In The LCIA
No. 7941

THE UNITED STATES OF AMERICA,

Claimant,

v.

CANADA,

Respondent.

THE UNITED STATES REPLY MEMORIAL ON REMEDY

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THE UNITED STATES REPLY MEMORIAL ON REMEDY

1. Pursuant to the Tribunal's Procedural Order No. 2, dated May 2, 2008, the United States respectfully submits this reply memorial regarding remedy.

INTRODUCTION

2. In its March 3, 2008 award, the Tribunal determined that the 2006 Softwood Lumber Agreement ("SLA" or "Agreement") obligates Canada to make a particular calculation for export measures that apply to what the Agreement calls "Option B" regions. The Tribunal concluded that the SLA obligated Canada to perform this calculation for Option B regions from the beginning of the Agreement. Award, p. 97, ¶ I.2. Insofar as Canada breached the SLA by failing to make this required calculation throughout the first half of 2007, the Tribunal found "Canada is liable for the consequences of that breach." *Id.*

3. Now Canada contends that it is not liable for the consequences of its breach because it started making the calculation as of July 2007, before the the United States requested arbitration and before the Tribunal issued its award. Ignoring the SLA's requirement that Canada cure its breach (or face the consequence of compensatory export measures), Canada states that "curing" its breach means *only* stopping the breaching behavior. Canada then contends – for the first time in these proceedings – that the arbitration is over because it ceased its breaching behavior before the United States submitted its request for arbitration initiating these proceedings. Although Canada claims to rely upon the SLA, no language in the SLA states or even implies that breaches that end before an award has been issued are exempt from the provisions of paragraph 22 of Article XIV of the SLA. Nothing in the SLA or its negotiating history suggests that the Agreement, by design, addresses only open-ended breaches and exempts all other breaches from any remedy.

4. Indeed, that Canada waited until its statement of defence on remedy to raise substantively what is clearly a threshold issue indicates the weakness of its interpretation.[1] If addressed during the liability phase of proceedings, Canada's interpretation, which is really an issue of liability, could have potentially obviated the need for a remedy phase, and saved the Tribunal and the parties much time and resources. Nevertheless, to the extent that Canada has made the strategic decision to delay proceedings by raising this threshold issue at a very late stage, its efforts fail.

5. Contrary to Canada's position, the SLA does not bar the Tribunal from ordering relief to compensate for a breach of the Agreement. Rather, the SLA states that the Tribunal shall identify a reasonable cure period within which Canada may cure its breach *and* determine appropriate adjustments to the SLA's "Export Measures" to compensate for the breach, should Canada fail to cure the breach within the reasonable period of time identified. We do not oppose Canada receiving the full amount of time – 30 days from the date of the remedy award– within which to attempt to cure its breach. The only remaining task is for the Tribunal to determine appropriate adjustments to the export measures should Canada fail to cure the breach within the time prescribed by the Tribunal.

6. Canada invites the Tribunal to reject these explicit provisions and instead determine that an entire category of breaches is exempt from the SLA. Canada contends that Article XIV of the SLA somehow contemplates only a "prospective" remedy, and attempts to draw phantom parallels between Article XIV and the dispute resolution provisions of the World

[1] In Canada's Response to the Request for Arbitration, Canada states that, to the extent it breached the SLA by failing to adjust expected United States consumption, it cured the breach by beginning to perform the adjustment effective July 1, 2007. Response to Request, ¶ 28(f). Canada made no further mention of this issue during any of the substantive briefing on liability, or at the hearing on liability in December 2007.

Trade Organization ("WTO") Dispute Settlement Understanding ("DSU") and the North American Free Trade Agreement ("NAFTA"). However, unlike the specialized dispute resolution provisions of the WTO and NAFTA, provisions with which both parties were highly familiar but explicitly rejected for purposes of dispute settlement under the SLA, the SLA contains absolutely no reference to, much less a distinction between, "prospective" and "retrospective" remedies. A party found in breach of the SLA shall "cure the breach," without regard to whether the breaching activity happens to have ceased by the time of award. The SLA does not require that a cure be prospective only. If Canada's position were to prevail, any breaching party under the SLA would be permitted to unilaterally end an arbitration and to escape compensation simply by ceasing to engage in the breaching behavior before the award on remedy. This is not the bargain into which the United States entered when it agreed to refrain from imposing trade measures under its domestic law.

7. Canada's breach resulted in an overshipment of approximately 200 million board feet ("MMBF") of softwood lumber into the United States. This overshipment conferred a benefit upon the Canadian industry at the expense of the integrity of the SLA and at the expense of the United States industry. To address this overshipment, and the resulting market distortions, the United States proposed reasonable adjustments to the export measures to compensate for the effects of the breach. In response to the four alternative proposals, Canada offers no remedy at all, choosing instead to criticize the proposals in its effort to convince the Tribunal to do nothing to address the consequences of its breach. It proposes no remedy in the alternative.

8. Canada goes so far as to label the proposed compensatory measures "punitive," apparently assuming its own conclusion — that any adjustments to the export measures constitute retroactive relief and therefore would punish Canada. Far from punishing Canada, the

compensatory measures would provide a necessary market correction for the consequences of Canada's breach, and they would do so within the framework of the SLA. In contrast, if the Tribunal adopts Canada's interpretation of the SLA, it will need to read into the SLA language that simply does not exist.

I. Canada's Discontinuation Of Its Breaching Behavior Has Not Cured Or Compensated For the Breach

9. The SLA allows Canada up to 30 days to cure its breach. If Canada fails to do so, Canada then subjects itself to compensatory measures determined by the Tribunal. Canada attempts to escape these two mandatory events, first by arguing that it has cured the breach already and that no further inquiry into appropriate compensatory export measures is necessary; and second by arguing that, even if compensatory measures could be determined, they should apply to only a very limited time frame commencing after the reasonable period of time to cure has expired.

10. Contrary to Canada's contention, nowhere does the SLA state that "cure the breach" means only stop the breaching practice. Stmt. Defence, ¶¶ 5, 13; *see* Stmt. Defence, ¶¶ 4, 10, 13, 20, 30, 32, 46, 50, 51 (insisting repeatedly that the SLA requires a cure to be prospective only, yet identifying no language in the SLA that requires this). Indeed, the SLA does not even imply – much less state explicitly – that Canada's cure (which Canada itself may fashion), or the compensatory measures (which the Tribunal orders) should remedy only post-award breaches. Nor does the SLA state or contemplate that certain breaches are entirely exempt from the SLA's dispute resolution framework. Yet Canada contends that so-called "past breaches" cannot be remedied; only "continuing" breaches can be remedied.

11. Finding no support in the SLA for its interpretation, Canada attempts to import wholesale into the SLA the WTO DSU and NAFTA Chapter 20 remedy regimes, justifying this effort to rewrite the SLA upon the ground that the WTO and NAFTA agreements share the same "structure" with the SLA. In particular, Canada asks the Tribunal to replace the concept of "breach" in the SLA with the concept of a "non-conforming measure" from the WTO DSU and NAFTA Chapter 20, and replace the concept of "cure" with the concept of "bringing a measure into conformity." Rather than confront the actual provisions of the SLA and the appropriate cure of its breach, Canada instead redefines the breach as no breach at all. According to Canada's logic, a finite "nonconforming" practice does not constitute a breach of the SLA, regardless of whether that historical "nonconforming" practice caused harm. No language in the SLA states or even suggests this interpretation.

12. In any event, the Tribunal has already defined the breach Canada has committed. In its Award on Liability, the Tribunal – aware that Canada's breach was limited to the first half of 2007 (Award, ¶ 38) – stated:

> 2. The Softwood Lumber Agreement 2006 (SLA) obligates Canada to make this [Annex 7D Paragraph 14] calculation for all export measures for softwood lumber as of January 1, 2007. Therefore Canada's case to the contrary as to interpretation is dismissed.
>
> 3. Insofar as, according to section 2 above, Canada breached the SLA by failing to make such calculation as of January 1, 2007, Canada is liable for the consequences of that breach.

Award, p. 97, ¶ I.2. The Tribunal determined that Canada's breach was failing to perform the Annex 7D Paragraph 14 calculation as of January 1, 2007, that is, in a *timely* manner.

A. The Text Of The Agreement Does Not Provide For Prospective Cures

13. The text of the SLA itself demonstrates that Canada misinterprets Article XIV in two ways: first, Canada incorrectly assumes that the Tribunal alone determines the content of a proper cure; and second, Canada unilaterally assumes that it has cured its breach merely by ceasing the breaching practice.

14. As the Tribunal found, and as Canada agrees, the SLA should be interpreted using customary international law principles for the interpretation of treaties, as reflected in Article 31 of the Vienna Convention on the Law of Treaties. Vienna Convention on the Law of Treaties, May 23, 1969, 1155 U.N.T.S. 331 ("Vienna Convention"), CR-7. The Vienna Convention therefore applies to the interpretation of the SLA's provisions setting forth the requirements of a final award. These provisions are interpreted in accordance with their ordinary meaning read in context, and in light of the SLA's object and purpose. Vienna Convention, art. 31 (1), CR-7. Further, the Vienna Convention dictates that "any relevant rules of international law applicable in the relations between the parties" should be taken into account together with the context. Vienna Convention, art. 31 (2), CR-7.

1. The Agreement Does Not Permit An Early Finding Regarding Cure

15. Under paragraph 22 of Article XIV of the SLA, the Tribunal makes two determinations once a breach is found. Specifically:

> 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.

SLA, art. XIV, ¶ 22 (emphasis added). That is, the Tribunal *simultaneously* (1) identifies a reasonable period of time for Canada to cure its breach, and (2) determines the appropriate adjustments to the export measures to compensate for the breach. Pursuant to the ordinary meaning of this provision, the Tribunal is to include *both* findings in its award. Once the reasonable cure period is over, the United States is entitled to impose the already-defined compensatory measures if it considers that Canada has failed to cure the breach and has failed to make the compensatory adjustments determined by the Tribunal. SLA, art. XIV, ¶ 27.

16. Nothing in Article XIV of the Agreement contemplates that the Tribunal make a determination at this stage as to whether Canada has cured its breach. Rather, Canada has the authority under the Agreement to identify in the first instance a possible cure for its breach. By declining to opine upon the form of a possible cure, the United States does not ignore the SLA (as Canada suggests, Stmt. Defence, ¶ 3). Rather, it honors Canada's prerogative to take the first step in identifying a proper cure. For this reason, Dr. Jonathan Neuberger, in his expert witness report and rebuttal to Canada's expert witnesses' report, limits his proposed remedies to compensatory adjustments to the export measures, and does not attempt to opine upon the form of Canada's cure.

17. Thus, the SLA provides Canada with up to 30 days from the award on remedy to propose an acceptable plan to cure its breach. Canada states that the "reasonable period of time" is rendered "nonsensical" by this interpretation, insisting that a six-month breach could not be cured within 30 days. Stmt. Defence, ¶¶ 27-28. However, the reasonable period of time does not necessarily contemplate a completed cure. Rather, it allows the breaching party to propose a

plan for a cure, which in turn allows both parties to agree upon an acceptable cure, if possible. If the breaching party can propose an acceptable cure, it can avoid the imposition of the export measures determined by the Tribunal.

18. Indeed, this interpretation is the only interpretation that makes sense when read in the context of Article XIV. Specifically, the paragraphs following paragraph 22 establish the roles played by the parties and the Tribunal in implementation following a finding of breach. Specifically, paragraphs 26 and 27 of Article XIV authorize the complaining party to take certain action (imposition of compensatory adjustments against the breaching party) if the breaching party has not cured the breach and has not itself applied the compensatory measures directed by the Tribunal after the expiration of the reasonable period of time. SLA, art. XIV, ¶¶ 26-27. If the nonbreaching party determines that the cure is sufficient to remedy the breach, or determines that the breaching party's plan to cure the breach is acceptable, the proceedings are concluded. If the breaching party considers that the complaining party has imposed the compensatory adjustments in a manner that is inconsistent with the Tribunal's Award, or if it considers that it has cured the breach, then it may initiate a new arbitration proceeding to challenge the complaining party's imposition of compensatory adjustments. *Id.* ¶ 29. Only at that point would the Tribunal be called upon to determine whether the breaching party has cured the breach that was found. *Id.* ¶¶ 29(c), 31. If the Tribunal does not establish appropriate compensatory measures in its award, then the post-award process established by Article XIV cannot function, and the complaining party, in this case the United States, is deprived of rights for which it negotiated in the SLA.

19. Notably, the language of the 2006 SLA departs from that of the previous SLA, which provided for earlier intervention by the Tribunal. Specifically, the 1996 SLA provided for

the early determination of a cure.[2] 1996 SLA, art. V, ¶ 14. In contrast, the 2006 SLA eliminated any finding regarding cure until a new arbitration is commenced pursuant to paragraph 29. Yet Canada insists that the Tribunal read into the 2006 SLA provisions that were not incorporated into the Agreement. The Tribunal should not indulge Canada's desire to rewrite the Agreement.

2. The Ordinary Meaning Of "Cure" Necessarily Includes Retroactive Relief

20. Canada concedes that the ordinary meaning of "cure" includes to remedy, rectify, and heal. Stmt. Defence, ¶ 12. It also concedes that "cure" is often used in respect of a disease or illness. *Id.* Nevertheless, Canada isolates the narrowest possible part of the ordinary meaning of cure ("remove") and insists upon conflating the concept of breach with the concept of breaching practice or non-conforming measure from other regimes. From this, Canada declares unilaterally that it has cured the breach simply by removing the non-conforming measure, that is, because it started to make the adjustment to expected United States consumption ("EUSC") before the Tribunal issued its award (and before the United States commenced the arbitration proceedings).

21. However, when "cure" is used in its ordinary sense, and when Canada's breach is defined in accordance with the Award and the Agreement, Canada's strained interpretation of the SLA by reference to irrelevant concepts fails.[3] Canada's breach was its failure to *timely*

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[2] "Where the arbitral panel finds that the responding Party has breached this Agreement, the arbitral panel shall provide in its decision a reasonable period of time for that Party to cure its breach. . . . If the Parties have not agreed by the expiry of that period that the breach has been cured, the complaining Party may request the panel to decide whether the breach has been cured . . . . The panel shall issue its decision within 15 days after the request is delivered. Paragraph 12 shall apply to proceedings initiated under this paragraph. 1996 SLA, art. V, ¶ 14. CR-17.

[3] Canada's glib reference to compensation for missed social engagements is not responsive. *See* Stmt. Defence, ¶ 12. The United States does not seek compensation for remote consequences of Canada's breach akin to missed social engagements. We seek compensation from Canada for its

calculate the EUSC adjustment from January through June 2007. Where cure means to remedy, rectify, and heal, the mere establishment of an endpoint for the breaching practice cannot constitute a cure for this breach. Particularly in this instance, where the breach led to the overshipment of millions of board feet of lumber, Canada's setting of proper quotas for later months outside the breach period did not remedy, rectify, or heal the effects of its overshipment of millions of board feet of lumber. To properly remedy, rectify, and heal Canada's failure to timely apply the calculations, Canada must provide full reparation for its breach, that is, compensate for the overshipment.

22. Given that the ordinary meaning of "cure" includes to "remedy," it is particularly instructive that the Agreement, read in its context, defines compensatory measures as measures that "remedy" the breach. That is, to "cure" is to "remedy," and, pursuant to the SLA, compensatory measures also "remedy." SLA, art. XIV, ¶ 23. Accordingly, compensation and remedy are equivalent concepts under the SLA. It follows then that a cure, which by definition must remedy the breach, includes some form of compensation. Importantly, the SLA allows the parties to avoid the imposition of compensatory measures if they agree upon an appropriate cure. Regardless of whether the breaching party cures the breach, the Tribunal still determines appropriate adjustments to the export measures to compensate for the breach.

23. Canada contends that the parties' failure to use the term "retroactive" with respect to "cure" means that they intended that any remedy would be prospective and only address the

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breach, namely the failure to timely adjust EUSC which directly resulted in a shipment of lumber at levels above those to which the parties expressly agreed.

A more apt comparison would be an illegally dumped toxic substance that could not be cured simply by ceasing further dumping. Common sense dictates that a cure would necessarily require cleaning the polluted area and removing the toxic substances, in addition to ceasing any future dumping.

continuation of the breaching practice past the end of the reasonable period of time. Stmt. Defence, ¶¶ 15-19. Canada misinterprets the reference to "retroactive" in Article XIV, paragraph 32. It is not intended to distinguish "retroactive" from "prospective" because it is understood that the application of the measures in paragraph 32 is retroactive. Rather, the term "retroactive" is used to clarify *at what point* in the past the measures should commence: the time of the breach; the time of the Award; or the end of the reasonable period. In any event, given that the term "prospective" does not appear in connection with "cure" or anywhere else in Article XIV, the absence of the term "retroactive" is meaningless.

24. Notably, there are other clearly "retroactive" provisions of the Agreement that also do not use the word "retroactive." For example, the Third Country Adjustment provisions clearly contemplate a retroactive refund, but do not use the term "retroactive." SLA, art. IX. In addition, even the "retroactive" international agreements that Canada relies upon (such as the ICSID Convention and NAFTA Chapter 11) do not use the term "retroactive."

25. Canada's failure to recognize the close relationship between cure and compensatory measures leads it to charge erroneously that the United States' interpretation of "cure" is punitive. Canada contends that anything other than a prospective cure would effectively result in a double remedy. Stmt. Defence, ¶ 24. The compensatory measures, however, by definition, cease when the breach has been cured. In certain cases, such as this one, compensatory measures imposed pursuant to paragraphs 22-24 of Article XIV could themselves serve as a possible cure. Therefore, even in situations, such as the current one, in which the "cure" consists primarily of "compensation," no punitive damages will result because the compensatory measures will cease as soon as Canada has appropriately compensated for its breach and therefore cured it.

26. Finally, not only does Canada reject its obligation to cure its breach, it also misinterprets the provisions of the Agreement concerning compensatory measures, believing incorrectly that compensatory measures apply only to the portion of the breach occurring *after* the reasonable period of time for curing the breach expires. That is, Canada believes that it is not required to impose any compensatory measures unless two things occur: first, it must continue to breach the SLA beyond the cure period; and second, it need only compensate for the portion of the breach that occurs after the end of the reasonable period of time.[4] Stmt. Defence ¶ 20 ("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." (emphasis added)); SLA, art. XIV, ¶ 23.

27. Canada's attempt to redefine the breach finds no support in the SLA. The SLA unequivocally provides that compensatory measures shall be *applied* at the end of the reasonable period of time. SLA, art. XIV, ¶ 24 ("Such adjustments may be applied from the end of the reasonable period of time until the Party Complained Against cures the breach."). It also states that the compensatory measures must remedy the breach. SLA, art. XIV, ¶ 23. The term "breach" as used in paragraph 23 is not limited or qualified in any way to breaches that continue after the expiry of the reasonable cure period. Accordingly, the plain meaning of this term "breach" is that it is the same "breach" to which paragraph 22 refers, that is, the "breach" the

[4] As demonstrated below, however, Canada's experts opine that no such compensatory measures are possible. RR-2, ¶ 11. Thus, Canada essentially reads the compensatory measures provision out of the SLA.

Tribunal has found. Therefore, the plain meaning of paragraph 23 is that, when a party has breached, the compensatory measures must remedy the entirety of the breach.

B. The WTO And NAFTA Chapter 20 Dispute Resolution Provisions Do Not Apply To The SLA

28. As the parties agree, the interpretation of "cure the breach" must begin with the actual text of the SLA. Yet Canada's argument that the SLA's structure was "modeled" after the WTO DSU and NAFTA Chapter 20 fails to acknowledge key differences in the language of the SLA and these two agreements. Moreover, Canada ignores language in the SLA that expressly divorces dispute settlement under this Agreement from the WTO and NAFTA Chapter 20 processes. SLA, art. XIV, ¶ 2. Rather than adopt the WTO DSU or NAFTA Chapter 20 frameworks, the SLA explicitly disavows them. In fact, the only mention of the WTO DSU or NAFTA Chapter 20 in the Agreement is a reference to the provisions prohibiting either party from bringing a WTO DSU or NAFTA Chapter 20 proceeding concerning the subject matter of the Agreement and the provisions resolving the related matters already pending at the WTO. SLA, art. II, ¶ 1(b); art. XIV, ¶ 2. Similarly, rather than adopting the language of the WTO DSU or NAFTA Chapter 20, the SLA instead uses the term "cure the breach," identifies the LCIA, an international commercial arbitration forum, as the sole forum for disputes, and adopts the International Bar Association ("IBA") Rules — rules that typically apply in commercial cases.[5] When the parties sought to incorporate rules or procedures from particular fora, they did so explicitly. No such reference or incorporation was made regarding the WTO DSU or NAFTA.

29. As Canada correctly observes, the parties were familiar with the WTO DSU and NAFTA Chapter 20 systems at the time of the SLA settlement negotiations. Both parties

[5] This arbitration constitutes the first state-to-state dispute that the LCIA has handled.

understand and agree that these systems are "prospective." The decision not to use the tried-and-tested language from those systems in favor of new language, leads only to one conclusion: "cure the breach" must have a different meaning than "bring the [inconsistent] measure into conformity," or "non-implementation or removal of a measure not conforming with this Agreement" — the language used in the WTO DSU and NAFTA. *See* WTO DSU, Art. 19, ¶ 1, CR-24; NAFTA, Art. 2018 ¶ 2, CR-25.

30. The term "breach" is commonly used in the commercial arbitration context in connection with ICSID disputes (Report, ¶ 26, CR-26), and in NAFTA Chapter 11 disputes, all of which Canada agrees are "retroactive" systems. Although Canada appears to concede that these are "retroactive" systems, none uses the term "retroactive."

31. In fact, numerous provisions of the SLA depart significantly from WTO and NAFTA Chapter 20 language:

> (1) The SLA discusses a finding of "breach" by the Tribunal. SLA, art. XIV, ¶ 22. In contrast, the WTO DSU refers to a finding that a "measure is inconsistent with a covered agreement" (Art. 19) and NAFTA Chapter 20 refers to "whether the measure at issue is or would be inconsistent with the obligations . . . ." (Art. 2016(2)(b)). *See* CR-24-25.
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> (2) The SLA states that when "a Party has breached an obligation under the SLA," it must "cure the breach" SLA, art. XIV, ¶ 22 (emphasis added). The WTO DSU provides that when a panel or the Appellate Body makes a finding that a measure is "inconsistent with a covered agreement" it shall recommend that a party "bring the measure into conformity with the covered agreement." Art. 19, CR-24. Similarly, under NAFTA Chapter 20, a party must choose either "non-implementation or removal" of the measure. Art. 2018(2), CR-25.
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> (3) The SLA provides for "compensatory adjustments" to be determined by the Tribunal. SLA, art. XIV, ¶ 22. The WTO DSU allows for voluntary "compensation" that is negotiated and agreed by the disputing parties. Art. 22(2), CR-24. NAFTA Chapter 20

similarly provides for voluntary compensation when the disputing parties are unable to agree on the non-implementation or removal of a non-conforming measure. Art. 2018(2), CR-25.

(4) The SLA permits a party to impose "compensatory measures" itself where the breaching party has failed to cure the breach or impose the "compensatory adjustments" ordered by the Tribunal. SLA, art. XIV, ¶ 27. In the purportedly analogous circumstance, the WTO DSU permits the "suspension of concessions or obligations." Arts. 22(2) & 22(3), CR-24. NAFTA Chapter 20 permits a party to "suspend the application . . . of benefits of equivalent effect." Art. 2019(1), CR-25.

32. These many differences between the SLA and the WTO and NAFTA provide context for the larger structure in which the WTO and NAFTA operate. Unlike the SLA, the WTO and NAFTA are comprehensive agreements to progressively liberalize international trade. The preamble to the WTO Agreement establishing the World Trade Organization, an international organization of which 152 countries are members, refers to "entering into reciprocal and mutually advantageous arrangements directed to the substantial reduction of tariffs and other barriers to trade and to the elimination of discriminatory treatment in international trade relations." CR-23. Likewise, the preamble to NAFTA notes that the parties resolved to, among other things, "REDUCE distortions to trade" and "BUILD on their respective rights and obligations under the General Agreement on Tariffs and Trade and other multilateral and bilateral instruments of cooperation." CR-25.

33. In both the WTO and NAFTA, the parties have bargained for market access in exchange for market access. Accordingly, when a party fails to act consistently with its commitments under either agreement, the dispute settlement provisions allow the aggrieved party to restrict market access, or suspend concessions and obligations until the defending party brings itself into conformity with its obligations to open trade.

34. In contrast, the SLA is not intended to liberalize international trade in general, but to compromise specific litigation and regulate trade in one specific sector. To that end, the parties did not bargain for market access in exchange for market access. Rather, the parties agreed to replace antidumping and countervailing duty orders, which the United States imposed to prevent injury to its industry, with a system of export measures to be applied by Canada. The United States agreed to compromise multifaceted litigation, eliminate existing trade measures, and forego additional trade measures as long as the SLA remains in place. Each of these obligations, those of both Canada and the United States, is narrowly tailored to the softwood lumber markets in the two countries and is specifically tied to the real-world market conditions of the softwood lumber trade. Canada's failure to honor its commitments under the SLA is wholly unlike a failure to abide by the trade liberalizing commitments of the WTO and NAFTA.

35. Ignoring these important differences between the SLA and the WTO/ NAFTA agreements, Canada insists upon placing the SLA within the WTO/NAFTA framework simply because the SLA concerns trade matters between two states. Specifically, Canada goes to great lengths to establish that within international law there is a strict taxonomy of "retroactive" and "prospective" systems and to show that a particular agreement's placement within this taxonomy depends exclusively on whether it contains certain features (including state-to-state disputes settlement, pre-arbitration consultations, and limitations on remedies). Stmt. Defence, ¶¶ 31-42. According to Canada, the placement in the taxonomy based upon these features then determines whether the remedy provisions of the agreement should be read "retroactively" or "prospectively."

36. Canada provides no support for this novel proposition and ignores entirely that the question whether a particular agreement contains a remedy that contemplates reparation

depends upon the text of the agreement, *not* upon whether it shares certain arbitrary features commonly associated with "retroactive" systems versus "prospective" systems. As demonstrated above, the SLA contemplates full compensation for breaches, not prospective-only compliance. And, notably, the SLA shares several important features with the so-called "retroactive" systems Canada discusses. For example, the SLA explicitly uses a commercial arbitration forum, the LCIA, and it refers to "breaches" as opposed to "non-conforming measures."[6]

37. Of course, even Canada must concede that state-to-state disputes arising from bilateral agreements do not require only prospective remedies. For example, in *The Gabcikovo-Nagymaros Project*, involving a treaty between Hungary and Czechoslovakia, the International Court of Justice ("ICJ"), citing *Chorzow*, concluded that both parties were entitled to retrospective compensation.[7] Additionally, Canada itself brought a claim against the Soviet Union for retrospective damage arising under the Convention on International Liability for

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[6] Canada asserts that the United States implies that prospective systems uniquely are open to abuse. Stmt. Defence, ¶ 50. This is untrue. Clearly any system has the potential for abuse; prospective systems no more than any other. In fact, as Canada itself noted, the United States is a party to numerous agreements with "prospective" systems, including the WTO and NAFTA Chapter 20, as well as our other Free Trade Agreements, and has never suggested that these systems are particularly open to abuse. As stated in our Statement of the Case, an obligation of good faith attends state participation in all of these agreements.

[7] *Gabcikovo-Nagymaros Project (Hungary/Slovakia)*, Judgment, I.C.J. Reports 1997, p.7, para. 152 ("It is a well-established rule of international law that an injured State is entitled to obtain compensation from the State which has committed an internationally wrongful act for the damage caused by it. In the present Judgment, the Court has concluded that both Parties committed internationally wrongful acts, and it has noted that those acts gave rise to the damage sustained by the Parties; consequently, Hungary and Slovakia are both under an obligation to pay compensation and are both entitled to obtain compensation."), CR-27.

Damage Caused by Space Objects.[8] Yet Canada argues that the unique features of this dispute – a "dispute between two States," concerning "cross-border trade in goods" prevents either party from receiving "an award for damages." Stmt. Defence, ¶ 56. The United States requests only what the SLA provides — either that Canada cure its breach within a reasonable period of time, or that Canada impose the compensatory adjustments to the export measures determined by the Tribunal. In any event, Canada offers no support (apart from its flawed comparison of the SLA to the WTO and NAFTA) for its interpretation that the SLA precludes retrospective remedy.

38. Canada further confuses the issue when it states, unremarkably, that any breach of the SLA is the result of government not private action. Stmt. Defence, ¶ 42. It then concludes that "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." *Id.* Again, the Tribunal is to determine appropriate compensatory adjustments to the export measures, not to determine whether private parties have suffered a loss or whether government action is the proximate cause. Canada cannot simply read the Tribunal's obligations out of the SLA simply because the Tribunal's task may be more difficult than it might be in a private-party action. In any event, Dr. Neuberger has proposed four reasonable ways in which to adjust the export measures to compensate for Canada's breach.

39. Stretching the "retroactive" / "prospective" taxonomy even further, Canada argues that "the dispute settlement provisions under these trade agreements [WTO, NAFTA Chapter 20, and other bilateral agreements] including Article XIV of the SLA, therefore make

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[8] *Claim Against the Union of Soviet Socialist Republics for Damage Caused By Soviet Cosmos 954*, No. FLA 286, CR-14; *Canada-Union of Soviet Socialist Republics: Protocol on Settlement on Canada's Claim for Damages Caused By "Cosmos 954," available at* 1981 WL 155523, CR-15; *Convention on International Liability for Damage Caused by Space Objects, available at* 1973 WL 151962, CR-16.

clear that the objective of dispute settlement under them is preserving future trading opportunities, not redressing past injuries or making the prevailing party whole." Stmt. Defence, ¶ 40. Canada thus asserts an object and purpose that has no support in the text of the agreement. Both parties expended a considerable amount of energy on the question of object and purpose during the liability phase. In the end, the Tribunal noted, that, unlike other treaties, the SLA contains no preamble or introductory text setting forth the object and purpose of the agreement. Award, ¶ 130. The Tribunal also commented that the SLA is a "very special treaty. There does not seem to have been any similar bilateral treaty in international treaty practice . . ." Award, ¶ 49. Given this, the only object and purpose the Tribunal discerned was "the economic effects of the SLA." Award, ¶ 187, 190.

40. Ignoring the Tribunal's prior holding, Canada now advances, as the object and purpose of the agreement, "preserving future trading opportunities, not redressing past injuries or making the prevailing party whole." Stmt. Defence, ¶ 41. Canada has provided no justification for its self-serving assertion that "preserving future trading opportunities, not redressing past injuries or making the prevailing party whole" is the Agreement's object and purpose. Stmt. Defence, ¶ 41.

C. The Plain Meaning Of "Cure" Is Consistent With International Law On Remedy

41. The SLA's requirement that a cure should remedy the breach comports with prevailing principles of international law concerning remedies for breaches of international agreements. As established in our statement of the case on remedy, it is axiomatic that states must generally provide reparations for breaches of international obligations. ILC Draft Articles

on State Responsibility[9] ("ILC Articles"), CR-9; *Case Concerning the Factory at Chorzów* (Germ. v. Pol.), 1928 P.C.I.J. 47 (ser. A) No. 17 (Sept. 28), CR-8. Canada responds by alleging that the SLA constitutes a *lex specialis* and therefore the principles set forth in the ILC Articles and *Chorzów Factory* do not apply. Stmt. Defence, ¶¶ 51-56. According to Canada, because there is no "gap" to be filled in the SLA on the issue of remedy, the ILC Articles and *Chorzów Factory* are inapplicable. We agree that the SLA provides a comprehensive remedy scheme; however, the scheme does not render the ILC Articles and *Chorzów Factory* inapplicable.[10]

42. Even where there exists a *lex specialis*, the *lex generalis* may be relied upon to clarify the meaning of terms. As the NAFTA Chapter 11 tribunal in *ADF v. United States* explained, "[t]hose general objectives may be conceived of as partaking of the nature of *lex generalis* while a particular detailed provision set in a particular context in the rest of a Chapter or Part of NAFTA functions as *lex specialis*. The former may frequently cast light on a specific interpretive issue; but it is not to be regarded as overriding and superseding the latter." CR-28, *ADF Group Inc. v. United States*, ICSID Case No ARB(AF)/00/1, Award (January 2003).

43. The ILC Articles and *Chorzów Factory* elucidate the meaning of the terms "cure" and "breach" that were chosen by the parties in their remedy scheme.[11] *Lex specialis* does not bar this use of these authorities. In fact, Article 55, cited by Canada, specifically addresses Canada's position:

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[9] Responsibility of States for Internationally Wrongful Acts, U.N. GAOR, International Law Commission, 53d Sess., pt. I, ch. 1, arts. 4-11, 16, U.N. Doc. A/CN.4/L.602/Rev.1 (2001).

[10] Furthermore, Canada's resort to *lex specialis*, if accepted, would eviscerate completely Canada's arguments relying upon the WTO DSU and NAFTA Chapter 20.

[11] This stands in contrast to Canada's use of the WTO DSU and NAFTA Chapter 20, agreements that do not use "cure" or "breach" at all, and therefore cannot be used meaningfully to discern the plain meaning of "cure" and "breach" in the SLA.

> (4) For the lex specialis principle to apply it is not enough that the same subject matter is dealt with by two provisions; *there must be some actual inconsistency between them*, or else a *discernible intention that one provision is to exclude the other*. Thus, the question is essentially one of interpretation. For example, in the Neumeister case, the European Court of Human Rights held that the specific obligation in article 5, paragraph 5, of the European Convention on Human Rights for compensation for unlawful arrest or detention did not prevail over the more general provision for compensation in article 50. In the Court's view, to have applied the lex specialis principle to article 5, paragraph 5, would have led to "consequences incompatible with the aim and object of the Convention". It was sufficient, in applying article 50, to take account of the specific provision.

ILC Articles, Commentary on Article 55, Paragraph 4 (footnotes omitted) (emphasis added), CR-9. There is no inconsistency between "cure the breach" and reparations under the United States interpretation, whereas the SLA explicitly provides that the WTO DSU and NAFTA Chapter 20 should not apply. [12] See SLA, art. XIV, ¶ 2.

44. Contrary to the WTO/NAFTA Chapter 20 formulation concerning a "non-conforming measure," the ILC Articles and *Chorzów Factory*, like the SLA, use the term "breach" to discuss the wrongful act at issue. Given that the ILC Articles and *Chorzów Factory* apply to "breaches" and given the parties choice of the term "breach," it is reasonable to use the reparation principles of the ILC Articles and *Chorzów Factory* to interpret the term "cure the breach," particularly where the principle of reparation is entirely consistent with the ordinary meaning of "cure."

[12] In Paragraph 2 of Article XIV, the parties agree that neither party will institute proceedings pursuant to the WTO DSU or NAFTA Chapter 20 regarding any dispute concerning the SLA. (In Paragraph 1(b) of Article II, the parties confirm their agreement to terminate the pending WTO proceedings. Annex 2B contains the parties' agreement.)

D. The Negotiating History Of The SLA Does Not Support Canada's Interpretation Of "Cure"

45. Canada suggests that "the negotiating history of Article XIV provides insight into the [United States] understanding of the meaning of 'cure the breach.'" Stmt. Defence ¶ 43. Canada notes that an early United States proposal included the term "eliminate the breach," and Canada subsequently proposed using "cure the breach," which it borrowed from the SLA 1996. Canada alleges that the parties used "eliminate" and "cure" interchangeably during the drafting of the SLA, and thus they have the same meaning — to cease the breach or remove the offending measure. Stmt. Defence ¶ 46.

46. As the Tribunal noted in the liability award, there are no official "'travaux préparatoires'" of the SLA. Award, ¶ 142. To the extent that documents exist memorializing certain communications between negotiators, as the Tribunal found, with respect to the question of the negotiating history of the development of paragraph 14 of Annex 7D, this material does not give any clear indication of the express or implied intention of the parties. *See* Award, ¶ 144. In any event, as the Tribunal noted in its award, the Vienna Convention "clearly places negotiating history on a lower level of interpretation" than the more direct means provided in Article 31. Award, ¶ 138.

47. Additionally, Canada suggests that 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." Stmt. Defence ¶ 45. However, Canada was aware during the SLA 2006 negotiations that the United States had previously taken the position it now maintains with respect to the meaning of "cure." Canada

notes that it borrowed the term "cure the breach" from the SLA 1996. In arbitration under the SLA 1996, the United States argued that "cure" required a compensatory remedy:

> The Panel's question may implicitly be read to relate to how Canada might cure any breach the Panel may find. Again, the value of Canada's breach is at least the full extent of the lumber cost reduction. The simplest and fairest remedy would be for British Columbia to rescind the stumpage reduction and extract from its industry the differential between collections under reduced stumpage rates and what those collections would have been absent the June 1998 action. The Agreement establishes that the appropriate remedy for a breach is to "cure" the breach. Art. V(14). "Cure" implies that the problem is removed. Webster's Ninth New Collegiate Dictionary defines cure as "something that corrects, heals, or permanently alleviates a harmful or troublesome situation … to deal with in a way that eliminates or rectifies … to free from something objectionable or harmful …."
>
> In this regard, repayment by the B.C. industry of a sum equal to fee payments would leave the industry with the balance of the value of the stumpage reduction. That balance continues to represent circumvention, including a fee offset.

In the Matter of British Columbia's June 1, 1998 Stumpage Reduction, Response of the United States of America to Panel Questions, p. 6 (June 4,1999) (citation omitted), CR-19. The United States further explained in a subsequent submission that "The concept of 'cure' arises from contract law. When a contract breach is serious enough to justify a suspension of performance by the injured party, the breaching party can often 'cure the breach by correcting the deficiency in performance.' E. Allan Farnsworth, Contracts § 8.17 (2d ed. 1990)." *In the Matter of British Columbia's June 1, 1998 Stumpage Reduction*, Comments of the United States of America on Canada's Response to Panel Questions, p. 8, n.27 (June 14,1999), CR-21.[13] And more plainly,

[13] It is a first principle of United States contract law that when determining the proper remedy, the aim is to put the injured party in as good a position as it would have occupied if performance had occurred as planned. Corbin On Contracts, Vol II, ¶ 992 (1979). This principle has been codified in our Uniform Commercial Code, which provides that "[t]he remedies provided by this Act shall be liberally administered to the end that the aggrieved party may be put in as good a

the United States argued that "[a] full cure would require Canada not only to reverse its stumpage decrease (or collect an offsetting fee) on future exports, it would also require Canada to collect the stumpage fees foregone since June 1, 1998." *Id.* at p. 12.

48. The panel in that arbitration never rendered a decision or interpretation of "cure" because the dispute was settled prior to the release of the panel report. However, Canada was certainly aware when it proposed "cure the breach" for inclusion in the SLA 2006 that the United States had previously expressed a particular understanding of the meaning of that term in the context of a prior softwood lumber agreement between the two parties. In light of this, the ultimate decision to replace all instances of the term "eliminate" with "cure" undercuts, rather than supports, Canada's assertion that the term "cure" has the meaning it desires.

II. Appropriate Compensatory Adjustments To The Export Measures Must Be Determined

49. Not only does Canada believe that its prospective compliance with the SLA ends the Tribunal's inquiry, it also refuses to acknowledge the existence of any reasonable remedy for its breach. Canada contends that the Tribunal should decline to determine compensatory export measures as it would simply be too difficult to craft an effective remedy. Building upon its previous argument that the SLA prevents any remedy at all except for breaches that occur after the award date, Canada concludes that, even in this circumstance, determining compensatory adjustments "*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." Stmt. Defence, ¶ 23 (emphasis added).

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position as if the other party had fully performed." U.C.C. § 1-106 (2005); *see also Matter of Clark*, 738 F.2d 869, 872 (7th Cir. 1984). (the term "cure" means to remedy or rectify the default and "restore matters to the *status quo ante*.").

50. Canada's pessimism arises from a desire to avoid the consequences of the plain terms of the bargain to which it agreed. The SLA provides that the Tribunal is to determine adjustments to the export measures for each and every breach. Although Canada posits that a purely historical breach would evade the calculation of a reasonable remedy, it is arguably even easier to fashion a set of compensatory measures to remedy a breach that has ceased. That is, an historical breach is discrete and quantifiable, and, therefore, more easily redressed by compensatory adjustments to the export measures, which can account for the market effects of a limited period of time. In contrast, to remedy a continuing breach, the Tribunal would need to account for both past, present, and future effects of the breach.

51. Canada continues to criticize the terms of the SLA, arguing adjustments to the export measures are a form of remedy "ill-suited" to "compensation."[14] Stmt. Defence, ¶ 25. This argument appears to be based upon a conclusory assertion that "making future adjustments of export measures to compensate for past effects would have an erratic and distortive effect on market conditions." Stmt. Defence, ¶ 29. Canada fails entirely to recognize that its breach created the original market distortion that has contributed to the market's current condition. It is the job of expert economists to recommend options for how best to place the United States in the position it would have occupied absent the breach.

52. Relying once again upon the inapposite WTO/NAFTA dispute resolution framework, Canada suggests that, because market conditions change, it is inappropriate to use adjustments to the export measures as a form of compensation for "past effects." Stmt. Defence,

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[14] Contrary to Canada's claim that we "implicitly acknowledge[]" that export measures are "ill-suited" to compensation, Stmt. Defence, ¶ 25, our brief and expert report demonstrate various adjustments to the export measures that we believe would be well-suited to compensate for Canada's breach. Unlike Canada, we accept rather than criticize the terms of the SLA in any way.

¶ 42. This objection, however, applies with equal force to compensatory measures even as Canada interprets them. Under either scenario, the Tribunal would be placed in the position of having to fashion adjustments to the export measures that would apply in the future, at a time when market conditions may change and will not be known in advance. Given that the same "problem" presents itself under either party's interpretation, this "problem" does not militate in favor of Canada's interpretation of "cure" as "cease" and "remedy the breach" as "remedy the ongoing effects of the continuation of the breach past the reasonable time period."

53. To the extent that Canada even engages upon the question of remedy, it poses a series of ineffective criticisms of Dr. Jonathan Neuberger's expert report, contending, first, that any remedy must ignore the effects of Canada's overshipment and instead, account only for Canada's current shipping practices; second, that Dr. Neuberger's proposed remedies, or indeed, any remedies, are punitive, arbitrary, or simply too speculative; and third, that the United States has failed to calculate Canada's overshipment correctly. At each turn, Canada relies upon self-serving conclusions, many of which assume Canada's original premise that it has already cured its breach. At no point does Canada propose its own remedy, even in the alternative.

54. Canada does argue in the alternative that its breach has resulted in no harm to the United States because its overshipments of lumber from January through June 2007 have been "offset" by Option B region shipments in the second half of 2007, shipments that fell below the volume restraints authorized under the SLA (called regional quota volumes or "RQVs"). Stmt. Defence, ¶¶ 58-59. This argument is unpersuasive.

55. The Option B regions appear to have adhered to the properly-calculated volume restraints in the second half of 2007. Yet, the SLA does not permit a party to cure its breach merely by later complying with the Agreement. Similarly, Canada's belated compliance with

the SLA, even if Canada's Option B regions shipped under their RQVs in the second half of 2007, does not "offset" Canada's failure to do so in the first half of 2007. The breach in this case allowed the flow of approximately 200 MMBF of softwood lumber into the United States. This disruption in the softwood lumber market remains uncorrected to this day.

56. Option B volume restraints are designed to be fixed limitations on the volume of lumber from the Canadian regions that elect to be subject to Option B. The SLA does not allow a region to exceed its quota in one month or a series of months, then "make up" for the excess shipments in later months by undershipping, either intentionally or unintentionally.[15] If it could, Canada could freely breach the Agreement at any time only to subsequently undership to "make up" for the overshipment. This would undermine the very purpose of the volume restraints in the SLA. Subsequent practice, which itself is a product of the market disruption caused by the overshipment, cannot compensate for the overshipment. For these reasons, Canada's "offset" argument is not contemplated by the SLA, and would thwart the intent of the parties to limit the volume of lumber imported into the United States from Option B regions on a monthly basis.

III. Canada's Criticisms Of Dr. Neuberger's Remedy Proposals Are Unfounded

57. The remainder of Canada's statement of defence consists of a hodgepodge of attacks upon the remedies proposed by Dr. Neuberger to compensate for Canada's breach. Stmt. Defence, ¶¶ 60-89. Canada labels Dr. Neuberger's proposals "punitive," "draconian," and not sufficiently tied to the objective of compensating for the economic effects of Canada's breach.

[15] As discussed below, the Agreement provides a comprehensive scheme for "carrying forward" or "carrying back" limited quantities of overshipments. This is the *only* manner in which Canada can "make up" for excess shipments in later months. And, as Dr. Neuberger notes, Canada has never notified the United States of its intention to use this provision (as it must), nor has Canada even performed the calculation correctly in its experts' report. Therefore, there is no reason to assume, for purposes of a remedy calculation, that Canada would have used the provision during the breach period.

Yet Canada offers no proposal of its own – even in the alternative – to compensate for its failure to "cure the breach." Canada's failure to propose an appropriate remedy for its breach is part of its overarching strategy to deny the existence of a remedy, not a statement that a remedy cannot be crafted. Canada's election not to propose an appropriate remedy effectively waives Canada's opportunity to object to the adoption of at least one of the proposed remedies provided by the United States, should the Tribunal reject Canada's all-or-nothing approach.

A. Canada's Focus Upon The United States' Overall Economic Welfare Is Misplaced In The Context Of The SLA

58. Canada first asks the Tribunal to consider the economic effects of Canada's breach upon the United States economy as a whole. Stmt. Defense, ¶ 66. Canada asserts that the overshipment of Canadian lumber into the United States caused no economic harm to the United States. *Id.*; RR-2 at ¶¶41-42. Drs. Kalt and Reishus admit in their report, however, that this commentary focuses upon the United States economic welfare more broadly, as opposed to the interests of the American softwood lumber industry. RR-2 at ¶ 41. As Dr. Neuberger notes in his rebuttal report, an economic analysis must respond to the policy question being asked, not operate in a vacuum. CR-13, ¶ 12. When the analysis concerns the functioning of the SLA, a primary concern is the effect of the breach upon American producers. CR-13, ¶¶ 12, 26-28.

59. The SLA balances the interests, in part, of the Canadian softwood lumber industry against the American softwood lumber industry. Indeed, the United States specifically agreed to forego available domestic trade remedy measures, which are by definition imposed when the domestic industry is being materially injured, in favor of the SLA regime. This reality is borne out by the nature of the export measures themselves. Yet Canada assumes that, to the extent that its breach affected the price of lumber, the relevant inquiry is whether the consumer benefitted

from that effect. RR-2, ¶ 41. If the SLA considered only the effect upon the consumer, then the parties would not have agreed to a system of export measures that restrict Canadian exports, let alone restrict them when the United States price falls below a certain price. CR-13, ¶ 27.

60. Again, as the Tribunal noted, the SLA is a "very special treaty. There does not seem to have been any similar bilateral treaty in international treaty practice . . ." Award, ¶ 49. Given this, the only object and purpose it could discern was "the economic effects of the SLA." Award, ¶ 187, 190. Yet Canada contends that "standard" economic considerations of the effect upon the consumer should prevail. Given the unique nature of the SLA and its goals, and given the SLA's primary focus upon price, the relevant inquiry is, as Dr. Neuberger concludes in his effects-based remedy, the effect of Canada's overshipment upon the price of lumber, not the effect of the price on the consumer. CR-13, ¶ 27.

61. Notably, Canada provides no analysis suggesting that its softwood lumber industry, and in particular the industry in the Option B regions, obtained no tangible benefit from its six-month breach of the Agreement. Similarly, Canada does not deny that the American industry was harmed by the breach. For example, the Option B regions, through Canada's breach, were able to sell and export a significant volume of softwood lumber to the United States, free of the Option B volume restraints and not subject to the full Option A export measures. CR-3, ¶ 48. Further, the excess supply of Canadian lumber in United States during the breach period reduced lumber prices in the United States below what they would have been had Canada not breached the SLA. CR-3, ¶ 57. Canada offers no analysis in its statement of defence to counter these conclusions.

B. Dr. Neuberger's Remedies Are Fair And Equitable

62. Dr. Neuberger has provided the Tribunal four logical and carefully-tailored remedies to correct Canada's breach: (1) two price-based remedies that assess additional export charges; and (2) two volume-based remedies that adjust the volume of lumber exported. CR-13, ¶ 24. An appropriate and meaningful remedy must reduce the actual volume of lumber exported by Canada under current or reasonably anticipated future market conditions in order to correct the harm caused by Canada's breach. CR-3, ¶¶ 33-34. Canada does not take issue with this objective; instead, Canada complains that the United States did not state this sooner. Stmt. Defence, ¶¶ 60-61 (complaining that the request for arbitration requested more narrow relief). Of course, this is no real criticism, particularly when the United States revised its request for relief in its statement of the case on liability.[16]

63. Canada is correct that, in the words of Dr. Neuberger, "the remedy should in some way be commensurate with the violation, and not punitive." CR-3, ¶ 33. Contrary to Canada's unsupported claims, however, none of the four alternative remedies is punitive because each would offset, but not exceed, the measured effect of Canada's breach. CR-13, ¶ 52. Each remedy is precisely linked to the magnitude of Canada's breach, and each is implementable over time. To the extent that the remedies depress Canadian imports of softwood lumber during the remedy period, this is not a "punitive" result, but rather the natural and intended market correction necessitated by Canada's breach.

64. It is clear that Canada considers *any* additional export measures on lumber shipments, no matter how modest, to be a "penalty." Stmt. of Case, ¶73; RR-2 at ¶47. This

[16] For its part, Canada waited until its statement of defence to explain that in its view, the Tribunal's job was completed at the time of award.

conclusion reflects a radical departure from the terms of the SLA, which require the imposition of *compensatory* adjustments to the export measures to compensate for *all* breaches for which there has been no cure. Relying upon this flawed reasoning, Canada proposes no remedy of its own. In contrast, the goal of all four of Dr. Neuberger's remedy alternatives is to compensate and correct for Canada's breach, not punish Canada generally or the Option B regions in particular.

65. All four remedies rely upon the imposition of modest additional export measures, measures authorized by the SLA itself. In contrast, a punitive remedy would fine Canadian producers from Option B regions a set amount unrelated to the magnitude of the overshipments, or reduce RQVs in excess of the Option B overshipments. CR-3, ¶33. The United States proposes no such remedy. CR-13, ¶¶ 51-53.

66. Canada is responsible for its current predicament and could have taken steps to mitigate the effect of any remedy that the Tribunal orders. The United States notified Canada in March 2007 that Canada was incorrectly calculating RQVs for the Option B regions, and that RQVs had to be adjusted downward to take into consideration paragraph 14 in Annex 7D. *See* Req. For Arbitration, Exh. B. Canada publicly announced the United States' request for consultations the same day. *See* http://w01.international.gc.ca/minpub/Publication.aspx ?isRedirect=True&publication_id=385017&language=E&docnumber=52, CR-18. Yet Canada refused to reduce the Option B region RQVs for another three months, the very months during which its Option B regions overshipped the greatest volumes of softwood lumber into the United States. Thus, it is Canada's refusal to make the adjustment – even after being put on notice– that has placed it and its industry in a position where a market correction must be imposed. The

Tribunal should reject Canada's attempts to paint itself the victim. There is no unfairness in the remedies proposed by the United States.

1. *Remedy Based Upon Collection Of Option A Export Charges*

67. Canada claims that Dr. Neuberger's first proposed remedy – to treat the Option B regions as if they were Option A during the breach period – is "drastic" and unjustified. Stmt. Defence, ¶¶ 71-76. The proposed additional export charge is 10 percent, and will be applied over a period of months to softwood lumber from Canadian regions whose exports make up only one-third of Canada's exports to the United States. CR-13, ¶ 24; SLA, Annex 7B, ¶9, Table 1. The benefit of the breach in this case was recognized by Option B producers; it is logical that these same producers bear the burden imposed by the remedy. CR-13, ¶ 53.

68. Dr. Neuberger prefers this first remedy because of its conceptual simplicity and its ease in implementation. CR-3 at ¶ 47. Canada does not dispute this simplicity, but complains that the remedy would be the same whether the Option B regions overshipped one board foot of lumber or 200 MMBF of lumber. Stmt. Defence, ¶ 73. As a practical matter, of course, the Option B regions collectively overshipped approximately 200 MMBF of softwood lumber into the United States, not one board foot. In any event, the purpose of the remedy is to treat Option B regions in a manner commensurate with their violation of fixed volume restraints. CR-13, ¶ 54. Because these regions effectively acted as Option A regions and because Option A regions are assessed an export charge regardless of the magnitude of their shipments, Canada's criticism is beside the point. Dr. Neuberger has considered the criticisms of Drs. Kalt and Reishus, and continues to prefer the additional Option A export charge on Option B producers because this offsets the most direct economic effect of the overshipments: Option B producers paid too few

export charges given that they exceeded the hard quota and thereby were effectively operating as Option A producers. CR-13, ¶ 53.

69. As such, Option A export charges are neither "draconian" nor "punitive." CR-13, ¶ 52. Canada agreed to the Option A export charges for certain regions, chief among them British Columbia, the province with by far the greatest volume of softwood lumber exports to the United States. *See* SLA, Annex 7B, ¶ 9, Table 1. It is difficult to comprehend how these agreed-upon export charges can be reasonable as applied to British Columbia, but "draconian" and "punitive" when applied to the breaching Option B regions with their far smaller volumes of lumber exports.

70. Moreover, the total export charge to be collected is only CDN $64 million. This is a small burden upon the Canadian industry whether measured against total Canadian imports to the United States, or Option B imports to the United States. CR-3, Ex. 3. Yet despite the small burden upon the Canadian industry, the additional export charges will encourage Canadian producers in Option B regions to reduce their exports in order to avoid paying the export charges. CR-13, ¶¶ 36, 52. It is this commensurate reduction in exports that is important, a reduction that will only happen if the Tribunal creates a financial incentive to reduce exports or (if the Tribunal chooses to impose Dr. Neuberger's volume-based remedies) a meaningful reduction in export volume.

71. Canada's claim that the first approach is the "equivalent of a lump sum tax" is incorrect. Stmt. Defence, ¶ 75; CR-13, ¶ ¶ 31-35. In fact, while the export charge theoretically could be collected from importers as a lump sum, Dr. Neuberger does not recommend this. CR-3, ¶ 51. Instead, the export charge will be paid on an *ad valorem* basis over time, until the entire $64 million is collected. CR-3, ¶ 52.

72. As Dr. Neuberger explains in his rebuttal expert report, the proposed Option A export charge will affect the marginal incentives of Option B producers to export to the United States, and will not operate as a "lump sum" payment. CR-13, ¶¶ 13, 33-37. There is no monopoly exporter and the additional export charge will not be assigned to exporters in fixed allocations. Thus, the individual exporter would be affected by the amount of export charge it pays (which will depend on the volume of lumber it exports), not by the effect of its payment on the Government's receipts of the total export charge. *Id.* Therefore, although Canada's "lump sum" claim could be valid if there were a monopoly exporter, or very small numbers of exporters in the Option B regions, CR-13, ¶ 13, in reality, there are too many exporters in the Option B regions for any one exporter to take this effect into account. Therefore, Dr. Neuberger concludes that "the proposed price remedies are very much tied to compensation for the violation, and will not be punitive." *Id.*

73. Contrary to Canada's contention, the amount to be collected by assessing the additional 10 percent export charge is not arbitrary. Stmt. Defence, ¶ 73. To the contrary, the remedy is tied directly to the amount of export charges not paid by the exporters within each Option B region. CR-13, ¶¶ 52-53. These foregone export charges are a measure of the benefit enjoyed by Option B exporters, exporters who, under the SLA, were required to be subject to either a fixed volume restraint or higher export charges. Thus, the link between the remedy and the benefit to Canadian exporters is clear.

2. *Dr. Neuberger's Second Price-Based Remedy*

74. Dr. Neuberger's second preferred remedy is an additional export charge on Option B regions designed to boost American lumber prices by the same US$ 1.94 (per thousand board feet) that prices were lowered by Canada's overshipments during the breach period. CR-3,

¶¶ 57-61. In order to counteract the reduction in United States lumber prices, Dr. Neuberger calculates that an additional export charge of $39.65 (per thousand board feet) should be applied. CR-3, ¶ 61. Dr. Neuberger recommends that this additional export charge be applied to the same volume of lumber shipped during the first half of 2007, resulting in an additional export charge totaling $87 million. CR-3, ¶¶ 62-63. Like the first remedy, this alternative is "directly calibrated to compensate for injury incurred during the violation period by the United States lumber industry." CR-13, ¶¶ 24, 61.

75. Canada does not question the legitimate objective "to place the United States in the position it would have occupied absent the breach," but claims only that the remedy does not meet the objective. Defense, ¶¶ 77-78. Canada then repeats many of the same arguments and criticisms of Dr. Neuberger's first remedy. Stmt. Defence, ¶ 78; RR-2, ¶ 60. Finally, Canada and its economists criticize the economic model used by Dr. Neuberger, and mathematically manipulate the remedy to argue that it is "draconian." Stmt. Defence, ¶¶ 79-82; RR-2, ¶ 64.

76. Canada's criticisms are unpersuasive. The second remedy, which calculates and then counteract the effect of the breach upon United States lumber prices, is obviously related to the harm to United States producers. CR-13, ¶ 24. Canada's breach not only disrupted the operation of the SLA by changing the supply and price of lumber in the United States, Canada's lumber companies realized profits from the overshipment that they would not otherwise have gained, to the detriment of the United States lumber industry. CR 3, ¶ 25. Therefore, the second remedy meets its compensatory objective and is in no way punitive. In the words of Dr. Neuberger, "each remedy is intended to reduce exports by no more than the amount necessary to offset the original economic effect of the overage." CR-13, ¶ 52.

77. As for Canada's criticism of Dr. Neuberger's economic model, Dr. Neuberger explains in his rebuttal report that Kalt and Reishus have generated an inferior model (a model that does not consider the price effects of trade policy measures), then improperly borrowed price elasticities from their model into Dr. Neuberger's work. CR-13, ¶¶ 39-42. This renders Canada's criticism as confusing as it is illegitimate.

78. Dr. Neuberger modeled lumber supply and demand in Canada and the United States in order to quantify the economic effect of Canada's overshipment of softwood lumber into the United States. CR-3, Appendix A. His model uses accepted recognized figures for elasticity of supply (in Canada, the United States, and the rest of the world) and elasticity of demand (in the United States). CR-13, ¶ 43. Elasticity is a measure of how one variable (supply or demand) changes with another variable (price). *Id.* Dr. Neuberger's economic model allows him to analyze the effect of the increased Canadian supply to the United States (caused by the overshipments) on United States lumber prices.

79. Dr. Neuberger also explains that his price elastisities do not use "extreme values" as Canada claims. Dr. Neuberger bases his elasticity estimates on the most current, state of the art academic study, a study by Canadian economists Stennes and Wilson. CR-13, ¶¶ 43-44. Dr. Neuberger, in contrast to Drs. Kalt and Reishus, correctly uses elasticities for softwood lumber generally (as opposed to subcategories of lumber products such as kiln-dried or air-dried products). CR-13, ¶¶ 45-50.

80. Finally, Canada's exaggerated mathematical manipulation does not pass scrutiny. For example, Canada's application of the $87 million collected via the additional export charge only to the volume of lumber overshipped during the first half of 2007 allows them to assert that the additional export charge "equates" to an export charge of $613/mbf. Stmt. Defence, ¶¶ 80-

81. However, when the additional export charge is correctly applied to *total* Option B shipments, as recommended by Dr. Neuberger, the additional export charge is $39.65, translating into a modest 13 percent charge on a shipment of $300/mbf lumber. CR-13, ¶¶ 61-62. Similarly, Drs. Kalt and Reishus' alarmist application of the additional export charge to Saskatchewan and Manitoba, while omitting Quebec and Ontario, is not helpful. RR-2, ¶ 63.

81. Tellingly, Canada elected to offer the Tribunal no competing price-based proposal to those of Dr. Neuberger. It merely protests that it is too difficult to craft a remedy to compensate for its breach. In doing so, Canada effectively reads out of the SLA the requirement that compensatory measures be determined.

3. *Adjusting, Then Reducing RQVs*

82. The United States also proposed two volume-based remedies in its statement of the case. First, Dr. Neuberger proposes adjusting RQVs to a level at which they are binding, then applying a second volume reduction commensurate with the overshipments in the first half of 2007. CR-3, ¶¶ 42-43; CR-13, ¶ 69. Dr. Neuberger explains in his original expert report, and Canada agrees, that market conditions now are substantially different from those present in early 2007 (the breach period) because Option B regions are now exporting volumes substantially less than those permitted under current and recent RQVs. CR-3, ¶ 41. Accordingly, simply lowering RQVs by the amount of the overshipments (the "straight volume-based approach") would constitute no remedy because it will not result in a reduction in exports of softwood lumber to the United States. CR-3, ¶¶ 40-41.

83. Canada yet again labels this remedy "drastic" and "punitive," but in this case only because of the difficulty in generating an accurate forecast of actual exports so that RQVs can meaningfully be reduced. Stmt. Defence, ¶¶ 83-86. Drs. Kalt and Reishus claim that because

future predictions of lumber volumes are difficult and uncertain, "this approach is highly likely to lead to future export reductions greater than the targeted past overages." RR-2, ¶¶ 68-69.

84. Canada's criticism of Dr. Neuberger's volume-based remedy is exaggerated. While uncertainty in forecasting lumber exports may lead to RQV reductions slightly greater than the volume of overshipments in the first half of 2007, it is just as likely that forecasting may lead to an insufficient reduction in RQVs. CR-13, ¶ 70. As Dr. Neuberger observes, "while there may be prediction error, there is no *a priori* bias in the application of this remedy." *Id.* Given that forecasting error may be in either direction, there is no basis for Canada's statements that "on average . . . exports will be reduced by more than the intended amount" and that the remedy is "likely to result in a punitive restriction on future exports." Stmt. Defence, ¶ 86. Once again, neither Canada nor its experts offer the Tribunal a competing remedy for the Tribunal's consideration.

4. *Reducing EUSC*

85. The fourth remedy proposed in the United States' Statement of Case is based upon Canada's failure to adjust EUSC during the first half of 2007. Stmt. of Case on Remedy, ¶¶ 63-64. Under this alternative, Canada would be required to calculate an additional downward adjustment to EUSC beyond any adjustment that Canada would already be required to make. CR-13, ¶ 71. This second adjustment represents the adjustment that Canada should have made in 2007.

86. Canada faults this remedy for not "accounting for the underutilization of RQVs during the second half of 2007." Stmt. Defence, ¶ 88. However, Canada's breach – the failure to properly adjust EUSC – occurred in the first half of 2007. Lumber shipments from Option B regions following this breach period are irrelevant to the magnitude of the breach. To the extent

Canada is arguing that its post-breach shipments "offset" its previous breach, we have previously addressed this argument. *See* section II, *supra*.

87. Without any reasoning, Canada then repeats its claim that the remedy is not sufficiently tied to the effects of its breach and is intended to punish Canadian exporters. As stated previously, a remedy that seeks to offset, but not exceed, the measured effect of a previous breach is not punitive. This proposed remedy, by measuring and compensating for Canada's failure to adjust EUSC, cannot be called punitive.

C. Canada's Calculation Of The Option B Overshipments Incorrectly Implements The Carry Forward/Carry Back Provisions In The SLA

88. Both parties agree that, as a result of Canada's breach, Option B regions shipped volumes of lumber in excess of the properly-adjusted RQVs for the first half of 2007. Yet Canada quibbles with the United States calculation of the overshipment, contending first, that the United States general calculation is too conservative, and second that the United States failed to give Canada the benefit of certain provisions in the SLA.

89. Using the most current publicly available data, Dr. Neuberger calculates that Canada's Option B regions shipped 182 MMBF of softwood lumber into the United States in excess of properly-adjusted volume restraints. CR-3, ¶ 32. Canada's response to these calculations is twofold:

a. Using data contemporaneously available at the time when the RQVs were calculated (as opposed to the revised data used by Dr. Neuberger), Canada's overshipment was significantly *greater* than the 182 MMBF calculated by Dr. Neuberger. Stmt. Defence, ¶ 59; CR-13, ¶ 68.

b. However, had Canada utilized the SLA provisions allowing Canada to "carry forward" or "carry back" limited volumes of lumber between months, Canada believes its

overshipments would be only 142 MMBF. *Id.*

90. We agree with Canada's first observation that Canada's overshipment was actually greater than 182 MMBF, if contemporaneous data is used. Canada's economists separately provided their calculations using contemporaneously available data. Using this data, Canada estimates that the overshipments from Option B regions from January through June 2007 were 216 MMBF. CR-13, ¶ 68.[17]

91. We disagree with Canada's second observation, which arrives at an artificially-low overshipment calculation using a flawed application of the carry forward and carry back provisions of the SLA. First, Canada is not entitled to reduce the quantum of its overshipments via the carry forward/carry back provisions in the SLA because it has not satisfied the SLA's requirements. The SLA permits regions to borrow ("carry forward" or "carry back"), a quantity of RQV between two consecutive months, limited to 12 percent of a region's RQV for a particular month. SLA, Annex 7B, ¶¶ 4-6. Pursuant to a September 12, 2006 side letter to the SLA, Canada agreed to notify the United States each month of any RQV volumes carried forward from a previous month or carried back from the following month. CR-4. Even when Canada has overshipped for reasons unrelated to its breach, Canada has never notified the United States that it intended to or did use carry forward or carry back. Thus, Canada has never made use of the carry forward/carry back provisions, and fails in its statement of defence to provide any explanation for why the Tribunal should permit it to make use of them now.

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[17] When requested in March 2008, Canada refused to provide its calculations of the Option B overshipments. CR-5, CR-6. Only now, in its Statement of Defense, does Canada provide calculations of what it believes to be the volumes of lumber shipped in excess of properly-adjusted RQVs. Canada's calculations differ from those of Dr. Neuberger because Canada uses data that was contemporaneously available, rather than updated data and because Canada misapplies certain provisions of the SLA.

92. Even if permitted to make use of carry forward/carry back retroactively, Canada improperly carries forward over 37 MMBF of volume from December 2006 to January 2007. CR-13, ¶ 67. A carry forward from December 2006 to January 2007 is barred by paragraph 7 of Annex 7B. According to paragraph 7, regions can carry forward or carry back between two months *only if* "the Region's exports are subject to a volume restraint in both months." SLA, Annex 7B, ¶ 7, CR-13, ¶ 67.

93. There was no volume restraint from October - December 2006 applicable to any SLA regions, even regions that elected to be Option B. This is because of Article VI of the SLA, which established the SLA "transition period." SLA, art. VI, n.2. During this "transition period," Option B regions were treated as Option A, meaning they were subject to no volume restraints. Option B regions could ship without limitation during this three-month period, and were required to pay the higher Option A export charges. *Id.* To the extent an Option B region shipped under what its RQV would have been under Option B in any month of the "transition period," the region was entitled to a refund of the difference in export charges (the difference between Option A and Option B charges). *Id.*[18]

94. Because there was no volume restraint in December 2006, Option B regions were not permitted – and cannot be permitted now – to carry forward volume from December 2006 to January 2007. This correction to Canada's calculation results in an increase to Canada's overshipment figures, even with carry forward/carry back in the remaining months, from 142 MMBF to 178 MMBF. CR-13, ¶ 67.

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[18] The transition period's treatment of Option B regions as Option A regions undermines Canada's contention that Dr. Neuberger's preferred remedy is punitive. Neither party considered the treatment of Option B regions as Option A regions during the transition period to be punitive. Yet Canada now considers Dr. Neuberger's preferred remedy, which operates no differently than the transition period, to be punitive.

95. As stated previously, Canada should not be permitted to use carry forward/carry back to reduce its overshipments during the first half of 2007. However, to the extent the Tribunal permits such a result, Canada's corrected figure for purposes of crafting compensatory measures for Canada's failure to "cure the breach," is 178 MMBF.

AWARD SOUGHT

96. For all of these reasons, the United States respectfully repeats its request for an award under paragraph 22 of Article XIV determining (1) a reasonable period of time for Canada to cure the breach; and (2) appropriate adjustments to the export measures to if Canada fails to cure the breach.

Respectfully submitted,

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July 21, 2008

CERTIFICATE OF SERVICE

I hereby certify that I caused a copy of the United States Reply Memorial on Remedy to be submitted, together with attachments, pursuant to Article 15.3 of the LCIA Rules and Procedural Order No. 2, and is being simultaneously transmitted by email and by overnight courier to the legal representative of the Respondent on July 21, 2008.

Claudia Burke