In the LCIA
No. 91312

CANADA,

Claimant,

v.

THE UNITED STATES OF AMERICA,

Respondent.

THE UNITED STATES STATEMENT OF DEFENCE

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June 1, 2009

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THE UNITED STATES STATEMENT OF DEFENCE

1. Pursuant to Procedural Order No. 1, dated April 27, 2009, respondent, the United States, respectfully submits this statement of its defence.

INTRODUCTION

2. By offering to settle the dispute in *United States v. Canada*, LCIA No. 7941, with a conditional lump sum payment of US$34 million, Canada has not cured the breach found by the Tribunal in its Award on Liability. The 2006 Softwood Lumber Agreement ("SLA" or "Agreement") permits the breaching party to commence a new arbitration if it "considers that it has cured the breach in whole or in part," and if the nonbreaching party disagrees. C-1, SLA, art. XIV, ¶ 29. The SLA then contemplates that the Tribunal determine whether the "breach *has been cured* in whole or in part." *Id.*, ¶ 31 (emphasis added). On the most basic level, Canada's settlement offer did nothing at all — it resulted in no payment and would have depended upon actions of the United States to have any effect. Even if Canada had done more than merely offer a settlement proposal, its alleged action contravenes the remedy principles set forth in the Tribunal's Award on Remedies, is inconsistent with the provisions of the SLA, and has not cured the breach.

A. Canada's Settlement Offer Has Not Cured The Breach

3. The ordinary meaning of the SLA makes clear that in an Article XIV, paragraph 29 proceeding, such as this, the breaching party must have *already taken* an action that can be determined either to have cured the breach in whole, cured the breach in part, or failed to cure the breach. Here, Canada took no steps to cure the breach – indeed, took no action whatsoever – and therefore cannot be deemed to have "cured the breach."

4. Instead, Canada merely sent a settlement offer to the United States. Now, Canada asks the Tribunal to determine whether its condition-laden *offer* (which it misleadingly terms a "tender" or a "payment") *would* have constituted a cure *if* the United States had accepted it. Canada goes so far as to seek an award that would effectively force the United States to retract its rejection and accept Canada's offer, despite the offer's inadequacies and overt disregard for the Tribunal's Award on Remedies. As justification for this request, Canada relies entirely upon misrepresentations of the United States' position during the remedy proceedings in *United States v. Canada*, LCIA No. 7941 ("remedy proceedings"). Contrary to Canada's operating premise, the SLA does not contemplate a new arbitration to determine the merit of such a settlement offer.

B. A Lump Sum, Government-To-Government Payment Could Not Cure The Breach

5. Even if Canada's offer of a conditional payment could be considered an attempted cure as opposed to a settlement offer, and even if an attempted cure could be a valid basis for a paragraph 29 arbitration, a lump sum payment of $US34 million still would not cure the breach.

6. In its Award on Remedies, the Tribunal explained that a breaching party must provide complete reparation for any breach. Thus, any cure or compensatory measures must "wip[e] out all the consequences of the breach." C-5, ¶¶ 309, *see also* 295-96. The Tribunal then described the characteristics that remedies should possess, explaining that any remedy must affect the volume of lumber exported by Option B regions, which is, as the Tribunal concluded, the very purpose of the SLA. C-5, ¶¶ 329-335. The Tribunal chose the United States' preferred remedy, which assesses an additional export charge on Option B regions, as a means to encourage those regions to decrease exports. This ultimately would achieve the necessary effect upon the volume of exports that is central to the Agreement and to remedying the breach. C-5, ¶¶ 335-36.

7. Canada's proposed conditional payment would do nothing whatsoever to encourage Option B regions to decrease their exports. In fact, the lump sum payment would not even originate from Option B regions. Rather, it would originate from the Canadian federal government and essentially act as a subsidy to Option B regions, thus providing no incentive for Option B regions to decrease exports. Additionally, a lump sum payment would not remedy the harm to United States producers in any way. On any level, then, the offer is substantially inferior to the compensatory adjustments ordered by the Tribunal, which provided a mechanism to wipe out the consequences of the breach by encouraging Option B regions to reduce exports, thus benefiting United States producers, and honoring the core structure and economic effect of the export measures. To force the United States to accept such an inferior remedy – one that disregards the effect of the Tribunal's award and necessarily *does not* wipe out the consequences of the breach – would be to render entirely meaningless the remedy proceedings.

8. Aware of this fundamental flaw, Canada mischaracterizes its proposal as merely the "lump sum" version of Dr. Neuberger's second preferred remedy, but no such version exists. Canada seizes upon one aspect of the model supporting that proposal, takes that aspect out of context, and claims that a lump sum payment of US$34 million is tantamount to the relief described in the remedy proposal. In reality, Canada's offer of a conditional lump sum payment is wholly different from Dr. Neuberger's second preferred remedy and reflects only Canada's attempt to revisit issues that were addressed and disposed of during the remedy proceedings.

FACTUAL BACKGROUND

I. The Tribunal's Award

9. On February 23, 2009, the Tribunal issued its Award on Remedies in *United States v. Canada*, LCIA No. 7941. C-5. In the Award, the Tribunal stated that 30 days was a

reasonable period of time for Canada to cure the breach found in the Tribunal's Award on Liability, and determined appropriate compensatory adjustments to the export measures if Canada failed to cure the breach within 30 days. *See* C-5, at I.1 (p. 148). Importantly, the Tribunal concluded that any cure or any compensatory measures must wipe out all consequences and effects of the breach. C-5, ¶¶ 295-96, 309. Adhering to the terms of paragraph 22, the Tribunal did not determine the form of a cure, but determined that compensatory measures should adhere to certain goals in order to wipe out the consequences of the breach.

10. Central to the Tribunal's Award were the object and purpose of the SLA. Although observing that the SLA contains no preamble or other statement of purpose, the Tribunal nevertheless determined that the "volume of exports of Softwood Lumber Products from Canada to the United States" is "the subject-matter of the SLA" and constitutes the "economic effect" of the SLA. C-5, ¶ 301 (citing the Award on Liability, C-4, ¶¶ 181-182). Against this backdrop, the Tribunal evaluated the four remedy proposals offered by the United States and chose the one that best effectuated the purpose of the SLA, stating "[e]conomically, in view of the relevance of the economic effect found above to be determinative for the object and purpose of the SLA, the remedy should reduce the actual volume of lumber exported by Canada . . . ." C-5, ¶ 329.

11. The Tribunal chose the United States' first and preferred remedy as a means to wipe out the effects of Canada's breach. This remedy treats Option B regions, which exceeded their quota volumes, like Option A regions, in recognition of the benefit realized by B regions as a result of the breach. As the Tribunal stated, "[f]or the benefit they had, it would [] seem appropriate to impose an additional export charge on Option B producers to make up what these producers would have paid had they been treated as Option A producers." C-5, ¶ 333.

According to the Tribunal, the United States' first remedy is a "reasonable method to effectively undo the benefits [Option B regions] enjoyed during the six months of the SLA violation and thus restore, as much as possible . . . the SLA's economic effect to its intended state." C-5, ¶ 335.

12. Noting that Canada did not propose a remedy of its own, the Tribunal stated that "as an appropriate adjustment to compensate for the breach found above, Canada shall be required to collect an additional 10 percent *ad valorem* export charge upon softwood lumber shipments from Option B regions until an entire remedy amount of CDN$63.9 million, plus CDN$4.36 million in interest (a total of CDN$68.26 million), has been collected." R-1 at I.3 (page 148). The Tribunal rejected the possibility that the compensatory adjustments for this breach could take the form of a lump sum payment by producers, stating "to create an incentive for Option B regions to reduce the volume of lumber they ship, the compensatory assessments found above should not be collected as a lump sum." R-1, ¶ 336.

II. The 30-Day Cure Period

13. Following the Tribunal's Award, Canada first expressed its intention to comply with the Award. *See* R-2, p. 1226-27 (Statement of Hon. Stockwell Day, Minister of Int'l Trade and Minister for the Asia-Pacific Gateway); R-3, p. 1275 (Statement of Hon. Stockwell Day). Then, more than halfway into the cure period, after its provincial governments urged it to enter into a "negotiated settlement" with the United States, Canada made an offer to resolve the dispute, hoping to avoid the imposition of the compensatory adjustments determined by the Tribunal. *See* R-4 (Press Release, Quebec Forest Industry Council and the Ontario Forest Industries Association (March 19, 2009).

14. By letter dated March 27, 2009, 24 hours before the expiration of the 30-day period of time established to cure the breach, Canada submitted a written offer to settle the dispute with a conditional lump sum payment of US$34 million, plus simple interest, *in exchange for* the United States' promise not to take further action under the SLA. C-6. Specifically, Canada's formal offer was contingent upon the following conditions: *first*, the United States must promise that it will no longer "claim that Canada has failed to 'cure the breach;'" *second*, the United States must promise that it "will not claim that Canada has any obligation to impose compensatory adjustments under paragraphs 22-25 of Article XIV of the SLA and Canada may refund in full any compensatory adjustments that Canada has collected pursuant to those provisions;" *third*, that LCIA No. 7941 be "terminated," and that "the United States will have no right to, and will not, impose compensatory measures of any kind . . . and will refund in full any import duties it may have collected as a compensatory measure, and will not request a new arbitration under Article XIV(29) of the SLA"; and *fourth*, that the United States "will not re-file any Request for Arbitration under Article XIV(1) with respect to Canada's failure to adjust Expected United States Consumption . . . ." *Id.* Canada expressed its intention to initiate this arbitration should the "United States decline[] to consider this payment a full cure of the breach . . . ." *Id.*

15. On April 2, 2009, before receiving a written response from the United States, Canada sent its request for arbitration to the LCIA.[1] Later that same day, in a letter dated April 2, 2009, the United States informed Canada that "the United States has never represented,

[1] On March 27, 2009, after receiving Canada's written offer, a United States official confirmed by email that Canada's letter had been received and explained that Canada should expect the United States to "respond to the Government of Canada in writing as soon as possible." R-11. Canada filed its request on April 2, 2009, at 3:01 p.m. EDT. R-12. The United States responded to Canada's offer letter on April 2, 2009, at 4:43 p.m. EDT. R-13.

and does not consider, that such a payment cures the breach found by the Tribunal." C-7. The United States explained that, 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." *Id.*

16. Canada made no further offer and never imposed the compensatory adjustments determined by the Tribunal. Therefore, on Tuesday, April 7, 2009, pursuant to paragraph 27 of the SLA, the United States announced that it had taken action under section 301 of the Trade Act of 1974, and would impose compensatory measures in the same amount determined by the Tribunal, assessing a 10 percent *ad valorem* charge on imports. C-8. The United States began collecting those charges on April 15. CA-2 (stating that a 10 percent *ad valorem* charge will be assessed upon imports of Canadian softwood lumber until US$54.8 million is collected).[2]

ARGUMENT

I. Canada's Offer To Settle The Dispute Does Not Constitute A Reviewable Cure

17. The purpose of this proceeding is to determine whether Canada has cured the breach simply by offering to settle the dispute. The ordinary meaning of paragraph 31 of Article XIV of the SLA makes clear that only actions that have already been taken may be reviewed. The Tribunal's Award on Remedies explains in detail what an action needs to accomplish to cure or remedy a breach of the SLA. That is, the Tribunal determined that to cure the breach, Canada must "wip[e] out all the consequences of the breach." C-5, ¶ 309. Canada minimizes this determination by assuming its correctness for purposes of argument, when in fact, the Tribunal's determination represents the definitive criterion by which any alleged cure *must* be judged. Stmt.

[2] US$54 million is the equivalent of CDN$68.26 million, the amount determined by the Tribunal, based on the exchange rate at the time the Award on Remedies was issued.

of Case, ¶ 35. If Canada's action has not "wiped out" the consequences of the breach, Canada has not cured the breach.

A. Applicable Law

18. The governing law is the SLA, to be interpreted in accordance with customary international law applicable to the interpretation of treaties. Article 31 of the Vienna Convention on the Law of Treaties, May 23, 1969, 1155 U.N.T.S. 331 ("Vienna Convention"), reflects customary international law on the interpretation of international agreements between state parties. RA-2. The Tribunal noted this in both its Award on Liability and Award on Remedies. *See* C-4, ¶ 32; C-5, ¶ 71 (stating that both parties agree that the Vienna Convention applies). Article 31(1) of the Vienna Convention provides that "[a] treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose." RA-2.

B. Provisions Of The SLA

19. The SLA provides that if Canada considers it has cured the breach, but the United States disagrees, Canada may commence a new arbitration during which the Tribunal decides whether the breach "*has been cured*." SLA, art. XIV, ¶ 31 (emphasis added). The SLA states:

> 29. 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 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.
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> ******

> 31. If in its award in an arbitration initiated under paragraph 29, the tribunal finds that the compensatory adjustments or measures that are the subject of the arbitration are inconsistent with the award in the original arbitration *or that the breach has been cured in whole or in part*, the tribunal shall determine the extent to which the compensatory adjustments should be modified or whether they should be terminated.

SLA, art. XIV, ¶¶ 29, 31 (emphasis added).

20. By using the language "has been cured" in paragraph 31, the SLA contemplates that the Tribunal will review only actions that have already been taken.[3] This makes practical sense. If the breaching party has not yet taken some action to cure the breach either in whole or in part, then there is nothing for the Tribunal to review.

21. The Tribunal has already determined the ordinary meaning of "cure" in the context of the SLA. In its Award on Remedies, the Tribunal explained that a cure, like any remedy, must wipe out all consequences, *including retrospective consequences*, of the breach. First, relying upon the ordinary meaning of "cure," read in its context, the Tribunal determined that paragraph 22 gives the breaching party 30 days "for 'curing' the effects of [the] past breach by '*wiping out the effects of the breach*.'" C-5, ¶ 295 (emphasis in original). The Tribunal then determined that compensatory measures should also be a "wiping out of the full effects of the breach . . . ." *Id.*, ¶ 296.

[3] The SLA also contemplates that compensatory adjustments or measures will have already been implemented before they can be "modified or terminated." SLA, art. XIV, ¶ 29(c). As explained above, Canada declined to impose the compensatory adjustments awarded by the Tribunal, and filed its request for arbitration before the United States had imposed any compensatory measures of its own. After Canada filed its request, however, the United States did impose compensatory measures pursuant to paragraph 27. Technically, those measures were not in place at the time of the request; however, as practical matter, because measures are now in place, we have chosen not to ask the Tribunal to require Canada to cease this arbitration and commence another arbitration to conform to the terms of the SLA.

22. Identifying a reasonable period of time within which Canada must cure the breach, the Tribunal said the following:

> "for the Party to cure the breach" according to subsection (a) has to be understood, in case of a past and completed breach as at stake here, as meaning a reparation "*wiping out all the consequences of the breach*." It would seem obvious that this intended effect of the reparation must be considered as more important as its timing within the 30 day period. Therefore, if such a reparation is not possible within the maximum period of 30 days given by subsection (a), in the view of this Tribunal, the most appropriate interpretation within the object and purpose of § 22 and 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.

C-5, ¶ 309 (emphasis in original).

23. Consequently, the task before the Tribunal here is to determine whether Canada has taken any action that wipes out the consequences of its breach. As explained fully below, Canada has not.

C. Canada Has Failed To Demonstrate That The SLA Permits Review Of Its Offer

24. Despite the ordinary meaning of paragraphs 29 and 31, and despite the Tribunal's unequivocal and binding determination as to what a cure is, Canada requests the Tribunal to give it an advisory opinion whether Canada's conditional offer would hypothetically cure its breach.

25. Here, Canada eventually declined to impose the compensatory adjustments and instead attempted to negotiate a settlement. Notably, during the 30-day period of time established by the Tribunal, Canada initially appeared inclined to implement the compensatory adjustments ordered by the Tribunal. *See* R-2, p.1226-27; R-3, p.1275.

26. After Canada's provincial governments expressed unhappiness with the compensatory adjustments, however, and encouraged Canada to negotiate a settlement or some result other than the imposition of compensatory adjustments determined, Canada sought to

settle the matter. This resulted in the April 27, 2009 settlement offer that Canada now alternately labels a "tender" of payment, and a "payment." *See, e.g.*, Stmt. of Case, ¶¶ 1, 4, 6, 8, 14, 42. The settlement offer proposed a lump sum cash payment of US$34 million from Canada to the United States, *provided that* the United States gave up its rights and remedies under the SLA regarding this dispute. Canada agrees that it has made no actual payment. Stmt. of Case, ¶ 42.

27. Nor has Canada "tendered" a payment. A "tender," by any construction, is an *unconditional* offer to make a payment. RA-1 (BLACK'S LAW DICTIONARY 1023 (abridged 6th ed. 1991)). It is an "actual payment of money, as distinguished from a mere proposal or proposition to offer it." *Id.* Canada's alleged tender of a payment was far from unconditional. In fact, it came with four separate conditions, requiring the United States to take certain actions or to give up certain rights under the SLA. C-6.

28. In short, all that Canada has done is propose a settlement to the United States. For a party to have cured the breach, it must have taken some action that could be considered a cure. Here, Canada has taken no action, and there is, therefore, nothing for the Tribunal to review under paragraph 31.

29. Nevertheless, Canada requests the Tribunal to opine upon its opening settlement offer and to force the United States to accept that initial offer, despite its numerous deficiencies, including a complete disregard of the economic effect of the compensatory adjustments ordered by the Tribunal. This is not what the SLA contemplates nor is it logical. It would have been irrational for the United States to have accepted a conditional settlement offer, made at the eleventh hour of the reasonable period of time to cure, containing a remedy inferior to that which the Tribunal awarded. As demonstrated below, Canada's offer would not produce any decrease in shipments from Option B regions, would not benefit the United States industry, and by its very

nature, would actually subsidize the very same regions that overshipped during the breach period. There is no reason why the United States should be forced to accept such a significantly discounted settlement offer simply because Canada proposed it during the 30-day cure period.

30. Whether Canada offered this conditional payment as a means to delay compensatory adjustments that were unpopular among Option B producers, or whether Canada has offered this as a means to relitigate matters rejected during the remedy proceedings, the SLA simply does not contemplate that the 30-day cure period be used effectively to coerce the nonbreaching party to accept an inferior settlement offer that fails to wipe out the consequences of the breach, simply because it is, at best, tangentially related to a remedy proposal that was presented to, but not adopted by, the Tribunal. That is, Canada contends that its offer is based upon one of the United States' remedy requests that the Tribunal did not select. As demonstrated below, the offer does not, in fact, reflect any of the United States' remedy requests, but simply parrots Canada's positions from the remedy proceedings. In any event, the SLA does not contemplate that parties would engage in lengthy remedy proceedings only to have the breaching party ignore entirely the remedy awarded by the Tribunal and instead offer a settlement that is unrelated to the Tribunal's award.

31. This is not to say that Canada could not have taken some other action that would be reviewable here. The Tribunal explained that the 30-day cure period could be used to "take the steps necessary" to cure the breach, even if a complete cure could not be accomplished. C-5, ¶ 310. Such steps could have led to a proper paragraph 29 action. For example (and without conceding that these examples would have cured the breach), Canada could have imposed different compensatory adjustments from those determined by the Tribunal and asked the Tribunal to determine whether those different adjustments cured the breach such that the

compensatory adjustments should be modified or terminated. Similarly (and, again, without conceding that this would cure the breach), Canada might have assessed and collected a lump sum export charge upon Option B regions and requested the Tribunal to determine whether such a lump sum charge cured the breach. If the United States were to have disagreed that either action cured the breach, either of these courses of action could have at least led to a paragraph 29 arbitration. That is, either might have constituted action that could potentially have been reviewed. Here, however, Canada took no such action.

32. Despite Canada's contentions, this reading of the SLA is fully consistent with the United States' position during the remedy proceedings. To give meaning to the entire dispute resolution provision, the United States explained that the 30-day cure period could accomplish several goals. The United States noted in its opening remarks:

> [T]he cure period serves several valid purposes . . . . It permits the Parties to agree as to a cure which preserves the Agreement's preference for Party-directed solutions. It also permits the breaching Party to implement a cure of its own devising rather than face the imposition of compensatory adjustments. And it also permits the breaching Party and the nonbreaching Party to agree to implementation of a cure which is not limited to modification of the Export Measures. C-3(D), 42:9-16.

33. The United States agrees with Canada that a cure need not require the nonbreaching party's consent. Stmt. Case, ¶¶ 37-41. The United States never contended anything to the contrary. Rather, the United States explained that the cure period could accomplish several different goals, some of which would require consent of both parties, some of which would not. The cure period could allow Canada to take steps to impose the compensatory adjustments directed by the Tribunal. It could allow Canada to devise a cure that was different in form from – but equivalent to – the compensatory adjustments determined by the Tribunal. Or, it could allow Canada to settle the dispute with the United States in some other way. The latter

course would, of course, require the United States' consent. As the United States explained repeatedly during the hearing on remedies, the latter course could be deemed a cure of the breach *if the parties agreed*. C-3(F), 301:4-10.

34. This flows directly from the fundamental design of the SLA, which consists of export measures imposed by and collected by Canada. It does not envision an exchange of money between governments; rather, it envisions *Canada* maintaining an agreed-upon volume of exports to the United States through a self-imposed system of export measures. Paragraph 22 memorializes this by contemplating adjustments to export measures as a remedy. For this reason, the United States should not be required to take action to effectuate Canada's proposed offer.

35. Here, Canada's offer has not cured the breach precisely because it requires the United States' acceptance and because it is conditioned upon the United States' actions.

II. A Government-To-Government Payment Would Not Cure Canada's Breach

36. Even assuming that the Tribunal has authority under paragraph 29 to review the terms of the payment proposed in Canada's offer, the Tribunal should find that such a payment would not cure Canada's breach. The US$34 million payment proposed by Canada fails to wipe out the consequences of Canada's breach, which is required of any cure. In fact, Canada's offer bears no resemblance to the Tribunal's determination of an appropriate remedy, it fails to provide even a modicum of the economic effect of the Tribunal's determination of compensatory adjustments, and does not address the harm targeted by the United States' second proposed remedy.

37. Canada mischaracterizes its offer of a US$34 million payment as the lump sum equivalent of the United States' second proposed remedy. Stmt. of Case, ¶ 53. Rather, the offer

is and always has been Canada's fallback view of an appropriate remedy. As such, it bears no relationship to the Tribunal's determination of appropriate compensatory adjustments, no relationship to the breach, and no relationship to the United States' second proposed remedy; it merely represents Canada's disregard for the Award on Remedies in favor of its continuing adherence to its previous positions.

A. Canada's Offer Does Not Affect The Volume Of Lumber Exported To The United States

38. As the Tribunal determined, cure and compensatory adjustments have the same goal — to wipe out the retrospective and continuing consequences of the breach. C-5, ¶¶ 295-96, 309. Canada's violation of the SLA consisted of failing to apply certain export charges for the first six months of the Agreement. The parties agreed that those export charges would impose certain economic effects on exporting regions in Canada — that is, Option B regions' exports are limited under certain circumstances. By allowing Option B regions to ship more than the SLA permitted, the breach diminished the intended economic effect of the export measures. To "wipe out the consequences" of the breach, then, Canada must impose an economic effect commensurate with the economic effect that should have been in place during the breach period. A government-to-government payment fails to impose such an effect.

39. Indeed, the Tribunal recognized the unique nature of the breach and the effect of the breach upon the intended purpose of the export measures. First, it emphasized the central role played by the export measures, noting that the "volume of exports of Softwood Lumber Products from Canada to the United States" was the "economic effect" and the "subject matter" of the SLA. C-5, ¶ 301 (citing C-4, ¶¶ 181-82). Second, the Tribunal acknowledged that any remedy for the breach must account for the effect of the breach, which in this case, was an overshipment of lumber from Option B regions. Specifically, the Tribunal stated, "in view of the

relevance of the economic effect . . . *the remedy should reduce the actual volume of lumber exported by Canada*" and restore the United States "to the position it would have occupied absent the breach." C-5, ¶ 329-30 (emphasis added). A remedy should not take the form of a lump sum payment because a lump sum payment does not "create an incentive for Option B regions to reduce the volume of lumber they ship . . . ." C-5, ¶ 336. Although the Tribunal was, of course, addressing appropriate compensatory measures, both a cure and compensatory measures must achieve the same goal — to wipe out the consequences of the breach. Accordingly, the same principles apply to both actions.

40. Canada's offer of a lump sum payment to the United States would not accomplish any of the remedy goals articulated by the Tribunal. As demonstrated above, the Tribunal has already determined that the goals of compensatory adjustments and cure are identical — to wipe out all effects of the breach by placing the nonbreaching party in the position it would have occupied absent the breach. Given the subject matter and economic effect of the SLA, any remedy must reduce the volume of lumber exported to the United States. Canada's offer of a payment between governments would not reduce the volume of lumber to the United States and, therefore, would not wipe out the consequences of the breach.

41. Nor would Canada's offer of a lump sum payment accomplish any of the remedy goals articulated by Dr. Neuberger during the remedy proceeding. Dr. Neuberger explained that any remedy should satisfy several criteria:

> First, the remedy should be in some way commensurate with the violation, and not punitive . . . . Similarly, if Canadian regions exported amounts in excess of applicable quotas, a reasonable remedy would remove a comparable volume from the market . . . .
>
> Second, the proposed remedy should be economically meaningful. By this I mean that the remedy should have an effect such that it actually compensates for the violation. In the current case, a

> meaningful remedy would encourage Option B regions to restrict export volumes for a period of time to compensate for the failure to restrict such exports, as required under the SLA, during the first six months of 2007. C-3(G), ¶¶ 33-34.

42. Dr. Neuberger confirms in his report in this proceeding that, given the unique nature of the SLA and its system of export measures, any remedy should provide Option B regions with an incentive to lower their exports to the United Sates. R-1, ¶¶ 19-20. Dr. Neuberger states that, "the most efficient way to accomplish this goal is through an export charge that raises the cost of exporting to the U.S." R-1, ¶¶ 20. In contrast, a lump sum payment from the Canadian government to the United States government "does not serve this goal" because it does not alter the incentives of Option B producers. *Id.* Rather, it would allow those producers to continue to export to the United States "as if the breach never occurred." *Id.*

43. Even Canada's expert, Joseph Kalt, agrees that lump sum payments do not affect marginal incentives of producers to export to the United States. *Id.* at ¶ 21, citing C-3(A), ¶ 47. Specifically, during the remedy proceedings, Dr. Kalt explained that "'[m]arginal' incentives can be understood by contrasting them with the incentive effects of 'lump-sum' payments. A lump-sum payment is one whose amount does not change based on the actions of the payor, and *generally do not affect going-forward incentives and economic decisions*." C-3(A), ¶ 47 (emphasis added). Indeed, Dr. Kalt concedes in his most recent report that Canada's proposal of a government-to-government lump sum payment would not affect in any way the incentives or "exporting behavior" of Option B exporters to export lumber to the United States. C-3, ¶ 18. In effect, Canada's proposal would subsidize, if not reward, the "economic decisions" of the Option B exporters carried out in breach of the SLA. This result is contrary to the remedy principles articulated by the Tribunal.

44. Canada's offer suffers from other fundamental problems. R-1 at ¶ 23. Canada's offer "is wholly disconnected" from Option B producers, it would not affect the volume of exports, and it would not deter future breaches. *Id*. In fact, if the United States were forced to accept Canada's settlement offer, the United States would effectively allow Canada to provide a subsidy to the very same Option B regions and producers or exporters that overshipped during the breach period.[4] This subsidy itself could constitute a violation of the SLA, because it could be considered a "grant or other benefit" that offset the export measures, in potential violation of the anti-circumvention article of the SLA. SLA, art. XVII.

45. Similarly, a lump sum payment to the United States "does not provide "any mechanism for distributing the proceeds to those U.S. entities that were affected by the breach" and fails to address other groups injured by the breach. R-1, ¶¶ 24-25. As even Dr. Kalt recognized during the remedy proceedings, the lump sum payment he encouraged would be paid "to a particular subset of damaged Parties." C-3(D), Tr. 129:6-11. Perhaps Canada believes that it is the United States' responsibility to distribute the payment to this "subset of damaged parties." If so, this would effectively place yet an additional condition upon Canada's settlement offer. As demonstrated above, it is *Canada's* obligation alone to cure the breach. To require the United States to accept an inferior offer *and* participate in the alleged cure is contrary to the ordinary meaning of paragraph 31 of Article XIV of the SLA, and contrary to common sense.

[4] The SLA does not provide that exporters pay money directly to the United States; rather, it requires Canada to collect charges from its own exporting regions. The payment Canada offers here is not collected from Option B regions and therefore, provides the exporters and producers in those regions with a subsidy because it would allow Canada to forgo the collection ordered by the Tribunal as compensatory measures.

B. Canada's Offer Is Inferior To The Compensatory Adjustments

46. Contrasting Canada's offer with the compensatory adjustments determined by the Tribunal further demonstrates why the offer could not cure Canada's breach. Although a cure need not match exactly the terms of the compensatory adjustments awarded by the Tribunal, a cure must be at least as effective in achieving the economic goals that the adjustments were designed to effectuate. In this sense, the compensatory adjustments represent a floor under which no cure should fall. It is illogical that, once the Tribunal has set forth compensatory measures that "wip[e] out all the consequences of the breach," C-5, ¶ 309, a breaching party could cure with a less effective remedy. A less effective remedy is, by definition, less than complete reparation and fails to wipe out all effects of the breach. That is, if a cure could be inferior, it always would allow the breaching party to ignore the Tribunal's determination and would render meaningless the Tribunal's remedy determination. As the United States explained during the remedy proceedings, the Tribunal's determination under paragraph 22 of Article XIV serves two purposes: it defines appropriate compensatory measures and permits the breaching party to use the cure period to effect a cure *with the compensatory adjustments in mind*. *See* C-3(D), 42:7-16. As a matter of logic, then, a cure necessarily provides a remedy equivalent to that already determined by the Tribunal.

47. Here, Canada's offer of a government-to-government payment falls far short of achieving the goals of the compensatory adjustments determined by the Tribunal. Faced with four proposals from the United States, the Tribunal determined that the two price-based proposals were more likely to affect the volume of lumber exported to the United States (identified by the Tribunal as the object and purpose and economic effect of the Agreement). C-5, ¶¶ 329-30. Between those two proposals, the Tribunal further determined that the United

States' preferred remedy presents the most appropriate compensatory adjustments to provide the United States with complete reparation. In doing so, the Tribunal recognized certain qualities offered by the remedy, none of which would be furthered by Canada's offer.

48. The Tribunal recognized that Option B producers "effectively operated as Option A producers" during the breach period. C-5, ¶ 333. The Tribunal specifically determined this to have provided a benefit to Option B regions. *Id.* The United States' preferred remedy constitutes a "reasonable method to effectively undo the benefits" enjoyed by the Option B regions. *Id.* at 335.[5] This, in turn, will "restore, as much as possible . . . , the SLA's economic effect to its intended state." *Id.* Although Canada disputed the reasonableness of this remedy, it nevertheless understood the goal — to recapture the benefits enjoyed by Option B regions during the breach. C-3(D), Tr. 85:6-7, 19-21.

49. In contrast, a government-to-government payment would fail to address the central premise of the Tribunal's Award — that Option B regions benefited from the breach. Indeed, Canada's payment would actually enhance that benefit and subsidize the breach, rather than correct it. In no way could a payment restore the SLA's economic effect to its intended state; it would have no effect upon Option B regions at all, and would not recapture the benefit to those regions. Accordingly, Canada's proposed cure would fail to provide an equivalent remedy to that determined by the Tribunal would entirely ignore the Tribunal's determinations on remedy.

[5] Option B regions logically enjoyed some benefit during the breach period; that is, presumably Option B regions shipped over their correctly calculated quota volumes because it was in their interest to do so. As even Dr. Kalt has previously recognized, "[t]he engine of the world to an economist, we think not just to our brains but to the real world, is what we call rational self-interest." R-10 at 2:06-2:14.

C. Canada's Offer Is Inferior To The Remedy Proposed As The United States' Second Preferred Remedy

50. Canada's contention that its offer is tantamount to the United States' second remedy proposal misrepresents and distorts the United States' proposal. To defend its position, Canada merely repackages the same arguments raised and implicitly rejected during the remedy proceedings, by virtue of the Tribunal's adoption of the United States' first preferred remedy proposal.

51. Dr. Neuberger's second remedy, proposed during the remedy proceeding, sought to return the United States' price of lumber to what it would have been absent the breach. C-3(G), ¶ 61. Dr. Neuberger determined that an additional export charge should be assessed on entries of lumber until approximately C$110.5 million was collected.[6] C-9, ¶ 46. Restoration of the United States price of lumber was always the sole focus of this proposal. As Dr. Neuberger explains, "[r]estitution of producer surplus was never a remedy standard that I proposed or endorsed." R-1, ¶ 5.

52. It was Canada, and not the United States, that raised the issue of lost producer surplus. The Tribunal will recall that Dr. Kalt offered a host of reasons to support his belief that – as a fallback position to no remedy at all – a cash payment that returned only lost producer surplus provided the only appropriate remedy, including several hours of testimony during which he identified what were, in his view, fatal flaws in the model underlying Dr. Neuberger's second remedy. C-3(D), Tr. 135:19-38:13, 192:20-25; C-3(F), Tr. 262:2-263:18; R-9, ¶ 22. Now, Canada distorts the United States' second remedy for its own purposes and, in doing so,

[6] Dr. Neuberger originally proposed that CD$91.5 million should be collected under this remedy proposal. C-3(G), ¶ 66. However, during the hearing, he agreed with Dr. Kalt that it was more appropriate to use contemporaneous data, rather than data from the six month breach period. Accordingly, his remedy proposal changed to reflect this update. C-9, ¶ 46, n.9.

mischaracterizes that proposed remedy's nature and purpose. Dr. Neuberger made clear during the remedy proceedings that his second remedy sought to restore the United States price of lumber to what it would have been absent the breach.

53. Canada now ignores the events leading to the discussion of lost producer surplus during the remedy proceeding. In Canada's first submission on remedy, it contended that Dr. Neuberger's model demonstrating the price effect of the breach was flawed because, among other reasons, the model allegedly did not acknowledge that the breach actually benefited the United States. C-3(A), ¶¶ 41-42. That is, according to Canada, because the breach lowered the price of lumber, United States consumers benefited from the breach, resulting in an overall net benefit to the United States. In response, Dr. Neuberger explained that underlying each of his remedy proposals was the understanding that the breach harmed United States producers. R-14, ¶¶12, 23-24. As such, each of his remedy proposals was "calibrated to compensate for the effect of the breach on the U.S. softwood lumber industry." *Id.*, ¶ 24.

54. Abandoning its contention that the price depression benefited the United States, Canada then accused Dr. Neuberger of not having considered the concept of "lost producer surplus." C-3(B), ¶¶ 7-8. Dr. Neuberger explained that his second preferred remedy accounted for the figure. Canada then argued during the hearing that a remedy (to the extent one could be crafted), must return lost producer surplus, no more, no less. *See* C-3(D), Tr. 192:20-25.

55. Canada now seizes upon Dr. Neuberger's explanation, contending that its offer of a lump sum payment of US$34 million – the same amount calculated by Dr. Neuberger as lost producer surplus – would cured the breach. But as Dr. Neuberger explains in his expert report, "[w]hile producer surplus is a commonly used economic concept, there is no reason that a proper remedy in this matter must have restitution of producer surplus as its only goal." R-1, ¶ 6.

56. Indeed, Dr. Neuberger explains now, and explained during the remedy proceedings, that an effective remedy should strive to accomplish several goals. It should address the disruption in supply and price resulting from the breach; it should address the benefit to Option B regions; and it should address the detriment to the United States industry. R-1, ¶¶ 19-26; C-3(G), ¶¶ 33-39. During the remedy proceedings and now, Canada fails to address these goals; rather, it persists in advocating a standard found nowhere in the SLA. Even under Canada's fallback position, there is no provision in the SLA that requires a remedy to return lost producer surplus to affected producers.[7]

57. Dr. Neuberger explains that his "second (effects-based) remedy proposal, which was calibrated to undo the price effect of the breach (and, in the process, return lost producer surplus), operated by means of changing the incentives of Option B producers to export to the United States." R-1, ¶ 7. It did this by creating a mechanism (a restoration of price) to force Option B producers to reduce exports to the United States. *Id.* As Dr. Neuberger further explains, his other proposed remedies also did not attempt to directly address lost producer surplus but similarly encouraged Option B regions to reduce exports. *Id.* at 9. As demonstrated above, a government-to-government lump sum payment from the Canadian government to the United States government would in no way encourage Option B producers to reduce exports to the United States.

III. Canada's Requests For Relief Fall Outside The Scope Of The SLA

58. In its request for relief, Canada asks the Tribunal to find that its offer to pay US$34 million has cured the breach and that, upon receipt of such payment, the United States

[7] Dr. Kalt contends that Dr. Neuberger's calculation of lost producer surplus is at the high end of possible values. Dr. Neuberger explains that, using the actual, updated overshipment figures the parties agreed upon during the remedy hearing, "Canada's proposed payment . . . is, in fact, toward the lower end" of the range. R-1, ¶ 10, n.12.

must terminate any compensatory measures imposed under paragraph 27 and refund any customs duties collected plus simple interest, retroactive to the date that the compensatory measures were imposed. Stmt. of Case, ¶ 62. Alternatively, if the Tribunal finds that Canada has not cured the breach, Canada asks the Tribunal to determine the additional amount of payment that would be required for a "full[] cure," *id.*, ¶¶ 63-65, or "advise Canada on the allocation of additional charges to be collected either by region or by individual exporter," *id.*, ¶¶ 66-67 (subheading "b"), and/or "modify [the] Award in LCIA 7941 to deduct any customs duties collected by the United States." *Id.*, ¶ 68. Canada's requests for relief are unjustified, incomplete, and, in some instances, fall outside the scope of the SLA. Remarkably, Canada goes so far as to use this proceeding to appeal certain aspects of the Tribunal's Award on Remedies, despite the SLA's clear prohibition against appeals.

A. Canada's First Request Fails To Acknowledge That No Payment Has Been Made And Seeks An Interest Payment Not Permitted By The SLA

59. Canada's request for relief begins by requesting the Tribunal determine that its offer (which it terms a "payment") "fully cures the breach . . . ." *Id.*, ¶ 62(1). As a threshold matter, Canada's request does not even require it to make the payment to the United States, nor does it clarify, as it should, that any interest must be paid to the date of the Tribunal's Award in this proceeding. In any event, as explained above, Canada has not cured its breach and therefore its first request for relief should be denied.

60. Additionally, Canada's first request seeks relief outside the scope of the SLA. Canada requests that the Tribunal order the United States to cease imposition of compensatory measures, and refund any monies collected. *Id.*, ¶ 62(2)-(3). This is permitted under the SLA. SLA, art. XIV, ¶ 32. However, the SLA does not permit the Tribunal to award anything more

than a refund of collected duties. Therefore, Canada's request for "simple interest at 4 percent" exceeds the scope of the provision. *See* Stmt. of Case, ¶ 62(3); SLA, art. XIV, ¶ 32.

B. Canada's Contingent Requests Seek Relief Outside The Power Of This Tribunal

61. Canada's "contingent" requests for relief exceed the Tribunal's authority. *Id.*, ¶¶ 63-68. Even in the event the Tribunal determines that Canada's offer (or as Canada terms it, its "payment") has not cured the breach, Canada requests, in the alternative, that the Tribunal nevertheless identify "the amount of a payment . . . that the Tribunal would consider sufficient to fully cure the breach." *Id.* at ¶ 63. The SLA does not contemplate that the Tribunal identify a payment that would cure the breach. SLA, art. XIV ¶ 31. Rather, the SLA contemplates only that the Tribunal determine whether the breach "has been cured in whole or in part" and, if so, whether the compensatory adjustments or measures should be modified or terminated. *Id.* Canada's alternative request represents yet another attempt to resist the SLA's plain terms.

62. Similarly, the SLA does not authorize the Tribunal to identify what would constitute a partial cure. That is, if the Tribunal were to find that Canada's offer cured the breach in part, the SLA does not authorize the Tribunal to determine what "additional amount over USD$34 million [would be] necessary to effectuate a full cure of the breach." Stmt. of Case, ¶ 64. This would require the Tribunal to determine not only that a lump sum payment partially cures Canada's breach, and that the United States should be forced to accept that payment, but also that the United States should be forced to accept an *additional* lump sum payment. The SLA simply does not contemplate such a determination. Rather, it authorizes the Tribunal to determine only whether the breach has been cured in whole or in part and, if so, whether the compensatory adjustments should be terminated or modified. This presumes that if the Tribunal determines the breach has been cured in whole, the compensatory adjustments should be

terminated. Similarly, if the Tribunal determines that the breach has been cured in part, the compensatory adjustments should be modified to reflect the partial cure. There is simply no provision that permits the Tribunal to take the additional step, nowhere mentioned in the SLA, to determine a cure, as Canada requests.

63. In its second alternative request, Canada proposes to impose the compensatory adjustments ordered by the Tribunal, but not without conditions. Stmt. of Case, ¶ 66. Canada requests 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 [during the breach period] . . . or in the amount that they shipped in excess of what their correctly calculated quota would have been." *Id*. There is nothing in paragraph 29 or 31 that permits Canada to "request clarification" of a prior award.

64. Even if Canada were truly requesting clarification, it was required to do so during the remedy proceedings. Except for its fallback position that a lump sum payment would be the only proper remedy, Canada's approach to the remedy proceeding was unwavering — it refused to engage on the question of compensatory adjustments and, as part of that strategy, refused to offer any competing remedy proposals or seek any "clarifications" of the United States' remedy proposals. Because the SLA does not permit appeals, Canada must now bear the consequences of its strategic decision to remain silent on the details of the proposals. SLA, art. XIV, ¶ 20.

65. In any event, Canada is not actually requesting clarification; it is requesting a different remedy award — one that allows it to assess the export measure on a producer level to reduce the incremental effect of the charge. This is not what the Tribunal awarded. *See also*, R-14, ¶¶ 33-36 (explaining that an assessment on the producer level would be tantamount to a lump

sum assessment). The Tribunal identified 30 days as a reasonable period of time to cure the breach. In the absence of a cure within that period, the Tribunal ordered Canada to assess the additional export charge to Option B regions. Any request to change that determination is tantamount to an appeal, which is prohibited by the SLA. SLA, art. XIV, ¶ 20.

66. Finally, Canada's last request for relief is also outside the scope of the SLA. Canada asks the Tribunal to "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." Stmt. of Case, ¶ 68. This request is contrary to the terms of paragraph 31 of Article XIV. If the Tribunal were to find that Canada has not cured the breach, it would be without jurisdiction to modify the compensatory adjustments or measures. Only if the Tribunal were to find that the breach has been cured in whole or in part, would it be able to modify or terminate the compensatory adjustments or measures.

RELIEF REQUESTED

67. The United States respectfully requests that the Tribunal issue an award in favor of the United States and against Canada:

a. Declaring that Canada's offer does not cure the breach in whole or in part;

b. Declaring that Canada has not cured the breach in whole or in part; and

c. Denying and dismissing Canada's claims in their entirety.

Respectfully submitted,

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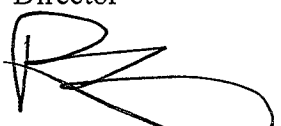

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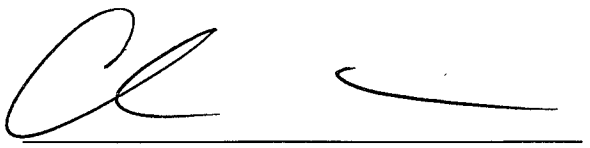
June 1, 2009

CERTIFICATE OF SERVICE

I certify that I caused to be sent, by overnight courier, THE UNITED STATES STATEMENT OF DEFENCE, to the members of the Tribunal and to the legal representative of Canada on June 1, 2009.



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