In The London Court Of International Arbitration

THE UNITED STATES OF AMERICA,

Claimant,

v.

CANADA

Respondent.

POST-HEARING BRIEF OF THE RESPONDENT CANADA

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POST-HEARING BRIEF

In accordance with the Tribunal's Procedural Order No. 4, dated September 29, 2008, the Government of Canada ("Canada") respectfully submits this Post-Hearing Brief.

INTRODUCTION

This Post-Hearing Brief responds to the questions posed by the Tribunal in Procedural Order No. 4. In Part I, Canada addresses the Tribunal's specific questions in section 3.2 of the Procedural Order. In Part II, Canada evaluates the most relevant results of the hearing for the relief sought in this case. Section A of Part II discusses the legal arguments made by the Parties at the hearing in their opening and closing statements. Section B of Part II discusses the economic issues discussed at the hearing.

PART I. RESPONSES TO TRIBUNAL'S QUESTION 3.2

A. QUESTION 3.2(a)

Has the Agreement of the Parties at the end of the Hearing on Liability, recorded in section I paragraph 4 of the Decisions in the Award on Liability, applied by parties' submissions of April 3, 2008, and later, and consequently by PO 2 on the further procedure on remedies, changed the provisions of Art. XIV paragraphs 22 seq. SLA, and if so, to which effect?

1. Canada does not consider that the Parties, through the actions identified in this question, modified the provisions of Article XIV, paragraphs 22 *et seq.* of the SLA. Nor did the predicate for these actions – the Parties' agreement to bifurcate the proceedings in October 2007 – have such effect. Instead, by agreeing to bifurcate the proceedings, and by agreeing to the procedures that decision precipitated, the Parties intended only that the Tribunal's performance of its mandate under Article XIV, paragraph 22, would be deferred until after the Tribunal's Award on Liability. Achieving

that outcome did not require the Parties to modify Article XIV, paragraph 22, because, as explained below, that provision does not command the fulfillment of the Tribunal's mandate thereunder immediately upon the issuance of an interim or partial award on liability.

2. As Article XIV is structured, arguments regarding whether there has been a breach and, if so, the consequences of that breach, would normally be presented in a single proceeding. At the end of this single proceeding, the Tribunal would determine whether a breach has occurred, and, if so, identify a reasonable period of time (up to 30 days) for the breaching Party to cure the breach, and the appropriate adjustments to be made to compensate for the breach if that Party fails to cure the breach by the end of the reasonable period of time.

3. The original schedule proposed by the Tribunal for this proceeding would have resulted in such a single proceeding and a single award addressing liability and its consequences, if any.[1] If a single proceeding had taken place, Canada would have presented its position on liability and remedies with respect to both Option A and Option B Regions, including as outlined in Canada's Response to the Request for Arbitration of September 12, 2007.[2] In this single proceeding, Canada would have argued with respect to Option B Regions that it already had cured any breach by applying the adjustment to EUSC beginning July 1, 2007, and therefore that it was not necessary for the Tribunal either to identify a reasonable period of time for Canada to cure or to determine appropriate compensatory adjustments. With respect to Option A Regions,

[1] *See* Draft Procedural Order No. 1 attached to Chairman Böckstiegel's letter of September 25, 2007.

[2] Response to the Request for Arbitration ¶ 28(f) (Sept. 12, 2007) ("… even if Canada had breached its obligations for the period January 1 – June 30, which is denied, this breach has been cured by the timely application of the adjustment for Option B Regions effective July 1, 2007. Therefore, no adjustments may be required or authorized under Article XIV of the Agreement.").

Canada would have argued that if the Tribunal found an ongoing breach, it should identify a reasonable period of time for Canada to cure the breach (by applying EUSC for Option A Regions) and also determine appropriate compensatory adjustments to apply until Canada cured the breach if Canada did not cure the breach within that reasonable period of time.[3]

4. The Tribunal's award in such a case necessarily would have dealt with both liability and remedy. It would have included not only a finding of no breach with respect to Option A Regions (therefore rendering moot any argument about consequences in the event a breach had been found) and breach with respect to Option B Regions, but also would have addressed the consequences that should have resulted pursuant to paragraph 22 *et seq*., based on the arguments that the Parties would have made.

5. Rather than addressing liability and remedies in one proceeding, however, the Parties agreed to bifurcate the issues in order to enable an earlier award on liability.[4] In Canada's view, this agreement was possible without an amendment of paragraph 22 because that provision contains no timing requirement. Paragraph 22

[3] In paragraph 22(c) of its Response to the Request for Arbitration (Sept. 12, 2007), Canada argued that: "[t]he Claimant is not entitled to any relief because Canada has not breached the Agreement. Moreover, even if there were a breach of the Agreement, the United States asks for remedies that are not authorized under the Agreement. Article XIV, paragraph 22 of the Agreement provides that if the Tribunal finds that a Party has breached an obligation under the Agreement, the Tribunal shall 'identify a reasonable period of time for that Party to cure the breach' and '… *if* that Party fails to cure the breach within the reasonable period of time' determine '… adjustments to the Export Measures to compensate for the breach' (emphasis added). The Agreement does not allow compensation to a successful claimant, and provides for compensatory adjustments in the form of increased (or decreased) volume restrictions or export charges imposed or collected by Canada only if Canada does not cure the breach within the time period identified by the Tribunal. Even if there were a breach of the Agreement, which Canada denies, the Tribunal does not have power to award relief outside the specific terms of Article XIV, including most of the relief requested by the United States.").

[4] *See* Ms. Patricia McCarthy's letter to the Tribunal of October 9, 2007 proposing bifurcation and Canada's reply of October 10, 2007.

does not compel the Tribunal to make its findings under paragraph 22 at the same time it determines that there has been a breach. Although the obligations in paragraph 22 are tied to the issuance of "the award," nothing in paragraph 22 or in Article XIV of the SLA mandates interpreting "the award" as meaning a partial or interim award on liability in the context of a bifurcated proceeding. This is especially true because Article XIV expressly incorporates the LCIA Arbitration Rules into the SLA, and Article 26.7 of those Rules expressly authorizes the Tribunal to issue separate awards in a single proceeding.[5] In context, the reference to "the award" in paragraph 22 should be read to mean the final award issued in a proceeding.[6]

6. Canada expressed its understanding of the agreement to bifurcate in a letter to the Tribunal dated October 10, 2007 as follows:

> … Canada is in agreement with bifurcation of the proceedings and Canada further supports the "Proposed Timetables for Proposed Liability Phase" … attached to Ms. McCarthy's letter [of October 9, 2007]. Canada understands that both Parties agree that this liability phase is to deal solely with the issue of alleged breach of the SLA, and that a determination under Article XIV(22) of the SLA, if any, shall be reserved for the remedies phase.

7. In accordance with the Agreement, both Parties limited their submissions in the liability phase of the proceeding to the question whether there had been a breach of the Agreement in either of the respects claimed by the United States. This limitation

[5] Article 26.7 of the LCIA Arbitration Rules provides that: "[t]he Arbitral Tribunal may make separate awards on different issues at different times. Such awards shall have the same status and effect as any other award made by the Arbitral Tribunal." Article 26.9 of the LCIA Arbitration Rules further states that "[a]ll awards shall be final and binding on the parties."

[6] The Tribunal may disagree with Canada's interpretation of the SLA, and conclude that Article XIV, paragraph 22, imposes a mandatory obligation to make the determinations set forth in subparagraphs (a) and (b) concurrently with the issuance of an award on liability, even in the context of a bifurcated proceeding. If the Tribunal adopts this interpretation, then it would be reasonable for the Tribunal to construe from the Parties' agreement to bifurcate, and the concomitant actions identified in the Tribunal's question, that they authorized the Tribunal to depart from the timing requirements of Article XIV, paragraph 22.

of the arbitral debate to the issue of liability was consistent with Section 3 of Procedural Order No. 1 (revised on October 28, 2007):

> As indicated by their letters of October 9 and 10, 2007, the Parties have agreed on a bifurcated procedure to the effect that a first phase shall be restricted to the issue of liability (the *liability phase*) and, should liability be found by the Tribunal to exist, a second phase on remedies (the *remedies phase*).

8. Bifurcation in this proceeding offered the same potential benefits that often lead Tribunals and parties to establish separate phases in an arbitration – it may eliminate the need for the parties to brief, and the Tribunal to consider, issues that may become moot depending on the Tribunal's resolution of threshold issues. In this case, bifurcation had the virtue of avoiding the need to argue the consequences of breaches that Canada considered had not occurred. With this in mind, Canada agreed, in response to the Tribunal's question at the close of the liability hearing of December 12, 2007,[7] that the Parties should convene after the Tribunal had made its Award on Liability to try to agree on what should be the next steps, if any, in the proceeding.

9. When the United States proposed bifurcation of the proceedings in October 2007, and when it agreed at the close of the December 12, 2007 hearing to provide comments to the Tribunal on how to proceed in the event of a finding of breach by the Tribunal, the United States was well aware of Canada's position that Canada had cured any breach with respect to Option B Regions, and that no compensatory adjustments were called for in these circumstances. At a minimum, the United States

[7] Hearing on Liability, Tr. at 123:19 to 124:14 (Dec. 12, 2007).

was aware of this because Canada so stated in its Response to the Request for Arbitration.[8]

10. Canada reiterated its position to the United States following the Tribunal's Award on Liability and indicated, as a result, that there was no need for further proceedings.[9] The United States disagreed, necessitating this second phase of the proceedings. Accordingly, on April 11, 2008 each Party submitted its proposal for a new procedural order and schedule, noting certain points of difference, which the Tribunal resolved in Procedural Order No. 2.

11. Both Parties agree that the Tribunal should now make the decisions required under paragraph 22, though obviously they disagree as to what those decisions should be. The United States, contending that Canada has not cured the breach (or that the Tribunal should ignore whether Canada has cured the breach), argues that the Tribunal should grant Canada 30 days to cure the breach and should order compensatory adjustments in one of four alternative ways and levels. By contrast, Canada considers that it has already cured the breach by correctly applying the adjustment provided in Annex 7D since July 1, 2007. Canada also considers that no

[8] Response to the Request for Arbitration ¶ 28(f) (Sept. 12, 2007) ("… even if Canada had breached its obligations for the period January 1 – June 30, which is denied, this breach has been cured by the timely application of the adjustment for Option B Regions effective July 1, 2007. Therefore, no adjustments may be required or authorized under Article XIV of the Agreement".) As discussed below at ¶¶ 54-56, Canada believes that both Parties shared the view that the SLA would not provide retrospective compensation, as was the view evinced by both Parties in regard to the final arbitration under the SLA 1996, from which the "cure the breach" language is derived.

[9] *See* Letter from Guillermo Aguilar Alvarez to Patricia McCarthy (Mar. 14, 2008) ("Canada's position remains that Canada has cured the breach identified by the Tribunal. We understand from our conversation that the United States does not agree and wishes to present its case in the second phase of this proceeding.") (CR-6). Canada has repeated this view throughout the proceedings. *See* Response to Request for Arbitration ¶ 28(f) (Sept. 12, 2007); Canada Rebuttal ¶¶ 11–15; Tr. at 59:4-7 ("Canada has cured[,] and its position that it has cured[,] has been known to the United States since the answer to the Request for Arbitration, long before the Tribunal was even constituted."); Tr. at 67:13-16 ("In the case of the breach with respect to Option B Regions, Canada had already cured the breach, if any existed, in fact, about a month before the Request for Arbitration was even filed.").

compensatory adjustments are required or authorized because the SLA does not provide for compensatory adjustments in relation to past breaches.

12. However the Tribunal resolves these competing positions of the Parties, one thing is certain: the Tribunal will need to decide what it means to "cure" the breach under the SLA, and whether Canada has cured its breach in the context of this proceeding. As Canada explained in its Rebuttal Memorial, the Tribunal's two tasks under paragraph 22 – setting a "reasonable" period of time to cure the breach and determining "appropriate adjustments" to the export measures to compensate for the breach if there is no cure – cannot be undertaken without deciding whether ceasing the breaching conduct constitutes a cure of the breach.[10] There is nothing in the text of paragraph 22 that prevents the Tribunal, at this stage, from deciding what a cure would be.

B. QUESTION 3.2(b)

Which Party has the burden of proof for which aspects of the claims raised?

13. If, contrary to Canada's position, the Tribunal interprets the SLA as allowing some form of reparations as a cure for Canada's breach, the United States has the burden of proving its allegations of damages to U.S. interests, benefits to Option B exporters, and the quantum of compensatory adjustments it claims is justified as a consequence of Canada's breach.[11]

[10] Canada Rebuttal ¶¶ 20-23.

[11] Canada interprets this question as pertaining to propositions of fact. Questions of law are to be decided by the Tribunal and are not subject to specific burdens of proof. For example, neither Party has the burden of proof with respect to the proper interpretation of Article XIV, paragraph 22 *et seq*. of the SLA. As the Tribunal recognized in its Award on Liability, the meaning to be given to the relevant terms of the SLA is a question of legal interpretation for the Tribunal, to be decided using the principles set forth in Articles 31 and 32 of the Vienna Convention of the Law of Treaties.

14. The U.S. has raised one claim for damage: that Canada's breach of the SLA during the first six months of 2007 resulted in the overshipment of approximately 180 million board feet of lumber[12] and that, as a result, U.S. producers suffered damage in the form of a decrease of $1.94 per thousand board feet in the price of softwood lumber sold in the United States during that period.[13] Although the United States initially framed the alleged harm as harm to the United States as a whole, in response to Canada noting that overall U.S. interests benefited from the increased imports, the United States subsequently focused on the harm to U.S. lumber producers.[14] The

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The allocation of the burden of proof to the complainant means that if the Tribunal considers that the United States has not carried its burden of proof in establishing facts requisite for damages to be awarded, then no award shall be made. The Panel does not have authority under the SLA nor under any rules of international law to assume the burden for the United States and craft an award on its own when the United States, as complainant, has failed to establish the proper factual basis itself for the remedy it now seeks.

[12] *See, e.g.*, Stmt. of Case ¶ 37 ("…Canada's breach – its failure to adjust EUSC in calculating Option B Regional quota volume for six consecutive months in 2007 – caused over 180 million board feet of lumber to be shipped into the United States that otherwise would not have entered the United States market."). At the hearing Dr. Neuberger changed his mind, indicating that the amount of the overage should be 216 million board feet rather than 182 million board feet (Tr. at 96:24-97:3). But the calculations on the record are not based on this new number.

[13] *See, e.g.*, Stmt. of Case ¶ 44 ("Canada's failure to apply these export measures resulted in over-exportation, which in turn affected the price of lumber and disrupted the specific balance of trade to which the parties agreed.").

Expert Witness Report of Jonathan A. Neuberger ¶ 57 (May 29, 2008) ("Neuberger Report") (CR-3) ("This means that the excess supply of softwood lumber products in the U.S. resulting from Option B regions' exceeding their export quotas reduced prices in the U.S. below what they would have been if the quotas had been observed.").

Neuberger Report ¶ 59 (CR-3) ("This economic simulation reveals that Canada's breach of the SLA by Option B Regions reduced U.S. lumber prices during the January – June 2007 period by approximately 0.7 percent. As the average U.S. price during this period, as measured by Random Lengths, was US$ 290.66 per thousand board feet ("MBF"), this translates into a price reduction of US$ 1.94 per MBF.").

Stmt. of Case ¶ 53 ("… the excess supply of lumber in the United States logically reduced prices in the United States below what prices would have been had Canada performed the correct EUSC calculation and properly restricted the volume of lumber entering the United States.").

[14] *See, e.g.*, U.S. Reply ¶ 58 ("When the analysis concerns the functioning of the SLA, a primary concern is the effect of the breach upon American producers."); *see also* U.S. Reply ¶ 60; Rebuttal Expert Witness Report of Jonathan A. Neuberger ¶¶ 12, 27 (Jul. 21, 2008) ("Neuberger Rebuttal Report") (CR-13).

United States did not present any evidence of damage to any U.S. interests other than the allegation of the $1.94 price reduction alleged to harm U.S. lumber producers during a six month period.

15. Lacking any textual basis for asserting that compensatory adjustments are to address past harms to the U.S. industry, the United States relies on the *Chorzów Factory* case and the ILC Articles to support its position.[15] As the Permanent Court of International Justice articulated in *Chorzów*, two of the fundamental questions raised by Germany's claims were: (1) whether the non-breaching party suffered damage as a consequence of the breach, and (2) the extent of the damage.[16] In rejecting some of Germany's claims, the court found that such claims were "insufficiently proved"[17] or "discarded for want of evidence."[18]

16. In reaching these conclusions, the court recalled that in accordance with the jurisprudence of arbitral tribunals "possible but contingent and indeterminate damage … cannot be taken into account."[19] The ILC Articles likewise reflect these principles. Article 36 makes clear that compensation is appropriate only when damage is "financially assessable" and "established."[20] The Commentary to ILC Article 34 further

[15] *See* Stmt. of Case ¶ 31, n.9, ¶ 59; U.S. Reply ¶¶ 41-44.

[16] *Case Concerning the Factory at Chorzów* (Merits) (Germ. v. Pol.), 1928 P.C.I.J. 47 (ser. A) No. 17, at 29 (Sept. 13) ("*Chorzów*") (CR-8).

[17] *Id.* at 56.

[18] *Id.* at 57.

[19] *Id*.

[20] Responsibility of States for Internationally Wrongful Acts, U.N. GAOR, International Law Commission, 53d Sess., pt. II, Art. 36, U.N. Doc. A/56/49 (Vol. 1) Corr. 4 (2001) (RRA-9).

confirms that "[c]ompensation is limited to damage actually suffered as a result of the internationally wrongful act, and excludes damage which is indirect or remote."[21]

17. As the Tribunal is aware, it is Canada's position that the SLA contains a comprehensive and prospective-oriented dispute resolution regime that is *lex specialis*.[22] However, to the extent that the Tribunal disagrees, and concludes that Article XIV authorizes "retroactive compensation," then the United States must be held to the standards international law imposes on parties seeking such compensation, as reflected in the findings of the authorities on which it has relied in this arbitration to claim an entitlement to compensation for damages: the burden of proving the damage that it alleges falls squarely on the United States[23] and speculative compensation must be denied. In addition, the Tribunal must adjudicate this dispute on the basis of the documentary evidence and expert testimony on the record, because Canada and the United States agreed in the SLA to modify the LCIA Arbitration Rules in a way that prevents the designation of a Tribunal expert.[24]

18. At the hearing, the United States contended that only the second of its four proposals was directed at compensating U.S. producers for the harm caused by the alleged temporary $1.94 reduction in the U.S. lumber price,[25] though it also argued that each proposal would compensate the U.S. industry by discouraging exports to the

[21] Responsibility of States for Internationally Wrongful Acts, U.N. GAOR, International Law Commission, 53d Sess., pt. II, Art. 34, Commentary 5, U.N. Doc. A/CN.4/L.602/Rev.1 (2001) (CR-9).

[22] Canada has explained why it believes that the SLA acts as a *lex specialis* which excludes the application of the ILC Articles and *Chorzów Factory*. Stmt. of Defence ¶¶ 51-57.

[23] *See ADF Group Inc. v. United States*, ICSID Case No. ARB(AF)/00/1, Award, ¶¶ 140-145 (January 2003) (CR-28), where the tribunal rejects certain claims as a result of claimant's failure to meet its burden of proof.

[24] *See* SLA Art. XIV(6) (Ex. RR-1); LCIA Arbitration Rules, Art. 21.

[25] Tr. at 283:11-18.

United States.[26] The rationales that the United States has presented for its other alterative proposals are not based either in the text of the SLA or in customary international law. The first, third and fourth proposals appear to be based on a U.S. theory that Option B exporters should be restricted by compensatory adjustments because they allegedly benefited from Canada's failure to apply the EUSC adjustment for six months.

19. If the Tribunal were to determine that benefit to Option B exporters was the appropriate measure of damages – as is the apparent rationale for the U.S. proposals other than Proposal No. 2 – the United States, as claimant, would have the burden of proving the benefit to Canadian producers and the quantum of that benefit, as well as proving that any of its proposed remedies appropriately redresses that benefit.

20. Dr. Neuberger testified that:

> … it is clear that Canadian exporters benefited from the breach. By their actions, exporters in these regions revealed that it was in their economic best interests to exceed their quota volumes. It is thus reasonable to conclude that Canadian exporters earned incremental profits from their conduct, to the detriment of U.S. producers.[27]

21. However, when asked during cross-examination about the supposed benefit to Option B exporters, Dr. Neuberger admitted that a drop in U.S. lumber prices would have affected Option B exporters, and that he did not calculate the net effect on these exporters.[28] Dr. Neuberger thus failed to explain how Option B exporters "benefited," which he admitted he did not verify.

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[26] Tr. at 292:2-4.

[27] Neuberger Report, n.13 (CR-3).

[28] Tr. at 100:14-102:6.

22. Dr. Neuberger further failed to show how the amount he calculated as the harm to U.S. producers – US$ 34.0 million[29] – puts the U.S. producers in the position they would have been but for the breach. In his third report, Dr. Neuberger calculates that export charges totaling US$ 86.7 million are "necessary to 'undo' the $34.0 million loss of U.S. producer surplus resulting from the breach."[30] But as Professor Kalt testified, because the export charges would be imposed in the future, Dr. Neuberger's model actually "returns about 35 percent more than the $34 million he says there."[31]

23. Finally, Dr. Neuberger failed to explain just how the export charge he advocates would result in appropriate reparations to U.S. producers, or why this group should be his only target. The flaws in the U.S. remedy proposals, and the failure of any of the proposals to achieve the objectives stated, are discussed in greater detail below in Section II.B.

24. Canada's position has at all times been that, consistent with other international trade agreements between the Parties, to "cure the breach" under the SLA means to cease the breaching conduct. Canada has demonstrated that the SLA does not authorize the retrospective relief sought by the United States in this arbitration, and it is undisputed that the breaching practice stopped even before the United States filed its Request for Arbitration: Canada correctly applied the adjustment to EUSC to Option B Regions as of July 1, 2007.[32] The issue of burden does not arise on Canada's interpretation of the SLA, given the uncontested facts.

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[29] Second Rebuttal Expert Witness Report of Jonathan A. Neuberger ¶ 13 (Sept. 15, 2008) ("Neuberger Second Rebuttal Report") (CR-29).

[30] Neuberger Second Rebuttal Report ¶ 15 (CR-29); *see also* Tr. at 104:24-105:3.

[31] Tr. at 144:11-15.

[32] *See supra* Part I.A.

C. QUESTION 3.2(c)

In case the Tribunal concludes that a retroactive compensation system has to be applied under Art. XIV paragraphs 22 seq., what are the results of the examination of the experts at the hearing regarding the possible models or the best model for determining appropriate adjustments according to paragraph 22(b)?

25. In the event that the Tribunal decides that "a retroactive compensation has to be applied," it must address the questions of *who* or *what* has to be compensated, and *for what*. The United States claimed at some points in this proceeding to be seeking compensation on behalf of U.S. lumber producers for alleged harm suffered by them, but was unable to show authority for such compensation in the SLA, and did not meet its factual burden to demonstrate harm. At other points, the United States claimed to seek recapture of the alleged benefits to Canadian exporters of overshipments, but the United States was unable to show legal authority or meet its factual burden on that theory either. The multitude of problems associated with the remedy options proposed by the United States are detailed below in Part II.

26. Based on the testimony and evidence presented during the examination of experts at the hearing, if the Tribunal concludes that retroactive compensation must be applied, it should also conclude that such compensation has already been realized in the operation of the SLA since July 1, 2007. Specifically, the below-quota shipments in the second half of 2007 from Option B Regions more than offset the regional quota volumes that were miscalculated in the first half of 2007.[33]

27. If the Tribunal concludes that such compensation has not been realized, the Tribunal should look to see how the SLA provides for compensation in the most closely analogous instance where past measures or actions are redressed.

[33] Stmt. of Defence ¶ 58.

28. Canada has shown that, where the SLA provides for retroactive compensation or adjustments, it does so explicitly. In the situation most analogous to this dispute, it provides for a one-for-one offset of excess export volumes caused by the measure.[34] This point was underscored at the hearing, where Canada explained that retroactive compensation under Article XIV(32) of the SLA is a simple one-for-one offset at the border of excessive export volumes (or the improper restriction of volumes by an import measure). Article XIV(32) provides for a reduction in quota to compensate for volumes overshipped as a result of the breach.

29. Importantly, Article XIV(32) does not inquire into the effects of the overshipment on the export market, nor does it consider the implications of the overshipment for the exporting industry.[35] On the contrary, the provision imposes a straightforward one-for-one offset of excess export volumes or excess import restraints in the event that a Tribunal finds that a Party has misapplied compensatory adjustments or measures. It also provides for a finite equal number of adjustments to export measures that correspond to the offending measure (*i.e.* a decrease in quota to compensate for excess export volumes) on a monthly basis over a limited period of time.

30. In the instant case, such a one-for-one offset would involve a reduction of regional quota volumes over a six month period in an amount equal to the amount of overshipment of exports that occurred as a result of the breach. Indeed, this is consistent with the original specific request for relief requested by the United States with respect to the Option B Regions in its Request for Arbitration.[36]

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[34] *See* Canada Rebuttal ¶ 100; Stmt. of Defence ¶ 62; Tr. at 83:19-21.

[35] Canada Rebuttal ¶ 100.

[36] In its Request for Arbitration ¶ 61(d) (Aug. 13, 2007), the U.S. requested a decision from the Tribunal with respect to Option B Regions "Ordering Canada, with respect to Option B regions, to

31. This case is distinguished from a circumvention case under Article XVII on the following basis. In a circumvention case, an element of the substantive offense is whether the challenged measure or action had the effect of reducing or offsetting the export measure, whereas in this case the failure to make an adjustment to the EUSC affected the export measure directly.

PART II. EVALUATION OF THE MOST RELEVANT RESULTS OF THE HEARING FOR THE RELIEF SOUGHT IN THIS CASE

A. LESSONS LEARNED FROM THE HEARING – LEGAL ARGUMENTS

32. Paragraph 22 of Article XIV of the SLA calls for the Tribunal, if it finds there is a breach of the SLA, to determine: (a) a reasonable period of time (up to 30 days) to cure the breach; and (b) adjustments to export measures to compensate for the breach to be applied if the breaching Party has not cured the breach. The issue of reasonable period of time has not been debated because, on the one hand, Canada considers that it has already cured the breach by stopping the breach, and, on the other, the United States disagrees that Canada's cessation of the breach constitutes curing the breach, but concedes the 30 day maximum for curing the breach. The net result is that the issues that the Tribunal must now decide are: (1) what constitutes a cure and whether Canada cured the breach by making the EUSC adjustment for Option B Regions from July 1, 2007 onward, and (2) if not, whether and in what manner paragraphs 22, 23 and 24 authorize adjustments to export measures to compensate for the effects of a past breach.

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make additional downward adjustments to quota volumes (or maximum volumes) in future months in an amount equal to the amount by which shipments form Option B regions exceeded the properly calculated quota volumes (or maximum volumes) for January through June 2007."

1. SUMMARY OF CANADA'S LEGAL CASE

33. Canada considers that it has cured the breach within the meaning of Article XIV of the SLA and that compensatory adjustments may not be applied under paragraph 22 for past breaches. Canada has demonstrated that its interpretation is supported by the ordinary meaning of the terms of Article XIV, in their context, and by other international trade agreements to which the United States and Canada are parties, which are the "relevant rules of international law" under Article 31 of the Vienna Convention on the Law of Treaties ("VCLT"). Specifically, Canada has shown that:

(a) the ordinary meaning of the term "cure the breach," read in its context, is to remove or cease the breaching conduct.[37] This ordinary meaning does not imply an additional obligation to compensate for the effects or consequences of past breaching conduct;

(b) the Agreement says "cure the breach" not "cure the effects of the breach;"

(c) the terms "cure the breach" and "compensatory adjustments" are separate concepts, and compensatory adjustments are to be applied only if the breaching Party fails to cure the breach and only until the breaching Party has cured the breach.[38] Compensatory adjustments are to be used, therefore, to encourage a Party to cure, not to compensate for harm caused by a past breach;

[37] Stmt. of Defence ¶¶ 11-30; Canada Rebuttal ¶¶ 29-31.

[38] Stmt. of Defence ¶ 21; Canada Rebuttal ¶¶ 32-33.

(d) when the drafters of the SLA wanted provisions to have retroactive effect they so stated, including in Article XIV(32); no such intent can be implied from the text of paragraph 22;[39]

(e) the structure and operation of Article XIV, in particular the inclusion of the provision for a "reasonable period of time to cure the breach" and the limitation of the form of compensatory adjustments to export measures (and the omission of any language providing for monetary damages or its equivalent) manifest an intent by the Parties to provide only prospective remedies;[40]

(f) relevant rules of international law, which pursuant to VCLT 31.3(c) are required to be taken into account by the Tribunal in interpreting Article XIV of the SLA, include other international trade agreements, most notably the WTO and NAFTA.[41] The dispute settlement systems of the DSU and NAFTA Chapter 20 are similar in structure and operation to the SLA, and are prospective in design and application, in that they provide for a reasonable period of time for a breaching Party to cure the breach, the imposition of compensatory measures only if a breach is not cured and only until the breach is cured, and a limitation on the form of compensation to adjustments to trade measures (and not monetary damages);[42]

[39] Stmt. of Defence ¶¶ 15-19; Canada Rebuttal ¶¶ 43-46.

[40] Stmt. of Defence ¶¶ 20-30; Canada Rebuttal ¶¶ 34-42, 47-52.

[41] Stmt. of Defence ¶ 31; Canada Rebuttal ¶ 53.

[42] Stmt. of Defence ¶¶ 32-42; Canada Rebuttal ¶¶ 54-70.

(g) the ILC Articles and the *Chorzów* case invoked by the United States are not apposite because Article XIV of the SLA creates *lex specialis*, like that of the WTO.[43] The Parties agreed on special rules to govern the consequences of a breach that differ from those provided in the ILC Articles. Both Parties describe the SLA dispute settlement regime as "a comprehensive remedy scheme."[44] The ILC Articles, which serve only a gap-filling or residual role, cannot be resorted to in this case, given the acknowledged comprehensive nature of the SLA remedy regime.

34. The text of the SLA bears no similarity whatsoever to remedy regimes in typical bilateral investment treaties. Most significantly, the SLA does not provide for monetary damages.[45] The United States has failed to address entirely – in either of its Memorials or during the hearing – why the dispute settlement provisions of the SLA look so different from the remedy regimes in bilateral investment treaties (such as the U.S. Model Bilateral Investment Treaty (BIT), Canadian Model Foreign Investment Promotion and Protection Agreement (FIPA) and NAFTA Chapter 11) that both Parties were very familiar with when they negotiated the SLA.[46] Nothing prevented the Parties from using language in the SLA that would have provided for monetary damages in the event of a breach, as is provided in these treaties. Instead, the SLA provides for compensation in the form of an adjustment to export measures only if a Party fails to cure a breach and then only until the breach has been cured. The U.S. claim that the provision of a reasonable period of time to cure the breach was designed to allow the Parties to agree

[43] Stmt. of Defence ¶¶ 51-57; Canada Rebuttal ¶¶ 80-91.

[44] U.S. Reply ¶ 41; Tr. at 60:12-13.

[45] Stmt. of Defence ¶ 26; Canada Rebuttal ¶ 52.

[46] Tr. at 63:6-20.

on a cure that does not involve an adjustment to the export measures, and that could include "a form of cash compensation,"[47] has no basis in the text of Article XIV or the negotiating history of the SLA.

35. The United States also has failed to offer a credible explanation – in either of its Memorials or at the hearing – as to why the Parties included a provision in the text for a reasonable period of time to cure the breach, why they specified that compensatory adjustments are only to be applied if a cure is not achieved by the end of the reasonable period time, and why they limited the compensatory adjustments to be applied if a breach is found, to adjustments to the export measures. These concepts are found nowhere in reparations-based regimes. These rules function logically – and well – for a prospective remedy system but make no sense for a system that is intended to compensate for the effects of past breaches.[48] In its Rebuttal Memorial and again at the hearing, Canada asked the United States to identify a single reparations based treaty that uses these concepts.[49] The United States failed to do so.

36. Finally, the United States has not addressed why the Parties so clearly specified retroactive application of a Tribunal award in paragraph 32 proceedings in the event that the Tribunal finds that an export or import measure had been misapplied, and why they did not so specify in the case of a paragraph 22 review following a determination of breach.[50] The only argument the United States has offered, in response, is that the word "retroactive" in paragraph 32 was not intended to distinguish between "prospective" and "retroactive" but was used "to clarify at what point in the past

[47] Tr. at 31:5-13; 300:17-19.

[48] Stmt. of Defence ¶¶ 25-28; Canada Rebuttal ¶¶ 47-52.

[49] Canada Rebuttal ¶ 62; Tr. at 66:12-16.

[50] Stmt. of Defence ¶¶ 15-19; Canada Rebuttal ¶¶ 43-46.

the measures should commence."[51] The United States misses the point here. It is not merely that the word "retroactive" is used, but rather that the substantive rule is explicitly retroactive in effect. Paragraph 32 specifies that if a Tribunal finds that the measures applied by a Party under paragraph 26 or 27 are unjustified, those measures must be undone beginning from the date they were applied. Although this result is stated expressly in paragraph 32 by use of the term "retroactive," it is also apparent from the chapeau of the paragraph. If the Parties had intended for compensatory adjustments under paragraph 22(b) likewise to compensate for past effects, they would have made that intent express and unambiguous, just as they did in paragraph 32. They did not.

2. RELEVANT RULES OF INTERNATIONAL LAW

37. From the outset of this proceeding, Canada consistently has argued that trade agreements to which the United States and Canada are parties contain "relevant rules of international law" under Article 31.3(c) of the VCLT for purposes of interpreting Article XIV.[52] The United States did not dispute this in either of its memorials, nor did it take issue with Canada's characterization of the WTO and NAFTA Chapter 20 dispute settlement regimes as providing exclusively prospective remedies.[53] The United States' only disagreement was whether Article XIV, in fact, incorporated the prospective-only structure and terminology of those prospective regimes.[54]

38. At the hearing, the United States for the first time attempted to dismiss the interpretative weight to be given these "relevant rules of international law" by

[51] U.S. Reply ¶ 23.

[52] Stmt. of Defence ¶ 31; Canada Rebuttal ¶ 53.

[53] U.S. Reply ¶ 36, n.6.

[54] U.S. Reply ¶¶ 28-40.

suggesting that they are a "secondary" means of interpretation.[55] This is a mischaracterization of the VCLT.

39. Paragraphs 1 through 3 of Article 31 of the VCLT are principles of treaty interpretation that are applied together. These principles include an examination of the ordinary meaning of the SLA's terms, in their context and in the light of their object and purpose (VCLT Article 31.1 and 31.2) and, on an equal basis, the relevant rules of international law applicable in the relations between the parties (VCLT Article 31.3). Notably, there is no legal hierarchy within Article 31 as each of the interpretive steps informs the others. Article 31.3(c) states that there "shall be taken into account" together with context, relevant rules of international law between the parties. There is thus no discretion in this regard. Relevant rules of international law must be considered, and they must be given equal weight in the interpretative process with ordinary meaning, context and object and purpose.

40. Trade agreements to which the United States and Canada are parties are "relevant rules of international law." In response, the United States argues that the SLA is a "settlement agreement," not a "comprehensive trade agreement," and that "no rational nation" would agree to a settlement agreement that provided for a prospective remedy system in exchange for: refunding retroactively 5 billion in collected duties; vacating retroactively antidumping and countervailing duty orders; and refraining from the imposition of domestic remedies.[56] These statements are wrong for several reasons.

[55] Tr. at 304:1-7 ("Canada has relied heavily upon the secondary rules of interpretation of the Vienna Convention to justify its heavy reliance on the WTO and NAFTA Agreements. We, in contrast, rely on the primary rule of interpretation, which is the ordinary meaning of the text of the SLA read in its context in light of the object and purpose of the SLA."); *see also* Tr. at 29:3-7, 53:21-54:5.

[56] Tr. at 297:12-16.

41. The United States' assertion that the SLA is a "settlement agreement," and not a "trade agreement," is belied by the very first sentence of the SLA. The SLA is a comprehensive mutli-year agreement governing "trade in Softwood Lumber Products."[57] "Trade" in softwood lumber products between Canada and the United States amounts to billions of dollars annually, and in typical years represents the largest component of the world's largest bilateral trading relationship. Although the SLA served in part to settle numerous outstanding litigations involving that trade over the 2001-2006 period, it also established a new comprehensive framework for that same trade prospectively for the seven-to-nine year duration the Parties intended the SLA to have. Indeed, the bulk of the SLA is devoted to establishing the parameters of the Parties' trading relationship in softwood lumber going forward.

42. Both Parties have obligations under the Agreement that extend for the duration of the Agreement. Under the terms of the Agreement, in addition to refunding the illegally collected duty deposits, the United States agreed not to initiate domestic trade actions with respect to softwood lumber for the life of the Agreement,[58] and Canada agreed to impose export measures in the form of export charges and quotas on softwood lumber exports from Canada to the United States.[59] As Canada explained in the hearing, the US$ 4.4 billion was paid by the United States, not as consideration, but to return deposits that the U.S. Court of International Trade, a NAFTA Chapter 19 Panel and the WTO had determined were illegally collected and held by the United States.[60] There is no question that the SLA was designed to regulate ongoing trade between the

[57] SLA Art. I (Ex. RR-1).

[58] SLA Art. V (Ex. RR-1).

[59] SLA Art. VI (Ex. RR-1).

[60] Tr. at 325:9-326:8.

Parties and – barring abrogation of the Agreement by one of the Parties – will continue to do so for many years.

43. The United States nonetheless seeks to distinguish between the WTO and NAFTA Chapter 20, on the one hand, and the SLA on the other, based on a narrow notion of "trade liberalization." The United States claims that the WTO and NAFTA are trade liberalizing agreements, but the SLA is not.[61] The United States provides no support for its assertion that this is the key criteria that defines whether a treaty qualifies as a trade agreement, and its assertion in any event is incorrect. Global agreements regulating trade in textiles, sugar, coffee and a host of other products are not trade agreements simply because their explicit purpose and effect is to restrict trade. Nor does the United States explain why a trade agreement, however characterized, cannot serve multiple purposes. The binary world the United States posits, in fact, does not exist. Trade agreements routinely contain both liberalizing and non-liberalizing aspects. For instance, the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (or TRIPS) is undeniably trade regulatory in nature, yet it stands as Annex 1C to the Marrakesh Agreement as one of the fundamental pillars of what the United States characterizes as the "liberalizing" WTO trade regime.

44. The United States' one-dimensional characterization of the SLA as non-trade liberalizing is in any event inaccurate, particularly in relation to the trade regime in place at the time the SLA was executed. Under the pre-SLA regime, virtually every shipment of softwood lumber from Canada was subject to substantial duty liability – nearly 30 percent from late 2001 through 2004 – regardless of market conditions in the United States. These duties applied even when lumber prices in the United States were at record levels during the peak of the U.S. housing boom. The SLA replaced that blunt

[61] U.S. Reply ¶¶ 32, 34; Tr. at 298:1-5.

instrument with a regime that moderates export taxes and quotas as U.S. market conditions vary, eliminating restraints entirely when market conditions warrant. The SLA is thus far more trade liberalizing than the duty-regime it replaced. In sum, the dichotomy the United States' seeks to establish between liberalizing and non-liberalizing trade agreements is a false one, and in any event, inaccurate as applied to the WTO, NAFTA and the SLA.

3. RESPONSE TO U.S. LEGAL ARGUMENTS

45. In its closing statement, the United States again argued that Canada, in asking the Tribunal to determine the issues of what constitutes a cure, and whether Canada has cured the breach in this instance, is seeking "to short-circuit the careful, deliberate process to which the Parties agreed in Article XIV" and attempting to build in an "exception [to paragraph 22] … that allows the Tribunal to, before applying the [ ] provisions [of paragraph 22], consider whether Canada has cured the breach in the first instance."[62]

46. Canada agrees that the Tribunal has two mandatory tasks under paragraph 22 – setting a "reasonable" period of time to cure the breach and determining "appropriate adjustments" to the export measures to compensate for the breach if there is no cure.[63] Neither can be undertaken, however, without deciding what a cure of the breach is and whether stopping the breach constitutes a cure of the breach.[64] First, the Tribunal would not be able to determine what length of time would be "reasonable" without deciding if Canada had to take some action in addition to eliminating the

[62] Tr. at 300:7-8, 299:4-7.

[63] Canada Rebuttal ¶ 20.

[64] Canada Rebuttal ¶¶ 21-23.

breach.[65] Similarly, this Tribunal would not be in a position to determine what compensatory adjustments were "appropriate," without first determining whether there is a continuing breach and whether paragraph 22 contemplates adjustments to compensate for the effects of a past breach.[66]

47. The Parties have joined issue on this point, which is now ripe for decision in this proceeding.[67] There is nothing hypothetical about Canada's position, the United States has not contested that Canada has applied the required EUSC adjustment since July 1, 2007, and nothing will change regarding this factual basis of Canada's defense. There is also no reason to expect, absent a decision from the Tribunal, that either Party will change its legal position regarding what constitutes a cure of the breach. Therefore, there is no justification for implying a limitation on the capacity and duty of the Tribunal to address the issue of what constitutes a cure and whether Canada has cured the breach in this case.

48. At the hearing, the United States repeated an assertion first stated in its Reply – that the U.S. domestic bankruptcy case, *In the Matter of Clark,* was persuasive authority showing that "cure" implied compensation for the consequences of a past breach.[68] The United States said that Canada's only response to this U.S. argument had been to point out that a Party's internal domestic court rulings are not a primary or even supplementary means of treaty interpretation under the Vienna Convention.[69] This was not, in fact, Canada's only response. Canada also pointed out that, even if *In the*

[65] Canada Rebuttal ¶ 21.

[66] Canada Rebuttal ¶ 22.

[67] Canada Rebuttal ¶ 25.

[68] Tr. at 308:12-309:7.

[69] Tr. at 308:23-309:2.

Matter of Clark was entitled to any weight, it is clear from the text of that decision that the U.S. court was interpreting a U.S. bankruptcy statute that used the word "cure," in relation to a default.[70] Not surprisingly, the court found that the cure of a default – a failure to pay money owed – in the context of that U.S. bankruptcy statute would necessarily entail making the payment owed. The SLA is an entirely different context, establishing rules of conduct for the governments, and in this context curing the breach means ceasing the breach, not compensating for the effects of the past breach. Thus, even if a local court decision were entitled to weight, which it is not, the context of the use of cure is so different as to make *In the Matter of Clark* inapposite.

49. The United States repeated its argument in its closing statement that Canada's interpretation of Article XIV would leave the United States without a "remedy" if Canada implemented a one-time subsidy or an intermittent subsidy and without recourse for a wide-range of current and possibly future breaches of the SLA.[71]

50. As Canada has noted, the United States' fears are feigned. They cannot be squared with the United States' own prior trade dispute practice and the fact that prospective remedy regimes are the norm in international trade agreements.[72] The dispute settlement regime that the Parties agreed to when they entered into the SLA is the same dispute settlement regime both Parties agreed to in the WTO (as did more than 150 other signatories) and NAFTA Chapter 20.[73] Whether the SLA provides for

[70] Canada Rebuttal ¶ 79.

[71] Tr. at 301:14-18.

[72] Stmt. of Defence ¶ 17.

[73] During the hearing, the United States claimed that a prospective remedy system was absurd, illogical, counterintuitive, and that no "rational" nation would sign such an agreement. *See* Tr. at 23:6-12, 31:25-32:7, 297:12-20. These arguments are an exaggeration and the United States' feigned outrage should be ignored by the Tribunal. In fact, such an approach is the norm for international trade agreements and more than 150 nations – including the United States and Canada – having signed onto the WTO, which sets forth precisely these type of prospective-only

compensation for past breaches should be decided based on the text of the Agreement; not on the parade of horribles that the United States has speculated could result if the Tribunal does not adopt its interpretation of the text.

51. Canada has also refuted the U.S. argument that Article VIII of the Agreement (the surge mechanism) would be unenforceable if there were only prospective remedies.[74] To the contrary, as Canada noted in its closing statement, this example makes Canada's point.[75] Had the Tribunal decided that Option A Regions were subject to the EUSC adjustment, Canada would have been obligated on a prospective basis to calculate the surge level based on the adjusted EUSC rather than the unadjusted EUSC for the remaining term of the SLA. If Canada failed to cure the breach in this way, Canada's exports from Option A Regions would have been subject to compensatory adjustments – *i.e*. additional export or import taxes triggered on a basis as if the surge were properly calculated – until Canada did so – to compensate for Canada's ongoing miscalculation of the surge tax.

52. The United States, in an effort to explain away the inconsistency of the terms of the Agreement with the U.S. demand for retroactive compensation, suggests that the concept of "cure of the breach" could include a wide array of different measures acceptable to the complaining Party, including cash compensation for damages caused by past breaches.[76] In effect, the United States is arguing that a cure of a breach can be

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remedies. Far from being absurd or counterintuitive, a prospective remedy approach is consistent with expected good faith compliance by nations to their trade obligations, recognition and appreciation of nations' individual sovereignty over internal trade matters and a need to preserve the negotiated trade equilibrium rather than attempt to address alleged harms to individual companies or persons that are not parties to the agreement.

[74] Tr. at 51:14-21.

[75] Tr. at 324:21-325:6.

[76] Tr. at 31:5-13, 300:17-19, 303:10-16.

whatever Canada is willing to do that the United States agrees is sufficient to avoid application of whatever compensatory adjustments, if any, may have been established by the Tribunal.

53. This U.S. interpretation is not supported by the terms of the Agreement.[77] Article XIV does not provide that a cure is whatever the United States and Canada can agree upon. The complaining Party, as a sovereign state, can agree to accept a substitute for a cure of the breach, but the complaining Party has no veto over what constitutes a cure of the breach, because the SLA vests that authority in the Tribunal. Likewise, the United States cannot avoid the obvious insufficiency of a 30-day "reasonable period of time" if the intent had been to compensate for past breaches, by pretending that it may be a sufficient "cure" to have an agreed plan to complete a compensation in the future. The U.S. interpretation is a rewrite of paragraph 22 and has no support in the text of the Agreement or its negotiating history.

54. Contrary to the position that the United States argues as a claimant in this proceeding, the United States knew or should have known, for all the reasons explained by Canada, that Article XIV was a prospective-only dispute settlement system. The last dispute settlement case under the SLA 1996, in which the United States was the responding Party, is a particularly graphic illustration.[78] Both Parties agree that the term "cure the breach" comes directly from the SLA 1996. In the last arbitration conducted under the SLA 1996 (the only one that reached a decision) Canada sought a determination of liability, but did not ask for any decision on how the United States must

[77] Canada Rebuttal ¶¶ 49-51.

[78] 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) (RRA-1). This case is discussed in Canada's Rebuttal at ¶¶ 77-78 and Stmt. of Defence at ¶ 47, n.40.

"cure the breach." Plainly, Canada did not think that it was entitled to a cure that compensated Canada for trade losses resulting from the U.S. breach since July of 1999, or Canada would have requested such a finding. The United States either agreed with Canada that relief could only be prospective, or acquiesced fully in Canada's decision not to claim the compensation that the United States thought was Canada's entitlement, if Canada prevailed.

55. The panel found that the United States' action was a breach of the SLA 1996, but the panel, with the specific agreement of both Parties, made no finding on what would be a reasonable period of time to cure the breach, nor on the content of the cure. The United States implied at the hearing that compensation for past breaches was not at issue because the SLA 1996 had terminated. But this is wrong. The SLA had not terminated when the case was argued and it was still in force when the panel issued its award.

56. The United States also declared at the hearing that the suggestion that Canada would allow a U.S. breach to go uncompensated if it had the effect of reducing Canada's quota access to the U.S. market was "absurd."[79] However, that is precisely what Canada did for the same reasons that parties do not seek or receive compensation for past breaches under the WTO or NAFTA Chapter 20 – because the systems are prospective-only.

57. Finally, the United States repeated, in closing, its now familiar argument that Canada's position "does not regard the Tribunal's … Award [on liability as] … final and binding."[80] This is incorrect. Canada has never questioned the finality of the

[79] Tr. at 302:21-303:9.

[80] Tr. at 36:2-20, 303:10-16.

Tribunal's finding that Canada had breached the SLA. Canada does not consider, however, that the Tribunal's award in the liability phase extended beyond a finding of breach to the appropriate consequences under the SLA of that breach. Canada always has understood that a determination of what consequences, if any, were appropriate would take place in this remedy phase of the proceeding.

B. LESSONS LEARNED FROM THE HEARING – ECONOMIC ARGUMENTS

1. OVERVIEW

58. As noted in response to the Tribunal's question 3.2(b), the United States has the burden of proving the level, type and rationale of any compensatory adjustments that the United States claims should apply. The economic testimony and the results of the hearing show that, as an economic matter: (1) the United States failed to establish damage to the United States or to the U.S. industry; (2) the United States assumed, but did not attempt to establish or quantify a benefit to Canadian exporters; (3) the U.S. proposed remedies, notwithstanding their claims to serving various different allegedly economic principles, lack any coherent or consistent economic rationale; and (4) the breach at issue resulted in a very small amount of overshipments that were immediately offset in the second half of 2007.

59. Canada's legal interpretation of Article XIV emerges strengthened from the examination of the written and oral testimony of the Parties' experts. The United States has had to concede that the Agreement allows only adjustments to export measures to compensate for a breach. As Canada has noted, such compensatory adjustments work well in a prospective-only system, but will result in market distortion if applied to address the consequences of a past breach. The United States, however, has insisted that there must be some sort of retroactive compensation. Canada has summarized the lack of legal basis for the U.S. position above, but it is no less striking

how the testimony of both economic experts has shown what inaccurate and unpredictable tools adjustments to export measures are if the objective is to compensate the United States for alleged past harms occurring nearly two years ago. The U.S. expert concedes many of these difficulties, but says that he must use the tools available.[81] The United States accuses Canada of failing even to try to devise a remedy to compensate for the past breach. Canada, however, notes that the answer to the "problems" of the United States is that the Agreement does not, and was never intended to, provide retroactive compensation.

60. The United States' attempt to use future intervention to compensate for past actions creates tremendous economic difficulty. Professor Kalt described this difficulty clearly in the hearing: with the passage of time from the breach to the corrective action, "the market has changed, the Parties have changed, and in this context the size of the target … is quite small."[82] He noted that the remedy would be implemented in a world "considerably changed from the world in the first half of 2007 when the breach occurred,"[83] a fact documented in detail in Professor Kalt's original report, where he described a 41 percent fall in U.S. lumber consumption and a 27 percent fall in U.S. lumber prices.[84] The report concluded that "[w]ith volatile and declining markets, multiplicity of market participants, and numerous economic effects, it is implausible that a market intervention can have an effect equal in magnitude, but opposite, to the effect

[81] Neuberger Second Rebuttal Report ¶ 8 (CR-29).

[82] Tr. at 126:16-18; *see also* Tr. at 153:22-25 ("[When] you're trying to hit very small targets in a changing world on a going forward basis using market interventions rather than cash payments, and that creates this added problem of a small target that's moving.").

[83] Tr. at 130:19-20.

[84] Expert Witness Statement of Joseph P. Kalt and David Reishus ¶ 24 (Jun. 29 2008) ("Kalt/Reishus Report") (Ex. RR-2).

of some market action in a previous period."[85] Professor Kalt explained the insurmountable difficulties associated with trying to use export measures to address the consequences of past breaches.[86] In Kalt's words "the use of export measures by having these effects and difficulties … point[s] the arrow away from the U.S. [retroactive remedy] interpretation."[87]

61. A significant factor that emerged clearly from the hearing is that the totality of the breach was an extremely small event.[88] Professor Kalt testified that the overshipments during the breach represented less than one percent of the U.S. lumber market – about one day's worth of U.S. consumption.[89] This was portrayed visually during the hearing, with the overshipments showing as tiny black dots on a graph portraying the overall U.S. market.[90] The accuracy of this portrayal has not been questioned or challenged by the United States.

62. This has several important implications. It places in high relief the challenge, if not impossibility, of offsetting with the tools permitted such a small event

[85] Kalt/Reishus Report ¶ 25 (Ex. RR-2).

[86] The United States asserted in its closing statement that Professor Kalt concealed his "true position" that the SLA is not well suited to provide compensation for the past effects of a breach. Tr. at 285:20-23. To the contrary, Professor Kalt has not masked this position at all – he has made it quite clear that the SLA's limitation of remedy to adjustments to the export measures provides a tool that is ill-suited for providing retroactive reparations.

[87] Tr. at 143:12-14.

[88] The United States asserted in its closing statement that Professor Kalt's position that large market distortions were likely to result from the U.S. remedies was inconsistent with his assertions that the effects of the breach were small. Tr. at 292:20-24. There is no inconsistency – Professor Kalt has explained that the minimal effects of Canada's breach provide small targets for any remedy attempting to offset them.

[89] Tr. at 139:12-18; Kalt/Reishus Report ¶ 7, Figure 1 (Ex. RR-2). The U.S. describes this overage as "one-and-a-half month's worth of sales of softwood lumber in the northern part of the United States and looked at another way, 3.5 months of sales in the State of Maine." Tr. at 19:6-9.

[90] Tr. at 140:8-22.

with any accuracy. How can the Panel confidently calibrate a measure intended to offset a beach of a mere 1 percent, which occurred nearly two years ago, in a market that is capable of shrinking 41 percent in the course of two years?

63. The small scale of the breach imposes stringent demands on any attempt to engage in economic modeling of the breach's effects. As detailed below, no pretension of accuracy can be made by a model that does not account for the factors that can absorb such a small, temporary event. As Professor Kalt testified, the failure of Dr. Neuberger's model to consider changes in lumber inventories – easily capable of absorbing completely a quantity that is roughly one day's consumption – makes his model highly suspect in this regard.[91] The small size of the breach also places a high premium on the accuracy of the assumptions incorporated into the model. Dr. Neuberger's admitted error in selecting the wrong parameter for the critical elasticity assumption,[92] and the wide variations of outcomes based on small variations in that assumption, demonstrate the insufficiency of his model to deal with small magnitudes.[93]

64. The small scale of the breach also necessitates statistical testing to ensure that the model's results are not purely speculative. Professor Kalt testified that Dr. Neuberger failed to conduct any sensitivity analysis of his results, and failed to test the statistical confidence of those results.[94] As a consequence of this and of the shortcomings in Dr. Neuberger's model, Professor Kalt testified that one cannot draw the

[91] Tr. at 154:12-155:7.

[92] Tr. at 111:17-24, 107:11-25; Kalt/Reishus Report, Appendix A ¶¶ 5-9 (Ex. RR-2).

[93] Tr. at 152:5-18.

[94] Tr. at 152:25-153:9.

conclusion that his estimate of the price effects of the breach ($1.94) is statistically different from zero.[95]

65. The hearing also revealed a wide array of other failings in the U.S. economic case, such as the failure to even attempt to calculate the actual value of the alleged benefit to Canadian producers that the United States seeks to offset;[96] the disproportionate effects of the proposed remedies when compared to the small magnitude of the breach;[97] the failure to attempt to calculate the effects of the proposed remedies in the current market;[98] and the failure to consider the inherent bias in any attempt to recalibrate export quotas to ensure that they are binding in current markets.[99] All of these further shortcomings are dealt with in the next section and highlight by how much the United States has failed to carry its burden of causation and actual damages.

66. Before addressing these shortcomings, Canada would like to make two general observations with respect to the overshipments and their price effect.

67. In its Statement of Case, the U.S. argued that:

> "… Canada's breach – its failure to adjust EUSC in calculating Option B regional quota volume for six consecutive months in 2007 – caused over 180 million board feet of lumber to be shipped into the United States that otherwise would not have entered the United States market."[100]

[95] Tr. at 156:17-22.

[96] Tr. at 100:24-102:6.

[97] Tr. at 83:12-17.

[98] Tr. at 130:14-20, 136:23-137:9; *see infra* ¶¶ 82-85.

[99] Tr. at 239:14-240:4. The utter absence of authority to make such an adjustment also is treated below at ¶¶ 92-94.

[100] Stmt. of Case ¶ 37.

68. Although Dr. Neuberger's calculations in this case are all based on the assumption of an overshipment figure of 182.43 million board feet,[101] at the hearing Dr. Neuberger indicated that the amount of the overage should be 216 million board feet, based on data presented by Canada, but disallowing the adjustments for the carry-forward and carry-back by Canada.[102]

69. For reasons Canada has explained previously, and which are summarized in Annex 1, both figures are incorrect because they do not consider the carry-forward/carry-back adjustment. Allowing for the application of the carry-forward/carry-back adjustment, Canada calculates overshipment to be 142 mmbf.[103] Dr. Neuberger has not considered this correct number in any of his calculations. Accordingly, the first critical variable used by the U.S. and its expert to calculate the harm to U.S. producers is incorrect.

70. Using Dr. Neuberger's initial assumption of an 182 million board foot overage, the United States argued that "…Canada's breach of the SLA lowered U.S. prices and thereby harmed U.S. lumber producers."[104] Dr. Neuberger calculates this "harm" to be a reduction of $1.94 per thousand board feet during the relevant six month period in the U.S. lumber market.[105]

71. After testifying in writing that "the overages had a significant price effect on the U.S. market that should be remedied,"[106] Dr. Neuberger acknowledged at the

[101] Neuberger Report, Exhibit 3 (CR-3).

[102] Tr. at 96:24-97:3.

[103] Canada Rebuttal ¶ 102.

[104] Neuberger Rebuttal Report ¶ 12 (CR-13).

[105] Neuberger Report ¶ 59 (CR-3).

[106] Neuberger Rebuttal Report ¶ 58 (CR-13).

hearing that the alleged "harm" represents a reduction in price of less than 1 percent on the average U.S. price of $290.66 during the first six months of 2007.[107] The United States did not claim, and Dr. Neuberger did not attempt to show, any difference in regional effects within the U.S. market, nor did he attempt to show particular effects on any U.S. lumber producer or the U.S. industry as a whole, other than the assumption that the $1.94 reduction was a harm. The flaws and unreliability of Dr. Neuberger's calculations of alleged harm to U.S. producers are discussed below.[108]

2. THE FIRST U.S. REMEDY PROPOSAL

72. The first U.S. remedy proposal – which is still the preferred U.S. proposal – is to impose an extra 10 percent export tax on all Option B exporters on the premise that any exporter who exceeds its quota level by any amount is acting as if it were an Option A exporter and should be taxed accordingly. This proposal is based on a series of false premises: (1) that Option B exporters have benefited from exceeding the quotas, a point that Dr. Neuberger and the United States simply assumed; (2) that Option B exporters acted during the period of the breach as if they were Option A exporters unconstrained by any quota; and (3) that the alleged benefit to Option B exporters justifies imposing an increased export tax as a compensatory adjustment, without regard to either the level of benefit the exporters may have attained or any harm that may have been caused to any U.S. interest.

73. In his first report, Dr. Neuberger acknowledged that Proposal No. 1 "fails to provide an economic anchor to the effects the 'over-exporting' by Option B Regions had on lumber markets in both the U.S. and Canada"[109] and that it "is not tied to the

[107] Tr. at 102:22-103:7.

[108] *See infra* ¶¶ 80-91.

[109] Neuberger Report ¶ 57 (CR-3).

magnitude of the overage."[110] It is telling that the United States and its economic expert prefer a remedy proposal that they concede has no basis in economics and no tie to any particular harm or benefit. Given the lack of any basis in economics, Dr. Neuberger's preference, as an economic expert, is entitled to no weight.

74. Nevertheless, the United States argues that it is appropriate to recapture an alleged benefit gained by Canadian exporters as a result of Canada's failure to correctly calculate EUSC in the first half of 2007.[111] However, Canada's cross-examination tested Dr. Neuberger's written testimony that Option B exporters had benefited from a higher quota than Canada should have imposed.[112] Dr. Neuberger's reply shows that the U.S. assumptions of benefits had no foundation[113]

> Aguilar Alvarez: Your reports don't consider the lower [p]rice you calculated would have the effect of reducing profits [for Option B exporters], do they?
>
> Neuberger: I did not specifically analyze the impact of Option B producers on their own profits. What I did do was infer from the behavior of exporters in those regions that assuming they were acting rationally, that it was in their economic best interest …

75. Dr. Neuberger conceded that he did not measure the supposed benefit that Option B exporters received.[114]

> Aguilar Alvarez: Your reports do not calculate the net effect on Canadian exporters: correct?

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[110] Neuberger Second Rebuttal Report ¶ 29 (CR-29).

[111] U.S. Reply ¶¶ 67-73. ("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." *Id.* at ¶ 67).

[112] Neuberger Report, n.13 (CR-3).

[113] Tr. at 101:7-10, 101:21-25.

[114] Tr. at 102:4-6.

Neuberger: That's correct.

76. In fact, it was a mere assumption by Dr. Neuberger. The only support he or the United States offered was that Option B producers are rational profit-seeking entities, an observation that provides no basis for the U.S. position.[115] Dr. Kalt, on the other hand, testified that if Dr. Neuberger's own model was used, the effect of the overshipments was at best a wash for Option B producers, and may even have caused a diminishment in their profitability.[116]

77. The second fundamental premise of this U.S. proposal is also wrong. Dr. Neuberger claims that it is appropriate to treat Option B producers as if they were Option A producers for purposes of remedy, because during the breach period they were acting like Option A producers, unrestrained by quota. There is no basis whatsoever for this premise. It is undisputed that Option B producers were at all times subject to a quota calculated by the Canadian federal government. In the first six months of 2007, every Option B Region shipped within the constraints of the quota allocations assigned to them.[117] Option A producers, in contrast, were not constrained by any quota during that period.

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[115] Tr. at 282:7-11. Profit maximizing behavior by competing suppliers does not imply that every response to changing market conditions (such as a higher perceived quota level) will result in a net benefit to the suppliers. In a competitive market, it means that the choice of an individual supplier is its best option given the expected actions of its competitors. Indeed, if supply is artificially restricted (perhaps through a quota) below competitive levels it is in every individual supplier's self-interest to expand supply, despite the fact that if all competitors behave that way, prices and profits to all competitors could fall.

[116] Tr. at 178:2-5 ("I looked at his [Dr. Neuberger's] model analyzed what it says and the net effect is approximately a wash. If you use constant elasticity assumption, it's a slight negative for the Option B producers. I've done that analysis.")

[117] Dr. Neuberger's first report stated that "… Option B Regions generally complied with the incorrect RQVs during this period, exporting less than the specified quota amounts." ¶ 31 (CR-3). Professor Kalt corrected the incorrect "generally" qualification explaining that Option B exporters respected the hard cap they were assigned by Canada at the time. A cap that the Tribunal has now found to be incorrect through no action of the exporters themselves. Tr. at 216:22-217:11, 177:11-19.

78. Finally, the text of the SLA provides no support whatsoever for this U.S. proposal, even if it were assumed that a retroactive compensation should be implied. Except for its very explicit initial transition rules, the SLA does not require Option A exporters to be treated like Option B exporters, or *vice versa*. Canada cannot refund export taxes to Option A Regions on the basis that they are shipping at lower levels than the quotas that would be applied if those Regions had chosen Option B. The SLA simply does not provide for such a cross-over. Moreover, neither the SLA nor customary international law provide for compensation without regard to quantum of injury to claimants. Canada knows of no customary international law principle justifying compensation for alleged benefits to respondents, let alone a principle that would disregard the quantum of such benefits or even their existence.

3. THE SECOND U.S. REMEDY PROPOSAL

79. The second U.S. remedy proposal calls for the imposition of an $86.7 million tax on exports from Option B Regions to offset the effect that Canada's breach allegedly had on the price of softwood lumber within the United States during the period of the breach. This proposal occupied a substantial portion of the testimony of the economic experts, primarily because, for all of its legal and economic failings, it is the only proposal for which the United States even attempted to quantify a harm or benefit from the breach, and the only proposal that the United States sought to justify as having a quantum of compensatory adjustments that would have the effect of matching the level of alleged harm to U.S. interests.

80. Utilizing a static supply and demand model of the U.S. market, Dr. Neuberger first estimated that Canada's overshipments caused a $1.94 decrease in the price of lumber during the first half of 2007. Dr. Neuberger then estimated the amount of tax that would have been necessary to increase prices by this same $1.94

during this period, in order to offset the decrease caused by Canada's overshipments, to be $39.65 per thousand board feet. The total tax of $87.6 million is derived by multiplying the $39.65 tax by the total amount of lumber shipped by Option B Regions during the breach period.

81. As Professor Kalt explained in his reports and testimony at the hearing, this U.S. proposal is plagued by a number of fundamental problems that render it unreliable and speculative. Even if Dr. Neuberger's model for determining alleged price effects were reliable, which it is not, this proposal assumes that the level of tax necessary to increase prices by $1.94 in 2007 will be equivalent to what would be necessary to increase prices by this same amount in 2009. The problem, however, is that lumber markets have changed significantly, and the future effect of the U.S. proposed tax would not have the same effect on lumber price and market participants as it would have in the first half of 2007.[118] Further, this model contains no mechanism to adjust or account for future market changes.[119]

82. Dr. Neuberger claims the U.S. proposals can account for this change. However, as Professor Kalt explained at the hearing and in his rebuttal report, Dr. Neuberger's calculations are not calibrated to determine the effect that would occur from each remedy under different market conditions.[120] The U.S. remedies will vary depending on future market conditions, but this variance is economically unrelated to the purported harm suffered by U.S. producers.[121] For example, the length of time that the

[118] Tr. at 136:23-137:5, 140:23-141:16.

[119] The use of a fixed tax revenue target does not automatically adjust for future changes. Kalt/Reishus Report ¶¶ 13, 60 (Ex. RR-2).

[120] Tr. at 141:2-16; Rebuttal Expert Witness Statement of Joseph P. Kalt and David Reishus ¶¶ 23-24 (Aug. 11, 2008) ("Kalt/Reishus Rebuttal Report") (Ex. RR-27).

[121] Kalt/Reishus Rebuttal Report ¶ 24 (Ex. RR-27).

Option A export tax is imposed will vary depending on the future price of lumber. This remedy, however, does not take into account the effect that this tax would have on U.S. producers under market conditions considerably different from 2007. There is no adjustment to keep the U.S. remedies focused on their purported targets.[122]

83. The same problem does not occur when an adjustment to an export measure is made to compensate simply for the current effect of an ongoing breach on the export measure. As Professor Kalt and Dr. Reishus explained in their Rebuttal Report, and as Professor Kalt reiterated at the hearing, "[i]n general, in the case of a breach that has a continuing effect on market outcomes, undoing the ongoing breach through the imposition of an offsetting market restriction on the breaching party can restore the market equilibrium to that which would have occurred absent the breach."[123] No distortion occurs because the effect of the breach, and the offset, is applied to the same market conditions.

84. Professor Kalt also pointed out that the adjustments to the export measures proposed by Dr. Neuberger would cause collateral effects on multiple market participants and that these effects are unlikely to be related to any gain or loss that they experienced as a result of the breach.[124] A given change in the volume of lumber shipments will have a different effect on market prices, revenues, and profits of the various market participants in one period (the first half of 2007) than it would in another (e.g., the first half of 2009).[125] The lumber market is not static and unchanging.[126]

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[122] Tr. at 141:13-16.

[123] Kalt/Reishus Rebuttal Report ¶ 11 (Ex. RR-27).

[124] Tr. at 137:14-25.

[125] Tr. at 144:2-15.

[126] Kalt/Reishus Report ¶¶ 7-9; Figures 1 and 2 (Ex. RR-2); Tr. at 87:12-13.

Unless the market were static and unchanging, these collateral effects can never be "equal and opposite"[127] to the economic effect of the past breach.

85. Beyond the highly unusual need to identify a *future* intervention in the market to compensate for the effects of a *past* breach, the situation in this case poses a difficult additional challenge. The amount of the overshipment was very small in the context of the U.S. market. The overshipment was also temporary, lasting a mere six months. That means that the model must be structured in a way that can account for very small and temporary effects. This also means that the very small actual market effects that the model is trying to measure can be overwhelmed by the effects of the errors and simplifying assumptions incorporated into the model itself. Because of these difficulties, it means that special care must be given to the sensitivity of model results to the assumptions incorporated into the model. Any results that the model produces should be subjected to statistical analysis to ensure that those results can reliably be attributed to the market events being measured, and are not simply "noise" in the operation of the model itself. The testimony at the hearing probed all four of these issues.

86. First, Professor Kalt addressed the small size and temporary nature of the overshipments, in the context of the U.S. market. Professor Kalt indicated at the hearing that the overshipments amounted to approximately one day's worth of consumption and the U.S. estimated price effect represented less than 1 percent of the price of softwood lumber.[128] Even assuming that the general approach of the second proposal was valid, one would need a model that was structured in a way that could account for these very small and temporary effects. However, Dr. Neuberger's model is structured to analyze

[127] Tr. at 281:2-4.

[128] Tr. at 139:12-18.

significant and permanent changes in market equilibrium, not small and temporary changes.[129]

87. Second, as Professor Kalt explained at the hearing, Dr. Neuberger's model has "missing parts" that would be required to properly analyze and predict the behavior of the market in response to these small, temporary effects.[130] For example, the model failed to account for inventory behavior. Inventories are used throughout the chain of distribution, from lumber mill to consumer, to manage temporary fluctuations in supply and demand, and are essential to understanding any temporary change in the market for commodities such as lumber.[131] Professor Kalt pointed out that producers in the Option B Regions, the rest of Canada and in the United States, and also buyers along the chain of distribution, can adjust the level of their inventory holdings. As the volume of overshipments and the intended effects of the proposed export tax are small relative to the size of inventories, adjustments in these inventories have the potential to dampen or magnify the intended economic effect of the temporary U.S. export measure.[132] The failure to incorporate an analysis of inventory behavior, as well as other economic responses to market interventions of the size and nature relevant to this proceeding, makes the U.S. proposal unreliable and speculative.[133]

88. Third, due to the difficulties caused by the small target of this remedy proposal and the structure of the model, special care must be given to the sensitivity of

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

[130] Tr. at 184:14-185:3, 262:2-263:18.

[131] Whenever temporary changes in prices or availability of commodities, such as oil, are assessed by economists, inventories are always central to any reliable analysis. Lumber is no different.

[132] Tr. at 154:5-155:2.

[133] Tr. at 154:20-155:7.

the model's results to the assumptions incorporated into the model itself. As mentioned, Dr. Neuberger uses a static supply and demand model of the U.S. lumber markets,[134] the results of which are highly sensitive to the model's assumptions. The model's results are determined, in part, by the shape of various supply and demand curves, which economists summarize through the use of a parameter known as elasticity.[135] A change in the elasticity values can dramatically change the results generated by Dr. Neuberger's model. Professor Kalt identified at least two fundamental errors in Dr. Neuberger's selection of elasticity values. First, as Professor Kalt explained in his expert report, Dr. Neuberger used elasticity estimates intended for a general supply curve, rather than for a supply of exports for each of the Canadian regions in his model.[136] Dr. Neuberger acknowledged at the hearing that it was incorrect to use general supply elasticities in his model and that export elasticities were more appropriate.[137] Second, Dr. Neuberger's model was based on elasticity values outside the range that even he identified in his evaluation of the relevant literature.[138]

89. The extreme sensitivity of the U.S. proposal to the range of elasticity values highlights the speculative nature of the results.[139] Professor Kalt testified to the change that might result over the full range of elasticity estimates in the literature. He testified that just by moving to the 2.0 used by Dr. Neuberger's own partners,

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[134] Neuberger Report ¶ 58 (CR-3); Kalt/Reishus Rebuttal Report ¶ 37 (Ex. RR-27).

[135] Elasticity measures the percentage change in quantity supplied or demand to a percentage change in price.

[136] Kalt/Reishus Report, Appendix A ¶¶ 5-9 (Ex. RR-2).

[137] Tr. at 111:17-20 ("I acknowledged based on Dr. Kalt's critique and also my further review of the literature that in this context an export supply elasticity may be more appropriate in this setting.").

[138] Tr. at 107:18-108:3.

[139] Tr. at 149:24-150:6.

Dr. Neuberger's results would be cut by two thirds.[140] This is but one of the several errors identified by Professor Kalt. As such, all of the relevant estimates from Dr. Neuberger's model are erroneous, including the effect of the overage on U.S. lumber prices (*i.e.*, the $1.94) and the resulting tax to be applied to future Option B exports (*i.e.*, the $39.65).

90. Finally, the small magnitude and temporary nature of the effect being measured, combined with the sensitivity of the model, require that the results be subjected to statistical testing to determine if they are meaningful, or simply the result of noise in the model itself. Despite the importance of conducting such a test, Dr. Neuberger provides no analysis of the range of statistical reliability or significance of the results of the model.[141] More fundamentally, Dr. Neuberger's model is simply incapable of providing reliable and non-speculative estimates of future compensatory adjustments.[142] Due to the multiple problems with the model and its sensitivity to parameters that were subjectively assigned, Professor Kalt testified at the hearing that based on the information before the Tribunal, there is no basis for saying that "the $1.94 is statistically different from a penny or statistically different from $4" or even "statistically different from zero,"[143] and that "[w]e don't have a reliable non-speculative number."[144]

4. THE THIRD U.S. REMEDY PROPOSAL

91. The Agreement provides for the establishment of Regional Quota Volumes (RQVs) in a fixed proportion of Expected U.S. Consumption (EUSC). In its

[140] Tr. at 152:8-12.

[141] Tr. at 152:23-153:9.

[142] Tr. at 153:10-20.

[143] Tr. at 156:17-22.

[144] Tr. at 156:19-20.

third remedy proposal, however, the United States first would establish RQVs based on expected Option B exports. This is directly contrary to the Agreement. The Agreement adjusts quota levels only in relation to EUSC and to prices prevailing in the U.S. market, never in relation to quota utilization. Article XIV(23) provides that the adjustment shall be in an amount that compensates for the breach. It does not allow imposition of additional adjustments to compensate for the degree to which quotas are underutilized or expected to be underutilized.

92. This proposal should be rejected out of hand for legal reasons alone. However, at the hearing it was evident that the proposal has economic flaws as well. Like Proposal No. 1, it simply assumes that Region B exporters benefited from the breach and must be punished accordingly with a measure that will alter their export plans negatively in the same degree as it is assumed that they benefited from the breach. Even if this premise had a legal basis, and were built on a valid demonstration of benefit, which it is not, as Professor Kalt pointed out,[145] and Dr. Neuberger now acknowledges,[146] projecting future desired export levels is subject to significant error, which can have major disruptive and punitive consequences. Furthermore, reducing that forecast by the targeted overage amount is a biased procedure that would on average result in future reductions in exports greater than the past overage.[147]

[145] Tr. at 155:8-18.

[146] Tr. at 101:21-25.

[147] Kalt/Reishus Rebuttal Report ¶¶ 27-29 (Ex. RR-27); Neuberger Second Rebuttal Report ¶ 26 (CR-29); Tr. at 239:18-240:4, 293:11-13. The United States confuses bias in the *effect on export levels* with the unbiasedness of the export projections. Tr. at 293:6-13. At the hearing, Mr. Schwind implied that Canada receives an offsetting benefit in the months when the projection was too high. This analysis is wrong as it confuses these two different concepts. In the U.S. hypothetical, when the forecast was too high by 100, there is no effect on exports.

93. The effect of the bias could an be seen in the hypothetical posed at the hearing by the United States.[148] Underutilization is fully built into the model, but overutilization is legally impossible and so ignored, lowering the overall average. The forecast errors will be easily many times the amount of the overshipment – and biased in only one direction, against Canadian exporters.

5. THE FOURTH U.S. REMEDY PROPOSAL

94. The fourth U.S. proposal asks the Tribunal to intervene in the quota calculation mechanism and reduce Expected U.S. Consumption ("EUSC") in the future by the amount that it was miscalculated during the first half of 2007.

95. As Canada explained in its Rebuttal, this remedy fails to consider that the Option B Region exporters did not ship the full amount of the albeit incorrectly-calculated RQV. If Option B exporters had in fact utilized all of their quota during the first six months of 2007, this future reduction in EUSC would reflect the amount of overshipment. However, by failing to account for this unused quota, Professor Kalt and Dr. Reishus have explained that the reduction in RQV resulting from the downward adjustment to EUSC would be in an amount that is two and a half times greater than the actual amount that Option B exporters exceeded the correctly calculated RQV.[149] The United States has failed to rebut this flaw.

CONCLUSION

96. The results of the hearing reinforced the following main legal conclusions: (1) by ceasing the conduct that was found to breach the SLA, Canada "cured the breach"; and (2) paragraphs 22 through 24 of Article XIV do not provide for adjustments

[148] Tr. at 240:5-249:23.

[149] Kalt/Reishus Report ¶ 72 (Ex. RR-2).

to compensate for past breaches. The Tribunal accordingly should find that no reasonable period of time will be necessary to cure the breach because it has already been cured, and that compensatory adjustments may not be applied since paragraph 22 provides for compensatory adjustments only if the breach has not been cured. Applying the interpretive principles of the VCLT, these legal conclusions are grounded in the ordinary meaning of the terms of the Agreement, in their context and in light of the object and purpose of the Agreement, and are supported by the applicable rules of international law in the WTO and the NAFTA. By contrast, as was evident at the hearing, the text must be ignored or severely strained to reach the position advocated by the United States.

97. The expert testimony of the economic experts corroborates the legal analysis. Significantly, the preferred remedy of the United States and its appointed expert, Dr. Neuberger, is Proposal No. 1, which Dr. Neuberger admitted is not anchored in economics and would have economic effects that he did not attempt to relate to either a harm to U.S. interests or a benefit to the Canadian exporters. As Professor Kalt's testimony and witness statements demonstrated, there are insurmountable difficulties associated with trying to make adjustments to future export measures in unknown future market conditions to target minor breaches of the past. These difficulties lead Professor Kalt, as an economist, to conclude that the arrow "point[s] … away from the U.S. [retrospective remedy] interpretation."[150]

98. Finally, much of the testimony of the economic experts concerned what, if any, economic basis exists for the remedy proposals advanced by the United States. The Tribunal inquired about burden of proof – and for good reason considering the speculation and conjecture that formed much of the U.S. economic arguments regarding

[150] Tr. at 143:12-14.

alleged harm. The Tribunal can award no remedies if the basis for alleged harm is speculative. Only one U.S. proposal – No. 2 – even pretends to measure damage to the United States and to equate a remedy to that damage, but that proposal is based on a deeply flawed model that is too simple to meet international and economic standards for accuracy, reliability and predictability. The other proposals are based on a vague allegation by the United States of benefit to Region B exporters, but, as was clear from his testimony at the hearing, Dr. Neuberger simply assumed that benefit. These proposals, like Proposal No. 2, suffer from deep flaws of accuracy, fairness and predictability. Thus, even if it were assumed, wrongly, that the SLA provided for a retrospective compensation, the United States has not met its burden of proving any entitlement to a compensatory adjustment.

AWARD SOUGHT

1. For the reasons set forth above, Canada respectfully reiterates its request for an award:

(a) 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

(b) 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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ANNEX 1

1. The United States has argued that carry-forward and carry-back should not be accounted for in establishing the level of overshipment at issue. The United States attempts to portray its position as based in economics, to which Dr. Neuberger's expertise might be relevant,[151] but in fact it is simply a legal question whether carry-forward and carry-back apply under the SLA. Dr. Neuberger's opinions on this issue are entitled to no weight.

2. First, the United States claims that carry-forward/carry-back, a basic feature of the Option B system, should not apply because the United States had no notice that it would be applied in these particular months.[152] In fact, the United States has been notified about the operation of the Option B system since January 2007,[153] when the Department of Foreign Affairs and International Trade ("DFAIT") began publishing this information online.[154]

3. Second, the United States claims that paragraph 7 in Annex 7B prohibits any carry forward or carry back between December 2006 and January 2007 because no mandatory volume restraint was in force until January 2007. Paragraph 7 of Annex 7B specifies that "[n]o quota volume may be carried back or carried forward between any two months unless the Region's exports are subject to a volume restraint in both months." The Tribunal will recall that during the October 12 to December 31, 2006

[151] Tr. at 293:25-294:5.

[152] U.S. Reply ¶ 91.

[153] Canada Rebuttal ¶ 106.

[154] In addition to the information posted on the website, Canadian officials explained and illustrated the calculations to U.S. officials, and shared the volumes of carry-forward/carry-back used by each region on a monthly basis in a bilateral meeting in Washington on November 15 and 16, 2007. *See* Canada Rebuttal ¶¶ 104-106, n.88.

transition period, Option B Regions were taxed at the same rate as Option A Regions and then retroactively treated as subject to a volume restraint by the operation of footnote 2. The U.S. claim is without merit as it seeks to make a general running rule for the Option B system – *i.e.* paragraph 7 of Annex 7B – into a transition-specific rule. At the same time, the United States ignores the rules in footnote 2, which are specific to the transition period.

4. Footnote 2 of the Agreement specifies that Option B exporters were entitled to a refund of the difference between what they paid during the transition period (when they were taxed at the rate of Option A Regions) and the lower rate they would have paid as Option B Regions. However, they were only entitled to this refund if they shipped below the RQV that would have been in effect. Most importantly, footnote 2 explicitly provides that "the carry-forward and carry-back rules laid out in Annex 7B shall be taken into account for all of the months of the transition period."

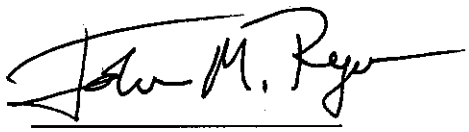
5. The United States attempts to dismiss this sentence in footnote 2 as having a limited meaning by arguing that carry-forward and carry-back are only considered for calculating the refund, but this is not what the last sentence provides. The text is clear – carry-forward and carry-back are calculated during the transition period. It is consistent with the text of the Agreement, as well as the intent of the Parties, to rely on the carry-forward and carry-back rules when calculating the amount by which Canada overshipped its quotas.

6. The correct number for overshipments is therefore 142 mmbf. Dr. Neuberger has not considered this correct number in any of his calculations. Accordingly, the first critical variable used by the U.S. and its expert to calculate the harm to U.S. producers is incorrect.

CONFIRMATION OF SERVICE

I, John M. Ryan, hereby certify that I caused a copy of this Post-Hearing Brief to be submitted, together with attachments, pursuant to Article 15.3 of the LCIA Rules and the Tribunal's Procedural Order No. 4, and is being simultaneously transmitted by e-mail to the legal representatives of the Claimant on October 31, 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,



John M. Ryan