In the LCIA
No. 111790

THE UNITED STATES OF AMERICA,

Claimant,

v.

CANADA,

Respondent.

REQUEST FOR ARBITRATION

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January 18, 2011

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I

INTRODUCTION

1. The United States respectfully requests arbitration pursuant to Article XIV of the 2006 Softwood Lumber Agreement between the Government of the United States of America and the Government of Canada ("SLA" or "Agreement"). Exhibit A.

2. The SLA requires Canada to impose "Export Measures" (charges and volume limitations as defined in the Agreement) upon shipments of softwood lumber into the United States when the United States price of lumber falls below certain levels. SLA, arts. VI-VII. Canada agreed not to circumvent commitments under the SLA by agreeing not to take any action that would reduce or offset the Agreement's Export Measures. SLA, art. XVII, ¶ 1. This commitment binds "any public authority of Canada," including the provincial governments. *Id.* ¶ 1.

3. The SLA establishes that "[g]rants 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." *Id.* ¶ 2. Accordingly, a government grant or benefit provided to producers or exporters of Canadian softwood lumber *per se* breaches the Agreement unless the program meets the criteria for certain enumerated exceptions.

4. Canada has failed to abide by its commitment not to circumvent the Export Measures. This request for arbitration to resolve Canada's breach of the SLA concerns the pricing of timber — the raw material for softwood lumber. Canada has been underpricing timber cut from government-owned land in British Columbia and sold to Canadian producers. As a result, not only have Canadian softwood lumber producers been paying close to nothing to obtain

valuable timber, they have done so contrary to the timber pricing system in place under the Agreement. This has provided a benefit to softwood lumber producers. As provided in the Agreement, these additional benefits circumvent the Export Measures and thus breach Canada's obligations under the Agreement.

II

PARTIES TO THE ARBITRATION

A. The Claimant

5. The claimant in this proceeding is the United States of America ("United States"). The claimant's legal representatives in this proceeding are:

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B. The Respondent

6. The respondent in this proceeding is Canada. The respondent's legal representatives in this proceeding are:

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III

THE ARBITRATION AGREEMENT

7. The United States respectfully requests arbitration pursuant to the dispute settlement provisions in Article XIV of the Agreement. The United States has complied with the

formal requirements of Article XIV. Since 2008, the United States informally has discussed with Canada its concern about Canada's breach of the Agreement, in the hope that the matter could be resolved without resorting to the dispute settlement provisions of the Agreement. After informal discussions failed to resolve the matter, the United States initiated formal consultations with Canada by letter dated October 8, 2010. *See* Exhibit B; SLA, art. XIV ¶ 4. Canada requested that the United States provide a list of detailed questions and requests for further information on this matter before the consultations. In response, the United States provided questions and requests for information to Canada. Formal consultations occurred in Ottawa on October 25, 2010, at which Canada indicated that it would not provide the United States with any additional information. The Agreement's 40-day consultation period expired on November 17, 2010. SLA, art. XIV ¶ 6. Having now determined that further consultations will not resolve the dispute, the United States respectfully requests arbitration in accordance with the Agreement.

IV

MATTERS REGARDING THE ARBITRATION

The parties have agreed in the SLA to the following matters:

A. Selection Of The Arbitral Tribunal

8. The Arbitral Tribunal shall consist of three arbitrators, and no citizen or resident of either the United States or Canada shall be appointed to the Tribunal. SLA, art. XIV ¶¶ 7-8. Each party shall nominate one arbitrator within 30 days after the commencement of the arbitration pursuant to Article 1.2 of the LCIA Rules. SLA, art. XIV ¶ 9. Under Article 1.2 of the LCIA Rules, the arbitration commences on the date on which the LCIA Registrar receives the Request for Arbitration. Within 10 days of the nomination of the second arbitrator, the two nominated arbitrators shall jointly nominate the Chair. SLA, art. XIV ¶ 10. The Agreement calls

upon the LCIA to endeavor to appoint the three nominated arbitrators within five business days after the date the Chair is nominated. SLA, art. XIV, ¶ 11.

B. Remuneration Of The Tribunal

9. According to the Agreement, the arbitrators will be remunerated and their expenses paid in accordance with LCIA rates. SLA, art. XIV ¶ 12.

C. Hearings Of The Tribunal

10. The legal place of arbitration shall be London, United Kingdom, but the hearings of the Tribunal shall be held in the United States or Canada and shall be open to the public. SLA, art. XIV ¶¶ 13, 17. In addition, each party shall make the record of the arbitration and underlying documents available to the public. SLA, art. XIV ¶ 16.

D. The Taking Of Evidence

11. The International Bar Association Rules on the Taking of Evidence in International Commercial Arbitration shall generally apply, with the exception of the provisions regarding experts. SLA, art. XIV ¶ 14. The LCIA rules regarding experts do not apply. SLA, art. XIV ¶ 6.

E. The Award Of The Tribunal

12. The Tribunal shall endeavor to issue an award within 180 days after appointment. SLA, art. XIV ¶ 19. The award shall be final and binding with no appeals. SLA, art. XIV ¶ 20. The Tribunal may not award costs. A portion of the funds allocated to the binational industry council established under Annex 13 of the Agreement shall be used to cover costs of the arbitration other than those of the parties. SLA, art. XIV ¶ 21. Each party shall bear its own costs, including costs of legal representation and related costs. SLA, art. XIV ¶ 21.

13. If the Tribunal finds that Canada has breached an obligation under the Agreement, to the SLA requires the Tribunal to:

> (a) identify a reasonable period of time for Canada to cure the breach or breaches, which shall be the shortest period of time feasible and, in any event, not longer than 30 days from the date of the award; and
>
> (b) determine appropriate adjustments to the SLA's Export Measures to compensate for the breach or breaches if Canada fails to cure its breach or breaches within the reasonable period of time. Such adjustments are to be in an amount that remedies the breach or breaches.

SLA, art. XIV ¶¶ 22-25.

V

FEE

14. The fee prescribed in the LCIA Schedule of Costs was transmitted to the Registrar of the LCIA on January 13, 2011.

VI

NATURE OF THE CASE

A. Nature Of Claims

15. Canada, through the provincial government of British Columbia ("BC"), has breached the SLA by selling timber to its lumber producers for far less than required by the pricing system in place on July 1, 2006. These actions have provided substantial additional benefits to softwood lumber producers and offset the Export Measures provided for under the SLA, and thereby circumvent the Agreement.

16. The United States respectfully requests that the Tribunal determine that Canada has been underpricing timber in BC, that this underpricing circumvents the Export Measures, and that Canada has been breaching the SLA. The United States further requests that the Tribunal determine the reasonable period of time for Canada to cure its breach or breaches (not to exceed 30 days), and the appropriate adjustments to the Export Measures to fully compensate the United States if Canada fails to cure its breach or breaches within the reasonable period of time.

B. Summary Of Claims

17. The SLA entered into force on October 12, 2006. It resolved the decades-long dispute over Canadian softwood lumber imports into the United States. As part of the SLA, the United States agreed to cease collection of antidumping and countervailing duties and to refund US$5 billion in deposits of duties collected on Canadian imports since May 2002. SLA, art. III-IV.

18. In exchange, Canada agreed, among other things, to apply Export Measures – export charges and volume limitations – to shipments of softwood lumber from Canada into the United States when the price of lumber products falls below a certain level. *Id.* arts. VI-VIII. The price of lumber products has remained low since the inception of the Agreement in October 2006, and thus the Export Measures have been in effect in every month in which the SLA has been in force, with the exception of June 2010.

19. Canada further agreed not to offset or circumvent the Export Measures. This commitment is memorialized in Article XVII of the SLA, the Anti-circumvention provision, which explicitly prohibits Canada from providing grants or other benefits to softwood lumber producers or exporters. SLA, art. XVII ¶ 2.

20. Specifically, the provision prohibits a party, "including any public authority of a Party," from taking "any action to circumvent or offset the commitments under the SLA 2006, including any action having the effect of reducing or offsetting the Export Measures." *Id.* at XVII, ¶ 1. "Grants or other benefits" that the Canadian federal, provincial, or local governments provide *de jure* or *de facto* to softwood lumber producers are deemed to circumvent the Export Measures, unless they fall within certain limited exceptions. *Id.*, art. XVII, ¶ 2. As a general matter, the provision allows programs or systems that existed as of July 1, 2006, to continue — that is, such programs and systems are not considered to circumvent the Agreement. Importantly, post-July 1, 2006 *changes* to programs, or new programs, *are* generally considered circumventions if they provide increased grants or other benefits beyond what was provided as of July 1, 2006.

21. This dispute involves benefits provided by BC that do not fall within any of the Anti-circumvention provision's exceptions. In particular, this dispute involves post-July 1, 2006 changes to BC's provincial timber pricing system, including (but not necessarily limited to) the so-called Market Pricing System ("MPS"), for timber harvested in the Interior region of BC. Under this system, BC allows lumber producers to cut and buy timber from government-owned land and determines the price for that timber.

22. The parties specifically agreed that post-July 1, 2006 modifications to the provincial timber pricing or forest management provincial stumpage systems, including to the MPS, would not be considered circumvention, if the change "*maintain[ed]* or *improve[d]* the extent to which stumpage prices reflect market conditions." *Id.* XVII.2(a) (emphasis added). In addition, the parties agreed that any "action that conflicts with" the BC MPS as it existed on July 1, 2006, "may constitute circumvention." *Id.* at XVII.4(a).

23. BC's underpricing of timber has not "maintain[ed] or improve[d] the extent to which stumpage prices reflect market conditions." Rather, BC's underpricing has done the opposite by ensuring that stumpage prices have borne less relation to market prices.

24. The provincial timber pricing system, as it existed on July 1, 2006, provided that government-owned timber that was mostly suitable for lumber would be subject to a variable "stumpage rate," or timber price, calculated in accordance with the "policies and procedures in the Interior Appraisal Manual in effect on July 1, 2006." SLA, Art. XXI, ¶ 35(b). This rate was to apply to all timber harvested in the Interior region, except timber that is mostly unsuitable for the manufacture of merchantable lumber, which would be sold at a low, fixed price.

1. Log Grading In BC

25. Some general knowledge of the sale and harvest of timber is useful. Under the timber pricing system that BC had in place for the Interior region as of July 1, 2006, timber harvesters are required to have the harvested logs graded and "scaled" (that is, the volume of the timber is measured) after harvest. Timber is scaled by lumber company employees called "scalers," who are licensed by the province. BC Provincial authorities check, audit, and if necessary, correct the scalers' conclusions on a random basis.

26. Where the majority of the timber is useable for lumber, and the majority of the lumber produced will be "merchantable," BC regulations require the scalers to grade the timber as "grade 1" or "grade 2." The BC Interior Appraisal Manual sets forth a procedure by which a "grade 1" and "grade 2" timber price is determined for each timber stand. Price varies based on a number of factors, but it can never be lower than C$.25 per cubic meter. If the majority of a particular log is *not* useable for lumber, or if the majority of the lumber that can be produced from the log will *not* be merchantable, BC regulations provide that the log be graded as "grade

4." The BC Interior Appraisal Manual provides that this timber will be sold for a flat price of C$.25 per cubic meter.

27. This grading and pricing procedure was developed expressly to ensure that the large volume of timber affected by a mountain pine beetle infestation would no longer be automatically sold for C$.25 per cubic meter but, rather, would be priced according to its suitability for lumber. Only timber that did not meet the designated threshold of suitability for lumber manufacture would be eligible for the minimum price of C$.25. The system took into account any decrease in timber quality that would be caused by the mountain pine beetle infestation. This system went into effect on April 1, 2006.

28. For nearly one year, the percentage of timber harvested in the BC Interior that was graded as grade 4 was relatively constant, at approximately 16 percent of the harvested volume, according to BC public data.

2. BC's Breach

29. Contrary to the purposes of the system to which Canada agreed to adhere in the SLA, the percentage of timber classified as grade 4 and sold for the minimum rate of C$.25 per cubic meter increased dramatically in the spring of 2007. According to BC public data, by mid-summer 2007, BC was selling approximately 30 percent of Interior timber as grade 4. And by summer 2008, BC was selling approximately 48 percent of timber from the Interior as grade 4. Data available for more recent periods show that the share of grade 4 has remained at these high levels.

30. This dramatic increase in grade 4 classifications and sales is not attributable to changes in the quality of timber available to lumber producers. Although a significant mountain pine beetle infestation has affected the BC Interior over the past decade, publicly available data

on the effect of the beetle infestation, as well as other publicly available data, establish that the percentage of the BC Interior timber harvest meeting the grade 4 criteria – *i.e.*, not useable for producing merchantable lumber – has not increased significantly since 2006. Yet the percentage of timber *classified* as grade 4, and then sold at the negligible rate of C$.25 per cubic meter has substantially increased. BC has thus not applied the timber pricing system as it existed on July 1, 2006, and has sold timber at prices below those contemplated under the system as it existed on that date.

31. Additionally, BC has taken other actions that have contributed to the underpricing of government-owned timber. These measures include but are not limited to: (1) allowing the practice of warming logs in kilns prior to grading and scaling — a practice that has resulted in the classification of at least some logs as grade 4 that would have otherwise been graded as grade 1 or grade 2; and (2) changes to the norms governing scaling practice in the BC Interior and published in the "Scaling Manual" that have also contributed to increased volumes of timber being classified as grade 4.

32. These actions, taken together, demonstrate that BC has provided a benefit to the BC lumber producers who have paid C$0.25 per cubic meter for timber that should have been categorized as merchantable, and thus should have been sold at the higher, variable price of grade 1 or 2 timber, the latter of which has been as high as C$17.70 per cubic meter during the course of the SLA.

33. These actions have not only produced unwarranted increases in grade 4 sales, but also have affected the variable price for the other grades by reducing those prices below what would have prevailed but for the excessive volumes classified as grade 4. That is, even lumber

producers buying primarily grade 1 or grade 2 timber from BC have been benefitting from reduced prices.

34. BC's underpricing of government-owned timber has been inconsistent with the "provincial timber pricing or forest management systems as they existed on July 1, 2006." SLA, art. XVII ¶ 2(a).

35. Additionally, BC's actions do not "maintain or improve the extent to which stumpage prices reflect market conditions." *Id.* Accordingly, BC's actions do not fall within any of the enumerated exceptions in the Anti-circumvention provision and provide a clear benefit to softwood lumber producers who have been able to pay almost nothing for lumber-quality timber. These actions therefore constitute a circumvention of the SLA.

VII

CLAIMANT'S REQUEST FOR RELIEF

36. The United States respectfully requests an award in its favor:

(a) that Canada has breached the SLA;

(b) determining a reasonable period of time, not to exceed 30 days, for Canada to cure the breach;

(c) determining compensatory adjustments to the Export Measures in an amount that remedies the breach if Canada does not cure the breach within the reasonable period of time; and

(d) ordering any further relief that may be appropriate.

VIII

SERVICE OF THE REQUEST

37. This Request, together with Exhibits A- B, is being simultaneously transmitted to Canada's legal representative by email. Attached is a Certificate of Service confirming service. A copy will also be served by overnight delivery upon the LCIA and upon Canada's legal representative.

Respectfully submitted,

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January 18, 2011

CERTIFICATE OF SERVICE

I certify that the attached REQUEST FOR ARBITRATION was served, by electronic mail, to Canada's legal representative and that I caused to be sent, by overnight courier, copies of the same REQUEST FOR ARBITRATION, to the LCIA and to the legal representative of Canada on January 18, 2011.