In the LCIA

No. 91312

CANADA

Claimant,

v.

THE UNITED STATES OF AMERICA

Respondent.

STATEMENT OF CASE

GUILLERMO AGUILAR ALVAREZ
Weil, Gotshal & Manges LLP
767 Fifth Avenue
New York, NY 10153
UNITED STATES
Tel: +1.212.310.8981
Fax: +1.212.310.8007
guillermo.aguilar-alvarez@weil.com

JOANNE E. OSENDARP
CHARLES E. ROH, JR.
Weil, Gotshal & Manges LLP
1300 Eye Street, NW, Suite 900
Washington, D.C. 20005
UNITED STATES
Tel: +1.202.682.7193 (Osendarp)
Tel: +1.202.682.7100 (Roh)

Fax: +1.202.857.0940
joanne.osendarp@weil.com
chip.roh@weil.com

May 12, 2009

Attorneys for Claimant, Canada

TABLE OF CONTENTS

Page

TABLE OF CONTENTS
(continued)

Page

STATEMENT OF CASE

Canada respectfully submits this Statement of Case pursuant to the Tribunal's Procedural Order No. 1 dated April 27, 2009 and pursuant to Rule 15.2 of the LCIA Rules.

A. INTRODUCTION

1. This arbitration arises under Article XIV(29)(c) of the Softwood Lumber Agreement Between Canada and the United States ("SLA").[1] Pursuant to that paragraph, Canada requests the Tribunal to determine that a cash payment of USD$34 million, plus simple interest at 4 percent,[2] which Canada has tendered, fully cures the breach found in LCIA Case No. 7941 ("LCIA 7941").[3] The United States to date has refused Canada's tender of payment on grounds that the United States does not consider such payment to cure the breach, in whole or in part.[4] The United States has thus imposed import duties pursuant to Article XIV(27). In these circumstances, Article XIV(29)(c) of the SLA provides for the Tribunal to determine whether the cash payment which Canada has tendered cures the breach, in whole or in part, and if so to require that the United States

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

[2] Hereinafter, Canada will use the phrase "USD$34 million" to refer to the cash payment of "USD$34 million, plus simple interest at 4 percent."

[3] Canada submits as an appendix to this submission, a list of documents filed in the record in *The United States of America v. Canada*, Case No. 7941 (Remedy), LCIA proceeding. *See* Ex. C-2. Canada reserves its right to rely on the documents listed in that appendix in the June 2009 hearing in this case. Documents directly relied on by Canada in its Statement of Case have been attached as exhibits to it.

[4] U.S. Response to Request for Arbitration ¶ 35.

cease or modify its imposition of import measures and refund in whole or in part duties already collected.

2. Without prejudice to Canada's position with regard to the correct interpretation and application of the SLA for any other purpose or proceeding, Canada will assume for the purposes of this proceeding that the Award in LCIA 7941 was correct in finding (1) that cessation of a breach does not constitute a "cure" of a breach and (2) that a cure of the breach, and compensatory adjustments in the absence of a cure, should have the same objective of providing full reparation for the past breach in accordance with customary international law standards. Even assuming that a cure and compensatory adjustments have identical objectives, however, the Tribunal recognized differences in the SLA rules applicable to each.

3. In LCIA 7941, the Tribunal rightly found that its mandate was limited to determining compensatory adjustments, which, under the SLA, must take the form of adjustments to Export Measures. Acknowledging that this limitation posed difficulties for its objectives, the Tribunal nevertheless chose what it considered the appropriate remedy among those proposed by the United States, to be applied if Canada did not cure the breach within the reasonable period of time determined by the Tribunal.

4. Canada comes before this Tribunal because Canada considers that a cash payment of USD$34 million cures the breach. Such a lump-sum payment provides the United States with full reparation for the only harm that the United States attempted to demonstrate in LCIA 7941 – harm to U.S. producers during the period of Canada's breach. Such a payment meets the objective of a cure identified by the Tribunal – wiping out the consequences of the breach in the

sense of customary international law and the ILC Articles[5] – and with much greater certainty and fewer collateral distortions than any remedy the LCIA 7941 Tribunal could determine within the SLA's constraints with respect to compensatory adjustments.

5. Canada's position in this proceeding can be summarized succinctly. First, a cure of the breach can take the form of cash compensation, which is also the best means in this case to provide full reparation for any harm suffered by U.S. producers. Article XIV restricts the form that the compensatory adjustments may take, but does not restrict the form that a "cure" may take, as the United States conceded in the LCIA 7941 proceedings.[6]

6. Second, USD$34 million provides full reparation to the United States for any injury to its softwood lumber producers. That sum represents the amount of lost producer surplus to U.S. producers, as calculated using the methodology and assumptions made by Dr. Neuberger, who testified in the LCIA 7941 remedy proceeding, and whose testimony and reports were endorsed by the United States in that proceeding. As testified by Dr. Joseph Kalt in a report appended to this Statement of Case (the "Kalt Report"),[7] producer surplus is the standard measure of economic effects on a market's producers of an event or government program that changes supply and demand in the market and the sum

[5] Responsibility of States for Internationally Wrongful Acts, U.N. GAOR, Int'l Law Commission, 53d sess, pt. 2, ch. 1, art.31 ("ILC Articles") (CA-1).

[6] *See, e.g.,* Transcript of Hearing on Remedies, *The United States of America v. Canada*, Case No. 7941, LCIA, Sept. 23, 2008 (hereinafter, "Day II Tr.") at 290:16-291:18; 300:6-25; 301:4-10 (Ex. C-3F).

[7] Expert Witness Statement of Joseph P. Kalt and David Reishus, May 12, 2009 (hereinafter, "Kalt Report") (Ex. C-3).

of USD$34 million equals the amount of lost producer surplus.[8] A cash payment of USD$34 million corresponds to the United States' own calculations as to the harm suffered by its producers. The United States is not entitled to anything more under the SLA or customary international law than full reparation for the harm to its producers.

7. Accordingly, the compensatory measures imposed by the United States should be terminated because a cash payment of USD$34 million constitutes a cure of the breach found by the Tribunal in LCIA 7941. Furthermore, all customs duties collected by the United States should be refunded retroactively to the date the compensatory measures were imposed.

8. In its Response to the Request for Arbitration, the United States posed three objections, none of which has merit. First, the United States objects that a cash payment cannot be a cure because it was only offered, but not agreed to nor received by the United States. This objection assumes that a cure requires U.S. agreement, which is plainly not so under Article XIV. The United States cannot block consideration by this Tribunal of whether a tender of cash payment cures the breach by refusing the payment. The United States may prefer the compensatory adjustments determined by the Tribunal in LCIA 7941, but that is not a basis for refusal of a cure.

9. Second, the United States notes in its Response that at the time Canada requested arbitration, neither the United States nor Canada had yet put in place compensatory import measures. The SLA, however, does not require that such measures be in place as a precondition to the Request for Arbitration, and in

[8] *Id*. ¶¶ 4-5, 13-14 (Ex. C-3).

any event the issue is now moot because on April 15, 2009 the United States implemented compensatory measures.[9]

10. Third, the United States suggests that a cash payment would not wipe out all consequences of the breach. As Canada will show, supported by the Kalt Report, the cash payment is sufficient to compensate the United States for the only harm it alleged in the LCIA 7941 proceeding – the harm to U.S. softwood lumber producers. Neither the SLA nor customary international law requires more.

B. FACTUAL BACKGROUND

11. On March 3, 2008, the Tribunal, in its LCIA 7941 Award on Liability, determined that Canada had breached the SLA by failing to adjust "Expected United States Consumption" ("EUSC") with respect to Regions operating under Option B for the period of January 1, 2007 to June 30, 2007.[10]

12. In its Award on Remedies in LCIA 7941,[11] the Tribunal determined that Canada was liable for the consequences of its breach and that Canada had not cured its breach as of the date of its Award. In accordance with Article XIV(22)(a) and (b) of the SLA, the Tribunal identified 30 days from the date of the Award as the reasonable time for Canada to cure its breach,[12] and determined

[9] *See Canada – Compliance with Softwood Lumber Agreement*, 74 Fed. Reg. 16,436 (initiation of Section 302 Investigation) (U.S. Trade Representative, Apr. 10, 2009) (hereinafter, "*SLA Initiation of Section 302 Investigation*") (CA-2).

[10] Award on Liability, *The United States v. Canada*, Case No. 7941, LCIA, Mar. 3, 2008 (hereinafter, "Award on Liability"), Section I.3 (Ex. C-4).

[11] Award on Remedies, *The United States v. Canada*, Case No. 7941, LCIA, Feb. 23, 2009 (hereinafter, "Award on Remedies") (Ex. C-5).

[12] *Id*. Section I.2 (Ex. C-5).

compensatory adjustments, to be applied in the event that Canada failed to cure the breach within the 30 day cure period, in the amount of an additional 10 percent ad valorem export charge on softwood lumber shipments from Option B Regions until CDN$68.26 million has been collected.[13]

13. By agreement of the Parties, the reasonable period of time ended on March 28, 2009.

14. On March 27, 2009, prior to the expiration of the reasonable period of time, Canada tendered a cash payment to the United States of USD$34 million found by the Tribunal.[14] Canada requested that the United States accept or reject this tender by 4:00 pm on March 30, 2009. The United States failed to do so.

15. On April 2, 2009, Canada received a letter from the United States Trade Representative ("USTR") Kirk stating: "the United States cannot accept Canada's proposed tender of payment. The United States has never represented, and does not consider, that such a payment cures the breach found by the Tribunal. In particular, the payment Canada has proposed neither provides a remedy for Canada's breach nor wipes out the consequences of that breach, as the Softwood Lumber Agreement requires."[15] Mr. Kirk also noted that "under the terms of the SLA, Canada's failure to impose the compensatory adjustments determined by the Tribunal authorizes the United States to impose compensatory measures in the form of customs duties on imports of softwood lumber products from Canada in an amount that shall not exceed the adjustments to the export

[13] Award on Remedies, Section I.3 (Ex. C-5).

[14] Letter of Canadian Ambassador to the United States, Amb. Michael Wilson, to the United States Trade Representative, Amb. Ronald Kirk dated Mar. 27, 2009 (Ex. C-6).

[15] Letter of United States Trade Representative, Amb. Ronald Kirk, to the Canadian Ambassador to the United States, Amb. Michael Wilson dated Apr. 2, 2009 (Ex. C-7).

charges determined by the Tribunal."[16] On that same day, Canada filed its Request for Arbitration.

16. On April 10, 2009, USTR issued a notice of initiation of a Section 302 investigation and determination, focused on imposing duties on softwood lumber from Canada.[17]

17. According to the notice, the USTR "(i) determined that Canada is denying U.S. rights under the SLA; (ii) found that expeditious action is required to enforce U.S. rights under the SLA; and (iii) determined that appropriate action under Section 301 of the Trade Act is to impose 10 percent ad valorem duties on imports of softwood lumber products from the provinces of Ontario, Québec, Manitoba, and Saskatchewan."[18] The notice indicated that the duties were to apply to articles entered for consumption or withdrawn from warehouse for consumption on or after April 15, 2009, and to remain in place until the U.S. has collected USD$54 million in duties.[19]

---

[16] *Id*. (Ex. C-7).

[17] *See SLA Initiation of Section 302 Investigation* (CA-2). This Notice confirms what the United States repeatedly denied in the 7941 proceeding—that the SLA is a trade agreement. Article XIV(28) authorizes the United States to initiate an investigation or take action under Sections 301-307 of the Trade Act of 1974. Those provisions of U.S. law authorize USTR to take action to enforce U.S. rights under a "trade agreement." The United States initiated this investigation under Section 302. The Notice clarified that Section 302 of the Trade Act "authorizes the Trade Representative to initiate an investigation of any matter covered under Section 301, including whether the rights of the United States under a *trade agreement* are being are being denied." 74 Fed. Reg. at 16, 437 (emphasis added) (CA-2).

[18] *See SLA Initiation of Section 302 Investigation* 74 Fed. Reg. at 16. 437 (CA-2).

[19] *See Id.* (CA-2).

C. THIS ARBITRATION IS PROPERLY BEFORE THIS TRIBUNAL

18. Canada brings this arbitration under Article XIV(29)(c), which provides that:

> If, after the expiry of the reasonable period of time:
>
> (c) the Party Complained Against considers that it has cured the breach, in whole or in part, such that the compensatory adjustments or measures should be modified or terminated, and the Complaining Party does not agree;
>
> The Party may commence a new arbitration to address the matter, by delivering a written Request for Arbitration to the Registrar of the LCIA Court.

19. Article XIV(29)(c) sets forth three conditions that Canada must meet before commencing arbitration under 29(c). First, arbitration may be commenced only "after the expiry of the reasonable period of time." Second, the Party Complained Against must consider that it has cured the breach. Third, the Complaining Party must not agree that the breach has been cured. As Canada has demonstrated, all of these conditions are met and this arbitration is therefore properly before this Tribunal.

20. In its Award on Remedies in LCIA 7941, the Tribunal ordered Canada to cure the breach within a reasonable period of time defined as 30 days from the date of the Award.[20] The Parties agreed that the reasonable period of time would end on March 28, 2009. On March 27, 2009, prior to the end of the reasonable period of time, Canada tendered a cash payment of USD$34 million to the United States to cure its breach.

21. By letter dated April 2, 2009, the United States confirmed its rejection of Canada's tender and stated its disagreement that the cash payment

[20] Award on Remedies, ¶ 310 (Ex. C-5).

tendered by Canada cures the breach.[21] Canada requested arbitration on April 2, 2009, indisputably "after the expiry of the reasonable period of time" and after the United States had disagreed that the payment would cure the breach.

22. Because Canada believes that it fully cured the breach before the expiry of the reasonable period of time and because the United States disagrees that Canada has cured, the question of whether a cash payment of USD$34 million cures the breach is now ripe for review.

1. Compensatory Measures Need Not Be In Effect Prior To The Filing Of A Request For Arbitration Under Article XIV(29)(c)

23. The United States implies that Canada's Request for Arbitration was premature because the United States had not yet imposed compensatory measures on the date that Canada requested arbitration.[22]

24. The SLA does not require that compensatory measures or adjustments be in effect prior to the filing of a request for arbitration under paragraph 29(c). The reference to "compensatory adjustments or measures" in paragraph 29(c) is not framed as a precondition that compensatory adjustments or measures be in place prior to the commencement of an arbitration. Indeed, the text and the context of paragraph 29(c) demonstrate the contrary.

25. Article XIV(29)(a) and (b) both contain the phrase "is applying" when referring to the compensatory measures or compensatory adjustments being challenged under each provision, expressly signaling that compensatory adjustments or measures must be applied before an arbitration is commenced

[21] Letter of United States Trade Representative, Amb. Ronald Kirk, to the Canadian Ambassador to the United States, Amb. Michael Wilson dated Apr. 2, 2009 (Ex. C-7).

[22] U.S. Response to Request for Arbitration ¶ 9.

under either of those subsections. Paragraph 29(a) provides that if "[t]he United States considers that the compensatory adjustments that Canada *is applying* reduce Export Charges or allow for export volumes beyond those that the tribunal has determined under paragraph 22(b)" (emphasis added) it may request arbitration to address the matter. Similarly paragraph 29(b) provides that if "Canada considers that the compensatory measures the United States *is applying* exceed the levels authorized for those measures under paragraph 27" (emphasis added) it may request arbitration to address the matter. The words "is applying" are noticeably absent from paragraph 29(c). Had the drafters intended the application of compensatory adjustments or measures to be a precondition to arbitration under paragraph 29(c), as they did in paragraphs 29(a) and (b), they could have included similar "is applying" language – *i.e*. such that the compensatory adjustments or measures that Canada or the United States *is applying* should be modified or terminated. They expressly did not.

26. More fundamentally, the United States has not claimed that it was prejudiced in any way by Canada's alleged premature request nor could it colorably do so. The existence of compensatory measures at the time the Request for Arbitration was filed is entirely irrelevant to the Tribunal's decision of whether a cash payment constitutes a cure. There is no logical or practical reason to require the implementation of compensatory measures as a precondition to commencing arbitration under paragraph 29(c). The question of whether a cash payment of USD$34 million fully cures the breach found in LCIA 7941 is ripe for review regardless.

27. Moreover, on April 7, 2009, the United States publicly announced its intention to impose compensatory measures if Canada did not impose

compensatory adjustments,[23] and the United States in any event put compensatory measures in place on April 15, 2009.

28. Tribunals have waived even seemingly mandatory procedural conditions when enforcement of those conditions would serve no purpose except delay. In *SGS v. Pakistan*,[24] and *Biwater v. Tanzania*,[25] arbitral tribunals found that to efficiently and effectively resolve the disputes at issue, it was appropriate to permit the continuation of the arbitration to a decision on the merits, despite the fact that the requests for arbitration were filed prior to the completion of a statutory "cooling off period" – a precondition to filing. Canada does not consider that there is any requirement that measures have been in place at the time of Canada's request, but enforcement of that requirement would be even less justified than with respect to the cooling off periods waived in those two cases.

D. A CURE MAYBE IN THE FORM OF A CASH PAYMENT

1. A Cure, Unlike Compensatory Adjustments, Is Not Limited In The Form It May Take

29. The Tribunal's authority in LCIA 7941 arose from paragraphs 22(b), 23, and 24, which contain express language to constrain the mode or quantum that compensatory adjustments may take. First, Article XIV(22)(b) prescribes the form of a remedy that can be determined and directs the Tribunal

[23] Press Release, United States Trade Representative, *United States Imposes Tariffs on Softwood Lumber from Four Canadian Provinces Due to Canada's Failure to Comply With the Softwood Lumber Agreement,* Apr. 7, 2009 (Ex. C-8).

[24] *SGS Société Générale de Surveillance S.A. v. Islamic Republic of Pakistan*, ICSID Case No. ARB/01/13, Decision of the Tribunal on Objection to Jurisdiction, Aug. 06, 2003, ¶ 184 (CA-3).

[25] *Biwater Gauff v. United Republic of Tanzania*, ICSID Case No. ARB/05/22, Award, July 24, 2008, ¶¶ 343-348 (CA-4).

"to determine *appropriate adjustment to the Export Measures* to compensate for the breach…" This language expressly limits the form of a remedy that a Tribunal may establish under the SLA to adjustments to Export Measures and excludes all other potential forms of remedies, such as cash compensation. Second, paragraph 24 again specifically references the "adjustments" specified in paragraph 22(b) and dictates when the "adjustments" may be applied. Last, paragraph 23 limits the amount of the "adjustments" to an amount that remedies the breach." Together these three paragraphs significantly constrain the Tribunal's determination of compensatory adjustments under paragraph 22(b) by defining the form, timing, and amount of that remedy.

30. No such constraint is imposed with respect to "cure" under Article XIV(22)(a) or Article XIV(29)(c). Under Article XIV(22)(a), the Tribunal must "identify a reasonable period of time for [the Party Complained Against] to cure the breach," but there are no limitations as to what form a cure may take. If the drafters of the SLA intended to limit the form that a "cure" must take, that limitation would have been expressly stated as were the limitations on the form of compensatory adjustments.

31. In its Award on Remedies, the Tribunal interpreted "cure" in this case not as Canada had proposed, namely ceasing the breaching activity, but as reparation for the effects of the breach.[26] The Tribunal further found that "the most appropriate interpretation of the object and purpose of §22 of the SLA is that the reparation should be started and performed as fast as possible after its award, even if going beyond the 30 day period."[27] Canada's tender of cash

[26] Award on Remedies ¶ 283 (Ex. C-5).

[27] *Id*. ¶ 309 (Ex. C-5).

compensation of USD$34 million constitutes full reparation for the harm caused by the breach, performed as fast as possible after the Award on Remedies, and is thus consistent with the Tribunal's interpretation of cure.

32. The United States acknowledges that under the SLA Canada has flexibility to design its cure. For instance, at the September 22, 2008 Hearing on Remedies, Counsel for the United States recognized that "[t]he agreement on a cure during the cure period permits the breaching Party to implement a cure of its own design rather than be subject to the compensatory adjustments that the Tribunal has determined, which may not be its preference."[28]

33. Counsel for the United States also agreed that a "cash payment could potentially effect a cure of the breach and by cash payment – I mean a cash payment to the United States or to the producers."[29] The United States even lays claim to being the Party responsible for the idea that the cure could take the form of a cash payment: "Canada has not responded to our demonstration that the cure contemplates wide panoply of relief, including a direct cash payment."[30] In its Post-Hearing Brief, the United States restated its position that "Canada is free to propose a *cure* in the form of a cash payment to the United States or to the United States industry."[31]

34. In a public statement about the award issued on February 26, 2009, the United States reaffirmed that the form of cure is flexible. The USTR

[28] Transcript of Hearing on Remedies, The United States of America v. Canada, Case No. 7941, LCIA, Sept. 22, 2008 (hereinafter, "Day I Tr.") at 30:22-31:1 (Ex. C-3D).

[29] Day II Tr. at 290:25-291:2 (Ex. C-3F).

[30] *Id*. at 300:17-19 (Ex. C-3F).

[31] U.S. Post-Hearing Brief, *The United States v. Canada*, Case No. 7941, LCIA, Oct. 31, 2008 (hereinafter, "U.S. Post Hearing Brief") ¶ 56 (emphasis in original) (Ex. C-9).

stated that "under the provisions of the SLA, while Canada has some flexibility in determining an appropriate means of curing the breach, Canada must implement the compensatory adjustments determined by the Tribunal unless Canada cures the breach some other way."[32]

2. Cash Compensation Is An Acceptable Form Of "Cure"

35. If it is assumed – as the Tribunal did in LCIA 7941 – that a cure must compensate for past harms, cash payment is, in many respects, the most efficient and logical form of a cure. As Professor Kalt explains in his expert testimony, a cash payment, among other things, avoids the market distorting consequences of attempting to provide compensation to injured Parties through trade restrictions, which both have significant collateral effects and may readily miss their target of compensating the claimant for adverse effects of the breach.[33]

36. Moreover, monetary damages offer certainty. As Professor Kalt explains, "direct cash payment is not subject to any party, U.S. or Canada, being able to increase or decrease the benefit or burden, respectively, of the payment by altering any aspect of their supply, demand or exporting behavior."[34] By curing in the form of cash compensation, therefore, Canada has chosen a form of cure that offers the United States certainty that it will receive full reparation for the harm suffered as a result of Canada's breach.

---

[32] Press Release, United States Trade Representative, *Tribunal Orders Canada to Cure Breach of the Softwood Lumber Agreement*, Feb. 26, 2009 (Ex. C-10).

[33] Kalt Report ¶¶ 3, 18 (Ex. C-3).

[34] *Id*. ¶ 18 (Ex. C-3).

E. THE SLA DOES NOT REQUIRE AGREEMENT OF THE PARTIES ON THE FORM OF A CURE

37. Not only does the SLA permit the Party Complained Against flexibility in the form of a cure, it also allows that Party to cure the breach without the consent of the Complaining Party, so long as a Tribunal confirms that the Party Complained Against has cured. The United States insists that it must agree to a cash payment for it to be a cure or even to give this Tribunal jurisdiction.[35] That is not so. Canada will show that there is no support for this interpretation in the wording of either Article XIV(22)(a) or XIV(29)(c). The SLA makes it clear that it is for the Tribunal, not the United States, to determine whether Canada has cured the breach. The contrary U.S. interpretation would render the dispute resolution mechanism in Article XIV(29)(c) meaningless.

38. The plain meaning of the terms in both Article XIV(22)(a) and XIV(29)(c) is that a cure may be effectuated by the Party found to be in breach of the SLA, regardless of whether the Complaining Party agrees. While the Parties doubtless can agree on a cure, Article XIV(29)(c) makes it clear such agreement is not necessary. That provision states that if "the Party Complained Against considers that *it* has cured the breach," and if the Complaining Party disagrees, then a tribunal is to resolve the disagreement. This paragraph would make no sense if a cure required agreement, because there would be no disagreement for the Tribunal to resolve.

39. Paragraph 22(a) states that if the "tribunal finds that a Party has breached an obligation under the SLA 2006, the tribunal shall … identify the reasonable period of time for that Party to cure the breach." The emphasis on

[35] U.S. Response to Request for Arbitration ¶ 30.

curing the breach falls solely on Canada as the Party found to have breached the SLA.

40. Similarly, the terms of paragraph 29(c) unambiguously confirm that the agreement of the United States is not a condition for a cure.[36] The function of Article XIV(29)(c) is to have the Tribunal definitively resolve cases in which the Parties do not agree. This paragraph provides that in the event that the Parties disagree on the adequacy of a cure, the Tribunal may nonetheless determine that the Party Complained Against has in fact cured the breach. It would be nonsensical to provide a mechanism to resolve disagreements between the Parties as to a cure if that cure *must* be mutually agreed to by the Parties.

41. In its Response, the United States concedes that a cure can take the form of a cash payment, "*if the parties agreed that such payment remedied the breach*."[37] The U.S. Response goes on to say that "[a]bsent such agreement of the parties, a lump sum cash payment cannot cure this breach." The United States provides no explanation for these statements. Nothing in the SLA provides that cures in the form of cash payments require agreement of the Parties while other forms of cure do not. Nor is there anything about "this breach" that is incompatible with a cash payment cure. To the contrary, as explained below in Section F(4), a cash payment is a particularly suitable form of cure in this proceeding and in light of the Tribunal's findings.

42. The United States notes that, having refused Canada's tender of payment, it has not received an actual cash payment. Canada does not contest

[36] *See* SLA Article XIV (22)-(29) contemplating that the breaching Party will decide on a cure. The fact that the mechanism under paragraph 29 exists confirms that the breaching party decides the cure (Ex. C-1).

[37] U.S. Response to Arbitration ¶ 30.

that the United States may refuse Canada's tender in circumstances where the United States does not agree that the cash payment cures the breach. However, the United States may not exercise its right of refusal to block the Tribunal's decision of whether the cash payment is a cure. Such a reading of paragraph 29(c) would effectively deprive the Tribunal of the ability to review the adequacy of cash payments altogether. This result is contrary to paragraph 29(c) and to principles of judicial efficiency.

F. A PAYMENT OF USD$34 MILLION MEETS INTERNATIONAL LAW STANDARDS FOR FULL REPARATION

43. Having established that the SLA permits a cure in the form of a cash payment and that such a cure does not require the agreement of the United States as Complaining Party, Canada will demonstrate that a cash payment of USD$34 million provides full reparation for the harm caused by Canada's breach, and in so doing meets the standard of the ILC Articles, as called for by the Tribunal. First, Canada will discuss the international law standard as endorsed by the LCIA 7941 Tribunal. Second, Canada will show that producer surplus is a standard measure of economic harm, as measured by economists. Third, Canada will demonstrate that cash is the most effective means to compensate past economic harms, which are the only harms that the United States even attempted to demonstrate in the LCIA 7941 proceeding. Finally, Canada will show that USD$34 million represents a sound economic determination of the level of harms caused by Canada's breach, correcting for Dr. Neuberger's errors in the calculation of the loss suffered by the U.S. lumber industry.

1. The Customary International Law Standard For Reparation

44. In its Award on Remedies in LCIA 7941, the Tribunal found that a cure of the breach should "wipe out the consequences of [Canada's] breach of the SLA during the period from January 1 to June 30, 2007, which the Tribunal found in its Award on Liability."[38] The Tribunal drew this standard from Article 31 of the ILC Articles on State Responsibility, which provides:

> 1. The responsible State is under an obligation to make full reparation for the injury caused by the internationally wrongful act.
>
> 2. Injury includes any damage, whether material or moral, caused by the internationally wrongful act of a State.

45. Article 31 codifies customary international law standards articulated in cases such as the *Chorzów* decision, which the ILC Commentaries observe called for a breaching state to "wipe out all the consequences of [its] illegal act and reestablish the situation which would, in all probability, have existed if that act had not been committed."[39] By finding that Canada must compensate for past harms caused by its breach[40] and impose a cure that wipes out all of the consequences of that breach,[41] the LCIA 7941 Tribunal gave presumptive weight to the rule of Article 31.

46. Despite the broad phrasing of the *Chorzów* decision, in particular, "wiping out all the consequences" of a breach, Article 31 itself, the relevant cases, and the ILC Commentaries make evident that the consequences referred to are the injurious consequences to the claimant, insofar as the claimant has met its

[38] Award on Remedies ¶ 310 (Ex. C-5).

[39] ILC Articles, Commentary 2 to Article 31 (CA-1).

[40] Award on Remedies ¶¶ 306, 309 (C-5).

[41] *Id*. ¶¶ 306, 309 (C-5).

burden to prove them. The Commentaries to the ILC Articles emphasize that reparation is for the injury caused by the breaching act: "The notion of 'injury', defined in *paragraph 2*, is to be understood as including any damage caused by that act."[42] The focus of reparation is thus the "injury resulting from and ascribable to the wrongful act, rather than any and all consequences flowing from an internationally wrongful act."[43] Under this standard, the injured Party is only permitted reparation for the injury it suffered, and the ILC Articles limit material damage to "damage to property or other interests of the State and its nationals which is assessable in financial terms."[44]

2. Prior Decisions, Including The *Chorzów* Decision, Demonstrate That Reparation Is For The Harm Suffered By The Non-Breaching Party

47. International courts and tribunals implement the Article 31 standard in their awards by granting awards to claimants for the specific injury to them caused by a respondent's breach. In these decisions, tribunals have assessed injury based exclusively on the loss to the claimant.

48. In the *Gabčíkovo-Nagymaros Project* case, the International Court of Justice declared that, "it is a well-established rule of international law that an injured State is entitled to obtain compensation from the State which has committed an internationally wrongful act for the damage caused by it."[45] The *Chorzów* decision of the Permanent Court of International Justice, also makes

[42] ILC Articles, Commentary 5 to Article 31 (CA-1).

[43] *Id.*, Commentary 9 to Article 31 (CA-1).

[44] *Id.* (CA-1).

[45] *Case Concerning The Gabčíkovo-Nagymaros Project (Hungary/Slovakia),* ICJ Reports, 1997, Judgment, Sept. 25, 1997, ¶ 152 (CA-5).

clear that reparation is limited to compensation for the injury suffered by the non-breaching party.[46]

49. Similarly, quoting the umpire in the *Lusitania* case, the Commentary to the ILC Articles states that the fundamental concept of "damages" is reparation for a "loss suffered" and a remedy should be "commensurate with the *loss*, so that the injured party may be made whole."[47]

50. Canada's understanding is that the LCIA Tribunal was endorsing as the objective of "cure" the customary international law standard of full reparation for past harm demonstrated by the Claimant to have resulted from the breach – what Canada's tender provides.

3. "Lost Producer Surplus" Measures The Harm To U.S. Producers Caused By The Breach

51. The Tribunal found that Canada breached the SLA by shipping lumber into the United States in excess of the limits allowed under the Agreement. The United States argued that when considering the harm caused by Canada's breach, the proper focus under the SLA was harm to U.S. producers rather than harm to the United States as a whole. Canada and the United States agreed that the harm to U.S. producers due to the additional lumber imports from Canada can be measured in terms by the reduction in the U.S. lumber industry's "producer surplus."

---

[46] *Case Concerning the Factory at Chorzów* (Merits) (Germ. V. Pol.), 1928 P.C.I.J. 47 (ser. A) No. 17, Sept. 13, 1928, at 29 (CA-6).

[47] "Lusitania" Cases (U.S./Ger.), 7 R.I.A.A. 32, 39 (1923), *quoted in* ILC Articles, Commentary 3 to Article 36 (emphasis added) (CA-7).

52. The Kalt Report further explains the methods conventionally used to measure lost producer surplus.[48] *Producer surplus* is the term used in economics to describe the revenues generated in a market for producers of a good or service which are in excess of the minimum revenues that would be needed to call forth producer supply.[49]

53. As Professor Kalt succinctly explained in his 7941 Rebuttal Report:

> [I]f, as the U.S. now argues, the proper focus regarding remedy is not on all economic effects on the U.S., but is to be solely on effects on U.S. producers, standard economic analysis provides the means of measuring the economic effect on U.S. producers of any purported past volume and price effect. This measure, known as "producer surplus," utilizes the economic tools we previously described and quantifies the economic effect on U.S. producers of any purported change in the U.S. lumber price caused by the export overage.[50]

Dr. Neuberger, agreed that changes in producer surplus could be used as a measure of economic harm to U.S. softwood lumber producers resulting from Canada's breach,[51] and confirmed that he would quantify the harm as the lost producer surplus.[52] Agreeing with Canada's expert, Dr. Neuberger remarked, "Kalt is correct that changes in producer surplus can be used as a measure of economic harm to producers resulting from market effects caused by a breach.

---

[48] Kalt Report ¶¶ 5-8 (Ex. C-3).

[49] *Id*. ¶ 5 (Ex. C-3).

[50] Rebuttal Expert Witness Statement of Joseph P. Kalt and David Reishus, *The United States of America v. Canada*, Case No. 7941, LCIA, Aug. 11, 2008, ¶ 7 (Ex. C-3B).

[51] Second Rebuttal Expert Report of Jonathan A. Neuberger *The United States v. Canada*, Case No. 7941, LCIA, Sep. 15, 2008 (hereinafter, "Neuberger Second Rebuttal Report") ¶ 13 (Ex. C-3E).

[52] Day I Tr. at 103:14-18 (Ex. C-3D).

Importantly, this loss of producer surplus is directly related to the price effect that I estimate and discuss in my earlier reports."[53]

54. In his second rebuttal report, Dr. Neuberger computed the "lost producer surplus to be US $34 million,"[54] expressly clarifying that "U.S. producers were harmed by Option B exporters exceeding their RQVs during the first six months of 2007 by an amount equal to US $34 million."[55] Dr. Neuberger reiterated this position during his cross examination at the hearing:

> Q. In this paragraph, again, towards the end you testified that U.S. producers were harmed by Option B exporters by an amount that you calculated, $34 million; correct?
>
> A. That is the lost producer surplus according to the economic model I used for my second remedy, yes.
>
> Q. And if not money damages were possible here, Doctor, this is the amount you would say Respondent should pay; correct?
>
> A. I would certainly consider this figure as a potential remedy. I have certainly been involved in other cases where other remedies, other potential measures were used. But certainly, and as I indicate in this paragraph, using the standard of economic harm that Dr. Kalt puts forward in his second – or actually both of his reports, the loss in producer surplus to U.S. producers was $34 million, yes.[56]

55. Lost producer surplus, in the United States' own words, and as confirmed by Canada's expert, is the appropriate measure of the harm to the U.S.

---

[53] Neuberger Second Rebuttal Report ¶ 13 (Ex. C-3E).

[54] *Id*. ¶ 13 (Ex. C-3E).

[55] *Id*. ¶ 13 (Ex. C-3E). *See also*, Kalt Report ¶ 4 ("Immediately prior to the hearing, Dr. Neuberger reported that his modeling indicated that the economic effect on U.S. producers as a result of the subject SLA violations was a loss of US$34 million. He reiterated this value at the hearing.") (Ex. C-3).

[56] Day I Tr. at 103:14-104:3 (Ex. C-3D).

industry caused by Canada's breach of the SLA. Professor Kalt summarizes his finding as follows: "[this is the] loss in producer surplus that we have previously discussed in our prior statements, and that the U.S.'s expert, Dr. Neuberger, has acknowledged is the standard measure of harm to producers … He measured what is conceptually expressed by these components and found the value to be USD$34 million."[57]

4. The Most Effective Means To Restore Lost Producer Surplus Is Cash Compensation

56. Although the SLA only allowed the Tribunal to provide compensation through adjustments to the Export Measures, both Parties also agreed that the most effective way to restore lost producer surplus is through a direct cash payment to the United States. In his oral testimony at the Hearing on Remedies, Professor Kalt explained that this is the norm:

> Q. Would cash compensation be a complex remedy, Doctor?
>
> A. No, well, I'm sure we'll probably have a hearing and the economists will go back and forth, but in principle, it's a matter of calculating as you heard what economists call producer surplus. This is a standard measure of lost economic profit. Our distinction between economic and accounting profit here deals with – fundamentally with sunk costs. If you're really trying to restore someone to a particular position via a cash payment, you would ignore the sunk costs and just ask what's their net economic change in their net economic well being, and that's what we call producer surplus. And it's a very common concept applied in commercial litigation, even antitrust damage matters, where someone writes a check for the lost producer surplus.[58]

[57] Kalt Report ¶ 12 (Ex. C-3).

[58] Day I Tr. at 127:18-128:6 (Ex. C-3D).

A benefit of using cash compensation, rather than relying on adjustments to the Export Measures, is that it does not distort the market moving forward:

> If it's the case that reparations for past damages are appropriate, is the appropriate legal standard, then the most basic way that that can be done in a non-distorted way is through direct cash payment.[59]

57. Export taxes as a means to compensate for the past harm caused by a past breach are inherently inferior to direct cash compensation. As Professor Kalt explains, "compensation for U.S. lost producer surplus via going-forward imposition of the export measures is subject to inherent uncertainty and inaccuracy … [that] can be avoided by direct cash compensation."[60] Specifically, export taxes would operate through uncertain price effects on producer surplus.[61] Further, "as compared to direct cash compensation, attempting to offset and compensate for the effects of the subject SLA violations via going-forward export measures is inherently distortive of the going-forward North American lumber market equilibria otherwise embedded in and envisioned by the SLA."[62]

58. During the Remedies phase of 7941, the Tribunal could not award cash compensation to repair the harm caused by Canada's breach, but was limited to determining compensatory adjustments to the Export Measures. The Tribunal determined that the compensatory adjustments should consist of the collection of a 10 percent export tax on all exports from the breaching provinces until a total USD$68 million in export taxes would be collected. While the

---

[59] *Id*. at 130:2-5 (Ex. C-3D).

[60] Kalt Report ¶ 15 (Ex. C-3).

[61] *Id*. ¶ 18 (Ex. C-3).

[62] *Id*. ¶ 18 (Ex. C-3).

collection of additional export taxes may return some measure of lost producer surplus to the U.S. industry, both Parties recognized that trying to compensate for a past breach through future imposition of export taxes produces inherently uncertain results.

59. As Professor Kalt explains in his analysis of the additional 10 percent *ad valorem* export charge: "Only by happenstance would the producer surplus gains by U.S. producers total a specific value such as US$34 million."[63] Moreover, the export charges would do so only by introducing unnecessary distortions into the marketplace equilibria that otherwise flow from the SLA."

5. Economics Demonstrate That USD$34 Million Is an Appropriate Calculation of the Lost Producer Surplus

60. The amount presented by the United States, USD$34 million, is a high-end estimate of lost producer surplus. As Dr. Kalt explained in his submissions to the Tribunal and in his testimony at the hearing, Dr. Neuberger's model estimating the effects of Canada's overshipment of lumber tends to overstate the effects. As Professor Kalt explained in his first expert report:

> iii. The model results and estimated penalty is also sensitive to the assumed demand and supply elasticities. The range of possible outcomes using reasonable elasticity values is large. For example, if just one of the elasticities is replaced with an intermediate value from the same ultimate academic source used by Dr. Neuberger, rather than the extreme value he selected (and also correcting for the previous mistake), then the estimated penalty amount is reduced by 75%.[64]

[63] *Id*. ¶ 17 (Ex. C-3).

[64] Expert Witness Statement of Joseph P. Kalt and David Reishus, *The United States of America v. Canada*, Case No. 7941, LCIA, June 29, 2008, ¶ 64 iii (Ex. C-3A).

Additionally, Dr. Neuberger's model is unable to account for certain factors that would affect a model that was attempting to measure such a small overshipment. For example, Professor Kalt explained at the hearing that:

> [I]n order to target [producer surplus] in a reliable way, one would have to build a model that reflected underlying supply and demand conditions, but also reflected because of the temporary nature and the small nature of what you're doing here, such things as the way the market responds.
>
> I used the phrase yesterday "missing parts" in Dr. Neuberger's model. You have to explicitly model, I believe, inventory behavior, for example. You would have to explicitly model, there are layers in this industry. If wholesalers, for example, altered their inventory behavior or didn't, you might change the price at the wholesale level, but not for the producer, so you're not hitting any target.[65]

61. After again reviewing Dr. Neuberger's estimates of the harm to U.S. lumber producers caused by the overshipment, Professor Kalt concludes that the compensation of USD$34 million to U.S. producers is more than is necessary to compensate for the harm.[66] Various assumptions in Dr. Neuberger's modeling tend to overstate the effects of Canadian overshipments of lumber. Therefore, a cash payment of USD$34 million adequately compensates the United States for any harm caused by Canada's overshipment of lumber.[67]

[65] Day II Tr. at 262:16-263:2 (Ex. C-3F).

[66] Kalt Report ¶ 3 (Ex. C-3).

[67] As Professor Kalt states in his report, these conclusions hold true even after accounting for overshipments of 216 mmbf, the highest amount the United States alleged during the LCIA 7941 proceedings. *See Id*. at n.14 (Ex. C-3).

G. CLAIMANT'S REQUEST FOR RELIEF

62. Canada respectfully requests an Award finding that:

1) A payment to the United States of USD$34 million plus simple interest at 4 percent fully cures the breach found by the Tribunal in LCIA 7941;

2) The United States, upon receipt of the payment, must terminate any compensatory measures imposed under Article XIV(27); and

3) The United States, pursuant to Article XIV(32), must refund all customs duties collected, plus simple interest at 4 percent retroactive to the date that the compensatory measures were imposed.

1. Contingent Requests

a. If The Tribunal Finds That Canada Has Not Cured The Breach, The Tribunal Should Determine The Additional Amount Required For A Full Cure

63. If the Tribunal finds that Canada's payment has not cured the breach in full, Canada respectfully requests that the Tribunal identify in its Award the amount of a payment to the United States from Canada that the Tribunal would consider sufficient to fully cure the breach.

64. The Tribunal's mandate under Article XIV(29)(c) includes determining whether Canada has cured the breach in whole or part. If the Tribunal finds that Canada's payment cures the breach only in part, paragraph 31 requires the Tribunal to determine the extent by which compensatory adjustments or measures should be modified, in accordance with paragraph 32. A determination by the Tribunal of the extent to which the compensatory adjustments or measures should be modified will necessarily require a

determination of the additional amount over USD$34 million necessary to effectuate a full cure of the breach. In addition, if the Tribunal finds that Canada's payment cures the breach only in part, the Tribunal must also determine the extent to which Canada has cured the breach before it can determine an appropriate adjustment to the export charge that Canada would collect under paragraph 32. Given that the Tribunal will necessarily have to determine the amount necessary to cure the breach in its determinations under Article XIV(31) and (32), Canada respectfully requests that the Tribunal advise Canada of any additional amount necessary, if the Tribunal considers that Canada's tender does not fully cure the breach.

65. Determining the additional amount required for a full cure of the breach will assist in achieving an expeditious and satisfactory end to this dispute, as required by Article XIV(3). An objective of the dispute settlement system under the SLA is the fast and final resolution of disputes.[68] The timeframe for proceedings under Article XIV(19) provides that "the tribunal shall endeavour to issue an award not later than 180 days after the LCIA Court appoints the tribunal." The timeframe for arbitrations commenced under Article XIV(29) is just 60 days from the Request for Arbitration. Advising of the amount necessary to effectuate a full cure is consistent with this objective of efficient and expeditious dispute settlement, because it will obviate the need to return to the Tribunal for a determination on this issue.

[68] This latter goal is expressed in Article XIV(4), which although pertains to consultations, makes it clear the Parties are expected to use the dispute settlement process to arrive "at a satisfactory resolution of the matter."

b. If The Tribunal Finds That Canada Has Not Cured The Breach, The Tribunal May Advise Canada On The Allocation Of Additional Charges To Be Collected Either By Region Or By Individual Exporter

66. Alternatively, if the Tribunal determines that a cash payment cannot cure the breach found in this case, Canada will impose the compensatory adjustments identified in the February 23, 2009 Award.[69] In this event, Canada respectfully asks the Tribunal to clarify whether Canada may allocate the total amount of the additional charge to be collected either by Region, or by individual exporters from the Option B Regions, in proportion either to the amount that Region or exporter shipped to the United States from January 1, 2007 to June 30, 2007 (the breach period) or in the amount that they shipped in excess of what their correctly calculated quota would have been.

67. In answering this request, the Tribunal would be acting consistently with the administrative efficiency principles mentioned above. As discussed, an objective of the Parties in creating the dispute settlement system was to ensure that the system resolved matters expeditiously. This implies bringing finality to matters.[70] Without the Tribunal determining how Canada may or should allocate the export charge, there is a significant risk that the United States may disagree with the allocation method Canada chooses resulting in an additional arbitration under Article XIV(29), significantly delaying a final resolution of this matter.

---

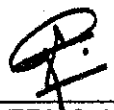
[69] *See* Statement of Canada's Minister of International Trade, the Hon. Stockwell Day (Mar. 31, 2009) (Ex. C-11).

[70] As noted above, Article XIV(3) requires "[d]ispute settlement shall be conducted as expeditiously as possible" and paragraph 19 further buttresses this notion by establishing the aspiration that an award be issued no later than 180 days after a Tribunal is appointed. This timeframe is further shortened for arbitrations commenced under Article XIV(29) to 60 days.

c. If The Tribunal Finds That Canada Has Not Cured The Breach, Canada Requests That The Tribunal Modify Its Award In LCIA 7941 To Deduct Any Customs Duties Collected By The United States

68. Finally, Canada requests that the Tribunal exercise its jurisdiction under paragraphs 31 and 32 to modify the award in LCIA 7941, if it finds that Canada has not cured the breach, by deducting any customs duties collected as compensatory measures by the United States under Article XIV(27) from the total amount of compensatory adjustments Canada would be required to collect. This will ensure that Canada is not paying more compensatory adjustments than necessary to fully cure the breach found by the Tribunal.

Respectfully submitted,



GUILLERMO AGUILAR ALVAREZ
Weil, Gotshal & Manges LLP
767 Fifth Avenue
New York, NY 10153
UNITED STATES
Tel: +1.212.310.8981
Fax: +1.212.310.8007
guillermo.aguilar-alvarez@weil.com

JOANNE E. OSENDARP
CHARLES E. ROH, JR.
Weil, Gotshal & Manges LLP
1300 Eye Street, NW, Suite 900
Washington, D.C. 20005
UNITED STATES
Tel: +1.202.682.7193 (Osendarp)
Tel: +1.202.682.7100 (Roh)
Fax: +1.202.857.0940
joanne.osendarp@weil.com
chip.roh@weil.com

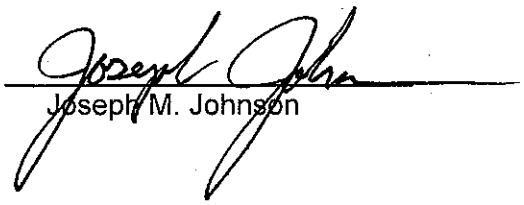
Attorneys for Claimant,
Canada

May 12, 2009

CONFIRMATION OF SERVICE

I, Joseph M. Johnson, hereby certify that I caused a copy of this Statement of Case to be submitted, together with attachments, pursuant to the Tribunal's Procedural Order No. 1, and is being simultaneously transmitted by e-mail to the legal representatives of the Respondent on May 12, 2009. Discs containing electronic copies of this Statement of Case and all attachments, as well as hard copies of the same, are being sent via Federal Express.

Respectfully submitted,



Joseph M. Johnson