In The London Court Of International Arbitration

THE UNITED STATES OF AMERICA,

Claimant,

v.

CANADA

Respondent.

NON-CONFIDENTIAL POST-HEARING BRIEF OF THE RESPONDENT CANADA

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POST-HEARING BRIEF

In accordance with the Parties' joint-letter of July 31, 2009 and the Tribunal's confirmation letter of August 31, 2009, the Government of Canada ("Canada") respectfully submits this Post-Hearing Brief.

INTRODUCTION

1. This Post-Hearing Brief responds to the questions posed by the Tribunal and to the U.S. arguments presented at the Hearing.

2. The Hearing has clarified the issues dividing the Parties and has made apparent that the United States claims should all be dismissed. The Hearing also demonstrated that if the Tribunal does find that any of the challenged Canadian programs breach the SLA, the proper way to determine the export tax adjustments to compensate for the breach is not the U.S. Beck "high case" or so called "low case" proposals, neither of which has a basis in law or economics, and both of which would impose punitive damages. Rather, the proper way to determine any compensatory adjustment, if necessary, is through a model constructed under sound economic principles that will calculate an adjustment to offset any economic effect on the Export Measures caused by the breach. That is what Canada has proposed in the event the Tribunal reaches this issue, supported by the work of Professor Kalt and, to a large degree, by the U.S. economic expert, Dr. Topel.

3. The Tribunal will first have to decide the issue of liability with respect to each of the Challenged Programs. The specific evidence and arguments presented at or in conjunction with the Hearing with respect to the three Ontario and the seven Québec programs are discussed in Part I and Part II, respectively. These Parts address issues relating to liability for each of the Challenged Programs, including the failure of

the United States to meet its burdens with respect to the critical elements of Article XVII(2) on which it relies, namely (1) to identify and quantify the provision of benefits, (2) provided to producers or exporters of softwood lumber (3) by the governments of Ontario or Québec.

4. Parts I and II of this Post-Hearing Brief also review and comment on the evidence developed at the Hearing relating to the applicability of the various safe harbour provisions appearing in subparagraphs 2(a), 2(b), and 2(c) of Article XVII. That evidence establishes that even if the Tribunal finds that a benefit has been provided by government action to producers or exporters of softwood lumber, such measures fall within one or more of the enumerated safe harbours.

5. At the Hearing, the United States affirmed and made even more explicit the errors of interpretation of Article XVII that underlie its claims. Those related to the first sentence of paragraph 2 of Article XVII and the individual safe harbours are addressed in the discussion of individual Challenged Programs in Parts I and II. For a full discussion of the U.S. errors of interpretation related to the interplay between paragraphs 1 and 2 of Article XVII, please see the discussion in Canada's Statement of Defence at paragraphs 35-52 and Canada's Rejoinder at paragraphs 40-68.

6. If the Tribunal finds that any of the programs circumvent the Agreement, it will have to determine appropriate adjustments to the Export Measures to compensate for the breach. A key threshold issue the Tribunal will have to resolve is whether those adjustments should be calibrated to address the offset or reduction of the Export Measures caused by the breach, as Canada argues, or whether they must be designed to recapture the benefits provided by any program found to be a circumvention of the

SLA, as the United States asserts. The implications of the Hearing for this issue are described in Part III at paragraphs 186-208.

7. If the Tribunal accepts Canada's position, which forms the analytical framework for each of the Parties' economic experts, the Tribunal's resolution of the following six general issues will provide the economic experts with most of the necessary guidance and the parameters required for them to calculate the appropriate compensatory adjustments. These issues, and the implications of the Hearing for each of them are addressed in detail below in Part III, paragraphs 209-293:

(1) *Termination of Programs:* Whether it should be assumed that the Challenged Programs will continue indefinitely, or will terminate where termination is provided by law;

(2) *Post-SLA Benefits or Effects:* Whether compensatory adjustments should take into account the benefits or effects that occur after the expiration of the SLA;

(3) *Retroactivity:* Whether compensatory adjustments should only address the ongoing effects of a continuing breach, or also include an amount to cover past effects of a breach;

(4) *Pulp Mill Benefits:* Whether benefits provided to producers of pulp and paper should be considered as benefits to producers of softwood lumber and, if so, in what amount;

(5) *Loan and Loan Guarantee Benefits*: Whether the benefits provided by a loan or loan guarantee should be determined using the standard practice, or following Mr. Beck's methodology; and

(6) *Gross Investment Expenditures:* Whether the value of the benefit should be the amount actually provided by the government, or the amount of the entire investment that enjoyed government support.

8. Once these key issues have been resolved, the Tribunal's work will be simplified by the fact that there is substantial agreement between the Parties' experts regarding the economic principles that should govern the Tribunal's approach to determining appropriate compensatory adjustments. Aside from agreeing that compensatory adjustments should compensate for the effects of the programs on the Export Measures, Professors Kalt and Topel also agree in principal on how the compensatory adjustments should be calculated.

9. Professor Kalt testified that he tried to replicate Professor Topel's model using the available descriptions in Professor Topel's Reports. There is very little disagreement, therefore, on economic modeling issues. The Tribunal, as a result, can determine the appropriate compensatory adjustments in this case without the need to resolve complex economic differences between the two experts.

10. Should the Tribunal find liability with respect to any program, decisions on these six issues will give the economic experts sufficient guidance to run their models and arrive at appropriate adjustments to the Export Measures. Indeed, Canada believes that if these six issues are resolved, the differences in compensatory adjustments calculated by the two models will be relatively minor. Canada respectfully suggests that the Tribunal provide this guidance to Professors Kalt and Topel, and ask them to work

together to calculate a single, consensus estimate of the resulting compensatory measures. The economists could be asked to draft a joint report, and in the event that they are unable to resolve any of the remaining differences, to put in that report sufficient information about the nature and significance of the differences for the Tribunal to resolve the issue.

11. Finally, in Annexes I through VI of this brief, Canada responds to the questions posed by the Tribunal during the Hearing. The Annexes address: (I) the additional modeling and program-specific issues the Tribunal may have to address in the calculation of benefit amounts for the various programs; (II) the specific steps taken by Professor Kalt to determine compensatory adjustments; (III) the legal effect of the 7941 Tribunal Award on this proceeding; (IV) the question whether the term "existed" is used in Article XVII as a legal notion or a factual question; (V) a response to the Tribunal's questions to Professor Kalt on the extent to which the economic models contemplate the effects of government support on a mill's decision whether to remain open; and (VI) a response to the Tribunal's question regarding the negotiating history of the SLA, including a correction of the U.S.'s description of the antecedents to the Agreement.

PART I. ONTARIO PROGRAMS

THE FOREST SECTOR PROSPERITY FUND AND THE LOAN GUARANTEE PROGRAM

12. The Tribunal can determine whether Ontario's Forest Sector Prosperity Fund and Loan Guarantee Program meet the Article XVII(2)(b) safe harbour, by resolving only two specific questions. The first question is: what is the proper interpretation of "non-discretionary"? Canada and the United States have presented divergent interpretations of that term. If the Tribunal accepts Canada's interpretation – that, as a general matter, a non-discretionary decision is one that is subject to

reasonable constraints and that, in the particular context of the SLA, a non-discretionary program is one which ensures that any benefits to the softwood lumber industry are predictable – then it follows that Ontario's FSPF and LGP qualify for safe harbour. The United States has never challenged Canada's claim that these programs meet the non-discretionary standard *as Canada has interpreted that term*.

13. However, if the Tribunal instead accepts the U.S. interpretation of "non-discretionary," then – and only then – the Tribunal must consider the second question: do the FSPF and LGP meet the "non-discretionary' standard as the United States has interpreted the term? Here the evidentiary record leads to a decision for Canada. Program administrators have exclusively employed the mandatory program criteria in making decisions, and the United States has conceded that decision-making according to these mandatory criteria meets its definition of non-discretion. Program benefits have in fact been provided on a non-discretionary basis even under the U.S. interpretation.

A. CANADA SHOULD PREVAIL ON THE CORRECT INTERPRETATION OF "NON-DISCRETIONARY"

14. The first key issue that the Tribunal must resolve is the proper meaning of "non-discretionary" in the context of Article XVII(2)(b). Canada has shown that an administrative process is non-discretionary when it is subject to reasonable constraints. In the context of the safe harbour, this means that the administrative process is sufficiently constrained to ensure that benefits flowing to the softwood lumber industry are reasonably predictable.

15. At the Hearing, the United States proposed that an administrative process is non-discretionary only when it is mechanical, when it consists of a "tick-box" approach,

and when it entails no hint of choice or judgment.[1] The United States would hold that any program that deviates from this ideal – that involves any official making any judgment concerning any aspect of the decision at any stage of the administrative process – is discretionary. The Tribunal must decide which interpretation to accept. If the Tribunal decides that the United States is correct in its reading of "non-discretionary," then it must still consider whether, in fact, Ontario's programs meet this standard. (That is the subject of Section B below).

16. However, if the Tribunal agrees with Canada's reading of "non-discretionary," it need proceed no further. Canada has explained that Ontario's FSPF and LGP are subject to reasonable constraints in so far as these programs set forth mandatory parameters for the administrative process.[2] Even if the supplementary guidelines were used, these guidelines would not *expand* the administrators' scope of decision-making; the mandatory parameters, even coupled with the supplementary guidelines, would tightly constrain program administrators.[3]

17. Canada has also explained that the basis for benefits under the FSPF and LGP is limited to wood product manufacturing and paper manufacturing, thereby ensuring that funding to the softwood lumber industry is predictable.[4] It would be strange if the United States were affirmatively to argue that the funding to the softwood lumber industry is *not* predictable, since it expresses no hesitation in attributing future program benefits to softwood lumber in its remedy calculations.

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[1] Tr. vol. 1-A, 31:9-15; Stmt. of Case ¶ 41; U.S. Reply ¶ 55.

[2] Canada Rejoinder ¶¶ 132-135.

[3] Canada Rejoinder ¶¶ 136-139.

[4] Stmt. of Defence ¶¶ 118-119; Canada Rejoinder ¶ 127.

18. The United States has not seriously contested Canada's claim that Ontario's programs meet the standard under Canada's interpretation of "non-discretionary." If Canada prevails in its interpretation of "non-discretionary," it follows that it prevails in showing that the FSPF and LGP fall within the Article XVII(2)(b) safe harbour.

1. The Ordinary Meaning of "Non-Discretionary" Is Not "Mechanical"

19. The United States has asserted throughout these proceedings that "non-discretionary" means mandatory, mechanical and lacking any element of judgment. The initial basis for this assertion was quotations from two domestic court cases.[5] But these court cases did not support the U.S. interpretation of "non-discretionary." As Canada has explained, *Baker v. Canada* does not endorse the U.S. interpretation;[6] and *U.S. v Gaubert* unambiguously rejects it.[7] These two isolated cases, moreover, have no relevance under international law.[8]

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[5] Stmt. of Case ¶ 21.

[6] Canada Rejoinder ¶ 125 (discussing *Baker v. Canada* (Minister of Citizenship & Immigration), 1999 S.C.J. No. 39 (S.C.C.), ¶ 54 (CA-6)). The United States has focused on the court's discussion of "discretion." But it has consistently ignored the court's *subsequent* discussion where it rejected the rigid dichotomy between "discretionary" and "non-discretionary" – the very basis for the U.S. interpretation of "non-discretionary."

[7] The court held that the element of judgment does not make a decision "discretionary." *United States v Gaubert*, 499 U.S. 315, 322 (1991) (CA-7); *see* Canada Rejoinder, n.55. Indeed, the United States has effectively conceded that that the term "discretionary" in its *statutory* context is not related to the element of choice. U.S. Reply ¶ 56. The use of the term in U.S. law is, of course, the only point that is relevant – as the United States acknowledged when it claimed to draw support from the principle of "discretion under United States *law*." Tr. vol. 5, 1104:24-5 (emphasis added).

[8] These two cases do not demonstrate ordinary meaning under VCLT Art. 31.1 and do not give rise to special meaning under VCLT Art. 31.4. Stmt. of Defence ¶¶ 100-101; Canada Rejoinder ¶¶ 120-123. They cannot be the basis for interpreting the SLA under the principles of international law.

20. Canada, following the conventional methods of interpretation under international law, introduced several dictionary definitions of "discretionary" and "non-discretionary."[9] The United States not only accepted the accuracy of these definitions, it claimed that these definitions actually support its far-fetched interpretation of "non-discretionary."[10] The United States did so by consistently misinterpreting and even – in its Opening Statement at the Hearing – misquoting the dictionary definitions.[11] Perhaps recognizing its error, the United States put forward in its closing a new dictionary definition of "administrative discretion," quite different from the definition it advanced just four days earlier.[12]

21. This definition is the *Black's Law Dictionary* definition of "administrative discretion" – defined as "a public official's or agency's power to exercise judgment in the discharge of its duties."[13] Of course, the United States simply ignores all the *other* dictionary definitions on the record. These include: the *Oxford English Dictionary* definition of "discretionary" as "limited or restrained *only* by discretion or judgment;" its definition of "discretion" as "*uncontrolled* power of disposal;" and *Black's Law Dictionary* definition of "discretion" as "the power of *free* decision-making."[14] All of these clearly contradict the U.S. interpretation.[15]

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[9] Stmt. of Defence ¶¶ 111-112.

[10] U.S. Reply ¶¶ 47-48.

[11] Tr. vol. 1-A, 26:1-3.

[12] Tr. vol. 5, 1103:22-1104:4.

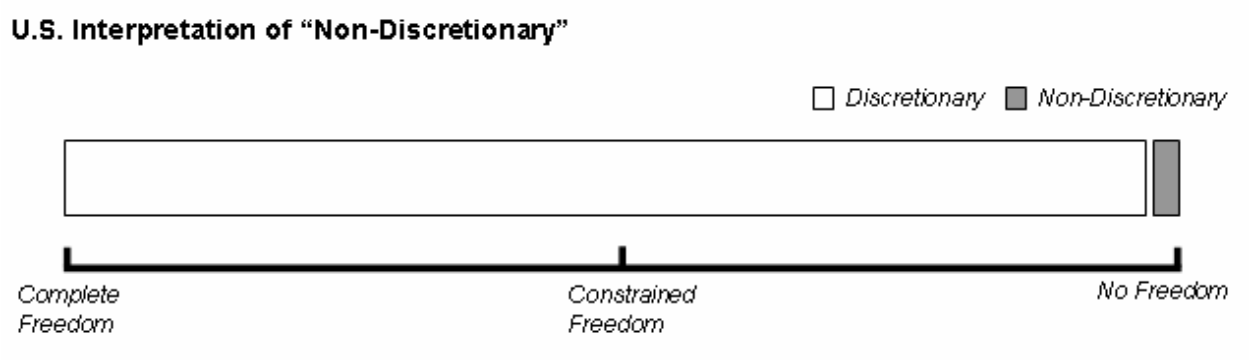
[13] Tr. vol. 5, 1103:22-1104:4 (citing definition of "discretion" in *Black's Law Dictionary*, 2004 (Exhibit RA-27)).

[14] Stmt of Defence ¶ 111, nn.84-86.

[15] Indeed if the United States wishes to consider further dictionary definitions from the record, it might add another definition of "discretion" in Black's: "{A} public official's power or right to act in certain circumstances according to personal judgment and conscience, often in an official or representative capacity." Black's Law Dictionary, 2004 (Exhibit RA-27). If a public official's

22. The Tribunal can consider three approaches to this issue and may benefit from a graphic portrayal of them. First, the Tribunal can find that a decision is non-discretionary only if it involves no element of choice whatsoever. This is the U.S. interpretation, reflected in Figure 1.1. The only support for this interpretation is a single dictionary definition.

Figure 1.1



23. Second, the Tribunal can find that a decision is non-discretionary as long as it has some element of constraint – as long as the choice is not completely unfettered. This is the interpretation reflected in Figure 1.2, and it is supported by all but one of the dictionary definitions on the record. It is not in fact the interpretation that Canada has advanced (although Canada would certainly prevail if this interpretation were accepted).

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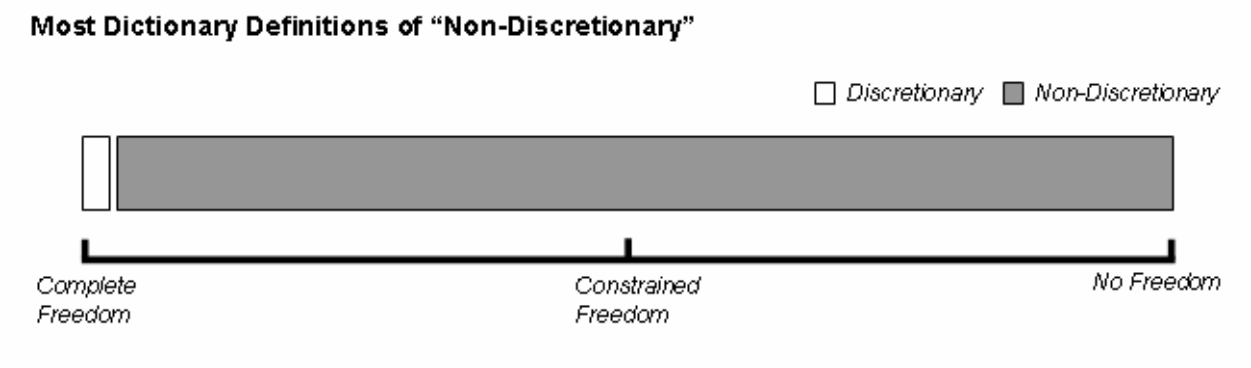
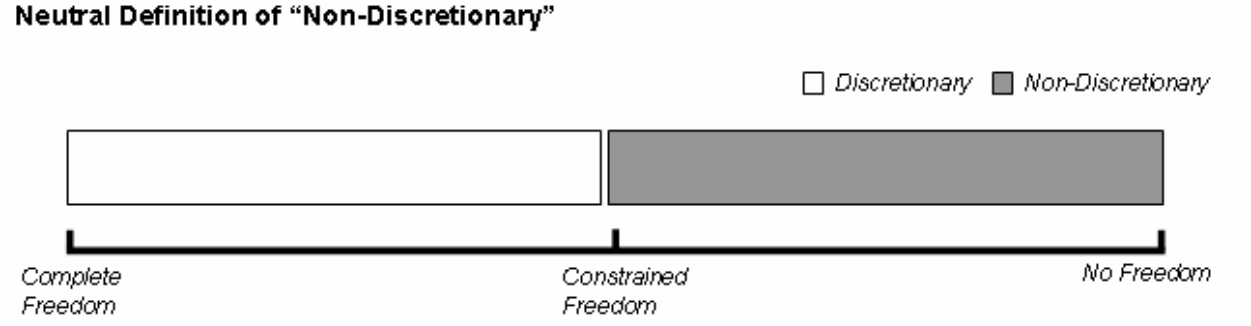
power is bound only by her conscience, she effectively has unconstrained power. It follows from these dictionary definitions that a decision is "non-discretionary" where it is subject to any constraint.

Figure 1.2



24. Third, there is a considerable middle ground between these two interpretations. The Tribunal can find that a decision is non-discretionary if it entails some choice (but not too much choice) – that is, if the decision is bound by an appropriate level of constraint. This is the interpretation set forth in Figure 1.3.

Figure 1.3



25. This last interpretation reflects the understanding that "discretion" and "discretionary" are not absolute concepts and that even the prefix "non" permits a certain range of meanings.[16] It is the reasonable and moderate interpretation of "non-discretionary." It is also the interpretation that Canada has advanced from the start.

[16] The OED notes that "non" is more likely to express a neutral negative sense than other negative prefixes, such as "in" or "un." *Oxford English Dictionary Online* (RA-28).

26. This graphic depiction illustrates that the United States has advanced an extreme interpretation of "non-discretionary," one that lacks support as a matter of ordinary meaning and that is inconsistent with the treaty context. Canada has not argued for the *opposite* interpretation – an equally extreme interpretation, even though that interpretation is far better supported by the dictionary definitions than the U.S. interpretation. Instead, Canada has argued for a moderate interpretation of "non-discretionary," which reflects the variety of dictionary definitions and the treaty context of the term.

2. The Context Also Demonstrates That the U.S. Interpretation of "Non-Discretionary" Is Erroneous

27. It is not sufficient under international law to consider the ordinary meaning of the term "non-discretionary" in isolation.[17] Canada has presented two types of context arguments. The first type of context argument focuses on the words surrounding "non-discretionary." This follows the principle of *noscitur a sociis* – which holds that the "meaning of an unclear word or phrase should be determined by the words immediately surrounding it."[18] The second type of context argument considers the broader logic of Article XVII and the rationale of the text.

28. Canada's interpretation is fully consistent with the Treaty context. The U.S. interpretation is not and, indeed, the United States has barely addressed these

[17] Under Article 31.1 of the Vienna Convention, the terms of the treaty must be considered "in their context." This approach also follows WTO rulings, which have emphasized that "the ordinary meaning of a treaty term must be ascertained according to the particular circumstances of each case." Appellate Body Report, *European Communities – Customs Classification of Frozen Boneless Chicken Cuts*, WT/DS269/AB/R, WT/DS286/AB/R, ¶ 175 (Sept. 12, 2005) (RA-31).

[18] *See* Canada Rejoinder ¶ 140, n.70.

context arguments. Worse, it has never explained why its extreme interpretation of "non-discretionary" makes any sense in the context of the SLA.

a. The Surrounding Text Is Not Consistent With the U.S. Interpretation of "Non-Discretionary"

29. The words surrounding "non-discretionary" help to interpret the meaning of that term. These words include "grants or other benefits," "total aggregate amount" and "administered." These words are all inconsistent with the interpretation of "non-discretionary" that the United States has proposed. The United States did not address at the Hearing the significance of other terms, such as "total aggregate amount" and "administered." Canada rests on its briefs on those issues.[19]

30. The United States did raise at the Hearing the issue of "grants or other benefits." As Canada has explained, Article XVII(2)(b) is designed to protect government programs that provide "grants or other benefits."[20] It follows logically that the term "non-discretionary" therefore cannot be interpreted in such a way as to *preclude* government grant programs from the scope of Article XVII.

31. Yet, it is unchallenged that the typical government program involves "evaluation according to standards, and administrative decisions."[21] The archetypal government grant program would fail to meet the Article XVII(2)(b) safe harbour as the

[19] Canada Rejoinder ¶¶ 109-110.

[20] The chapeau of Article XVII(2) refers to "grants or other benefits." Accordingly, "grants" are the principal subset of benefits. Since none of the enumerated safe harbours of Article XVII(2) refers specifically to "grants," it must be that the term "benefits" refers, principally, to "grants." Article XVII(2)(b) is supposed to provide a safe harbour for government programs that provide *grants* on a non-discretionary basis. *See* Canada Rejoinder ¶¶ 104-108.

[21] Canada Rejoinder ¶ 105. The U.S. Government has itself declared that "virtually every subsidy program in the world" involves the exercise of judgment. *Countervailing Duties: Final Rule*, 63 Fed. Reg. 65,347, 65,356 (Dep't. of Commerce Nov. 25, 1998) (RA-23).

United States has interpreted it.[22] The U.S. interpretation of "non-discretionary" therefore fails to give full effect to the safe harbour designed to protect government grant programs.

32. The only response that the United States offered in its Reply was that the Québec tax credit programs and the Ontario road reimbursement program would both qualify as "non-discretionary." But neither of these programs is an archetypal government *grant* program. The U.S. interpretation of "non-discretionary" does not give effect to the Article XVII(2)(b) safe harbour for government grant programs.

33. In the Hearing, the United States did not contest the fact that its interpretation of "non-discretionary" reads out government grant programs. In its Opening Statement, the United States declared:

> Ontario argues that the United States interpretation of non-discretionary would preclude the "archetypical government program." Such considerations are not contemplated by the text of the Softwood Lumber Agreement, and thus are not relevant to these proceedings.[23]

The United States did not challenge the point that its interpretation would preclude the "archetypical government program," but makes the bizarre claim that "such considerations" are not relevant. In fact, such considerations go to one of the most basic principles of treaty interpretation: the principle of effectiveness, by which a Tribunal seeks to give effect to each word of the text.

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[22] The archetypal government grant program, of course, involves certain judgments, like those called for in the supplementary guidelines, about how to disburse program funds. If the Ontario FSPF and LGP had been over-subscribed, the program administrators would have made judgments according to those supplementary guidelines. In the event, the Ontario programs are in the unusual situation – by virtue of under-subscription – that the guidelines have not in fact been invoked.

[23] Tr. vol. 1-A, 32:25-33:5.

34. The Appellate Body of the World Trade Organization has held that:

> A fundamental tenet of treaty interpretation flowing from the general rule of interpretation set out in Article 31 is the principle of effectiveness (*ut res magis valeat quam pereat*). In United States – Standards for Reformulated and Conventional Gasoline, we noted that "{o}ne of the corollaries of the 'general rule of interpretation' in the Vienna Convention is that interpretation must give meaning and effect to all the terms of the treaty. An interpreter is not free to adopt a reading that would result in reducing whole clauses or paragraphs of a treaty to redundancy or inutility."[24]

The U.S. failure to give effect to the term "grants or other benefits" – that is, interpreting "non-discretionary" in such a way as to preclude government grant programs from qualifying for safe harbour under Article XVII(2)(b) – is a fundamental error.

35. In its Closing Statement at the Hearing, the United States stated:

> Canada also argues that the plain language of the SLA is overly broad because archetypal government programs would circumvent the SLA. Canada sheds no light on what this means. Even if the programs were so, Canada agreed that all grants or other benefits would circumvent the SLA, subject to certain exceptions.[25]

But Canada has never argued that the SLA is "overly broad;" it has argued that the U.S. interpretation of "non-discretionary" is *unduly restrictive* because it would mean that government grant programs necessarily circumvent the SLA even though Article XVII(2)(b) clearly provides safe harbour for certain government grant programs. The United States would all but eviscerate one of the "exceptions," or safe harbours, to which the Parties agreed.

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[24] Appellate Body Report, *Japan – Taxes on Alcoholic Beverages*, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, p. 12 (Oct. 4, 1996) (citing Panel Report, *United States - Standards for Reformulated and Conventional Gasoline*, WT/DS2/9, adopted 20 May 1996, p. 23) (RA-130).

[25] Tr. vol. 5, 1105:7-13.

b. The U.S. Interpretation of "Non-Discretionary" Does Not Comport With the Logic of SLA Article XVII

36. Throughout these proceedings, Canada has also presented a second type of context argument: an argument that considers the logic and structure of Article XVII(2)(b). This too is an integral piece of the treaty context. As Canada explained at length in its Statement of Defence, a rigorous analysis of the treaty text should consider the function of the "non-discretionary" element and its relationship to other terms in Article XVII(2)(b).[26]

37. The United States attempted in its Closing Statement to dismiss this approach as negotiating history.[27] But the United States ignores that this is an analysis of the internal logic of the Agreement's provisions. It is an analysis that considers the scope of the Article XVII(2)(b) safe harbour and the logic of the "non-discretionary" standard.

38. Indeed, it is disingenuous of the United States to ask the Tribunal to ignore any consideration of the logical function of the "non-discretionary" standard within Article XVII(2)(b), when the United States has plainly acknowledged the significance and relevance of this analysis. In its Opening Statement, the United States emphasized that:

> the requirement in paragraph 2(b), that the program be non-discretionary, is significant because, among other things, the future administration and effects of a non-discretionary program could be anticipated and estimated.[28]

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[26] Stmt. of Defence ¶¶ 61-62, 116-117. *See also* Canada Rejoinder ¶¶ 140-146.

[27] Tr. vol. 5, 1107:16-24. ("Canada further contends that the purpose of this exception was to provide predictability and to prevent circumvention of the export measures through existing programs by funneling benefits to the lumber industry in a surprise manner. Canada provides no evidence of this litigation position, and in any event, the plain meaning of the SLA lacks any such purpose.")

[28] Tr. vol. 1-A, 16:1-6.

39. This U.S. statement effectively endorses Canada's analysis of Article XVII(2)(b). Clearly, Article XVII(2)(b) is designed to keep in place certain programs serving the softwood lumber industry that existed as of July 1, 2006 but to preclude *additional* sources of funding to the industry.[29] As the United States effectively acknowledges, the "non-discretionary" element fills a gap left by the other elements of the safe harbour. Without the "non-discretionary" element, a government could still find ways to give additional money to the softwood lumber industry (specifically, it could use a general discretionary fund to disburse money).

40. An interpretation of "non-discretionary" must consider this context. Article XVII(2)(b) was not designed to *prohibit* certain programs, but to *protect* programs so long as they did not provide unexpected funding to softwood lumber. The U.S. interpretation of "non-discretionary" – as mandatory and mechanical – does not comport with this context.

B. THE ONTARIO PROGRAMS MEET EVEN THE U.S. STANDARD OF "NON-DISCRETIONARY"

41. In the event that the Tribunal accepts the U.S. interpretation of non-discretion, despite the arguments presented, then the Tribunal must resolve whether Ontario's FSPF and LGP meet the *U.S.* standard of "non-discretionary." Even if the extreme U.S. interpretation of "non-discretionary" were correct, the facts demonstrate that the Ontario programs have met this definition.

42. In its Closing Statement, Canada summarized several points of agreement between the Parties.[30] First, the Ontario FSPF and LGP are bound by a set

[29] Stmt. of Defence ¶ 58.

[30] Tr. vol. 5, 1192:25-1194:1.

of mandatory criteria. Canada laid out the mandatory criteria in its Rejoinder; they include rules requiring that projects must be new and that they must be located in specific geographic areas.[31] These criteria are mandatory (under the program rules, successful applications must meet them) and they are mechanical (no judgment is required, for example, to decide whether a project meets the geographical criteria). The United States does not appear to contest any of these points.

43. Second, the Ontario programs also provide for supplementary guidelines. These guidelines include such principles as whether a project contributes to the socioeconomic health of certain Ontario regions or whether it contributes to Aboriginal communities. These supplementary guidelines are not mechanical and, when relied upon, they do allow for a certain amount of judgment (although, as Canada has explained earlier, they are still subject to the constraints of the mandatory criteria).[32] Again, the United States does not appear to contest any of these points.

44. The United States has made no objection to the mandatory criteria. In its Opening Statement, the United States declared:

> Indeed, if the programs were limited to those threshold eligibility requirements and program officials were not required to consider subjective factors, it is likely that these programs would survive the non-discretionary requirement of exception 2(b)…[33]

The United States thus acknowledged that if the program administrators relied *only* on the mandatory criteria, then the programs would meet the U.S. standard of "non-discretionary."

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[31] Canada Rejoinder ¶¶ 132-135.

[32] Canada Rejoinder ¶¶ 137-139.

[33] Tr. vol. 1-A, 33:19-24.

45. The crucial question for the Tribunal – and the only point of genuine factual disagreement between the United States and Canada – is whether the program administrators of the FSPF and LGP rely on the supplementary guidelines, in addition to the mandatory criteria, in making their decisions to disburse benefits. If the program administrators do in fact use and rely upon the supplementary guidelines – when these guidelines allow a limited amount of judgment – then Canada concedes the Ontario programs would not meet the *U.S.* standard of non-discretionary. (They would, of course, still meet the *Canadian* standard of non-discretionary.) Alternatively, if the program administrators do *not* in practice use and rely upon the supplementary guidelines – if these guidelines are available, but not exercised – then as a factual matter, these administrators only use the mandatory criteria in making their decisions, and therefore, these programs meet the U.S. standard. This follows from the U.S. concession above.

46. In the sections below, Canada explains that the administrators of the FSPF and LGP were allowed to, but did not in fact, use the supplementary guidelines. In particular, Canada shows that U.S. reliance on Minister Briefing Notes – a U.S. focus at the Hearing – does not advance the U.S. cause. Next, Canada reviews the U.S. observations that the Ontario programs provide supplementary guidelines and also that the administrative process for both programs have many steps and multiple parties. These observations are correct but in no way support the U.S. conclusion that program administrators have actually used supplementary guidelines. Finally, Canada examines the U.S. claim, raised at the Hearing, that Canada bears the burden of proof: a claim that is both inaccurate and unhelpful to the U.S. case.

1. Canada Has Demonstrated That the Program Officials Used Only Mandatory Criteria – Not Supplementary Guidelines – in Providing Benefits

47. The legal test under Article XVII(2)(b), in its simplest form, is whether a program provided benefits on a non-discretionary basis. The test is not whether the program potentially allowed for the consideration of supplementary guidelines, but whether the actual basis for the disbursement of benefits – that is, the actual set of considerations used in making the decision – was non-discretionary. This is clear from the text of Article XVII(2)(b), which focuses on the manner in which the benefits were "administered." This is a factual standard. The issue is how the administrators actually made decisions and actually disbursed benefits – not how the administrators *might* or *could* have done so.

48. In fact, Ontario officials relied only on mandatory criteria in providing benefits through the FSPF and LGP. The decisions they reached had a non-discretionary basis, even under the U.S. interpretation of that term.[34] The officials did not use supplementary guidelines in making their decisions.

49. The FSPF and LGP allow for the use of supplementary guidelines. They also allow – it follows logically – for the rejection of applications meeting the mandatory criteria. (The authority to use guidelines beyond the mandatory criteria *is* the authority to reject applications meeting the mandatory criteria). But while these programs *allow* this, they do not require it. The programs provided for supplementary guidelines for the

[34] In its Opening Statement. Canada stated that administrators would make "judgments based on legal criteria." Tr. vol. 1-A, 150:10-11. The United States seized upon this as some sort of admission. Tr. vol. 5, 1105:3-6. It was nothing of the sort. Canada used the term "judgment" in the commonly used sense of "decision" or "determination" – and not in the particular sense of "the process of judging" in which it has frequently been used in these proceedings. As Canada has plainly stated, repeatedly, and as the United States has itself conceded, a determination that is based solely on the mandatory criteria is purely mechanical.

contingency that there were more applications than funds available. These guidelines, designed to supplement the mandatory criteria, would allow administrators to choose *amongst* applications that had met the mandatory criteria. However, in practice, it was clear from very early in the administration of the program that it was likely that there would be too few applications. (Indeed, prior to July 1, 2006, the Ontario Cabinet relaxed certain rules so as to encourage more applications).[35] The program administrators had the authority to use the supplementary guidelines (and to reject applications meeting mandatory criteria) but in practice did not use them.

50. The United States mocked this explanation in its Closing Statement. The United States made the following characterization:

> despite organizing a detailed application and award process, it {Canada or Ontario} had no intention of considering any of the subjective criteria but instead intended to blindly approve any request for grants.[36]

But the U.S. characterization misses the mark. Ontario's Ministry of Natural Resources had every intention of considering the subjective criteria (*i.e.*, the supplementary guidelines) in the event that the programs were over-subscribed and there was need to choose amongst the qualified applications. In the same way, a new university might allow for a highly subjective admissions process, in the hope and expectation that thousands will apply for 500 spots in the incoming class; but if only 200 individuals apply, then the admissions process would likely, in fact, be purely mechanical.

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[35] Four modifications were introduced on June **[ ]**, 2006: the loan cap guarantee was increased from 50 to 100 percent; the Ministry was authorized to issue guarantees that were either residual or first call; the maximum loan guarantee was increased to $25 million; and the one-time administrative fee was reduced. *See* Stmt. of Defence ¶ 75. All these modifications were designed to entice a greater number of applications.

[36] Tr. vol. 5, 1098:9-14.

51. At the Hearing, the United States emphasized that the Minister Briefing Notes provide options to approve or to reject applications.[37] This, of course, is simply the corollary of the fact that the Ontario programs allow for the use of supplementary guidelines. But the United States failed to observe that these same Minister Briefing Notes reflect a clear awareness amongst Ontario officials that the supplementary guidelines had little relevance when the programs are under-subscribed. One Minister Briefing Note observes that

[

. **]**

52. Similarly, another Minister Briefing Note observes that **[** "

[39] **]** Ontario officials understood that it would be contrary to the goals of the program to consider supplementary guidelines, or to reject qualified applications, when the programs were under-subscribed.

53. The unchallenged factual record of funding in the FSPF and LGP demonstrates that officials relied only on mandatory criteria – and not supplementary guidelines – in making their decisions. Notwithstanding the U.S. focus on the Minister Briefing Notes, the factual record demonstrates that in every one of these Notes, the Forest Sector Prosperity Fund Approval Committee approved the application that met

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[37] Tr. vol. 5, 1102:17-21.

[38] **[** **]** Listed in Kalt Report, Appendix B, Item 16 (R-2) and presented by the United States at the Hearing.

[39] **[** **]** Listed Kalt Report, Appendix B, Item 16 (R-2) and presented by the United States at the Hearing.

the mandatory criteria; and indeed, in all these instances, the Committee endorsed the recommendation of the MNR Secretariat, including the recommended amount.[40] In the final dispositions, 100 percent of applications meeting the mandatory criteria were approved.[41] The only applications that were rejected failed to meet the mandatory criteria. [42] There is simply no evidence that any official, at any point, departed from the mandatory criteria in making determinations on the applications.

2. The U.S. Claims About the FSPF and LGP Do Not Support the Conclusion That These Programs Have Provided Discretionary Benefits

54. The United States has advanced two factual claims about Ontario's FSPF and LGP: first, that these programs allow for the consideration and use of supplementary guidelines (and therefore for the opportunity to reject applications meeting the mandatory criteria); and, second, that these programs provide for a multi-party, multi-stage review process. Both these claims are correct, but neither supports the conclusion that the Ontario programs have thereby provided benefits on a non-discretionary basis (even under the U.S. interpretation of that term).

a. The U.S. Argument That Ontario Programs Allow The Use of Supplementary Guidelines

55. The United States has observed that the FSPF and LGP allow for the use of the supplementary guidelines: for example, program officials may consider the **[.]**[43] The United States has also observed

[40] *See* ON-CONF-02832-2884; ON-CONF-02899-2922; ON-CONF-02939-2946; ON-CONF-02978-2997. Listed in Kalt Report, Appendix B, Item 16 (R-2) and presented by the United States at the Hearing.

[41] Canada Rejoinder ¶¶ 88, 96.

[42] Canada Rejoinder ¶¶ 89-94, 97-98.

[43] U.S. Reply ¶ 48.

that these programs allow for the rejection of applications meeting the mandatory criteria: for example, that the Minister of Natural Resources has the power to provide or to deny the benefits.[44] These observations are accurate (Canada has never claimed otherwise); but they prove nothing.

56. The question is not whether program administrators are *allowed* to use supplementary guidelines, but whether in fact they *have used* supplementary guidelines. This is evident even on the face of certain supplementary guidelines. The United States has frequently cited to one such provision, which states:

[

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57. The key phrase, of course, is **[ ]** The guidelines that follow are relevant only where there exists a need for prioritization among the applications. If there are excess numbers of applications meeting the mandatory criteria, then they must be prioritized according to those guidelines. But if there are not enough applications, then there will be *no* need for prioritization or preferencing among the applications. Since the Ontario programs were under-subscribed, there was no prioritization among applications and therefore there was no recourse to the supplementary guidelines.

58. The United States understands well that it is not enough to argue that the Ontario programs allow for the use of supplementary guidelines. Thus, the United States has consistently asserted that the programs *require* the use of these guidelines: it

[44] Tr. vol. 5, 1102:15-21.

[45] Tr. vol. 1-A, 27:19-24; *see also* U.S. Reply ¶ 49.

claimed at the Hearing that "Ontario program officials are required to evaluate subjective criteria"[46] and that the programs "require Ontario public officials to exercise judgment."[47] However, these are baseless claims.

59. The United States cannot support its assertions that program officials are required to consider the supplementary guidelines. The evidence on the record does not provide a single example of officials relying on the supplementary guidelines in making a decision (or rejecting an application that met the mandatory criteria). In every case on the record, Ontario officials relied only on the mandatory criteria and approved every application meeting the mandatory criteria.

60. The *opportunity* for judgment and the *exercise* of judgment are different things. The standard under SLA Article XVII(2)(b) is not whether programs *allowed* for the exercise of discretion under certain circumstances, but whether programs in fact *provided* benefits in a non-discretionary manner. The record of the FSPF and LGP is that officials provided benefits in a "non-discretionary" manner, even under the U.S. interpretation of that term.

b. The U.S. Argument That Ontario Programs Use a Multi-Party, Multi-Stage Process

61. The United States has emphasized throughout the proceedings that the administrative process of the FSPF and LGP involves multiple parties and multiple stages. In its Statement of Case, the United States suggested that "the very fact that each stage results in mere recommendations illustrates the fundamentally discretionary

[46] Tr. vol. 1-A, 26:4-5.

[47] Tr. vol. 1-A, 34:3-4.

nature of the process."[48] Of course, in a multiple-stage process, it is necessarily the case that each stage but the final one will result in a recommendation. At the Hearing, the United States once again talked about the "multiple government actors involved."[49]

62. The United States tries to infer the presence of discretion from the many stages and parties involved in the administrative process. But it makes a logical leap. Even the grading of a multiple-choice exam might well be subjected to several layers of review (all the more, if there are millions of dollars at stake). There is a simple reason for so many layers of review: enhancing conformity with the mandatory criteria. Governments, like banks, traditionally have carefully subjected expenditures of funds to multiple layers of review, and avoided vesting authority in a single decision-maker. The purpose of this is to *restrict* discretion. Multiple layers of review ensure adherence to mandatory constraints.

63. In fact, the Tribunal should draw an altogether different inference: not only did the two Ontario programs ultimately approve all applications meeting the mandatory criteria, every government official at every stage of the review process approved all applications meeting the mandatory criteria. Government officials apparently reached exactly the same conclusion at every stage of the process. **[**

] This is yet further evidence that government officials did not rely on supplementary guidelines, but relied exclusively on mandatory criteria.

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[48] Stmt. of Case ¶ 44.

[49] Tr. vol. 1-A, 27:4-6.

[50] *See* ON-CONF-02832-2884; ON-CONF-02899-2922; ON-CONF-02939-2946; ON-CONF-02978-2997. Listed in Kalt Report, Appendix B, Item 16 (R-2) and presented by the United States at the Hearing.

3. The U.S. Allegations on Burden of Proof Do Not Salvage the U.S. Case

64. During the Hearing, the United States argued on several occasions that Canada bears the burden to demonstrate that its programs meet the safe harbours of Article XVII(2)(b).[51] The United States claims that it only bears the burden to prove that Canada has provided grants or other benefits to a producer or exporter of Canadian softwood lumber; and that once it has discharged this burden, Canada assumes the burden to prove the affirmative defense that the grants or other benefits qualify for safe harbour.[52] Canada wishes to make two points in response: first, the United States wrongly characterizes the Article XVII(2)(b) safe harbours as an affirmative defense when in fact they simply define the offense; and, second, whereas the United States has not put forth facts sufficient to support its conclusion, Canada has.

a. The United States, Not Canada, Bears the Burden of Proof with Respect to the Article XVII(2)(b) Safe Harbour

65. The United States asserts that it bears a burden of proof only with respect to the proposition that Canada has provided grants or other benefits to a producer or exporter of Canadian softwood lumber; and it further asserts that the Article XVII(2)(b) safe harbours are affirmative defenses with respect to which Canada bears the burden of proof. [53]

66. However, the United States has offered scant support for its suggestion that the Article XVII(2)(b) are affirmative defenses. The superior interpretation is that Article XVII in its entirety *defines* the wrongful conduct; and Article XVII(a) – (e) set forth

[51] Tr. vol. 1-A, 12:5-17; Tr. vol. 5, 1096:21-1097:11.

[52] Tr. vol. 1-A, 12:5-17.

[53] Tr. vol. 1-A, 12:5-17. *See also* U.S. Reply ¶ 24.

the negative elements of the offense. The WTO Appellate Body has specifically warned against the approach now advanced by the United States. The Appellate Body has stated that the burden of proof on the complaining party to establish a prima facie case of inconsistency with a treaty provision "is not avoided by simply describing that same provision as an 'exception.'"[54]

67. A close reading of the text shows that Article XVII(a) – (e) help define the breach. Article XVII concerns "Anti-circumvention." A breach of the SLA is defined in Article XVII(1) as "action to circumvent or offset the commitments under the SLA 2006, including any action having the effect of reducing or offsetting the Export Measures." Article XVII(2) clarifies the type of conduct that would have this effect of reducing or offsetting the Export Measures. Article XVII(2) stipulates that certain conduct – namely, grants or other benefits to softwood lumber producers – shall be considered to have these particular effects; but it also stipulates that certain other conduct – namely, conduct falling within the safe harbours – shall be considered *not* to have these particular effects. The Article XVII(2)(a) – (e) are not defenses *after* breaching conduct has been established. Rather, they define – in conjunction with the chapeau of Article XVII(2) – the type of conduct that gives rise to effects that reduce or offset the Export Measures, and therefore that breach the SLA.

68. In the WTO *Brazil-Aircraft* dispute, Canada argued that Article 27.2(b) of the SCM Agreement – which provided that the general prohibition of Article 3 against subsidies "shall not apply to" developing countries under certain circumstances – was an affirmative defense. The Panel disagreed. It reasoned that Article 27(2)(b) was not an affirmative defense against the substantive obligation of Article 3, but rather a

[54] Appellate Body Report, *European Communities – Hormones*, WT/DS26/AB/R, ¶ 104 (Jan. 16, 1998) (RA-131).

precondition for the application of Article 3.[55] Accordingly, the Panel held that Canada, the complaining party, held the burden of proof with respect to for Article 27(2)(b).[56] In the same way, Article XVII(2)(a)-(e) are not affirmative defenses, but define the preconditions for the application of the general prohibition in Article XVII(1) and (2).

69. The United States, with no support, has simply asserted that Article XVII(2)(a) – (e) are affirmative defenses. In fact, they are definitional elements of the offense. The United States has the burden of showing that Canada has breached the SLA – a point which it has conceded.[57] The United States therefore bears the burden of proving that Canada's programs do *not* meet these safe harbours and thereby are in fact the sort of conduct that has the effect of reducing or offsetting the Export Measures.

b. Canada – But Not the United States – Has Presented Sufficient Evidence to Support Its Claims

70. The United States and Canada both have claims about the operation of the FSPF and LGP; but only Canada has presented evidence that is sufficient to support its conclusions.

71. The United States has claimed that the Ontario officials are *required* to use the supplementary guidelines. In the Opening Statement, for example, the United States characterized its central factual claim as such: "Because the prosperity fund and the loan guarantee programs *require* Ontario program officials to exercise discretion, exception 2(b) does not apply."[58] But the United States has never presented sufficient

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[55] Panel Report, *Brazil – Export Financing Programme for Aircraft*, WT/DS46/R 7.56 (Apr. 14, 1999) (RA-132).

[56] *Id*. at 7.57.

[57] U.S. Reply ¶ 24. ("{T}he United States bears the initial burden of demonstrating a breach by Canada of Art. XVII.")

[58] Tr. vol. 1-A, 31:12-15 (emphasis added).

evidence for that claim. The United States has only demonstrated that the Ontario programs *allow* Ontario program officials to use supplementary guidelines and therefore – by the U.S. definition of "non-discretionary" – to exercise discretion. The United States has not shown that officials are required as a matter of law to use the supplementary guidelines; and the United States has neither shown nor even attempted to show that in practice the officials did in fact use the supplementary guidelines. The U.S. evidence – that the programs allowed for the consideration of supplementary guidelines – is simply not sufficient to support its own conclusion.

72. In contrast, Canada has explained that the Ontario programs allowed for the consideration of supplementary guidelines (for the event that the programs were over-subscribed); and Canada has further claimed that *in fact* the Ontario officials never used these supplementary guidelines. As evidence for this proposition, Canada has demonstrated that Ontario officials approved *every* application that met the mandatory criteria. That is to say, in every instance on the record, Ontario officials relied only the mandatory criteria in making their decisions. In the absence of the supplementary guidelines, the outcomes would have been exactly the same in every instance. The factual record indicates no example of a decision – whether an approval or a rejection – that was based on the supplementary guidelines. Canada's evidence is therefore sufficient to support its claim that Ontario officials relied only on the mandatory criteria and did not use the supplementary guidelines.

ONTARIO ROADS PROGRAM

73. The Ontario Forest Road Construction and Maintenance Program (hereinafter "Ontario Roads Program") is fully consistent with the SLA. After hundreds of pages of briefs and a week-long Hearing, the United States has failed to demonstrate

that this program violated any aspect of the SLA. The Ontario Roads Program is a measure that falls under Article XVII(2)(a) and therefore "shall not be considered to reduce or offset the Export Measures in the SLA 2006."[59] In addition, even if the Article XVII(2)(a) safe harbour were not available, the Ontario Roads Program would still comply fully with the SLA as a result of the Article XVII(2)(b) safe harbour.

74. Following the Hearing, the contested issues before the Tribunal regarding the Ontario Roads Program are now quite narrow. With respect to the Article XVII(2)(a) safe harbour, the United States has conceded that the Ontario Roads Program was in existence prior to the SLA's July 1, 2006 cut-off date. Therefore, the United States' argument that the program does not fall under the Article XVII(2)(a) safe harbour rests solely on its contention that the program is not part of Ontario's forest management system. Yet, as demonstrated below, the United States has never defined the term "forest management system" or coherently explained its use in the SLA.

75. Even more fundamentally, the United States is contending that any program in which the government increases its responsibility for forest management costs shared with industry cannot qualify as part of a forest management system because its purpose is to relieve costs previously borne by the industry. This "purpose" test has no basis in the SLA and leads to a conclusion that would require the Tribunal to read Article XVII(2)(a) out of the SLA altogether. By contrast, Canada has presented a consistent interpretation of Article XVII(2)(a) that gives full meaning to all the terms of the provision, and demonstrated that the Ontario Roads Program properly falls within this safe harbour.

[59] SLA 2006 Art. XVII(2)(a) (Ex. R-1).

76. The United States' only remaining challenge to Canada's position that the Ontario Roads Program also fully satisfies the Article XVII(2)(b) safe harbour is to contend "whether the program was being administered on July 1, 2006."[60] The position advanced by the United States ignores the direct and substantial evidence of administration presented by Canada, and is also inconsistent with the ordinary meaning of "administer" as used in the SLA and understood by reference to the basic rules of treaty interpretation set forth in the Vienna Convention. Specifically, the United States provides no reason or rationale for repeatedly quoting, but then ignoring, the basic dictionary definition of "administered." The U.S. claim that the Ontario Roads Program does not satisfy the requirements of Article XVII(2)(b) is based entirely on the U.S. reliance on a secondary and figurative definition of "administered" that does not make sense in the context of the SLA. The Ontario Roads Program also qualifies for the Article XVII(2)(b) safe harbour.

A. THE ONTARIO ROADS PROGRAM IS SAFE-HARBOURED UNDER ARTICLE XVII(2)(A) OF THE SLA

1. The United States Fails to Define the Critical Term – "Forest Management System" – and Takes a Position That Would Read Article XVII(2)(a) Out of the SLA Altogether

77. Despite multiple rounds of briefing and a Hearing before the Tribunal, the United States still has not provided the Tribunal with a definition for the term "forest management system." Without defining this critical term, it is impossible for the United States to discuss in a reasoned manner whether the Ontario Roads Program is a part of Ontario's forest management system. By contrast, Canada provided the Tribunal with its

[60] Tr. vol. 1-A, 45:3-6. Canada's consistent position throughout this proceeding is that Article XVII(2)(b) does not contain a separate "administration" requirement. *See* Stmt. of Defence ¶¶ 83-84; Canada Rejoinder ¶¶ 63-65.

clear understanding of "forest management system" and explained why this definition is fully consistent with the SLA and the implementation of forest management systems in both Canada and the United States. Canada demonstrated through positive evidence that Ontario's forest management system includes the Ontario Roads Program.[61]

78. Rather than explain what programs the Parties understood to be properly covered by Article XVII(2)(a) and the applicable criteria, the United States simply asserts that the provision of benefits to the forest industry through the Ontario Roads Program must be inconsistent with Article XVII(2)(a). The United States' position is dependent on its view that "{n}either the SLA nor any definition of forest management envisioned conferring benefits to industry through this process."[62] This view reads Article XVII(2)(a) out of the SLA entirely, which is inconsistent with the interpretive rules of the Vienna Convention.

79. Article XVII(2) of the SLA provides, in relevant part:

> 2. Grants or other benefits that a Party, including any public authority of a Party, provides shall be considered to reduce or offset the Export Measures if they are provided on a *de jure* or *de facto* basis to producers or exporters of Canadian Softwood Lumber Products. Notwithstanding the foregoing, measures that shall not be considered to reduce or offset the Export Measures in the SLA 2006 include, without limitation:
>
> > (a) provincial timber pricing or forest management systems as they existed on July 1,2006…

80. Thus, the safe harbour in Article XVII(2)(a) is only implicated where a grant or other benefit has been provided to producers or exporters of Canadian

[61] *See* Stmt. of Defence ¶¶ 122-161; Canada Rejoinder ¶¶ 147-178.

[62] Tr. vol. 5, 1115:14-17.

Softwood Lumber Products. The function of the safe harbour is to declare which measures are protected notwithstanding that they provide a benefit. Accordingly, it makes no sense to argue (as the United States does) that measures are excluded from a safe harbour because they confer benefits. The question under Article XVII(2)(a) is not whether a benefit has been provided. By definition, Article XVII(2)(a) need only be analyzed by the Tribunal when there is a grant or other benefit. The key question under Article XVII(2)(a) is whether the alleged grant or other benefit was provided as part of the provincial forest management system as it existed on July 1, 2006

81. The purpose of this safe harbour was to preserve provincial forest management systems as they existed on July 1, 2006. The United States' position would do the opposite, by finding that any benefits provided by the government for forest management activities violate the SLA no matter how long they have been in place. Not only does this view depart radically from the intent of the Parties, but it reads Article XVII(2)(a) out of the SLA altogether.

2. The United States Creates an Artificial Distinction Between Forest Management Activities and Attendant Costs That Has No Basis in the Text of the SLA or the Governing Forest Management Manuals

82. Although the United States claims that it is not imposing a "purpose" test, its argument with respect to Article XVII(2)(a) nevertheless rests entirely on its view that one of the primary purposes of the Ontario Roads Program was to assist industry. The United States now concedes that the activities for which companies are reimbursed under the Ontario Roads Program are important forest management activities.[63] However, the United States attempts to create a false distinction between the activities for which the costs are incurred, and the allocation of the costs between the government

[63] Tr. vol. 5, 1112:15-1114:18.

and private industry. The United States cites to no text or aspect of the SLA to support such a distinction, and a plain reading of the text of the SLA undermines it.

83. First, the attempt by the United States to claim that forest management activities are somehow separate from their attendant costs raises the same interpretive issue the United States refuses to address elsewhere. If integral forest management activities – like fire-fighting, road building, or forest renewal – are considered to be part of the provincial forest management system, but the costs associated with those activities somehow are not, then there was no reason to include this aspect of Article XVII(2)(a) in the SLA. Safe harbour treatment is only needed when dealing with grants or benefits provided to producers or exporters of Canadian Softwood Lumber Products.

84. Second, the United States focuses exclusively on establishing a fact that is not in dispute – that the Ontario Roads Program was intended, in part, to "assist industry" – without accounting for the context in which that assistance was being provided. Specifically, the United States fails to acknowledge the role of cost-sharing in forest management.

85. All forest management activities come with costs, and forest management planning cannot be undertaken without allocating those costs. The United States' own witness acknowledged during the Hearing that forest management planning necessarily includes contemplation of how to allocate attendant costs. When asked why, from a forest management standpoint, a province would want to make sure that roads are constructed and maintained in accordance with a forest management plan, Mr. Beck responded that the province "{would} want an orderly development of the road system to get to the areas that you want to either harvest timber or have access to for other

reasons, and there needs to be an orderly progression to make sure that both from a ***cost perspective*** and an environmental perspective that certain conditions are met."[64]

86. The SLA in no way prohibits the government from utilizing cost-sharing arrangements to manage provincial forests as efficiently and effectively as possible. Canada demonstrated the long history of cost-sharing with respect to roads in Ontario, which the United States continues to ignore.[65] The United States also ignores that reimbursements under the Ontario Roads Program are provided for specific, verified construction and maintenance activities on roads identified in approved, multi-year forest management plans. And the United States ignores that the only roads for which reimbursements are eligible (and partial reimbursements at that), are Crown-owned, multiple-use roads that are available to other users – roads that necessarily assist the government in other forest management activities (like fire-fighting) and provide community and forest access to public users. The United States fails completely to acknowledge that the Ontario Roads Program was intended to (and in fact does) effect cost-sharing associated with a critical aspect of forest management.

87. In the Hearing, the United States quoted a minister's council report to show that the Ontario Roads Program was designed to assist industry in the completion of forest roads on public lands.[66] However, the report cited by the United States reinforces the reality that Canada has consistently highlighted: Ontario intended to shift the allocation of cost-sharing for road construction and maintenance at the time, and did

[64] Tr. vol. 2, 423:20-424:2 (emphasis added).

[65] Stmt. of Defence ¶¶ 132-139.

[66] Tr. vol. 1-A, 37:3-14 (emphasis added).

so recognizing that this would assist industry in performing this forest management system task.

88. In essence, the United States seeks the imposition of a *per se* rule that no measure through which the government assumed increased responsibility for shared forest management costs would be protected under the Article XVII(2)(a) safe harbour no matter how long before July 1, 2006 the measure came into existence. There is absolutely no textual support for such a rule in the SLA. To the contrary, in recognition of the reality that the allocation of cost-sharing responsibilities will ebb and flow over time, the SLA provides a safe harbour for benefits provided to softwood lumber producers and exporters for forest management activities that existed on July 1, 2006. And even if the United States continues to ignore the long history of cost-sharing for forest management in Ontario, it still cannot claim ignorance of this practical reality. As Mr. Beck explained at the Hearing, "the {U.S.} government has had to pick up much more of the ongoing maintenance activities related to the roads and so on because there's not the revenue from the timber sales."[67]

89. What remains critical is that the SLA does not prohibit cost-sharing arrangements – which are vital to accomplishing many critical forest management activities, including road building. Nor does the SLA dictate what the allocation of costs must be between private industry and the government. Rather, the SLA recognizes that forest management may very well involve the provision of grants or other benefits to private industry, including softwood lumber producers and exporters. And where such benefits are provided, the SLA ensures that those in place as of July 1, 2006 "shall not be considered to reduce or offset the Export Measures in the SLA." As the allocation of

[67] Tr. vol. 2, 427:19-23.

road construction and maintenance costs in Ontario has not changed since July 1, 2006, and in light of the substantial evidence provided by Canada demonstrating that the Ontario Roads Program is part of the provincial forest management system,[68] pursuant to Article XVII(2)(a) of the SLA, the benefits provided though this program "shall not be considered to reduce or offset the Export Measures in the SLA."

B. THE ONTARIO ROADS PROGRAM IS SAFE-HARBOURED UNDER ARTICLE XVII(2)(B) OF THE SLA

90. As confirmed at the Hearing, the United States concedes that the Ontario Roads Program meets every requirement of the Article XVII(2)(b) safe harbour except one. The United States stated flatly that "the only element of exception 2(b) in contention with respect to the road costs reimbursement program concerns whether the program was being administered on July 1, 2006."[69] Canada has provided substantial evidence to the Tribunal demonstrating that as of the beginning of the fiscal year on April 1, 2006, the Ontario Roads Program was administered in the same form and total aggregate amount as it is today.[70]

91. The United States does not contest this evidence. Instead, the United States constructs an argument based on a forced application of a secondary and figurative definition of "administered." In its Opening Statement at the Hearing, the United States argued:

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[68] *See* Stmt. of Defence ¶¶ 122-158; Canada Rejoinder ¶¶ 147-175.

[69] Tr. vol. 1-A, 45:3-6. It is worth noting that Canada has already demonstrated that administration is not a separate requirement under the SLA. *See* Stmt. of Defence ¶¶ 83-84; Canada Rejoinder ¶¶ 63-65.

[70] *See* Canada Rejoinder ¶¶ 198-201.

> The Oxford English Dictionary defines administered to mean "managed and carried on" and also defines administered as "to manage as a steward, to carry on or execute," and "to dispense, furnish, supply or give anything beneficial or assumed to be beneficial to a recipient." The ordinary meaning of the term "administered" then is dispensing or supplying something beneficial to a recipient. Thus, if the ministry only made cost reimbursement programs available to the public after July 1, 2006, exception 2(b) does not apply.[71]

92. The United States also stated in its Closing Argument:

> {T}he Oxford English Dictionary defines administered to mean managed and carried on and also defines administer in the present tense to manage as a steward, to carry on or execute and to dispense, furnish, supply or give anything beneficial or assumed to be beneficial to the recipient. This implies that Ontario needs to be actually providing reimbursements before it is administering the program.[72]

93. Despite twice conceding that the dictionary defines administered as "managed and carried on" and "to manage as a steward, to carry on or execute," the United States never applied this basic and primary definition to the Ontario Roads Program. Nor did it explain to the Tribunal or Canada why this basic definition should be ignored in the context of the SLA. Instead, the United States simply asserts that only a secondary and figurative definition of dispensing or giving something beneficial to a recipient is relevant under the SLA. There is no principled basis to ignore the primary definition of a key term of the SLA, without even attempting to provide a reason for doing so.

94. In addition, the secondary definition of "administered" relied on by the United States is transparently incompatible with the actual text of the SLA. Article

[71] Tr. vol. 1-A, 45:9-21.

[72] Tr. vol. 5, 1117:12-21.

XVII(2)(b) applies to "other government *programs that provide benefits* on a non-discretionary basis in the form and the total aggregate amount in which they existed and were administered on July 1, 2006."[73] The text of the SLA makes it clear that "administered" modifies "programs."[74] The meaning and basic structure of this provision are clear and make sense when the primary definition of "administered" is used: the provision refers to the form and amount in which the programs existed and were "managed" on July 1, 2006.

95. The clarity of the provision, as well as its straightforward logic, falls apart when the secondary definition advocated by the United States is inserted in the overall text. Under the U.S. view, the provision would refer to the form and amount in which the programs existed and were "dispensed" on July 1, 2006. Simply put, the provision was not intended to address the "dispens{ing}, furnish{ing}, supply{ing} or give{ing}" of *programs* to recipients. Therefore, the term administered cannot properly be read to have the secondary definition ascribed to it by the United States in the context of Article XVII(2)(b) of the SLA.

96. The definition of "administered" advanced by the United States leads it to advance inconsistent interpretations with respect to the Ontario Roads Program. In its Opening Statement at the Hearing, the United States implied that administration would begin once the program is made "available to the public," although it does not explain how its secondary definition of "administered" makes this the key event.[75] While

[73] SLA 2006 Art. XVII(2)(b) (emphasis added) (Ex. R-1).

[74] The United States communicates this same view in its Slide # 2 presented to the Tribunal during its Opening Statement.

[75] Tr. vol. 1-A, 45:16-21.

proffering this understanding, the United States provides no basis for its conclusion that the e-mail sent to SFL holders on July 14, 2006 attaching the Road Construction and Maintenance Agreement marks the critical date on which the program was made "available to the public." The United States' exclusive focus on this e-mail ignores that the program was announced to the public in February 2006, that MNR made presentations to the public and met with them in April 2006, and that "the public" incurred costs throughout April, May and June 2006 for which they expected reimbursement under the existing government program (and received it).[76] Therefore, even under the United States' unsupported "made available to the public" test of administration, the United States still cannot show that the Ontario Roads Program for FY 2006-07 was not already being administered prior to July 1, 2006.

97. In its Closing Statement, the United States abandoned this "made available to the public" test and took a different position – that the secondary definition of administered "implies that Ontario needs to be actually providing reimbursements before it is administering the program."[77] This position leads to absurd results. Under this view, if reimbursements for past expenditures were made in a lump sum at the end of the

[76] *See* Canada Rejoinder ¶¶ 198-200. In addition, the United States is wrong to suggest that "Canada relies on one invoice form seeking reimbursements for the period between April 1, 2006 and June 20, 2006." Tr. vol. 1-A, 48:5-7. Canada cited this invoice as one example to demonstrate that companies incurred road construction and maintenance costs from the start of the fiscal year with the expectation that such costs would be reimbursed. This invoice was one of many on the record. There were at least 19 invoices requesting reimbursements for work completed between April 1 and June 30, 2006, all of which the United States cited to and included in Attachment BW to the Beck Rebuttal Report (Ex. C-43). *See* ON00000593-ON00000596, ON00000658-ON00000661, ON00000715-ON00000718, ON00000749-ON00000752, ON00000775-ON00000777, ON00000817-ON00000820, ON00000861-ON00000863, ON00000913-ON00000916, ON00000948-ON00000950, ON00001172-ON00001175, ON00001258-ON00001261, ON00001420-ON00001422, ON00001468-ON00001470, ON00001553-ON00001556, ON00001620-ON00001623, ON00001688-ON00001691, ON00001739-ON00001742, ON00001762-ON00001764, ON00001835-ON00001838.

[77] Tr. vol. 5, 1117:19-21.

fiscal year (or even at some later date), the United States would necessarily conclude that the entire program was not administered until (and was only administered on) that single day, and that weeks, months or even years worth of managing the program were inconsequential to the administration of the program. There is no support in the text of the SLA or the intent of the relevant provision for such an unreasonable interpretation.

98. The United States has taken two different but equally untenable positions based on a secondary and figurative definition of the term "administered" that is incompatible with the text of the SLA and ordinary meaning of administered. By contrast, Canada has applied the basic definition of administered as cited by both Parties and has provided substantial evidence that the Ontario Roads Program was, in fact, administered prior to July 1, 2006. Accordingly, the Ontario Roads Program, even when analyzed under Article XVII(2)(b) of the SLA (rather than Article XVII(2)(a)), is fully consistent with the ant-circumvention provisions of the SLA.

PART II. QUÉBEC PROGRAMS

THE SEVEN CONTESTED QUÉBEC MEASURES DO NOT CIRCUMVENT THE SLA

99. The United States has based its challenge to the Québec measures on a mixture of conjecture and assertion. For all but two of the measures, the United States has failed to demonstrate the benefit it claims Québec provided to producers or exporters of Softwood Lumber Products. Even if a benefit were demonstrated, the United States has failed to demonstrate the inapplicability of one or more safe harbours in Article XVII(2) with respect to each of the seven Challenged Programs.

A. THE UNITED STATES HAS FAILED TO DEMONSTRATE THAT THE QUÉBEC MEASURES PROVIDED BENEFITS TO SOFTWOOD LUMBER PRODUCERS OR THAT THE MEASURES ARE NOT COVERED BY THE SLA'S ENUMERATED SAFE HARBOURS

100. In lieu of engaging on the evidence, the United States has reduced its position to an argument that any government expenditure is a circumvention. Of course, this is not the case and Canada has demonstrated at great length that the text of Article XVII cannot support such an interpretation.[78] The government's act of making a loan or any other expenditure does not in itself constitute the provision of a "benefit" as that term has been understood in all trade agreements.[79]

101. The U.S. approach to the Québec measures in dispute has been remarkable. Even within the portion of Article XVII for which the United States acknowledges it carries the burden of proof (Article XVII(2), first sentence), the United States has failed to do so. In response to the document requests relating to the Québec measures, Canada produced more than 100,000 pages of documents covering the full range of issues from law to finance, to accounting, even to Québec's implementation procedures for tax measures. To analyze these documents and present their case, the United States relied on a single "forestry expert" from the U.S. state of Oregon. Mr. Beck may be an expert on forestry matters in the U.S. Pacific Northwest, but he did not testify on those matters.

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[78] *See* Stmt. of Defence ¶¶ 35-52; Canada Rejoinder, ¶¶ 40-68.

[79] Canada Rejoinder ¶¶ 303-304. Despite numerous U.S. arguments to the contrary throughout the LCIA 7941 arbitration, the United States has been forced to acknowledge, *inter alia*, through its implementation of retaliation under Section 301, *et seq*., of the Trade Act of 1974, that as a matter of law, the SLA is a Trade Agreement. *See* Canada Rejoinder ¶ 437, n.431 discussing Canada – Compliance with Softwood Lumber Agreement, 74 Fed. Reg. 16, 436 (Initiation of Section 302 Investigation) (USTR Apr. 10, 2009) (RA-112); *see also* 7941 Award, ¶¶ 124-140 (Ex. CA-12).

102. Mr. Beck's lack of knowledge on the matters for which the United States designated him as an expert in this arbitration was evident during the Hearing. His expertise did not include matters of timber pricing, forest management, tax law, fiscal policy, or other aspects of the Québec measures. This lack of familiarity even resulted in his own counsel inadvertently impeaching Mr. Beck when he had to interrupt Canada's cross- examination to assert that Mr. Beck could not have any way of knowing Revenu Québec's processes to implement tax measures upon announcement and before Parliamentary action.[80] An expert on Québec matters would have known, but U.S. counsel was correct that Mr. Beck certainly does not.

103. Twice Mr. Beck was forced to admit that he had no expertise in the matters before him and relied instead on "common sense."[81] "Common sense expertise" is an oxymoron. When asked how he arrived at his conclusions, Mr. Beck further admitted that he had neither the information nor the expertise necessary to provide a quantitative analysis or anything based on accounting principles and that his conclusions were merely "subjective."[82] Whatever else he may be, Mr. Beck has no familiarity with Québec's forestry sector and certainly can claim no expertise in that regard.

104. In the end, the U.S. claims are based on twisting the concept of anti-circumvention so as to make it stricter than the substantive provisions of the SLA it is designed to protect, and far more restrictive than the international and domestic rules that were the subject of the disputes and court cases that preceded the SLA.

[80] Tr. vol. 2, 358:20-22.

[81] Tr. vol. 2, 346:13-18; 481:14-15.

[82] Tr. vol. 2, 469:1-2.

105. Canada has provided extensive arguments and evidence with respect to the seven challenged Québec measures. These discussions will not be repeated here. Instead, Canada will review each of the programs in light of the evidence and testimony as it stands at the end of the Hearing. Canada will show that the United States has failed to demonstrate that a benefit was conferred by Québec in regard to most of these programs. With respect to all of the programs, Canada will show that there is clear, uncontroverted evidence that each is covered by one or more of the safe harbours. The United States has failed to demonstrate that these programs are within the parameters of the anti-circumvention provisions and has, additionally, been unable to refute Canada's direct evidence.

B. SILVICULTURE INVESTMENT MEASURE: UNCONTESTED EVIDENCE DEMONSTRATES THAT THE MEASURE DOES NOT PROVIDE A BENEFIT TO SOFTWOOD LUMBER PRODUCERS AND MEETS THE REQUIREMENTS OF SAFE HARBOUR (2)(C)

106. On March 23, 2006, Québec's Minister of Finance announced a $75 million increase in the budget of the Minstère des Ressources naturelles et de la Faune (MRNF) for the specific purpose of funding investments in silviculture activities. The budget enhancement became effective as of April 1, 2006, at the start of the 2006/2007 fiscal year. The United States challenges the measure as a benefit to the softwood lumber industry. Yet the record shows that the measure did not provide a benefit of any kind to Canadian producers of softwood lumber. Primarily a measure directed at hardwood stands, the measure did not remove any costs or relieve any financial burdens to a company in the forest sector. The record also shows that the measure is covered by the safe harbour in sub-paragraph 2(c) as it is manifestly for environmental protection and conservation and was specifically recommended by a multi-year commission of environmental experts, the Coulombe Commission.

1. Uncontested Evidence Demonstrates That the Measure Does Not Provide a Benefit to Softwood Lumber Producers

107. The United States' entire support for its claim that the measure provided a benefit to industry is a statement in the 2006-2007 Budget Plan that $210M was budgeted "to reduce the cost of operations and silvicultural investments."[83] As François Trottier, an MRNF official, explained, the $75M investment was an increase to MRNF's budget to fund increased silvicultural activities, mostly for hardwood species, and did not involve any payments to the softwood lumber industry or remove any obligation from tenure holders.[84] The United States declined to cross-examine Mr. Trottier at the Hearing, so his testimony now stands as a statement of uncontested facts.

108. Nevertheless, at the Hearing, the United States continued to speculate that the $75 million allocation will indirectly benefit the softwood lumber industry by ensuring better quality of forests. But the United States did not even attempt to quantify this highly conjectural "benefit" or explain why that benefit would accrue to softwood lumber producers rather than to the people of Québec, who own the national resource. Therefore, there is no evidence of any benefit provided by this measure.

2. Record Evidence Demonstrates That the $75 Million Silviculture Investment Measure Meets the Requirements of Safe Harbour (2)(c)

109. Canada has also demonstrated that the $75M silviculture investment measure meets the requirements of safe harbour 2(c). Mr. Trottier stated that the measure responded to the recommendations of the Coulombe Commission; a commission that was established to study Québec's forest management practices with

[83] 2006-2007 Budget Plan, Beck Report, Att. U, § 6, at 8 (Ex. C-1).

[84] Trottier Statement ¶¶ 8-10 (Ex. R-4).

the purpose of recommending improvements that would allow for better protection and conservation of the forests for future generations.[85] Indeed, Mr. Beck himself agreed that "Forest Management Measures … are based on the recommendations of the {Coulombe} Commission."[86] Therefore, Mr. Trottier's testimony stands uncontested. Although Mr. Beck also argued that less than half of this measure provides a benefit to softwood lumber producers by assuring a long-term supply of timber and improving forest productivity, he presented no analysis whatsoever of the measure of that benefit.

110. Therefore, the United States failed to show that the $75M silviculture investment measure provided any benefits to softwood lumber producers or that the measure does not fall within safe harbour 2(c).

C. PSIF LOANS: HEARING TESTIMONY CONFIRMED THAT THE PSIF DOES NOT CIRCUMVENT THE SLA

"{I}t is a subjective rather than a quantitative analysis."[87]

- Thomas Beck

111. With this single statement, the U.S. forestry expert confirmed what Canada has explained to the Tribunal is the fundamental flaw in the U.S. case against the PSIF – the United States has failed to demonstrate that PSIF loans provided a benefit to softwood lumber producers in any objective and quantifiable manner.

112. Instead of applying a specific method, the U.S. expert adopted a holistic approach that he characterized as "something quite different."[88] And he used this

[85] Trottier Statement ¶ 9 (Ex. R-4).

[86] Beck Report at 30 (Ex. C-1).

[87] Tr. vol. 2, 469:1-2.

[88] Tr. vol. 2, 467:21-22.

approach to reach his conclusions that PSIF provided and has continued to provide "significant benefits" and that "many or most" of the projects would not have gone forward without government support.[89] Compounding the problem, at no point in this arbitration has the U.S. forestry expert provided a company-specific loan or project analysis.

113. The problem inherent in a benefit methodology that is not based on law, economics, or even the terms of the loans it claims to measure is that the conclusions drawn from it cannot be tested or analyzed. Both Parties' economic experts understood the flaws in this approach, as did the only financial expert involved in this arbitration, Robert Reilly, who politely called the approach a de novo method unlike anything he had ever seen in his thirty-three years in finance.[90] Whether recommended by his counsel or simply adopted by the U.S. forestry expert on his own initiative, this subjective, non-quantitative approach undermines the entire U.S. case against the PSIF and the remedies the United States seeks.

1. The United States Has Failed to Demonstrate That PSIF Loans Provide Any Benefit to Producers or Exporters of Softwood Lumber Products

114. To establish circumvention under paragraph 2 of Article XVII of the SLA, two fundamental elements must be pled and proven. The government must have provided a grant or other benefit, and the government grant or other benefit must have been provided to a softwood lumber producer or exporter subject to the agreement.[91] The demonstration of a government benefit is a precondition to a finding of liability. The

[89] Tr. vol. 2, 306:18-20; 467:25-468:2.

[90] Tr. vol. 3, 654:11-15.

[91] SLA 2006 Art. XVII (Ex. R-1).

United States in its briefs and again at the Hearing correctly acknowledged that, as Complainant, it bears the burden of proving each of these elements. Yet, to date, the United States has failed to do so.

a. The United States Did Not Apply the Accepted Legal and Financial Standard for Determining Whether a Government Loan Provides a Benefit to the Recipient

115. The accepted approach to determine whether a government loan provides a benefit is by comparison of the loan's terms to a commercial benchmark.[92] Under all trade laws and financial texts, this requires at a minimum a comparison of the government loan rate to the rate the company would have obtained from a commercial lender.[93]

116. This is the standard announced and practiced in domestic U.S. and Canadian trade law, as well as the domestic trade laws of every major country in the world involved in global trade.[94] It is the standard followed in international trade agreements such as the WTO's SCM Agreement.[95] It is also the standard accepted in the financial, accounting, tax, and investment banking industries.[96] In the underlying trade litigation that led to the creation of the SLA, the United States' own Department of

[92] Canada Rejoinder ¶¶ 303-304.

[93] *Id.*

[94] *See* United States, 19 C.F.R. 351.505(a)(1) (RA-133); Canada Special Import Measures Act Regulations, Part II, Arts. 28-29, *Loan at a Preferential Rate* (RA-134); European Community, Regulation No. 597/2009, at Art. 6(b), *Calculation of Benefit to the Recipient* (RA-135); and China, *Regulations of the PRC on Countervailing Measures,* as notified to the WTO, Committee on Subsidies and Countervailing Measures, 10/20/04, G/SCM/N/1/CHN/1/Suppl.3, at Art. 6 (2) (Oct. 20, 2004) (RA-136).

[95] *See* WTO, Subsidies and Countervailing Measures Agreement, Art.14 (b-c) (RA-101). *See also* NAFTA, Art. 1902: Retention of Domestic Antidumping Law and Countervailing Duty Law.

[96] Tr. vol. 3, 653:1-656:8.

Commerce applied this methodology in determining that similar loans made by the same institution (Investissement Québec) did not provide benefits to softwood lumber producers.[97]

117. Even as recently as this past month, the lead American trade official, United States Trade Representative Ronald Kirk, explained the correct methodology for determining whether a government loan provides a benefit in a letter to U.S. Senator Richard Shelby regarding loans the EU made to Airbus.[98] In his letter, USTR Kirk explained that "{T}he United States did not challenge the simple fact that European governments have provided loans to Airbus. WTO rules on subsidies do not prohibit government loans." The rules, USTR Kirk explained, "provide that government loans are subsidies only when they are provided on terms and conditions that are more favorable than would be available to the recipient of such loans in the commercial market."[99]

b. The U.S. Forestry Expert Was Unable to Defend His Holistic Approach to Benefit Calculations When Questioned by the Tribunal

118. Rather than acknowledging the generally-accepted loan benefit methodology and applying it to the PSIF loan terms, the U.S. forestry expert testified at

[97] *See* Canada Rejoinder ¶¶ 363-364; *see also* Memorandum to M. Skinner from E. Greynolds, re: Verification of the Questionnaire Responses Submitted by the Gov't of Québec (GOC), Case No. C-122-839; Memorandum from B. Carreau to F. Shirzad, re: Issues and Decision Memorandum: Final Results of the Countervailing Duty Investigation of Certain Softwood Lumber Products from Canada, Case No. C-122-839 (March 21, 2001) (RA-44).

[98] Letter from U.S. Trade Representative Ronald Kirk to Senator Richard Shelby (Sept.16, 2009). (RA-137) (emphasis added). Under Article I of the WTO Agreement on Subsidies and Countervailing Measures, the finding of a subsidy is a two-step process. Ambassador Kirk's letter assumes a government transfer and discusses how one calculates "benefit" in order to establish subsidization.

[99] *Id*. (RA-137).

the Hearing that, "{i}n this case, I have chosen to do something quite different."[100] Because the United States had provided no explanation of this unorthodox approach in any of the six expert reports and three briefs filed prior to the Hearing, the Chair had to specifically ask the U.S. forestry expert to explain what he had done to reach his conclusions so that she could "understand what type of assessment Mr. Beck had made…"[101] In responding, Mr. Beck explained that while he was aware of the standard approach, he was not willing to apply it in this instance because "many or most of these projects would not have proceeded without the government's support" and because the result of applying any of the accepted analytic methods "seemed to be inappropriate, too low."[102] At the same time, despite including total loan value, third party investment, and even the companies' own money, he explained that both his high and his so-called low remedy calculations were appropriate.[103]

119. But when asked whether he had made an independent examination to determine whether non-government financing was available to the specific companies receiving PSIF loans, Mr. Beck conceded that he had not, because he "did not see the need to do that."[104] This was true despite acknowledging that there are other types of financing besides large commercial banks including but not limited to project finance

[100] Tr. vol. 2, 467:21-22.

[101] Tr. vol. 2, 471:17-20.

[102] Tr. vol. 2, 467:25-468:10.

[103] Tr. vol. 2, 430:8-15.

[104] Tr. vol. 2, 455:2-12.

companies, leverage lease companies, private debt or equity companies, and venture capital companies.[105]

120. When asked by the Chair to explain how he determined which specific projects would not have gone forward without PSIF loans, Mr. Beck stated that "I don't have a specific list" and I cannot "tell you every one that would have or wouldn't have, but I did go through and concluded, hey, that these projects – there are many different reasons that these projects would not have proceeded."[106] Mr. Beck explained some of those reasons for adopting total investment as the proper benefit for all of the PSIF loans. "They are high-risk projects. The evaluation reports done under the PSIF … indicated they were higher-risk projects. I look at the amount of government support, very low amount of equity investment in these projects."[107] Nonetheless, Mr. Beck never identified which loans and which projects he was referencing or even what documents he had reviewed.

121. The reasons for Mr. Beck's departure from using the generally accepted loan benefit methodology are not based on his examination of any specific PSIF loan file, company, or project. Indeed, the entire explanation is based on supposition about the overall nature of the industry and the program. Supposition that all of the companies receiving PSIF loans could not have obtained non-government financing and that, as a result, "many or most" of the projects could not have gone forward. These suppositions were contradicted by direct evidence and testimony of the Canadian witnesses. Canada's financial expert cited to a PricewaterhouseCoopers report explaining that there

[105] Tr. vol. 2, 455:21-456:8.

[106] Tr. vol. 2, 469:5-10.

[107] Tr. vol. 2, 469:10-13.

was significant and extensive debt financing in the forest sector during the relevant periods ($17 billion in 2007 and $8 billion in 2008).[108] Canada's economic expert explained that within the PSIF files **[**

][109]

122. The conclusions of a forestry expert that acknowledges that he lacks expertise in banking and finance is of little use to a trier-of-fact in attempting to determine whether commercial finance is available. Those conclusions are of even less utility when the forestry expert fails to ground his conclusions in specific facts. Mr. Beck's explanation for departing from the universally accepted loan benefit methodology should not be accepted.

2. Because the United States Has Never Presented a Company-Specific Analysis of the PSIF Loans, Its Expert's Conclusions Are Meaningless and His Remedy Calculations Speculative

123. Mr. Beck's approach to determining alleged benefits is not flawed simply because it is idiosyncratic to Mr. Beck and inconsistent with the generally-accepted methodology for measuring loan benefits. Mr. Beck's approach is also problematic on a much more basic level. Although, Mr. Beck claimed during the Hearing to have "analyzed basically all the projects" and claimed he had "many different reasons" for his conclusions, none of that analysis and none of those reasons appeared in his reports. This was confirmed during the Hearing by the Canadian economic expert who reviewed the U.S. submissions.[110] But when given the opportunity, Mr. Beck did not want to

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[108] Tr. vol. 3, 666:15 -667:6.

[109] Tr. vol. 4-A, 877:2-10.

[110] Tr. vol. 4-A, 953:21-954:7 ((Professor Kalt testifying that neither Professor Topel nor Mr. Beck provided a loan-by-loan analysis of the PSIF loans in this proceeding).

discuss specifics. Instead he only wanted to discuss the reasons for his conclusions "in general."[111]

124. Thus, even if the United States had applied the correct benefit methodology to the PSIF loans, the approach taken by its expert and the contents of his reports provide nothing by which to make the analysis. Again, the United States Trade Representative's recent correspondence is an instructive comparison to the approach taken by Mr. Beck and the United States in this arbitration. In particular, Ambassador Kirk notes the importance of examining specific loan terms to the U.S. benefit allegation. The United States challenged the EU's loans "based on the specific terms and conditions of the loans."[112] The United States "did not make arguments about the acceptability of government loans in general, or whether government loans in general are an 'acceptable funding mechanism.'" "Rather, our arguments were directed only to whether the specific terms and conditions of launch aid amounted to a subsidy because the aid carried better than market rates. We would not have expected the WTO panel to make findings on any other basis."[113]

125. Here, there is no way for the Tribunal to know what specific loan terms Mr. Beck believed were beneficial and why. Reading Mr. Beck's reports does not identify the companies he claimed were able to increase their production capacity and how. His reports do not indicate whether a PSIF loan reduced delivered log costs for a specific company. His reports do not lend support to his conclusion at the Hearing that

[111] Tr. vol. 2, 467:12-18.

[112] Letter from U.S. Trade Representative Ron Kirk to Senator Richard Shelby, September 16, 2009 (RA-137).

[113] *Id*.

the projects and companies receiving PSIF loans were very-high risk. The reports do not identify which companies, if any, had too much debt, too few customers, no history of profitability, too much inventory or not enough inventory. His reports do not discuss the structure of any project or what types of projects were funded during the relevant period.

126. As a result, Canada was not able to cross-examine the U.S. expert on any of the specific information from which he claimed to base his conclusions and was left to guess what aspects of the loans, the companies, and the projects were considered to be objectionable.

127. By filling his reports with allegations devoid of company specific facts or loan analyses, Mr. Beck insulated his conclusions from examination. But in doing so, he also ensured that his reports could serve no evidentiary purpose in this proceeding for the Tribunal. Without foundation, Mr. Beck's conclusions are simply suppositions.

3. Despite Having the PSIF Loan Files for Over a Year, the United States Still Has Not Examined Them and Still Does Not Understand Their Content

128. The Tribunal's job is to evaluate and weigh the evidence presented by the Parties. Here, because of the approach followed by Mr. Beck and his failure to provide a company specific analysis of even one PSIF loan, the Tribunal is prevented from doing so. Perhaps Mr. Beck failed to provide company specific loan analyses because, as he readily acknowledged, he is not an investment banker and does not have experience in finance. But whatever the reason, the failure of the United States to provide an analysis of the specific loans alleged to have provided benefits undercuts its remedy claims.

129. Although the importance of a loan specific analysis may not have been appreciated by Mr. Beck, U.S. counsel appeared to recognize the problem and attempted to address the situation live during the cross-examination of Professor Kalt.

But in attempting for the first time in this proceeding to discuss the actual content of the PSIF files, the United States made it apparent that it still does not understand the handful of documents cited by Mr. Beck. In a short but revealing demonstration, the United States had to be corrected from making a sweeping assertion that all PSIF loans provided interest-free periods because the document being discussed expressly stated otherwise.[114] Similarly, U.S. counsel had to be told that the company that Mr. Beck listed as receiving the largest loan amount was not insolvent, but rather had a strong balance sheet and, contrary to counsel assertion, had access to other private financing.[115] As a result of the apparent lack of understanding, U.S. counsel was forced eventually to admit to the Chair that it had never translated the actual terms of the loans[116] and promised the Tribunal that the United States would review them, for the first time, *after* the Hearing.[117]

a. Contrary to U.S. Counsel's Argument at the Hearing, [ ] Are Not Indicative of Benefit Conferred to a Specific Company or the Risk Associated with a Specific Project

130. In the cross-examination of Professor Kalt, U.S. counsel called attention to **[ ]** appearing on a document – the only document – cited by Mr. Beck relating to a loan made to **[ ]**. Apparently, the purpose of the inquiry was to have Professor Kalt concede that **[ ]** should "be construed as a benefit provided to" the company.[118] Professor Kalt testified

[114] Tr. vol. 4-A, 869:17-870:8.

[115] Tr. vol. 4-A, 875:17-876:12.

[116] Tr. vol. 4-A, 870:22-24 ("To be honest, Madam Chair, we don't have full translations of these documents.").

[117] Tr. vol. 4-A, 872:11-13 (Again, we will look at the terms. That may be in the terms. We will look at that.").

[118] Tr. vol. 4-A, 860:3-4.

that he was not familiar with **[ ]**, but that "{a} benefit to the firm would arise from the differential" if the company "got something at below market."[119]

131. Listening to the exchange, Professor van den Berg noted that he was able to trace the calculations and he believed they indicated how **[ ]**, but he asked U.S. counsel to clarify its significance.[120] U.S. counsel then stated that he would do so in oral argument, but never did. Instead during Closing Statements, U.S. counsel simply asserted that "Professor Kalt did not seem to know the contents of the documents he cited and relied upon."[121]

132. Considering U.S. counsel's utter lack of understanding of the documents used to cross-examine Professor Kalt – the handful of documents cited by Mr. Beck – this assertion was not only wrong, it was unfair. The reason Professor Kalt was never asked to examine **[ ]** is the same reason that the majority of issues raised by the U.S. counsel and Mr. Beck at the Hearing have not been discussed, the United States and its forestry expert had never before indicated that this information was relevant or that it was a basis for the assertions made. Had the issue been mentioned in even one of Mr. Beck's reports or any of the U.S. briefs, Canada could have dispelled the incorrect assumption made at the Hearing.

133. U.S. counsel's attempt to equate **[ ]** with a perceived level of benefit to a specific company is misplaced. As the word **[ ]** indicates, **[**

[119] Tr. vol. 4-A, 860:5-7.

[120] Tr. vol. 4-A, 861:15-862:14; 866:3-12.

[121] Tr. vol. 5, 1130:14-16.

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followed by Investissement Québec. The **[ ]** do not provide any insight into whether the loan terms are more or less beneficial than the commercial market or whether a specific project is more or less risky. Accordingly, U.S. counsel's attempts at the Hearing to suggest that the **[ ]** are indicative of benefit to specific companies or the allegedly high risk of specific projects is inaccurate and misleading.

134. Because the United States has failed to provide a quantitative and non-speculative analysis of a single PSIF loan, the United States has failed to demonstrate that the government provided a benefit to any softwood lumber producer or exporter. And because no government benefit has been demonstrated by the Complainant, the Tribunal cannot find that the PSIF loan program circumvents the SLA. When a claimant so fails to substantiate its allegations by the time the evidentiary phase of the proceeding ends, the only appropriate thing for the Tribunal to do is to dismiss those allegations in their entirety.

D. SILVICULTURE CREDITS MEASURE: UNCONTESTED TESTIMONY AND DIRECT DOCUMENTARY EVIDENCE DEMONSTRATE THAT THE CREDITS BECAME A PART OF QUÉBEC'S TIMBER PRICING SYSTEM BEFORE JULY 1, 2006, QUALIFYING FOR SAFE HARBOUR (2)(A)

135. Canada has demonstrated, through the uncontested testimony of Messrs. Trottier and Adam, that the $135 million of new and increased silviculture credits which were announced March 23, 2006, effective April 1, 2006, were part of Québec's timber pricing system prior to July 1, 2006. Québec Ministerial Orders and a silviculture credit note demonstrate that the silviculture credits went into effect before July 2006, and

corroborate the fact testimony of Messrs. Adam and Trottier. It is inescapable that these credits are covered by safe harbour (2)(a).

136. The United States relies on the March 2006 Budget Plan as the sole basis for its contention that new and increased silviculture credits announced in that budget and published in Ministerial Orders in March and May 2006 circumvent the SLA because they were designed "to reduce the cost of operations and silvicultural investments."[122] Canada has not contested that increasing the value of existing silviculture credits and establishing new ones will reduce the net cost of silviculture activities. Instead, Canada has argued that the new and increased credits were part of Québec's timber pricing and forest management systems on July 1, 2006 and therefore fall within the scope of safe harbour 2(a). Canada has presented uncontested testimony and indisputable documentary evidence establishing that the new and increased silviculture credits became a part of Québec's timber pricing system prior to July 1, 2006. Specifically, Canada has shown:

- $135M was the estimated budget effect of adding new credits to the Québec timber pricing system as of April 1, 2006.[123]
- The increase in silviculture credits was incorporated fully into Québec's timber pricing system in April and May 2006.[124]
- The newly published credits were in fact applied prior to July 1, 2006.[125]

[122] 2006-2007 Budget Plan, Beck Report, Att. U, § 6, at 8 (Ex. C-1).

[123] Trottier Statement ¶ 7 (Ex. R-4).

[124] Adam Rejoinder Statement ¶¶ 17-19 (Ex. R-125).

137. Mr. Beck's final calculation of the alleged benefits provided by Québec's measures continues to include both the $75 million of silviculture investment discussed above and the $135 million of new and increased credits that were added to Québec's timber pricing system in April and May 2006.

138. During the Hearing, Canada questioned Mr. Beck with respect to many documents showing that these credits were incorporated into the timber pricing system before July 1, 2006. Mr. Beck professed bewilderment, stating that he never did understand the relationship between the silviculture credit and investment provisions in the Budget Speech, the Ministerial Orders which implemented the credits, and documents illustrating the actual grant of silviculture credits.[126] This lack of understanding is striking, particularly as Mr. Beck was offered as an expert to opine on Québec forestry measures, and given the exhaustive nature of the documents Canada provided,[127] and the detailed explanation of this matter by Mr. Adam in his Rejoinder Statement, and the amount of time devoted to this topic by Mr. Miller at the Hearing. As Canada committed at the Hearing to remove any confusion about the incorporation of the silviculture credits into Québec's timber pricing system by July 1, 2006 in the Post-

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[125] Credit Note for **[ ]**, Kalt Second Rebuttal Report, Att. S (Ex. R-148).

[126] *See, generally,* Tr. vol. 2, 377:24-414:2, and more specifically, Tr. vol. 2, 413:5-22.

Q. Then {Mr. Trottier} states: "These credits were immediately added to the pricing system and became part of Québec's timber pricing system on April 1, 2006." (As read) Did I read that correctly?

A. That is correct.

Q. You don't have any basis in your report to question the accuracy of that statement by Mr. Trottier; isn't that true?

A. No, that is not true. I certainly have tried to look behind this statement and go through just what we've gone through here, trying to look and understand the underlying documents that supported that statement, and I couldn't make the connection here.

[127] All relevant documents have been provided to the United States well in advance of the Hearing.

Hearing Brief (the confusion that caused Mr. Beck to continue to include the $135 million in silviculture credits in the calculation of benefits),[128] and we do so below.

139. As Mr. Beck correctly notes, the Budget Plan prepared in connection with the March 23, 2006 Budget Speech included an amount of $210 million "to reduce the cost of operations and silvicultural investments." Forty million dollars of this amount was budgeted for the 2006-07.[129] Further, as correctly quoted by Mr. Beck from the Québec Cabinet Memorandum, the $210 million amount is divided into two components: the $135 million over four years in measures associated with the reduction of operating expenses through new and increased silviculture credits, and $75 million over four years for a forestry investment program.[130] The budget for financial year 2006-07 included $30 million out of $135 million for reduction of operating expenses, and $10 million out of $75 million for forestry investment.[131]

140. As further detailed in the Québec Cabinet Memorandum and explained by Messrs. Trottier and Adam, the $30 million budgeted for the reduction of operating expenses in 2006-07 consisted of $8 million of the change in dues for the exploitation of private forests, $10 million for new silviculture credits for the costs related to planning and follow up, and $12 million for the increase in credit for selection and pre-selection cutting.[132] The relevant changes to Québec's timber pricing system were these credit increases – the creation of the new credit for planning and follow up for silviculture works

[128] Tr. vol. 5, 1210:7-24.

[129] Beck Report, Att. U, § 6, at 5 (Table 2) (Ex. C-1).

[130] *See* Beck Report, at 46 and Att. AD at 2 (Ex. C-1).

[131] *Id.*

[132] *See* Beck Report, Att. AD at 2 (Ex. C-1); Trottier Statement ¶ 7 (Ex. R-4); and Adam Rejoinder Statement ¶¶ 11, 17 (Ex. R-125).

($10 million), and the increase of the credit for selection and pre-selection cutting to $660/ha ($12 million).[133]

141. During the Hearing, Mr. Beck initially appeared to have a difficulty understanding the role of the silviculture credits in Québec's timber pricing system.[134] This is surprising, considering that Mr. Adam devoted an entire section of his Rejoinder Statement to the "Role of Credits in Québec's Timber Pricing System."[135] In his statement, Mr. Adam clearly explained that silvicluture credits are available to tenure holders as payments-in-kind for stumpage dues tenure holders may could perform various silviculture treatments to offset the amount of stumpage dues they would have to pay according to the rates established in Ministerial Orders.[136] Under cross-examination, however, Mr. Beck soon recognized that silviculture credits constitute payments-in-kind of stumpage dues.[137]

142. Canada has submitted documentary proof that the increases in silviculture credits officially became a part of Québec timber pricing system prior to July

[133] Mr. Beck appears not to believe that the increase in credit for "gardening works" to $660/ha mentioned in the Cabinet Memorandum is the same as the increase in credit for selection cutting and pre-selection cutting to $660/ha. Tr. vol. 2, 384:5-21; 390:24-391:8. According to Mr. Beck, "gardening works" means "ground preparation and replanting," and "has nothing to do" with pre-selection cutting. Beck Report at 46 (Ex. C-1); Tr. vol. 2, 391:9-12. While Mr. Beck did not explain the basis for his interpretation or the mechanism through which, in his view, the increase in credit for "gardening works" was implemented, Mr. Adam, the person in charge of Québec's timber pricing system, did. Mr. Adam's uncontested testimony confirms that the increase in the credit for selection and pre-selection cutting to $660/ha is the same as the increase in the credit for "gardening works" mentioned in the Cabinet Memorandum. *See* Adam Rejoinder Report ¶¶ 11, 189 (Ex. R-125).

[134] *See* Tr. vol. 2, 378:5-11.

[135] *See* Adam Rejoinder Statement ¶¶ 5-19 (Ex. R-125).

[136] *Id.* ¶¶ 11-12 (Ex. R-125).

[137] *See* Tr. vol. 2, 381:19-382:5.

1, 2006. This proof consists of three Ministerial Orders announcing rates of credit for various silvicultural treatments.[138] Ministerial Order No. AM 2005-009, published on March 31, 2005, and establishing credit rates for silvicultural treatments in the fiscal year 2005-06, establishes the prevailing credit rates of $325/ha for various selection and pre-selection cutting treatments.[139] By contrast, Ministerial Order No. AM 2006-010, which replaces Order 2005-009 effective April 1, 2006, establishes an increased credit rate of $660/ha for the same silviculture treatments for the fiscal year 2006-07.[140] Ministerial Order No. AM 2006-015 further adds an additional column establishing credits for planning and follow-up of silvicultural activities, effective May 15, 2006, the date of its publication.[141] Together the Ministerial Orders demonstrate that by May 15, 2006, Québec's incorporated new credits for planning and follow up activities and the increased rate of credit for selection and pre-selection cutting, which are parts of the $135 million silviculture investment measure.

143. Going even further, Canada has provided evidence that the new silviculture credits were not only part of Québec's timber pricing system by July 1, but that such credits were claimed, processed, and paid to forestry companies before July 1,

[138] Québec Ministerial Orders published in the Gazette Officielle are equivalent to the Swiss Bundesblatt, http://www.admin.ch/ch/d/ff/2009/index.html; New Zealand Gazette, http://www.dia.govt.nz/diawebsite.nsf/wpg_URL/Services-New-Zealand-Gazette-Index; and Netherlands Staatsblad van het Koninkrijk der Nederlanden, https://zoek.officielebekendmakingen.nl/Pages/BladerenPublicaties.aspx.

[139] *See* Ministerial Order No. 2005-009 at 716A-717A (RA-98). Canada concedes that the credit rate for selection and pre-selection cutting activities that can be derived from Cabinet Memorandum is $330/ha. To the extent this credit rate differs from the rate in Ministerial Order AM 2005-009 ($5/ha), Canada believes the Cabinet Memorandum contains a typographical or a rounding error. The credit rate was officially set by the Ministerial Order, not the Cabinet Memorandum. It is possible that the authors of the Cabinet Memorandum rounded down the increase in this credit from $335/ha to $330/ha for the sake of simplicity.

[140] *See* Ministerial Order No. 2006-010 at 1142A (¶¶ 5-6), 1146A-1147A (RA-97).

[141] *See* Ministerial Order No. 2006-015 at 1431B (¶ 5), 1434B-1436B (RA-99).

2006. Attachment S to Second Rebuttal Expert Witness Report of Professor Kalt contains a credit note issued by Québec's Ministry of Natural Resources and Fauna (MRNF) to a tenure holders, **[ ]**, and supporting documents. The supporting documents include two screen shots printouts from the MRNF Oracle-based database. One of these screen shots is of the portal of measurement and billing and identifies the silviculture treatment as "Plt with preparation of land – Rec 45-110cc."[142] The abbreviation "Plt." here stands for planting. The box below shows the number of containers of seedlings (137,000) that were both declared and approved for credit as planted. Further down, there are boxes for rate of credit for planting and for "P & S." The letters "P & S" stand for the French words plannification et suivi, which mean planning and follow up.

144. The schedule of the rates of credits for silviculture treatments admissible as payments of stumpage in Attachment S which was also published as Ministerial Order No. AM 2006-015, indicates that the rate of silviculture credit for planting of 45-110 containers of seedlings is $220 per 1000 seedlings, which is equivalent to $0.22 per seedling. In addition, the rate of silviculture credit for planning and follow up activities associated with planting is $20/1000 seedlings, or $0.02 per seedling. These are the rates found in the respective boxes of the portal of measurement and billing. These silviculture credit rates are followed by a multiplication sign and the figure 90 percent. As Mr. Adam explained in his Rejoinder Statement, beginning in April 2005, the value of silvicultural credits was reduced from 100 percent to 90 percent of the execution cost of the silvicultural treatment.[143] If the silviculture credit for planting and the silviculture

[142] Mr. Beck has explained that "45 to 110 c" represents the size of the seedling container. Tr. vol. 2, 409:21-410:2.

[143] Adam Rejoinder Statement ¶ 14 (Ex. R-125).

credit for planning and follow up are combined and multiplied by 90 percent, they produce the credit rate of $0.216/seedling ((0.22 + 0.02) x 0.9 = 0.216). If that number, in turn, is multiplied by 137,000, the number of seedlings declared by the tenure holder as planted, it produces the credit figure of $29,592.00. That is the figure that appears in the first line of the credit note in Attachment S. The date at the top right corner of this document is 2006-06-29, indicating that the credit note was issued on June 29, 2006.

145. Hence, the credit note is dispositive evidence that the planning and follow up silviculture credit promulgated by Ministerial Order 2006-015 was claimed, processed, and approved before July 1, 2006. This evidence leaves no doubt that increased silviculture credits announced in the March 2006 Budget were firmly a part of Québec timber pricing system by the July 1, 2006 safe harbour date, exactly as Mr. Adam – a fact witness with personal knowledge of Québec's timber pricing system – testified. In these circumstances, Mr. Beck's failure to recognize clear evidence of the incorporation of the silviculture credits into the provincial timber pricing system in April and May of 2006 confirms that whatever his expertise on matters of U.S. forestry and mill operations, that expertise does not extend to Québec or to the Québec timber pricing or forest management systems.

E. CAPITAL TAX CREDIT MEASURE: THE UNITED STATES PRODUCED NO CREDIBLE EVIDENCE TO COUNTER CANADA'S SHOWING THAT THE MEASURE BOTH EXISTED AND WAS ADMINISTERED BY JULY 1, 2006, QUALIFYING FOR SAFE HARBOUR (2)(B)

146. For this measure, the only issue before the Tribunal is whether the increase in the Québec Capital Tax Credit was in existence prior to July 1, 2006. As with the Road Tax Credit, Canada has established that the Capital Tax Credit was in fact in existence prior to July 1, 2006. All the United States has offered in opposition to this

evidence is the "common sense" testimony of a forestry expert with no knowledge whatever of Canadian and Québec tax laws or parliamentary processes.

147. In his March 23, 2006 Budget Speech, Québec's Finance Minister announced that "forest sector companies will also enjoy, as of the day following this budget speech … a non-refundable capital tax credit of 15 percent…"[144] his announcement put into immediate effect an increase in the Capital Tax Credit from 5 percent (which had applied to all manufacturing entities) to 15 percent for companies in the forestry sector. Hearing testimony confirmed that this rate change was the only modification made to a credit that had been in existence and administered since 2005.[145]

148. The United States' core contention is that the Finance Minister's statement was incorrect; companies could not enjoy the increased tax credit as of March 24, 2006 because as a matter of law the credit could not have been in existence until it received final assent in December 2006.[146] Hearing testimony confirmed what has been clear throughout the briefing: the change in the Capital Tax Credit rate was in existence as of the day following the Budget Speech, exactly as Québec's Finance Minister pronounced the change.[147] Therefore, the Capital Tax Credit of 15 percent for companies in the forestry sector falls within the Article XVII(2)(b) safe harbour as an "other program" that is in the same form as it existed and was administered on July 1, 2006.

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[144] Tr. vol. 2, 320:22-321:3; 329:5-21; 2006-2007 Budget Plan, Beck Report, Att. U, § 6, at 10 (Ex. C-1).

[145] Tr. vol. 2, 318:8-319:6.

[146] Stmt. of Case ¶ 137.

[147] Tr. vol. 2, 320:22-321:9.

149. In its Statement of Case, the United States cited Mr. Beck – and only Mr. Beck – to support its assertions that "{i}n order to be implemented, new tax credits require amendments to the Taxation Act" and "{t}he tax credit could not have been in existence or have been administered until it was legally authorized in December 2006."[148] On cross-examination at the Hearing, Mr. Beck explained that his conclusions about the Capital Tax Credit were based entirely on "trying to understand {the measure} from a common sense perspective."[149] Mr. Beck acknowledged that he has no training or background in tax law or parliamentary process.[150] When asked to identify the basis for his conclusions, Mr. Beck twice referred to discussions he had with U.S. counsel and documents he could not recollect or identify.[151] As cross-examination revealed, Mr. Beck's common sense approach was in fact nothing more than the parroting of assertions fed to him by counsel.

150. Mr. Beck was presented by the United States as an expert witness with respect to forestry. His testimony relating to the effective dates of tax measures in

[148] Stmt. of Case ¶ 137.

[149] Tr. vol. 2, 316:18-21.

[150] Tr. vol. 2, 316:9-317:10.

[151] Tr. vol. 2, 313:3-17; 335:3-336:3. The first of these exchanges reads as follows:

Q: And I believe you had expressed an opinion that those two programs did not exist on July 1, 2006; is that true?

A: I could check my reports, but my – in discussions with counsel, the United States, and on their advice, I have concluded that the programs were not in place as of July 1{, 2006}. It was a December date when they were assented through the legislative process, the Parliament, that they went into effect.

Q: All right. And so your opinion on whether these programs exist is based on discussions with counsel? That's one input to it; is that true?

A: That's correct.

Québec, both at the Hearing and in his reports, are stunningly inexpert on those issues. There is nothing sensible about Mr. Beck's application of his "common sense" to a system of law with which he is unfamiliar and the errors resulting from Mr. Beck's "common sense" approach are apparent.

151. Unquestioned testimony by Ms. Danielle Hudon of Revenu Québec established that Revenu Québec had implemented fully the change in the Capital Tax Rate by May 2006 and was ready then to process fiscal returns claiming the new rate.[152] Mr. Beck testified that he had no basis to question this fact testimony.[153]

152. Similarly, unquestioned testimony by other officials of Revenu Québec established that the need to implement tax measures in advance of legislative action is so common that Revenu Québec has written policies and procedures to enable the immediate implementation of tax measures contained in budget speeches and that this process was followed to give immediate effect to both the Capital Tax Credit and the Road tax Credit at the time of announcement in March 2006.[154] In response, Mr. Beck testified merely that he was unfamiliar with Revenu Québec's internal processes.[155]

153. Canada also offered documentary evidence to show that after March 24, 2006 tax payers began claiming the 15 percent credit on capital purchases. In fact, Attachment P to Exhibit R-148 shows a tax payer applying a 5 percent credit rate to purchases made prior to March 24, 2006 and a 15 percent credit rate to purchases

[152] Tr. vol. 2, 349:20-351:5.

[153] Tr. vol. 2, 351:6-9.

[154] Tr. vol. 2, 357:17-358:15.

[155] Tr. vol. 2, 358:16-359:4. *See also* Revenu Québec Witness Statements, Testimony of Danielle Hudon (Ex. R-124); and Ministère du Revenu and Mémore au Comité de politiques ministérielles relatives à la fiscalité (Dec. 18, 2007), (Ex. R-69).

made beginning on March 26, 2006 – just two days after the Budget Speech.[156] Notably, the purchases made after March 26 were significantly more expensive than the earlier purchases.[157] Mr. Beck acknowledged that the taxpayer in question must have timed its purchases of capital equipment by a matter of days to take advantage of the increased tax credit immediately after the Finance Minister's March 23, 2006 Budget Speech.[158] Canada also demonstrated that the credit forms were received and processed by Revenu Québec prior to the legislative assent date.[159]

154. In its closing remarks, the United States argued that the question of existence with respect to Québec's increased Capital Tax Credit was a matter of objective being, stating "{u}nder the plain meaning of the word 'exist,' a program must have more than mere potential; it must have objective being."[160] The facts, as developed in the pleadings and at the Hearing, establish that Québec's Capital Tax Credit had objective being as of March 24, 2006, exactly as pledged by Québec's Finance Minister.

155. Because it has no credible factual response to the "objective being" of the Capital Tax Credit prior to July 1, 2006, the United States repeated its assertion that as a matter of law the two Québec tax credits could not have existed prior to final legislative action in December 2006 and again provided a partial quotation from a 1985 article written by a former Canadian Finance Minister.[161] Canada already has refuted the

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[156] *See* Capital Tax Credit forms, Kalt Second Rebuttal Report, Att. P (Ex. 148).

[157] Tr. vol. 2, 341:4-342:7.

[158] Tr. vol. 2, 340:1-342:24.

[159] Tr. vol. 2, 334:15-335:8.

[160] Tr. vol. 5, 1120:21-23.

[161] Tr. vol. 5, 1121:5-19.

arguments made by the United States on the basis of this and other incomplete citations. In keeping with the Tribunal's injunction not to repeat arguments,[162] Canada will not reprise all those points here.[163] But one point bears repeating.

156. The export taxes imposed under the SLA as of October 12, 2006 were assessed on the basis of government pronouncement and without legislative enactment. Assent came two months later, in December 2006. Although the 20 year-old article cited incompletely by the United States proposed that the practice of implementing tax measures immediately followed by later legislative ratification be changed, no change to that established practice has been made. Had a change been made, the SLA's export tax could not have gone into effect on October 12, 2006, Québec's Finance Minister could not have declared that taxpayers would enjoy the increased Capital Tax Credit as of March 24, 2006, Québec taxpayers could not have made capital purchases in March 2006 to take advantage of the increased credit, and Revenu Québec could not have received or processed claims prior to December 2006. But all of these did occur and they did so because tax measures, like the Capital Tax Credit (and the Road Tax Credit), have objective and legal being at announcement, which for both credits was prior to July 1, 2006.

F. ROAD TAX CREDIT MEASURE: THE UNITED STATES FAILED TO DEMONSTRATE THAT THE MEASURE PROVIDED BENEFITS OR THAT SEVERAL SAFE HARBOUR PROVISIONS DO NOT APPLY

157. The United States has argued that the entire 90 percent refundable tax credit for the construction and major repair of forest roads and bridges circumvents the SLA. Canada presented a variety of reasons why Québec's road tax credit measure

[162] Tr. vol. 4-B, 1068:18-24.

[163] *See* Canada Rejoinder ¶¶ 215-220.

does not constitute circumvention: 1) it is not a grant or other benefit to the softwood lumber industry; 2) it falls within safe harbour 2(a) as a modification of Québec's timber pricing and forest management system; 3) it falls within safe harbour 2(b) because it existed and was administered by July 1, 2006, and, finally 4) it falls within safe harbour 2(c) because its purpose was environmental forest management, protection, and conservation.

1. The United States Failed to Demonstrate the Alleged Benefit Provided by the Road Tax Credit Program

158. In an attempt to prove that the Road Tax Credit measure is a grant or other benefit to the softwood lumber industry, the United States continuously cites the language of the 2006-2007 Budget Plan that the measure was introduced "{t}o help forest companies reduce supply costs and forest managers to harvest the most appropriate stands in a timely manner."[164] In doing so, the United States ignores the second part of this sentence which states that the measure was, "{t}o help … forest managers *to harvest the most appropriate stands in a timely manner*" (emphasis added) and points to a purpose consistent with safe-harbour 2(c). The United States never attempted to state what the "other benefit" of the measure is, instead relying instead on Canada's expert and fact witnesses. Yet despite conceding during the Hearing that the roads built as a result of the road tax credit measure belong to the Province of Québec rather than the companies that built them,[165] United States' witness Mr. Beck never attempted to assess the value of the benefit accruing to Québec through the development of its public road network.

[164] 2006-2007 Budget Plan, Beck Report, Att. U, § 6, at 9 (Ex. C-1).

[165] Tr. vol. 2, 373:7-10.

2. Evidence Presented by Canada Establishes That the Road Tax Credit Measure Qualifies for Safe Harbour 2(a)

159. Canada has presented ample evidence that the Road Tax Credit measure was a modification of Québec's forest management and timber pricing systems qualifying for safe harbour 2(a). First, Canada has shown that road construction has long been a part of the Québec's forest management system, as demonstrated by the requirement to specify road construction projects in 5-year and annual plans required for all tenure holders.[166] At the Hearing, Mr. Beck acknowledged that road building must be reported in tenure holders' forest management plans.[167]

160. Second, Canada's unchallenged fact witness Mr. Adam testified that pursuant to Québec's Forest Act and *Regulation respecting forest royalties*, timber prices (stumpage fees) in Québec are determined according to the parity technique, which includes the costs of road building as a specific variable.[168] Further, Canada has shown that the U.S. Department of Commerce has verified on several occasions that the costs of road building are specific variables of Québec's timber pricing system.[169]

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[166] Forest Act, §§ 32, 53, 59 (RA-46).

[167] Tr. vol. 2, 372:19-22.

[168] Adam Statement ¶¶ 4-6 (Ex. R-3); Adam Rejoinder Statement ¶ 20 Ex. R-125).

[169] *See* Memorandum to M. Skinner from E. Greynolds, re: Verification of the Questionnaire Responses Submitted by the Gov't of Québec (GOC), Case No. C-122-839; Memorandum from B. Carreau to F. Shirzad, re: Issues and Decision Memorandum: Final Results of the Countervailing Duty Investigation of Certain Softwood Lumber Products from Canada, Case No. C-122-839 (March 21, 2001) at § 1, Province of Québec: Road Construction and Maintenance (RA-44); *see also* Memorandum to M. Skinner from B. Ledgerwood, re: Verification of the Questionnaire Responses Submitted by the Gov't of Québec (GOQ) in the 1st Administrative Review, Case No. C-122-838 (June 2, 2004); Memorandum to J. Jochum from B. Tillman, re: Issues & Decision Memorandum: Final Results of 1st Administrative Review: Certain Softwood Products from Canada, Case No. C-122-839 (Dec. 13, 2004) (RA-45).

161. Finally, Mr. Adam testified that the increase in the Road Tax Credit led to the reduction of the corresponding cost element in the parity equation, which is designed to calculate the market value of standing timber.[170] The United States presented no evidence to refute the measure's eligibility for the 2(a) safe harbour, essentially asking the Tribunal to make assumptions about market distortion based on budget figures.

3. Documentary and Hearing Evidence Establishes That the Road Tax Credit Measure Both Existed and Was Administered by July 1, 2006

162. Like the capital tax credit, the initial 40 percent Road Tax Credit was announced during the March 23, 2006, Budget Speech with immediate effect on the following day.[171] With respect to both of these measures, the two main issues that the United States disputed were whether the tax credit could have existed before formal assent by the legislature, and whether it was administered by July 1, 2006. In paragraphs 148 to 150 and 154 to 156, above, we have already reviewed the evidence that was presented concerning the existence of both measures and Mr. Beck's admitted lack of qualification to opine on the issue. The insufficiency of Mr. Beck's "common sense" approach applies equally – to the U.S. position on the existence of the Road Tax Credit measure as it did to the existence of capital tax credit measure.

163. With regard to the administration of the Road Tax Credit measure by July 1, 2006, Mr. Beck's Hearing testimony confirmed that the original 40 percent refundable tax credit for the construction and major repair of forest roads was available on the day

[170] Adam Statement ¶¶ 5, 10, 28, 32-33, 39 (Ex. R-3); Adam Rejoinder Statement, ¶¶ 20, 36-38 (Ex. R-125); Adam Second Rejoinder Statement ¶¶ 15-17 (Ex. R-150).

[171] 2006-2007 Budget Plan, Beck Report, Att. U, § 6, at 9 (Ex. C-1); 2006-2007 Budget Speech, Att. T, § II, at 13 (Ex. C-1).

following the Budget Speech.[172] Mr. Beck's Hearing testimony also confirms that e-mail messages sent by Québec officials in April 2006 to industry members transmitted explanatory documents pertaining to the Road Tax Credit program and offered to meet with industry to discuss the measure.[173] Mr. Beck further testified that a Certificate of Eligibility form for Road Tax Credit (which could not have existed before the program was announced) was in the hands of industry and was completed and signed by industry to claim the new credit on June 13, 2006.[174] In light of this evidence, it is difficult to see how Mr. Beck can maintain his conclusion that the Road Tax Credit measure was not in existence and administered by July 1, 2006. However, Mr. Beck provided some insight into the basis for his position, when he admitted during cross examination that "I don't know how the process worked."[175]

164. Other documents that Canada has presented, but which were not discussed by Mr. Beck or U.S. counsel at the Hearing include:

- MRNF Certificates of Eligibility issued to an applicant on October 3, 2006, on the basis of attached documentation showing numerous road-making and repair expenditures in May and June 2006.[176]

- Letters from MRNF to industry members dating from July 13, 2006 to March 12, 2007, denying Certificates of Eligibility for road credit.[177]

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[172] Tr. vol. 2, 354:15-357:13.

[173] Tr. vol. 2, 359:8-361:21.

[174] Tr. vol. 2, 361:22-365:25.

[175] Tr. vol. 2, 364:7-8.

[176] *See* Crédit d'impôt relative à la construction ou la réfection majeure de chemins d'accès et de ponts d'intérêt public en milieu forestier, QC-C-099231-099316, especially pages QC-C-099270-316 (Certificates of Eligibility) and QC-C-099255-61 (Expenditures) (Ex. R-77).

- Revenu Québec claim forms claiming reimbursement for expenses made after March 23, 2006, and before October 23, 2006.[178]

- Internal Revenu Québec documents illustrating early steps to implement forestry tax measures stemming from the 2006-2007 Budget Speech.[179]

165. Together, this evidence illustrates that not only did the Road Tax Credit measure exist well before legislative assent, but that the administration of this measure was in full operation by July 1, 2006.

4. Extensive Evidence Presented by Canada and Mr. Beck's Own Testimony Confirms That the Primary Purpose of the Road Tax Credit Measure Was Consistent with Safe Harbour 2(c)

166. Finally, the United States argued that the Road Tax Credit measure does not qualify for safe harbour 2(c) because its primary objective is to help forest companies reduce supply costs.[180] For proof of the measure's primary objective, the United States relies on one statement from the 2006-2007 Budget Plan:

> To help forest companies reduce supply costs and forest managers to harvest the most appropriate stands in a timely manner, the government is setting up a new tax

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[177] *See* Letter regarding Attestation d'admissibilité à l'égard de ponts en milieu forestier 13 July 2006QC-C-001571, Letters regarding Attestation d'admissibilité à l'égard de chemins d'accès en milieu forestier, QC-C-001574-76 (Ex. R-78).

[178] *See, e.g.*, Crédit d'impôt pour la construction de chemins d'accès et de ponts d'intérêt publicen milieu forestier, QC-C-100544-47 (Ex. R-79).

[179] *See* E-mail message from Michelle Simard dated Mar. 28, 2006 (Ex. R-70); Impacts du budget 2006-2007 sur le manuel Impôt des sociétés, QC-C-002118-2121 (Ex. R-72); Revenu Québec, Calendrier des travaux relatifs aux mesures du budget du 23 mars 2006, (Ex. R-73); Revenu Québec, *Prise en charge globale et continue: discourse sur le budget 2006-2007* (Mar. 23, 2006), QC-C-002122-02228, especially QC-C-002182-84, (Ex. R-74).

[180] Beck Rebuttal Report, Ex. C-43, ¶¶ 148, 152 (Ex. C-43).

> credit for the construction and major repair of forest access roads and bridges.[181]

167. The United States and Mr. Beck appear not to notice that the very statement they rely on also sets forth another objective; namely, to "harvest the most appropriate stands in a timely manner." Nothing in the statement indicates whether one objective is more important than the other. At the same time, extensive evidence presented by Canada demonstrates that the primary objective of the measure was to improve environmental management of Québec's forest by improving access for forest protection and conservation activities, improving public access, and encouraging better distribution of harvesting areas.

168. First, official documents presented by Canada establish that "{t}he purpose of {the road credit} measure is to foster the development of the forest road network to make forested land in Québec accessible to its many users …"[182] and that "{t}he program is designed to facilitate access to the territory for the many users of the forest," and "encourages better geographical distribution of harvesting areas, as recommended by the Coulombe Commission."[183] Second, Canada has shown that the Coulombe Commission was established to recommend modifications to ensure the best possible management of forests taking into account fauna, socio-economic, and environmental elements, and found that a forest road program "would make it possible to harvest a higher number of presently inaccessible overmature stands, while abiding by

[181] Beck Report, Att. U, § 6, at 9 (Ex. C-1) (as quoted in Beck Rebuttal II ¶ 192 (Ex. C-61)) (emphasis added).

[182] Revenue Québec Information Bulletin 2006-4 at 1 (October 23, 2006) (Ex. R-58).

[183] IQ Press Release, Beck Report, Att. AB, at 2 (Ex. C-1).

environmental protection objectives and maintaining biological diversity."[184] The Coulombe Commission, accordingly, made the following recommendations:

- "That the forest road network be planned by all territory users …"
- "That a forest road system assistance program be set up …"
- That MRNF adopts a transition strategy for readjusting overall budget based on a forest road measure as one of the top priorities.[185]

169. What is most telling is that Mr. Beck himself confirms this evidence. In his first expert report. Mr. Beck acknowledged that "{m}ost of the {Forest Management} programs were initially recommended by the Coulombe Commission."[186] During his cross-examination, Mr. Beck further conceded that the Coulombe Commission Report was focused on forest management, and not on the interests of the softwood lumber industry.[187] Mr. Beck also confirmed that overmature timber stands present risks to forests[188] and that forest roads are important for reaching overmature stands[189] to combat forest fires and pests.[190] Thus, Mr. Beck's own forestry expertise tells him that a program designed to promote forests road construction and repair serves important conservation and forest management objectives.

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[184] Coulombe Commission Press Release, *Changes needed in silvicultural practices*, at 2 (Ex. R-83); *see* Mandate of the Commission (as translated from French) (Ex. R-80).

[185] Coulombe Commission Press Release and Final Report Summary, at 4 (Ex. R-82).

[186] Beck Report at 38 (Ex. C-1).

[187] Tr. vol. 2, 366:9-367:8.

[188] Tr. vol. 2, 369:24-370:12.

[189] Tr. vol. 2, 369:24-370:12.

[190] Tr. vol. 2, 368:6-16.

170. As this review of the Hearing record reveals, the United States' evidence regarding the benefit it claims the Road Tax Credit measure provided, as well as its evidence regarding inapplicability of safe harbours, is confined primarily to discussions of the measure in the public documents related to the March 2006 budget. Canada has presented extensive documentary and testimonial evidence to support its position that no benefit was conferred and that the three safe harbours apply if any benefit is found to have been conferred. The overwhelming weight of the evidence establishes that the Road Tax Credit measure does not circumvent the SLA.

G. SOPFIM AND SOPFEU: THE UNITED STATES HAS FAILED TO DEMONSTRATE BENEFIT AND EXPLAIN WHY SIMPLIFICATION OF THE QUÉBEC TIMBER PRICING SYSTEM DOES NOT SATISFY SAFE HARBOUR (2)(A)

171. The SOPFIM/SOPFEU measure also did not provide a benefit to producers and exporters of softwood lumber products. The measure relates to the longstanding, legal obligation of the Gouvernment du Québec as the owner of the natural resource to protect the public forests from insect, disease, and fire. As Mr. Adam testified, SOPFIM/SOPFEU charges were integral elements of the parity formula that changed when costs were reallocated. This is a fact known by the United States for many years,[191] even if it came as a surprise to the U.S. forestry expert in this arbitration. Moreover, as a modification of timber pricing that improves the extent to which stumpage prices reflect market conditions including costs, the SOPFIM/SOPFEU measure also fall under the 2(a) safe harbour. As the U.S. declined to examine Mr. Adam on the eve of the Hearing, his statements of fact are un-rebutted.[192]

[191] *See* 2001 and 2004 Verification and Issues and Decision Memoranda.

[192] *See* Procedural Order #1, ¶ 6.5: "the witness statements … shall come in lieu of direct examination of a witness at the Final Hearing."

172. In October of 2006, the Gouvernement du Québec announced that it would reassume the full cost of suppressing forest fires (SOPFEU) and eradicating insect and disease infestations (SOPFIM).[193] The United States alleged that elimination of the SOPFIM and SOPFEU payments conferred a benefit to softwood lumber producers, but failed to cite any documentary evidence to support its contention. In the Statement of the Case, the United States relied only on Mr. Beck's report.[194] In its Reply brief, the only citations the United States offered were to Mr. Adam's first report and Canada's Statement of Defence.[195]

173. At the Hearing, the United States continued to argue that this measure circumvents the SLA.[196] The United States bases this position on a misallocation of the burden of proof, asserting that Canada must demonstrate that these measures do not confer a benefit.[197] This is remarkable because earlier in the same day at the same Hearing, the United States admitted that under the SLA it carries the burden of proof on the issue of benefit.[198]

174. Canada has introduced two fact statements from Mr. Adam to clarify the operation of these measures. In his first statement, Mr. Adam explained that SOPFIM and SOPFEU contributions became part of the timber pricing formula in Québec when

[193] Adam Statement ¶ 22 (Ex. R-3).

[194] *See* Stmt. of Case ¶¶ 119-124.

[195] *See* U.S. Reply ¶¶ 148-157.

[196] Tr. vol. 1-A, 65:11-13.

[197] Tr. vol. 1-A, 66:7-10.

[198] Tr. vol. 1-A, 12:5-10.

these charges were first imposed on industry.[199] Mr. Adam noted that removal of these charges resulted in changes to the parity formula, producing stumpage fees higher than they otherwise would have been.[200]

175. Historically, the Gouvernement du Québec has borne full responsibility for the costs of protecting its forest lands from fires and infestations. Because Québec is the owner of public lands, it is the responsibility of the government to protect this natural resource. Only in the early 1990s did Québec impose a charge on industry to cover a portion of the cost of suppressing forest fires and eradicating insect and disease infestations, while offsetting this charge by including corresponding cost variables in the parity formula, resulting in lower stumpage fees. In 2006, Québec chose to reassume the full amount of these costs directly as it had done in the past. Mr. Adam testified that removing this charge restored the status quo as it existed before 1995.[201] The United States has yet to explain why restoring the status quo constitutes a benefit.

176. Canada's evidence also demonstrates that these measures qualify under the 2(a) safe harbour. Canada provided evidence showing that because SOPFIM and SOPFEU programs entail fire suppression, and insect and disease control, Québec law makes them parts of Québec's forest management system.[202] In addition, Canada provided evidence that under Québec law, stumpage prices are determined according to a parity formula, which until April 2007 included SOPFIM and SOPFEU as specific

[199] Adam Statement ¶ 21(Ex. R-3).

[200] Adam Statement ¶ 36 (Ex. R-3).

[201] Adam Statement ¶ 22 (Ex. R-3).

[202] *See* Forest Act, R.S.Q., ch. F-4.1, (1986), ¶ 3 (RA-46).

variables.[203] Further, Canada demonstrated that for many years the U.S. government has been aware that these SOPFIM and SOPFEU charges were specific variables in Québec's timber pricing system.[204] Thus, Canada established that both programs formed parts of Québec's timber pricing and forest management systems.[205]

177. Mr. Adam testified that the elimination of the requirements for the industry to contribute to SOPFIM and SOPFEU resulted in the elimination of these costs from the parity formula, which is designed to calculate the market value of standing timber.[206] Thus, the measure actually restored a more direct way to calculate market pricing for timber.

178. In response, the United States ignores the parity formula's operation and role in setting the price of public timber in Québec. Instead, in its Closing Statement, the United States contended that the measure circumvents the SLA because the government is transferring the costs of doing business.[207] But the evidence establishes that Québec bore the full cost of these activities prior to 1995. Thereafter, Québec shifted the costs in part to tenure holders, but adjusted timber pricing to reflect these

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[203] Adam Statement ¶ 5 (citing *Regulation respecting forest royalties*, §2) and ¶ 21 (Ex. R-3).

[204] *See* Memorandum to M. Skinner from E. Greynolds, re: Verification of the Questionnaire Responses Submitted by the Gov't of Québec (GOC), Case No. C-122-839; Memorandum from B. Carreau to F. Shirzad, re: Issues and Decision Memorandum: Final Results of the Countervailing Duty Investigation of Certain Softwood Lumber Products from Canada, Case No. C-122-839 (March 21, 2001) at § 1, Province of Québec: Road Construction and Maintenance (RA-44); *see also* Memorandum to M. Skinner from B. Ledgerwood, re: Verification of the Questionnaire Responses Submitted by the Gov't of Québec (GOQ) in the 1st Administrative Review, Case No. C-122-838 (June 2, 2004); Memorandum to J. Jochum from B. Tillman, re: Issues & Decision Memorandum: Final Results of 1st Administrative Review: Certain Softwood Products from Canada, Case No. C-122-839 (Dec. 13, 2004) (RA-45).

[205] Adam Statement ¶¶ 22-23 (Ex. R-3).

[206] Adam Statement ¶¶ 5, 10, 18, 39 (Ex. R-3).

[207] Tr. vol. 5, 1128:22-1129:17.

costs on public lands. And the contested measure simply reflects Québec's decision to return to the status quo ante that prevailed prior to 1995.

H. FORESTRY FUND: THE UNITED STATES HAS FAILED TO DEMONSTRATE BENEFIT AND EXPLAIN WHY SIMPLIFICATION OF THE QUÉBEC TIMBER PRICING SYSTEM DOES NOT SATISFY SAFE HARBOUR (2)(A)

179. In October 2006, Québec announced that it would waive a fee that was formerly charged to industry to cover the government's cost of providing seedlings, known as the Forestry Fund contributions.[208] The United States alleged that the Forestry Fund measure confers a benefit. However, as with SOPFIM and SOPFEU, the United States failed to cite any documentary evidence to support its contention. Instead, the United States attempted to shift the burden of proof onto Canada.

180. The points relating to the SOPFIM/SOPFEU measure also apply to the Forestry Fund. Mr. Adam explained that Forestry Fund contributions were a specific variable in the parity formula.[209] Just as with the SOPFIM and SOPFEU, the U.S. government has been aware of this fact for many years.[210] Québec law also designates the Forestry Fund as part of Québec's forest management system.[211] Because the elimination of the requirement to contribute to Forestry Fund led to the elimination of the

[208] Adam Statement ¶¶ 23, 24 (Ex. R-3).

[209] Adam Statement ¶ 21 (Ex. R-3).

[210] *See* Memorandum to M. Skinner from E. Greynolds, re: Verification of the Questionnaire Responses Submitted by the Gov't of Québec (GOC), Case No. C-122-839; Memorandum from B. Carreau to F. Shirzad, re: Issues and Decision Memorandum: Final Results of the Countervailing Duty Investigation of Certain Softwood Lumber Products from Canada, Case No. C-122-839 (March 21, 2001) at § 1, Province of Québec: Road Construction and Maintenance (RA-44); *see also* Memorandum to M. Skinner from B. Ledgerwood, re: Verification of the Questionnaire Responses Submitted by the Gov't of Québec (GOQ) in the 1st Administrative Review, Case No. C-122-838 (June 2, 2004); Memorandum to J. Jochum from B. Tillman, re: Issues & Decision Memorandum: Final Results of 1st Administrative Review: Certain Softwood Products from Canada, Case No. C-122-839 (Dec. 13, 2004) (RA-45).

[211] *See* Forest Act, R.S.Q., ch. F-4.1, (1986), ¶ 3 ("reforestation") (Ex. RA-46).

corresponding variable from the parity formula, the measure simplified the formula, resulting in a better reflection of market conditions, including pricing and costs. As with the SOPFIM and SOPFEU measure, Mr. Adam testified that removal of contribution requirement resulted in a change to the parity formula, producing stumpage fees higher than they otherwise would have been.[212]

181. As with SOPFIM and SOPFEU, the Gouvernement du Québec historically bore the full cost of providing seedlings. In the mid 1990s, Québec imposed a charge on industry for these costs, while offsetting it by making the charge a variable in the parity formula resulting in lower stumpage fees. Mr. Adam testified that removing this charge also restored the status quo.[213] The United States had a chance to contest Mr. Adam's testimony that the Forestry Fund measure restores the status quo at the Hearing. Because the United States declined to question Mr. Adam, his testimony stands as an uncontested statement of facts.

PART III. REMEDY

182. Parts I and II of this Post-Hearing Brief reviewed the record evidence on liability. That review demonstrates for each of the challenged programs that: (1) the United States has either failed to establish the core elements of its case (*i.e.*, the provision of a benefit by a government to a softwood lumber producer or exporter); and/or (2) that the measure at issue falls within one or more of the paragraph 2 safe harbours. But if the Tribunal determines that one or more of the challenged measures does circumvent the SLA, then it must fashion a remedy – a compensatory adjustment in the language of the SLA – to restore whatever reduction or offset of the Export

[212] Adam Statement ¶ 36 (Ex. R-3).

[213] Adam Statement ¶ 23 (Ex. R-3).

Measures was caused by the circumventing program. This Part reviews the evidence and issues relating to the determination of compensatory adjustments if the Tribunal determines that any of the challenged measures is a circumvention of the SLA.

183. The United States proposed three alternative remedies in this case: the "high case" and so-called "low case" remedies, based on the reports prepared by its forest industry consultant Mr. Beck, which propose compensatory adjustments based on grossly inflated benefit amounts, and a third remedy based on an economic model and analysis by economic expert Professor Topel, which proposes adjustments based on the effect of the challenged programs on the Export Measures.[214]

184. The United States argues that the export tax should be increased by an amount that, during the period the Agreement is in force, will collect increased export tax revenues equal to the amount of benefit that Mr. Beck considered were provided to softwood lumber producers or exporters by the challenged programs. The U.S. contention that the remedy should recapture benefits is contrary to the plain terms of the Agreement and contrary to international law. There is no justification for the U.S. methods of determining the amount of benefits, and no justification for asserting that the amount of revenue collected by export tax adjustments should recapture the amount of benefits provided, even if the benefits were measured correctly.

[214] Although it had proposed all three remedies in its Statement of Case, in its Reply Memorial the United States abandoned the Topel remedy in favor of the Beck remedies, arguing that the Topel Remedy dealt only with the harm to U.S. producers and with "all consequences" of the breach. At the Hearing the United States advanced the Beck "high case" as its preferred remedy, describing the Topel Remedy as what should be used, should the Tribunal determine that the compensatory adjustments are to compensate for the effects of the benefit, rather than the U.S. preferred proposals. Tr. vol. 1-B, 295:8-12; vol. 5, 1153:25-1154:3. The Tribunal should take into account that the United States originally considered the Topel remedy to be consistent with the standards of the SLA, even though its result was much less favorable to U.S. interests than either Beck remedy.

185. In Section A we review the reasons why the United States' high case and so-called low case proposals have no basis in the SLA or international laws and why Canada's proposed Remedy, the Kalt proposal, conforms with the SLA. In Section B, we discuss six key issues the Tribunal will need to resolve in order to determine the appropriate compensatory adjustments for any breach that the Tribunal may find. With respect to each of the six issues, we summarize the positions of the Parties, the relevant testimony at the Hearing, and the reasons that we think the Tribunal should agree with Canada's position on the issue.

A. COMPENSATORY ADJUSTMENTS MUST COMPENSATE FOR THE REDUCTION OR OFFSET OF THE EXPORT MEASURES CAUSED BY THE BENEFITS UNDER THE PROGRAM, NOT THE BENEFITS THEMSELVES

186. The United States noted during the Hearing that "the anti-circumvention provision exists to ensure that the measures have their intended effect."[215] Canada agrees. The intended effect of the Export Measures is to restrain exports to the United States by way of taxes and export quotas when lumber prices are low (by historical measures). Circumvention occurs when an action has the effect of offsetting or reducing these taxes or quotas.[216]

187. Whether the challenged program has the effect of offsetting or reducing the Export Measures should be determined by looking at whether, and to what degree, a particular measure has an effect on the supply of exports to the U.S. market and a consequent effect on the price of lumber in the U.S. market. This is the approach taken by Professor Kalt and Professor Topel. If a program is found to breach the SLA, then the Export Measures must be adjusted so as to "compensate for the breach" – *i.e.*

[215] Tr. vol. 5, 1137:25-1138:2.

[216] Canada Rejoinder ¶ 37; Stmt. of Defence ¶¶ 37-41; Stmt. of Case ¶¶ 18, 36, 50, 95, 102, 129.

compensate for the offset or reduction of the Export Measures – caused by the program. An adjustment to the Export Measures that mirrors the offset or reduction of the Export Measures caused by the benefits will fully remedy the breach. As Professor Kalt explained in the Hearing, the compensatory adjustments should restore the Export Measures to what they would have been in the absence of the circumvention, and restore the effectiveness of the export restraints.[217] Professor Kalt and Professor Topel both have calculated adjustments that do this.

1. Plain Meaning of Terms of the Agreement – Articles XIV and XVII

188. As Canada explained in its Rejoinder[218] and at the Hearing,[219] the text of Articles XIV and XVII makes clear that what must be remedied in a circumvention case is the reduction or offset of the Export Measures. Article XIV(22) provides that what is to be remedied is "the breach." The breach claimed by the United States is a violation of Article XVII.

189. The first paragraph of Article XVII provides, in part, that "Neither Party … shall take action to circumvent or offset commitments under the SLA 2006, including any action having the effect of reducing or offsetting the Export Measures." Article XVII is breached, therefore, if an action is taken that reduces or offsets the Export Measures, not as claimed by the United States, "by virtue of a benefit being given."[220] A benefit is not itself a breach. Rather a benefit causes a breach insofar as it is considered to reduce or offset an Export Measure. If the compensatory adjustments are to

[217] Tr. vol. 4-A, 886-893.

[218] Canada Rejoinder ¶¶ 439-447.

[219] Tr. vol. 5, 1222:14-1223:8.

[220] Tr. vol. 5, 1138:18-23.

compensate for the uncured breach, they must compensate for the reduction or offset of the Export Measures, not the benefit that produced that result.

190. Accordingly, determining the appropriate compensatory adjustments under Article XIV(22)(b) in an anti-circumvention case is a three-step process. First, you must calculate the amount of the benefit provided to softwood lumber producers. Second, you must determine the extent to which the benefit reduces or offsets the Export Measures. And third, you must determine the necessary adjustment to Export Measures to compensate for this effect.[221] These steps, as undertaken by Professors Kalt and Topel in their calculation of the appropriate adjustment, are described in Annex II below.

191. The SLA is not designed to recapture benefits received by specific Canadian producers. Under the SLA, Export Measures are applied at the border to every exporter, regardless of whether individual exporters received benefits or not. There is no certain identity between who received benefits (and in what degree) and who pays export taxes (and in what degree). Accordingly, the burden of compensatory adjustments would fall on, among others: (1) exporters that did not exist at the time of the administration of the different programs; (2) exporters that did not apply for benefits; and (3) exporters that did not receive benefits. Conversely, exporters that received benefits but subsequently went out of business *will not* pay any compensatory adjustment to the Export Measures. In sum, Article XIV of the SLA was not designed to recoup benefits. The proposed U.S. remedy – focused on the disgorgement of benefits provided under the programs – is unreasonable in the treaty context of the SLA.

[221] Tr. vol. 5, 1223:8-16.

2. International Law

192. The United States argued at the Hearing and in its submissions that the SLA calls for a remedy meeting the customary international law standard of wiping out all the consequences of the breach, citing the ILC Articles and the *Chorzów* factory decision.[222] The United States argues that the receipt of benefits is the primary "consequence" of the breach that international law requires be wiped out.[223] Since the Tribunal under the SLA only has authority to order adjustments to Export Measures, the United States argues that the export taxes must be used to recapture the benefits.[224]

193. As Canada has shown, the remedy provisions of the SLA constitute a *lex specialis* that displace customary international law principles governing the obligations of States to make reparation for the breach of their international obligations. As noted by Professor Reisman:

> In my opinion, it is hard to see how one can resist reading the dispute settlement provisions of the SLA as a special regime for the legal consequences of a breach of that agreement. The fact that the SLA recognizes and provides for only specific legal consequences of breach would appear to testify to its *lex specialis* status.[225]

194. Even if customary international law did apply, however, Canada has established that it does not support the U.S. claim that remedying the breach requires

[222] Tr. vol. 1-A, 86:19-87:8; 107:8-15.

[223] Tr. vol. 1-A, 107:8-20.

[224] Tr. vol. 5, 1136:18-21.

[225] Reisman Report ¶ 37 (Ex. R-102). We also refer the Tribunal to Professor Reisman's testimony that the SLA displaces customary international law and the ILC Articles. (Reisman Report ¶¶ 18-26) (Ex. R-102).

levying an additional export tax that does more than compensate for the damage suffered by the United States.

195. Professor Reisman has given unchallenged expert evidence in this arbitration that undoing or recapturing benefits "bears no resemblance whatsoever to the legal notion of 'reparation' under Article 31 of the Articles on State Responsibility. Nor can it find any support in customary international law."[226] In the decisions of international courts and tribunals that Professor Riesman has consulted, reparation was awarded for injury, and "injury was assessed based on the loss to the Claimant."[227] International law provides no support for remedial measures that do more than compensate for the loss to the injured state. Thus, even if Article 31 applied, it could only be used to repair the injury caused to the United States, and not to recapture the benefits provided to Canadian producers.[228]

196. The United States also asserted at the Hearing that a remedy in this proceeding "is not limited to the provable economic effects of the circumvention on the United States producers."[229] This statement is wrong as a matter of customary international law. Commentary 9 to Article 31 of the ILC Articles is clear about the requirement of a causal link between the internationally wrongful act and the injury:

> Paragraph 2 addresses a further issue, namely the question of a causal link between the wrongful act and the injury. It is only "{i}njury … caused by the internationally wrongful act of a State" for which full reparation must be made. This phrase is used to

[226] Reisman Report ¶ 63 (Ex. R-102).

[227] *Id.* ¶ 64 (Ex. R-102).

[228] *Id.* ¶ 51 (Ex. R-102).

[229] Tr. vol. 1-A, 99:14-18.

> make clear that the subject matter of reparation is, globally, the injury resulting from and ascribable to the wrongful act, rather than any and all consequences flowing from an internationally wrongful act.[230]

197. As explained below, and as was made clear in expert testimony and at the Hearing, the United States uses the false pretext of pretending to collect benefits to demand export tax increases at a rate that is punitive, providing benefits to U.S. producers far in excess of any harm suffered, and with punitive effects on Canadian exporters in terms of both trade and revenue loss.

198. Canada has established that customary international law would not support remedying the breach by levying an export tax that does more than wipe out the loss to the injured State.[231] Article 31(1) of the Articles on State Responsibility provides that the "responsible State is under an obligation to make full reparation for the injury caused by the internationally wrongful act." Paragraph 5 of the Commentary to Article 31 explains, "{t}he responsible State's obligation to make full reparation relates to the 'injury caused by the internationally wrongful act.'"[232] The focus, therefore, is on preparation of the injury to the non-breaching Party caused by the wrongful act.

199. As testified by Professor Reisman, "{i}n the absence of any proof of injury to or effects on the Claimant, the imposition of compensatory adjustments amounts to 'punitive damages,' a form of damages that is not recognized in international law."[233] The ILC Articles expressly provide in Article 34 that the function of damages is

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[230] ILC Draft Articles, Commentary 9 to Article 31 (CA-20)

[231] *See* Stmt. of Defence ¶¶ 434, 460; Tr. vol. 1-A, 187:13-25; vol. 5, 1224:11-1225:1; vol. 3, 761:23-762:17.

[232] ILC Draft Articles, Commentary 5 to Article 31 (CA-20).

[233] Reisman Report ¶ 59 (Ex. R-102).

essentially compensatory.[234] Paragraph 4 of the Commentary to Article 36 confirms this critical point:

> {c}ompensation corresponds to the financially assessable damage suffered by the injured State or its nationals. It is not concerned to punish the responsible States, nor does compensation have an expressive or exemplary character.[235]

200. Canada refers the Tribunal to the unrebutted authorities and expert evidence in the record that support the conclusion that injury and causation must be proven, and that the remedy must be commensurate with the injury caused by the breach.[236]

201. The only injury that the United States has even attempted to demonstrate in this proceeding is through Professor Topel, whose model is intended to calculate the reduced prices for U.S. producers that would result from benefits to Canadian producers. Mr. Beck made no attempt to calculate injury to U.S. producers.

202. The U.S. also relies on *Chorzów* for the proposition that the remedy must address not only harm to U.S. producers but "all consequential effects" of the breach, including the benefits provided to Canadian producers and the investments facilitated by the programs. Just like Article 31 of the ILC Articles, *Chorzów* does not support the U.S. argument. The decision in that case was concerned only with wiping out the damage

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[234] ILC Articles, Article 4 (CA-20).

[235] ILC Articles, Commentary 4 to Article 36 (CA-20). *See also Id.,* Commentary 20, n.549 to Article 36 (CA-20).

[236] *See* the discussion in Professor Reisman's written report of: (1) the *Lusitania* case ("The fundamental concept of 'damages' is … reparation for a *loss* suffered; a judicially ascertained *compensation* for wrong. The remedy should be commensurate with the loss, so that the injured party may be made whole." (emphasis in original). Reisman Report ¶ 64 (Ex. R-102); and (2) the *Mavrommatis, Batchelder, H.A. Spalding, William R. Hier, Levis & Levis* and *Vaso Turajlich* cases. Reisman Report ¶¶ 31-35 (Ex. R-102).

resulting from Poland's actions. The court specifically held that "when … compensation {representing the present value of the undertaking} has been paid, the Polish Government will have acquired the right to continue working the undertaking."[237] The decision focused on the injury caused by the wrongful act and there is no discussion of negating or otherwise accounting for the benefits that the breaching party may have attained.

203. While the "wiping out" standard articulated in *Chorzów* may be customary international law, there is no support in international law, conventional or customary, for the leap from this standard to the U.S. claim for unproven economic damages, or for recapturing benefits. *Chorzów* is of no assistance to the attempt by the United States to create a standard of reparation that would displace both the SLA and customary international law.

3. The Beck Remedies Would Result in Punitive Damages Contrary to International Law

204. As was affirmed and demonstrated again at the Hearing, the proposed U.S. high case and so-called low case remedies are demonstrably punitive, imposing taxes at a rate far above the level that either Professor Kalt or Professor Topel determined to be sufficient to offset any harm caused by breaching measures, even if all of them were determined to be a breach.[238] By requesting additional export taxes at a rate high enough to collect revenues from exporters equal to the amount of benefits provided to certain producers, the United States would provide trade protection to U.S.

[237] *Case Concerning the Factory at Charzów* (Germ. v. Pol.), 1928 P.C.I.J (ser. A), at 59 (CA-19)

[238] Tr. vol. 3, 761:23-762:5; vol. 5, 1224:11-15; 1227:13-17

producers and against Canadian exporters in a degree that far exceeded any harm caused U.S. producers by the benefits.

205. With respect to Canadian producers, the United States makes a false equation between export tax revenues and the benefits provided. The benefits provided were not in the form of direct export subsidies per unit of exports, which might justify a tax equal to the subsidy per unit exported to the United States. Rather any benefits were provided to producers, and affected exports by affecting production as a whole. It is axiomatic that collecting taxes on exports to the United States in an amount equal to even the "low case" benefits provided for all production in option B Regions will penalize exports to the United States well in excess of the benefit that exporters received.

206. With respect to U.S. producers, the tax rates requested by the U.S. bear no relationship to the effect of the programs. Professors Topel and Kalt estimated the tax rate necessary to offset the cost advantage from the programs (under their differing measures of the program benefits).[239] The Beck so-called low case results in tax rates that are more than three times the highest rate estimated by Professor Topel (under the assumption of the programs being permanent) and five times that of Professor Kalt.[240] The high case remedy tax rate is another multiple of two higher than the so-called low case. The tax rates under the so-called low case (10%) and the high case (20%) substantially exceed by multiples the Option B export tax rate of 5 percent, which the United States claims is reduced or offset by the provincial programs.

[239] Kalt Rebuttal Report ¶ 106 (Ex. R-101); Topel Report ¶¶ 53-56 (Ex. C-2).

[240] Kalt Second Rebuttal Report, Figures 12, 13-A and 13-C (Ex. R-148).

207. The Beck high and so-called low case proposed by the United States would grossly overcompensate U.S. producers. The so-called low and high cases results in export taxes generating economic benefits, as measured by the additional surplus obtained by U.S. producers, of 8 to 30 times more than that calculated by Professor Kalt.[241] The gain to U.S. producers and both U.S. proposals exceeds the harm that would occur to U.S. producers, as determined by Professor Topel under the factually unsupported assumption that the programs are permanent.[242] In no case is the U.S. proposal proportionate to the harm suffered by the U.S.

208. The Tribunal must therefore reject the Beck remedies as punitive and contrary to principles of international law.

B. THE TRIBUNAL SHOULD RESOLVE SIX ISSUES TO PERMIT AN ACCURATE CALCULATION OF REMEDY

209. In the previous section, Canada explained that any remedy under the SLA should compensate for the reduction or offset of the Export Measures resulting from benefits found to cause the offset or reduction, and not the benefits themselves. If the Tribunal accepts this premise, it accepts the basic framework of the economic models presented by Professors Kalt and Topel. Both of these models are intended to measure the effect of the breach on the Export Measures.

210. If the Tribunal finds any breach, the next task for the Tribunal is then to resolve the principal issues in the valuation of benefits. For the Kalt and Topel

[241] Professor Kalt determines the loss of producer surplus to the U.S. producers from the programs at $43 million; the benefit to U.S. producers from the so-called low and high cases is $344 million and $1.230 billion, respectively.

[242] Professor Topel calculates a loss with all programs permanent of $328 million. Tr. vol. 5, 1155:11-14.

proposals, the valuation of benefits enables the calculation of effects of those benefits on the Export Measures and U.S. producers. The valuation of benefits is also the first step if, contrary to Canada's view, the Tribunal finds that the U.S. high case or low case is the proper way to determine compensatory adjustments.

211. In Canada's view, there are six key differences between the Parties regarding how to value benefits: (1) whether to assume that the challenged programs will continue indefinitely, or instead recognize that they will terminate where termination is provided by law; (2) whether to include benefits and effects that occur after the expiration of the Softwood Lumber Agreement; (3) whether to include an amount to cover any past effect of a breach; (4) whether benefits provided to pulp and paper producers should be considered as benefits to softwood lumber producers and, if so, in what amount; (5) whether the benefits provided by a loan or loan guarantee should be determined using a market benchmark, or instead using Mr. Beck's approach; and (6) whether to value a benefit as the amount actually provided by the government, or to use the total amount of an investment made, as Mr. Beck has done. Resolution of those issues will then determine the level of benefits, and in turn the amount of compensatory adjustments.

212. The section below addresses each of these six points and argues that, in each case, Canada's approach is in fact correct.

1. Whether to Assume That the Programs at Issue Will Continue Indefinitely, or Will Terminate Where Termination Is Provided by Law

213. Professor Topel's model considers two different cases. In the first case, the Challenged Programs "cease" at the end of 2009.[243] In the second case, Professor Topel makes an assumption that the Ontario and Québec Governments will take action in the future to make the Challenged Programs "permanent," meaning that they are reenacted in the future irrespective of whether they are set to expire at a time certain, and irrespective of whether this Tribunal finds them to be in violation of the SLA.[244]

214. The Ontario Forest Sector programs – the Forest Sector Prosperity Fund and Loan Guarantee Program – have fixed budgets and termination dates imposed by Ontario statute.[245] Professor Topel's "permanent" case ignores these provisions of law. Instead, he simply assumes, based on no evidence whatsoever, that future parliaments will enact laws to grant more benefits in the future.[246]

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[243] Tr. vol. 1-B, 280:5-8; Expert Report of Robert H. Topel, Nov. 21, 2008 (hereinafter the "Topel Report"), ¶ 54, Ex. 7 (Ex. C-2); Expert Response of Robert H. Topel, Mar. 23, 2009 (hereinafter "Topel Response Report"), Ex. 7 (Revised) (Ex. C-44); Expert Rejoinder Approach of Robert H. Topel, June 19, 2009 (hereinafter "Topel Rejoinder Report"), Ex. 7 (Revised 2) (Ex. R-62).

[244] Topel Report ¶ 54, Ex. 3 (Ex. C-2); Topel Response Report, Ex. 3 (Revised) (Ex. C-44); Topel Rejoinder Report (Revision 2) (Ex. C-62). In Professor Topel's own words, "{t}he permanent case assumes that the authorization for programs that have not ended will continue." Tr. vol. 1-B, 283:20-22. He makes this assumption even for programs that have set expiration dates. Tr. vol. 1-B, 281:17-21.

[245] Canada Statement of Defence, ¶¶ 73, 78; see also Summary of **[** **]** (June **[** **]**, 2005), ON-CONF-07253-R (Ex. R-22 to Statement of Defence) and Summary of **[** **]** (Sep. **[** **]** , 2005), ON-CONF-07268-R (Ex. R-29).

[246] As the Ontario Roads Program is part of Ontario's Forest Management System and has no expiration date, it is more reasonable to assume that this program will extend over time. Stmt. of Defence, ¶ 122; *see* also Summary of **[** **]** (Feb. **[** **]**, 2006), ON-CONF-07318-R (Ex. R-34 to Statement of Defence).

215. Similarly, the challenged Québec measures either already have expired, or are limited by fixed budget allocations. With regard to the Capital Tax Credit measure, the record shows that it ceased being specific to the forestry sector on November 23, 2007, and was completely eliminated in March 2008.[247] The PSIF program is subject to a limited budget allocation of $425 million.[248] The remaining measures, including the Road Tax Credit, the Silviculture Investment and Silviclutre Credits, SOPFIM/SOPFEU and Forestry Fund, were funded through a four-year budget plan, with the last budget allocations planned for FY 2009-2010 (the fiscal year in Québec ends in March).[249]

216. The Tribunal should disregard Professor Topel's "permanent case." In advancing it, the United States asks this Tribunal to take a preposterous step: to award a remedy for actions that have not been taken, and may never be taken. This request must be rejected on at least two grounds: (1) there is no authority in the SLA for this Tribunal to award a remedy for an action that has not been taken; and (2) the request violates fundamental principles of international law.

217. The United States has challenged specified measures in this dispute. If the Tribunal finds that a measure that expires on its own terms is in breach of the Agreement, the Tribunal cannot determine compensatory adjustments based on the assumption that the measure will be changed to extend the time or amount of benefits that will be accorded under it. If Canada were to act to extend a measure found to have

[247] *See* Revenu Québec, Information Bulletin 2007-9 (Nov. 23, 2007), Ex. R-89, at QC-000088-89; 2008-2009 Budget Speech (Mar. 13, 2008) at 10, Ex. R-90.

[248] *See* IQ Press Release (Oct. 20, 2008), Ex. C-1, Att. AB at 3, 6.

[249] *See* 2006-2007 Budget Plan, Ex. C-1, Att. U, Section 6 at 5; Québec Cabinet Memorandum (Oct. 18, 2006), Ex. C-1, Att. AD at 6.

breached, that would be a new measure that the United States could challenge under the SLA. Article XIV(22) – (24), however, do not provide authority for a Tribunal to order compensatory adjustments based on the assumption that a new measure will be implemented that is the same or similar to the measure that has been found in breach.

218. Professor Topel's Hearing testimony revealed just how speculative his assumptions are. Asked to explain on what basis he assumed that measures scheduled to expire on their own terms would somehow be extended or expanded, he stated:

> I guess the example I had in mind in thinking about that was, well, you know, if these things were annual appropriations then we'd be back here over and over and over again trying to figure out, gee, they renewed them this year now what are we going to do. So I offered two alternatives, but there's obviously as many alternatives as you want in-between. I said, well, suppose they last forever and they're just continually renewed, what would the world look like in that situation.[250]

219. Professor Topel's "permanent" case also violates the international law principle of *pacta sunt servanda*, set forth in Art. 26 of the Vienna Convention on the Law of Treaties.[251] Under this article, every treaty is binding upon the parties to it and must be performed by them in good faith. Canada is bound to make a good faith effort to comply with its obligations under the SLA. The corollary, of course, is that sovereign states are presumed to perform their international law obligations in good faith.[252] The U.S. "permanent case" turns this principle on its head. It assumes that even if the Tribunal determines that the Challenged Programs violate the SLA, Canada will act in

[250] Tr. vol. 4, 1057:16-1058:1.

[251] Vienna Convention on the Law of Treaties, 1969, Art. 26 (RA-14).

[252] "It is implicit from the duty to perform treaty obligations in good faith that a party to an international agreement should be deemed to have acted in good faith in the performance of its treaty obligations." *U.S. - Hormones Suspension (Panel)* WT/DS320/R (Mar 31, 2008) ¶ 7.317 (RA-138).

direct opposition to its SLA obligations and extend the duration of the programs. The United States has not cited to a single proposition of international law to justify this assumption of future non-compliance by Canada of its obligations under the SLA.

220. Professor Kalt's model, in contrast, properly accounts for the effects of the Challenged Programs. His model assumes that Challenged Programs cease either when they expire or when the expenditures under them cease, [253] while properly accounting for any effects on Export Measures that continue even after expiration of the program, until the SLA itself expires.

2. Whether to Include Benefits and Effects That Occur After the Expiration of the Softwood Lumber Agreement

221. The previous section considered programs that are scheduled to terminate prior to the expiration of the SLA. But Professor Topel's permanent case, endorsed by the United States, raises additional issues. Professor Topel in his permanent case, assumes that the Tribunal should require adjustments to compensate for benefits that he presumes will be provided and effects that he presumes will occur *after* the expiration of the SLA.

222. By advancing Professor Topel's "permanent" case, the United States demands that benefits received after the SLA expires be included in the remedy calculation of this Tribunal. This U.S. position really involves two questions. First, should adjustments compensate for the reduction or offset of Export Measures caused

[253] Tr. vol. 3, 756:3-5. Professor Topel acknowledged this approach, stating that "The other big one that I think Professor Kalt did, and he was upfront about doing it, is that he sunsetted the programs at their legislative termination." Tr. vol. 4, 1057:13-16. With respect to the Ontario Roads program (which does not have an expiration date), Professor Kalt did not calculate a remedy past 2014 because while the program may continue past this date, "after the expiration of the SLA there would be no SLA to circumvent." Tr. vol. 4, 757:7-9.

by benefits conferred by Canada *after* the expiration of the SLA?[254] Second, regardless whether *benefits* provided post-expiration are covered, should the increased export taxes compensate for effects of benefits that occur *after* expiration, if the benefits were provided before the SLA expired.[255] Canada respectfully submits the inclusion of either type of benefit in the remedy calculation is inconsistent with the text of the SLA; and it is inconsistent with Article 70 of the Vienna Convention principle that termination of a treaty "releases the parties from any obligation further to perform the treaty."[256]

223. The first U.S. claim is truly astonishing. In the context of an anticircumvention claim, the breach requiring a remedy is "action to circumvent or offset the commitments under the SLA 2006, including any action having the effect of reducing or offsetting the Export Measures."[257] Actions that are taken after the expiration of the SLA are taken at a time when there are no "commitments under the SLA." And they cannot "be considered to reduce or offset the Export Measures" since those Export Measures will not be in effect. Indeed, the United States apparently is asking this Tribunal to award relief for government actions that have not been taken, and will be taken, if at all, only after the SLA expires. It is axiomatic that if the Agreement is no longer in effect, the provision of a benefit cannot be a circumvention.

224. The second U.S. claim is more subtle, but no less flawed. The United States believes that the future effects of current Canadian actions – effects that last

[254] Topel Report ¶¶ 43, 48.

[255] U.S. Stmt. of Case ¶ 160, U.S. Rebuttal ¶¶ 177-204, Topel Report ¶¶ 43, 48.

[256] Stmt. of Defence ¶¶ 350-375, 461; Canada Rejoinder ¶¶ 396-437, and Kalt Rebuttal Report ¶¶ 126 (Ex. R-101).

[257] SLA 2006 Art. XVII:1.

years beyond the expiration of the SLA – should be addressed in this Tribunal's remedy calculation. It is not disputed that some types of financial benefits paid out by Canada today – principally benefits that lead to the acquisition of capital assets – will have effects over many years. (An investment's improvements in efficiency are not limited to the moment of the capital investment, but accrue over its life.) The question is: should the Tribunal count the long-term effects of a current program benefit, past the expiration of the SLA? Or should the Tribunal count only those effects of a current program benefit that take place prior to the expiration of the SLA?

225. The Tribunal should reject the U.S. claim. Recall that under Article XVII of the SLA the breach consists in the circumvention of the SLA. Under Article XVII, an action is a breach if it has "the effect of reducing or offsetting the Export Measures." The breach does not consist in the grant or other benefit *per se*, but rather in the *effect* of the grant or other benefit in reducing or offsetting the Export Measures. An offset can only occur while there are Export Measures in place. Effects that occur subsequent to the expiration of the SLA cannot have an effect on the Export Measures, because the Export Measures are no longer in effect.

226. Beyond the plain text of the SLA, the Tribunal should further consider the prospect of Canada suffering punishment twice-over. As long as the SLA is in effect, the United States is prohibited from seeking antidumping or countervailing duties against softwood lumber products from Canada.[258] However, upon the normal expiration of the SLA the United States will be freed from this obligation. After the expiration of the SLA, the U.S. industry will be able to petition for action under U.S. countervailing duty law, including against imported products on account of alleged subsidies that they received

[258] SLA 2006 Art. V(1) (Ex. R-1).

prior to the expiration of the SLA, to the extent that they continue to have a subsidizing effect. Such actions will have to comply with normal U.S. and WTO law, but will not be prohibited by an SLA obligation that no longer exists.

3. Whether Compensatory Adjustments Should Reflect Past Effects

227. The Tribunal must decide whether the SLA provides for a prospective-only remedy, as Canada contends, or if it also provides compensation for the past effects of a breach, as asserted by the United States.

228. As Canada has demonstrated, the United States' position cannot be reconciled with a proper application of the VCLT. The United States asks the Tribunal to read into the SLA words that are not there and ignore other words and provisions that do not support the U.S. interpretation. This is reflected in the strained ordinary meaning the United States attempts to attribute to the word "cure," and its failure to explain the absence of language indicating a retroactive intent in paragraph 22 of Article XIV while such language is used expressly in paragraph 22 and elsewhere in the SLA, the inclusion of a reasonable period of time to cure the breach, and the limitation of the remedy to adjustments to the Export Measures. By contrast, Canada's interpretation conforms with the ordinary meaning of the terms of the treaty, in their context and in light of the object and purpose of the Agreement.

229. The Parties have provided similar dictionary definitions of the word "cure," but dispute the proper inferences to be drawn from these definitions. Canada defines the word "cure" to mean to eliminate or remove and, therefore, interpret the phrase "cure the breach" to mean to eliminate or remove the breach. The United States defines cure to mean "to subdue or remove by remedial means; remedy; remove; and heal." According to the United States, this means that "{t}he ordinary meaning of the term cure

is complete reparation."[259] But none of these words connote a removal, remedy, rectification, or healing of the *past consequences* of whatever is being cured. Instead, this assertion implicitly incorporates the words "the effects of." As Professor Reisman notes, "the ordinary meaning of Section 22 could hardly be clearer; the text says 'cure the breach' and does not say 'cure the effects of the breach.'"[260]

230. The United States also mistakenly argues that "the term 'remove' connotes complete reparation."[261] This is wrong. Chapter 20 of the NAFTA and Article 7.9 of the WTO SCM agreement – two provisions that the United States agrees are prospective-only – use the word "remove" as the remedial action necessary for a breaching Party to comply with a dispute settlement ruling. In both of these examples, a Party "removes" the breach through cessation or termination of the conduct found to be inconsistent with its obligations under the treaty – neither involves the provision of compensation for the past effects of that conduct. The drafters of these agreements, which include both Canada and the United States, understood the word "remove" to have the opposite meaning than what the United States now asserts.

231. The United States also focuses on the word "remedy" in the chaussette to paragraph 23 and the French translation of paragraphs 22 and 23, which use the same word "remedier" in paragraph 23 for "remedy" that is used for the word "cure" in paragraph 22. However, the French word "remedier," which is also used primarily in the context of curing an illness, does not imply compensation for past effects. Instead, this

[259] Tr. vol. 1-A, 80:9-10.

[260] Reisman Report ¶ 33 (Ex. R-102).

[261] Tr. vol. 1-A, 80:23-81:6.

is another attempt by the United States to attribute "full reparation for past and future consequences of" to a word that does not share that meaning.

232. The United States argues that the use of the phrase "has breached" in the chapeau of paragraph 22 indicates that cure and compensatory measures are intended to provide reparations for the past effects of the breach.[262] But the fact that the drafters used that phrase accurately reflects what the Tribunal finds – that the record shows that the Respondent has "breached" the Agreement, based on the record evidence. That fact is an essential prerequisite to the determination of appropriate compensatory adjustments in all cases, but it says nothing about the proper scope of such adjustments, *i.e.*, whether they should address past effects of a breach or only the ongoing effects.

233. The United States also argues that the ordinary meaning of the term "breach" means "the entire breach," which the United States says includes past and future effects of the breach.[263] But Canada is not arguing that it must only partially cure the breach or that the compensation should be in an amount that remedies only part of the breach. Even if the word "entire" were in the SLA text, that would not mean that the entire breach includes its past effects – or its future effects. The breach is the reduction or offset of the Export Measures, not the past effects of that reduction or offset.

234. The United States cannot explain the absence of language expressly conveying a retroactive intent in the language of paragraph 22 of Article XIV, which is meaningful, especially when contrasted to other provisions of the SLA that contain such

[262] "Canada's view that the United States is not entitled to a remedy if Canada simply ceases to continue the breach beyond the cure period requires the use of the phrase 'has breached' to be replaced with 'is breaching,' and this is not permissible." Tr. vol. 1-A, 79:4-8.

[263] Tr. vol. 1, 77:4-10; U.S. Reply ¶ 191.

express language. Canada has highlighted paragraph 32 of Article XIV as a significant example in this respect. The United States argues that the word "retroactive" in paragraph 32 is used only to indicate at what point in the past compensatory measures should commence[264] and that the use of the word was not necessary because it was "obvious" that the provision was retroactive.[265] But this only supports Canada's point – the retroactive intent in paragraph 32 is indeed obvious, not just in the use of the word "retroactive", but with equal clarity in the language of the chapeau of paragraph 32 and in subparagraph 32(b). If the Parties intended for the compensatory adjustments under paragraph 22(b) to compensate for past effects, they would have used language expressly stating that intent as they did in paragraph 32.

235. The United States is forced to even greater contortions to try to make its objectives fit within the SLA's rules concerning the reasonable period of time to cure the breach. The provision of a "reasonable period of time" is a concept taken directly from the WTO and the NAFTA and makes sense only if curing the breach has its ordinary meaning of ceasing or removing the breach. Its purpose is to allow the breaching Party time to cease the breach and thereby avoid any countermeasures.

236. Such a short period of time would hardly have been chosen if the drafters had contemplated anything other than cessation of the breach because it would be improbable that a party could provide full reparation for the past consequences of a breach, in addition to ceasing the breach, within a period of only 30 days. The United States acknowledges that "there are certain and probably many situations, particularly in

[264] U.S. Reply ¶ 189.

[265] U.S. Reply ¶ 189.

this arbitration, where it would not be feasible to complete a cure within the 30 days,"[266] but argues that "it's not necessary that the breaching party actually have completed a cure but it's enough to simply put into place the measures that will eventually cure the breach during those 30 days."[267] But the text of the Agreement, as written, cannot be read to suggest merely the "initiation" or "beginning" of a cure within the reasonable period of time.[268]

237. The United States also struggles to reconcile its interpretation of Article XIV with the drafter's limitation of remedy to adjustments to trade measures. In the case of an uncured breach by Canada, paragraph 23 provides that the only form of compensation that the Tribunal may order is an adjustment to the export charges or export quotas imposed by Canada alone. As Professor Kalt explained, export restrictions are a clumsy and inaccurate way to try to provide compensation for past harms and the use of future adjustments to Export Measures to compensate for the past effects of a breach would have an erratic and distortive effect on market conditions. The United States incorrectly argues that the same problem exists if Export Measures are used to compensate for future harms. There is no distortion where the adjustments are limited to offsetting the effect of a continued breach because it counterbalances the distortion that would be caused by the uncured breach. This is why adjustments to trade measures are well suited to encouraging prospective compliance and are routinely used as a remedy in prospective remedy systems.

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[266] Tr. vol. 5, 1173:10-13.

[267] Tr. vol. 5, 1173:15-19.

[268] If the U.S. interpretation of the cure period were intended by the drafters, the text would have indicated that compensatory measures could be imposed only if Canada failed to "institute measures that will cure the breach" and impose compensatory adjustments.

238. The United States claims that Canada has offered no explanation as to why, if the Parties had intended a prospective-only relief framework like the WTO and NAFTA Chapter 20, they did not adopt the same language used in those agreements.[269] In fact, Canada responded at length to this question in its Rejoinder, and demonstrated that notwithstanding the lack of identical language (even between the WTO and NAFTA Chapter 20), the structural and substantive similarities between the three agreements indicate that the SLA was modeled after the prospective dispute settlement systems of the WTO and NAFTA.[270]

239. Conversely, it seems fair to point out that the United States has offered no persuasive response to the same question applied to its position. Given the Parties' "intimate familiarity" with the language both of acknowledged retrospective remedy regimes, such as NAFTA Article 1135, and customary international law principles as reflected in Article 31 of the ILC Articles, why did they "consciously avoid" the use of the words "damages," "full reparations," or "restitution," any or all of which "would have clearly conveyed" the retrospective meaning the United States claims the Parties intended?[271] The SLA contains none of this language, nor does it bear any similarity whatsoever to the retrospective remedy regimes in typical bilateral investment treaties or commercial contracts.

240. If compensation for the past effects of a breach were intended, the drafters would have provided for monetary damages. As noted by Professor Reisman,

[269] Tr. vol. 1, 90-90.

[270] Canada Rejoinder ¶¶ 427-433.

[271] Tr. 90-91.

> {i}f the SLA intended to provide for reparation, as understood under Customary International Law, namely reparation for injury already caused by the breach, it is reasonable to assume that the Parties, both of which are seasoned international actors with extensive experience in the conclusion of international agreements, would have crafted more effective mechanisms for reparation.[272]

241. Cash compensation is generally the most efficient compensation where the intent is to compensate for past harms and is the normal method of compensation in dispute settlement systems that provide full reparation. This is the method of compensation in the investor-state arbitrations typical of bilateral investment treaties and in NAFTA Chapter 11. In those types of systems, the cash compensation is paid by the Respondent to the Claimant – the cash is certainly not collected and retained by the Respondent.

242. Concluding that the remedy regime set forth in the SLA is prospective only does not, as the United States continually asserts, deprive it of a remedy where a beach of the SLA has been found. It simply means that the *scope* of the remedy the United States obtains under the SLA, similar to the remedies available under the WTO and Chapter 20 of the NAFTA, is *limited* to the cessation of the violation within a reasonable period of time, accompanied by the authorization for countermeasures if Canada fails to cease the breaching conduct within that period. This outcome is the *norm* in regimes governing international trade, and there is nothing in the language, context or object and purpose of the SLA – which the United States itself has properly characterized as a trade agreement[273] – that suggests the prospective-only nature of

[272] Reisman Report ¶ 38 (Ex. R-102).

[273] Rejoinder ¶ 437 n.431.

remedies under the SLA is any less valid or appropriate than the remedies under these other regimes to which the United States is a party.

243. The Tribunal's decision on this issue of whether the SLA provides for a prospective-only remedy will impact how the compensatory adjustments are to be applied. If the Tribunal agrees with Canada's interpretation, the economic experts should be directed to calculate a compensatory adjustment that offsets only the effects of a program occurring after the reasonable period of time. To the extent that the Tribunal disagrees with Canada and finds that the compensatory adjustment should also account for the past effects of a breach, a reasonable method would be to estimate the total economic effect that the program had on the Export Measures during the period before the reasonable period of time, which can be measured in terms of lost producer surplus, and increase the compensatory adjustment by an amount that would return this lost producer surplus over the life of the Agreement.

244. Concluding that the remedy regime set forth in the SLA is prospective only does not, as the United States continually asserts, deprive it of a remedy where a breach of the SLA has been found. It simply means that the *scope* of the remedy the United States obtains under the SLA, similar to the remedies available under the WTO and Chapter 20 of the NAFTA, is *limited* to the cessation of the violation within a reasonable period of time, accompanied by the authorization for countermeasures if Canada fails to cease the breaching conduct within that period. This outcome is the *norm* in regimes governing international trade, and there is nothing in the language, context or object and purpose of the SLA – which the United States itself has properly characterized as a trade agreement – that suggests the prospective-only nature of remedies under the SLA is any less valid or appropriate than the remedies under these other regimes to which the United States is a party.

245. The Tribunal's decision on this issue of whether the SLA provides for a prospective-only remedy will impact how the compensatory adjustments are to be applied. If the Tribunal agrees with Canada's interpretation, the economic experts should be directed to calculate a compensatory adjustment that offsets only the effects of a program occurring after the reasonable period of time. To the extent that the Tribunal disagrees with Canada and finds that the compensatory adjustment should also account for the past effects of a breach, a reasonable method would be to estimate the total economic effect that the program had on the Export Measures during the period before the reasonable period of time, which can be measured in terms of lost producer surplus, and increase the compensatory adjustment by an amount that would return this lost producer surplus over the life of the Agreement.

4. Whether Benefits Provided to Pulp and Paper Mills Should Be Considered as Benefits to Softwood Lumber Producers and, if So, in What Amount

246. Under Article XVII(2)(a), only benefits "provided to producers or exporters of Canadian Softwood Lumber" are "considered" to reduce or offset Export Measures. Notwithstanding this limitation, the United States contends that any benefit provided to a producer of pulp or paper should equally be considered to reduce or offset the Export Measures, if the pulp or paper mill to whom the benefit is provided is owned by an entity that also owns a softwood lumber mill. The U.S. theory is that a producer of pulp should be defined for purposes of this provision as a producer of softwood lumber simply by reason of its affiliation with a real softwood lumber producer. On this basis all of the U.S. remedies treat any dollar of benefit provided to a pulp and paper producer with such an affiliation as a benefit to a producer of softwood lumber.

247. Canada has pointed out that this U S interpretation is far-fetched in ordinary parlance, and it is impossible to justify in the context of the SLA and light of the SLA's object and purpose. The ordinary meaning of the terms "provided to producers or exporters of softwood lumber," in this context is plainly to refer to benefits provided on account of the recipient being a producer or exporter of softwood lumber.

248. As Canada explained in its Rejoinder,[274] this ordinary meaning is reinforced by examining the equally authentic French text, which uses the term benefits "spécifiquement destinés" (specifically destined for") producers or exporters of softwood lumber. It is also evident that, if the drafters meant to cover more than softwood lumber producers, they knew how to do so. Safe harbour 2(e) of Article XVII uses the term "forest products industry" when a broader meaning was intended.

249. The context strongly supports Canada's position. The SLA exclusively regulates softwood lumber. The cases terminated or settled by the SLA related exclusively to softwood lumber. Export Measures under the SLA apply exclusively to softwood lumber, and vary exclusively according to market prices for softwood lumber. The U.S. commitment not to take trade actions applies exclusively to softwood lumber. There are no restrictions on either Party in relation to pulp and paper. Canada did not agree to apply any Export Measures on pulp and paper; and the U.S. made no commitment not to apply its trade laws to imports of pulp and paper from Canada.

250. If the Tribunal agrees with Canada that no benefits provided to pulp or paper producers fall as a matter of law within the first sentence of Article XVII(2), that resolves the question. The entire U.S. claim against benefits to pulp and paper

[274] Canada Rejoinder ¶¶ 51-52.

producers was premised on their legal interpretation. On the other hand, if the Tribunal should find that benefits to pulp and paper producers affiliated with softwood lumber producers are within the first sentence of paragraph 2, then the Tribunal still needs to determine the degree of reduction or offset of Export Measures on Softwood Lumber Products that will result from a benefit to pulp and paper producers. The first sentence of paragraph 2 does not create any presumption as to the degree of reduction or offset.

251. Professors Kalt and Topel disagree as to the proper treatment of benefits provided to pulp and paper operations. Professor Topel treats each dollar of benefit provided to the pulp and paper operations as if the dollar was provided to sawmill operations and investments, wherever the pulp mill's corporate family also owns sawmills.[275] Professor Topel thus treats a dollar that is invested in an electrical plant at a pulp mill as if it had been invested in a sawmill. He assumes, in effect, that the pulp mill investment improves saw mill productivity in exactly the same way as a direct investment in sawmill machinery.[276] He does this even where the benefits in question are (1) awarded to a mill that does not produce or export softwood lumber; (2) awarded expressly for the purpose of investment in non-lumber activity; and (3) disbursed only as the mill presents evidence of investment in the non-lumber activity.[277]

252. This is wrong from both a legal and an economic standpoint. From a legal standpoint, benefits provided to pulp and paper operations are not "provided on a *de jure* or *de facto* basis to producers or exporters of Canadian Softwood Lumber

[275] U.S. Reply ¶¶ 227-241; Beck Report ¶¶ 7, 66 (Ex. C-1); Beck Rebuttal ¶¶ 11-31, 67 (Ex. C-43); and Beck Rebuttal ¶¶ 50-98, 118-120 (Ex. C-61).

[276] Topel Report ¶ 21 (Ex. C-2); Topel Response Report at ¶¶ 13-15 (Ex. C-44); and Topel Rejoinder Report ¶¶ 12-15 (Ex. C-62).

[277] Stmt. of Defence ¶¶ 416-423; Canada Rejoinder ¶¶ 552-570.

Products"[278] and therefore do not reduce or offset the Export Measures. Canada demonstrated this point in its Rejoinder,[279] and the United States made no responsive argument in the Hearing. Canada's Rejoinder also showed that the United States has not demonstrated, as it must, that benefits awarded to pulp mills are both cause-in-fact and a proximate cause of an offset of Canada's Export Measures.[280] The United States also failed to confront this legal issue of causation in the Hearing.

253. From an economic standpoint, it is simply wrong to assume that a dollar invested in an electricity plant at a pulp mill will somehow magically have exactly the same effect on lumber production as a dollar invested in a log sorting machine at a sawmill. Professor Kalt analyzed this issue extensively, examining carefully the markets for sawmill byproducts and collecting evidence regarding pulp mill purchasing practices. Neither U.S. witness engaged in any remotely comparable inquiry. Professor Kalt concluded that government benefits to pulp and paper operations produce no meaningful effect on the production and export of softwood lumber.[281] Based on this conclusion, he does not include any benefits received by pulp and paper operations as affecting lumber production and U.S. lumber markets. Canada respectfully asserts that the Tribunal should rule that this is the correct approach.

254. The Hearing testimony laid bare the lack of basis for the U.S. inclusion of pulp mill benefits, as explained in the following paragraphs.

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[278] SLA 2006 Art. XVII:2.

[279] Canada Rejoinder ¶¶ 552-570.

[280] Canada Rejoinder ¶¶ 571-595.

[281] Stmt. of Defence ¶¶ 390, 393, 416-428; Canada Rejoinder ¶¶ 552-595; Kalt Report ¶¶ 57-61, 71, 74-77; Kalt Rebuttal Report ¶¶ 7, 51-72 (Ex. R-101); Kalt Second Rebuttal Report ¶¶ 16-19, 50-56, 69, pages 48-49 (Ex. C-148); Reilly Report at 33-36 (Ex. C-6).

a. Hearing Testimony Demonstrated That Neither the United States nor Its Witnesses Have a Coherent Justification for the Attribution of Pulp Mill Benefits to Softwood Lumber

255. The United States has alleged two alternative arguments why pulp mill benefits should be attributed to softwood lumber producers: first, that benefits to pulp mills strengthen the pulp mill sector, which in turn increases demand for softwood lumber by-products, and thereby somehow helps softwood lumber production, and second, that benefits to pulp mills are somehow diverted to other parts of a corporate enterprise, including softwood lumber mills. There was testimony at the Hearing on both issues. That testimony showed that the United States has failed to advance a coherent justification under either theory for the attribution to softwood lumber of government benefits that are provided to pulp mills.

(1) Testimony Revealed That the U.S. Witnesses Have Made No Factual Investigation of Market Relationships That Even Approaches the Standards the United States Must Meet

256. Mr. Beck testified that he included support provided to certain pulp and paper projects in his calculations in part because pulp mills buy sawmill by-products.[282] As Canada has pointed out in its Rejoinder, to sustain this theory the United States must demonstrate that benefits actually flow to sawmills through some market mechanism, such as an increase in the price of by-products that pulp mills purchase from sawmills.[283] Canada further pointed out that a proper analysis of this would be a complex undertaking – it would involve a review of supply and demand, prices, non-sawmill sources of fiber, upstream competition for timber, and consideration of the ability of

[282] Tr. vol. 2, 437:1-439:21.

[283] Canada Rejoinder ¶¶ 571-595.

sawmills to alter the proportionate output of lumber and by-products.[284] Indeed, that consideration would have to contemplate whether benefits, if they pass at all, might more readily pass from the sawmill to the pulp mill, than vice versa.

257. At the Hearing Mr. Beck was given an opportunity to demonstrate how he had handled these many factors. It was abundantly clear that he had given them no thought whatsoever. Mr. Beck agreed with Mr. Miller that Mr. Beck had undertaken no analysis to determine the degree of interdependence of particular pulp mills with particular saw mills. Mr. Miller then followed up to ask:

> Q: … you didn't go through and do the analysis of how many woodchips from a particular sawmill went to a particular pulp and paper mill; isn't that true?[285]

258. Had Mr. Beck actually conducted a sufficient analysis, he would have pointed to tables in his reports, discussed individual cases, commented on price movements, changes in demand, market conditions, and so on. Instead, he replied:

> A: I looked at aspects of that as a part of a different program, but not as a part – I don't remember that I specifically did that as a part of this project …[286]

259. Mr. Beck tried to defend his lack of analysis by continuing "I did look at every individual, either grant or loan guarantee, that were a part of the two programs from Ontario and looked at the companies, the individual operations that were supported and whether or not they were a part of that, an integrated company."[287] Thus, Mr. Beck

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[284] Canada Rejoinder ¶¶ 571-595; Kalt Rebuttal Report ¶¶ 57-72 (Ex. R-101).

[285] Tr. vol. 2, 439:25-440:3.

[286] Tr. vol. 2, 440:4-7.

[287] Tr. vol. 2, 440:7-12.

admitted that he conducted no analysis of the potential pass-through of benefits in market transactions on an individual company basis. Indeed, had he even made an assessment on a market-wide basis, he would have mentioned it here, but he could not – because he did no such analysis. As his answer demonstrates, he ultimately fell back on corporate ownership as his only justification.[288]

(2) The Hearing Demonstrated Serious Flaws in the U.S. Justification for Allocating Pulp Mill Benefits Within a Corporate Family

260. In addition to disposing of the U.S. theory that benefits pass to sawmills through by-product transactions, the Hearing also revealed the shallowness of the U.S. reliance on corporate relationships between pulp mills and sawmills. In none of the briefing before the Hearing, of course, did the United States offer the Tribunal any actual example of funds for a pulp mill project freeing up money for sawmills. The Hearing revealed that the U.S. methodology for making such attributions is utterly without support, and that the United States' own argument undercuts the contention that funds flow through corporate relationships.

[288] While the issue did not arise at the Hearing, Mr. Beck's analytical failures are also evident when viewed in light of the Ontario Roads Program. Any calculation of relevant benefit provided by the Ontario Roads Program should be determined by taking the applicable total amount of the annual program and multiplying that amount by the proportion of the total harvest dedicated to softwood sawmill operations in Ontario based on actual, verified provincial data. Canada made this calculation. Mr. Beck did not. Rather, Mr. Beck's benefit calculation for this program is substantially inflated because his proportion of total harvest attributable to "Softwood Lumber Producing Companies" includes harvest by pulp and paper mills. Mr. Beck's flawed calculations lead to conclusions in which millions of dollars provided to a company that did not have a sawmill operation in Ontario is included in a benefit calculation in which Mr. Beck attributes to "Softwood Lumber Producing Companies" in Ontario an amount of softwood that exceeds the total scaled softwood harvest in Ontario for the relevant fiscal year. *See* Canada Rejoinder ¶ 569; Kalt Second Rebuttal, Addendum ¶¶ 4-7 (Ex. R-148).

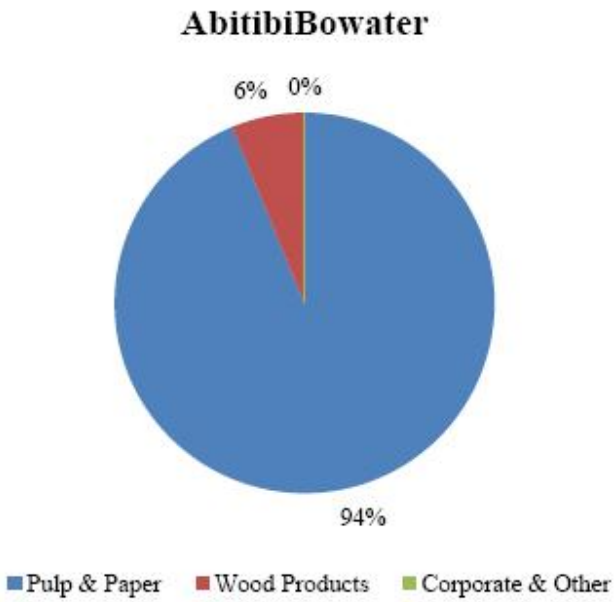
(a) Mr. Beck admitted that he did not consider the fact that sawmill operations constitute a very small percent of operations for several leading companies

261. When Mr. Beck allocated pulp mill benefits to sawmills that are part of the same corporate family, his methodology assumed that every single dollar of benefit was transferred from the pulp mill to sawmills, with all flows being from pulp to saw, and none in the opposite direction, and no flows that involve any other operations of a company. At the Hearing, Mr. Beck was confronted with facts that demonstrate the outrageousness of such a simplistic allocation.

262. As pointed out at the Hearing, there are three major publicly traded companies that operate both sawmills and pulp mills in Ontario or Québec.[289] In each case where Mr. Beck allocated pulp mill benefits to sawmills, he allocated to a company's sawmill operations 100 percent of benefits awarded to a pulp mill operation owned by the company. In the case of AbitibiBowater, Mr. Beck's analysis considered the full amount of benefits provided to pulp mills at Fort Frances ($22.5 million grant for an investment of $84 million) and Thunder Bay ($1.16 million grant for an investment of $11.6 million) in his remedy calculations.[290] At the Hearing, Mr. Miller displayed the following chart, depicting revenue from Abitibi's various operations in 2008.

[289] Tr. vol. 2, 444:9-20. Revenue information is available by product line only for the publicly-trade companies.

[290] Beck Rebuttal II, Table 27 (Revision 2) (Ex. C-61).



263. Mr. Beck admitted that only 6 percent of AbitibiBowater's revenue comes from lumber operations,[291] yet he allocated 100 percent of the benefit received for a pulp mill project to those operations.[292] Mr. Miller also displayed charts representing the breakdown of revenue in 2008 for the two other publicly-traded integrated companies in Eastern Canada, Domtar and Tembec. Despite the consistently low proportion of revenue from lumber operations compared to pulp and paper operations for all three of these integrated companies, Mr. Beck admitted that he nevertheless attributed to sawmills 100 percent of the benefits provided to any integrated company, even when those benefits were expressly directed to pulp mills.[293]

[291] Tr. vol. 2, 443:21-444:3.

[292] Tr. vol. 2, 446:14-25.

[293] Tr. vol. 2, 445:20-24.

264. Under the U.S. theory that pulp mill benefits are deemed to pass through the corporate family, why would they *all* be attributable to operations that are a small fraction of the company's business? And why wouldn't benefits received by sawmills flow to pulp mills? There is no more reason to believe that pulp mill benefits pass to saw mills than vice versa. Even the United States, in the shallow discussion contained in its Reply, offered that "a benefit to one is a benefit to both."[294]

265. In short, the Hearing revealed that the United States has no coherent justification for allocating pulp mills benefits to sawmills because of a corporate relationship.

(b) The United States failed to resolve the direct conflict between the U.S. assertion that pulp mill benefits free up funds for sawmill investment, and the U.S. assertion that investment capital was hard to obtain

266. The United States has not offered a single example of benefits provided to pulp mills actually flowing to sawmills. The only economic justification that the United States has offered is exceedingly simplistic: its statement that "{a}s a matter of simple economics, money is fungible."[295] Yet at the same time the United States has placed great focus on deteriorating credit markets and statements about the unwillingness of banks to lend to forestry companies.[296] These two contentions are directly in conflict. In a time of tight capital, a government incentive that draws a company's funds into a pulp

[294] U.S. Reply ¶ 233.

[295] U.S. Reply ¶ 232.

[296] *See*, e.g., Tr. vol. 2, 499:1-500:12 (where Mr. Beck discusses a memorandum from Québec ministers stating that banks are withdrawing from financing the forestry sector); *see also* Tr. vol. 2, 505:9-506:2 (where Mr. Beck discusses a credit crisis in the Québec forestry sector).

mill project will divert limited capital *away* from sawmills, not vice versa. Yet at the Hearing the United States continued to advocate both points.

267. Mr. Beck, for example, conceded that a company that receives a loan under the Ontario Loan Guarantee Program faces a decreased borrowing capacity to seek other loans.[297] But he never attempted to confront the obvious consequence of that statement: such a loan, if secured for pulp mill investment, would make it more difficult to secure a loan for sawmill investment. On redirect, Mr. Beck spoke at length about the difficulty of access to capital by Canadian lumber companies in the current environment.[298] Again, he seemed not to recognize that this position contradicts the U.S. argument about "fungibility" of funds.

268. In fact, in time of tight credit, a government incentive for a pulp mill project, if it has any effect at all, makes a sawmill project by the same company less likely. As Mr. Reilly testified, the offer of a government grant or loan guarantee for an investment project reduces the company's cost of capital for that project, and makes it more attractive.[299] If that grant or guarantee attaches to a pulp mill project, that makes the pulp investment relatively more attractive than a sawmill project that might be competing for the company's capital. In a time of tight credit, the decision to proceed with the pulp mill project makes the sawmill project that much less likely.

[297] Tr. vol. 2, 479:15-20.

[298] Tr. vol. 2, 497:17-502:1.

[299] Tr. vol. 3, 651:25-652:12.

5. Whether the Value of Government Loans and Loan Guarantees Should Be Calculated According to Standard Practice, or According to Mr. Beck's Methodology

269. The Hearing demonstrated that the U.S. valuation of loans and loan guarantees is unsupported by doctrine or by common sense. The United States claims, in its so-called "low case" remedy, that the entire loan principal amount should be the benefit assigned. This approach greatly exaggerates the benefit.

270. The U.S. methodology treats a loan or a loan guarantee as if it were a grant.[300] The huge gap in this reasoning is that unlike grants, companies must pay loans back, plus interest. Mr. Beck admitted that he did not subtract the liability for the loan in his remedy estimates.[301] Under Mr. Beck's methodology, the entire value of the loan would be shown as an asset on the company balance sheet, with no offsetting liability. This is not only be misleading, it would be illegal from an accounting perspective.

a. Mr. Beck Revealed That He Had No Factual or Doctrinal Support for His Methodology, and That He Used It to Create a Higher Number

271. During the Hearing, Mr. Beck attempted to justify his approach by stating that loan guarantees induced banks to make loans to companies that the banks otherwise would not have made at all.[302] This is wrong in doctrine, and also unsupported by the facts. With respect to the facts, Mr. Beck admitted at the Hearing that he did not make a determination that each and every project supported by loan

[300] Tr. vol. 1-A, 196:25-198:1.

[301] Tr. vol. 2, 433:25-434:5; 467:12-468:10.

[302] Tr. vol. 2, 448:11-12.

guarantees had no commercial financing available.[303] Instead, Mr. Beck stated that he "is quite certain, as I've said, for many or most of the projects, that they would not have received loans."[304] The United States alleges that two loan guarantees made under the Ontario Loan Guarantee Program are in violation of the SLA. Even though there were only two cases to investigate, when probed in cross examination Mr. Beck admitted that he failed to take the time, and "did not see the need," to explore whether alternate financing was available for the two projects.[305]

272. Mr. Beck's testimony at the Hearing also demonstrated that he has no doctrinal support for his methodology. In his first report and during the Hearing, Mr. Beck agreed that the typical way to value the benefit of a loan guarantee to a company would be to compare (1) the total amount the company pays for a loan with a government-provided guarantee to (2) what the company would have paid for a comparable commercial loan on the open market without a guarantee.[306] Mr. Beck had initially claimed that Ontario had not provided the documents necessary to make the appropriate calculations.[307] Canada demonstrated, in its briefs and through Mr. Reilly's reports, that Canada had in fact provided the information necessary to calculate the correct value of a loan guarantee.[308] During the Hearing, Mr. Beck admitted that Canada

[303] Tr. vol. 2, 449:10-16.

[304] Tr. vol. 2, 449:16-18.

[305] Tr. vol. 2, 455:11-12.

[306] Tr. vol. 2, 447:14-448:6. The specific line of questions involved loan guarantees, but is equally applicable to government loans.

[307] Beck Report ¶ 65 (Ex. C-1).

[308] Tr. vol. 3, 641:10-650:23. Stmt. of Defence ¶¶ 207-208.

had in fact provided the documents necessary to appropriately value a loan guarantee.[309]

273. Tellingly, Mr. Beck also revealed his motive for departing from the normal methodology. He found that the correct methodology did not yield a large enough number for his purposes. He stated:

> {F}or example, we talked about the loan guarantees, and I said that the typical way to value those was to look at the interest rate differential. In this case, I have chosen to do something quite different. When I look at the values that I come up with that interest rate differential approach, they are very low, and yet these companies – and many of these – I said many or most of these projects would not have proceeded without the government's support … {t}o value those simply as whether it's the amount of the grants or the interest rate differential seemed to me to be inappropriate, too low.[310]

274. Asked if he could identify *any* doctrinal support for this practice, either in economics, or law or forest management or banking, Mr. Beck could identify none. He merely stated:

> I guess that I would come back to my applying common sense to this. It's not an economic doctrine or a legal doctrine that I'm aware of.[311]

275. Thus, the key U.S. expert witness admitted that he adopted a methodology with no doctrinal support, and did so solely to inflate his results: to prevent that estimate from being "too low".

[309] Tr. vol. 2, 449:21-451:6.

[310] Tr. vol. 2, 467:17-468:10.

[311] Tr. vol. 2, 481:14-17.

b. Mr. Reilly Explained That the U.S. Approach Is Contradicted by the Long-Standing, Accepted Methodology for Government Loans and Loan Guarantee Valuation

276. Mr. Reilly explained that the U.S. approach is contradicted by the accepted approach to the valuation of loans and loan guarantees. Mr. Reilly calculated the market rate for loans that the borrowers could have obtained absent government support, and calculated the difference between interest payments at this market rate and the rate that the company received with the guarantee. Professor Kalt relied on this analysis for establishing the value of the LGP program benefits and the effect of that program on U.S.-Canadian lumber markets.[312]

277. Mr. Reilly stated:

> There is a generally-accepted method that has been accepted by all the courts I'm familiar with in the U.S., not here, but in the U.S., where this issue comes up before the U.S. tax court … {t}here is a generally-accepted method for valuing loan guarantees. There's a generally-accepted method when it comes to all types of international trade disputes for valuing loan guarantees.
>
> I've just never, ever, ever in my career had this disagreement where one party says it's the interest rate differential and the other party says it's the loan principal. I have never seen that … {y}ou could honestly say I don't think your 8 percent alternative cost of capital is right. It should be 8.5 percent. I think I'm right, but there's judgment there. But to extrapolate that to the total amount of the loan, that's just not a generally-accepted methodology. It's just not in any of the courses. It's not in any of the books. It's not in any of the literature. It's a de novo methodology.[313]

278. Mr. Reilly also demonstrated that Mr. Beck's suggestion that banks would not have made loans absent the guarantee reflects Mr. Beck's lack of familiarity with

[312] *See* Kalt Rebuttal ¶ 86 (Ex. R-101); and Kalt Second Rebuttal Report, Appendix Figure C-2 (Ex. R-148).

[313] Tr. vol. 3, 653:24-655:3.

bank regulation. In fact, if the borrower is not worthy of bank credit without a guarantee, a bank would not be permitted to make the loan, irrespective of whether a guarantee were available:

> A bank can't make a loan, even with a government guarantee, unless they think that the debtor is solvent. They have to pass the solvency test, they have to pass the capital adequacy test and they have to pass the cash flow test.
>
> They have to pass three tests before a bank, whether federally chartered or provincially chartered can make a loan. You are willing to make a loan to a less-creditworthy person with a guarantee. You are willing to make a loan at a lower interest rate than the guarantee, but if you thought: I just can't make this loan. This company, you know, has negative cash flow, negative capital, negative equity, negative everything, well, you wouldn't make the loan. You couldn't. I mean, legally you couldn't make the loan even with the guarantee so you wouldn't have a case where there was never any alternative because if the debtor was in that sad of a shape that they couldn't even qualify for venture capital money, the bank couldn't legally make the loan even with the government guarantee.[314]

279. As a result, the primary U.S. justification for the inclusion of total value of the loan as the benefit to softwood lumber companies under the LGP is simply not realistic. The government guarantee may induce banks to make loans at a lower interest rate, but the guarantee could not cause a bank to offer a loan that it otherwise would not have made.

280. Canada notes that even the other U.S. expert, Professor Topel, disagrees with Mr. Beck's *de novo* methodology. Instead, Professor Topel agreed that the appropriate measure of the benefit is the difference between the actual rate that the

[314] Tr. vol. 3, 657:12-658:9.

borrower paid and the market rate that the borrower would have paid absent the government loan or loan guarantee.[315]

6. Whether the Value of a Benefit Is the Amount Provided by the Government, or the Entire Investment Amount

281. The United States claimed, in its "high case" remedy, that the entire amount of an investment should be treated as the value of the benefit, whenever the investment was made with even partial government support.[316] The Hearing demonstrated that there is no justification for the inclusion of full investment amount as the value of the benefit provided to softwood lumber producers under the Challenged Programs.

a. There Is No Justification for Considering Full Investment Amount to Be a Benefit Irrespective of Whether That Investment Was Enabled by Government Support

282. There was considerable testimony at the Hearing on the question of whether specific investments would or would not have been made in the absence of government support. The following section will demonstrate that the United States is in error where it contends that projects would not have proceeded without government support. But Canada respectfully reminds the Tribunal that it need not, and should not, reach this issue. Canada has demonstrated in its briefs that even if a company would not have made an investment unless the transaction had been made more attractive by

[315] Tr. vol. 1-B, 252:1-11. Professor Topel chose to use the loss reserve estimated for the Ontario LGP as the benefit provided under the program, as he believed this amount constituted the amount of subsidy to risk. Canada disagrees with Professor Topel's specific approach, since Mr. Reilly was able to calculate the traditional value of the loan guarantees from the documents on the record, but the fundamental point is that all experts except Mr. Beck oppose the use of principal value of the loan as an estimate of the value of a loan guarantee.

[316] Stmt. of Case ¶¶ 63-66; U.S. Reply ¶¶ 244-247; Beck Report at 54-55, 64-65 (Ex. C-1); Beck Rebuttal Report ¶¶ 32-37 (Ex. C-43); Beck Rebuttal II ¶¶ 7-49 (Ex. C-61).

government support, the company's investment of its own funds or borrowed funds *still* is not a benefit provided by the government. Canada refers the Tribunal to paragraphs 500-530 of its Rejoinder, and paragraphs 407-410 of its Statement of Defence. As a result, there is no justification for a remedy that includes the entire value of an investment, regardless of whether that investment was enabled in any way by government support.

b. All of the Qualified Experts at the Hearing, Including Professor Topel, Disagreed With the U.S. Methodology

283. All of the qualified experts at the Hearing disagreed with this U.S. methodology. Professor Topel considers the additional investment during the time period covered by the SLA, but only the marginal amount of additional investment that has resulted because of any alleged benefits provided by the government.[317] For example, in the Hearing Professor Topel testified that for a $100,000 grant to a softwood lumber producer for a $1 million project, his methodology would value the benefit provided by Ontario as $100,000, even though he understands Mr. Beck would take a different approach, and value the whole $1 million as the benefit.[318] Unlike Mr. Beck, Professor Topel's model does not crudely assume that all investment made with government support was a benefit. Professor Kalt's model also considers only the portion of the additional new capital investment that was actually provided under the Challenged Programs.[319]

[317] Topel Report at 26 (Ex. C-2).

[318] Tr. vol. 1-B, 261:7-10.

[319] Tr. vol. 3, 783:19-787:11.

284. Mr. Reilly supported the view of the two economists, spelling out in pragmatic terms how a company approaches investment on an incremental basis. He testified that in the absence of government support, a company can scale back the size of the project, reprioritize its other investments, or delay the project until the remaining funds are obtained.[320] The government support changes the marginal attractiveness of an investment, and might lead to changes in the amount invested and the timing at which the investment is made, but the mere presence of a government support does not cause the entire investment to be made.

c. The United States Has Failed to Demonstrate That Government Support Caused the Investments to Be Made, Even if Its Approach Were Justified Under the SLA

285. The Hearing revealed that the United States cannot actually establish, as a factual matter, that *any* project would not have gone forward but for government support. Mr. Beck was asked directly by the Tribunal Chair how he identified which projects would not have gone forward without government support. He admitted in his response that he had not conducted a rigorous, case-by-case assessment, saying:

> Again, madam, it was based on some of the things that I – it is a subjective rather than a quantitative analysis.[321]

286. Mr. Beck proceeded to state that there were "many different reasons" that the projects would not have proceeded absent government support, but the only reason he could articulate was his view that they are "high risk."[322]

[320] Tr. vol. 3, 628:9-22; Reilly Surrebuttal Report ¶ 16 (Ex. R-149).

[321] Tr. vol. 2, 468:25-469:2.

[322] Tr. vol. 2, 469:8-9.

287. Even when U.S. counsel tried to repair Mr. Beck's testimony in redirect, the witness was unable to cite to any case-by-case or quantitative analysis he had undertaken. Despite guidance from counsel, Mr. Beck could base his opinion only on company press statements (in actuality, corporate "thank-you notes") and a subjective impression of market conditions.[323] Professor Kalt explained that these corporate statements are political in nature and unreliable for the purpose used.[324] They are no substitute for an examination of the actual facts surrounding the specific investments at issue in this proceeding. Mr. Reilly testified that there are two types of evidence that the Tribunal can consider in this case, the forensic accounting evidence of real documents that were reviewed and relied upon by Mr. Reilly, or the self-serving press releases and public announcements made by government officials and company executives.[325] The Hearing made clear that the United States relies only on the latter evidence, and conducted no independent inquiry into whether these statements are supported by the facts in this proceeding.

288. Further, as the Tribunal Chair correctly noted during the Hearing,[326] Mr. Beck failed to explain how his conclusion is justified in light of the facts surrounding the projects at issue. For example, Mr. Beck did not dispute that commercial lenders such as **[ ]** undertake a detailed risk analysis before making a decision to loan to a softwood lumber company such as **[.]**[327] Mr. Beck

[323] Tr. vol. 2, 497-98.

[324] Tr. vol. 3, 797-805.

[325] Tr. vol. 3, 560:19-562:9.

[326] Tr. vol. 2, 469:15-471:13.

[327] Tr. vol. 2, 470:2-14.

claimed that specific example was a "different situation," but still included the total investment amount in his calculations despite strong evidence that an objective third-party did not view the project as high risk.[328] The simple fact is that neither the United States nor Mr. Beck undertook a sufficient analysis of the facts.

d. Mr. Reilly Demonstrated the Range of Alternative Financing Available to Support the Investment Projects

289. Mr. Reilly demonstrated extensive experience in project finance, including experience with forestry companies, and discussed the wide range of alternative financing options available to softwood lumber producers to support proposed investments. Relying on that experience and on the strength of a quantitative, case-by-case analysis, he explained that each one of the Ontario projects that he reviewed could have gone forward without government support. The companies would have been able to obtain financing to carry out these projects as a result of the profitability projections for each project.[329]

290. Mr. Reilly's testimony disproved the only premise for the U.S. methodology. He explained that a contraction in commercial bank lending to the lumber sector did not preclude lumber companies from commercial financing for lumber projects. This revealed a central flaw in the U.S. argument: the United States and its witnesses failed to distinguish general corporate lending by commercial banks, on the one hand, from project financing. The statements of executives and other evidence

[328] Mr. Beck in fact gave a very misleading response to the Tribunal Chair. Mr. Beck suggested **[ ]** received special treatment because it was a part of the **[ ]** corporate family. Tr. vol. 3, 607:1-611:2. In fact, that was not the case. Mr. Reilly testified, based on his review of the underlying documents, that lenders to **[ ]** had no recourse to other assets or operations of the **[ ]** corporate family. Mr. Beck gave no indication at the Hearing that he was familiar with those documents.

[329] Tr. vol. 3, 544:16-546:13.

relied upon by the United States to show tight credit conditions[330] thus was shown to be largely irrelevant, because it was focused on the wrong question. The issue is not whether commercial banks would offer general corporate loans to companies in the forestry sector. This issue is whether a project could be financed by *any* of the large number of project finance options available in the marketplace. To answer that question the Tribunal must focus less on general corporate profitability and creditworthiness, and more on the terms of specific projects. Mr. Reilly, in contrast to Mr. Beck, performed just such an analysis.

291. Project financing is secured only by the assets of a specific project. As the United States recognized, in project financing the lender would have a security interest in the equipment purchased for the a specific project, such as an electricity co-generation facility.[331] Financing provided in support of a project is paid back by the income of the project to which support was provided.[332] Mr. Reilly has assisted companies in obtaining project financing through finance company loans, private debt funds, venture capital funds, and other alternative financing options.[333] Mr. Reilly's project profitability analysis (or "hurdle rate" analysis) focused on the type of information that these project financing sources would review; namely, on the profitability of the specific project at issue.[334]

[330] Tr. vol. 2, 499:1-506:12; U.S. Reply ¶¶ 219-20; Beck Report at 68-70 (Ex. C-1).

[331] Tr. vol. 3, 598:19-599:3.

[332] Tr. vol. 3, 548:4-7.

[333] Tr. vol. 3, 548:10-17.

[334] Tr. vol. 3, 551:15-24; Reilly Report ¶ 49 (Ex. R-6).

292. As a result, the Hearing demonstrated that the question whether a project could attract financing turns on the specific characteristics of the project. It turns much less on either the general commercial financing conditions, or the overall financial posture of a company. Therefore, deteriorating commercial lending conditions in the forestry sector – the lynchpin of the U.S. argument[335] – does not drive the availability of financing for profitable lumber projects.

293. Mr. Reilly's project profitability analysis demonstrated that every one of the lumber projects at issue have returns on investment that exceed the general hurdle rate for forest sector companies. Attempts by counsel for the United States to challenge his methodology were completely unsuccessful.[336] These projects therefore would have been able to receive support from project financing sources even in the absence of government support.[337]

[335] Tr. vol. 2, 497-508; U.S. Reply ¶¶ 222-26.

[336] When the United States attempted to criticize Mr. Reilly's analysis for not considering the overall financial position of the company, Mr. Reilly testified that his analysis focused on specific project financing, rather than general corporate finance of the type normally undertaken by commercial banks. Accordingly, his analysis focused "entirely on the project, the project returns and the project financeability," all of which were rooted in the documents to the case. Tr. 551. Mr. Reilly's analysis determined that all of the projects were profitable enough to have attracted some form of project financing, and the United States did nothing in the Hearing to undermine that conclusion.

[337] It should be noted that Mr. Beck himself relied on Mr. Reilly's project profitability analysis during his testimony to claim that projects would have benefits to the company beyond interest payments on loans. Tr. vol. 2, 480:25-481:6; 514:11-19. While Mr. Beck relied on this analysis in an attempt to justify that the benefits to a company are greater than the value of government support, he apparently did not recognize that in so doing he conceded that the projects at issue were in fact profitable projects. Profitable projects will attract financing, with or without government support.

ANNEX I

ADDITIONAL DECISION-POINTS FOR CALCULATING COMPENSATORY ADJUSTMENTS

1. Part III(B) of this post-hearing brief sets out the six most important issues that the Tribunal needs to resolve, if it finds that any of the challenged Canadian programs breach the SLA, in order to determine the appropriate adjustments to export measures to compensate for the breach. Beyond those key issues, there are certain program-specific issues of lesser consequence regarding the level of benefit that the Tribunal will also need to decide, depending on its decisions on liability. These are listed here.

1. Modeling and Program-Specific Issues

2. Specific questions arise from the limited differences in the U.S. and Canadian calculations of benefits and economic models. First, Professor Topel's derivations of benefit amounts are much less detailed than, and usually different from, those of Professor Kalt. Professor Topel omits many elements included by Professor Kalt in determining benefit levels.[1] For example, Professor Topel assumes that the benefit levels from each program remain the same every year. Second, Professor Kalt and Mr. Beck disagree on a number of program-specific calculations of benefits conferred. As a result, the benefit amounts differ among Kalt, Topel, and Beck. Precise calculation of the effect of the programs requires that the program-specific benefit amounts be specified.

[1] Compare Topel Second Rebuttal Report, Appendix D (Ex.C -2) to Kalt Second Rebuttal Report, Appendix Figures A-1 to A-6, B-1, and C-1 to C-7 (Ex. R-148).

2. Whether any compensatory adjustments should be determined separately for Ontario and Quebec?

3. The United States' most recent so-called low and high cases treat the Regions separately and indicate separate tax rates for each Region. Canada and Professor Kalt also treat Ontario and Québec as separate Regions and calculate the compensatory adjustment for each specific Region based on the economic effects of the programs in that region. Professor Topel's calculation, however, treats Ontario and Québec as a single Region and calculates a single export tax rate based on an average of the programs.[2] The Tribunal, therefore, must determine whether one compensatory adjustment will be applied to both Ontario and Québec or if two separate compensatory adjustments will apply.

4. In its Statement of Defence and Rebuttal Memorial, Canada explained in detail why the U.S. request for a single compensatory adjustment was inconsistent with the Tribunal's mandate in Article XIV(25).[3] To summarize Canada's argument, Article XIV(25) directs the Tribunal to determine a Region-specific compensatory adjustment where a breach is attributable to a specific Region. Ontario and Québec are defined as distinct Regions in Article XXI(45) of the SLA. Article XIV(25), when read in conjunction with Article XXI(45) mandates that in the case of a breach attributable to Ontario or Québec, it shall determine a compensatory adjustment applicable to Ontario or Québec – not Ontario and Québec.

[2] Stmt. of Case ¶¶ 158; U.S. Reply ¶¶ 209, n.70, 277; Topel Report ¶¶ 38, 49, 54 (Ex. C-2); Topel Response Report ¶¶ 25-26 (Ex. C-44); Topel Rejoinder Report ¶ 8 (Ex. C-62).

[3] Stmt. of Defence ¶¶ 384-388; Canada Rejoinder ¶¶ 473-483, 634-635; Kalt Rebuttal Report ¶¶ 111-116, 118 (Ex. R-101).

5. In this dispute, we are dealing with programs of Ontario and programs of Québec. Any benefits provided under the programs are provided to producers in the province. Accordingly, if the Tribunal finds that one of the challenged programs constitutes a breach of the SLA, the compensatory adjustment it identifies must be imposed only on that particular Region to which the breach is attributable.

6. Additionally, it is possible that Ontario and Québec, being found liable on the basis of different programs, may cure the breaches for which they are respectively responsible at different times. Because compensatory adjustments ordered to remedy a breach will have to remain in place until the breach is cured in whole or in part, treating the two provinces as a single region risks subjecting either province to compensatory adjustments that extend beyond the time when that province cures the breach attributable to its programs.

3. What is the appropriate market-based method and interest rates to value the loan guarantees provided under the Ontario LGP?

7. The U.S. and Canadian economic experts used similar but slightly divergent ways to measure the amount of the benefit provided under the Ontario LGP through loan guarantees. As described in Part III B, Canada applies the standard market-based valuation. To value for government lending and loan guarantees, the standard market-based valuation requires the identification of the cost of financing that would have been available to the recipients but-for the government program. Professor Topel does not apply the standard market valuation method and, instead, uses the total expected loan loss as a measure of the market value of the loan guarantees.[4] He

[4] Assuming perfect capital markets, the expected loan loss would be related to the reduction in interest rate charged. His benefit value assumes that all guarantees under the program provide an incentive for additional investment in lumber production.

determines the annual benefit level by dividing the total expected loan loss by the statutory life of the program. That result is not as accurate as the standard method that Canada applied. Canada's expert Mr. Reilly analyzed each loan guarantee provided by Ontario's LGP with respect to a sawmill project, identified the relevant alternative market-based cost of funds, and calculated the total difference in value that results.[5] Professor Kalt relies on this analysis for establishing the value and timing of the LGP program benefits and the effect of that program on U.S.-Canadian lumber markets.[6] The Tribunal should direct that the standard method, as applied by Canada, should be used.

4. How should the level of benefits provided under the Ontario Roads program be determined?

8. The Parties dispute the relevant value of any benefits under the Ontario Roads program. To resolve the dispute, the Tribunal must resolve two areas of difference between the Parties. First, Professor Topel attributes the entire amount of benefit to lumber producers from the Roads program to softwood lumber, while Professor Kalt and, to some extent, Mr. Beck, eliminate that proportion of harvest that is hardwood rather than softwood. Second, the experts employ slightly different treatment of road activity and reimbursements that occurred on or after the effective date of the SLA (October 12, 2006).

9. Both Professor Kalt and Mr. Beck agree that to the extent the reimbursement applies to roads that support hardwood harvests, these benefits are not a benefit to softwood lumber production. They also both agree that the benefit level

[5] Stmt. of Defence ¶ 439; Reilly Report ¶¶ 40-46 and Exhibit 2 at 24 (Ex. R-6).

[6] *See* Kalt Rebuttal Report ¶ 86 (Ex. R-101); Kalt Second Rebuttal Report, Appendix Figure C-2 (Ex. R-148).

includes only those actions occurring after the effective date for the SLA. They disagree, however, as to which adjustments are proper in relation to the entry into force of the SLA. Professor Topel, by contrast, appears not to adjust for the hardwood harvest or the effective date timing issue, as Beck and Kalt do. (He also does not adjust for administrative costs.) Instead, Professor Topel appears to treat the full budgeted $47 million as the benefit in every year.

10. With respect to the elimination of benefits resulting from the proportion of the harvest that is hardwood, Mr. Beck and Professor Kalt use slightly different data sources that result in very minor differences in the results. As a result, the amount of softwood Beck attributes to sawmills and affiliated pulp and paper *exceeds* the total softwood harvest. The benefit level resulting from Mr. Beck's calculation is necessarily too high.[7]

11. With regard to the initial year's timing, Mr. Beck calculates the benefit provided by the Ontario Roads program based on whether certain paperwork regarding the credit was received by the Ontario Ministry after October 12, 2006.[8] If it was, Mr. Beck included the reimbursement in his benefit calculation.

12. Professor Kalt looks to the date that the actual eligible road construction and maintenance work was completed.[9] If the work was completed prior to October 12, 2006, the reimbursement is not included in the benefits. If completed after that date, the

[7] Kalt Second Rebuttal Report at 48-49, Addendum Figure 1 (Ex. R-148).

[8] Beck Report at 72-73, Table 28 (Ex. C-2); Beck Rebuttal Report ¶ 66 (Ex. C-43); Beck Rebuttal II ¶¶ 102-103, 112-117 (Ex. C-61).

[9] Stmt. of Defence ¶¶ 441-446; Canada Rejoinder ¶¶ 492-494, 614-617; Kalt Report ¶ 78, n.74 (Ex. R-2); Kalt Rebuttal Report ¶¶ 87-89, Appendix A-3, C-3 (Ex. R-101); Kalt Second Rebuttal Report at 50-51, Appendix Figure A-3 (Revised) (Ex. R-148).

reimbursement for those road construction and maintenance activities are included. This is the more reasonable approach because the availability of the credit is dependent upon the completion of the construction work, not the timing of paperwork.

5. Whether to treat benefits for road construction as reducing the cost of capital for softwood lumber production, or as reducing the delivered costs of logs to softwood lumber producers?

13. Professors Kalt and Topel differ in their treatment of how benefits for road construction affect the lumber production process. As Canada has previously explained, benefits for road construction are provided with respect to logging activities – not lumber production. But logs are the primary input to lumber production and therefore benefits to logging may affect the quantity of lumber produced.

14. Professor Topel adopts an approach that commingles labor and capital used in logging with that used in the operation of sawmills. In Professor Topel's approach, lumber is the result of using capital and labor with an input "wood" that he defines as "raw wood inputs produced by the logging sector." It is clear by the discrepancy in the parameters used by Professor Topel that what he refers to as "raw wood input" is not a recognized product and is not the same as a "log" produced by the logging sector used in lumber production. Professor Topel has provided no support or evidence (because there is none) that such an approach has ever been used previously to model economically lumber production.

15. Professor Kalt models lumber production as the result of using capital and labor to convert logs delivered to the mill into lumber. This approach follows the standard methods used by economists for analyzing and describing lumber production.[10]

[10] *See* Kalt Report ¶¶ 152-155 and Figure 7 (Ex. R-2); Kalt Second Rebuttal Report, Appendix Figure C-8 (Revised) (Ex. R-148).

As a result, programs that provide benefits in the forests, upstream of sawmills, are treated as affecting costs of logs delivered to the mill. The Tribunal accordingly should direct that Professor Kalt's standard approach be used.

6. Based on the record presented by the Parties and before the Tribunal, what are the appropriate market-based interest rates to value the loans provided under Québec's PSIF?

16. To determine whether a government loan provides a benefit to the recipient, the accepted methodology under all trade laws, and in the financial, accounting, tax, and investment banking industries requires the identification of the cost of financing that would have been available to the recipients in the commercial market but-for the government program. With respect to the PSIF program, the United States provides no alternative for valuing the PSIF loans based on a market standard. Mr. Beck acknowledges that the loans were provided at commercial interest rates.[11] Professor Topel does not attempt to value the PSIF loans but rather assumes that the PSIF loans had a direct effect on capital used in lumber production.[12] While Professor Kalt has not determined the relevant market-based interest rates, he does show the effects of assuming various hypothetical interest rate differentials for PSIF loans as compared to the rates charged by the government of Québec.[13]

[11] Beck Rebuttal II ¶ 34 (Ex. C-61).

[12] Topel Response Report ¶ 35 (Ex. C-44).

[13] Kalt Second Rebuttal Report ¶¶ 99-101 (Ex. R-148); Kalt Rebuttal Report ¶ 95 (Ex. R-101).

7. Should any benefit associated with loans provided to SLA-exempt sawmills and entities that are not producers of softwood lumber be excluded from the remedy calculation?

17. As Canada has previously explained, Québec's PSIF program provided loans to entities that are specifically excluded from the Export Measures under the terms of the SLA and to entities that do not produce or export softwood lumber. If the PSIF is found to provide loans at a rate that provides a measurable benefit to such an excluded producer or entity, should those benefits be considered to offset or reduce the Export Measures?

18. The United States and Mr. Beck include loans made to SLA-exempt sawmills and to entities that are not producers of softwood lumber in its determination of PSIF beneficiaries.[14] Professor Topel does not distinguish among any PSIF program recipients.

19. Canada and Professor Kalt do not include loans made to SLA-exempt sawmills and to entities that are not producers of softwood lumber.[15] Benefits provided to companies that are either exempt from the SLA or that do not produce softwood lumber should not be included in a benefit calculation because, by definition, they are not producers of Canadian Softwood Lumber Products and, therefore, cannot offset or reduce the SLA's Export Measures.

[14] Beck Rebuttal II ¶¶ 99-101 (Ex. C-61).

[15] Kalt Second Rebuttal Report ¶¶14-15 (Ex. R-148).

8. To determine the benefit for the Québec Capital Tax Credit, should the value of the credit to investors be reduced to adjust for the inability of investors to utilize the credit?

20. The United States argues that the Québec Capital Tax Credit benefits softwood lumber producers by reducing costs and improving competitiveness and treats the credit as a dollar-for-dollar offset against the Capital Tax.[16] Canada considers that this U.S. premise is incorrect. The economic benefit provided by the Capital Tax Credit equals the amount by which the additional credit for the forest sector reduced actual capital tax payments for softwood lumber producers. To properly calculate the benefit the Tribunal must take into account two critical factors: (1) the non-refundable nature of the tax credit; and (2) the elimination of the capital tax for manufacturers in 2008.

21. The Capital Tax Credit was not refundable against the Québec capital tax base against which it was to be applied. As such, any amount of the credit that was unused by a taxpayer could either be carried forward to the following year, or would be lost by the taxpayer. In those circumstances, the reduction in tax payments would be less than the amount of the credits claimed. The amount of the gross credit attributed to the taxpayer in that case must be reduced by the amount of the credit left unused. The adjustment must also be made where the non-refundable credit is left unused due to the elimination of the underlying capital tax.

22. Professor Kalt incorporates these characteristics in his calculation of the economic benefit provided as a result of the Québec Capital Tax Credit. Mr. Beck and Professor Topel apparently count as a benefit amounts that were not and cannot be

[16] Beck Rebuttal II ¶ 34 (Ex. C-61).

used as a credit because of the "use or lose" rule. The Tribunal should find that Professor Kalt is correct in deducting amounts that were not and cannot be used.[17]

[17] Kalt Second Rebuttal Report ¶¶ 48-50 (Ex. R-148); Kalt Rebuttal Report ¶ 26 (Ex. R-101); Canada Rejoinder ¶¶ 238-50; Stmt. of Defence ¶¶ 208-11; Trottier Statement ¶¶ 8-11 (Ex. R-4).

ANNEX II

HOW PROFESSOR KALT DETERMINED THE APPROPRIATE COMPENSATORY ADJUSTMENTS

1. During the Hearing, the Tribunal asked Professor Kalt to explain the steps he had taken to determine the compensatory adjustments that should apply if the Tribunal finds one or more of the challenged programs circumvent the SLA.[1] This section elaborates on the explanation provided by Professor Kalt as to how he determined compensatory adjustments, noting where, to the best of Canada's knowledge, Professor Topel agrees or disagrees with Professor Kalt's determinations and methodology. Professor Topel did not provide full details on his methodology, but Professor Kalt testified that he was able to recreate Professor Topel's model to produce results that were not substantially different from those of Professor Topel.

2. Professor Kalt's assignment in this proceeding was to analyze the economic effect of the programs, based on the assumption, contrary to Canada's position that, except as noted, each of the challenged programs provided benefits to softwood lumber producers that did not fall within any safe harbour and breached Article XVII(1) of the Agreement.[2] This involved four steps:

- Determine the level of benefits provided, if any, to producers or exporters of softwood lumber from Québec and Ontario.

[1] Tr. vol. 4-A, 960:19-963:11.

[2] Exceptions are (a) Excluding the FY2005-06 level of funding ($28 million) for the Ontario roads program; (b) excluding the pre-existing 40 percent roads tax credit from the 90 percent roads tax credit under the Québec FMM; (c) exclusion of any benefit level for Québec's PSIF because the United States presented no evidence that any PSIF loans provide a benefit to SWL producers or exporters (d) exclusion of the $135 million portion of Québec's silviculture program and not counting all of the 75 million horticulture.

- Determine the level of increased softwood lumber exports, if any, from Québec and Ontario as a result of program benefits.

- Determine the extent, if any, to which any increase in exports caused a decrease in the softwood lumber price received by U.S. producers.[3]

- Calculate the export tax that would fully offset this decrease in softwood lumber price.

3. These steps paralleled the steps taken by Professor Topel, whose model Professor Kalt assessed and recreated, correcting for errors in the level and duration of benefits used by Professor Topel and for shortcomings in the model itself.[4]

1. Determining the Level of Benefits Provided

a. Benefit Dollar Amounts

4. Professor Kalt calculated the benefits that Canada asked that he assume were provided, by determining the dollar amount on an annual basis that softwood lumber producers received from the program that they would not have received if the programs did not exist.

5. In doing so Professor Kalt applied the following well-established economic principles of valuation:

- For grant programs, he assumed that the amount of the benefit was the full amount of the grant.

[3] Kalt Report ¶ 9 (Ex. R-2).

[4] Topel Report ¶ 2 (Ex. C-2).

- For loan guarantee and loan programs, he determined, in accordance with customary practice and sound economics, that the amount of the benefit was the difference between what the recipient would have paid without the guarantee and what was actually paid with the guarantee, or what the recipient would have paid for the loan on the competitive open market as compared to the interest rate paid for the government loan.[5]

6. Annual program benefits were determined year-by-year for each program based on when these benefits had been or were likely to be provided. For programs limited in time or amount, he assumed that the government would provide no further benefits beyond those limits; however, for subsidies to capital, he assumes that the subsidy will continue to affect output and ultimately U.S. producers for a period after the benefit is granted.

7. Professor Topel follows a similar strategy in first calculating benefit amounts. He values grants as the amount of the grant and loan guarantees based on the expected loan losses. Professor Topel, however, appears to ignore year-to-year differences in the level of benefit provided, program termination dates, and consequently, limits imposed by program budgets. Professor Topel treats the programs as though they all cease at once or, alternatively, never cease. Professor Topel also includes all benefits regardless of whether they go to softwood lumber producers, pulp and paper producers, or another forest product industry.

[5] As noted, Professor Kalt assumed that PSIF provided no benefits, since the United States provided no evidence of any PSIF loans provided at below market rates.

b. Capital Investment v. Delivered Log Costs

8. Professor Kalt classifies the benefits into two categories: (1) those that lower the cost of the purchase of new capital equipment, and (2) those that lower the price for the delivered logs that softwood sawmills purchase. The second category includes all those programs where any benefit provided is to timber harvesters, generally by relieving them of some cost they had previously assumed. Such benefits are a benefit to Softwood Lumber producers to the extent that they lower the cost of logs that the softwood lumber producers must purchase from the harvesters. Unlike a capital loan, grant, or tax credit used to install new productive capital equipment, a reduction in the cost of a logs delivered to a sawmill does not increase the productive capacity of a mill. This differs from Professor Topel who treated most benefits as lowering the cost of purchasing new capital equipment.

c. Annual Benefit Rate

9. Professor Kalt (and Professor Topel) converted dollar benefit amounts into annual benefit percentage rates by dividing the net dollar amount of benefit by the base activity, relative to the type of benefit provided. The bases for these percentages differ depending on the classification of benefit as a capital investment benefit or a delivered log cost benefit. For capital investment benefits, dollars are converted to annual benefit percentages using estimates of total annual capital expenditures in the appropriate province as the base. For benefits reducing delivered log costs, annual revenue to the softwood logging sector in the appropriate province is used as the base. In either case, the resulting value represents the share of the particular cost element provided by the provincial program. Topel did the same except he treated all benefits as benefits that reduced the cost of capital for softwood lumber production.

d. Aggregation and Disaggregation

10. Professor Kalt's economic model can determine both the effects of benefits provided by any one program, and the aggregate effect of more than one program. It also takes proper account of the differences between a subsidy to sawmill capital and a subsidy that reduces the delivered cost of logs to softwood lumber producers. This means that the model can calculate the proper level of export tax adjustments depending on which, if any, programs the Tribunal finds to confer benefit that breach the SLA, and the amount of those benefits.

2. Summary of Individual Program Benefits Used by Professor Kalt

11. For many of the individual programs, Professors Topel and Kalt apply a similar approach. However, unlike Professor Kalt, Professor Topel uses budgeted amounts over the budgeted life of the program to determine an annual level, and then applies this level as though the program never ceases (in the permanent case). No consideration for differences between beginning year and later values appears to be taken into account by Professor Topel or consideration of changes over time. Professor Topel also appears to includes all benefits regardless of whether they are directed at softwood lumber producers or not and includes a base for determining the rate that is broader than softwood lumber activities.[6] Additional differences will be noted below.

a. Ontario Forest Sector Prosperity Fund

12. For the Ontario Forest Sector Prosperity Fund ("FSPF") program, Professor Kalt calculates benefits from October 12, 2006 through FY2008-09 using approved project grant amounts by the Ontario Ministry of Natural Resources. Benefit

[6] Topel Rejoinder Report at Appendix D (revised 2) (Ex. C-62).

amounts in future years were calculated based on the remaining approved amounts budgeted to softwood lumber projects**.**

13. Professor Kalt counted benefit provided starting at October 12, 2006 through FY2009-10, when the program will expired by its own terms.[7] Annual benefit rates are calculated for the program by dividing the annual dollar benefit amount provided under the program by total new investment in the Ontario softwood lumber sector for the corresponding fiscal year.[8]

b. Ontario Loan Guarantee Program

14. Professor Kalt also treated benefits calculated for Ontario's Loan Guarantee Program ("LGP") as a reduction in the price of capital faced by softwood lumber firms because they are provided for specific capital projects. The benefit amount is calculated as the difference between the terms of the loan that the recipient obtained with the LGP guarantee and terms the project at issue could have obtained in the market in the absence of that guarantee. In comparison, Professor Topel uses the budgeted loan losses for the program.[9]

15. Annual benefit amounts are spread over the life of the program, beginning at the announcement date for each project. This means that benefit amounts are calculated for FY2006-07 (starting at October 12, 2006) through FY2011-12.

[7] Kalt Second Rebuttal Report, Appendix Figure C-1 (Ex. R-148). The Canadian fiscal year is April 1 – March 31.

[8] Kalt Second Rebuttal Report, Appendix Figures C-1 and C-1A (Ex. R-148).

[9] Under certain assumptions, these would result in the same valuation.

16. Professor Kalt uses the same softwood lumber capital expenditure dollar amounts as used in the calculation of annual benefit rates for the Ontario FSPF, to convert Ontario LGP benefit dollar amounts into a percentage reduction in the price of new capital investment, calculated annually based on when each capital project was placed into productive service.[10]

c. Ontario Roads Program

17. Professor Kalt categorizes and treats the benefits provided under the Ontario Roads Program as reducing the cost of logs delivered to sawmills. Professor Topel, however, treats these benefits as a reduction in the cost of capital used in the production of lumber.

18. In determining the amount of benefit Professor Kalt begins with the annual funding amount for the program, and then deducts the Ontario MNR program administration fees charged to the projects and pre-SLA funding under the program. The amount of benefit to softwood lumber production is determined by the percentage of harvest delivered to softwood lumber mills.

19. Only roads constructed or maintained after October 12, 2006 can be considered benefits that could breach the SLA, if the roads program, contrary to Canada's view, were considered to breach the SLA at all. The determination of the pre-October 12, 2006 level of benefit was based on dates listed on road project reimbursement forms from the Ontario MNR.

[10] Appendix Figure C-2 of Kalt Second Rebuttal Report details the benefit calculation for the Ontario LGP. (Ex. R-148).

20. Reimbursements made during FY2006-07 (post-October 12, 2006) and FY2007-08 are treated as benefits provided under the program for those years. Benefits for future years are calculated based on a time-weighted average of data from previous years.

21. Professor Topel does not make appropriate adjustments for administrative costs, logs not delivered to softwood lumber mills, or for timing on the beginning year.

22. The dollar benefit amounts determined by Professor Kalt under this program are converted to a percentage utilizing data on annual Ontario softwood logging revenue. Annual benefit amounts for this program are detailed in Kalt Second Rebuttal Report Appendix Figure C-3 (Revised).

d. Québec Capital Tax Credit

23. In calculating the benefit provided by the Québec Capital Tax Credit, Professor Kalt looked at the degree to which the capital tax credit for the forest products sector was greater than that generally available to other industries and greater than that which the United States claimed was provided as of July 1, 2006. Using actual capital tax returns, he calculated benefits for FY2006-07 and FY2007-08 because the program was eliminated in March 2008. These calculations are detailed in Kalt Second Rebuttal Report Appendix Figures A-4A (Revised), A-4B (Revised), and C-4 (Revised). In comparison, Professor Topel relied on the annual benefit amounts determined by Mr. Beck.

24. As with the Ontario FSPF and LGP, benefits under the Québec Capital Tax Credit were calculated as a percentage of total softwood lumber capital investment

in Québec and behave in the economic model as a percentage reduction in the price of new softwood lumber capital.

e. Québec Roads Credit

25. As has been detailed in our briefs, the Québec Roads Credit of 40 percent was increased to 90 percent in October of 2006. Professor Kalt uses the difference of 50 percent in his calculation of benefit for this program. Professor Topel, however, uses the full 90 percent rate.

26. Using road credit amounts granted by Revenue Québec from May 31, 2007 to January 31, 2008 (which corresponded to road expenditures from calendar year 2006), Professor Kalt infers a monthly expenditure amount on roads annualized for amounts (post-October 12, 2006) for FY2006-07 and FY2007-08. Because totals include road expenditures to access both hardwood and softwood timber, Professor Kalt scales down the totals by the percentage of Québec's annual allowable cut allocated for softwood timber. Professor Topel makes no such adjustment.

27. Professor Kalt also deducted an amount to reflect the automatic increases in stumpage for FY2007-08 and FY2008-09 since the cost of building forest access roads are a component in the calculation of Québec's stumpage fee charged to companies for the right to harvest timber. As explained by Mr. Adam, a decrease in the cost of building forest roads leads to an increase in the stumpage fee.[11] These annual offset amounts are then subtracted from the annual benefit amounts before they are converted to percent price reductions and enter into the economic model. Professor Topel does not include an offset for the change in stumpage charges.

[11] Adam Rejoinder Report ¶ 23 (Ex. R-125).

28. As with the Ontario Roads Program, Professor Kalt converted the benefits under this program to a percentage reduction in delivered log costs for sawmills; while Professor Topel again treats them as a reduction in the cost of sawmill capital. Annual logging revenues in Québec were used as the base for this percentage calculation. Since the Roads Credit was announced as a four year program, Professor Kalt estimated benefits for FY2006-07 (starting October 12, 2006) through FY2008-09.[12]

29. Detailed annual benefit calculations for this program are presented in Kalt Second Rebuttal Report Appendix Figures A-5 (Revised) and C-5 (Revised) (Ex. R-148).

f. Québec Forestry Fund Credit

30. Professor Kalt treats benefits from the Forestry Fund program as a reduction in delivered log costs, since they do not add to the productive capacity of a sawmill.

31. Benefits for the program are calculated based on the softwood charge that would have been owed to the Forestry Fund had the requirement to contribute to the fund not been eliminated.[13] This calculation is detailed in Kalt Second Rebuttal Report Appendix Figure C-6 (Revised) (Ex. R-148).

32. This amount is then reduced by the amount by which stumpage rates were increased to take into account the fact that payments to the Forestry Fund were no longer required. Softwood logging revenue is used as the base to convert the benefit dollar amounts into annual benefit percentage rates.

[12] Kalt Second Rebuttal Report, Appendix Figure A-5 (Revised) (Ex. R-148).

[13] Adam Rejoinder Report ¶ 23 (Ex. R-125).

g. Québec SOPFIM/SOPFEU Credit

33. Professor Kalt treats benefits from the Québec SOPFIM and SOPFEU programs in the same way as those from the Forestry Fund program. He calculates benefits as those dollar amounts that would have been charged to softwood lumber harvesters had the SOPFIM/SOPFEU contribution requirement not been removed, less any resulting increase in stumpage charges. He then treated those benefits as a reduction in the cost of raw wood input to softwood sawmills.

34. Logging revenue was used as the base to convert benefit dollar amounts into annual benefit percentages.

35. Professor Topel does not distinguish among Québec programs and treats $210 million of "Silviculture Investment Measures" as a "per-unit subsidy for logs."[14] The full $210 million budget amount is treated as a reduction in the raw wood input costs. No offset for changes in stumpage charges are made.

3. Economic Model

36. Following calculation of the amount of the benefit and the conversion of that amount into inputs that were usable in a model, Professor Kalt ran the model to determine the effect of the benefits on U.S. lumber prices, output and U.S. producers. The results of that modeling were then used to calculate the compensatory adjustments that would address the effects of the programs on the Export Measures.

37. As Professor Kalt explained at the Hearing, an economic model is necessary to quantify the effects of the programs on the U.S. market and U.S. producers

[14] Topel Rejoinder Report at Appendix D (revised 2) (Ex. C-62).

because of the nature of the programs (*i.e.*, incentives to investment in productive equipment and programs affecting the delivered costs of logs) and the relatively small size of the programs relative to the North American lumber market.[15]

38. Economic models are commonly used to analyze the economic differences that would occur with and without some policies or economic changes. In this case, we are seeking to determine the effect that benefits provided to some Québec and Ontario producers of softwood lumber will have on U.S. producers of softwood lumber. A credible and coherent model must reasonably and accurately determine the effects of the benefits on the Québec and Ontario softwood lumber producers and then determine how and in what degree these effects in turn will affect U.S. lumber markets, prices, and U.S. producers. The model also must account for the relevant duration of the program benefits and any continuing effects of benefits accorded by the programs.

39. Professor Kalt's model, based on the earlier work of Professor Topel in these proceedings, is well-designed to determine the effects of the disputed programs, including the effects on U.S. producers and the Export Measures. As explained above, to the extent the programs have any effect they do so in one of two ways: (1) by reducing the cost of new capital goods used in producing softwood lumber, or (2) by reducing the costs of logs delivered to the mill. Professor Kalt's model incorporates directly changes in the cost of new capital used in lumber processing in Québec and in Ontario and in delivered log costs to lumber producers in Québec and Ontario. Consistent with economic principles, it accounts for the duration of both the effects of capital additions on lumber production and changes in the cost of new capital goods. And, consistent with standard economic principles and empirical studies of this industry,

[15] Tr. vol. 3, 718:25-719:7-13.

it determines the effects of these changes on lumber markets and lumber producers in Québec, Ontario, and the United States. By doing so, the Kalt model can establish the adjustments to the export tax that will compensate for the effects of any breach that the Tribunal may find on U.S. producers. (The models of Professors Kalt and Topel have many elements in common; significant differences between Professors Kalt's and Topel's models are listed below.)

b. The Kalt Model Is Based on Standard Economics of Supply and Demand

40. The Kalt model is based on standard economic principles of supply and demand applied to lumber markets.[16] It starts, as does the Topel model, with a standard representation of an integrated lumber market for the United States and Canada in which lumber producers throughout the United States and Canada supply the demands of U.S. and Canadian consumers. Since the issue in this proceeding is the effect of the Québec and Ontario programs, respectively, on lumber production, the model allows producers in Québec to respond to Québec policies, while those in Ontario respond to Ontario's policies.

41. The total supply of lumber consists of the total of the lumber supplied from Québec, Ontario, and the rest of the United States and Canada. The total demand for lumber consists of the total of lumber demanded which increases as the price of lumber falls and decreases as the price of lumber rises. As is standard in supply-demand models, the price of lumber is that price which balances supply with demand – the price at which the quantity demanded equals the amount of lumber supplied.

[16] Tr. vol. 3, 728:22-729:2.

42. The model makes a number of reasonable simplifications. Given the duration of the programs, the model balances lumber consumption and production on an annual basis and generates an annual average price and quantity of lumber. Due to the long-term duration of the programs under consideration (which provide benefits over a number of years), short term changes in inventory can be ignored. Similarly the model treats softwood lumber as a single good and ignores differences between lumber produced in different regions. These simplifications are likely conservative in that ignoring these factors tends to overstate the effect of the provincial programs on the United States.

c. Lumber Production Is Modeled in Detail

43. In order to capture the effect of the programs, the lumber production and the decisions of lumber producers are modeled in detail. Because lumber producers are numerous in Québec, Ontario, and elsewhere, lumber production is modeled as a competitive industry. First, individual lumber producers are unable to affect market prices, so they make decisions as though the prices that prevail in lumber and input markets are beyond their control. Second, lumber producers are assumed to maximize profits, so that the choice of lumber output and inputs used in a year are the best possible, given prices that prevail in lumber and input markets and given past decisions about how much capital has been invested in lumber production capacity.

d. Investment Decisions Are Modeled in Detail

44. Since a number of the provincial programs involve investments in physical capital – sawmilling, log handling, and other equipment used in lumber production, investment decisions by lumber producers are also modeled in detail. The distinctive feature of physical capital is that it lasts for a number of years, and wears out

(depreciates) over time. Thus, to maintain the existing stock of productive capital, investments in new physical capital must be made each year to replace that which wears out. Consistent with the time to plan and install capital, Professor Kalt treats investments in physical capital as adding to the productive capital used in lumber production in the year following the disbursement of investment funds; this assumes it takes a year, on average, to put new capital into service once funds for the investment are acquired**.**

e. Calibrating the Model

45. In order to provide reliable estimates of the changes in the export taxes needed to compensate for the effects of these provincial programs, Professor Kalt calibrated the model to be consistent with recent data on the levels of lumber consumption, production in each region, and lumber prices. In addition, Professor Kalt utilized information describing the price responsiveness of demand (of lumber) and supply (of inputs) that have been empirically estimated in the economics literature and are consistent with previous analyses.[17] He also established the relative importance of delivered log costs, capital and other inputs into lumber manufacturing based on empirical analyses of lumber production costs.

46. Since the period at issue coincides with the worst U.S. housing market on record, and a calamitous fall in the demand for lumber, Professor Kalt allowed lumber demand to fall consistent with the recent past and then recover consistent with forecasts by leading independent forecasters for this industry.

[17] Kalt Second Rebuttal Report ¶ 73, n.68 (Ex. R-148).

f. Calculating the Effects of the Programs

47. Once the amount of benefits is determined and whether the benefits reduce the cost of sawmilling capital or the cost of delivered logs, then, as a first step, the model is run assuming that the provincial programs are *not* in effect. The model is run a second time with the only difference being the inclusion of the program benefits. The difference between the two runs of the model – with and without the provincial programs –shows the effects of programs.

48. The effect of a program that reduces delivered log costs in a region is relatively direct. The program reduces costs of production for producers. As a result, lumber production from that region increases, lumber prices fall, and producers in other regions reduce somewhat their output (and potentially investments). All of this is captured in the Kalt model.

49. Benefits that reduce the costs of capital investment can result in a wider range of outcomes given the inherent forward-looking nature of the programs. Knowledge that investment will be less expensive in the future will result in higher future investment levels and lower current investment levels. Similarly, knowledge that a region will receive future investment support will tend to reduce current investments given the knowledge that future lumber production will rise and lumber prices fall from what they otherwise would be. Thus lumber prices could actually rise and investment fall given anticipation of a future investment support program.

50. Investment from the future may be pulled back into the period of the government support in the supported region when an investment support program has a known termination date or maximum level of funding. In general, there will be some period following the end of the program over which the effect of any additional

investment dissipates. The model captures all of these effects by allowing investors to respond to expected future changes in profit opportunities.

g. Model Outcomes

51. The Kalt model provides a set of related outcomes relevant to this proceeding. First, it permits calculation of the compensatory adjustments in each year that offsets the additional lumber production in that year resulting from the programs. Second, it permits calculation of the harm caused to U.S. producers from reduced lumber prices in each year attributable to the programs. This harm is calculated based on the change in producer surplus to U.S. producers caused by changes in lumber prices and the amount of lumber produced in the United States. As explained by Professor Kalt, change in producer surplus is the standard means to express, in dollar terms, the harm to producers as a result of changes in the market outcomes.[18] Finally, it permits calculation of the additional tax necessary to increase lumber prices for U.S. producers to the levels that would have occurred absent any breach found by the Tribunal.

52. The model also allows, for example, the determination of the amount of tax necessary to compensate U.S. producers for past harms, if the Tribunal, contrary to the view of Canada, decides that compensatory adjustments should compensate for past effects of the breach in addition to the ongoing effects. For the reasons explained above, the model will produce a result that overcompensates for past harms, since it does not account for the effect of the compensatory adjustments in causing reduced investment and production in Canada.

[18] *See* Kalt Second Rebuttal Report ¶ 77 (Ex. R-148).

53. The Kalt model corrects certain errors in the very similar Topel Model. Professor Topel's model differs in the following ways from that of Professor Kalts.

- Professor Topel treats Québec and Ontario as a single blended region.
- Professor Kalt treats benefits to build logging roads as a reduction in the cost of logs delivered to sawmills, while Professor Topel treats these as a reduction in the costs of sawmill capital. In short, Professor Topel treats capital used in logging as like capital used in sawmilling, and thus differs in his treatment of log costs.
- Professor Kalt did not include benefits to pulp and paper mills as he determined after extensive analysis that such benefits did not increase softwood lumber production. Professor Topel treated such benefits to pulp and paper mills the same as benefits to softwood lumber sawmills (based primarily on the assertions of Mr. Beck).
- Professor Topel treats the softwood lumber market as though it would always remain the at 2006 levels, whereas Professor Kalt incorporates into his model the precipitous fall in demand for lumber following the crash in the U.S. housing market.

Some of these corrections increased, rather than decreased the export tax adjustment called for in relation to a given level of benefit than might be determined by the Tribunal. These differences are explained further below.

h. The Economic Analysis Provided by the U.S. Expert in LCIA 7941 Is Irrelevant to Professor Kalt's Analysis in This Arbitration

54. The United States, in its cross-examination of Professor Kalt and again in its Closing Statement, argued that Professor Kalt's model was incorrect because it produced results that differed from those produced in LCIA Case No. 7941 and 91312. The United States asserted that Professor Kalt's model in this proceeding would collect $30 million in additional export taxes in order to return $26 million in lost producer surplus to U.S. producers, but that the economic model in 7941 required the collection of $87 million in export taxes to return $34 million in lost producer surplus. The implication of the U.S. argument was that if it took $87 million in export taxes to return $34 million in producer surplus in 7941, it cannot be that only $30 million in export taxes could return $26 million in lost producer surplus in 81010.

55. This U.S. reasoning is incorrect and misleading, primarily because Professor Kalt did not construct a model in 7941. The only economic model introduced in that proceeding was provided by the U.S. economist Dr. Neuberger. Professor Kalt examined Dr. Neuberger's model and found that it suffered from a number of deficiencies, including drastic oversimplifications and its reliance on incorrect parameters. It was Dr. Neuberger's deeply flawed model that provided the estimates cited by the United States – not Professor Kalt's.

56. Further, the facts and circumstances of these two cases are drastically different. In 7941, the breach at issue, which arose from the miscalculation of regional quota volumes, had a direct effect on the Export Measures, resulting in an overshipment of lumber during a relatively short six-month period. If a breach is found in this case, it will have occurred over a longer period of time, and the nature of the breach is different

because the benefits at issue are subsidies to capital which do not have a direct effect on the Export Measures. Additionally, the breach in 7941 occurred at a time when the lumber market was much more robust than the current situation it now faces. The United States attempts to critique Professor Kalt's model for providing different results than those in a different model, in a different arbitration, under different economic conditions, and constructed by a different economist, are irrelevant to the issues before the Tribunal in this Arbitration.

ANNEX III

WHAT IS THE EFFECT OF THE LCIA 7941 AWARD ON 81010?

1. The Tribunal raised several questions regarding what weight, if any, should be given in this proceeding to the Award on remedies in the 7941 proceeding.[1] This section demonstrates that the Parties are in agreement on all three issues raised by the Tribunal (1) that the 7941 Award should not be given *res judicata* or collateral estoppel effect, and that this outcome is consistent with relevant international law principles; (2) that the 7941 Award may inform this Tribunal's resolution of the legal issues in this proceeding *only* to the extent that the reasoning of the 7941 Award is, in the view of the Tribunal, "persuasive", *i.e.*, "correct"; and (3) that adopting an interpretation inconsistent with the 7941 Award would not create "problems" for the Parties, and that the Tribunal's understandable concern regarding "consistency" in international arbitration does not in the context of this proceeding compel following the 7941 Award.

1. The 7941 Award Does Not Have Any Binding Effect Under the Doctrines of *Res Judicata* or Collateral Estoppel

2. The Parties agree that the 7941 Award is not binding on the Tribunal in this case under the doctrines of *res judicata* or collateral estoppel. *Res judicata* is a principle of domestic law that has been adopted in international law, but is applied much more narrowly due to various policy concerns. This is due in part out of respect to the sovereignty of the actors involved, in acknowledgement that no international tribunal is

[1] Tr. vol. 4-B, 1076:8-1077:18.

superior to any other international tribunal, and because an expanded conception of res judicata could infringe the stringent rules of denial of justice under international law.[2]

3. *Res judicata* applies only when "{t}he three traditional elements for identification: parties, object, and cause are the same."[3] All three elements must be met for *res judicata* to attach. International *res judicata* applies only in circumstances in which there is an identity, as between a prior decided case and a new dispute, among the parties, the object and the cause. Judge Anzilotti enunciated the criteria in his dissent in *Factory at Chorzów* (Interpretation): *persona, petitum, causa petendi*.[4] In his separate opinion in *Pajzs, Czaky and Esterhazy*, he formulated the criteria as parties, *causa petendi* and *res petita*.[5]

4. Applying these principles of *res judicata* to this particular case, the 7941 Award fails to meet the tri-partite test. The tri-partite requirements for *res judicata* are cumulative. If any one of the requirements is not met, there is *no res judicata*. Here, the United States agrees that the 81010 arbitration arises from "distinct and different causes of actions and claims" than the 7941 arbitration.[6] This case involves claims of circumvention under Article XVII against a variety of provincial measures, none of which are directly prohibited by the SLA. The 7941 arbitration, in contrast, challenged Canada's failure to apply the quota adjustment mechanism of paragraph 14 of Annex 7D

[2] Tr. vol. 5, 1178:7-18.

[3] *Case Concerning the Factory at Charzów* (Germ. v. Pol.), 1928 P.C.I.J (ser. A), at 23 (CA-19).

[4] *Id.*

[5] *The Pajzs, Cáky and Esterházy Case*, Judgment, December 16, 1936, Series A/B, No. 68, p. 30 at p. 67 (RA-139).

[6] Tr. vol. 5, 1134:25-1135:11.

of the Agreement as of January 2007 (rather than July 2007 when Canada did start applying it), which resulted in overshipments of lumber for the first six months of 2007.

5. Collateral estoppel is a doctrine of domestic laws not accepted in international law. Nor, it might be added, is collateral estoppel automatically applied in the national legal systems which have it. Even in such systems, "{i}t is often difficult to prove collateral estoppel to the satisfaction of a court that did not hear the original case, especially if a case was heard by an arbitrator. Some courts have opposed preclusion of any issue in subsequent litigation that was decided in arbitration."[7] In any event, the United States did not disagree with Canada's assertion that collateral estoppel does not apply in the instant matter.[8]

2. The Parties Agree that the 7941 Award is Relevant to This Tribunal's Consideration of Legal Issues In this Proceeding Only to the Extent it Concludes that the 7941 Award Is Persuasive

6. Just as the Parties are in agreement that the 7941 Award does not have any binding legal effect in this proceeding, they also agree that it is relevant to this Tribunal's task only to the extent that the Tribunal considers the Award's reasoning to be persuasive. The United States recognized this at the hearing."[9]

7. Canada agrees with the United States that the 7941 Award would be relevant only to the extent that the Tribunal considered it had persuasive effect. As the members of this Tribunal are well aware, it is axiomatic that there is no concept of *stare decisis* in international arbitration. An award in a prior case may nonetheless be

[7] Dunham, "International Arbitration Is Not Your Father's Oldsmobile," 2 Journal of Dispute Resolution 323, 328 (2005) (RA-140).

[8] Tr. vol. 5 1132:18-21.

[9] Tr. vol. 5, 1135:16.

considered by a subsequent tribunal if the latter body concludes, after conducting its own independent analysis, that the former's consideration of the same or similar issue reached the correct result.

8. As another tribunal aptly observed, "The Tribunal is of course mindful that decisions of ICSID or other arbitral tribunals are not a primary source of rules. The citations of and references to those decisions respond to the fact that the Tribunal in examining the claim and arguments of this case under international law, believes that in essence the *conclusions and reasons of those decisions are correct*."[10]

9. The tribunal in *AES Corp*. v. *Argentina* expressed a similar view: "Each tribunal remains sovereign and may retain, as it is confirmed by ICSID practice, a different solution for resolving the same problem; but decisions on jurisdiction dealing with the same or very similar issues may at least indicate some lines of reasoning of real interest; *this Tribunal may consider them in order to compare its own position with those already adopted by its predecessors and, if it shares the views already expressed by one or more of these tribunals on a specific point of law, it is free to adopt the same solution*.[11]

10. What is clear from these and similar statements of international tribunals is that a prior tribunal's resolution of a particular legal issue should play a residual role in

[10] *Enron* v. *Argentina*, ICSID Case No. ARB/01/3, Decision on Jurisdiction, ¶ 40 (Jan. 14, 2004) (emphasis added) (RA-141).

[11] *AES Corporation v. the Argentine Republic*, ICSID Case No. ARB/02/17, Decision on Jurisdiction, ¶ 40 (Apr. 26, 2005) (emphasis added) (RA-142). *See also Id.* ¶ 31 ("One may even find situations in which, although seized on the basis of another BIT as combined with the pertinent provisions of the ICSID Convention, a Tribunal has set a point of law which, in essence, is or will be met in other cases whatever the specificities of each dispute may be. Such precedents may also be considered, *at least as a matter of comparison and, if so considered by the Tribunal, of inspiration*.)

a subsequent tribunal's consideration of the same or similar issue, and in no circumstances can substitute for the latter tribunal's independent judgment on an issue. In international law, each tribunal is independent of other tribunals, and each is expected to fulfill its own mandate and decide the issues before it as it believes the law requires.

11. The tribunal in *Gas Natural SDG, S.A*. v. *Argentina* underscored the importance of this critical point:

> The Tribunal wishes to emphasize that it has rendered its decision independently, without considering itself bound by any other judgments or arbitral awards. Having reached its conclusions, however, the Tribunal thought it useful to compare its conclusion with the conclusions reached in other recent arbitrations conducted pursuant to the ICSID Arbitration Rules and arising out of claims under contemporary bilateral investment treaties. We summarize a few of these decisions here, and confirm that we have not found or been referred to any decisions or awards reaching a contrary conclusion.[12]

12. In this case, the 7941 Award cannot play even the limited confirmatory role a cogently reasoned award might otherwise play in a subsequent proceeding for the simple reason that its reasoning is not merely unpersuasive, but reflects "very serious and entirely manifest misapplications of the law."[13] Indeed, Professor Reisman goes so far as to opine that the errors of law are so severe that "had there been an arbitral review of the Award, these {misapplications of law} should have led to its annulment."[14] Professor Reisman catalogs these errors in detail in his expert report, which effectively stands unrebutted. In these circumstances, there simply is no basis for giving the 7941

[12] *Gas Natural SDG, S.A*. v. *Argentina*, ICSID Case No. ARB/03/10, Decision on Jurisdiction, ¶ 36 (June 17, 2005) (RA-143).

[13] Reisman Report ¶ 3 (Ex. R-102).

[14] *Id.* (Ex. R-102).

Award any weight in this proceeding on the key issue of the proper scope of the remedies provided for under the SLA, let alone binding or preclusive effect.

13. There is an additional and critical reason why the 7941 Award should not be given any weight whatsoever in this proceeding. First, under the express terms of the SLA, all arbitral awards issued pursuant to Article XIV are deemed "final and binding and shall not be subject to any appeal or other review."[15] As a result, the 7941 award was not subject to any review mechanism, either by recourse to an annulment proceeding or pursuant to review in any domestic forum pursuant to the New York Convention or comparable national legislation, that might have identified legal errors sufficient to preclude its enforcement. Both Parties agreed to this outcome as a way to ensure that an arbitral award under the SLA would be given immediate and conclusive binding effect. At the same time, it cannot seriously be contended that the Parties in so doing agreed that even manifestly incorrect decisions with respect to critical interpretative issues regarding the operation of the Agreement would be binding on future tribunals.

3. Not Following The 7941 Tribunal Award on Remedies Will Not Create Practical Difficulties for the Parties

14. The Tribunal asked whether it would create any practical difficulties for the Parties if the Tribunal interpreted any SLA provision in a way different from the 7941 tribunal. Here again, the Parties are in agreement that the answer is no. As the United States observed in its closing argument,

> If the tribunal does not reach the same conclusion as the 7941 tribunal on the question of retrospective remedy, the tribunal has asked the parties to comment upon whether this poses any difficulty going forward. If this proceeding had consisted of the United States' challenge to Canada's failure to timely apply the

[15] SLA 2006 Art. XIV(20) (Ex. R-1).

> calculation of article 7D.14 of the agreement, if this arbitration concerned the same issue, the same claims and causes of action as the 7941 case, conflicting decisions would indeed be troubling to the United States. Here, as I said, however, the cases involve wholly different breach allegations and underlying sets of facts.[16]

Canada agrees with this position, and likewise sees no practical difficulties resulting from this Tribunal's potentially contrary interpretation on the question of the proper scope of relief provided under the SLA.

15. If this Tribunal finds that any of the challenged programs breach Article XVII, it must also decide whether compensatory adjustments must compensate for the ongoing breach only, or for any past effects that the breach may have had. If this Tribunal accepts Canada's position that compensatory adjustments must compensate for the ongoing breach only, the binding character of the 7941 award on remedy will not be affected. Canada and the United States have accepted the 7941 Tribunal's findings as binding on the Parties for that case. That will remain true even if this Tribunal concludes that the SLA does not provide for retroactive remedies, so that no retroactive remedies are ordered in this proceeding.

16. Although the two awards would diverge on the question of remedy, the practical consequences of that divergence are minimal. Indeed, the only practical effect of the diverging awards would be on the quantum of remedy ordered. Past effects of the programs in this case make very little difference. And, substantively, the Parties' obligations remain unchanged. The Parties would remain obligated to comply with all their obligations under the Agreement, whether the remedy system is prospective only or also requires compensation for past effects of the breach. This is not a case where the

[16] Tr. vol. 5, 1135:25-1136:14.

Parties would be left in doubt how they should conduct lumber trade under the SLA in light of a difference of interpretation of rules having operational application.

17. Canada understands the Tribunal's desire to foster consistency in international arbitral decision-making, but respectfully suggests that this concern must be tempered in the context of this proceeding for several reasons. First, it is one thing to take into account the goal of consistency when the same or similar issue has been the subject of repeated and careful analysis by a number of separate tribunals resulting in a series of consistent outcomes.[17] It is quite another thing, however, to do so when the purported consistency involves a single prior decision, as is the case here. As one ICSID Tribunal confronting a similar situation observed, "As will become clear, the present Tribunal does not in all respects agree with the conclusions reached by the *SGS v. Pakistan* Tribunal on issues of the interpretation of arguably similar language in the Swiss-Philippines BIT. This raises a question whether, nonetheless, the present Tribunal should defer to the answers given by the *SGS v. Pakistan Tribunal*."[18] The Tribunal answered this question in the negative, in part on the grounds that "{t}here is no

[17] *See e.g., Compañía de Aguas del Aconquija, S. A. & Vivendi Universal (formerly Compagnie Générale des Eaux) v.Argentine Republic*, ICSID Case No. ARB/97/3, Decision on Jurisdiction, ¶ 94 (Nov. 14, 2005) (RA-144). (noting that "numerous arbitral tribunals have rejected this very same jurisdictional objection as shown by the 18 cases referred to in Appendix 1 to this Decision. In each of those eighteen cases the tribunals upheld the right of shareholders to pursue such claims. In 11 cases, the Argentine Republic was respondent and asserted, and lost, this same objection."). *See also*, *Saipem v. Bangladesh*, ICSID Case No. ARB/05/07, Decision on Jurisdiction and Recommendation on Provisional Measures, ¶ 67 (Mar. 21, 2007) ("The Tribunal considers that it is not bound by previous decisions. At the same time, it is of the opinion that it must pay due consideration to earlier decisions of international tribunals. It believes that, subject to compelling contrary grounds, it has a duty to adopt solutions established in *a series of consistent cases.*") (emphasis added).

[18] *SGS* v. *Philippines*, ICSID Case No. ARB/02/06, Decision of the Tribunal on Objections to Jurisdiction, ¶ 97 (Jan. 29, 2004) (RA-145).

hierarchy of international tribunals, and even if there were, there is no good reason for allowing the first tribunal in time to resolve issues for all later tribunals."[19]

18. This reasoning is even more compelling in the circumstances of this case for two reasons. First, as just discussed, the 7941 Award, unlike awards issued under the auspices of ICSID, was not subject to any review mechanism. Second, the 7941 Tribunal itself expressed significant reservations regarding the interpretation it reached on the prospective or retrospective nature of relief under the SLA. Indeed, the Tribunal concluded that the SLA provided for retroactive remedies only after repeatedly acknowledging that application of the interpretive principles of the VCLT to the relevant SLA provisions in fact supported the *contrary* conclusion.

19. In its examination of the text and context of the relevant SLA provisions, the Tribunal observed "that the procedures established by sections 22 to 24 function logically for prospective remedies and are ill-suited for retroactive remedies"[20] and "are primarily shaped and are easier to be applied to deal with breaches that still continue at the time the Tribunal has to decide,"[21] and that in the aggregate, "the weight of the arguments against retroactivity is not sufficiently strong to outweigh those in favor to such an extent that the presumption of Article 31 ILC Draft Articles in favour of retroactive reparation must be considered as reversed."[22]

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[19] *Id.*

[20] 7941 Award ¶ 294 (CA-12).

[21] 7941 Award ¶ 285 (CA-12).

[22] 7941 Award ¶ 306 (CA-12).

20. This is not the reasoning of a Tribunal that is confident in its own conclusions, and at a minimum, considered the legal issue it decided to be an extremely close question. It would be highly anomalous in these circumstances for this Tribunal to consider itself obligated to defer to such a decision for the sake of consistency in the face of its own contrary interpretation.

21. This is all the more true given the legitimate questions Canada has raised regarding the validity of the Tribunal's reasoning through the unrebutted expert opinion of Professor Reisman. As explained by Professor Reisman, the 7941 Award on Remedy "is entitled to no persuasive authority because" it suffers from "serious errors in misapplication of international law" and "deficits and in cogent reasoning."[23] A critical error is the Award's misconstruing of and failure to apply the rules for interpretation of international instruments as set out in the Vienna Convention on the Law of Treaties. Rules of interpretation are designed to guide decision maker's tasked with interpreting ambiguous treaty provisions that affect relationships between parties. Their function is to inject predictability and consistency into what would otherwise be an unguided and subjective process of interpretation. When those rules are misapplied – as they were in the 7941 Award – that predictability and consistency are disrupted, making the process of interpretation unreliable. A decision that emerges from such a process cannot be given weight as binding precedent, and in any event, prior awards are not binding under VCLT principles. Indeed, the VCLT does not even create a presumption in favor or past precedents.

22. The VCLT does, however, obligate this Tribunal to interpret the SLA in good faith and in accordance with VCLT principles. Proper application of the VCLT rules

[23] Reisman Report ¶ 3 (Ex. R-102).

will provide the predictability and consistency that the Parties need as they move forward to comply with their obligations under the Agreement.

ANNEX IV

IS THE TERM "EXISTED" AS USED IN ARTICLE XVII A LEGAL NOTION OR FACTUAL QUESTION

1. During the Hearing, the Tribunal asked the Parties to comment on the meaning of the word "existed" as it appears in Article XVII(2)(b). More specifically, the Tribunal asked whether the issue of a measure's existence for purposes of paragraph 2(b) is a question of law or of fact.[1]

2. The relevant language from Article XVII(2)(b) is:

> other government programs that provide benefits on a non-discretionary basis in the form and the total aggregate amount in which they ***existed*** and were administered on July 1, 2006.
>
> (emphasis added)

The Tribunal's questions were posed in the specific context of Québec's Road Tax Credit and increased Capital Tax Credit. These measures were adopted by Québec in March 2006. Canada has and continues to argue that as tax measures announced in a Parliamentary system, the two measures went into immediate effect upon announcement and as such, existed before July 1, 2006. The United States however contends that the two measures only came into existence in December 2006, when enabling legislation received final assent.

3. In its closing remarks the United States answered that "existence" for purposes of Article XVII(2)(b) is a question of law, stating "this is a legal issue based entirely upon timing."[2] For the United States the measures could not have existed

[1] Tr. vol. 2, 342:25-346:8 (Panelist Williams) and Tr. vol. 5, 1077:19-1078:2 (Chairwoman Kaufmann-Kohler).

[2] Tr. vol. 5, 1119:11-12.

before they were "actual law".[3] Canada disagreed, stating that Parliamentary convention and relevant legal precedent establish that tax measures may be given immediate effect upon announcement. Whether the two Québec tax credits "existed" on July 1, 2006 is, in the end, a question of fact (*i.e.* did the Gouvernement du Québec exercise its prerogative to give those measures immediate effect?).[4] On the basis of the evidence, the answer to that question is Yes.

4. The United States argues the two measures did not complete the legislative process and receive final assent until December 2006[5] and, as a result could not legally have "existed" on July 1, 2006. The essence of the United States' argument was summarized in its Closing Statement. Mr. Tosini first stated that the term "existed" should be given its ordinary meaning and that the ordinary meaning of "existence" is "a place in the domain of reality, to have objective being."[6] Mr. Tosini then articulated how the United States converts presence "in the domain of reality" and "objective being" into a question of law rather than a question of fact: "{t}o obtain objective being, a measure should be actual law."[7] This articulation turns the Tribunal's question into "when do these measures become law." This does not answer the Tribunal's question (*i.e.* should "existed" be viewed as a question of law or of fact.). Canada submits that to answer that question, once you have determined the meaning of "existed," *i.e.* interpreted the meaning of the term in the context of the SLA, the question of when a particular measure

[3] Tr. vol. 5, 1121:18-19.

[4] Tr. vol. 5, 1213:12-1217:16.

[5] *See* U.S. Reply ¶¶ 112-13.

[6] Tr. vol. 5, 1120:15-18.

[7] Tr. vol. 5, 1121:18-19.

first "existed" should be viewed as a question of fact to be determined by applying the meaning of "existed" to a particular set of facts or circumstances.

5. The U.S. position that "{t}o obtain objective being, a measure should be actual law" is an impermissible revision of Article XVII. As Canada noted in its Closing Statement "{t}he SLA specifies the proper analysis is to determine whether the measure 'existed' prior to July 1, 2006, not whether it had received royal assent."[8] The very choice of the word "existed" over "enacted" reflects the SLA's focus on objective factual existence of the measure. In their normal meaning and application, the terms "existed," "domain of reality," and "objective being" require application of these meanings to a particular set of facts.

6. Canada has already provided conclusive evidence and authority (citing more than ten sources, including judicial decisions) establishing that as a matter of long-standing parliamentary convention, both in Canada and in Québec, tax measures can be given immediate effect (can exist) upon announcement if the government desires.[9] Canada explained that this convention works in Parliamentary systems:

> Because the government enjoys the confidence of Parliament, the government has great power over fiscal measures. As a result, this parliamentary convention allows tax measures to have immediate effect upon announcement. Eventually, Parliament ratifies them through the formal adoption of legislation, but such ratification can be assumed as governments enjoy the confidence of Parliament. If a catastrophe occurs as posited by the {T}ribunal, such as the government falling before adoption of the measure, tax authorities may announce the tax measures are void. In the current arbitration, however, as a matter of fact, the government did not fall during the March 2006-December 2006

[8] Tr. vol. 5, 1213:17-20.

[9] *See* Stmt. of Defence ¶¶ 237-244; Canada Rejoinder ¶¶ 211-220.

period and measures continued since the date of their announcement.[10]

7. The United States has tried to counter this evidence by offering: (1) the common-sense-based opinion of its forest expert, Mr. Beck on questions of Québec law and Parliamentary process; (2) a citation to the explanatory notes of the very legislation that was passed by Parliament to give final ratification to dozens of tax measures announced by the government March 2006 budget (and a few left over from the March 2005 budget), (3) an incomplete citation to a twenty-year old article published by a former federal minister, and (4) the Federal Court decision in *Hervé Pomerleau v. Canada*.

8. Canada has already shown that the opinion expressed by Mr. Beck merely recited a position he was fed by U.S. counsel.[11] Mr. Beck's 'opinion' lacks foundation in personal knowledge, experience, or research and therefore carries no evidentiary weight.[12] The explanatory note to Bill 41 does not aid the U.S. position either. It merely states the obvious: that Bill 41 enacts and ratifies prior actions taken by the government. That explanatory note is not the legislation itself, it is simply a statement of purpose. If Bill 41 stands for anything, it stands for the proposition that in 2006 the government of Québec in fact enjoyed the support of Parliament. The third and fourth sources cited by the United States and by Canada refute the U.S. position and support Canada's contention that tax measures can be given immediate effect at the option of the government. Thus, even if the existence of the measures were purely a

[10] Tr. vol. 5, 1215:10-25.

[11] Tr. vol. 2, 313:3-17.

[12] Mr. Beck's willingness to so easily attempt to apply the veneer of his expertise to a legal assertion by U.S. counsel casts doubt on the quality and utility of Mr. Beck's common sense.

matter of law, Canada has demonstrated that the measures existed in the context of Québec's legal system, while the United States failed to present any convincing evidence to the contrary.

9. In the end, the U.S. approach seeks to blindfold the Tribunal as to the factual existence of the challenged tax credit measures based on American legislative processes. Québec has a Parliamentary form of government and the Gouvernement du Québec chose to give immediate existence and effect to the capital tax credit and road tax credit. Under established procedures and processes, those measures came into existence immediately after their announcement and not when they were formally ratified. Canada has presented extensive evidence that immediately after the announcement of the tax credit measures in the March 2006 Budget Speech, companies began making eligible investments in reliance on these measures, and the Gouvernement du Québec started putting in place the administrative machinery for their implementation.[13] Relevant Québec ministries publicized the measures and processed application forms before the formal enactment of the measure and prior to July 2006,[14] even issuing credits to taxpayers before formal enactment.[15] The record evidence, therefore, establishes that both tax credit measures objectively existed well before their formal enactment. The actions of Québec and of Québec taxpayers (the real test of whether they had "a place in the domain of reality" as asked by the United States) establish that these credits "existed" on July 1, 2006.

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[13] *See* Stmt. of Defence ¶¶ 245-251, 286-292; Canada Rejoinder ¶¶ 221-227, 273-276.

[14] In particular, for the road tax credit measure, the first Certificate of Eligibility form was approved in July 2006. *See* Ex. R-76.

[15] In particular, for the capital tax credit measure, the first credit claim was granted in November 2006. *See* Ex. R-123.

10. The U.S. insistence that existence of the tax credit measures requires the enactment of "actual law" is a formalistic approach that mixes the concepts of "question of law" and "legislation" to avoid the incontrovertible evidence that these measures "existed" once they were announced. The U.S. position is also incongruent with other positions it takes in this case. It is ironic that the United States never claimed that the export charges under the SLA did not exist before December 2006. Canada began collecting export charges as of October 2006, when the SLA came into effect, pursuant to Notice of Ways and Means Motion. Yet the legislation that formally implemented the SLA in Canada was also not enacted until December 2006.[16] These facts confirm the Parliamentary norm: tax measures go into effect at announcement if the government so chooses. For both the Capital Tax Credit and the Road Tax Credit, Québec chose to give them immediate effect as the statements and actions of the government and of tax payers make clear.

11. For all these reasons, Canada submits that for purposes of Article XVII(2)(b) Québec's two tax measures existed on July 1, 2006 and therefore are within the scope of the 2(b) safe harbour.

[16] Tr. vol. 5, 1216:1-21.

ANNEX V

RESPONSE TO TRIBUNAL QUESTIONS REGARDING POSSIBILITY THAT GOVERNMENT BENEFITS MIGHT HELP KEEP LUMBER MILLS OPEN

1. At the Hearing, the Tribunal discussed with Professor Kalt how an economist would measure the effects of a government program on softwood lumber sawmill closures. In particular, Tribunal members asked how that measurement deals with the possibility that government benefits might help a mill to stay open and in production, when it otherwise might close.[1] The Tribunal inquired whether, in that instance, the "benefits" might exceed the money value of the government support.[2]

2. As Professor Kalt discussed and as explained further below, the models presented by Professors Kalt and Topel properly account for the value of the government support in terms of the effects on the market. Both Professor Kalt and Topel have measured the effect of the programs on the aggregate production of lumber in Ontario and Québec. Their analyses incorporate the incremental effect the provincial programs have on increasing lumber production, whether through expansion of particular softwood lumber mills, or keeping mills open that might have shut down. Adding to these estimates the production of particular mills that are alleged to be kept in production by virtue or government support would overstate the effects of these programs. Equally important, the record does not support a finding that the programs kept particular lumber mills open that would otherwise have closed.

[1] Tr. vol. 4-A, 981:14-991:10.

[2] Tr. vol. 4-A, 983:23-985:11.

1. The Economic Models Encompass a Range of Individual Response in Determining the Aggregate Market Outcomes

3. The economic models that Professors Kalt and Topel have presented in these proceedings consider the effect of government support on the softwood lumber industries and markets. The aggregate industry effect encompasses the possibility that some mills may stay open as a consequence of government benefits. The models take as their key input the money value of government support. The models then calculate the effects of that support on the industries and the marketplace, in part by calculating the additional investment that would occur where the government support acts a subsidy to capital investment (*i.e.*, capacity).[3]

4. Because the models examine the industry as a whole, and not each individual participant in the market, the models do not explicitly model individual mill closures or mills staying open. (As Professor Kalt explained at the hearing, "{t}he model does not have any plant closures in it.")[4] They do not attempt to isolate specific participants in the market and make determinations of the impact of the government support on a participant's operating status and production. One can think of all mills being open and adjusting their aggregate investment and production; the industry behavior, not the number of mills operating, determines market outcomes.[5] This is a strength of such modeling. As Professor Kalt explained, with programs of the type at issue here, it is not plausible that one could isolate a program benefit to a specific recipient as *the* determinative cause of that recipient staying open and any quantitative effect on its production. Remaining profitable and in operation is necessarily the result

[3] Tr. vol. 1-B, 236:10-238:3; 747:23-748:8.

[4] Tr. vol. 4-A, 987:20-21.

[5] Tr. vol. 4-A, 981:19-984:17.

of numerous, inherently inseparable factors, ranging from internal management decisions to market developments outside the control of any individual company.[6] By focusing on industry effects, the models properly abstract from particularized decisions of individual mill owners.

5. By looking at the industry at the aggregate level, the models recognize that any particular outcome in the industry, such as a mill staying open, will be accompanied by other developments. These include offsetting developments, such as a mill closure or a reduction of production or investment by other competitors as a consequence of the continued operation of any particular mill. The models seek to reflect the aggregate net effect of all of these individual forces on market-wide results, and determine how the overall government expenditure of a certain amount would cause, for example, additional net investment in the industry.

6. The aggregate approach is the correct one for an atomistic, competitive industry with hundreds or thousands of producers, such as the lumber industry. By way of contrast, in highly-concentrated industries, with only a handful of competitors, it might be feasible to consider the specific effects of government action on each firm, and then model the individual reaction of all the competitors. (For example the value and effect of government support for Airbus in competition with Boeing.) For a competitive industry like lumber, however, in which individual investments are small relative to the aggregate, such an approach is infeasible and unnecessary.

7. It is important to recognize that government support could also go to a mill that subsequently closes as well as to an open mill that would have made the same

[6] Tr. vol. 4-A, 985:15-24.

investment absent government support. But the relevant issue for the effect in the market is not the effect on any individual mill but how the industry behavior as a whole is affected. The "benefit" of the programs, in terms of their effect on the industry and the market, consists of a mix of outcomes at the individual mill level.

8. The models of Professors Kalt and Topel also take account of the offsetting effect of mills that may remain open or produce more in response to the benefits provided by the government. While it could be possible that a particular mill would stay open or expand production as a result of government support, the net effect on the market of this mill's continued operation will be smaller than that mill's continued production. If government support helped one particular mill keep open, this outcome will tend to crowd out production of *other* mills (whether they receive benefits or not) through, for example, log line or mill closure, reduction in work shifts, and so on. The aggregate industry effect will necessarily be less than would be implied by focusing on the particular mill that obtained a benefit. Rather than attempt to consider individually the various cross-currents of industry adjustments, the models in this case focus on the net aggregate effects in the market.

9. The models of Kalt and Topel assess the interaction of industry-wide effects consistent with statistical evidence on the operation of the industry. The relationships that drive the models – the market-wide increase in production that would result from a certain market-wide increase in investment, for example – are drawn from statistics that are compiled on an industry-wide basis. Those statistics already reflect the offsetting actions of many competitors, so the net effects of a large number of individual actions are already reflected in the models.

2. There Is No Evidence on the Record That Provincial Support Actually Kept Any Mills Open

10. Canada respectfully notes that, as a factual matter, there is no reason to believe that any mill stayed open as a consequence of the challenged Canadian programs. There is simply no evidence that any particular mill would have closed without government support, but instead stayed operational on account of government benefits that it received. Notwithstanding assertions by the United States, the only evidentiary inquiry (by Professor Kalt) found no indication that government support had kept mills open.

11. Professor Kalt undertook an analysis of the matter in his first and second rebuttal reports.[7] He explicitly tested the hypothesis that obtaining benefits under the programs led to a different pattern of continued operation or closure. Of the eleven pulp and sawmill projects identified by Mr. Beck as receiving support under the Ontario Forest Sector Prosperity Fund, six mills were currently closed or not operating as of July 2009. Professor Kalt also reviewed this issue in the context of Ontario pulp and paper mills in his first rebuttal expert witness report, where he determined that relevant evidence does not support the conclusion that pulp and paper mills receiving benefits would have closed but for the government support. No discernable pattern existed by which to conclude that government program support was keeping mills open.

12. Further, even if government support were awarded to a mill that was on the margin of closure, and even if that mill did indeed stay open, that is just the beginning of the inquiry. The continued operation of the mill, and any resulting effect on Export Measures, would likely have to be attributed to many factors beyond the receipt

[7] Kalt Second Rebuttal Report ¶66 (Ex. R-148); Kalt Rebuttal Report ¶¶ 71-72 (Ex. R-101).

of funding, and cannot be attributed solely to the government program. As Professor Kalt testified at the Hearing:

> The earnings that you're generating are a result of your activities and your decisions about how to run a plant, what inputs to use, et cetera … it's all of the inputs and all of the decisions that are creating your earnings if you indeed continue to have earning. It's all of your decisions, not in that case just the government grant.[8]

13. The record in this dispute does not support the conclusion that government benefits have kept mills operating where those mills otherwise would have closed.

[8] Tr. vol. 4-A, 985:16-25.

ANNEX VI

RESPONSE TO TRIBUNAL QUESTION REGARDING THE NEGOTIATING HISTORY OF THE SLA

1. At the Hearing, the Chair commented on the absence of any reference in the Parties' submissions to *travaux preparatoires* or negotiating history of the SLA, and asked the Parties to address this issue.[1] In its Closing Statement, the United States informed the Tribunal that there are no official *travaux preparatoires* for the SLA, as the Tribunal in LCIA No. 7941 recognized.[2] Canada concurred with this position.[3]

2. While the United States and Canada agree on this point, they continue to disagree regarding an important, related issue – namely, the antecedents to the SLA, and in particular, the appropriate characterization of the 5 billion dollars in estimated duties that the United States returned to Canada under the Agreement. This Annex addresses this issue.

3. The United States has persisted throughout this dispute to mischaracterize the antecedents to the SLA. At the Hearing , the United States characterized the Parties' bargain in the following terms:

> In the bargain, the parties received the following assurances: The United States would agree to forego all of its trade remedies and would return $5 billion that were the subject of Canada's many lawsuits. This was the retroactive relief that Canada received upfront in the agreement. In exchange, Canada would self-regulate its industry and abide by a system of self-imposed export measures. These export measures replaced the protections provided by the United States' antidumping and countervailing

[1] Tr. vol. 4-B, 1075:21-1076:6.

[2] Tr. vol. 5, 1100:16-22.

[3] Tr. vol. 5, 1238:11-14.

> duty laws and entrusted with Canada the responsibility to regulate exports.[4]

4. Conveniently omitted from this selective retelling is any reference to one of the central benefits the United States obtained in the bargain – namely, Canada's agreement to abandon its litigation in U.S. courts to have the Countervailing Duty and Antidumping Duty Orders issued by the U.S. Department of Commerce declared unlawful, and to compel the United States to revoke the orders back to the date of their issuance and return the 5 billion dollars in cash deposits – a kind of surety – that the United States had collected on lumber imports from Canada between 2001 and 2006 pursuant to those orders.

5. The U.S. mischaracterization amounts to a wholesale rewriting of the bargain the Parties struck in the SLA. By omitting any reference to Canada's agreement to abandon its litigation claims, the United States leaves the impression that the money it returned to Canada somehow was a key element of the bargain it struck with Canada regarding future trade in softwood lumber, including the anti-circumvention provisions and remedy provisions of the SLA. It was nothing of the sort.

6. The SLA accomplished two goals: it served to settle existing litigation relating to the Countervailing Duty and Antidumping Duty Orders, and it also established a new comprehensive framework for trade in softwood lumber going forward. The consideration exchanged to achieve these goals was not the amalgamation of various "assurances" that the United States now suggests.

7. To the contrary, the elements of each bargain were straightforward. To achieve the settlement of existing litigation, Canada abandoned its litigation claims

[4] Tr. vol. 5, 1094:18-1095:6.

seeking the invalidation of the Countervailing Duty and Antidumping Duty Orders and the full return of the 5 billion in cash deposits the United States had collected. For its part, the United States abandoned its efforts to defend the validity of the orders, and agreed to revoke them in their entirety and to return all cash deposits to Canada. In addition, the Parties agreed that Canada would set aside $1 billion of the returned monies to be split between the U.S. industry ($500 million), a binational industry council ($50 million) and so-called "meritorious initiatives" in the United States undertaken pursuant to SLA Article XIII(A) ($450 million).[5]

8. In effect, Canada accepted 80 cents on the dollar to have the money it claimed lawfully to belong to Canadian interests returned immediately, rather than waiting for the litigation process to be completed. For the record, Canada notes that a three-judge panel of the Court of International Trade (CIT) unanimously ruled in Canada's favor on July 21, 2006, and held that the Countervailing Duty and Antidumping Duty Orders were invalid.[6] Subsequently, on October 13, 2006, the same three-judge panel unanimously ordered the Department of Commerce to revoke the orders *ab initio* and to refund all of the nearly 5 billion in cash deposits held by the United States.[7]

9. The terms of the bargain going forward were equally plain. To avoid future contentious litigation of the sort the Parties had just resolved, they agreed to impose a different regime on trade in softwood lumber for the future. Under this new regime, the United States agreed not to apply its trade laws to imports of softwood

[5] SLA 2006 Annex 2C, ¶ 5 (Ex. R-1).

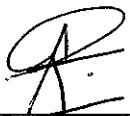
[6] *Tembec v. United States*, 441 F. Supp. 2d 1302 (Ct. Int'l Trade 2006) (RA-9).

[7] *Tembec v. United States*, 461 F. Supp. 2d 1355 (Ct. Int'l Trade 2006), *judgment vacated as moot*, 475 F. Supp. 2d 1393 (Ct. Int'l Trade 2007) (RA-10).

lumber from Canada for the duration of the Agreement (7 or 9 years), in exchange for which Canada agreed to impose export charges and quotas on exports of softwood lumber to the United States. In connection with this aspect of their bargain, Canada and the United States also agreed – in Article XVII – not to take actions that would offset or reduce Canada's commitment to impose export restraints or undermine the U.S. commitment not to impose trade actions.

10. Seen in this light, there is no basis for the United States' repeated assertion that the money it returned to Canada somehow was a central ingredient of the consideration it gave in connection with the forward looking aspects of the SLA, thereby justifying the extreme positions it is taking in this case regarding the proper interpretation of Article XVII and the SLA's remedy provisions. The money the United States returned to Canada did not somehow amount to an "advance payment" for the future oriented rights it obtained under the SLA. It was simply a vehicle to settle existing litigation regarding the Parties' competing claims to those funds, and to distribute roughly 20 percent of their value to the U.S. industry and other U.S. interests – nothing more and nothing less.

Respectfully submitted,



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