawal of the measure is impractical and as a temporary measure pending the withdrawal of the measure which is inconsistent with a covered

[47] Responsibility of States for Internationally Wrongful Acts, U.N.GAOR, International Law Commission, 53d Sess., pt. IV, Art. 55, U.N. Doc. A/56/49(vol.1/Corr.4 (2001) ("[t]hese articles do not apply where and to the extent that the conditions for the existence of an internationally wrongful act or the content or implementation of the international responsibility of a State are governed by special rules of international law.) (RRA-9).

[48] Bishop, Crawford and Reisman, Foreign Investment Disputes: Cases, Materials and Commentary 797 (Kluwer Law International 2005) ("where a specific obligation deals with framework issues (*e.g.*, with the scope of reparation to be made for a breach), it excludes the general framework. The secondary law of state responsibility is thus a residual law, a law of the gaps.") (Ex. RR-25).

[49] James Crawford, The International Law Commission's Articles on State Responsibility: Introduction, Text and Commentary 307 (Cambridge University Press 2002) (Ex. RR-26).

[50] *Id.*, n.863 (Ex. RR-26).

agreement."[51] The Commentary notes that, ". . .[f]or WTO purposes, 'compensation' refers to the future conduct, not past conduct . . ."[52]

54. Again, the SLA contains specific provisions concerning the remedies for breach. There is therefore no need for the "gap filling measures" of the ILC Articles. Under any interpretation, XIV of the SLA, in general, and paragraph XIV(22), in particular, are *lex specialis* for the Parties to the SLA 2006.

55. Paragraph 59 of the U.S. Statement of Case also relies on the *Chorzów Factory* case.[53] The principle of reparation articulated in *Chorzów* and codified by Article 31 of the ILC Articles is not applicable, as demonstrated above, to international trade agreements like the SLA, the WTO or NAFTA, which all include rules relating to remedies for breach. In *Chorzów* the PCIJ was forced to rely on the general rule that "the breach of an engagement involves the obligation to make reparation in adequate form," to fill a gap in the treaty at issue.

56. But *Chorzów* is inapposite to this case for at least one additional reason: the facts.[54] *Chorzów* is about the expropriation of a German investor's factory by Poland in Upper Silesia after World War I. Under a treaty with Germany, Poland was permitted to seize German state companies in its territory, but was not permitted to occupy private interests. The German government had sold the Chorzów factory to a private company before its seizure by Poland in 1922. Poland operated the Chorzów factory until 1928,

[51] DSU, art. 3(7) (RRA-10).

[52] *Id.*

[53] *Case Concerning the Factory at Chorzów* (Merits) (Germ. v. Pol.), 1928 P.C.I.J. 47 (ser. A) No. 17 (Sept. 13) (CR-8).

[54] It is telling that the U.S. has not cited to any trade case that has relied on Chorzów factory.

the year of the award. At the time that the case was settled, the Permanent Court of International Justice (PCIJ) was working with experts to determine the fair market value of the expropriated factory. The PCIJ heard evidence relating to the damage allegedly suffered by the expropriated company and investigated what portion of the damage, if any, was attributable to the conduct of the investor. In the instant matter the dispute is between two States, it concerns cross-border trade in goods, and it arises from a trade agreement that is not designed for either party to receive an award for damages if it prevails in arbitration proceedings.

57. In summary, had Canada not already begun calculating expected U.S. consumption pursuant to paragraph 14 of Annex 7D, the task of the Tribunal would now be to identify a reasonable period of time for Canada to do so. Were Canada to fail to do so within that reasonable period of time, compensatory measures pursuant to Article XIV(22)(b) would be at issue. Because Canada has correctly calculated EUSC for Option B regions consistently since July 2007, however, there is no need to identify a reasonable period of time to cure, nor may compensatory adjustments be authorized.

## PART II. THE UNITED STATES WOULD BE WRONG EVEN IF THE SLA PROVIDED A REMEDY FOR PAST BREACHES

### A. CANADA'S REDUCED EXPORTS IN THE SECOND HALF OF 2007 MORE THAN OFFSET EXCESS EXPORTS DURING THE FIRST HALF OF 2007

58. Even if the Tribunal agrees with the United States' interpretation of Article XIV(22), no compensatory adjustments would be warranted because actual Canadian exports to the United States from Option B regions in the second half of 2007 fell far below authorized levels under the SLA 2006. This "shortfall" in actual shipments compared to allowable shipments in the second half of 2007 was greater than the amount by which actual exports from Option B regions to the United States in the first

half of 2007 exceeded the correctly adjusted level permitted for that period if there had been no breach. By the end of 2007, each Option B region's cumulative allowable Regional Quota Volumes ("RQVs") exceeded their exports by more than the difference between the re-calculated RQV's and actual exports during the first six months of 2007. In these circumstances, even if Article XIV(22) of the SLA called for compensatory adjustments to offset prior excesses, that offset has already been achieved and no further action would be warranted.

59. The amount of excess exports in the first half of 2007 is far less than the 180 million board feet advanced by the United States.[55] The reason that the United States overstates the amount of excess exports resulting from the breach is that it did not account for available "carry forward" and "carry back" of monthly RQV, as provided for under Annex 7B of the Agreement. That Annex provides that an Option B region may "carry back" (or borrow) from the next month, and "carry forward" to the next month unused quota volume equal to 12% of its monthly quota volume.[56] A region may increase its calculated monthly quota volume by a maximum of 12% through the carry forward and carry back mechanisms. If these carry forward and carry back provisions are taken into account, and if data is used that was contemporaneously available in 2007, the excess level of exports resulting from Canada's belief that the adjustment did

[55] Stmt. of Case ¶ 20.

[56] Dr. Neuberger admits that he did not account for carry-forward and carry back in his calculation of the difference between actual exports and the Regional Quota Volumes, calculated using adjusted EUSC. Neuberger Report ¶ 31, n.16 (Ex. CR-3). After adjusting for carry-forward and carry-back amounts, the data that Dr. Neuberger used to calculate Regional Quota Volumes yield a difference between actual shipments and maximum Regional Quota Volumes of approximately 106 million board feet. However, as Professor Kalt and Dr. Reishus observe, Dr. Neuberger did not rely on data contemporaneously available when the Regional Quota Volumes were calculated, but instead relied on later revised data. If 2007 data are used, and carry-forward and carry-back amounts are properly accounted for, the figure is approximately 142 million board feet. Kalt/Reishus Report ¶¶ 29-30 (Ex. RR-2).

not apply in the first half of 2007 was for Saskatchewan 0,[57] for Manitoba 0.2 mmbf, for Ontario 93 mmbf and for Quebec 49 mmbf; for a cumulative Option B region total of 142 mmbf.[58] As a percentage of the re-calculated RQVs for the first six months of 2007, these quantities amounted to only 0.09 percent of Manitoba's RQVs, 4.2 percent of Quebec's RQVs, and 9.9 percent of Ontario's RQVs, or 1.3 percent of total Canadian exports of lumber to the United States.

## B. THE UNITED STATES PROPOSALS REFLECT A VARIETY OF MIXED OBJECTIVES AND UNPREDICTABLE EFFECTS

60. In the Statement of Case, the United States has changed position since it filed its Request for Arbitration on August 13, 2007. Paragraph 61(d) of that Request set forth the U.S. proposed specific remedy regarding Option B regions, and asked the Tribunal to render an award "Ordering Canada, with respect to Option B regions, to make additional downward adjustments to quota volumes (or maximum volumes) in future months in an amount equal to the amount by which shipments from Option B regions exceeded their properly calculated quota volumes (or maximum volumes) for January through June 2007."

61. The United States now argues that a commensurate reduction in allowable quota is not a satisfactory remedy, because it will not address the "consequences" of the "disruption" of the SLA's operation caused by an increase in

[57] It is undisputed that Saskatchewan did not have excess shipments due to the unadjusted EUSCs during the first six months of 2007. Recognizing this fact, the United States concedes that "the Tribunal may find it reasonable to exclude Saskatchewan from the calculation." U.S. Stmt. of Case ¶ 51. As such, Saskatchewan should not be subject to any compensatory measures, even if they were authorized by the SLA.

[58] The monthly data and calculations used to derive the difference between actual exports and maximum regional quota values re-calculated to reflect adjusted EUSC during the first six months of 2007 is included in the Kalt/Reishus Report ¶ 30 and figure 3 (Ex. RR-2).

volume of shipments.[59] The United States contends such a quota reduction could constitute "no remedy at all" in some market conditions, ignoring that such a reduction was in fact the precise relief originally requested by the United States in its Request for Arbitration. At that time, the United States evidently did not see in the Agreement the authority to take most of the actions it now proposes.

62. Even if Article XIV(22) were construed somehow to authorize remedies for past breaches, the United States is plainly wrong that anything about the Agreement would require that such a remedy have a particular market effect. On the contrary, in the only situation in which Article XIV actually does provide for action to deal retroactively with export (or import) measures applied at an unjustified level (the remedial measures review under paragraphs 26 through 32 of Article XIV), a simple one-for-one offset is provided for that applies regardless of its effect on the market and regardless of whether the original unjustified action under paragraph 26 or 27 had any particular market effect or caused any harm or benefit.

63. The United States seeks support for its claim that any remedy must have a compensatory effect in the Tribunal's Award with respect to liability. It asserts that the Tribunal characterized the volume of exports of lumber as an "economic effect" of the SLA and that the object and purpose of the SLA is to address economic effects.[60] This Tribunal best knows what it meant by its own words, but Canada understood the Tribunal's statement to concern the identification of the appropriate starting date for quota calculation methodologies provided for under paragraph 14 of Annex 7D.[61] The

[59] Stmt. of Case ¶¶ 13, 33.

[60] Stmt. of Case ¶ 42.

[61] Award on Liability ¶ 185.

Tribunal did not say that it was construing the provisions of Article XIV, nor addressing anything remotely related to the U.S. argument that a remedy under the SLA 2006 should take consequential effects of imports into account.

64. Ignoring its past positions and the provisions of the SLA, the United States proposes four "remedies" in its Statement of Case that it claims "monetize the effects of Canada's breach" and "restrict meaningfully the volume of lumber exports to the United States."[62] These remedies are in addition to the remedy requested by the United States for Option B regions in the Request for Arbitration.

65. Unable to point to any support for such remedies in the text of the Agreement, the United States offers an expert's report to argue that economics dictate that any remedy must have such an effect. The report provides no basis for the U.S. claim: it is not based on economic analysis, quantitative or theoretical. Rather, it simply presumes a requirement of "compensatory effect" and offers four proposals that allegedly have this effect. None of the proposed remedies offered by Dr. Neuberger have the effect claimed or achieve the objective identified. There is no connection in any of the proposals between the proposed remedy, the stated objective and the assumed effect, much less the text of the SLA. They only impose excessive penalties on Canadian lumber producers.

66. The United States argues that "[a]s a matter of economics, appropriate remedies should compensate for the breach" and cites to Dr. Neuberger's report in support of this statement.[63] Professor Kalt and Dr. Reishus point out in the attached

[62] Stmt. of Case ¶ 16.

[63] Neuberger Report ¶ 16 (Ex. CR-3).

expert report, however, that the United States does not identify an economically coherent "harm to the U.S."[64] Indeed, to the contrary, Professor Kalt and Dr. Reishus show that under accepted economic analysis, the additional exports during the first half of 2007 did not result in economic harm to the United States – there was no reduction in U.S. national economic welfare.

67. The United States further argues that the remedies it proposes are intended to attain an economic effect equivalent to the effect of the "excess" exports shipped.[65] But the United States fails to identify, and the SLA does not provide an economic factor or variable that should be targeted to achieve this effect. Rather, the United States floats a variety of objectives that it claims the proposed remedies are intended to achieve, including: reducing the volume of lumber exports;[66] restoring the United States to the position it would have occupied absent the breach;[67] undoing the benefits it asserts that Canadian producers gained;[68] and offsetting the effect on the U.S. price of lumber.[69]

68. As Professor Kalt and Dr. Reishus explain, to the extent that the miscalculation of RQVs might have some possible effect on market outcomes, it would have an effect on many economic variables – U.S. lumber prices, U.S. consumption, U.S. production, U.S. shipments, U.S. exports, profits and employment of U.S.

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[64] Kalt/Reishus Report ¶ 38 (Ex. RR-2).

[65] Stmt. of Case ¶ 42.

[66] Stmt. of Case ¶ 12.

[67] Stmt. of Case ¶ 44.

[68] Stmt. of Case ¶ 49.

[69] Stmt. of Case ¶ 53.

producers, Canadian lumber prices, Canadian lumber consumption, Canadian lumber production, Canadian shipments, Canadian exports, and profits and employment of Canadian producers.[70]

69. Conditions in the North American lumber market have changed dramatically since the first half of 2007.[71] Consequently, any change in export measures will affect these various market attributes differently. If a proposed remedy is designed to have a predetermined effect on one of these economic variables (e. g., Canadian lumber prices or export volumes), the remedy will induce disproportionate effects on one or more of the other relevant economic variables (e.g., Canadian producer profits or U.S. lumber prices). The United States does not identify the economic purpose of the proposed remedies and provides no justification for targeting one measure of the economic effect of Canada's breach, because no provision of the SLA calls for retroactive remedies, let alone remedies targeting any particular economic effect.

70. While the United States is unclear about the intended effect of its proposed remedies, its hierarchy prefers remedies with the most draconian effect on Canadian producers. The U.S. contends that the Tribunal should (in descending order of preference) require Canada: (1) to collect an additional tax on the Option B regions in an amount equal to the extra tax those regions would have paid if they were Option A regions (based on the bare assertion that the failure to make the adjustment means that Option B regions were treated as if they were Option A regions); (2) an extra tax designed to have the same positive effect on prices in the U.S. market as the negative effect that the U.S.' economic expert asserts resulted from the "overshipments" in the

[70] Kalt/Reishus Report ¶ 7 (Ex. RR-2).

[71] Kalt/Reishus Report ¶ 8 (Ex. RR-2).

first six months of 2007; (3) a quota adjustment that would "off the top" drastically reduce future permitted quota levels to correspond to predicted shipments under depressed market conditions, then further reduce the quota by an amount equal to the "overshipments" in the first six months of 2007; or least preferred the United States, (4), a downward adjustment to future Expected U.S. Consumption (upon which RQVs are based) by the amount that Expected U.S. Consumption was miscalculated during the first half of 2007.

### 1. U.S. PROPOSAL NO. 1

71. The first U.S. proposal is that Option B regions that "overshipped" be subjected to the higher tax rate of Option A regions because, in the U.S. view, the Option B regions were effectively operating without a volume restraint – that is, like Option A regions. The United States would have the Tribunal impose an additional export tax of 10 percent on exports from Option B regions, until Canada collected an amount of additional export charges equal to 10 percent of the total value of exports during the first half of 2007. The United States posits that this drastic increase in export taxes will "encourage Canada to restrict volume" to offset the benefits Option B regions received by overshipping a certain volume of lumber, erroneously estimated by the United States at 180 mmbf.[72] As the Kalt/Reishus Report observes, the proposal has no economic underpinnings but is instead based solely on a bare assertion that the higher Option A export tax should apply to Option B regions whenever Option B regions have exceeded permissible export levels.[73]

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[72] Stmt. of Case ¶ 20. The Neuberger Report, the source of the 180 mmbf figure, incorrectly calculated the export overshipment. The correct figure is 142 mmbf. *See* n.59 above.

[73] Kalt/Reishus Report ¶¶ 61-62 (Ex. RR-2).

72. Canada notes that the premise of the U.S. proposal – that Option B regions operated as if they were not subject to a quota for the first half of 2007 – is false. As the United States itself acknowledges, the quota amount available for the first half of 2007 at the RQV was established in accordance with unadjusted Expected U.S. Consumption and constrained shipments from Option B regions.[74] For most of the first half of 2007, exports were capped by the quota amounts, i.e., the RQVs were binding in an economic sense.

73. The additional export charge proposed by the United States, however, does not depend on how large the RQV error was or how much lumber was exported beyond corrected RQVs. Under the preferred U.S. remedy proposal, one board foot of lumber shipped above corrected RQV results in the same penalty as 200 million board feet above the corrected RQV. The size of the proposed monetary penalty is arbitrary relative to the magnitude of any benefit purportedly garnered by Canadian lumber producers and exporters.

74. The proposed additional export taxes are not related in any way to the U.S. claimed objective of compensating for the economic effects of the breach, even in the variety of ways the U.S. has interpreted that concept.

75. The Kalt/Reishus Report makes clear that the additional tax is the equivalent of a lump sum tax.[75] When viewed from the perspective of the Option B region as a whole or from an individual lumber exporter's perspective, payment of the total fixed amount of tax (or a particular producer's share) is fundamentally unavoidable.

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[74] *See* Stmt. of Case ¶ 60.

[75] Kalt/Reishus Report ¶¶ 16-18 (Ex. RR-2).

Unless the exporter can affect the total tax payment through its actions, a tax will have no incentive effect on its decisions, and will not alter behavior. The only way for the region (or producer) to avoid paying the tax would be to discontinue exporting lumber to the United States – which would put these producers out of business altogether. Thus, payment of the entire amount of the tax, just as if it were a lump sum tax, is the only behavior which can be expected.

76. This U.S. proposal would not be any more justified, legally or economically, if it achieved the apparently dual goals of the United States: to impose a punitive tax and to make sure that the tax limits exports to the United States. Neither objective is justified under the SLA, and the fact that only one bad objective might be achieved does not rescue this proposal, or provide a basis for the Tribunal to impose such a punitive award where none is authorized or justified. As Professor Kalt and Dr. Reishus conclude, "the primary effect of these proposals is not to compensate the U.S. for harm or change future market outcomes to somehow make up for past errors, but rather to extract a penalty from Option B region exporters (for an economic benefit never obtained) through payments to the Canadian government."[76]

### 2. U.S. PROPOSAL NO. 2

77. The second U.S. proposal attempts to approximate an increase in export tax to reverse the purported price effect on the U.S. lumber price allegedly caused by Canadian exports above adjusted RQVs during the first six months of 2007. The stated economic objectives of this U.S. remedy proposal range from an attempt to "capture the

[76] Kalt/Reishus Report ¶ 52 (Ex. RR-2).

economic effects by simulating the impact on U.S. lumber prices"[77] to placing "the United States in the position it would have occupied absent the breach."[78] Dr. Neuberger suggests that his economic model simulation is intended to "translate" past price effects into increased export taxes to approximate price effects in undetermined future economic conditions.[79] The simulation is based largely on subjectively assigned economic parameters regarding the operation of the lumber market(s) in North America.[80] Like the initial U.S. remedy proposal, this tax-based remedy suffers from similar fundamental problems.

78. Like the other proposals, this proposal has no legal or economic underpinnings and does not achieve the objectives identified or the effect claimed. As Professor Kalt and Dr. Reishus explain, this "approach does not attempt to identify the economic harm to the U.S. or the benefit (if any) obtained by Option B region exporters from the past EUSC miscalculation; it cannot reliably and proportionately make up for the past market effect of any past overage; it does not provide a meaningful or reliable incentive to reduce future exports (i.e., it is either a lump-sum penalty or a temporary tax on Option B exporters); and serves only to punish future Option B exporters in amounts unrelated to any relevant economic measurement of harm to the U.S. or past benefit to Option B region exporters."[81]

[77] Neuberger Report ¶ 23 (Ex. CR-3).

[78] Stmt. of Case ¶ 26.

[79] Neuberger Report ¶ 61 (Ex. CR-3).

[80] Neuberger Report ¶ 58 (Ex. CR-3).

[81] Kalt/Reishus Report ¶ 60 (Ex. RR-2).

79. The results of Dr. Neuberger's economic simulation depend crucially on assumed values of the economic parameters on which the model is built, including the price elasticities of U.S. supply, Canadian supply, U.S. demand and Canadian demand. Economic experts have claimed a broad range of values for these elasticities. If intermediate values from the sources relied upon by Dr. Neuberger are used, rather than the extreme values chosen by Neuberger, the estimated additional export tax would be reduced by 75 percent.[82]

80. Dr. Neuberger himself concedes applying a $40 additional export tax on a going forward basis will not proportionately make up for the effect of the excess exports in the first half of 2007.[83] Much like the first U.S. proposal, the second proposal bears no reasonable relationship to any conceivable benefit the Canadian industry could have accrued from shipping additional exports to the United States during the first half of 2007. An additional export tax of $40/mbf on a volume of exports equal to all lumber exported to the United States by the Option B provinces during first half of 2007[84] would amount to approximately US$87 million in tax (plus interest) to be paid by the Option B provinces.[85] The purported "benefit" of the incorrect RQV calculation to Canadian producers was, at maximum, the export of approximately 142 million board feet of lumber (*i.e.*, 142 mmbf, or 142,000 mbf).

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[82] *See* Kalt/Reishus Report ¶ 64(iii) (Ex. RR-2).

[83] *See* Neuberger Report ¶ 62 (Ex. CR-3).

[84] Neuberger considers the alternative of dropping those provinces and months for which exports were less than corrected RQV, but this change makes no significant difference.

[85] *See* Neuberger Report ¶ 63, n.27 (Ex. CR-3).

81. The proposed U.S. remedy is an export tax of $87 million. This equates to an additional export charge of, at a minimum, roughly $613/mbf lumber exported above the correct RQVs during the first half of 2007. At that time, the average U.S. lumber price during the first half of 2007 was approximately US$290/mbf. Thus, the proposed remedy would impose taxes on Canadian producers in the Option B regions at more than double the total *revenues* that resulted from RQV calculation error, and many more times any profit (or reduction in losses) Canadian producers may have gained from the additional exports to the United States.

82. This proposed draconian treatment of Canadian lumber producers cannot be justified and violates even the United States' own criteria for an appropriate remedy.[86] The adverse effect of the proposed remedy on Canadian producers is significantly greater than any benefit Canadian producers could have obtained and, by any reasonable economic standard, is severely punitive. At the same time, because these additional export taxes would function like a lump-sum tax, there would be no effect on Canadian lumber exports. The tax-based remedy proposed by the United States and its punitive effect on Canadian producers are without support anywhere in the text of the SLA. Tellingly, the United States has offered no such support.

### 3. U.S. PROPOSAL NO. 3

83. The United States introduces its third remedy proposal, a drastic reduction in quotas applicable to Option B exporters, by contending that simply reducing future export quotas by the "overshipment" amount – a solution the United States espoused in its Request for Arbitration – would not account for the specific

[86] *See* Neuberger Report ¶ 62 (Ex. CR-3).

consequences of Canada's overshipment at the time of the breach because Option B regions are now exporting at levels well below quota levels.[87] The United States proposes to reduce a forecasted prediction of each Option B region by its "overshipment" amount. The purported objective of this proposal is to "redress the effects of the breach at the time of the breach."[88] Again, this remedy is inconsistent with the purported U.S. objective. Rather, the U.S. concern appears to be that a quota reduction from Agreement levels may not sufficiently penalize Canadian producers.

84. Dr. Neuberger concedes it would be difficult to predict the actual level of exports. Professor Kalt and Dr. Reishus explain that the normal forecast error is likely to swamp the effect of excess exports.[89] As noted above, excess export volume was relatively small – less than 10 percent of Option B regions' actual exports during the first half of 2007. But the forecast error between predicted and actual future exports will likely be much larger. Thus, the primary driver of the magnitude of this U.S. proposed remedy would be Dr. Neuberger's forecast errors, and not the volume of excess lumber exports in the first half of 2007.

85. Also, given the nature of the binding quota, an unbiased but unavoidably inaccurate forecast would be likely to result in a more than equal reduction in exports.[90] If the forecast is below what would actually have been exported, then the relevant export quota for that month will be smaller than intended and exports will have been restricted by too much. However, if the forecast is significantly overestimates future export levels,

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[87] Stmt. of Case ¶ 60.

[88] Stmt. of Case ¶ 28.

[89] Kalt/Reishus Report ¶ 69 (Ex. RR-2).

[90] Kalt/Reishus Report ¶¶ 69-70 (Ex. RR-2).

then the quota may not bind, and actual exports will be less than the permitted quota level. On average, therefore, exports will be reduced by more than the intended amount. The more uncertainty in the forecast relative to the size of the proposed remedy, the greater the expected over-restriction of exports arising from this proposal.

86. Given the difficulty of forecasting exports, this proposal imposes significant risk on Canadian producers and all other participants in the North American lumber markets unrelated to the miscalculation of RQV in the first half of 2007. The realized risk is likely to result in a punitive restriction on future exports. Such a result is not authorized by the SLA.

### 4. U.S. PROPOSAL NO. 4

87. Finally, the United States posits that if none of the above three remedies is acceptable, the Tribunal should require Canada to reduce future Expected U.S. Consumption (upon which RQVs are based) by the amount that Expected U.S. Consumption was miscalculated during the first half of 2007. Here again, the United States offers a remedy inconsistent with its stated objective of approximating the economic effects of the breach found by the Tribunal.

88. The proposal overstates the "excess" exports during the first half of 2007. During part of that period, Option B regions exported less than RQV determined in accordance with unadjusted EUSC. Professor Kalt and Dr. Reishus explain that implementation of the remedy suggested in this proposal would reduce future EUSC by

the full amount of the past difference between adjusted EUSC and unadjusted EUSC, without accounting for the underutilization of RQV's during the second half of 2007.[91]

89. Again, this proposal is divorced from any economic effects of the miscalculation of RQV and is apparently simply intended to penalize Canadian lumber exporters.

**CONCLUSION**

90. While the United States asserts that its alternative proposals serve various "economic" objectives, none of these objectives are justified under the SLA. Moreover, as this review and the report of Professor Kalt and Dr. Reishus demonstrate, the U.S. proposals do not even serve the objectives that the United States and Dr. Neuberger claim to serve. Their common element is no economic principle, but simply to punish Canadian exporters, regardless of any other effect the proposed measures may have. There is no basis in the SLA for these proposals. Indeed, the wide variation in rationales and effects of the U.S. measures, and even the inability of the United States to design a measure that achieves its own unjustified objectives, reinforces the proper legal conclusion that the SLA provides for no retroactive damages directed at past breaches of the SLA

[91] Kalt/Reishus Report ¶ 33(iii) (Ex. RR-2).

## AWARD SOUGHT

91. For the reasons set forth above, Canada respectfully requests an award:

(1) declaring that Canada has cured its breach of the SLA 2006 by making the appropriate calculation of EUSC with respect to regions operating under Option B as of July 1, 2007; and

(2) dismissing all claims of the united States for compensatory adjustments to the export measures or other compensation as a result of Canada's failure to adjust EUSC from January 1, 2007 to June 30, 2007.

Respectfully submitted,


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June 30, 2008

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## CONFIRMATION OF SERVICE

I, Alejandra Montenegro Almonte hereby certify that I caused a copy of this Statement of Defence to be submitted, together with attachments, pursuant to Article 15.3 of the LCIA Rules and the Tribunal's Procedural Order No. 2., and is being simultaneously transmitted by e-mail to the legal representatives of the Claimant on June 30, 2008. A courtesy copy is also being hand delivered to Patricia M. McCarthy, Reginald T. Blades Jr., Claudia Burke, Maame A.F. Ewusi-Mensah, Gregg M. Schwind, David S. Silverbrand, and Stephen C. Tosini.

Respectfully submitted,

Alejandra Montenegro Almonte