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In the London Court of International Arbitration
No. 81010-B

THE UNITED STATES OF AMERICA

and

CANADA

CANADA'S REPLY

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CANADA'S REPLY

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INTRODUCTION

1. The United States argues, and Canada agrees, that "the Tribunal's remedy is 'effects-based.'"[1] But the United States' Statement of Case confuses the remedy ordered by the Tribunal in LCIA Arbitration No. 81010 with the effect that the remedy was designed to achieve. The remedy ordered by the Tribunal was the imposition of Compensatory Adjustments in the form of additional export taxes on lumber from Ontario and Québec for a fixed period of time. The effect that the Tribunal's remedy was designed to achieve was to neutralize the change in U.S. producer surplus caused by the programs that the Tribunal found in breach of Article XVII of the SLA.

2. The Compensatory Adjustments to the Export Measures imposed by the Tribunal were calibrated by the economics experts to exert an effect on the U.S. market for lumber that would compensate for the past and ongoing changes in U.S. producer surplus caused by the breaching programs. The goal of those Compensatory Adjustments was not the collection of taxes by Canada, but rather to exert upward pressure on prices in the U.S. market to compensate for the downward pressure on those prices caused by the circumventing programs.

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[1] United States' Statement of Case in *United States of America and Canada*, LCIA Arbitration No. 81010-B, ¶ 37 (Dec. 17, 2013) (hereinafter "U.S. Stmt. of Case 81010-B").

3. The Tribunal explained in the Award that "such adjustments may be in the form of increases in Export Charges or reductions in export volumes or both."[2] The Tribunal chose to impose increases in Export Charges. If the Tribunal had elected to order reductions in export volumes, rather than increases in export taxes, as Article XIV(23) of the SLA permits, the effect of the remedy on the U.S. market would have been the same, but there would have been no tax collections at all. The simple fact that the SLA provides for a remedy that collects *no* revenue exposes the fallacy underlying the United States' argument that the Award required a specific amount of tax to be collected.

4. At the request and under the direction of the Tribunal, the two economics experts cooperated to estimate the effects on U.S. producer surplus of the Ontario and Québec programs and to devise a set of adjustments to the Export Charges that would redress those effects. The adjustments they recommended were designed to take effect thirty days after the Award and to continue in effect until October 12, 2013. The experts, therefore, selected export tax rates to produce a particular effect over a defined period of time.

5. The Compensatory Adjustments were put in place as scheduled and continued for the period provided. During that time, the additional export taxes exerted an upward effect on U.S. producer surplus. The magnitude of that effect cannot be measured by the amounts of tax collected, because it would be necessary also to quantify the amount of

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[2] Award in *United States of America v. Canada*, LCIA Arbitration No. 81010, ¶ 335 (Jan. 20, 2011) (Exhibit A to Joint Request for Arbitration) (hereinafter "the Award" or "81010 Award").

lumber that the additional taxes caused *not* to be exported. Export taxes serve their purpose, and have their effect, by imposing a burden on exports of lumber. The purpose and the effect are the same whether exports of lumber are reduced or the price of the lumber exported is raised. Keeping the Compensatory Adjustments in place beyond the date for which they were designed would do nothing more than impose an arbitrary new penalty untethered to any breach.

6. The Parties agreed that no new facts would be submitted in this proceeding. There is accordingly no evidence before the Tribunal of the actual effect on U.S. producer surplus of the Compensatory Adjustments that Canada applied from March 2011 to October 2013. What matters for this proceeding is that the Compensatory Adjustments ordered by the Tribunal were put in place at the rates and for the period of time that the Tribunal directed. The experts had advised the Tribunal that imposing Compensatory Adjustments at those rates for that time would be likely, on the basis of what was known about market conditions at the time of the Award, to neutralize the effects of the programs found to circumvent the Agreement. There is no basis in the Award, the law, or the Joint Request for Arbitration for revisiting, after the fact, the terms of the remedy imposed to measure its precise effect on the market.

7. Indeed, the argument advanced by the United States is not that the Award has not had its intended effect, because the United States has no evidence of what that effect has been. All that the United States can argue is that the Compensatory Adjustments have not resulted in the collection, *by Canada*, of a dollar amount of tax revenue equal to the dollar

quantification of lost U.S. producer surplus calculated by the experts in their Joint Expert Report. The *non sequitur* here is striking. While insisting that it is the effects of the remedy that matter, the only argument the United States makes in support of its assertion that the effects have not been achieved is that Canada has not received enough tax revenue as a result of exports of softwood lumber to the United States.

8. The receipt by Canada of a certain amount of tax revenue was not the purpose of the Award. Instead, the Tribunal imposed a remedy in the form of additional export taxes calculated to restrain Canadian lumber exports and thereby restore lost U.S. producer surplus. The Compensatory Adjustments have now run their course and served their purpose, and the demand by the United States that they should be imposed for an additional period of time should be rejected.

ARGUMENT

I. THE AWARD REQUIRES APPLICATION OF AN EXPORT TAX RATE FOR A FIXED PERIOD OF TIME, NOT COLLECTION OF A FIXED AMOUNT

A. The Award Targets Change in U.S. Producer Surplus to Neutralize the Programs' Effects on Export Measures

9. The United States argues that "the Award requires Canada to continue to apply the Compensatory Adjustments … until Canada has collected the amounts of change

in U.S. producer surplus."[3] This argument rests on the premise that, when Canada collects a dollar of additional duty from its producers, that dollar neutralizes a dollar's worth of harm suffered by U.S. producers. This premise is inconsistent with the United States' own characterizations of the Award and the SLA and departs from basic economic principles and logic. It cannot stand on its own, much less bear the weight of the U.S. case.

10. The United States acknowledges – indeed, insists – that the Award imposes an "effects-based remedy to compensate for the harm to U.S. softwood lumber producers."[4] The United States also acknowledges that the harm for which the Tribunal intended the remedy to compensate was "the effect of the breach {of the SLA} on U.S. producers – measured by lost U.S. producer surplus."[5] The United States further acknowledges that the Tribunal "determin{ed} the effects of the breaching programs on U.S. lumber producers, then calculat{ed}, with the assistance of the Parties' experts, the Compensatory Adjustments necessary to 'neutralize' these effects."[6] Canada agrees with all of these statements.

11. Where the United States goes wrong is in arguing that the Award remedies lost producer surplus by requiring Canada to collect the amount of that lost producer surplus

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[3] U.S. Stmt. of Case 81010-B ¶ 29(b); Exchange of Diplomatic Notes Between the Government of Canada and the Government of the United States of America, ¶ 4(b) (Sept. 30, 2013) (Exhibit C to Joint Request for Arbitration) (hereinafter "Parties' Understanding").

[4] U.S. Stmt. of Case 81010-B ¶ 7.

[5] *Id.* ¶ 38.

[6] *Id.* ¶ 37 (internal footnotes omitted).

in export taxes.[7] This argument confuses cause and effect and construes the remedy imposed by the Award in a way that is foreign to the logic of the SLA. When Canada states that the Award imposed an "effects-based remedy" that was intended to "neutralize" the harm, it means that the remedy took one of the forms contemplated by the SLA: an increase in export tax (*i.e.*, a Compensatory Adjustment) calculated to suppress Canadian exports to a degree *that would have the effect* of increasing U.S. producer surplus to levels that would have existed but for the breaches found by the Tribunal (*i.e.*, neutralizing the harm).

12. Although the United States agrees that the intent of the remedy awarded was to neutralize the harm, it is difficult to understand how the neutralizing effect would be achieved in the U.S. construction of the remedy. The economics experts estimated that the programs found to be in breach would cause U.S. producers to have suffered a cumulative total of approximately $59 million in total lost producer surplus from 2006 through October 2013.[8] The United States simply equates the amount of that estimated loss with the amount of tax to be collected, as though this were a commercial dispute where the breaching party pays damages to the harmed party in the amount of the harm. This is not such a dispute.

13. When Canada applies export taxes, including Compensatory Adjustments, the tax revenue collected goes to the Canadian Government, not the United States.[9]

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[7] *See, e.g.*, *id.* ¶ 39.

[8] 81010 Award ¶ 410, table headed Attachment A.

[9] *See* Arbitration Hearing Before the LCIA Tribunal in *United States of America and Canada*, LCIA Arbitration 81010 (July 2009), Tr. vol.1-A, 109:8-17:

(Continued on next page)

U.S. producers, therefore, do not receive any payments when Canada collects the taxes from its producers. Rather, the benefit to U.S. producers results from the effects of the tax on Canadian exports, which involves an increase in the cost of exports or a reluctance on the part of exporters to export, either of which would have a positive effect on U.S. producer surplus.[10] This positive effect occurs through changes in the market; it can never be collected.

14. The United States' misunderstanding of the nature of the remedy adopted by the Tribunal is apparent from its statement that the experts' calculation of the rate to be applied was "merely ministerial."[11] There is no question that the experts ascertained the magnitude of change in U.S. producer surplus caused by the programs found to be in

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PROF. VAN DEN BERG: * * * Assume this tribunal would determine there would be an increase in export charge, assuming that all the other preconditions have been fulfilled, who will get the export charge?

MS. EWUSI-MENSAH: The export charges would still be collected by Canada.

PROF. VAN DEN BERG: And not the United States, isn't it?

MS. EWUSI-MENSAH: Correct.

[10] The United States acknowledged as much during the hearing in LCIA Arbitration 81010:

MS. EWUSI-MENSAH: * * * The nature of the export charges and the volume restraints is that they regulate the supply of lumber, the exports of lumber, from Canada to the United States, which is what the United States bargained for, and that's what the United States would receive, is additional regulation of these exports. *Id.* at 110:1-8.

[11] U.S. Stmt. of Case 81010-B ¶ 40.

breach.[12] But the model developed by the experts and adopted by the Tribunal calculates the amount of lost U.S. producer surplus merely as an initial step in the process.

15. Once lost producer surplus has been calculated, it serves as an *input* in calculating the remedy needed to restore that amount. The model applies various assumptions about such variables as demand and pricing to calculate what tax rate would need to be applied in each Province in order to constrain exports to the point that the lost U.S. producer surplus would be restored. The amount of lost U.S. producer surplus was the target that the effects-based remedy was intended to achieve by October 12, 2013.[13] The tax rate imposed by the Canadian government and the consequent restraint was designed to achieve that goal by that date.

16. This relationship between the remedy and the effect to be achieved by the remedy is illustrated by two hypothetical scenarios:

- First, under Article XIV(23) of the SLA, the Tribunal could have imposed a remedy that was purely quota-based, which would have neutralized the effects of the breaches by reducing exports, but which would have resulted in no tax collections at all.

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[12] Revised & Final Report to the Tribunal Pursuant to Procedural Order No. 6, by Professor Joseph P. Kalt & Professor Robert H. Topel in *United States of America v. Canada*, LCIA Arbitration No. 81010, ¶ 144 (June 22, 2010) (hereinafter "Joint Expert Report").

[13] *See* Letter from Tribunal to Experts at A.1, B.5 (Apr. 15, 2010) (clarifying the date the experts should use for their calculations).

- Second, as discussed in Canada's Statement of Case, a high tax rate could be so effective at restraining trade that it would result in very few exports (and thus very little tax collection), while creating significant surplus for U.S. producers.[14]

These hypotheticals, both of which could have occurred under the SLA, demonstrate that there is no need for the amounts collected by Canada to bear any relation to the amounts of lost producer surplus neutralized.

17. Indeed, there is no evidence in this proceeding that U.S. producers have not already recouped an appropriate amount of lost producer surplus. The United States argues that the total amount of taxes collected somehow indicates that the amount of producer surplus restored has been inadequate, but offers no support for that proposition. Lower export tax collections can be consistent with a strong trade restrictive effect. Lower export tax collections could also result from lower lumber demand in the United States. Neither of these instances would be a sign that the tax has failed to perform its function, and both can be consistent with a level of protection that permits U.S. producers to recover lost producer surplus in the marketplace.

18. Equally important, a decline in lumber demand can reduce the amount of producer surplus that is lost. Professors Kalt and Topel calculated the lost U.S. producer surplus as the price reduction in U.S. lumber prices times the total quantity of U.S. lumber

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[14] *See* Canada's Statement of Case in *United States of America and Canada*, LCIA Arbitration No. 81010-B, ¶ 43 (Dec. 17, 2013) (hereinafter "Canada's Stmt. of Case 81010-B").

production.[15] If U.S. lumber production were lower than expected, perhaps due to the enduring recession, the amount of lost producer surplus that needed to be restored would be lower. As Professor Kalt explained: "Since producer surplus is a calculation that depends in part on multiplying price times quantity, a reduction in both can have a large change in the effect of a program on producers. For a given percentage impact of a program on lumber market prices, the harm to producers from the program in the depressed market – one in which prices and volumes are down 30% – is roughly half that of normal market conditions."[16]

19. In other words, low tax collections may be a sign of a down market, but that down market also results in less producer surplus lost. It is thus quite possible that changes in the marketplace caused Canada's collection of the Compensatory Adjustments to *over*-compensate U.S. producers for more than the surplus lost.[17] The United States cannot build the case it seeks to make solely on the basis of the level of export tax collection.

20. The Tribunal based its Award on the expert witness advice and input offered by both Parties. The amount of export tax collected could not be, and was not, equated to

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[15] Rebuttal Expert Witness Report of Joseph P. Kalt in *United States of America v. Canada*, LCIA Arbitration No. 81010, ¶ 121 (May 8, 2009) (81010 R-101) (hereinafter "Kalt Report II"); Expert Report of Robert H. Topel in *United States of America v. Canada*, LCIA Arbitration No. 81010, ¶ 57 (Nov. 21, 2008) (81010 C-2).

[16] Kalt Report II ¶ 121 & n.77 ("For a given percentage change in lumber prices, producer surplus is roughly proportional to price times quantity. If the price and quantity are each 70% of normal conditions, then the economic effect on producers of the price change in such a market is proportional to 70% times 70%, which equals 49%, of normal market conditions.").

[17] Professor Kalt warned of just such an overly effective response in the Joint Expert Report. Joint Expert Report ¶ 201.

the amount of U.S. lost producer surplus. The only constants in the remedy awarded by the Tribunal were the percentage export tax rates – the tool the economists used to address the harm caused to U.S. producers by the circumventing programs – and the period during which those rates were to be applied.

B. The Anticipated Duty Amount to Be Collected Does Not Serve As a Proxy for the Change in U.S. Producer Surplus

21. The United States argues that "Anticipated Duty Amount to Be Collected" is merely an illustrative estimate that provides "a check on the rate provided" to ensure that application of the Compensatory Adjustments would yield collection of "almost exactly the amounts of the change in U.S. producer surplus."[18] The United States is half right. "Anticipated Duty Amount to Be Collected" did serve to provide the Tribunal with a general sense of the potential impact of the Award on Canadian lumber producers. But that check did not, and could not, establish whether the Award restored too much or too little lost U.S. producer surplus. The resemblance between the anticipated collection amounts and the amount of change in U.S. producer surplus was coincidental, and the United States cannot offer any support for the supposition that the two amounts were purposefully or necessarily similar.

22. The operation of the Interactive Spreadsheet demonstrates that it was a coincidence that the Tribunal's selection of the various decision points linked to the Interactive Spreadsheet (Award ¶ 409) resulted in an "Anticipated Duty Amount to Be

[18] U.S. Stmt. of Case 81010-B ¶¶ 21, 41.

Collected" close to the value of the model input for "Change in U.S. Producer Surplus." Selection of other options with respect to the Tribunal's decision points on the Interactive Spreadsheet would produce an "Anticipated Duty Amount to Be Collected" that would differ significantly from the "Change in U.S. Producer Surplus." For example, if the Tribunal had selected the Model Parameter of "Roads Tax Credit as Subsidy to Capital in Lumber Production – Topel" instead of "Roads Tax Credit as Reduction in Delivered Wood – Kalt," the Interactive Spreadsheet would have identified a "Change in U.S. Producer Surplus" for the Québec programs that would have been 34.4 percent higher than the "Anticipated Duty Amount to Be Collected" calculated for the Québec programs.

23. The disparity between the "Anticipated Duty Amount to Be Collected" and "Change in U.S. Producer Surplus" is further illustrated by Figures 29A through 29H of the Joint Expert Report. The "Change in U.S. Producer Surplus" and the "Anticipated Duty Amount to Be Collected" set forth in those eight figures are never identical and often differ considerably.[19] Professor Topel's calculations in Figure 29H, for example, show "Change in U.S. Producer Surplus" that is 57.7 percent higher than the anticipated tax collection for Québec and 16.1 percent higher than the anticipated tax collection for Ontario.[20] The tax collections and producer surplus amounts depend on, and are sensitive to, the relative supply and demand elasticities that were assumed by the experts. Accordingly, if actual market forces yielded an elasticity of demand for lumber that differed from what was projected by

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[19] *See* Joint Expert Report at 120-127 (Figures 29A-29H).

[20] *Id.* at 127 (Figure 29H).

the experts, the ratio of anticipated tax collections to anticipated change in U.S. producer surplus could diverge even more than the wide range of ratios displayed in Figures 29A through 29H.

24. Had the Tribunal directed Canada to collect taxes equal to the change in U.S. producer surplus, the "Anticipated Duty Amount to Be Collected" would not have been *similar* to the "Change in U.S. Producer Surplus." The numbers would have been identical. The United States has offered no explanation or theory for *any* difference between the two figures.

C. Procedural Order No. 6 Did Not Require Canada to Collect Duty Revenues Equivalent to the Change in U.S. Producer Surplus

25. The United States overreaches when it argues that Procedural Order No. 6[21] "confirms" that "the change in U.S. producer surplus shown in the table {in paragraph 410 of the Award} is the operative amount to be collected to remedy Canada's breach."[22] As an initial matter, the document most important to the interpretation of the 81010 Award is the Award itself, followed by the SLA, and the Joint Expert Report on which the Award relies. The Tribunal's conclusions explained in the Award serve as a better basis for the Tribunal's

[21] Procedural Order No. 6 in *United States of America v. Canada*, LCIA Arbitration No. 81010 (Jan. 21, 2010) (hereinafter "P.O. 6").

[22] U.S. Stmt. of Case 81010-B ¶ 56.

interpretation than instructions issued by the Tribunal to the experts six months before issuance of the Joint Experts Report and a full year before submission of the Award.[23]

26. That said, to the extent that the language of P.O. 6 may have any relevance to understanding paragraph 410 of the Award, the language of P.O. 6 cannot be reconciled with the U.S. position. Based only on speculation, the United States concludes that P.O. 6 demonstrates that "the change in U.S. producer surplus shown in the table is the operative amount to be collected to remedy Canada's breach."[24] But the United States offers no reason for why a reference to "overall amounts to be collected" should be assumed to refer to the "Change in U.S. Producer Surplus." Indeed, such an assumption would be at odds with the experts' response to P.O. 6. More important, it would be at odds with the Tribunal's adoption of the experts' calculations and conclusions.

27. Attachment A to paragraph 410 of the Award sets out the tax rates and the "Anticipated Duty Amount to Be Collected" for each program as well as the total tax rate to be collected and the total "Anticipated Duty Amount to Be Collected" for all of the Ontario and Québec programs found to have circumvented the SLA. Attachment A *does not* set out the "Change in U.S. Producer Surplus" for each one of the provincial programs, but only

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[23] The United States also mistakenly relies on paragraph 348 of the Award to support its point. Twice the United States cites that paragraph as supporting the proposition that the Award requires Canada to collect the amounts of change in producer surplus. U.S. Stmt. of Case 81010-B ¶ 43 & n.79, ¶ 55 & n.90. In fact, paragraph 348 of the Award says no such thing. Rather, it states in part, "In the present case, the Tribunal considers that the most appropriate measure for the amounts to be collected as Compensatory Adjustments is not the overall amount of the benefits but only the amounts necessary to neutralize the reduction or offsets to the Export Measures caused by the programs and measures in breach of the SLA."

[24] U.S. Stmt. of Case 81010-B ¶ 56.

includes this item in the "total" column for each of Ontario and Québec. The fact that the experts computed an "Anticipated Duty Amount to Be Collected" for each of subparagraphs (a) through (d) of paragraph 1.3 of P.O. 6, but only computed the "Change in U.S. Producer Surplus" for subparagraphs (a) and (b), strongly suggests that the experts did not construe "amount to be collected" in P.O. 6 to mean the "Change in U.S. Producer Surplus."[25] Rather, it suggests that the experts understood "amount to be collected" in P.O. 6 to mean the amount of duty that would likely be collected as a result of the tax rate they had calculated to address U.S. lost producer surplus.[26] Given that the model was not designed or intended to calculate duty amounts to be collected, and given the number of

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[25] In P.O. 6, Paragraph 1.3, the Tribunal ordered:

"On the basis of the benefits estimated in accordance with paragraphs 1.1 and 1.2 *supra*, the experts shall calculate the reduction or offset of the Export Measures (as defined by the SLA) caused by such benefits, including the past effects of such benefits, and calculate the compensatory adjustments to be collected in order to neutralize such reductions or offsets. The calculation of the compensatory adjustments shall be made in a manner that clearly spells out the following items:

a) The overall amount to be collected for Ontario;

b) The overall amount to be collected for Québec;

c) The overall amount to be collected for each one of the programs identified in paragraph 1.1 *supra* individually;

d) The amount to be collected yearly for each one of the programs identified in paragraph 1.1 *supra* individually, starting in 2010 and ending in 2014."

The Tribunal later confirmed that 2013 was the expiration date of the SLA, not 2014. *See* Letter from Tribunal to Experts at A.1 (Apr. 15, 2010).

[26] Joint Expert Report ¶ 5 ("The second page contains the results of our analysis and the answers to the various questions the Tribunal has posed, including program benefit amount, measurement of lost producer surplus, applicable rate of compensatory export duty, and *anticipated overall amount of export duty to be collected for each of the programs and each of the provinces as defined in the Tribunal's order.*") (emphasis added).

projections that were included in the model, the experts were careful to label this item "*Anticipated* Duty Amount to Be Collected" (emphasis added).

28. Finally, the *operative* portion of P.O. 6 is contained in the first sentence of paragraph 1.3. That sentence instructed the economists to "calculate the reduction or offset of the Export Measures (as defined by the SLA) caused by such {program} benefits … and calculate the compensatory adjustments to be collected in order to neutralize such reductions or offsets."[27] Subparagraphs (a) through (d) are clearly subordinate to the operative sentence. These subparagraphs, therefore, should be interpreted consistently with the first sentence of the paragraph. They cannot stand on their own to imply that the Tribunal intended the phrase "amount to be collected" to refer to the change in U.S. producer surplus.

D. Neither LCIA Arbitration No. 7941 Nor No. 91312 Supports Collection of a Specific Duty Amount Until that Amount is Fully Collected

29. The United States argues that the decisions in LCIA Arbitration No. 7941 ("LCIA 7941") and LCIA Arbitration No. 91312 ("LCIA 91312") support its claim that the 81010 Award required Canada to continue to apply the Compensatory Adjustments until a sum certain was fully collected.[28] Neither decision does so.

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[27] P.O. 6 § 1.3.

[28] U.S. Stmt. of Case 81010-B ¶ 70.

30. LCIA 7941 concerned whether the export tax for certain "Option B" regions had been under-collected.[29] Accordingly, the breach in LCIA 7941, in contrast to the breach in this case, was a violation of Article VII of the SLA, not a circumvention under Article XVII. The LCIA 7941 tribunal determined that the appropriate remedy for an under-collection of tax was the full collection of the amount that should have been collected.[30] The same tribunal reviewing the same award in LCIA 91312 merely confirmed what the LCIA 7941 tribunal had determined: the remedy for Canada's breach was the full collection of the amount that Canada had under-collected.[31]

31. As the United States has acknowledged, the Tribunal in LCIA 81010 decided that the most appropriate remedy in a circumvention case (as opposed to a violation case) was one that focused on countering the effects of the breaching programs on U.S. producers – that is, one that had as its target restoring lost U.S. producer surplus through the restraint of export volumes.[32]

32. LCIA 7941 and LCIA 81010 thus concerned different types of breaches which required different remedies to address the breach. Notwithstanding, the United States' repeated attempts to persuade the 81010 Tribunal to require Canada to collect an exact

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[29] Award on Remedies in *United States v. Canada*, LCIA Arbitration No. 7941, ¶ 113 (Feb. 23, 2009) (81010 CA-12) (hereinafter "7941 Award on Remedies").

[30] 7941 Award on Remedies at 148, Decision 3.

[31] Award in *United States v. Canada*, LCIA Arbitration No. 91312, at 86-87, Decision 2 (Sept. 27, 2009) (81010-B CA-65).

[32] 81010 Award ¶¶ 348-349.

dollar amount until that amount was collected in its entirety,[33] the 81010 Tribunal did not grant the U.S. request. This was no oversight. While collection of a tax amount might have been an appropriate remedy for the failure to collect export taxes in LCIA 7941, it would make no sense where the violation alleged was not a shortfall in collections. Just as the Tribunal declined the U.S. request in LCIA 81010 to have the remedy track that of LCIA 7941, so too should it decline the United States' unwarranted attempt to revive the LCIA 7941 remedy in this proceeding.

II. THE REMEDY AWARDED UNDER LCIA 81010 TERMINATED ON OCTOBER 12, 2013

A. SLA Article XIV Does Not Require Canada to Continue Applying Compensatory Adjustments Through October 12, 2015

33. The United States argues that the SLA's remedy provisions (paragraphs 22, 23 and 24 of Article XIV) require Canada to collect the entire "amount" of "Change in U.S. Producer Surplus" found in the Award. It argues that these paragraphs: (1) require the Tribunal to determine appropriate adjustments to the Export Measures to compensate for the breach; (2) require any Compensatory Adjustments be in an amount that remedies the breach; and (3) require Compensatory Adjustments to be applied until the party complained

[33] *See, e.g.*, United States Post-Hearing Brief in *United States of America v. Canada*, LCIA Arbitration No. 81010, ¶ 153 (Oct. 8, 2009); United States Post-Hearing Reply Brief in *United States of America v. Canada*, LCIA Arbitration No. 81010, ¶ 147 (Nov. 13, 2009); United States Comments on the Experts' Joint Report in *United States of America v. Canada*, LCIA Arbitration No. 81010, ¶ 82 (July 15, 2010); U.S. Stmt. of Case 81010-B ¶¶ 39, 67.

against cures the breach.[34] Based on these requirements, the United States concludes that "{c}ollection of only a fraction of the amount of the Tribunal's remedy could not possibly fulfill the SLA requirement that the Compensatory Adjustments 'be in an amount that remedies the breach.'"[35]

34. This argument reflects a continuing misunderstanding of the difference between export taxes collected and the effect of those taxes on lost producer surplus. Canada agrees that the SLA's remedy provisions govern the application of Compensatory Adjustments to remedy the breach, and that the SLA, by its plain language, "mandates that the Compensatory Adjustments must be in an amount sufficient to remedy the breach found, regardless of the measure of the adjustment selected by the Tribunal."[36] However, it does not follow that the plain language of the SLA's remedy provisions, as set out above, requires "Canada's continued application of the Compensatory Adjustments until it has collected the amount of change in U.S. producer surplus identified in the Award."[37]

35. The Tribunal considered paragraphs 22, 23 and 24 of Article XIV extensively in its Award and made the following observations. First, it noted that the provisions of Article XIV, when read together, imply "that the Tribunal is granted a certain level of

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[34] U.S. Stmt. of Case 81010-B ¶¶ 66-67.

[35] *Id.* ¶ 67.

[36] *Id.* ¶ 66.

[37] *Id.* ¶ 65.

discretion to determine the measure of adjustments that will remedy the breach."[38] The only restriction imposed on the Tribunal is that the Compensatory Adjustments must be in the form either of export charges or a reduction in the export volumes permitted, or both. Second, the Tribunal concluded that Article XIV (22), (23) and (24) required it to make two decisions – the determination of "(i) a reasonable period of time for Canada to cure the breaches and (ii) the Compensatory Adjustments, i.e. 'an increase in the Export Charge' and/or a 'reduction in the export volumes' … 'in an amount that remedies the breach' …, which will apply in the event that the Respondent does not voluntarily cure the breach."[39]

36. With respect to the second question, the Tribunal decided that the approach followed by Professors Kalt and Topel – targeting lost producer surplus and determining a rate to address that lost producer surplus within the period dictated by the Tribunal – was best suited to assess the amounts to be collected by Canada as Compensatory Adjustments in a circumvention case.

37. The Tribunal, therefore, did not interpret Article XIV (22), (23) and (24) to require Canada to apply the Compensatory Adjustments until an amount certain was collected. Rather, it read these provisions to allow it to award a remedy in the form of a percentage tax rate that would have the effect of increasing U.S. prices and thereby compensating U.S. producers for the harm caused by the breaching programs. The Tribunal could, with equal consistency with those sections of the SLA, have imposed only volume

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[38] 81010 Award ¶ 345.

[39] *Id.* ¶ 322.

restraints, in which case no dollars would have been collected, but it would still have ordered an adjustment "in an amount that remedies the breach."[40]

B. The U.S. Reliance on Conjecture and Misinterpretation of the Tribunal's Language Cannot Justify Extension of the Tax Rate to October 12, 2015

38. The United States speculates that, if Canada's application of the Compensatory Adjustments had yielded $58.85 million in duty collections prior to October 12, 2013, Canada would have stopped collecting the tax.[41] Canada has taken no such position, and the U.S. speculation has no more meaning than an allegation by Canada that, in such a situation, the United States would have insisted that the rate, not the amount, was the key element of the remedy.

39. The United States supports its speculation by citing paragraphs 361-363 of the Award for the proposition that a Party could return to the Tribunal to seek a modification or termination of the Compensatory Adjustments to ensure appropriate collection of a fixed dollar amount.[42] That is a misreading of the Award. In paragraphs 361-363, the Tribunal notes that, consistent with Article XIV(29) of the SLA, a Party may reconvene a tribunal when the Party cures a breach or the underlying cause is diminished or abolished.[43] The

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[40] SLA 2006 Art. XIV(23).

[41] U.S. Stmt. of Case 81010-B ¶ 52.

[42] *Id.* ¶ 53 & n.88 (citing to paragraphs 361-363 of the 81010 Award).

[43] 81010 Award ¶¶ 361-363; SLA 2006 Art. XIV(29).

United States seizes on this discussion about the *duration of the programs* and attempts to apply it to the *amount of taxes* collected.

40. The United States also argues that over-collection "could only be an issue if the remedy is to actually collect a specific amount."[44] This makes no sense. If it were as clear as the United States suggests that the remedy must be to collect a specific dollar amount, it would not be necessary to convene an Article XIV(29) tribunal to determine whether there had been an over-collection.

C. October 12, 2013 Is Important Both to the Calculation and the Application of the Remedy Awarded by the Tribunal

41. The United States stretches far when it dismisses the October 12, 2013 date as having "no significance other than to demonstrate that the SLA has remained in constant effect – which means that all of the rights and obligations of the Agreement remain in effect."[45]

42. To the contrary, October 12, 2013 was important both to the calculation, and to the application, of the remedy awarded by the Tribunal.[46]

- First, Attachment A to the Joint Expert Report, used as the basis for the table in paragraph 410 of the Award, lists tax rates to be applied only through October 12, 2013.

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[44] U.S. Stmt. of Case 81010-B ¶ 53.

[45] *Id.* ¶ 47.

[46] *See* Canada's Stmt. of Case 81010-B § II.A.

- Second, the Tribunal confirmed that the experts should use October 12, 2013 as the relevant date to calculate the additional export taxes necessary to address lost U.S. producer surplus, which they did.[47]
- Third, the United States acknowledges that October 12, 2013 was the date used to calculate the "rate of the Compensatory Adjustments necessary to address the harm to U.S. producers,"[48] which it admits was the objective of the remedy in LCIA 81010.

43. The Compensatory Adjustments were carefully calibrated by the experts to remedy the reduction or offset of the Export Measures caused by the provincial programs, using October 12, 2013 as the termination date for the model's calculations. Changing the end date used by the economists for the duration of the tax would result in tax rates different from those ordered by the Tribunal. Both Parties have agreed that those rates cannot be changed.[49]

44. The Tribunal will recall that the remedy ordered in LCIA 81010 was to compensate both for past and future effects of the Ontario and Québec programs.[50] Calculating the amount needed to compensate for future effects required predictions of the future and use of an economic model. But calculating the rate needed to compensate for

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[47] *See* Letter from Tribunal to Experts at A.1, B.5 (Apr. 15, 2010); Joint Expert Report ¶ 12.

[48] U.S. Stmt. of Case 81010-B ¶ 48.

[49] Parties' Understanding ¶ 7; U.S. Stmt. of Case 81010-B ¶¶ 27, 50; Canada's Stmt. of Case 81010-B ¶¶ 10-11.

[50] 81010 Award ¶¶ 357, 407.

past effects required only that a known amount be spread out over the time available. If that time were extended, the known amount would be more thinly spread out, in the same way that the same quantity of jam would be more thinly spread over two slices of toast than over one. One could not, therefore, extend the time period without either reducing the rate or increasing the total collected, neither of which is permitted by the Parties' Understanding.[51]

45. The termination date was a key parameter in the experts' calculation of lost producer surplus and of the appropriate rate to restore that producer surplus. Simply changing the termination date without adjusting all the date sensitive values used for the many variables in the model – a task beyond the mandate of this Tribunal – would result in collections that bear no relationship to the harm caused by the programs on U.S. producers. If the date for collection of the percentage rate were extended, the Compensatory Adjustments would not "neutralize" the effects of the programs found to have circumvented the Agreement. The effect of such an extension would be entirely random.

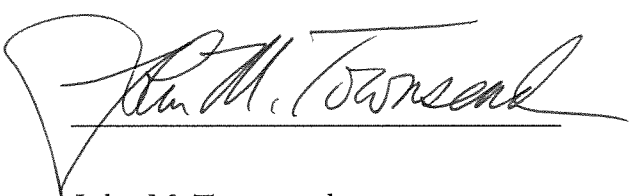
46. The Tribunal's Award was fully implemented as of October 12, 2013. The Tribunal should accordingly rule that Canada's obligation to impose the Compensatory Adjustments ended on that date.

[51] Parties' Understanding ¶ 7.

CONCLUSION

47. For the reasons stated above and in its Statement of Case, Canada respectfully requests that the Tribunal confirm that Canada's obligation to apply the Compensatory Adjustments set out in the 81010 Award terminated on October 12, 2013, the original termination date for the SLA. Canada further requests that the Tribunal direct that the Compensatory Adjustments collected from exporters between October 12, 2013 and the date of the Award should be reimbursed.

Respectfully submitted,



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