In the LCIA
No. 81010

THE UNITED STATES OF AMERICA,

Claimant,

v.

CANADA,

Respondent.

CORRECTED UNITED STATES REPLY MEMORIAL

NON-CONFIDENTIAL

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THE UNITED STATES REPLY MEMORIAL

1. Pursuant to the Tribunal's letter dated August 6, 2008, claimant, the United States, respectfully submits its Reply Memorial to Canada's Statement of Defence.

2. This Reply Memorial consists of the following sections: (1) an Introduction in which the United States summarizes its response to Canada's submission, as well as its interpretation of the provisions at issue; (2) an Argument on Liability in which the United States responds to Canada's arguments with respect to each program; (3) an Argument on Remedy in which the United States responds directly to Canada's submission and experts' analyses regarding each of the United States' remedy proposals; and (4) a Conclusion.

INTRODUCTION

3. The Anti-circumvention provision of the Softwood Lumber Agreement ("SLA" or "Agreement") prohibits either Canada or the United States from taking any action that would circumvent or offset the commitments each has made. In the Agreement, the parties settled protracted and multi-forum litigation regarding Canadian exports of softwood lumber to the United States by taking the following essential actions: the United States returned approximately US$5 billion in antidumping and countervailing duty cash deposits and, as consideration, Canada agreed to impose export charges and, in some cases, quota restrictions on lumber exports to the United States — these charges and quotas were, together, called "Export Measures."[1] The

[1] Canada misstates the context of the SLA. It claims to have prevailed in "virtually all" litigation before the World Trade Organization ("WTO"), the North American Free Trade Agreement ("NAFTA") panels, and the United States Court of International Trade (at ¶¶ 21, 27), and that the United States "refus[ed] to refund the more than 5 billion dollars in unlawfully collected cash deposits and threaten[ed] to delay the return of those deposits until the United States had exhausted every last avenue of domestic appeal." Stmt. Defence, ¶¶ 27. Canada then revises history to contend that only this "refusal" and "threat" prompted it to engage in negotiations. In fact, Canada did not prevail in all the litigation, and it ignores that the SLA negotiations occurred concurrently with the multi-fora litigation that the SLA ultimately settled.

Export Measures were intended to discourage or to prevent exportation when the price of lumber in the United States was low.

4. The parties included the Anti-circumvention provision to prevent any undermining of this system of Export Measures, namely by prohibiting Canada from collecting export charges and then funneling those charges back to the softwood lumber industry through grants or other benefits. The provision itself reveals its purpose, explaining that actions that reduce or offset the Export Measures are the parties' primary concern, and that providing grants or benefits will constitute circumvention. SLA, art. XVII, ¶ 1 (explaining that neither party may take any action that circumvents the Agreement, "including any action having the effect of reducing or offsetting the Export Measures"). It is unnecessary to venture beyond the terms of the SLA to discern the self-evident purpose of the provision.

5. As the United States demonstrated in its Statement of the Case, there are six programs – three in Ontario and three in Québec – that circumvent the SLA because they provide benefits on a *de jure* or a *de facto* basis to producers or exporters of softwood lumber. The SLA considers these benefits to reduce or offset the Export Measures and, therefore, to circumvent the SLA.

6. In its Statement of Defence, Canada attempts to demonstrate that these six programs fall within one or more of the SLA's enumerated exceptions to this general rule. The Statement, however, dwells upon issues that, in some instances are not contested, and, for issues that are contested, neglects to address evidence that directly contradicts Canada's assertions.

See, e.g., *United States – Final Coutervailing Duty Determination With Respect to Certain Softwood Lumber From Canada* (AB-2003-06), WT/DS257/AB/R (Jan. 19, 2004) (in which the Appellate Body upheld the Department of Commerce's determination regarding specific subsidies), CA-10; *see also* RA-10 (in which the United States Court of International Trade issued its decision in *Tembec v. United States* ***after*** the SLA went into effect).

Ultimately, Canada's Statement reveals that there are relatively few disputed issues, all of which can be distilled into the following two paragraphs.

7. Regarding the Ontario programs, Canada has disputed the ordinary meaning of "non-discretionary" as it applies to the Ontario Forest Sector Prosperity Fund ("FSPF") and the Ontario Forest Sector Loan Guarantee Program ("FSLGP"). Canada has failed to respond, however, to the United States' evidence demonstrating that the Ontario Forest Access Road Construction and Maintenance Program's ("road program's") purpose was to enhance competitiveness in the softwood lumber industry. Canada further contends that the road program did not circumvent the Agreement even though it was administered only *after* the Agreement's cut-off date for new programs.

8. Regarding the Québec programs, Canada asserts, without any authoritative support, that the Québec Capital Tax Credit program – enacted in December 2006 – actually existed when the program was announced in March 2006, merely because that was when it was announced. Moreover, Canada *concedes* that Québec's Forest Management Measures provide benefits to producers or exporters of softwood lumber, but asks the Tribunal to relinquish its mandatory task of determining appropriate compensatory adjustments to the Export Measures and, rather, allow Canada unilaterally to "offset" its liability by adjusting stumpage rates. The United States never agreed to this alternate remedy in the SLA; in any event, there is no "offset." Finally, Canada contends that the United States has failed to prove any actual disbursements under the Québec Forest Industry Support Program administered by a government corporation, Investissement Québec ("IQ"), even though the 2007-2008 IQ Annual Report confirms that hundreds of millions of dollars in disbursements have been made to forest sector companies under the program. Moreover, despite Canada's incomplete document disclosure, United States'

expert Tom L. Beck of the Beck Group identifies many transactions that demonstrate the benefits to softwood lumber producers.

9. The United States addresses these discrete issues in turn, but first offers the following general comments regarding Canada's position. To elude the ordinary meaning of the Anti-circumvention provision, Canada advances flawed grammar, as it does when offering its strained view of the provision overall and the meaning of paragraph 2(b). To avoid the common and ordinary meaning of "non-discretionary" and "administered," in the context of the Ontario programs, Canada either creates its own definition for the terms – relying upon a "purpose" and negotiating history that is unsupported by any documentation – or it simply ignores the terms altogether.

10. In fact, each time Canada informs the Tribunal of the alleged "purpose" of a certain word or provision, it fails to offer any documentary support. This would be of no moment if Canada were to have relied upon only the text and context of terms and provisions. But Canada ventures beyond the text of the Agreement to offer mere unsupported statements regarding the various alleged purposes behind these terms and provisions.

11. The slight documentary evidence Canada *does* offer to rebut the United States' claims of breach, does not, in many instances, even relate to the program in dispute, such as Canada's proffer in response to the Ontario Road Program. Or, Canada offers evidence that, while relevant to the program at issue, does not help establish Canada's position, as in the Québec tax credit program response.

12. On the question of remedy, Canada raises the identical arguments that were recently rejected by an LCIA Tribunal in *United States v. Canada*, LCIA No. 7941, *Award on*

Remedies ("Remedy Award").[2] In the Remedy Award, the Tribunal disagreed that the SLA allows only prospective remedies and rejected Canada's expert's contention that the SLA's prescribed form or remedy (adjustments to export measures) was too imprecise to render accurate remedies.[3] Because the Remedy Award in *United States v. Canada* interprets the very same remedy provisions in the very same Agreement at issue here, the United States respectfully urges the Tribunal to reach the same conclusion as the Tribunal.

I. Canada's Flawed Interpretation Of The Anti-Circumvention Provision

13. The Anti-circumvention provision states in relevant part:

> 1. Neither Party, including any public authority of a Party, shall take action to circumvent or offset the commitments under the SLA 2006, including any action having the effect of reducing or offsetting the Export Measures or undermining the commitments set forth in Article V.
>
> 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, including any modifications or updates that maintain or improve the extent to which stumpage charges reflect market conditions, including prices and costs. Fluctuations in stumpage charges that result from such modifications or updates, including fluctuations resulting from changes in market conditions or other factors affecting the value of the province's timber, such as transportation costs, exchange rates, and timber quality and natural harvesting conditions, do not constitute circumvention. A provincial timber pricing or forest management system includes, without limitation, the data, variables, and procedures it employs;
>
> (b) 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;

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[2] *United States v. Canada*, LCIA No. 7941, *Award on Remedies*, ¶ 197-242, (Feb. 26, 2009), CA-12.

[3] *See id.* at ¶¶ 326-27.

(c) actions or programs undertaken by a party, including any public authority of a Party, for the purpose of forest or environmental management, protection, or conservation, including, without limitation, actions or programs to reduce wildfire risk; protect watersheds; protect, restore, or enhance forest ecosystems; or to facilitate public access to and use of non-timber forest resources, provided that such actions or programs do not involve grants or other benefits that have the effect of undermining or counteracting movement toward the market pricing of timber;

(d) payments or other compensation to First Nations to address or settle claims; and

(e) measures that are not specific to the forest products industry.

3. Either Party may consult with the other if it believes the other Party has substantially failed to enforce its legal requirements in a manner that has a material impact on the price or cost of harvesting Softwood Sawtimber.

SLA, Art. XVII, ¶¶ 1-3 (footnote omitted).

14. Canada's labored interpretation aside (Stmt. Defence, ¶ 37-49), the provision is actually quite simple. The parties agreed in paragraph one that neither would take any action to circumvent the Agreement, especially "any action having the effect of reducing or offsetting the Export Measures." SLA, art. XVII, ¶ 1. This, then, is the central inquiry in determining whether something has circumvented the Agreement — whether it reduces or offsets the Export Measures.

15. Paragraph 2 then provides further amplification. It explains that there are some actions that "shall be considered" to reduce or offset the Export Measures — namely, grants or other benefits provided on a *de jure* or *de facto* basis to producers or exporters of Canadian softwood lumber. *See id*, ¶ 2. That is, for grants or other benefits provided on a *de jure* or *de facto* basis to the industry, there is no need to inquire as to whether they offset or reduce the Export Measures — the parties simply declared that they do.

16. Paragraph 2 goes on to describe five categories of grants or other benefits that will *not* be deemed to reduce or offset the Export Measures.

17. Highlighting that this list of five exceptions is introduced by the phrase "without limitation," Canada contends that these five exceptions are not enumerated exceptions but are, in fact, just examples of a limitless number of exceptions (or "safe harbours").[4] *See, e.g.*, Stmt. Defence, ¶ 42, 44. However, Canada fails to provide an alternative framework by which the Tribunal should analyze whether an action circumvents the SLA.

18. More importantly, Canada has never contended that any of the challenged programs should fit into an unenumerated, additional exception. Stmt. Defence, ¶¶ 38-42.[5] Therefore, to the extent that Canada challenges our interpretation of paragraphs one and two of the provision, such challenges do not assist its defence. The only questions at issue in this arbitration are whether the challenged programs fall within paragraphs 2(a)-2(e); and Canada has waived its ability to rely upon unenumerated exceptions later in these proceedings. As Procedural Order 1 makes clear, the United States Reply Memorial is to address only those issues raised in Canada's Statement of Defence. Procedural Order No. 1, ¶ 3.1(h). The United States has relied upon Canada's Statement as containing all of Canada's defenses. Because Canada has failed to raise the defense that its programs fall into any other, unenumerated exception, it may not do so now.

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[4] Canada notes that the United States uses the term "exception" to discuss paragraphs 2(a)-(e). Stmt. Defence, ¶ 1. The United States used the ordinary meaning of the term "exception" to refer to the list of actions that will not be considered to reduce or offset the Export Measures. Canada uses a term of art – "safe harbour" – that appears nowhere in the SLA.

[5] Similarly, although Canada contends that the United States' interpretation of the term "grants or other benefits" is incorrect, Canada does not appear to rely upon this contention elsewhere in its Statement to assist in its defence in any way.

19. Regarding the specific exceptions listed, Canada attacks the ordinary meaning of two terms in paragraph 2(b), "non-discretionary" and "administered." As demonstrated below, however, Canada contradicts the ordinary meaning of "discretionary," and avoids altogether the ordinary meaning of "administer."

20. As discussed further in section I of Argument on Liability below, Canada contends that the Ontario FSPF and FSLGP are "non-discretionary." Paragraph 2(b) states that "government programs that provide benefits on a non-discretionary basis" will not be considered to reduce or to offset the Export Measures if they meet certain other requirements. SLA, art. XVII, ¶ 2(b). After citing several dictionary definitions of "discretionary" demonstrating that the term means the exercise of reasoned judgment, Canada ultimately offers its own, counterintuitive definition found nowhere in any dictionary or other authority. According to Canada, discretion is the exercise of a "whim" — the very opposite of reasoned judgment. Canada reasons further that, because the judgment exercised in these two Ontario programs is exercised using more than mere "whim," the programs are non-discretionary. Canada's position flies in the face of the ordinary meaning of "discretion" and the common understanding of that term under Canadian and United States law.

21. Canada then contends that the reference to "non-discretionary" in paragraph 2(b) applies only to the question of whether government officials exercise discretion in selecting an industry to which benefits may be directed. When a program permits discretion at the level of the provision of benefits to individual applicants, as opposed to at the level of selecting an eligible industry, Canada contends the program is permitted under the SLA. However, nothing in the SLA distinguishes between discretion applied at the level of selecting an eligible industry and discretion applied to providing benefits to individual applicants.

22. Additionally, as discussed further in section I of the Argument on Liability below, Canada ignores the presence of the term "administered" in paragraph 2(b) as it applies to the Ontario road program. Paragraph 2(b) provides that "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*" will not be considered to reduce or to offset the Export Measures. SLA, art. XVII, ¶ 2(b).

23. Paragraph 2(b) requires a program to have existed *and* have been administered prior to July 1, 2006. It further requires the program to have existed and have been administered in the same way before and after July 1, 2006. Although Canada discusses in detail the meaning of "form," "amount," and "existed," it never defines or explains the term "administered," except to say that it means the same as "form." If "form" and "administered" meant the same thing, the phrase "in the form and total aggregate amount in which they existed and were administered" would be meaningless or inoperative. The phrase makes clear that a road program must have been *administered* in its present form *before* July 1, 2006, in order to be excepted from the Anti-circumvention provision. Unrefuted evidence demonstrates that the road program was not "administered" until after July 1, 2006.

II. The United States Has Demonstrated That Canada Has Breached The SLA

24. The next question is whether the evidence put forward by the United States demonstrates that Canada's six programs breach the SLA. As a general matter, the burden of proof rests upon the party asserting a claim or fact that, if not substantiated, will result in an adverse decision on the claim or fact.[6] Pursuant to the only reasonable reading of the SLA, the United States bears the initial burden of demonstrating a breach by Canada of Art. XVII, ¶ 1 of

[6] *See* Durward V. Sandifer, *Evidence Before International Tribunals*, 127 (University Press of Virginia 1975) (Revised Edition), CA-11.

the SLA. If it does so, it is then Canada's burden to overcome this showing with evidence sufficient to demonstrate that the program is not a grant or benefit, or, to demonstrate that, although the program is a grant or benefit provided on a *de jure* or *de facto* basis to producers or exporters, it falls within one of the enumerated exceptions. *See* Stmt. Defence, ¶ 31 (where Canada concedes it bears the burden to prove certain asserted facts). Canada has failed to do either. In light of Canada's breach, the Tribunal is to determine appropriate compensatory adjustments to the Export Measures to compensate for the breach, if Canada fails to cure the breach within a reasonable period of time. If a party proposes remedies, the Tribunal may select the most convincing remedy among the proposals, so long as it satisfies the requirements of the SLA. *See* SLA, art. XIV, ¶ 22.[7]

25. Regarding the Ontario FSPF and FSLGP, Canada does not deny that Ontario provided benefits to producers or exporters of Canadian softwood lumber. The question, then, is whether the programs provide benefits on a non-discretionary basis. Because the programs are administered by officials who exercise judgment in determining not only *how* to select entities to receive benefits, but *whether* to provide benefits to particular eligible entities, the programs are discretionary. Because there is no prescribed or required outcome, the decision whether to provide benefits is discretionary.

26. Regarding the Ontario road program, Canada has failed entirely to address any of the myriad documents demonstrating that the purpose of the road program was to enhance industry competitiveness by reducing delivered wood costs. Rather, Canada generally discusses

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[7] *See also* CA-12, *United States v. Canada*, ¶ 327 (stating "irrespective of the issue of burden of proof, since neither the Respondent nor its expert have presented a model which they claim is better, it further implies that the **Tribunal may select the most convincing adjustment method** among the Proposals submitted so long as it is economically plausible and legally not contrary to the requirements established in [¶¶] 22 and 23).

"forest management systems" in a vain attempt to show that paragraph 2(a) applies to the road program. Except for its general contention that programs like the road program are an "integral part" of a forest management system, Canada never attempts to demonstrate that the road program *itself* is a "forest management system." Similarly, by ignoring our demonstration that Ontario "officially rolled-out" the road program after July 1, 2006, Canada effectively concedes that the program cannot be excepted.

27. Regarding the Québec Capital Tax Credit, there is no dispute that the program was not enacted until December 2006, well after the July 1, 2006 deadline. Canada insists that the date of enactment is meaningless — failing to acknowledge that *Québec's own documents* establish that the proposed legislation is not effective until finally enacted. Canada has offered no evidence that the program was being administered before July 1, 2006. Rather, Canada offers only a tax statement that shows reliance by a private party on the expectation of the credit, but does not show that Québec administered the credit before July 1, 2006. It remains unrefuted that Québec did not administer the program until January 2007 because the program did not exist until December 2006.

28. Regarding Québec's forest management measures, Canada actually concedes the benefits conferred by the measures. But Canada contends that it unilaterally "offset" those benefits by certain stumpage rate changes. Canada has failed to explain precisely *how* those stumpage rates offset the benefits conferred by the programs, or to demonstrate the level of alleged offset. Moreover, the SLA does not allow Canada to breach freely so long as it later unilaterally decides it has offset the breach.

29. Indeed, Canada's position would effectively circumvent the SLA's remedy provision and disable the Tribunal from exercising its role under paragraph 22 of Article XIV.

Paragraph 22 mandates that, once a breach has been committed, the Tribunal is to (1) determine a reasonable period of time for Canada to cure the breach, and (2) determine appropriate compensatory Export Measures in an amount that compensates for the breach. SLA, art. XIV, ¶ 22. Canada proposes in its Statement of Defence, however, that Canada may breach and then be allowed to unilaterally determine that it has offset the breach. Breach of the Anti-circumvention provision does not allow circumvention of the SLA's remedy provision. Canada's interpretation effectively takes the determination of whether a breach has occurred, out of the Tribunal's hands.

30. Finally, Canada contends that the United States has failed to prove that Québec's PSIF provides a benefit. As demonstrated previously and further below, Mr. Beck has demonstrated that, and explained how, the PSIF confers quantifiable benefits in terms of loans, loan guarantees, interest-free loans, grants, and other forms of financial assistance.

III. A Recent LCIA Tribunal Determined That The SLA Provides For Retrospective And Prospective Remedies

31. An LCIA Tribunal in *United States v. Canada* recently and unequivocally concluded that the SLA provides for both prospective and retrospective remedies.[8] In its Award on Remedies, the Tribunal considered and rejected the same arguments and interpretations Canada raises in its Statement of Defence in this case. A brief overview of the SLA's remedy provision – all of which were considered by the Tribunal in *United States v. Canada* – follows, after which the United States will discuss the Tribunal's specific conclusions in *United States v. Canada*, as they relate to this arbitration.

32. Article XIV provides a comprehensive dispute resolution mechanism in which the Tribunal both determines a reasonable period of time for the breaching party to cure its breach

[8] CA-12, *United States v. Canada*, LCIA No. 7941, *Award on Remedies*, ¶ 306, (Feb. 26, 2009).

and determines compensatory Export Measures in an amount that remedies the breach, in the event the breaching party fails to cure the breach within the reasonable period of time. The Tribunal performs both tasks simultaneously so that the breaching party is aware both of the time it has to cure the breach and of the consequences of its failure to timely cure.

33. If a dispute arises as to whether the breach has been cured or remedied, Article XIV provides additional mechanisms to resolve any such dispute. SLA, art. XIV, ¶¶ 26-30. The absence of any retroactive compensatory Export Measures would undermine those additional mechanisms and prevent the parties from exercising their rights and applying the terms to which they agreed.

34. In contrast, to support its view that the SLA provides only prospective remedies for breaches, Canada offers what is at best a truncated view of Article XIV — one that violates the mandatory provisions of paragraph 22, and one that prevents the parties from invoking their rights under paragraphs 27 and 29 of the article. To defend its extra-textual and counterintuitive reading, Canada points to multilateral trade agreements that bear no resemblance in text or in purpose to the SLA.

35. Importantly, the Tribunal in *United States v. Canada, Award on Remedies,* recently rejected each and every one of Canada's arguments regarding the functioning of these provisions. Although the Remedy Award is not binding authority upon this Tribunal, the United States respectfully refers the Tribunal in this case to the Remedy Award, which interpreted the identical remedy provision at issue in this case, as a subsidiary means of interpretation — particularly because the provisions at issue here are the identical provisions at issue in *United*

States v. Canada.[9] Rejecting the very same comparisons between the NAFTA and the WTO, which provide prospective remedies, the Tribunal reasoned that the parties, who are very familiar with the dispute resolution language in NAFTA and the WTO, would have used similar language had they intended to allow only prospective remedies.[10]

36. To interpret the provision any other way, the Tribunal elaborated, "would mean that both Parties could breach also all other provisions of the SLA without any consequences and could continue the breaching conduct even after objections by the other Party and during any arbitration proceedings as long as they stop the breaching conduct within the cure period of up to 30 days after the Tribunal's award."[11] The Tribunal noted that this result was not contemplated by the SLA and, as such, ordered Canada either to cure the breach within 30 days or to impose $C68 million in additional export charges to compensate for Canada's breach (which had ceased prior to the request for arbitration).

37. Canada's interpretation of the remedy provision in this case would allow Canada to continue to circumvent the SLA until 30 days after the Tribunal issues its award. At that time, if Canada ceased its breaching behavior, the arbitration would be over and the United States would have received no remedy. As demonstrated, this interpretation eviscerates the remainder of Article XIV. But more importantly, it is illogical to interpret the Agreement as providing no remedy for breaches. In this regard, the Remedy Award noted the presumption of retroactive

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[9] *See id.* at ¶ 83 (discussing allowable secondary means of interpretation, including other awards).

[10] *Id.* at ¶ 289 ("[s]ince both Parties of the SLA, as parties of the WTO and of NAFTA are very well familiar with the [Dispute Settlement Understanding] and Chapter 20, one must conclude that they would have provided a similar express language in Art. XIV SLA had they intended to provide only for prospective 'cure.'").

[11] *Id.* at ¶ 304.

remedies in international law.[12] Thus, this Tribunal should also reject Canada's contention that it can breach the SLA with impunity.

38. Thus, pursuant to Article XIV, if the Tribunal finds that Canada has breached the SLA in any one of the challenged programs, the Tribunal is to determine a reasonable period of time for Canada to cure the breach.[13]

39. The Tribunal is simultaneously to determine appropriate adjustments to the Export Measures to compensate for Canada's breach. To aid the Tribunal in its task, the United States has offered proposed adjustments to the Export Measures, all of which are in an amount that compensates for the particular breach. The United States urges the Tribunal to consider the Tribunal's conclusion in *United States v. Canada*, that, despite Canada's expert's criticism of the United States' proposed remedies, the United States proposed a viable remedy, in keeping with the SLA's requirements. The Tribunal stated, "even the most distinguished experts in the field are not convinced to be able to come up with an adjustment which would be beyond any criticism."[14]

40. As in *United States v. Canada*, Canada has declined to present a competing proposal for appropriate adjustments to the Export Measures. Accordingly, the Tribunal may select one of the proposals offered by the United States as long as the Tribunal considers them appropriate.[15] Indeed, because Canada has declined to present a competing proposal in its

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[12] *Id.* at ¶ 277.

[13] The Tribunal in *United States v. Canada*, determined that "the longest grace period a breaching Party should be given is 30 days from the time of the Tribunal's award . . . [t]he breaching Party may be given that 30 day period for 'curing' the effects" of the breach, which in the case of that arbitration, was a breach that had already ceased. *See id.* ¶ 295.

[14] *Id.* ¶ 327.

[15] *See id.*

Statement of Defence, it may not do so in its Rebuttal or at any time during the remainder of these proceedings. Procedural Oder No. 1 limits Canada's Rebuttal to only issues raised in the United States Reply.

41. As discussed below, and as the Tribunal determined in the *United States v. Canada*, an appropriate remedy under the SLA must wipe out all the consequences of the breach.[16] To that end, the United States has proposed remedies that capture the two most critical results of the breach: the benefits conferred upon Canadian softwood lumber producers and the harm caused to United States producers. *Both* of these consequences of the breach must be reflected in any remedy imposed. Accordingly, the United States' expert Tom Beck proposes a straightforward remedy in which the Tribunal would determine that Canada should impose an additional export tax on Ontario and Québec, in an amount commensurate with the effects of the tax credits, grants, and other benefits made by the two provinces in these six programs. The Tribunal accepted a similar, straightforward remedy in *United States v. Canada* when it ordered Canada to assess an additional export charge of ten percent until the total amount of $C68 million (including interest) is collected.[17] The United States offers both a "low case" remedy that would assess at least C$217 million in export charges until fully collected, and a "high case" remedy that would assess at most C$640 million in export charges.[18] Regardless of whether the Tribunal chooses the low or the high case, Mr. Beck's proposals consider the benefits realized by Canadian lumber producers.

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[16] *See id.* ¶ 275.

[17] *See id.* ¶¶ 330-331.

[18] These calculations are subject to change, depending upon additional benefits conferred by the programs between now and the date of the Award.

42. United States' expert Robert Topel addresses one component of Canada's breach, namely, the adverse effect on prices in the United States and consequential impact on United States producers. Professor Topel opines that additional export charges could be imposed to bring United States prices up to where they would otherwise have been absent Canada's breach. However, as a practical matter, collection of additional export charges under Professor Topel's model would extend so far beyond the life of the Agreement, this approach would become impractical. Accordingly, we provide Professor Topel's analysis *not* as an alternate remedy, but as a clear articulation of *one* aspect of compensation that must be addressed.

43. Canada mainly complains that Mr. Beck's calculations of the benefits provided are "inflated," and then assigns that alleged inflation to Professor Topel's conclusions. As demonstrated in the Argument on Remedy and Mr. Beck's and Professor Topel's Rebuttal Reports, the quantification of the benefits provided under the six programs is accurate. Canada's view of its liability is so narrow, that it would not begin to compensate the United States for the effects of the benefits received by Canadian producers and exporters of softwood lumber products.

44. Canada assumes that the United States agreed to give Canada a grace period within which Canada could keep breaching the Agreement without consequence.[19] The suggestion that the United States would tolerate a certain amount of circumvention and, then, provide itself no compensatory remedy begs the question of why the parties would have agreed to the Anti-circumvention provision at all. Circumvention without consequences suspends the

[19] This assumption is belied by the reaction of Canada's largest provincial exporter of softwood lumber, British Columbia. Specifically, the British Columbia Forest and Range Minister "expressed disappointment" with the actions of Ontario and Quebec, which, according to the Minister, "make it difficult for our U.S. partners to understand that we are serious about the deal." C-49.

effect of the SLA. The United States would not have agreed to a system in which Canada could circumvent the Agreement until it received an unfavorable award in arbitration, and then avoid any consequences by ceasing the breaching activity.

ARGUMENT ON LIABILITY

I. The FSPF And The FSLGP Both Violate The Anti-Circumvention Provision Because They Provide Benefits On A Discretionary Basis[20]

45. In its Statement of the Case, the United States demonstrated that Ontario officials exercise significant discretion when deciding whether and to whom benefits should be awarded under the FSPF and the FSLGP. In response, Canada did not refute our recitation of the programs' administration (including our recitation of the myriad judgments officials make to determine whether to award benefits under the program). Rather, Canada has disputed that the programs are discretionary.[21]

46. Canada interprets the term "non-discretionary" in paragraph 2(b) of the Anti-circumvention provision in a manner contrary to its ordinary meaning. Although Canada represents that it is using the Vienna Convention's interpretive tools, Canada in fact departs significantly from the ordinary meaning of the term and relies upon unsupported statements regarding the paragraph's purpose and negotiating history.

A. The Ordinary Meaning Of "Non-Discretionary" Contemplates The Absence Of Choice And Judgment

47. Grants or benefits will not be considered to reduce or offset the Export Measures if they are "*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." SLA, art. XVII, ¶ 2(b) (emphasis added). This means that, even if programs exist and are

[20] We address the FSPF and the FSLGP together because the parties dispute only discrete legal issues common to both.

[21] Canada also contends that the form and amount allocated to the programs was constant. Stmt. Defence, ¶¶ 67-87. We do not dispute this. We do, however, disagree with Canada's interpretation of "form," "aggregate amount," and "administered." However, that disagreement is irrelevant for purposes of our discussion of these programs.

administered in the same form and amount as they were on July 1, 2006, they still circumvent the SLA if they are "discretionary." The meaning of discretionary – and consequently "non-discretionary" – in the context of a government program is well-known, well-understood, and common to the United States and Canada. In fact, Canada has offered several dictionary definitions confirming that "discretion" requires an exercise of "judgment," without a duty to produce a particular result. Stmt. Defence, ¶ 111.

48. Relying upon similar definitions, the United States demonstrated that, because the Ontario programs involve the exercise of judgment and do not require a particular result, these programs are discretionary. Officials exercise judgment and choice in determining: whether a given applicant meets the subjective criteria established by these programs, whether and how to apply the criteria, whether to grant an applicant a benefit once it has met the criteria, and how much of a benefit to grant a particular applicant. For instance, in reviewing an FSPF application, the official considers ["] but the program leaves to the official [ ] Canada has not devised any set of concrete standards that lead inescapably to a particular result when applied to a particular set of facts. This is unquestionably discretionary decision making.

49. Similarly, the program requires that [ ] C-4 at 3 (emphasis added). Officials must use discretion to determine [

] In his report, Tom Beck confirms the discretionary nature of the decisions made on the provision of benefits. C-43, pp. 1-2. In sum, as Canada's own documents show, and as Canada does not contest, officials administering the FSPF and FSLGP are not bound to grant benefits to every eligible applicant. Rather, they are granted the discretion to select among eligible applicants using various subjective, flexible criteria as well as their own judgment.

1. Canada's Interpretation Ignores The Plain Meaning Of "Discretion"

a. Canada's Self-Created Definition Contradicts The Very Dictionary Definitions It Offers

50. Although Canada offers multiple dictionary definitions of "discretion," it ultimately abandons them in favor of a definition of its own creation that is unsupported by any dictionary. Specifically, Canada contends that "non-discretionary" refers only to programs where the "decision-making is . . . [not] left totally to the decisionmaker's whim." Stmt. Defence, ¶ 112. Canada also defines "non-discretionary" decisionmaking as decisionmaking that is "reasonably constrained," Stmt. Defence, ¶ 112, "narrowly constrained," Stmt. Defence, ¶ 116, and "specifically constrained," Stmt. Defence, ¶ 118.

51. Canada omits a dictionary definition for whim, which is defined as "(1) [a] fanciful or fantastic creation; a whimsical object; (2) [a] capricious notion or fancy; a fantastic or freakish idea; an odd fancy."[22] According to Canada, then, any decision that is just short of capricious should be considered "non-discretionary." These definitions directly contradict the other dictionary definitions of discretion that Canada itself proffered. The inescapable implication of Canada's interpretation is that every government program that exercises reasoned

[22] *See The Oxford English Dictionary Online* (2d ed. 1989), CA-13.

judgment (the actual definition of discretion), is actually acting *without* discretion. This interpretation would render the "non-discretionary" requirement in 2(b) superfluous and unnecessary.

52. Canada has mischaracterized the United States' position as maintaining that any act would necessarily be discretionary. This is not so. For example, the Ontario Road Program and Québec tax credit programs being challenged in *this very case* appear to be non-discretionary: once a softwood lumber producer shows eligibility for the credit or reimbursement, the producer receives the credit or reimbursement. The programs do not permit an official to "prioritize" some requests over others, nor do they leave to the official's discretion whether to "consider" certain criteria or what weight to give to the existence of certain criteria.

53. Canada also unilaterally would add a limitation beyond the SLA upon what kinds of discretionary acts should be included. Canada contends that the determination of whether a program "provides benefits on a non-discretionary basis" must be based solely on whether discretion is applied when determining whether a given *industry* is eligible to receive a benefit. According to Canada, no consideration at all should be given to whether discretion is applied when determining whether a specific *applicant* shall receive the benefit.

54. Without any support in the SLA, Canada asserts that any benefits which do not involve the application of discretion in determining whether a given industry is eligible to receive a benefit do not contravene the SLA's Anti-circumvention provision, regardless of whether they involve the application of discretion in determining whether a specific applicant shall receive the benefit.[23] But the SLA does not distinguish between discretion applied at the

[23] Interestingly, one of Canada's own exhibits demonstrates that discretion at various levels is a consideration in international trade. The Federal Register notice Canada cites discusses discretion at the industry level as well as with respect to individual beneficiaries. *See*

level of selecting an eligible industry and discretion applied with respect to providing benefits to individual applicants. Rather, the SLA refers only to producers or exporters of Canadian softwood lumber products, that is, individual applicants. In any event, the actual provision of benefits to individual applicants is, without question, a key element of the Anti-circumvention provisions of the agreement. No doubt Canada agrees — its own arguments in the Statement of Defence focus on whether the benefits provided to certain individual *applicants* demonstrate a breach. It is therefore counterintuitive that discretion in this one area would be excluded.

b. Canada's Interpretation Contradicts The Meaning Of "Discretion" As Understood In The American And Canadian Legal Systems

55. Not only does Canada's interpretation of "discretion" contradict the ordinary meaning of the word, it contradicts the common understanding of the term as used within the legal systems of both Canada and the United States. As demonstrated in our Statement of the Case, in the legal systems of both countries, a discretionary act is one that involves judgment[24] and one that does not require a specific outcome.[25] Accordingly, "non-discretionary" must mean the absence of discretion, and, therefore, must refer to the absence of judgment or the absence of freedom to choose more than one outcome.

56. As such, Canada misunderstands the United States Supreme Court's analysis in *United States v. Gaubert*. Canada correctly states that *Gaubert* concerns an exception to the United States' Government's liability under the Federal Tort Claims Act. However, Canada

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RA-23 at 65356 (explaining that for purposes of the specificity determination, "the manner in which authorities have exercised their discretion in the early days of a new program (*e.g.*, by excluding certain applicants and limiting the benefit to a particular industry)" is most relevant).

[24] *See United States v. Gaubert*, 499 U.S. 315, 326 (1991), CA-7.

[25] *See Baker v. Canada*, [1999] S.C.J. No. 39 at 52, CA-6.

conflates the Court's discussion of "discretionary function" – a term of art used in the statute – with the Court's discussion of the general understanding of the term "discretion." Specifically, the Court stated that a "discretionary act is one that involves choice or judgment."[26] The Court then explained that "discretionary acts" as a general matter do not necessarily fall within the "discretionary function" exception to Federal Tort Claims Act liability.[27] That is, "discretionary functions" under the statute must be "based on the purposes that the regulatory regime seeks to accomplish."[28]

57. As an example, the Court further explained that a United States Government employee who is involved in a car accident while engaging in his official duties would not be excepted from liability. Although driving requires discretion, that discretion is not grounded in regulatory policy.[29] Here, at the very least, Ontario officials are exercising judgment in their official duties, consistent with the program policy. They are not only exercising "discretion," they might very well be considered to exercise "discretionary function" under a rubric similar to the Federal Tort Claims Act. In any event, the question here is not whether Ontario officials' actions would fall within the confines of "discretionary functions," as that term is understood in United States law, but the general meaning of "discretion" as the Supreme Court defined that word. By comparing ordinary "discretion" with the more limited "discretionary function" at issue in a particular American statutory scheme, the Court highlighted the ordinary meaning of "discretion" as understood in American law.

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[26] *See* CA-7, *Gaubert*, 499 U.S. at 326.

[27] *See id.*, n.7.

[28] *Id.*

[29] *Id.*

58. The term has the same meaning in Canadian law. Yet Canada similarly misinterprets the Supreme Court of Canada's decision in *Baker v. Canada*. In *Baker*, the Court explained that "discretionary decisions, like all other administrative decisions, must be made within the bounds of the jurisdiction conferred by the statute," and "discretion must still be exercised in a manner that is within reasonable interpretation . . . ."[30] The Court then went on to explain that there may be different levels of discretion that may not easily lend themselves to the "rigid dichotomy of 'discretionary' or 'non-discretionary.'"[31] Again, Canada ignores the purpose of the court's explanation. The Court addressed the concept of "discretion" specifically to provide a framework for how to review a discretionary action — meaning, how much deference to accord to the decisionmaker. In a regulatory framework that did not provide a strict dichotomy, the court preferred to apply deference using a pragmatic approach. That is, the amount of deference owed depends upon the situation. The understanding of a "discretionary" act, however, remains the same, namely, an act in which the decisionmaker is given a "choice of options."[32] Of course, here, the SLA provides exactly the kind of clear dichotomy that did not exist in *Baker*. Here, the parties agreed that there would be only two categories — "discretionary" and "non-discretionary."

B. Canada Manufactures A Purpose And Negotiating History

59. Because the language of the Agreement does not support Canada's interpretation, Canada reaches outside the SLA to attempt to justify its interpretation. Specifically, Canada

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[30] *See* CA-6, *Baker*, 53.

[31] *Id.* at 54.

[32] *Id.* at 52.

manufactures a purpose for paragraph 2(b) and a corresponding negotiating history to defend its interpretation of the provision, but fails to support its assertions with any context or evidence.

60. Specifically, Canada alleges that paragraph 2(b) is "a grandfathering provision that was designed to preserve programs that were already in existence," and argues that "there is no mechanism anywhere in the SLA that sought to terminate existing programs that support softwood lumber producers." Stmt. Defence, ¶ 98. To prove that this indeed was the design, Canada makes the wholly unsupported allegation that paragraph 2(b) was meant to grandfather all existing programs *of which the United States was aware*. Stmt. Defence, ¶¶ 58, 98.

61. In Canada's view, then, because the United States was *aware* that the FSPF and FSLGP involved a certain degree of discretion, Stmt. Defence, ¶ 98, when the parties referred to "government programs that provide benefits on a non-discretionary basis," they did not mean *existing* programs that exercise discretion.

62. Nowhere does the SLA state that all existing programs – regardless of whether they are mandatory or discretionary – should be grandfathered. If that were the case, at least one of the exceptions would have expressly stated as such (for example, "all programs of which the United States is aware") or provided a specific list of excepted programs as the Parties did in Paragraph 4. None does. Therefore, the exception in Paragraph 2(b) means only what it actually says.

63. Canada assigns yet additional alleged purposes to the "non-discretionary" requirement, contending that the parties intended to prohibit grandfathering of programs "where administrators are not meaningfully constrained in their power to select different industries for benefits, but can instead choose amongst a wide range of industries in disbursing benefits." Stmt. Defence, ¶ 61. Canada goes so far as to ascribe this concern to the United States, stating

that the United States "reasonably sought this limitation on the scope of the safe harbour." Stmt. Defence, ¶ 61. Nothing in either the provision itself or in the provision's context even implies, let alone states, that the "non-discretionary" requirement was intended to capture programs targeted to other industries that, by chance, decided to switch focus and provide benefits to the softwood lumber industry. Similarly, Canada offers no negotiating history or any other evidence to support its interpretation or its contention regarding the genesis of the provision.

64. In short, Canada disregards the Vienna Convention. In particular, Canada resorts to the interpretive aids of "purpose" and "negotiating history" in the absence of any evidence of either. *See* Vienna Convention, arts. 31-32.[33] To manufacture a purpose and negotiating history without any documentary support and then to "interpret" the SLA in light of this manufactured purpose and negotiating history, does not "follow" the Vienna Convention; it makes a mockery of it. Because Canada has manufactured a "purpose" for paragraph 2(b) and a corresponding negotiating history, it is unable to cite to a single document in support of the idea that the parties agreed to grandfather in all programs of which the United States was aware *but not* programs "where administrators are not meaningfully constrained in their power to select different industries for benefits, but can instead choose amongst a wide range of industries in disbursing benefits."[34]

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[33] Article 31(1) of the Vienna Convention states, "[a] treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its *object and purpose*." (emphasis added). Article 32 states, "Recourse may be had to *supplementary means of interpretation*, including the *preparatory work of the treaty and the circumstances of its conclusion* . . . ." Vienna Convention, art. 32 (emphasis added).

[34] The Tribunal in *United States v. Canada* determined that a purpose cannot be discerned from this Agreement's text and that this Agreement has no official travaux préparatoires. *United States v. Canada*, LCIA No. 7941, Award on Liability, ¶ 142, CA-12.

65. In any event, notwithstanding the absence of any support for the alleged "purpose" advanced by Canada or the "negotiating history" recounted, Canada's explanation for the source of paragraph 2(b) is flawed. The phrase "government programs that provide benefits on a non-discretionary basis," even as interpreted by Canada, does not accomplish any of Canada's allegedly desired goals: (1) it would not prevent the grandfathering of programs of which the United States was not aware; and (2) it would not grandfather *all* government programs that were in place as of July 1, 2006. Stmt. Defence, ¶ 58.

66. Canada's own interpretation, taken to its logical extension, does not hold up. Paragraph 2(b) as interpreted by Canada would not prevent the grandfathering of programs of which the United States was unaware because – as Canada contends – it would actually *permit* the grandfathering of programs where the administering official has discretion in the selection of industry but exercises that discretion on more than a "whim." Using Canada's example (at ¶¶ 61, 116), if a program provided a provincial minister the power to spend $10 million each year to achieve "improvement of forestry," but stated that he or she must first solicit and consider industry views in exercising his discretion, this program would be grandfathered. This would be so even if, prior to July 1, 2006, the minister had always (in his or her discretion) spent these funds on scholarships for forestry students, rather than grants to softwood lumber producers.

67. Under Canada's interpretation of Paragraph 2(b) also would not grandfather *all* existing programs, as Canada alleges it was designed to do. For example, if a program provided a provincial minister the power to spend $10 million each year to achieve "improvement of forestry," and stated that he could decide how to spend the money any way he or she saw fit, this

program would not be grandfathered, even if prior to July 1, 2006, the minister had always (in his discretion) spent these funds *exclusively* on grants to softwood lumber producers.

68. Regardless of whether government officials have the discretion to select other industries to receive benefits under the FSPF and the FSLGP, it is undisputed that they have considerable discretion in selecting applicants to receive the benefits. Accordingly, neither program constitutes a "government program[] that provide[s] benefits on a non-discretionary basis," SLA, art. XVII, ¶ 2(b). As such, neither falls within the Paragraph 2(b) exception of Article XVII and both violate the SLA.

II. The Ontario Forest Access Road Construction And Maintenance Program Benefits Ontario Softwood Lumber Producers

69. The Ontario Forest Access Construction and Maintenance Program ("road program") is an industry relief measure that reimburses Ontario lumber producers for millions of dollars in costs associated with constructing and maintaining forest access roads in direct contravention of the Anti-circumvention provision of the SLA. Canada has contended that the road program falls within exception 2(a) and within exception 2(b), despite extensive evidence to the contrary.

70. The road program does not fall within exception 2(a) because it is not a "forest management systems" measure as required by paragraph 2(a). Ontario's stated purpose in enacting the road program was to enhance the competitiveness of the forest products industry by reducing its delivered wood costs through reimbursements. *See* Stmt. Case, ¶¶ 69-72, 74, 76-77, 84, 88. Document after document cited by the United States in its Statement of the Case describes the road program's purpose in these terms. Rather than address the road program's *actual* purpose, or directly address the documents regarding this program, Canada opts instead to discuss forest management systems measures generally as if those were the programs at issue.

71. Nor does the road program fall within exception 2(b). Canada has relied upon a deeply flawed interpretation of that provision and ignored a central question — whether the program was "administered" before July 1, 2006. Indeed, the exception in 2(b) does not apply because the initial 2005 road program differed markedly from the version of the program that was administered after July 1, 2006.

A. Exception 2(a) Does Not Apply

72. Paragraph 2(a) of the Anti-circumvention provision states that "provincial timber pricing or forest management systems as they existed on July 1, 2006," shall not be considered to reduce or offset the Export Measures. SLA, art. XVII, ¶ ¶ 2, 2(a).

73. The road program does not satisfy exception 2(a) because it is not a "forest management systems" measure. Canada correctly notes that the United States did not engage in any analysis of the exception after rejecting its applicability to the road program. Stmt. Defence, ¶ 124. The reason for this is quite simple — the United States did not foresee any colorable argument supporting the application of exception 2(a) to the road program in view of the overwhelming evidence (and now unrefuted) establishing that the purpose of the road program was to provide "relief" to, "benefit," "assist," enhance the "competitiveness" of, and otherwise "support" the forest products industry by reducing delivered wood costs. *See* Stmt. Case, ¶¶ 69-72, 74, 77-79, 81 & C-33 at ON00617898; C-32 at ON00618119-20, ON00618127, ON00618130; C-4 at ON-CONF-07210; C-1, Att. AG; C-33 at ON00617883. Even the evidence cited by Canada establishes that the intention of the road program was to reduce the delivered wood costs faced by Ontario's troubled forest products industry. See R-29 at ON-CONF-07266-R; C-4 at ON-CONF-07209 (explaining that "

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1. Ontario Intended To Enhance Industry Competitiveness

74. As demonstrated in the United States' Statement of the Case, the impetus for the road program was the May 2005 Final Report issued by the Minister's Council on Forest Sector Competitiveness, which expressed concern that Ontario's delivered wood costs were "among the highest" in the world. *See* Stmt. Case, ¶¶ 70 (citing C-1, Att. S at 20-21); 71 (citing C-1, Att. S at 8-9). Even the name of the entity intended to administer the road program – the Forest Sector Competiveness Secretariat – reflected the road program's emphasis on enhancing industry competitiveness. *See* R-29 at ON-CONF-07271-R. Thus, contrary to Canada's contentions, the road program is an integral part of *enhancing industry competitiveness* — not of Ontario's provincial forest management system.

75. Indeed, in the Statement of the Case, the United States relied upon a multitude of statements by Ontario regarding the nature and purpose of the road program. *See* Stmt. Case, ¶ 74. For example, the Ontario Ministry of Natural Resources ("Ontario MNR" or "Ministry") described the road program as "an industry relief program," C-33 at ON00617898, the purpose of which was to reduce delivered wood costs. *See* C-1, Att. AG (stating that the C$75 million road program and other measures "will measurably reduce delivered wood costs"). Additionally, in a May 11, 2006 email from the MNR to all SFL holders and MNR District Managers, the MNR appends minutes of an April 19, 2006 Roads Funding Review Committee meeting in which one of the MNR presenters states that the "[i]ntention of [the] program is to assist in overall reduction of wood cost[s]." C-33 at ON00617883. The same presenter went on to state that the "MNR perspective is that all beneficiaries of wood fibre should receive the downstream

benefits of lower delivered wood costs," *id.* at ON00617896, and that the "Guiding Principle[ ]" of the road program was that the "[r]eimbursement of road *construction and* maintenance costs must have a direct impact on delivered wood costs," *id.* at ON00617900.

76. Furthermore, an MNR PowerPoint presentation entitled "Opportunities for Ontario's Forest Industry," dated February 23, 2006, shortly after the road program was announced, explained the purpose of the newly created Forest Sector Competitiveness Secretariat as "[a]dminister[ing] the newly created programs designed to assist the forest industry," and indicated that the purpose of the program was "[t]o offset costs" and "reduce delivered wood costs." C-32 at ON00618119, ON00618127, ON00618131.[35]

77. Even the softwood lumber producers recognized that they were receiving a benefit designed to reduce their costs. *See* Stmt. Case, ¶ 78 (citing C-26 (describing the program as having "a positive effect on delivered fibre costs," which is "very good news for both [our company] and the industry.")).

2. Canada Entirely Ignores The Evidence And Focuses On Irrelevant Issues

78. In its Statement of Defence, Canada ignores every piece of evidence demonstrating Ontario's actual purpose in instituting the program. Instead, Canada provides a lengthy discussion of forest management systems in general, contending that the road program

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[35] *See also* C-32 at ON 00618120 (listing the road program as one of the MNR programs "[s]upporting [i]ndustry"); C-32 at ON00618119 (recognizing that the road program and others "[f]acilitate . . . the implementation of the recommendations of the Minister's Council on Forest Sector Competitiveness"); C-32 at ON00618119-20 (stating that the C$75 million road program and other "newly created programs" were "designed to assist the forest industry"); R-29; C-4 at ON-CONF-07210 [

]); C-1, Att. AG (MNR stating that the C$75 million road program and other measures will provide "funding or savings to the industry" by "measurably reduc[ing] delivered wood costs").

"serves as an integral part of Ontario's provincial forest management system." Stmt. Defence, ¶¶ 122-46. At no point in its extensive submission, however, did Canada cite a document rebutting the considerable evidence establishing that the purpose of this program is to enhance the competitiveness of the forest products industry.

79. The only apparent attempt Canada even makes to address the evidence put forth by the United States, fails. Canada claims that the United States erroneously stated that the forest industry had previously been solely responsible for the construction and maintenance of roads, and instead contends that forest management systems have long included funding for road building. Stmt. Defence, ¶ 133. Canada fails to acknowledge the basis for the United States' statement. The United States relied upon the May 2005 Final Report of the Minister's Council on Forest Sector Competitiveness — Canada's *own* document, which stated, "[f]or the past several years, the forest industry has been bearing the full cost of building and maintaining access roads and bridges in Ontario's Crown forests." *See* C-1, Att. S at 20. Canada neglects to address this document or explain why the Tribunal should disregard it, particularly when the document directly speaks to the purpose of *this* road program, whereas Canada's evidence speaks only to general forest management systems.

80. Otherwise, Canada's response to our evidence is no response at all. Rather, Canada begins with a lengthy historical overview of Ontario's involvement with road construction and maintenance on Crown-owned land, dating back almost 30 years, and devotes several pages of argument to the importance of road construction and maintenance to forest

management systems. Stmt. Defence, ¶¶ 132-34; ¶¶ 143-46. In doing so, Canada presents no evidence establishing that forest management was the impetus for the road program.[36]

81. Apparently, the purpose of this historical overview was to draw an implicit link between the road program and forest management systems in general. However, contrary to Canada's contentions (*id.*, ¶¶ 122-46), that road construction and maintenance could be generically important to forest management systems does not undermine in any way the evidence establishing that *these* road programs were designed with a very specific purpose in mind — to enhance the forest products industry's competitiveness by reducing its delivered wood costs.

82. Regardless of whether some *other* program concerned with the maintenance and construction of forest access roads would qualify as a component of forest management systems measures, the road program at issue *here* was a reimbursement program that had other stated objectives — to benefit the industry. *See* C-4; R-29. As a matter of logic, it is the road program's stated purpose and intention that should be analyzed to determine whether exception 2(a) has been satisfied. That stated purpose is to enhance the forest products sector's competiveness by decreasing delivered wood costs. C-4 at ON-CONF-07208; R-29 at ON-CONF-07266-R, ON-CONF-07267-R, ON-CONF-07272-R, ON-CONF-07279-R. Indeed, the documents describe this as the program's principle. *See, e.g.*, R-29 at ON-CONF-07278-R, ON-CONF-07279-R.

83. In light of the purpose of the road program to enhance the forest products sector's competiveness, the road program is not a forest management systems measure for purposes of exception 2(a) simply because reimbursements under the program are related to road

[36] Canada's discussion of the term "forest management" as reflected in the *Ontario Forest Manual* (R-37) is unhelpful. Stmt. Defence, ¶ 126. The program being challenged here is the road program — not the general and aspirational policy goals reflected in the Ontario Forest Manual.

maintenance and construction, or because the program relies on forest management plans as the basis to formulate the agreements through which beneficiaries are reimbursed for their road-building costs for primary and secondary construction and maintenance. The Tribunal should reject Canada's attempt to conflate the building of roads in general with the road program's specific emphasis on increasing the forest products industry's competitiveness. A determination as to whether a challenged program constitutes a forest management systems measure must be informed by the program's objectives and intention, not secondary or unrelated ones. Under Canada's approach, almost any forest sector program could fall under exception 2(a) merely because it somehow touches on forest management.

84. To the extent that Canada delves beyond the general, its efforts are no more persuasive. Canada further contends that the road program is a forest management systems measure under exception 2(a) because lumber roads have "multiple classes of users" and multiple uses. Stmt. Defence, ¶¶ 135, 172, 174. The actual road program documents paint a picture that is quite industry-specific, focusing on the imperative to provide "relief" to the industry by reducing delivered wood costs. *See, e.g.*, C-33 at ON00617898. Thus, that such lumber roads may have multiple uses and multiple users does not somehow trump the "benefits" and "relief" that Ontario intended to confer on the forest products industry through the 2005 and 2006 road programs. As the evidence shows, the aspect of the road program was to " " R-29 at ON-CONF-07278-R; *see also id.* ON-CONF-07279-R.

85. Even the document Canada cites (Stmt. Defence, ¶ 174 (citing R-29)) in support of its argument that the road program was designed to benefit multiple users and uses focuses on the importance of enhancing industry competitiveness and relieving the " " under

which the Ontario forest sector was laboring. *See* R-29 at ON-CONF-07266-R; *see also* C-4 at ON-CONF-07204. Indeed, almost every page of the document refers to competitiveness challenges and/or the issue of delivered wood costs. *Id.* The document also relies heavily on the recommendations made in the May 2005 Final Report from the Council on Forest Sector Competiveness and the fact that "

" R-29 at ON-CONF-07267-R. Thus, the aspect of the road program concerned enhancing industry competitiveness. *See id.* at ON-CONF-07279-R (

). Multiple users and uses only came into play in setting priorities for selecting roads for reimbursement.

86. Finally, Canada contends that the United States shares a comparable view of forest management systems measures. *See* Stmt. Defence, ¶¶ 147-55. This question is not before the Tribunal. Whether the road program violates the SLA is the question before the Tribunal. Thus, whether or not Canada and the United States share common views on forest management systems is irrelevant.

B. Exception 2(b) Does Not Apply

87. As demonstrated in the United States' Statement of the Case, the road program does not satisfy the requirements of exception 2(b) because the program did not provide benefits "in the form and total aggregate amount in which [it] existed and [was] administered on July 1, 2006," SLA, art. XVII, ¶ 2(b). Specifically, the program does not fall within the exception because it was "administered" only *after* the July 1, 2006 cut-off date. *See* C-31 at ON00617788 - 617792 (July 14, 2006 email attaching July 12, 2006 letter announcing "official[] rollout" of

new program); C-34 at ON00617951 ("The 2006-07 program was officially rolled out on July 14, 2006 . . . .").

88. Despite the evidence establishing that the 2006 road program was not administered until after July 1, 2006, Canada contends that the road program comes within exception 2(b). *See* Stmt. Defence, ¶¶ 159-88. But Canada ignores entirely the existence of the term "administered" in paragraph 2(b); *see, e.g.* Stmt. Defence, Table of Contents at iv. The term "administered" is, in fact, part of the exception 2(b) inquiry and must be established by Canada.

1. The Ordinary Meaning Of 2(b) Requires A Program To Have Been Administered Prior To July 1, 2006

89. Exception 2(b) contains two distinct temporal elements in connection with the status of the road program as of July 1, 2006. It states that "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," will not be considered to reduce or offset the Export Measures. SLA, art. XVII, ¶¶ 2, 2(b).

90. Relying simply upon ordinary meaning of the provision, read in its context (and upon the basic rules of grammar), the provision requires: first, that excepted programs be in the form in which they existed on July 1, 2006; second, that they be in the total aggregate amount in which they existed on July 1, 2006; third, that they be in the form in which they were administered on July 1, 2006; and, finally that they be in the total aggregate amount in which they were administered on July 1, 2006. The dispute here arises because Canada does not believe that the third and fourth elements require consideration of whether and when a program was "administered."

91. Canada appears to argue that a determination as to when the program was "administered" requires the same inquiry as to "whether the current *form* of the program is consistent with the *form* of the program on July 1, 2006." Stmt. Defence, ¶ 166. In Canada's view, the term "administered" has the same meaning as "form." If this were the case, the Agreement would have eliminated the alleged redundant language and stated, "programs that provide benefits on a nondiscretionary basis in the form and in the total aggregate amount in which they existed on July 1, 2006," will not be considered to reduce or offset the Export Measures. This is not the language to which the parties agreed in the SLA.

92. Canada discusses at length the dictionary definition of "form," but fails to offer a definition of "administer" — perhaps because the definition of "administer" so clearly differs from the definition of "form." *See, e.g.*, Stmt. Defence, ¶ 69. The Oxford English Dictionary defines "administered" to mean "[m]anaged" and "carried on."[37] The Oxford English Dictionary also defines "administer" as "[t]o manage as a steward, to carry on, or execute . . ." and "[t]o dispense, furnish, supply, or give (anything beneficial or assumed to be beneficial, to the recipient . . .").[38] Similarly, Webster's New World College Dictionary defines "administer" to mean "manage or direct (the affairs of a government, institution, etc.").[39] Indeed, even the Ontario provincial documents refer to the "administering" and "implementation" of the program. *See* C-31 at ON00617789, ON00617790.

93. The ordinary meaning of the term "administered," then, is wholly distinct from the ordinary meaning of the term "form," which, as Canada suggests, means the "shape" or

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[37] *See* CA-14, The Oxford English Dictionary at 163 (2d ed., Clarendon Press 1989) (defining "administered" to mean "[m]anaged" and "carried on").

[38] *Id.* at 162.

[39] *See* CA-15, Webster's New World College Dictionary at 18 (4th ed. 2007).

"parameters" of a program. Stmt. Defence, ¶¶ 69-70. That is, a program that changes form is a program that changes its "shape" and "parameters." A program that changes the manner of administration, in contrast, changes the manner in which the program is "managed" or "directed," or, as several Ontario documents discuss, in the manner in which the program is "implemented." The SLA requires an analysis of whether the road program was in the form in which it was administered on July 1, 2006, and whether it was in the total aggregate amount in which it was administered on July 1, 2006. To do this, it is necessary to know what the form, aggregate amount, and administration were prior to July 1, and after July 1.

94. As a practical matter, Canada insists that there was no change in "form" between the initial 2005 road program and the 2006 version, but goes on to describe exactly that: "an expansion of the normal operations eligible for reimbursement commensurate with the increased funding levels provided for by Ontario's Cabinet." Stmt. Defence, ¶ 173.[40] The new program, in its new form, was not implemented until after July 1, 2006.

95. Contrary to Canada's dismissive statement (Stmt. Defence, ¶ 176) that the United States' reliance on the new name accorded to the 2006 road program "borders on frivolous," the new program name in fact memorializes a change in form from the program's initial version. The new name heralded the introduction of the new program with its increased funding (from

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[40] Canada erroneously accuses (Stmt. Defence, ¶ 170) the United States of not having pleaded affirmatively regarding the changes in "form" to the road program. In fact, the United States affirmative position appears at ¶ 85 of the United States Statement of the Case. There, the United States demonstrated that the road program announced in 2005 was substantially different from the enhanced program announced in 2006. The 2005 program was entitled the "Primary Forest Access Road Maintenance Program," was funded at C$28 million, and provided for reimbursements solely for the maintenance of primary roads. *See* Stmt. Case, ¶ 85. The 2006 program, however, was entitled the "Forest Access Road Construction and Maintenance Program," provided for a total of C$75 million in reimbursements, and was expanded to cover the construction and maintenance of primary and secondary forest access roads. *See id.* Furthermore, different legal agreements governed each program. *See id.*, ¶ 86.

C$28 million to C$75 million) and expanded scope (to include reimbursements for both primary and secondary roads). *See* C-43, ¶ 60 (explaining that "[t]hese are far more than cosmetic changes; besides the types of roads included and the types of activities covered, the basis for funding allocation was substantially changed between the original and updated programs.") Although Canada insists (at ¶ 176) that the differences between the 2005 and 2006 programs were "insignificant amendments" and "minor changes," the contemporaneous Ontario documents tell another story. In fact, Ontario itself characterized the 2006 road program as "new and expanded." C-35 at ON00617762-617764.

2. The Road Program Was Not Administered In Its Current Form Until After July 1, 2006

96. By conflating "form" and "administered," in paragraph 2(b), Canada ignores the central question here — whether the road program was administered differently after July 1 than it was prior to July 1. Canada compounds this error by further conflating the date the program was enacted into law with the date of administration.[41] That is, Canada confuses when a program "existed" with when a program was "administered." Specifically, Canada contends that the road program was legislatively approved prior to July 1, 2006, and was, therefore, "administered" before July 1, 2006. Stmt. Defence, ¶ 168. This undisputed date of approval has nothing to do with when the program was actually administered. As discussed above, paragraph 2(b) contains two distinct temporal elements — "existed" and "administered." Both must be given meaning.

[41] Canada notes (Stmt. Defence, ¶ 168) that the United States stated that the program was "not approved until after July 1, 2006." Despite this unintentional misstatement, in its Statement of the Case, the United States made its position clear, that the 2006 road program was *announced* in February 2006 and *administered* on July 14, 2006. *See* Stmt. Case, ¶¶ 69, 75.

97. Regardless of whether the Ontario Cabinet's approval of the program constituted "the authoritative step" in determining the program's funding and terms, *see* Stmt. Defence, ¶ 168, that step is not equivalent to the *administration* of the program by the MNR. Of course, a piece of legislation does not come into existence until enacted by the legislature, but the legislative enactment is not equivalent to administering the program, which must involve actually carrying out the program on a day-to-day basis. The distinction between the *enactment* of the road program and its *administration* is also borne out by the different government entities involved in each sphere of activity. The Ontario Cabinet may have approved the enhanced scope and funding of the 2006 road program, but it was the MNR that administered the program on a day-to-day basis as reflected by the record. *See* C-31, 34. As demonstrated below, that administration simply did not take place until, at the earliest, July 14, 2006.

98. To take the United States as an example, when considering the administration of an energy program, it would not limit the focus to the acts of the President or Congress, but would look to the agency responsible for carrying out or "administering" the program on a day-to-day basis — the Department of Energy. Here, the agency charged with implementing the program — the MNR — did not begin to administer the program until after July 1, 2006, when the MNR distributed the new legal agreements and invoices and was thus prepared to make program benefits available. *See* C-31, C-34.

99. Yet Canada ignores the absence of evidence showing administration before July 1, 2006, and the evidence showing administration after July 14, 2006. The fact is, the MNR did not make the 2006 road program benefits available to potential applicants until its official "roll-out" on July 14, 2006. C-31 at ON00617790.

100. Canada dismisses the significance of the Ontario documents that explicitly state the road program was administered after July 1, 2006. Stmt. Defence, ¶ 167. Canada begins by misreading the record when stating (*id.*) that the United States relies on a "single e-mail from MNR" regarding the administration of the road program. In fact, the United States relied upon multiple Ontario documents in connection with the date of administration. *See* C-31; C-34.

101. Although stating that there is no "credible rationale" for relying on the MNR documents for the date of administration, Canada fails to posit any reason why the documents are not credible. Stmt. Defence, ¶ 167. In fact, the documents bear all the markers of credibility. For example, one of the documents is an email dated July 14, 2006 from the MNR to SFL holders and all the MNR District Managers responsible for administering the road program. *See* C-31 at ON00617788-89. The email actually employs the term "administering" in connection with the new road program and, notably, attaches the new agreement and invoice form, both of which the MNR was distributing for the first time. *Id.* at ON00617789, ON00617793-817.

102. The July 14, 2006 MNR email also attached the "Final Version" of the new agreement that would govern the enhanced road program. *Id.* The "Final Version" of the new agreement is dated July 13, 2006. *Id.* at ON00617793. The email thanks all those involved in the review of the original 2005 program and those who assisted with the development of the 2006-2007 version of the program. *Id.* at ON00617789. Furthermore, the email also attached a memorandum dated July 12, 2006 to MNR District Managers and SFL holders from the Director of MNR's Industry Relations Branch. *Id.* at ON00617788. In the memorandum, the MNR Director states: "I am pleased to officially rollout the 2006/07 Road Construction and Maintenance Funding Program for implementation." *Id.* at ON00617790. The memorandum also refers twice to the "implementation" of the program — in particular, to the "implementation

of the expanded program." *Id.* at ON00617790. Thus, even the Ontario documents reflect the ordinary meaning of "administer."

103. Indeed, the Ontario documents show that the preparations required for the July 14, 2006 "rollout" of the new road program took many months of work by the MNR and the industry. *See* C-31, C-33, C-35. For example, in May 2006, the MNR was busy "develop[ing] the framework" for the new program and "mak[ing] progress in addressing the issues and concerns regarding the implementation of the new funding program." C-33 at ON00617881. Despite "anticipat[ing] that the program will be available for full implementation by the middle of June [2006]," *see* C-33, the "official [] rollout" did not take place until after July 1, 2006. C-31 at OON00617790. Indeed, information sessions, or "workshops" regarding the new program did not take place until the end of June 2006. *See* C-35 at ON00617763-64. This evidence notwithstanding, Canada suggests that Ontario's road program documents should be disregarded as if the provincial government entity responsible for administering the program – the MNR – were not the best source of information available to the parties.

104. The *only* evidence Canada offers to show that the program was administered prior to July 1, 2006 is one invoice that requests reimbursement for the period April 1, 2006 through June 30, 2006. Stmt. Defence, ¶ 183 (citing R-54). Contrary to Canada's contention, the invoice supports, rather than refutes, the United States' demonstration that the road program was not administered until after July 1, 2006.

105. The invoice was executed on August 15, 2006, and received in the MNR District Office on August 21, 2006, obviously after July 1, 2006. *See* R-54 at ON00001258. Moreover, the invoice was prepared on the new version of the invoice form distributed by the MNR when the enhanced road program was first rolled-out on July 14, 2006. *Compare* R-54 at

ON00001258-59 *with* C-31 at ON00617811-12. That the invoice may seek reimbursements for the three-month period immediately preceding implementation of the 2006 road program does not somehow modify the date the program was first administered. That is, there simply was no mechanism in place, prior to July 14, 2006, for parties to seek reimbursement for expenses covered under the expanded road program. That parties incurred costs for which they later sought reimbursement does not demonstrate that the program was "administered" any earlier than July 14, 2006. In fact, it demonstrates the opposite — that the Ontario government (through the MNR) is the entity that must "administer" a program. What private parties do is irrelevant.

106. Canada's reliance upon the invoice is also undermined by the underlying legal agreement governing reimbursement for the particular company and forest at issue (McKenzie Forest Products Inc. for the Lac Seul Forest). That agreement was not executed by the MNR and McKenzie Forest Products Inc. until July 21, 2006. *See* C-47.

107. Canada has simply not rebutted any of the evidence demonstrating that the road program was administered only after July 1, 2006. Paragraph 2(b) does not merely require that a program have existed in a particular form and amount prior to July 1, 2006. It also requires that the program have been administered in a particular form and amount prior to July 1, 2006. Canada's interpretation would render meaningless this second requirement.

III. Québec's Capital Tax Credit Circumvents The SLA

108. As demonstrated in the United States' Statement of the Case, the Québec Capital Tax Credit is a grant or other benefit that Québec provides on a *de jure* or *de facto* basis to increase the softwood lumber producers' competitiveness. As such, it is deemed to offset or reduce the Export Measures and circumvents the SLA. SLA, art. XVII, ¶ 2. In addition to ceasing all administration of the program, Canada must either cure the breach within a

reasonable period of time or impose compensatory adjustments to the Export Measures in an amount that remedies the breach.

109. In its Statement of Defence, Canada concedes that the United States accurately set forth the facts related to the history of Québec's Capital Tax Credit. Stmt. Defence, ¶¶ 281-282 ("The United States does not contest any of these dates. In fact, they are recited accurately in the Beck Report."); *see* Stmt. Case ¶¶ 130-134. As demonstrated in our Statement of the Case, United States' expert Mr. Beck estimates that, through November 23, 2007, [

Stmt. Case, ¶ 134 (citing C-1 at Table 13 (citing Att. AS at QC-C-098644 - QC-C-099141, QC-C-100655 - QC-C-100763)). Canada does not challenge Mr. Beck's summary of the total investments and capital tax credits claimed for fiscal years 2006-2007 and 2007-2008, based on actual investment and tax credit data provided. C-1 at 37; *see* Stmt. Defence, ¶¶ 281-296.

110. Canada does not challenge that the Capital Tax Credit offsets the Export Measures by providing a benefit to softwood lumber producers and exporters. Stmt. Case, ¶¶ 135; Stmt. Defence 281-296. Similarly, Canada does not argue that the tax credit program satisfies exception 2(e), which applies to "measures that are not specific to the forest products industry." SLA, art. XVII, ¶ 2(e). As demonstrated, the 15 percent tax credit program is specific to the forest industry. C-1 at 33-34 (citing Att. U, sec. 6, p. 5, Att. AR at QC003700, QC003444, QC003501); *see* C-1 at 33 (citing Att. AR at QC003700).

111. Canada contends, however, that the Capital Tax Credit falls within the exception in paragraph 2(b) for "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," SLA, art. XVII, ¶ 2(b). Canada asserts that the program was effective on the day it was announced: "the 15 percent capital tax credit went into immediate effect when announced, consistent with parliamentary convention. . . . [T]he evidentiary record confirms that the capital tax credit was in effect prior to July 1, 2006." Stmt. Defence, ¶ 286. As a result, according to Canada, "the capital tax credit for the forestry sector had effect as of the date of announcement." *Id.* at 287. Canada's contention is unsupported by the record, Canadian law, or the provincial laws of Québec.

112. In order to be enacted into law, new tax credits require amendments to the Taxation Act. The amendments relevant to the 15 percent tax credit appeared in Bill 41, which was introduced on November 8, 2006. C-1, p. 34 (citing Att. V at 177-78). Final passage of Bill 41 occurred on November 30, 2006, and final assent took place on December 6, 2006. *See id.* That the budget minister proposed the credit in March 2006 is immaterial. The tax credit could not have been in existence or have been administered until it received final assent and, therefore, was legally authorized in December 2006. *Id.* Indeed, the explanatory notes in Bill 41 state: "[t]his bill amends various legislation *to give effect to budgetary measures announced in the Budget Speech delivered on 23 March 2006* and in Information Bulletins published by the Ministère des Finances in 2005 and 2006." C-1, Att. V at 2 (emphasis added).

113. Contrary to Canada's contention, tax measures do not take effect upon announcement. Stmt. Defence, ¶ 287. Rather, "during the period until the proposed legislation is enacted by Parliament with retroactive effect, the system is, in effect, voluntary and is not backed by the force of law. In the case of taxes provisionally collected, *until the legislation is enacted there is no legal requirement to pay, nor any legal authority to collect, the proposed tax. . . . Revenue Canada has in the past declined to assess or to issue refunds where these are*

dependent on budget proposals that are incorporated in a Ways and Means Motion but are not yet law." [42]

114. Therefore, because there is no legal requirement to pay, or any legal authority to collect, a proposed tax until legislation is enacted, Canada's contention (at ¶ 290) that "Revenue Québec had to be in a position to process capital tax credit claims at 15 percent" immediately upon the Budget Minister's announcement in March 2006, is incorrect.

115. The evidence upon which Canada relies for its contention that "availability of the capital tax credit was publicized immediately" fails to establish that the Capital Tax Credit existed and was administered prior to July 1, 2006. Stmt. Defence, ¶ 288 (citing R-66, R-67, R-68). Indeed, the PricewaterhouseCoopers 2006/2007 Québec Budget Tax Highlights upon which Canada relies specifically states that the "[r]ate of the capital tax credit *will be raised* from 5% to 15% . . .," R-67 at 8 (emphasis added). It does *not* state that the tax credit *was* raised from 5 to 15 percent at the time of the budget speech.

116. Canada also contends that "documents and correspondence show some of the steps taken to enable immediate receipt and processing of the increased capital tax credit for the forestry sector . . . ." Stmt. Defence, ¶ 289. The documents upon which Canada relies, however, do not support Canada's contention. The e-mail message dated 28 March 2006 does not contain any statement indicating that the capital tax credit existed and was administered prior to July 1,

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[42] Michael H. Wilson, Minister of Finance, Dep't of Finance Canada, *The Canadian Budgetary Process Proposals for Improvement*, p. 15 (May 1985) (emphasis added), CA-16; *see generally Hervé Pomerleau Inc. v. Canada*, 108 F.T.R. 273 ¶ 26 (Fed. Ct. of Canada – Québec Div. 1996) (RA-53) ("[A] legislative process commenced by the tabling of a ways and means resolution is to be continued and completed by the adoption of a statute before prorogation, failing which it remains without effect. While I recognize that a tax provision may take effect before the adoption of and assent to the enabling legislation, it is nevertheless necessary that a statute in which the principle of retroactivity is implemented must have been enacted in the prescribed form, prior to the dissolution of the House. . . .").

2006. R-70. Indeed, the email lacks any mention of the credit at all. Moreover, it appears that the work schedule table for the implementation of the capital tax measures anticipated that the legislature would not consider the bill until November 2006. R-73 at 1 (["

"]).

117. Canada further contends that "[t]he best evidence establishing that the 15 percent capital tax credit . . . was in existence and was being administered from the date of announcement are the credit claims filed after the March 2006 Budget Speech, but before parliamentary assent in December." Stmt. Defence, ¶ 291. The "best" evidence upon which Canada relies does not support its contention that the capital tax credit was in existence and being administered prior to parliamentary assent. Indeed, although the tax year for the first corporation that applied for the tax credit ended [

] and the application was filed with Revenu Québec on [ ] the tax credit was not issued until [ ] The tax credit application for the second corporation was filed on [ ]; however, there is no indication of [

] Moreover, contrary to Canada's contention, nothing in the documents indicates that the handwritten note [ ] was placed in the file before the parliament authorized Bill 41 in December 2006. Stmt. Defence, ¶ 291. This assertion is based upon pure speculation.

118. Canada provides no support for its contention that "Revenu Québec accepted forms annotated to reflect 15 percent because the March 2006 announcement updated the capital tax credit to a 15 percent rate with immediate effect." *Id.* ¶ 292. As demonstrated above, the only forms upon which Canada relies indicate that the tax credit was not issued until October

2007. Thus, contrary to Canada's contentions, nothing in the credit claims indicates that the tax credit was being administered prior to December 2006.

119. Finally, Canada notes that Mr. Beck calculates the tax credit benefit as of October 12, 2006 — the date of the SLA's enactment and several months before final assent. Stmt. Defence, ¶ 294. That the tax credit was indisputably granted retroactively does not demonstrate that it existed before July 1, 2006. In sum, Canada's contention that the Capital Tax Credit is in the "same form and [] total aggregate amount in which [it] existed and [was] administered on July 1, 2006," SLA, art. XVII, ¶ 2(b), is wrong.

IV. Québec's Forest Management Measures Circumvent The SLA

120. In its Statement of the Case, the United States demonstrated that Québec's Forest Management Measures provide hundreds of millions of dollars to reduce the operating costs and improve the competitiveness of the forest products industry. Specifically, these programs include: (1) silvicultural benefits of more than $200 million provided to forest products companies; (2) a refundable tax credit of 90 percent for forest sector companies making investments in forest access roads and bridges, comprising new direct financial benefits that target companies in the forest product industry; and (3) a reduction of the cost of logging operations by providing new benefits for reforestation, fighting forest fires, and pest control.

121. The United States demonstrated further that Québec provides these benefits on a *de jure* or *de facto* basis to producers or exporters of softwood lumber products, and thus, pursuant to the SLA, they offset or reduce the Export Measures, SLA, art. XVII, ¶ 2. Canada has failed to counter the evidence that Québec's so-called Forest Management Measures circumvent the SLA.

A. Québec's Provision Of C$210 Million For Silvicultural Benefits Circumvents The SLA

122. Canada asserts that Québec's $210 million "silvicultural investment" program does not circumvent the SLA because: (1) it does not provide a benefit; and (2) the program had been implemented before July 1, 2006. Stmt. Defence, ¶¶ 206-11. Neither contention is persuasive.

123. First, Canada contends that the silvicultural program provides no benefits asserting that "[n]o funds were provided to industry [and] [n]o expense was removed from industry." *Id.* at ¶ 210. Canada identifies no authority to support this bold assertion. In contrast, Québec's own minister, in his March 2006 Budget Speech, stated that Québec would provide "$210 million to reduce operating costs and the costs inherent in silvicultural investments." C-1, Att. U, sec. 6 at 8. Likewise, the minister characterized the silvicultural measures as "help[ing] [to] meet the imperatives of sustainable development of Québec's forest while improving the financial position of forest companies." *Id.*

124. Canada also maintains that three credits used to determine stumpage charges totaling $135 million, which were announced in the March 2006 Budget Speech, had been implemented as of April 2006. Stmt. Defence, ¶¶ 207-08. As Mr. Beck explains in his rebuttal report, Canada has proffered no evidence that the "measures [for] reducing operating costs (C$135 million)," Stmt. Defence, ¶ 207, had been "implemented" as of July 1, 2006. C-43, p. 23. Indeed, Mr. Beck noted the types of evidence that should generally be available to demonstrate the administration of a program of this magnitude, and explained that the record was utterly bereft of such evidence. *Id.* Accordingly, Canada has failed to meet its burden of demonstrating that the C$135 million silvicultural measures benefit program was a "provincial

timber pricing or forest management system[] as [it] existed on July 1, 2006." SLA, art. XVII, ¶ 2(a).

125. Nor does Canada assert that the remaining $75 million in silvicultural benefits was implemented before July 1, 2006. Canada contends that the additional C$75 million in silvicultural benefits do not violate the SLA, asserting that these funds "have a particular emphasis on hardwoods" and that these funds were provided "for the operations of the MNRF." Stmt. Defence, ¶ 209. However, this says nothing about whether the program benefits "producers or exporters of Canadian Softwood Lumber." SLA, art. XVII, ¶ 2. Canada's own witness asserts only that the funds that target hardwood production are at some level greater than 50 percent of the total, without providing any greater precision. *See* C-43, pp. 91-92. This leaves up to 50 percent of the program's benefits unaccounted for.

126. Accordingly, the C$210 million in silvicultural investment benefits producers or exporters of Canadian softwood lumber. As Mr. Beck explains, the C$135 million in measures for reducing operating costs does exactly that: removes C$135 million of silvicultural expenses from industry. C-43, p. 24. Similarly, something less than half of the C$75 million in additional MNRF expenditures provides benefits to producers and exporters of Canadian softwood lumber by improving forest productivity, or yield. C-43, pp. 24-25. Lastly, Canada's remaining, unsupported contention that these benefits are "actions . . . for the purpose of forest or environmental management," SLA, art. XVII, ¶ 2(c), should be rejected given the hundreds of millions of dollars in benefits that "undermin[e] or counteract[] movement toward the market pricing of timber," *id.*, by artificially deflating the cost of timber harvesting. *See* C-43, p. 25.

B. Québec's Assumption Of 90 Percent Of The Cost Of Building Forest Roads Through A Tax Credit Circumvents The SLA

127. Canada raises numerous contentions concerning why Québec's assumption of 90 percent of the costs of building forest roads does not circumvent the SLA. Specifically, Canada asserts that: (1) the governmental assumption of this previously privately-borne cost did not provide a "benefit" pursuant to the SLA because of a purported increase in the price of logs from lands made accessible by the newly built roads, Stmt. Defence, ¶¶ 213-21; (2) the 90 percent tax credit for the building of roads is an "element ('data, variable or procedure') of Québec's timber pricing system," *id.* ¶¶ 213, 222-31; (3) the building of roads (not the tax credit) is an "other measure" that existed before July 1, 2006, *id.* ¶¶ 213, 232-51; and (4) the building of roads (again, not the tax credit) is "undertaken for the purpose of facilitating public access to Québec's forest resources and ensuring protection of forest resources." *Id.* ¶¶ 213, 252-60. None of these contentions overcomes the United States' demonstration that Québec implemented a new program to provide benefits (that is, infusions of cash) to softwood lumber producers by relieving them of the burden of paying to build roads to access timber for harvesting.

1. The Roads Tax Credit Provides A Benefit

128. Québec's absorption of 90 percent of the cost of building forest roads provides a benefit. Canada's own documents demonstrate that the program's purpose was to reduce costs to softwood lumber producers and exporters. In describing the tax credit for road construction and repair, the Budget Plan stated unequivocally that the goal was "to help forest companies reduce supply costs." *See* C-1, Att. U, sec. 6. Although Canada paid 90 percent of softwood lumber companies' business expenses in this area, Canada now contends that that payment provided no benefit. According to Canada, because Québec increased stumpage rates paid for harvesting

timber, it has "offset" the reduced costs enjoyed by softwood lumber companies that resulted from the forest road building credit. *Id.* ¶ 216 (citing R-3 ("Adam Stmt.")).

129. Canada thus *concedes* that the tax credit provided a benefit. Canada believes, however, that it may breach the Agreement freely so long as it alleges a purported "offset" of that benefit. This interpretation finds no support in the Agreement. Rather, the Agreement provides that grants or benefits "shall be considered" to circumvent the SLA if they are provided to exporters or producers of softwood lumber. SLA, art. XVII, ¶ 2. The Agreement says nothing about offsetting the benefit, nor does it provide that Canada is relieved from breach liability if it does so. More importantly, the Agreement provides that the Tribunal, not Canada, will determine compensatory measures to compensate the United States for a breach. SLA, art. XIV, ¶¶ 22. The United States does not agree that Canada has cured this breach. Accordingly, Canada's interpretation divests the Tribunal of its authority under the Agreement. In any event, as demonstrated below, Canada has not explained the nature or amount of this purported offset, except to allege, without support, that it provides a one-for-one offset.

130. Even if Québec *could* choose unilaterally to absolve itself of the consequences of its breach by changing stumpage rates, these changes would not erase the benefits conferred. Rather, by paying 90 percent of companies' road building costs, the provincial government assumes the risk that producers would not recover road building costs. There is no guarantee that a producer will ultimately harvest any timber made accessible by a forest road; nevertheless, Québec provided producers with the benefit of relieving producers of the risk of sustaining significant losses should harvesting not occur.

131. Likewise, Québec's

Indeed, Canada fails to explain the striking contrast between its litigation position

132. In support of its contention that changes in stumpage rates offset the benefits provided by the road building credit, Canada provides "simulations" based upon two tariff zones, carefully selected out of 187 zones in the province. Stmt. Defence, ¶ 220. Canada fails to provide data necessary to reproduce its two "simulations" and, thus, there is no basis upon which to assess their accuracy. C-43, pp. 28-29. Canada also fails to explain why the reliance upon only two zones presents an accurate reflection of the province as a whole. *Id.*, p. 29.

133. Most importantly, as Mr. Beck explained in detail in his rebuttal report, there are numerous instances under which there would be less than a full offsetting of the tax credit through stumpage increases, many of which are currently taking place. *Id.*, pp. 29-37.

134. Not even Canada's own fact witness alleges that the changes fully offset the tax credit. In fact, Mr. Adam admits that road building costs are but one of the factors used to calculate operating cost, which is itself one of six factors used to calculate stumpage rates, R-3, ¶¶ 17, 21, and Mr. Adam *never once* asserts that any increase in stumpage cost offsets 100 percent of the benefits obtained through the tax credit. Accordingly, even if the modified stumpage rates were somehow construed as offsetting the benefits received and, thus, could reduce the remedy to be assessed, Canada has not demonstrated the amount of any such offset. *See* R-3, Ex. 6 (purported stumpage costs based upon changes related to governmental benefits but lacking any indication of the amount of alleged benefit offsets reflected in increased rates).

2. The Governmental Assumption Of 90 Percent Of The Cost Of Forest Road Building Is Not A Variable Of Timber Pricing Or Of A Forest Management System

135. Canada also contends that, because the price of access roads is one of the eight factors used to calculate operating costs, R-3, ¶ 17, the 90 percent tax credit is an "element ('data, variable or procedure') of Québec's timber pricing system," and, therefore, should be excepted under paragraph 2(a). Stmt. Defence, ¶ 213. In so arguing, Canada conflates the building of roads with Québec's payment of money in the form of tax credits covering 90 percent of the cost of building forest access roads.

136. Canada asserts that "road building is a central element of Québec's public timber pricing system" and, because "[t]he road credit relates to road building, which is a component of timber pricing in Québec," *id.* ¶¶ 223-24, it must be considered a "provincial timber pricing" program pursuant to paragraph 2(a) that is not considered to circumvent the SLA's Export Measures. This produces an absurd result because, under Canada's view, any governmental benefit would be excluded from the SLA's bar on circumvention of Export Measures, so long as it "relates to" an activity that lumber companies undertake to harvest timber. Stmt. Defence, ¶ 224.

137. In Canada's view, Québec could provide free bulldozers to lumber companies without violating the SLA because this equipment would be a "Cost of Harvest Operations" that is used to determine "Operating Cost Index." R-3, ¶ 17. Likewise, the government could reimburse lumber companies' fuel costs, "Transportation Costs to the Mill [and] Transportation Costs to the Market," "forest camps" expenses, and "Administration and Supervision" expenses. *Id.* Taking Canada's reasoning to its logical extension, paragraph 2(a) would leave Québec free

to assume every conceivable cost associated with harvesting timber without circumventing the agreement.

138. Contrary to Canada's extreme reading of the SLA, when read appropriately and in accordance with its ordinary meaning, the SLA focuses upon the timber pricing system itself. The United States does not contest that the cost of road building, among other costs associated with numerous other activities, was an element of stumpage rates as they existed prior to July 1, 2006 and, accordingly, the United States does not contest the inclusion of those costs in Québec's stumpage formula. *See* R-3, ¶ 17. Nevertheless, Canada violates the Anti-circumvention provision when it provides benefits that "relate[] to" those expenses. Rather than being an "element" of a pricing system, as Canada contends, Québec's decision to reimburse lumber producers for 90 percent of the cost of building timber harvesting roads was a separate decision to provide a "benefit," which, as demonstrated in our Statement of the Case, circumvents the SLA.

139. Canada further contends that Québec's decision to reimburse lumber producers for 90 percent of the cost of building forest roads falls within another part of paragraph 2(a) — the SLA's exception for "forest management systems." Stmt. Defence, ¶ 225.

140. As with the assertion that the 90 percent tax credit is "merely an element ('data, variable or procedure') of Québec's timber pricing" system, *id.* ¶¶ 228-31, Canada reasons only that "road building is a component of forest management." *Id.* ¶ 229. Even assuming that road building is a "component" of forest management, the program at issue involves reimbursing industry costs, thereby conferring a benefit and violating the SLA. Simply because a benefit happens to also be a "component" of forest management, does not mean that the benefit is part of "forest management systems" as that term is used and understood in paragraph 2(b). As with the

Ontario road program, road building relates generically to other forest management issues, but if the purpose of the road program is to protect industry, it cannot be part of "forest management systems."

141. In any event, the credit was not announced until October 2006 and therefore, was not in effect prior to July 1, 2006. Indeed, Canada's own fact witness admits that, Québec did not announce its 90 percent tax credit until October 2006. R-3, ¶¶ 24-25. Québec did not enact legislation necessary to fund any road building tax credit until December 2006. C-1, Att. V. Accordingly, the road building tax credit could not have been in effect prior to July 1, 2006. *Id.* ¶ 225; *see also* Stmt. Defence, ¶ 58 (conceding that Canada agreed to "preclude . . . additional funding for additional programs").

3. The 90 Percent Tax Credit Did Not Exist Before July 1, 2006

142. Canada also claims that, even if the 90 percent tax credit provided a benefit and was not considered to be a "timber pricing" or "forest management systems" measure, SLA, art. XVII, ¶ 2 (a), this benefit came into existence and was administered for purposes of paragraph 2(b) upon the earlier announcement of a 40 percent credit in the budget speech of March 2006. R-3, ¶¶ 232-51; SLA, art. XVII, ¶ 2(b).

143. The relevant provision of the SLA excludes "other government programs that provide benefits on a non-discretionary basis in the form and total aggregate amount in which they existed and were administered on July 1, 2006." SLA, art. XVII, ¶ 2(b). This exclusion does not apply because the road building tax credit came into existence, with retroactive application, months after July 1, 2006. *See also* discussion *supra* ¶ 113 (regarding Canadian authorities on the giving of retroactive effect to tax measures at the time of enactment by Parliament).

144. In fact, the only tax forms that Canada proffers demonstrate that both the 40 percent tax credit announced in March 2006, and the 90 percent tax credit announced the following October, were not administered until after enactment of the enabling legislation. *See* R-77 at 41-87 (47 separate "ATTESTATION" forms for claiming 40 and 90 percent credits, all signed by Québec in either March or February 2007); R-78 (rejection letters, dated after July 1, 2006); R-79 (tax form, not submitted until after October 2006); R-79 ("ATTESTATION" form for 40 percent credit, not signed by governmental representative until after July 1, 2006). Accordingly, this credit is in not "the form and total aggregate amount in which [it] existed and w[as] administered on July 1, 2006." SLA, art. XVII, ¶ 2(b).

145. Additionally, contrary to Canada's contentions that the United States' "argument is based on a very narrow *Lex Americana* approach," Stmt. Defence, ¶ 244, it was the enabling legislation passed in November 2006 and assented to on December 6, 2006, that gave effect to the road building tax credit. Specifically, in Bill 41, the Québec National Assembly mandated that: "This bill amends various legislation to *give effect* to budgetary measures announced in the Budget Speech delivered on 23 March 2006." C-1, Att. V at 2 (emphasis added). Likewise, Bill 41 indicated that it "amends the Taxation Act to introduce, amend or repeal certain fiscal measures specific to Québec. In particular, the amendments concern . . . (12) the introduction of a refundable tax credit for the construction and major repair of public access roads and bridges in forest areas." *Id.* at 2-3. Accordingly, Canada's assertion that a program "existed" on July 1, 2006, even though Canada had not yet "give[n] effect," *id.* at 2, to that program, cannot overcome the express mandate of Québec's National Assembly.

146. Even if the road building tax credit announced in the March 2006 budget speech existed in some other form on July 1, 2006, by Canada's own admission, it did not exist *in the*

same form and total aggregate amount in which it existed on July 1, 2006. Canada's own fact witness states that the program as announced in October 2006 had changed from a 40 percent credit to a 90 percent credit, among other changes. R-3, ¶¶ 24-25. This is a dramatic change from the "the form and total aggregate amount in which [it] existed and w[as] administered on July 1, 2006," SLA, art. XVII, ¶ 2(b). Indeed, the announced "aggregate amount" of the program would have more than doubled between March and October, and the same announcement identified numerous other costs of doing business that the provincial government expressed its intention to assume. R-3, ¶¶ 24-25. Accordingly, even if the program came fully into force with the March 2006 announcement, Québec's superseding announcement of the 90 percent road building credit in October 2006 removes this program from the purview of the exception in paragraph 2(b). Therefore, the program, in its current form, did not exist on July 1, 2006.

C. Québec's Assumption Of Numerous Other Costs Of Doing Business Circumvents The SLA

147. For many of the same reasons that it asserts that Québec's assumption of road building costs does not circumvent the SLA, Canada also asserts that Québec's provision of new benefits for reforestation, fighting forest fires, and pest control does not circumvent the Agreement. Canada is incorrect.

1. Québec's Assumption Of Fire Suppression, Insect Management, And Disease Costs Circumvents The SLA

148. As with Québec's road building benefit, Canada argues that Québec's assumption of fire suppression and insect and disease costs previously borne by industry did not provide a benefit. The basis for this assertion is that "where costs associated with harvesting on public land are modified, an equivalent and corresponding change is made in the pricing formula for

public standing timber." Stmt. Defence, ¶ 269. Again, Canada effectively concedes that the program conferred a benefit, but has unilaterally determined that it can "offset" that benefit. As demonstrated earlier, the question is not whether Canada takes some action that purportedly offsets a benefit; the question is whether there is a benefit in the first instance. If there is, Canada has breached the SLA, and the Tribunal is to determine a remedy for the breach.

149. Canada's claim fails for the same reason its claim regarding the road building credit fails. Québec admits that it elected to relieve lumber companies of the cost of paying for fire suppression and insect and disease control services effective January 1, 2007. R-3, ¶¶ 22, 26. These expenses had previously been borne by lumber companies since at least the 1990s. *Id.* ¶ 22; *see id.* (referring to payments as "SOPFEU" for fire suppression and "SOPFIM" for insect and disease control).

150. Despite its contention that "an equivalent and corresponding change is made in the pricing formula for public standing timber," Stmt. Defence, ¶ 269, to offset this governmental assumption of a cost of doing business, Canada fails to demonstrate that this is in fact the case. Mr. Adam never asserts that there is the sort of one-for-one offset that Canada advances. Rather, he spoke only in generalities about "stumpage prices that are higher than they would otherwise have been." R-3, ¶¶ 28.

151. Moreover, under the previous system, "tenure holders" were required to make fire suppression and insect and disease control payments. *Id.* ¶ 23. Accordingly, these payments appear to be up-front costs of doing business. As a result, like the road building credit, the provincial government has assumed the risk associated with payment of the assessment in the case in which the lumber company ultimately harvests no lumber from a tract.

152. Canada also contends that "[t]he October 2006 announcement of the elimination of the industry's obligation to reimburse part of [these] costs" is also a part of "Québec's Timber Pricing and Forest Management Systems." Stmt. Defence, ¶ 271 (citing SLA, art. XVII, ¶ 2(a)). Again, this is erroneous for the same reasons that the road building tax credit circumvents the SLA.

153. First, the assumption of a cost previously borne by industry is not an element of timber pricing. Under Canada's reasoning, the government could reimburse lumber companies for every penny that they would otherwise have spent to harvest timber, and this benefit would simply be a "timber pricing" mechanism by virtue of the fact that stumpage rates may take back some of these benefits should the recipient ultimately harvest timber from public lands. Rather, as previously demonstrated, although the "timber pricing" formula itself may fall into the paragraph 2(a) "pricing" exception, the exemption cannot be stretched to include governmental assumption of costs (and risks) previously borne by lumber companies simply because the costs "relate[] to" activities that lumber companies undertake to harvest timber.

154. Second, Canada again conflates "forest management systems" with the payment of a benefit for the purpose of offsetting costs associated with alleged "forest management" activities. Stmt. Defence, ¶ 274. According to Canada, the province has continued to undertake the same activities that it has previously undertaken with respect to fire suppression and insect and disease control. R-3, ¶¶ 22, 24, 26. The only difference, however, was Québec's decision, effective January 1, 2007, to reduce industry's required contributions for fire suppression and insect and disease control. *Id.* ¶ 24. Reducing the companies' operating costs is not forest management. Québec is simply paying benefits.

2. Québec's Assumption Of Reforestation Costs Circumvents The SLA

155. Québec's assumption of reforestation expenses (or "tree seedling" or "forestry fund" charges) also circumvents the SLA. Once again, this is an expense that was previously borne by the forest products industry that Canada admits was "removed effective January 1, 2007." Stmt. Defence, ¶¶ 276, 278; R-3, ¶ 24.

156. Canada first contends that Québec's assumption of forestry fund charges provides no benefit for the exact same reason that the fire suppression and insect and disease control programs provide no benefit. *Id.* ¶¶ 278-79 (citing R-3, ¶¶ 30-31). Canada is incorrect for the same reasons as it is with respect to the other programs. Again, Canada alleges only a "corresponding and directly related increase in" stumpage rates, *id.* ¶ 279, yet it presents no evidence supporting a one-for-one offset, providing instead only unverifiable "simulations." *Id.* ¶ 220.

157. Likewise, as with the other newly assumed costs, Canada improperly conflates "forest management systems" with benefits provided for "forest management" activities. *Id.* ¶ 280. According to Québec, the province has continued to undertake the same reforestation activities that it has previously undertaken. R-3, ¶¶ 23-24. The only difference, however, was Québec's decision, effective January 1, 2007, to reduce industry's required contributions for the Forestry Fund. *Id.* ¶ 24. Reducing the companies' operating costs is not forest management activity. Again, Québec is simply paying benefits.

V. Québec's C$425 Million Forest Industry Support Program Benefits Softwood Lumber Producers

158. In its Statement of the Case, the United States demonstrated that Québec's C$425 million Forest Industry Support Program ("PSIF"), administered through IQ, provides grants or

other benefits on a *de jure* or *de facto* basis to softwood lumber producers and, thus, is deemed to offset or reduce the Export Measures. SLA, art. XVII, ¶ 2. Canada has failed to demonstrate that the PSIF program fits into one of the limited exceptions of SLA's anticircumvention provision or that this program would otherwise be SLA compliant.

159. Canada makes the following charges, none of which is sufficient to overcome our demonstration: (1) the PSIF qualifies for the anticircumvention exception as a program in "the form and total aggregate amount in which [it] existed and w[as] administered July 1, 2006," because a precursor program was announced in the March 2006 Budget Speech, Stmt. Defence, ¶¶ 307-311, 315; (2) the United States has failed to meet its evidentiary burden of showing that the PSIF program provides a grant or other benefit to softwood lumber producers, *id.* ¶¶ 316-46; and (3) the PSIF does not provide any "benefit" because PSIF loans and loan guarantees are provided at "market" rates. *Id.* ¶¶ 300-06, 316-46.

A. The PSIF Is Not Subject To The 2(b) Exception

160. For the first time, in October 2006, Québec implemented the PSIF *in the form at issue here*, to make C$425 million available to assist forest sector companies in financing capital projects and asset acquisition projects. C-1, Att. AB at 3, 6. Canada relies solely upon the announcement of a previous incarnation of the PSIF program in the March 2006 Budget Speech in an attempt to demonstrate that this program should be "grandfathered" pursuant to SLA, art. XVII, ¶ 2(b). Stmt. Defence, ¶ 315. However, no loans were made under this program until October 2006, and, thus, the PSIF program of October 2006 was not in "the form and total aggregate amount in which [it] existed and w[as] administered July 1, 2006," SLA, art. XVII, ¶ 2(b); *see* C-1, Att. AB at 1, 3, 6; C-1, Att. AD at 4; C-1 at 54 (citing Att. AR at QC002037, p. 10).

161. Canada makes the unsupported statement that "loans and loan guarantees . . . were available from June 2006 onward" Stmt. Defence, ¶ 309. Rather, what is known is that Québec *did not* lend any money under this program before July 1, 2006, and Québec has also provided no evidence of any loan guarantees dated before the SLA cutoff. C-43, pp. 51-54; Table 34 (comparing PSIF as of June 2006 and October 2006).

162. Additionally, the United States explained that "the Québec Finance Minister admitted in his 2007-2008 budget that the program was not implemented until the fall of 2006." Stmt. Case, ¶ 98 (citing C-1, Att. W. at 34). Canada never responds to this evidence. *See* R-94 at 2 (noting that no financing was provided as of a date after the SLA cutoff date).

163. Lastly, pursuant to PSIF, IQ makes loans and loan guarantees on a discretionary basis. C-1 at 54. Canada failed even to attempt to overcome this evidence. *See* Stmt. Defence, ¶ 301 (mentioning exception for certain "non-discretionary" programs but never applying the analysis to PSIF). Accordingly, Canada may not seek refuge in the paragraph 2(b) exception.

B. The United States Has Met Its Burden

164. Canada argues that the United States failed to meet its burden of demonstrating that the PSIF provides a "benefit" to softwood lumber companies. In our Statement of the Case, the United States proffered statements of the Québec Finance Minister that the purpose of PSIF, as well as other programs was "[t]o foster the rapid recovery of Québec's forest sector." C-1 at Att. W at 34. Likewise, in the same budget document presented to the National Assembly, Québec's Finance Minister admitted that "the government implemented, in the fall of 2006, a support plan providing $1.4 billion in assistance over the period 2007-2010," *id.* and identified PSIF funding as a "[s]upport plan for the forest sector." *Id.* at 35. In sum, Canada's post-hoc

rationalizations and revisionist history are fatally undermined by the actual evidence of contemporaneous statements of high level provincial officials.

165. Furthermore, Mr. Beck's rebuttal report quantifies the benefits provided to producers and exporters of Canadian softwood lumber. Specifically, the PSIF provided hundreds of millions of dollars in benefits to Canadian industry. Table 33 of Mr. Beck's rebuttal report provides a detailed summary of the commercial and interest free loans provided through PSIF to enable softwood lumber producers, customers, and suppliers to undertake activities that they would not have otherwise undertaken. C-43, pp. 45-46.

166. Likewise, Canada's focus upon funding provided to "softwood lumber projects," Stmt. Defence, ¶¶ 313, misstates the agreement between the United States and Canada. Québec may not so easily evade the SLA by providing benefits to softwood lumber producers or exporters for use in non-softwood lumber activities. Rather, the plain language of the SLA mandates 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." SLA, art. XVII, ¶ 2.

167. This provision simply does not allow governments to funnel benefits "to producers or exporters of Canadian Softwood Lumber Products," *id.*, by linking those benefits to the production of other merchandise. If the Parties had intended such a result, they could have agreed to such an arrangement; however, the ordinary meaning of the agreement does not allow such an open-ended exception to Canada's commitment not to circumvent the SLA.

C. PSIF Continues To Provides Benefits

168. Québec's PSIF program continues to benefit the province's softwood lumber industry. As announced in October 2006, the program allocated C$150 million to working capital financing projects and consolidation projects, and C$275 million to investment and asset acquisition projects. C-1 at 52; C-1, Att. AB at 6. This has resulted in loans totaling C$ 59.9 million, including C$ 18.3 million in interest free loans. C-43, pp. 45-46 (Table 33).

169. As Canada concedes, Québec "provide[s] loans and loan guarantees to companies operating in all forest sector industries." Stmt. Defence, ¶¶ 308. This begs the question, why would forest sector companies need government loans or "loan guarantees" if the market were willing to charge companies the same interest rate and while accepting the risk of default. Indeed, this position is implausible, given Québec's numerous statements to the effect that it intended to provide support for the forest sector. *See* R-94 at 1-2; C-1, Att. W.

170. Canada further concedes that these benefits are specific to the forest products industry. Stmt. Defence, ¶ 310 (noting that, under the PSIF, as amended in October 2006, the "original funding amount again was directed at the entire forestry sector"). Much of these benefits have gone directly to companies that produce or export softwood lumber. C-43, pp. 45-46.

171. Furthermore, Canada's contention that the United States Department of Commerce ("Commerce") has concluded that the PSIF provides no benefit is inaccurate. Stmt. Defence at ¶¶ 317-18. Rather, Commerce investigated a single loan under a different program, during a single pre-SLA annual period and found no countervailable subsidy during that period.

172. Specifically, in the 2003-2004 administrative review of the countervailing duty order covering certain softwood lumber products from Canada, Commerce examined assistance

under Article 28 of Investment Québec, which was a loan program. Commerce investigated the one outstanding loan under the program during the period of review in question, comparing the interest rates charged on the Article 28 loan to the benchmark interest rates. Using this methodology, Commerce determined that this particular loan provided no benefit during the period of review, because the interest rates and fees charged were equal to or higher than the interest rates charged on comparable commercial loans. *See* CA-48 at 8-9, 75-76 (*Notice of Preliminary Results of Countervailing Duty Administrative Review: Certain Softwood Lumber Products from Canada*, 70 Fed. Reg. 33,088, 33,115 (Dep't of Commerce June 7, 2005) (unchanged in Final Results); *see also* RA-44 at 145. Commerce's determination was specific to the period of review and the specific loan at issue in that case. That is, Commerce concluded that certain IQ administered (pre-PSIF) loans did not confer a subsidy between April 1, 2003 and March 31, 2004. *Id.*

ARGUMENT ON REMEDY

I. Introduction

173. Upon finding that Canada has breached the SLA, the Tribunal is to determine an appropriate remedy. The Tribunal's task is twofold. The parties agreed in the SLA that the Tribunal is to: (a) determine a reasonable period of time, but not more than 30 days, for Canada to cure its breach; and (b) determine compensatory adjustments to Export Measures should Canada fail to cure its breach within the reasonable period of time. SLA, art. XIV, ¶ 22. We agree that Canada should receive the full amount of time contemplated by the SLA – 30 days – to implement a cure for its breach. Therefore, this section addresses the appropriate compensatory adjustments to Export Measures should Canada fail to do so.

174. In its Statement of the Case, the United States demonstrated that a cure under the SLA requires both cessation and reparation. That is, Canada must cure its breach not only by ending the breaching programs immediately, but also by taking steps to erase all effects of the programs. In contrast, Canada contends that the SLA permits no "retrospective" remedy, that is, no remedy for the past effects of a Party's breach. Stmt. Defence, ¶¶ 350-52. Selectively borrowing from the WTO and NAFTA dispute settlement systems, Canada argues that a party should be permitted to cure its breach by discontinuing the breaching conduct within a reasonable period of time, and nothing more. *Id.*

175. Canada's interpretation of the SLA is not supported by the terms of the Agreement or international law. Significantly, all of Canada's legal arguments were raised and rejected by the Tribunal in its Award on Remedies in *United States v. Canada.*[43]

[43] *See* CA-12, *United States v. Canada, Award on Remedies,* ¶¶ 271-310.

176. After presenting its legal arguments in opposition to the imposition of a remedy, Canada finally addresses the substance of the remedies proposed by the United States to compensate for Canada's breach. Although Canada criticizes the proposed remedies at length, it pointedly failed to propose any other remedy for the Tribunal's consideration. This is a significant omission, one that prevents Canada from offering alternative remedies. Procedural Order 1 confines Canada's Rebuttal to only those issues raised in this Reply. Canada may not, therefore, use its Rebuttal to raise remedy proposals for the first time. Accordingly, the Tribunal may select from the comprehensive remedies offered by the United States.

II. The SLA Contemplates That The Tribunal Will Establish A Cure Period *And* Determine Appropriate Compensatory Measures To Remedy The Breach

A. The Ordinary Meaning Of Terms In The SLA Permits Both "Prospective" And "Retrospective" Remedies

177. Under paragraph 22 of Article XIV of the SLA, the Tribunal makes two determinations once a breach is found. The Tribunal is to:

> (a) identify a reasonable period of time for that Party to cure the breach, which shall be the shortest reasonable period of time feasible and, in any event, not longer than 30 days from the date the tribunal issues the award; and
>
> (b) determine appropriate adjustments to the Export Measures to compensate for the breach if that Party fails to cure the breach within the reasonable period of time.

SLA, art. XIV, ¶ 22.

178. Pursuant to the ordinary meaning of paragraph 22, the Tribunal *simultaneously* (1) identifies a reasonable period of time for Canada to cure its breach, and (2) determines the appropriate adjustments to the Export Measures to compensate for the breach. SLA, art. XIV, ¶ 22. The Tribunal is to include both findings in its award. *Id.* These compensatory

adjustments must consist of increases in export charges, reductions in export volumes, or both, and must be in an amount that remedies the breach. SLA, art. XIV, ¶¶ 23.

179. Article XIV authorizes both Canada and the United States to challenge the execution of a party's compliance with paragraph 22, stating, "[i]f Canada considers that the United States has failed to cure a breach by the end of the reasonable period of time, Canada may make the compensatory adjustments that the tribunal has determined under paragraph 22(b)." SLA, art. XIV, ¶ 26.

180. Further, "[if] the United States considers that Canada has failed to cure a breach and has not made the compensatory adjustments the Tribunal has determined under paragraph 22(b) by the end of the reasonable period of time, the United States may impose compensatory measures in the form of volume restraints and/or customs duties on imports of Softwood Lumber Products from Canada," as long as the volume restraints and customs duties do not exceed the adjustments to Export Measures previously determined by the Tribunal. SLA, art. XIV, ¶ 27.

181. Article XIV then provides that the breaching party may commence a new arbitration to determine whether the compensatory adjustments to the Export Measures permitted in paragraph 27 exceed what the Tribunal determined in its award pursuant to paragraph 22. SLA, art. XIV, ¶ 29(a), (b). If either party commences an arbitration under paragraph 29, the LCIA "shall appoint to the tribunal the arbitrators comprising the original tribunal, to the extent they are available." SLA, art. XIV, ¶ 30. If the Tribunal finds in this second arbitration that the compensatory adjustments or measures are inconsistent with the award in the initial arbitration, the Tribunal "shall determine the extent to which the compensatory adjustments or measures should be modified or whether they should be terminated." SLA, art. XIV, ¶ 31.

182. The ordinary meaning of these paragraphs is that, once the reasonable cure period has passed, the United States is entitled to impose the compensatory measures determined by the Tribunal under paragraph 22 if the United States considers that Canada has failed to cure the breach and has failed to make the compensatory adjustments itself. SLA, art. XIV, ¶¶ 22- 27.

183. With respect to the Tribunal's Award in this arbitration, if the Tribunal finds that the benefit programs breach the SLA, the United States agrees that Canada should be granted the maximum 30-day period allowed under the Agreement to cure its breach. SLA, art. XIV, ¶ 22(a).

184. The broad language of paragraph 22 contemplates a remedy that addresses both cessation of the breaching programs and adjustments to Export Measures to compensate for both the past and current effects of the breaching programs. Nonetheless, Canada urges the Tribunal to adopt its view that: (1) remedies under the SLA are restricted to adjustments to Export Measures only when a party continues to breach the SLA beyond the reasonable period of time; and (2) the SLA permits *no* remedy for the effects of a past breach. Stmt. Defence, ¶¶ 355-56, 361. Canada's position is not supported by the SLA.

185. The interpretation of the phrase "cure the breach" must begin with the actual text of the SLA. When used in the context of a malady, "cure" means "to subdue or remove by remedial means; remedy; remove; heal."[44] Similarly, when used in the context of evil of any kind, "cure" means "to remedy, rectify, remove."[45]

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[44] WEBSTER'S NEW INTERNATIONAL DICTIONARY OF THE ENGLISH LANGUAGE 646 (2d ed. 1958) (transitive verb definition 2.b), CA-17.

[45] THE OXFORD ENGLISH DICTIONARY: BEING A CORRECTED REISSUE WITH AN INTRODUCTION, SUPPLEMENT, AND BIBLIOGRAPHY OF A NEW ENGLISH DICTIONARY ON HISTORICAL PRINCIPLES 1263 (reprinted 1978) (1933) (verb definition II.5), CA-18.

186. Canada's restricted view of the term "cure" not only defies the ordinary meaning of the word, but also makes no sense in the context of its breach. Canada's breach is the implementation and expansion of government programs that provide grants and other benefits to Canadian softwood lumber producers. When cure means to remedy, rectify, and heal, the mere cessation of the breaching programs cannot constitute a cure for this breach. In this case, the breach has led to millions of dollars in investments in Canadian softwood lumber companies, investments that will remain in place even if Canada ceased the programs today. That would be no remedy. To properly remedy, rectify, and heal Canada's breach, Canada must make full reparation for its breach, that is, compensate for all of the investments made under the programs since inception.

187. Given that the ordinary meaning of "cure" includes to "remedy," it is particularly instructive that the Agreement, read in its context, defines compensatory measures as measures that "remedy" the breach. That is, to "cure" is to "remedy," and, pursuant to the SLA, compensatory measures also "remedy." SLA, art. XIV, ¶ 23. Accordingly, compensation and remedy are equivalent concepts under the SLA. It follows that a cure, which by definition must remedy the breach, includes some form of compensation.

188. Although the Tribunal in *United States v. Canada* concluded that the term "'cure' by itself does not have a clear meaning as being retroactive or prospective," it nevertheless determined that the ordinary meaning of the term should not be interpreted as prospective only.[46]

189. Canada also misinterprets the reference to "retroactive" in Article XIV, paragraph 32, arguing that the presence of the term "retroactive" in another paragraph signals the parties' intent to allow only prospective remedies. Stmt. Defence, ¶¶ 356-57. In reality, the use of the

[46] CA-12, *United States v. Canada, Award on Remedies*, ¶ 283.

term in paragraph 32 does not distinguish "retroactive" from "prospective" at all, because it is obvious that the application of the measures in paragraph 32 are retroactive. Rather, the phrase "retroactive to that date" is used to clarify at what point in the past the measures should commence, namely the date when the non-breaching party imposes compensatory adjustments.[47]

190. Canada's failure to recognize the close relationship between cure and compensatory measures leads it to charge that the United States' interpretation of "cure" is punitive. Stmt. Defence, ¶ 382. The compensatory measures, however, by definition, cease when the breach has been cured. Therefore, no punitive award results because the compensatory measures will cease as soon as Canada has compensated for its breach and, therefore, cured it.

191. Finally, the term "breach" as used in paragraph 23 is not limited or qualified in any way to breaches that continue after the expiration of the reasonable cure period. Accordingly, the plain meaning of the term "breach" is that it is the same "breach" to which paragraph 22 refers, that is, the "breach" the Tribunal has found. As the Tribunal noted in *United States v. Canada*, "[t]o nevertheless conclude that the provision is only applicable to continuing breaches and not to past breaches, would require specific language to that effect – which cannot be found in ¶ 22."[48] The Tribunal concluded that the breaching activity, which had ceased before the initiation of arbitration, had not been cured.[49] Therefore, the plain meaning of paragraph 23 is that, when a party has breached, the compensatory measures must wipe out the entirety of the breach.

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[47] CA-12, *United States v. Canada, Award on Remedies*, ¶ 292 (Tribunal observes that "§ 32 deals with quite a different situation than § 22" and concludes that "[t]he retroactivity mentioned in § 32 therefore does not permit conclusions regarding the lack of retroactivity of § 22.").

[48] *United States v. Canada, Award on Remedies*, ¶ 284, CA-12.

[49] *Id.*

B. Canada's Position Is Not Supported By Principles Of International Law

192. Pursuant to customary rules of treaty interpretation reflected in the Vienna Convention, any relevant rules of international law applicable in the relations between the parties shall be taken into account in interpreting the text of the Agreement. In the case of the SLA, those relevant rules include norms of public international law on remedy for breaches.

193. The law of state responsibility, including the secondary rule of international law set out in Article 31 of the International Law Commission's Draft Articles on the Responsibility of States for Internationally Wrongful Acts (2001), is commonly referred to by courts and tribunals when assessing remedies for treaty breaches.[50]

194. Article 31 of the Draft Articles on State Responsibility begins with the principle that "the responsible State is under an obligation to make full reparation for the injury caused by the internationally wrongful act." *Id.* The obligation to make full reparation need not be stated in the international agreement itself. *Id.* "[R]eparation must, as far as possible, wipe out all the consequences of the illegal act and reestablish the situation which would, in all probability, have existed if that act had not been committed."[51] Indeed, interpreting the same remedy provision at issue here, the Tribunal in *United States v. Canada* concluded that there is a presumption in favor of retroactive remedies in international law, and ruled that the SLA provides for retroactive remedies.[52]

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[50] Responsibility of States for Internationally Wrongful Acts, U.N. GAOR, Int'l Law Comm., 53d Sess., pt. I, ch. 1, arts. 4-11, 16, U.N. Doc. A/CN.4/L.602/Rev.1 (2001), CA-20.

[51] CA-19, *Case Concerning the Factory at Chorzów* (Germ. v. Pol.), 1928 P.C.I.J. 47 (ser. A) No. 17 (Sept. 28).

[52] CA-12, *United States v. Canada, Award on Remedies*, ¶ 289.

C. The Dispute Resolution Schemes Under The WTO And NAFTA Chapter 20 Are Entirely Dissimilar From That Of The SLA

195. Canada argues that the Tribunal should depart from the express language of the parties' agreement in the SLA and, instead, apply in this arbitration the dispute resolution system of the WTO and NAFTA. Stmt. Defence, ¶¶ 366-75. In fact, Canada claims that the SLA was "modeled" after the WTO and NAFTA Chapter 20, failing to acknowledge key differences in the language of the SLA and these two agreements. *Id.* Moreover, Canada ignores language in the SLA that expressly divorces dispute settlement under this Agreement from the WTO and NAFTA Chapter 20 processes. SLA, art. XIV, ¶ 2.[53]

196. Rather than adopt the language of the WTO Dispute Settlement Understanding ("DSU") or NAFTA Chapter 20, the SLA instead uses the term "cure the breach"; identifies the LCIA, an international commercial arbitration forum, as the sole forum for disputes; and adopts the International Bar Association ("IBA") Rules — rules that typically apply in commercial cases. When the parties sought to incorporate rules or procedures from particular fora, they did so explicitly. No such reference or incorporation was made in the SLA regarding the WTO DSU or NAFTA. As parties to both the WTO and NAFTA, Canada and the United States were familiar with the WTO DSU and NAFTA Chapter 20 systems at the time of the SLA settlement negotiations.[54] In fact, the parties were engaged in litigation in these fora at the time they negotiated the Agreement. Stmt. Defence ¶¶ 23, 25.

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[53] The relevant portion of Article XIV, paragraph 2, states: "Except as provided for in this Article, for the duration of the SLA 2006, including any extension pursuant to Article XVIII, neither Party shall initiate any litigation or dispute settlement proceedings with respect to any matter arising under the SLA 2006, including proceedings pursuant to the Marrakesh Agreement Establishing the World Trade Organization or Chapter Twenty of the NAFTA."

[54] CA-12, *United States v. Canada, Award on Remedies*, ¶ 289.

197. Contrary to Canada's contention, Article XIV of the SLA bears no structural or substantive resemblance to the dispute resolution provisions of the WTO and NAFTA Chapter 20. Stmt. Defence, ¶ 367. For example:

- Under the SLA, the Tribunal makes a finding of "breach." SLA, art. XIV, ¶ 22. In contrast, the WTO DSU refers to a finding that a "measure is inconsistent with a covered agreement" and NAFTA Chapter 20 refers to "whether the measure at issue is or would be inconsistent with the obligations . . ." under the agreement.[55]

- The SLA states that when "a Party has breached an obligation under the SLA," it must "cure the breach." SLA, art. XIV, ¶ 22. The WTO DSU provides that when a panel or the Appellate Body makes a finding that a measure is "inconsistent with a covered agreement," it shall recommend that a party "bring the measure into conformity with the covered agreement."[56] Similarly, a party under NAFTA Chapter 20 must choose either "non-implementation or removal" of the measure.[57]

- The SLA provides for "compensatory adjustments" to be determined by the Tribunal. SLA, art. XIV, ¶ 22. The WTO DSU allows for voluntary "compensation" that is negotiated and agreed to by the disputing parties.[58] NAFTA Chapter 20 similarly provides for voluntary compensation when the disputing parties are unable to agree on the non-implementation or removal of a non-conforming measure.[59]

- The SLA permits a party to impose "compensatory measures" itself when the breaching party has failed to cure the breach or to impose the "compensatory adjustments" ordered by the Tribunal. SLA, art. XIV, ¶ 27. The WTO DSU permits the "suspension of concessions or obligations."[60] NAFTA Chapter 20 permits a party to "suspend the application . . . of benefits of equivalent effect."[61]

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[55] *See* CA-21, Art. 19; CA-22, Art. 2016(2)(b).

[56] *See* CA-22, Art. 19.

[57] *See* CA-22, Art. 2018(2).

[58] *See* CA-21, Art. 22(2).

[59] *See* CA-22, Art. 2018(2).

[60] *See* CA-21, Arts. 22(2) & 22(3).

[61] See CA-22, Art. 2019(1).

198. Given the very dissimilar terms of the SLA on one hand, and the WTO and NAFTA Chapter 20 on the other, as well as the absence of any reference to these agreements in the remedy provisions of the SLA, there is no basis to conclude that the prospective remedy regime from these agreements should be applied to the SLA. Indeed, the panel in *United States v. Canada* considered and rejected all of the same WTO and NAFTA arguments that Canada has raised again in this proceeding, stating "[t]his complicated prospective procedure of Chapter 20 is obviously so different from the procedure provided in Art. XIV SLA that it permits no conclusions in favour of a merely prospective interpretation of the latter."[62]

199. These many differences between the SLA and the WTO and NAFTA provide context for the larger structure in which the WTO and NAFTA operate. Unlike the SLA, the WTO and NAFTA are comprehensive agreements intended to liberalize international trade. The preamble to the WTO Agreement establishing the 153-member World Trade Organization refers to "entering into reciprocal and mutually advantageous arrangements directed to the substantial reduction of tariffs and other barriers to trade and to the elimination of discriminatory treatment in international trade relations."[63] Likewise, the preamble to NAFTA notes that the parties resolved to, among other things, "REDUCE distortions to trade" and "BUILD on their respective rights and obligations under the General Agreement on Tariffs and Trade and other multilateral and bilateral instruments of cooperation."[64]

200. In both the WTO and NAFTA, the parties have bargained for market access in exchange for market access. Accordingly, when a party fails to act consistently with its

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[62] CA-12, *United States v. Canada, Award on Remedies*, ¶¶ 287, 289.

[63] *See* CA-23.

[64] *See* CA-22.

commitments under either agreement, the dispute settlement provisions allow the aggrieved party to restrict market access, or to suspend concessions and obligations until the defending party brings itself into conformity with its obligations to open trade.

201. In contrast, the SLA is not intended to *liberalize* international trade in general, but to *regulate* trade in one specific sector. To that end, the parties did not bargain for market access in exchange for market access. Rather, the parties agreed to replace antidumping and countervailing duty orders, which the United States imposed to prevent injury to its industry, with a system of Export Measures to be applied by Canada. The United States agreed to compromise multi-forum litigation, eliminate existing trade measures, and forego additional trade measures as long as the SLA remains in place. These obligations are narrowly tailored to the softwood lumber markets in the two countries and are specifically tied to the real-world market conditions of the softwood lumber trade. Canada's failure to honor its commitments under the SLA is wholly unlike a failure to abide by the trade liberalizing commitments of the WTO and NAFTA.[65]

202. Ignoring these important differences between the SLA and the WTO and NAFTA agreements, Canada insists upon placing the SLA within the WTO/NAFTA framework simply because the SLA concerns trade matters between two governments and has "time limits." Stmt.

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[65] Canada provides several examples of free trade agreements signed by the United States and Canada with other countries. Stmt. Defence, ¶¶ 366 n.369 and 373 n.376. According to Canada, the dispute settlement provisions in these agreements "adopt the same prospective approach embodied in the WTO . . . and the NAFTA." *Id.* As with the WTO DSU and NAFTA Chapter 20, these unrelated agreements are unhelpful in respect of how disputes are resolved under the SLA. The cited agreements are *trade-liberalizing* "free trade agreements," a category of agreement far different from the *trade-regulating* SLA. Unlike the SLA, these agreements do not use terms such as "cure the breach" and "compensate for the breach." Nor do these agreements call upon the Tribunal to determine trade adjustments in order to "remedy the breach." Simply put, the dispute settlement provisions in these agreements bear no resemblance to those in the SLA.

Defence, ¶¶ 373-74. However, the fact that the parties to the SLA are two governments says nothing regarding the dispute settlement procedures to which the two governments are permitted to agree.

203. State-to-state disputes arising from bilateral agreements do not require only prospective remedies. For example, in *The Gabcikovo-Nagymaros Project*, involving a treaty between Hungary and Czechoslovakia, the International Court of Justice ("ICJ"), citing *Chorzow*, concluded that both parties were entitled to retrospective compensation.[66] Additionally, Canada itself brought a claim against the Soviet Union for retrospective damage arising under the Convention on International Liability for Damage Caused by Space Objects.[67] Yet Canada argues that the "unique" feature of a dispute under the SLA, a dispute between two States, prevents either party from receiving "an award for damages." Stmt. Defence, ¶ 373-74.

204. Canada's assertion that the "time limits" in the SLA are akin to those in the WTO and NAFTA Chapter 20 is equally flawed. The "time limit" in the WTO and NAFTA Chapter 20 is provided for the party merely to bring its conduct into conformity with its obligations under the agreement.[68] In contrast, the "reasonable period of time" in the SLA is provided to allow the

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[66] *Gabcikovo-Nagymaros Project (Hungary/Slovakia)*, Judgment, I.C.J. Reports 1997, p.7, para. 152 ("It is a well-established rule of international law that an injured State is entitled to obtain compensation from the State which has committed an internationally wrongful act for the damage caused by it. In the present Judgment, the Court has concluded that both Parties committed internationally wrongful acts, and it has noted that those acts gave rise to the damage sustained by the Parties; consequently, Hungary and Slovakia are both under an obligation to pay compensation and are both entitled to obtain compensation."), CA-24.

[67] *Claim Against the Union of Soviet Socialist Republics for Damage Caused By Soviet Cosmos 954*, No. FLA 286, CA-25; *Canada-Union of Soviet Socialist Republics: Protocol on Settlement on Canada's Claim for Damages Caused By "Cosmos 954," available at* 1981 WL 155523, CA-26; *Convention on International Liability for Damage Caused by Space Objects, available at* 1973 WL 151962, CA-27.

[68] *See* CA-21, CA-22.

breaching party to "cure the breach." SLA, art. XIV, ¶ 22(a). The Tribunal in *United States v. Canada* considered these same arguments and concluded that the requirement to "cure the breach" must have a different meaning from the language in the WTO DSU and NAFTA requiring a party only to bring its conduct into conformance with the agreement.[69]

III. Canada's Secondary Legal Arguments Do Not Reduce The Remedy Necessary To Compensate For Its Breach In This Case

205. Canada raises two other, minor legal arguments related to remedy. First, Canada asserts that the SLA – to the extent any adjustments to Export Measures are permitted to remedy its breach – permits only adjustments that are tied to an exact calculation of the continuing adverse effects of the breaching programs on Export Measures. Stmt. Defence, ¶¶ 376-83. Second, Canada contends that any remedy must be tailored to the regions whose government programs are found to circumvent the SLA. *Id.* at ¶¶ 182-84.

206. Canada's first point is really an extension of its position that the dispute settlement provisions of the SLA permit only "prospective" remedies because it assumes that the United States is entitled to adjustments to Export Measures only to compensate for the effects of an ongoing breach. As explained above, the SLA permits adjustments to compensate for both past and continuing effects of Canada's breach, even if Canada discontinues the breaching programs.

207. Canada's position is directly contradicted by the terms of the SLA, which direct the Tribunal to determine "appropriate adjustments to the Export Measures to compensate for the breach." SLA art XIV, ¶ 22(b). There is nothing in the SLA that places a burden on the non-

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[69] CA-12, *United States v. Canada, Award on Remedies*, ¶ 289.

breaching party beyond demonstrating that the proposed adjustments are "appropriate" and "compensate for the breach."

208. An appropriate remedy under the SLA not only requires Canada to discontinue the breaching programs and to recoup the benefits, dollar for dollar, distributed to the softwood lumber industry, but also to "wipe out" current and future effects of the breaching programs. This comprehensive approach to remedy is consistent with the agreement of the parties as expressed in the SLA, honors the general principle in international law requiring "full reparation" for wrongful acts, and insures that Canada is not able to benefit from its breach.

209. Canada's second point relates to paragraph 25 of Article XIV: "[i]n the case of a breach by Canada attributable to a particular region, the Tribunal shall determine the compensatory adjustments applicable to that region." Stmt. Defence, ¶ 384, citing SLA, art XIV, ¶ 25. We agree with Canada that paragraph 25 generally requires the Tribunal in its decision on remedy to determine adjustments to Export Measures applied to exports by Québec and Ontario. Contrary to Canada's position, however, paragraph 25 does not prohibit the Tribunal from determining, in addition to region-specific remedies, appropriate adjustments to Export Measures from Ontario and Québec collectively.[70]

[70] The Tribunal may also consider that the Canadian federal government approved the challenged programs in February 2007, a fact confirmed in a February 21, 2007 article published in *The Vancouver Sun*. C-49. The Canadian newspaper reported that the Canadian Department of Foreign Affairs and International Trade (DFAIT) reviewed and approved the programs in February 2007 after a complaint from the United States Trade Representative that the programs violated the SLA. *Id.*; C-50. Canada confirmed the DFAIT review of the provincial programs in its responses and objections to the United States requests for disclosure of documents in this arbitration. *See* Procedural Order Nos. 3 and 4.

IV. The United States' Preferred Remedies Appropriately Capture The Benefits And Investments In Canadian Softwood Lumber Producers Made Possible By Canada's Breach

210. In the Statement of the Case, the United States proposed remedies, in the form of adjustments to Export Measures, should Canada fail to cure its breach within a reasonable period of time. Our preferred remedy, proposed through Tom Beck in his expert report, straightforwardly asks the Tribunal to impose an additional export charge on Ontario and Québec exports commensurate with the effects of the tax credits, grants, and other financial assistance made possible by the breach of the SLA. Stmt. Case, ¶¶ 145-49. As part of our remedy presentation, Professor Robert Topel explains in his expert report that Canada's breach has harmed United States producers. Stmt. Case, ¶¶ 150-60. The remedies proposed by the United States comprehensively account for harm to United States producers and benefits to Canadian producers.

211. To be clear, however, United States' expert Robert Topel addresses one component of Canada's breach, namely, the adverse effect on prices in the United States and consequential impact on United States producers. Professor Topel opines that additional export charges could be imposed to bring United States prices up to where they would otherwise have been absent Canada's breach. However, as a practical matter, collection of additional export charges under Professor Topel's model would extend so far beyond the life of the Agreement, this approach would become impractical. Accordingly, we provide Professor Topel's analysis *not* as an alternate remedy, but as a clear articulation of *one* aspect of compensation that must be addressed.

212. Canada alleges that Mr. Beck's calculations of benefits to and investments in Canada's softwood lumber industry are overstated. Stmt. Defence, ¶¶ 389-446. Canada

contends – as it did in disputing whether the programs breached the SLA – that the United States' calculations are flawed because (1) they rely upon Ontario and Québec projections of benefits, as opposed to documents showing actual program expenditures; (2) they incorporate, in part, benefits to pulp and paper mills; (3) they use the total amount of loans and loan guarantees; (4) they do not reduce the total benefits for offsets in other government programs; and (5) the United States' "high case" uses the total value of Canadian investments made possible by the breaching programs. *Id.*

213. As demonstrated in the sections that follow, Canada confuses liability and remedy. Canada has breached the SLA because it has provided benefits to its softwood lumber producers or exporters that do not fall within one of the enumerated exceptions. The determination of an appropriate remedy for the breach is a separate analysis that properly analyzes the consequences of the breach, and is not limited by the concept of "benefit." Instead, it comprehensively considers the effects of the benefits provided, including investments in Canada's softwood lumber industry that otherwise would not have been made but for Canada's breach.

214. None of Canada's criticisms places the breaching programs above the remedial authority of the Tribunal to determine appropriate adjustments to Export Measures to compensate for the breach. The United States has calculated the extent of the breach in terms of benefits and investments in Canada's softwood lumber industry in violation of Canada's obligations under the SLA. In the absence of any proposed remedy by Canada, it is reasonable for the Tribunal to adopt one of the remedy options proposed by the United States.[71]

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[71] *See United States v. Canada, Award on Remedies*, at ¶ 323 ("It is obvious that, once a breach and the applicability of subsection [22](b) is established, . . . there must be *at least one appropriate adjustment* satisfying the requirements of that subsection and the further

215. Canada then claims that Professor Topel's measure of the harm to United States producers – one component of the overall remedy that should be determined by the Tribunal – is unreliable because it is based upon the findings of Mr. Beck. Stmt. Defence, ¶¶ 447-65. Canada offers the report of long-time Canadian expert Joseph Kalt, who puts forward several technical criticisms of Professor Topel's work. *Id.* We explain below that the analysis by Professor Kalt is hindered by his misstatement of the nature of the breach and the proposed remedy.

A. Mr. Beck's Revised Figures Correctly State The Benefits Of The Ontario Programs

216. Canada contends that Mr. Beck has overstated the benefits and investments resulting from the Ontario programs in the following ways: (1) by relying upon website statements and other public pronouncements from both the government and benefit recipients; (2) by "speculating" on future benefits distributed under the programs; (3) by calculating the entire value of investments as the benefit to be remedied; (4) by considering investments in pulp and paper mills as a benefit to softwood lumber producers; (5) by including the full value of projects that were later reduced in scope; and (6) by overvaluing the loan guarantees. Stmt. Defence, ¶¶ 403-446.

217. Mr. Beck explains in his Rebuttal Report that, with the exception of Canada's new disclosure that two projects receiving grants and loan guarantees recently have been reduced in scope, none of Canada's criticisms of his calculations has merit. C-43, pp. 1-20. Therefore, Canada's "estimate" of a mere $3.3 million in Ontario program benefits to softwood lumber producers is not credible.

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qualification in § 23."); *id.* at ¶ 327 (because Canada did not present a remedy proposal, the SLA permitted the Tribunal to select "the most convincing adjustment method among the Proposals" submitted by the United States), CA-12.

218. Overall, Canada's criticisms confuse *liability* with *remedy*. We agree that it is proper to look at actual benefits in determining liability, that is, whether Canada's programs breach the SLA by providing benefits at all. SLA, art. XVII, ¶ 2. However, the separate determination of remedy assesses more broadly what Canada must do to wipe out the consequences of its breach as required by paragraph 22 of the SLA's remedy provisions. SLA, art. XIV, ¶ 22. Strictly limiting a remedy to the exact amount of the benefits provided under the programs, as Canada proposes, will leave many of the consequences of the breach uncompensated, allowing Canada to profit from its breach. This result is not contemplated by the SLA.

1. Public Statements Are Reliable Evidence That Support The United States' Remedy Estimates

219. Canada's first criticism, that the United States improperly relies upon public statements of softwood lumber producers and Ontario officials (including the Premier), Stmt. Defence, ¶¶ 403, 413, is unfounded. There is perhaps no better evidence in this case of Ontario's intent to provide benefits to softwood lumber producers than the receipt of benefits by the companies and the investments in these companies that otherwise would not have been made. These are Canada's own sources, and Canada does not contend that these statements of its own public officials and companies are false.[72]

220. Mr. Beck explains in his Rebuttal Report that the public statements from the companies and government officials convincingly demonstrate that the projects funded under the

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[72] *See Nuclear Tests (Australia v. France)*, 1974 ICJ 253, 267. In this decision, the ICJ stated that "[i]t is well recognized that declarations made by way of unilateral acts, concerning legal or factual situations, may have the effect of creating legal obligations." The ICJ went on to hold that unilateral declarations of high level French officials "if given publicly, and with an intent to be bound, even though not made within the context of international negotiations, is binding."), CA-30.

Ontario FSPF and FSLGP would not have obtained financing in the absence of government assistance. C-43, pp. 9-10.

221. Canada's second objection, that Mr. Beck "speculates" as to the future benefits provided under the Ontario programs, Stmt. Defence, ¶ 406, is belied by evidence from the Ontario government itself. Using Ontario's own documents, which Canada does not dispute, Mr. Beck has estimated Ontario program benefits through FY 2011-2012. C-1, p. 67. These estimates are based upon reliable evidence of benefits to softwood lumber producers if the programs are not discontinued. *Id.* However, for purposes of remedy, the United States conservatively utilizes estimated benefits only through FY 2008-2009 in its calculations, a period of time that ends on March 31, 2009. There is nothing impermissibly speculative in doing so.

2. The United States' Remedy Proposals Properly Consider The Total Investments Made Possible By The Breaching Programs

222. Canada's third criticism is that the United States incorrectly considers the full amount of investments in calculating a remedy, instead of the exact amount of the grant or loan guarantee provided. Stmt. Defence, ¶¶ 407-10. So, for example, Canada argues that if a C$5 million grant is provided to a company as part of a C$50 million investment, the remedy for Canada's breach should limited to the C$5 million grant. *Id.*

223. As previously stated, Canada's argument on this point reflects confusion between liability (when determining the existence of a benefit is relevant) and remedy (when compensation for all effects of the breach is appropriate). Mr. Beck cites and explains in his report the many Canadian documents demonstrating that the projects funded under the Ontario FSPF and FSLGP would not have gone forward without government intervention. C-43, pp. 9-11. This necessarily means that the total investments are properly placed before the Tribunal for purposes of determining an appropriate remedy. That is, the consequences of the benefits

conferred that must now be remedied are the total investments made because of the benefits provided. To do otherwise would not compensate the United States for the breach.

224. Mr. Beck takes issue with the faulty assumptions made by Mr. Reilly – who is not a lumber industry expert – in reaching his conclusion that some of the projects were viable with no intervention. C-43, pp. 11-13. Tellingly, none of the companies that received grants and loan guarantees has submitted statements contradicting the public statements or supporting Mr. Reilly's conclusions. Moreover, the public statements from Ontario and the companies were far more than mere "statements of thanks" for program benefits. Stmt. Defence, ¶ 413; C-43, p. 11 (For example, an executive from one recipient of FSPF and FSLGP assistance stated, "We would not be able to move forward without support from the McGuinty government.").

225. Mr. Reilly has failed to explain why these companies would have turned to the government at all if they could have obtained ordinary commercial financing. Mr. Reilly's analysis fails to realize that banks look at much more than the projected financial return on the investment; banks also consider the company's overall financial position, the nature of the collateral, and additional security for the loans. C-43, pp. 12-13. Mr. Reilly does not consider, much less explain, the overwhelming evidence from both Ontario and Québec that banks were not willing to lend to the troubled forest sector without government backing of the projects. *Id.* at 10-11.

226. Nor does Mr. Reilly appreciate that forest sector lenders insist on a much higher rate of return (or "hurdle rate") than he uses in his report. *Id.* at 13. Overall, Mr. Reilly's analysis – carried out in a vacuum – is untethered to the evidence in the case and the reality of the Canadian forest products industry.

3. For Remedy Purposes, All Benefits Provided To Softwood Lumber Producers And Exporters Are Properly Included

227. To determine the appropriate remedy, the United States begins by calculating the total benefits provided to softwood lumber producers and exporters under the programs. Despite this simple and straightforward approach, Canada faults Mr. Beck for including in his remedy analysis those benefits provided to softwood lumber producers but targeted for non-softwood lumber use. For example, Canada disputes that benefits to pulp and paper operations in companies that also produce softwood lumber should not be counted as benefits to softwood lumber producers. Stmt. Defence, ¶¶ 416-28. Again, Canada has distorted the ordinary meaning of the terms of Article XVII in their context.

228. The chapeau of Paragraph 2 states that "grants or other benefits . . . shall be considered to reduce or offset the Export Measures if they are provided . . . to producers or exporters of Canadian Softwood Lumber products." SLA, art. XVII, ¶ 2. Canada does not contest that the owners of the pulp and paper mills at issue are, in fact, "producers or exporters of Canadian Softwood Lumber products."[73] Although the plain meaning is that these benefits fall within the ambit of Paragraph 2, Canada urges that these benefits should be excluded because they are earmarked for use in the pulp and paper operations of these softwood lumber producers and exporters. In fact, Canada suggests that the test should be to what "facilities" the benefits are provided, Stmt. Defence, ¶ 416, rather than to which *companies* or *entities* the benefits are provided. Canada's reading of the SLA is untenable.

[73] For example, in respect of benefits provided to the Fort Frances pulp mill, Canada acknowledges that the mill is owned by Abitibi Consolidated, which "does operate a number of sawmills that produce and export Canadian Softwood Lumber Products." Stmt. Defence, ¶ 426.

229. Paragraph 2 of Article XVII does not limit "grants or benefits" by use, function or purpose. The uses to which the benefits are placed come into play, if at all, only in the narrow exceptions set forth later in the paragraph. Notably, Canada does not argue that the earmarking of program benefits for a particular purpose (such as pulp and paper operations) renders them eligible for any of the exceptions. This is because none of the exceptions allows this.

230. Further, nothing in the Agreement suggests that "producers and exporters" refers to *facilities* rather than the *companies* that own these facilities. Benefits are not provided to structures, they are provided to *companies*. The focus of prohibited circumvention in the SLA is on the *companies* themselves: the actual "producers or exporters of Canadian Softwood Lumber Products." SLA, art. XVII, ¶ 2. Similarly, Export Measures are levied upon "exporters." SLA, art. VII, ¶¶ 3-4. Therefore, if a program provides forest sector benefits to a softwood lumber producer, it is proper to consider that benefit, regardless of whether the benefit is to the producer's softwood sawmill or its integrated pulp mill.

231. Consistent with its strategy elsewhere in its Statement of Defence, Canada makes several arguments in an attempt to persuade the Tribunal that it should interpret paragraph 2 in a manner contrary to its ordinary meaning. Primarily, Canada suggests that the inclusion of certain grants is absurd because the pulp and paper mills at issue do not produce Canadian Softwood Lumber. To the contrary, as explained by Mr. Beck, the inclusion of these benefits makes good sense within the operation of the Agreement and the reality of Canadian companies that have integrated pulp mills and sawmills. C-43, pp. 2-8.

232. As Mr. Beck explains, these pulp and paper mills are part of integrated operations by companies that produce softwood lumber in addition to pulp and paper. C-43, pp. 2- 8. His analysis demonstrates that providing benefits to a softwood lumber producer reduces the cost of

its pulp and paper operations, effectively offsetting the increased cost of its softwood lumber operations caused by the Export Measures. *Id.* As a matter of simple economics, money is fungible: government benefits used for one purpose allow a company to keep funds available for other purposes.

233. Mr. Beck also explains in detail how pulp mills are dependent on sawmills, and sawmills are dependent on pulp mills. *Id.* at 3-4. Because of this interdependence, a benefit to one is a benefit to both.

234. Because the ordinary meaning of Article XVII is not amenable to Canada's interpretation, and because benefits to pulp mills in integrated companies are inescapably benefits to softwood lumber producers, the United States' inclusion of benefits to pulp mills belonging to softwood lumber producers is correct for purposes of both liability and remedy.

235. Canada attempts to complicate the issue when it states that "the Ontario government does not simply write a check to the owner of the pulp mill" because funding is tied to a particular purpose. Stmt. Defence, ¶ 422. But in the end, this is precisely what Canada does. After selecting the softwood lumber producer for inclusion in the program and determining that the company has expended resources on its pulp and paper mill, Ontario, in fact, writes a check. Calling the benefit a "reimbursement" does not change the fact that it is a "grant or other benefit" provided to a producer of Canadian softwood lumber products. SLA, art. XVII, ¶ 2.

236. Canada's discussion of the Terrace Bay and Fort Frances projects reveals that its argument relies solely on the use to which the benefits are placed, not the identity of the recipient, in contrast to the ordinary meaning of the SLA. Canada states: "The answer to the question before the Tribunal is clear: in both cases the funds are in fact used to improve a pulp

mill that neither produces nor exports lumber." In fact, the answer Canada gives is non-responsive to the question before the Tribunal under Article XVII: whether benefits have been provided to producers of softwood lumber products. In the case of both projects, the funds, regardless of use, are provided to entities that Canada agrees are softwood lumber producers. Again, funding can only be provided to a natural entity (a company), and there is no provision in the SLA that the recipient use the benefits for a particular purpose.

237. Canada also asks the Tribunal to focus on the "implications" of the ordinary meaning of Paragraph 2 in order to distract from the issue at hand. Stmt. Defence, ¶ 416. Canada states, "The United States . . . is asking the Tribunal to find that Ontario Government support for improvements at the Fort Frances pulp mill translates dollar-for-dollar into support for sawmills that are located in Québec, Newfoundland, and Labrador, or British Columbia." Stmt. Defence, ¶ 426.

238. To the contrary, the United States is simply asking the Tribunal to find whether Canada has breached the Agreement by providing "benefits . . . to producers or exporters of Canadian Softwood Lumber products," and, if so, to order Canada to redress that breach. The Agreement, not the United States, dictates the means by which the breach is addressed: by adjustments to Export Measures. Canada may believe that this tool is not well-suited to the task when sawmills are located in other Regions, but, as another Tribunal found with respect to similar arguments by Canada, the bluntness of the tools agreed to by the Parties does not justify ordering no remedy.[74]

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[74] *See* CA-12, *United States v. Canada, Award on Remedies*, at ¶ 323 (observing that despite the parties' disagreement as to a remedy, "there must be at least one appropriate adjustment satisfying the requirements" of paragraphs 22 and 23 of Article XIV).

239. Finally, Canada poses a series of hypotheticals concerning the locations of softwood mills owned by integrated companies to justify its disregard of the ordinary meaning of the Agreement. Stmt. Defence, ¶¶ 426-27. These hypothetical "implications" prove nothing beyond the fact that Ontario has provided program benefits that may benefit operations outside of Ontario. This is yet another distraction from the central question in Article XVII of whether a benefit has been provided to a producer of Canadian softwood lumber products. In the case of the Fort Frances mill, Canada admits that the benefit is provided to Abitibi Consolidated ("Abiti") and that Abitibi produces Canadian softwood lumber. Stmt. Defence, ¶ 426 ("Abitibi Consolidated is a corporation that does operate a number of sawmills that produce and export Canadian Softwood Lumber Products."). Mr. Beck has clarified Canada's "facts" in his Rebuttal Report: almost all of Abitibi's sawmill operations are in Canada (Québec, Ontario, British Columbia, and Nova Scotia). C-43, pp. 7-8.

240. Canada also notes that Abitibi has merged with another firm called Bowater. Stmt. Defence, ¶ 427. Mr. Beck has confirmed that "AbitibiBowater is a vertically integrated company operating both a number of softwood sawmills and pulp and paper operations in Ontario and Québec." C-43, p. 8. It is, therefore, appropriate for the Tribunal to consider the benefits to Abitibi (and AbitibiBowater) in determining a remedy for Canada's breach.

241. Because the ordinary meaning of the Agreement requires that all benefits shall be considered to reduce or offset the Export Measures unless they meet one of the enumerated exceptions, the benefits provided to softwood lumber producers – including benefits to pulp and paper mills in integrated companies – must be included in the remedy determination.

4. Mr. Beck Has Reduced His Estimates Based Upon New Evidence Disclosed By Canada In Its Statement Of Defence

242. Canada notes in its Statement of Defence that Mr. Beck's benefit summary for the Ontario programs includes the full amount of projects that have recently been reduced in scope. Stmt. Defence, ¶¶ 429-31. Mr. Beck has reviewed the new evidence of scope reductions attached to Canada's Statement of Defence, and concurs that adjustments should be made to his calculations, as reflected in a revised table in his Rebuttal Report. C-43, pp. 13-14. Mr. Beck has also added a FSPF project funded in October 2008 that was omitted from his initial report, Canada's Statement of Defence, and Mr. Reilly's analysis. *Id.*

243. Moreover, projects receiving benefits under the Ontario programs could also have been increased in scope or supported with additional program benefits. While Canada is quick to point out *reductions* in scope, it has not certified that the scope of the other projects has remained constant. If Canada seeks, for remedy purposes, to reduce the remedy because of scope reductions, it must be responsible for disclosing any scope increases as well.

5. The Investments Made Possible By The Government Loan Guarantees Are Properly Included In Remedy Calculations

244. Canada next objects to the principle that, for remedy purposes, the value of the loan guarantees provided by the breaching programs should be measured by the total value of the investment made possible by the guarantee, rather than simply the interest rate differential achieved by the guarantee. Stmt. Defence, ¶¶ 432-39. However, because these projects would not have gone forward at all without the Ontario government grants and loan guarantees, it is appropriate to look at the entire investment made possible by the grants and loan guarantees in determining a remedy. C-43, pp. 9-13.

245. Mr. Beck has reviewed Canada's positions, including those contained in Mr. Reilly's report, and adheres to his conclusion that the projects funded under the Ontario FSPF and FSLGP would not have been completed without the financial assistance provided by Canada. C-43, p. 9. Therefore, the value of the loan guarantees to the softwood lumber companies whose investments were made possible is far greater than the value of the loan guarantee in a vacuum.

246. For example, Mr. Beck concludes that the Olav Haavaldsrud Timber Company project, a sawmill project funded with a $700,000 grant and a $7 million loan guarantee through the FSPF and FSLGP, would not have been undertaken absent the loan guarantee. C-43, p. 9. The spokesman for Olav Haavaldsrud stated publicly: "We would not be able to move forward without support from the McGuinty government." C-1, Att. BC. In addition, there is unrebutted evidence that the loan guarantee program was wholly ineffective when Ontario initially proposed to guarantee only up to 50 percent of the loan value and to be the residual guarantor. C-43, pp. 9-10. Ontario then modified the program to make full loan guarantees and make itself a "first call" guarantor in order to entice lenders to participate in the investments. *Id.* It was only after Ontario made these changes that lenders began to make project funding available. *Id.*

247. Mr. Beck has also provided his unrebutted expert opinion, drawn from a review of Canadian documents, that forest industry companies were in the midst of an economic downturn and, as a result, unable to overcome the reluctance of lenders to make financing available. C-43, pp. 9-10, 12. It was the participation of the Ontario government, acting through the FSPF and the FSLGP, that made the investments possible. *Id.* Accordingly, the full value of these investments should be considered in determining what steps Canada must take in order to wipe away all effects of its breach.

6. Canada's Remaining Minor Criticisms Are Addressed In Mr. Beck's Rebuttal Report

248. Canada also makes two very minor observations in its attempt to reduce the appropriate remedy for its breach. Canada argues that two of the companies receiving benefits under the FSPF and FSLGP have not yet produced lumber. Stmt. Defence, ¶ 440. Canada also claims it does not understand the methodology Mr. Beck used in calculating the benefits of the Ontario road building program, and argues that there are "internal inconsistencies" in the calculations. Stmt. Defence, ¶¶ 441-46.

249. In his Rebuttal Report, Mr. Beck has considered and responded to each of Canada's remaining claims. C-43, pp. 15-20. There is no principled reason to exclude non-exporting companies from the benefits analysis because the companies are, as Canada concedes, producers of softwood lumber products. C-43, pp. 15-16. Mr. Beck confirms his opinion that the Ontario programs provide valuable benefits to Canadian softwood lumber producers and exporters. *Id.*

B. Mr. Beck's Revised Figures Correctly Summarize The Benefits And Investments Provided By The Québec Programs

250. Canada argues that Mr. Beck's calculations of the benefits conferred by the Québec programs are overstated for several reasons. Stmt. Defence, ¶ 396. Each is addressed below.

1. Canada's Claim That Program Benefits Are "Offset" By Increases In The Québec Stumpage Pricing Is Untrue

251. Canada first claims that Mr. Beck did not account for changes that Québec made to its stumpage, or timber pricing, system — changes that allegedly "offset" the benefits provided by several of the challenged Québec programs. Stmt. Defence, ¶¶ 390, 396. Canada asks the Tribunal to conclude from this that the programs conferred no benefit. Of course,

Canada's argument concedes that the Québec programs in fact provide benefits to softwood lumber producers in violation of the SLA; the only issue presented is whether, for remedy purposes only, there is an "offset" that should be taken into consideration when determining appropriate adjustments to Export Measures.

252. As the party raising this defense and making these assertions, Canada bears the burden of proof on demonstrating how Québec's timber pricing program functions and whether there is a complete "offset" of the challenged benefit programs.[75] Moreover, Canada's defense necessarily means that, if Canada fails to prove a one for one, dollar for dollar, offset, the United States is entitled to a remedy.

253. Canada offers only a statement of engineer Jean-Pierre Adam, who states that Québec made changes to its stumpage rates in April 2007 following the enactment of several of the Québec benefit programs. R-3, ¶¶ 17-18, 26-28. He claims that these stumpage changes increased a variable in Québec's complex stumpage equation, resulting in increased stumpage rates paid by tenure (forest license) holders. *Id.* He then provides "simulations" of stumpage calculations in two of Québec's 187 tariffing zones, purportedly to demonstrate, in these two zones at least, an increase in stumpage rates. *Id.* at ¶ 30, Exs. 6-7. Mr. Adam's conclusions are not credible for several reasons.

254. First, the claim that Québec's benefit programs actually confer no benefit on softwood lumber producers is contradicted by multiple contemporaneous statements by the Québec government itself. For example:

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[75] It is well-settled that the burden of proof rests upon the party asserting a claim or fact that, if not substantiated, will result in an adverse decision on the claim or fact. *See* CA-11, Durward V. Sandifer, *Evidence Before International Tribunals* 127 (University Press of Virginia 1975) (Revised Edition).

- Québec Finance Minister Michel Audet announced the programs as part of a "financial assistance" package intended "to make our forest companies even more competitive" by lowering wood costs to the forest sector. Mr. Audet stated in the same speech that the programs, when implemented, "will contribute to assisting the workers, regions, and companies." C-1, Att. T, p. 13.

- Mr. Audet's Budget Plan reiterated that the programs would "enable forest sector companies to become more competitive" by "reduc[ing] the costs of forest sector operations." In describing the tax credit for road construction and repair, the Budget Plan stated unequivocally that the goal was "to enhance the profitability of forest sector activities" and "to help forest companies reduce supply costs." C-1, Att. U, sec. 6.[76]

- In the October 18, 2006 internal memorandum among Québec ministers, a group that included the Minister of Natural Resources and the Minister of Economic Development), the ministers observed that the cost to the government of the tax credit for road construction and repair might exceed the $15 million originally budgeted for the program. C-1, Att. AD at CAN_CONF_0000002.

- In the same October 18, 2006 memorandum, the Québec ministers state that the firefighting and reforestation programs would receive a "bonus" expected to cost the government – and, therefore, save the industry – $65 million over two years. C-1, Att. AD at CAN_CONF_0000005-0000006.

- According to the Québec ministers, [

  ] *Id.* at CAN-CONF-00000014.

- Québec Premier Jean Charest announced on October 20, 2006, that his government enacted the forest measures in response to an economic "crisis" in the forest sector, and that the measures were "steps that will enable the entire industry in Québec to emerge from the crisis in a more solid position. . . ." C-1, Att. AB at 1.

255. The public announcements and internal discussions of the programs uniformly emphasize the benefits of the Québec programs to the industry. These public statements undermine Canada's current claim that the program benefits are not benefits. In fact, Canada's

[76] *See also* Additional Information on Budget measures at 40-50 (available at http://www.budget.finances.gouv.qc.ca/budget/2006-2007/en/pdf/AdditionnalInfoMeasures.pdf), C-51.

"no benefit" argument is not supported by *any* high-ranking government officials, documents, or statements of the companies.

256. Canada's contention that changes to the timber pricing system offset any benefits, if believed, would mean that the Québec government was either incompetent or deceitful. That is, Canada would have the Tribunal believe that the Premier's own cabinet either did not understand that the programs that it administered and recommended – on the basis of the programs' benefit to the forest industry – in fact provided no benefit at all.

257. Canada's position cannot be credited where Canada has offered no statements or other materials from any cabinet minister or other government official acknowledging the Cabinet's "error," or statements from these persons supporting Canada's new claim of "offsetting" benefits. Accordingly, Canada has not established that the United States overstated the benefits and effects of the Québec programs.

258. Mr. Beck has examined Canada's claim of offsetting increases in the Québec stumpage system. C-43, pp. 28-39. He has concluded that the reductions in operating costs provided by the Québec programs do not result in equivalent increases in stumpage charges. *Id.* Mr. Beck provides four examples where any increase in stumpage prices will necessarily be less than the reduction in operating costs provided by the government programs. *Id.* at p. 31.

259. Mr. Beck also concludes that Mr. Adam's selection of two zones – out of the 187 tariff zones in Québec – is questionable, and biases his "simulations." C-43, p. 29. Mr. Adam has provided very little of the data he uses for his "simulations," preventing a determination of whether his calculations are correct or whether the operating cost changes were made to the stumpage system. *Id.* at 28. Further, the zones are not representative of stumpage calculations

across Québec. For all of these reasons, Mr. Beck concludes that Canada's assertion that certain Québec programs confer no benefit is untrue. *Id.*, p. 38-39.[77]

2. Canada's Allegations That Mr. Beck Has Overstated Certain Other Québec Program Benefits Are Also Flawed

260. Canada also repeats its allegation that Mr. Beck has overstated the benefit of the Québec firefighting and insect and disease programs by "misreading and ignoring" documentary evidence. Stmt. Defence, ¶ 396, referring to ¶¶ 266-68. Mr. Beck did not misread or ignore any evidence. Canada's evidence, of course, is the new statement of witness Julie Fortin, which was not disclosed until Canada filed its Statement of Defence. *See* R-5. In any event, Mr. Beck has credited the new figures in Ms. Fortin's statement, and has adjusted his benefit calculations accordingly. C-43, pp. 42-43.

261. Canada then accuses Mr. Beck of treating the Québec Capital Tax Credit as a continuing benefit despite its repeal. Stmt. Defence, ¶ 396. We explained in the liability section on the Capital Tax Credit that Canada's legal position is incorrect. In addition, Canada states earlier in its Statement of Defence that Mr. Beck correctly confined his calculations to the start and end dates of the program. *Id.*, ¶ 282.

3. The PSIF Served As A "Lever" To Make Québec Investments Possible That Otherwise Would Not Have Been Undertaken

262. One of the most serious breaches of the SLA relates to Québec's initiation of the PSIF program in October 2006. Canada states that Mr. Beck's analysis of the PSIF program does not consider the nature of the projects funded under the program. Stmt. Defence, ¶ 396.

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[77] Even if the assertions in Mr. Adam's statement were true, and this is very doubtful, he is still conceding that a benefit was conveyed for several months at a minimum. According to Mr. Adam, stumpage rates did not change until April 2007, several months after the Québec benefit programs were put into place in October 2006. R-3, ¶ 28.

Mr. Beck stated in his initial report that the volume of documents – nearly all in French[78] – related to PSIF loans prevented him from performing a complete review of the program at that time. C-1, p. 54. His rebuttal report now contains a thorough analysis of the program, demonstrating that the program confers benefits on softwood lumber producers and that the program enabled investments that would otherwise not have been made. C-43, pp. 44-57. Mr. Beck has also updated his analysis of the PSIF to provide a detailed estimate of benefits and investments made possible through the PSIF loans, loan guarantees, grants, and other financial tools. C-43, p. 46.

263. It is indisputable that the PSIF was intended to confer a benefit upon the forest sector generally and the softwood lumber industry in particular by making loans available to companies who would otherwise be unable to obtain financing. *See* C-1, Att. AD at CAN_CONF_0000003 – 0000004 (Québec Ministers state in October 2006 that the "rules" of the PSIF had to be adjusted to allow troubled companies to obtain financing).

264. The public materials from IQ – the government corporation charged with administering the PSIF – confirm the Québec ministers' statement [

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For example, IQ states in its general brochure that IQ participation allows companies to "take on more ambitious projects" and "[o]btain financing more easily" because IQ "share[s] the risk with

[78] There is nothing improper in the production of documents in French. We point out that the documents are in French only to explain why additional time was needed in order to complete our review of the PSIF program.

your lending institution" and "guarantee[s] reimbursement of the net loss on the loan you contract."[79]

265. IQ boasted of the benefits to the forest sector in its 2007-2008 Annual Report. According to IQ, the PSIF falls under the category of "Economic Development Tools." *See* C-1, Att. AQ at 18, 119-24. "Economic Development Tools" are "primarily financial incentive programs designed to increase investment in Québec." *Id.* at 18. IQ admits that it evaluates the economic impact of the PSIF and other "Economic Development Tools" by considering that "supported projects would have been discontinued without the Corporation's financial assistance." *Id.* at 119.

266. Perhaps most telling is a September 2008 presentation by IQ Director Sylvie Pinsonnault. C-53. In her presentation, IQ advertises its expertise in finding "financial solutions" for "*projects that exceed the risk-taking capacity of financial institutions.*" *Id.* at 5 (emphasis added). Ms. Pinsonnault states that "by sharing risk, *[IQ] enables businesses to carry out projects that would otherwise not get off the ground.*" *Id.* (emphasis added).

267. IQ states in its 2007-2008 Annual Report that the most common type of financial assistance it provides are loan guarantees: "Investissement Québec has a variety of financial solutions to support the development of businesses. Loan guarantees are the most widely used tool and enable businesses to obtain loans from private financial institutions more easily. This year, loan guarantees represented 44% of financing operations and 35% of the value of authorized financing." *See* C-1, Att. AQ at 20.

268. IQ also offers "financial commitment guarantees," interest-free loans, and "non-repayable or conditional repayable financial contributions and interest payments." *Id.* Many

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[79] *See* C-52, http://www.investquebec.com/documents/en/publications/BrochureGeneraleIQ_en.pdf at 4.

other documents from the IQ website or produced by Canada in disclosure confirm that the PSIF not only makes forest sector investments possible, but makes forest sector investments that otherwise would not be made without government assistance. C-54.

269. In August 2007, IQ internally advised its employees that IQ would [

] C-43, Attachment BC at QC-C-001310.

The stated reason for the decision by IQ was that [

] *Id.* This action by IQ is evidence that Canada understood that at least the making of interest free loans as part of the PSIF constituted a breach of the SLA.

270. Canada has not produced any information demonstrating exactly how many PSIF projects, if any, would have or could have gone forward without IQ support. Clearly the burden of proof is on Canada with respect to its assertion that the PSIF provides no benefit. Just because IQ provided a project loan at a commercial rate does *not* mean that the loan could have been obtained commercially in the absence of the financial assistance provided by the PSIF program. This is particularly true in difficult economic times. Similarly, the benefit to the PSIF recipient of an interest free loan or a loan guarantee is not limited to the interest rate differential when the evidence strongly suggests that none of the projects would have gone forward without the favorable loan or loan guarantee.

271. In announcing the launch of the PSIF program and other forest sector initiatives in October 2006, Québec Premier Jean Charest and his ministers made this point. Mr. Charest observed that "[t]he forest industry is currently experiencing the worst crisis in its history" and that Québec was committed to "taking steps that will enable the entire industry in Québec to emerge from the crisis in a more solid position." C-1, Att. AB at 1. Mr. Charest and his

ministers announced the PSIF, emphasizing that "the participation of Investissement Québec will act *as a lever for financial institutions*." *Id.* at 3 (emphasis added).

272. Canada has not stated which of the projects received loan guarantees as opposed to outright "financial contributions," or grants, through IQ and its administration of the PSIF. And although Canada has provided statements of Québec officials explaining the impact of *other programs*, such as the road tax credit and firefighting programs, Canada offers nothing to explain or mitigate the benefits conferred under the PSIF. In the absence of any contrary evidence, the Tribunal should credit Mr. Beck's analysis of the PSIF.

V. The United States' Proposed Remedies Comprehensively Account For The Benefits Realized By Canadian Softwood Lumber Producers And The Harm Suffered By United States Producers

273. As the United States indicated in its Statement of the Case, the preferred concept of remedy is based upon the imposition of an additional export charge on Ontario and Québec softwood lumber exports to compensate for the effects of the tax credits, grants, and other benefits provided to Canadian softwood lumber producers in breach of the SLA. The table below contains Mr. Beck's revised figures for the benefits and effects of the programs that must be remedied by adjustments to Export Measures.

Revised Summary of Benefits And Effects of Breaching Programs

Program	High Case Estimate of Results/Benefits ($C)	Low Case Estimate of Results/Benefits ($C)
Ontario FSPF and FSLGP	$610.4 million (through FY 2008/09 and using total investments; Beck Report, Table 26 and 27 (revised)	$38.5 million (only through 10/15/08 and using only grants and guarantees; Beck Report, Table 26 (revised)
Ontario Road Building Program	$105.0 million (net benefit through FY 2008/09; Beck Report, Tables 30)	$67.3 million (net benefit only through FY 2007/08; Beck Report, Table 30)
TOTAL ONTARIO	**$715.4 million**	**$105.8 million**
Québec Capital Tax Credit	$3.7 million (Beck Report, Table 13)	$3.7 million (Beck Report, Table 13)
Québec Forest Management Measures	$266.1 million (using estimates through FY 2009; Beck Report, Tables 17, 20, 21 (revised))	$58.6 million (Beck Report, Tables 15, 18, 21 (revised))
Québec Forest Industry Support Program (PSIF)	$109.2 million (using total investment value; Beck Rebuttal Report, Table 33)	$50.1 million (using only Loan Envelope value; Beck Rebuttal Report, Table 33)
TOTAL QUÉBEC	**$379.0 million**	**$112.4 million**
TOTAL ONTARIO + QUÉBEC	**$1.094 billion**	**$218.2 million**

274. In order to fully wipe out the effects of Canada's breach, we respectfully request that the Tribunal determine that an appropriate remedy consists of imposing additional export charges designed to collect at least C$218.2 million on softwood lumber exports from Ontario and Québec. The Tribunal should also determine the rate at which the total additional export charge is to be collected on softwood lumber exports from Ontario and Québec. In setting the

rate of collection, the Tribunal's determination should consider that the SLA is a seven-year agreement that may be extended for an additional two years if the parties agree. SLA, art. XVIII.

275. The quantum of each of the proposed remedies is based upon program expenditures through FY 2008/2009 (March 31, 2009), Canada's document production to date, and other assumptions. Accordingly, the remedy ultimately determined by the Tribunal may need to be updated to reflect any unaccounted-for program expenditures and any additional information from Canada.

276. The United States' proposed remedies assume that Canada abolishes the breaching programs close in time following the Tribunal's award. Therefore, in order to anticipate the possibility that Canada does not discontinue administering the programs at that time and to provide Canada an incentive to discontinue the programs, the Tribunal should also determine appropriate additional adjustments to Export Measures based upon the estimates of future program disbursements calculated by Mr. Beck in his expert report. C-1, Tables 19-20, 24, 26. We propose that the Tribunal determine that an additional adjustment to Export Measures of 10 percent should be imposed if Canada does not discontinue the programs after 30 days, the maximum reasonable period of time under the SLA. This would be imposed in addition to any export charge assessed as a compensatory measure and would be intended to provide Canada with an incentive to comply with the Award.

A. Proposed Remedies Applied To Ontario Exports

277. Canada agrees in its brief that, in the case of a breach attributable to a particular region, the Tribunal should determine compensatory adjustments applicable to that region. Stmt. Defence, ¶¶ 384-86. Therefore, it may be appropriate to determine adjustments to Export

Measures applied to Ontario exports to compensate for the effects of the Ontario benefit programs found to breach the SLA.

278. There is a straightforward method to determine an Ontario-specific remedy. According to DFAIT data, monthly exports from Ontario have averaged 86,000,000 board feet over the past 24 months.[80] During that same period, the export price has averaged $260 per thousand board feet of lumber.[81] Under the SLA, export charges are applied as a percentage against the export price. SLA, art VII, ¶¶ 1-2. As shown in the table below, depending on the rate of collection and the amount to be collected, the remedy period may last from 2 years to 19 years.

Ontario-Specific Remedy		
Adj. to Export Measures (Rate of Collection)	**Period Required To Collect High Case (C$715.4 million)**	**Period Required To Collect Low Case (C$105.8 million)**
5 percent	50 years	8 years
10 percent	26 years	4 years
15 percent	18 years	2.5 years
20 percent	13 years	2 years

279. Given the expected remaining life of the SLA, we respectfully request that if the Tribunal determines an Ontario-specific remedy, the best alternative is to apply an adjustment of 20 percent to Ontario exports (if the Tribunal finds that the High Case is appropriate) or 10 percent (if the Tribunal finds that the Low Case is appropriate). Further, the Tribunal should

[80] Published Canadian (DFAIT) data on monthly exports from all regions is available at http://www.international.gc.ca/controls-controles/softwood-bois_oeuvre/index.aspx?lang=eng.

[81] Based upon Random Lengths Weekly Framing Lumber Composite Prices for the past 24 months. This information is publicly available.

state in its remedy that the adjustment to Export Measures is to remain in place until the entire amount is collected.

B. Proposed Remedies Applied To Québec Exports

280. Similarly, it may be appropriate to determine appropriate adjustments to Export Measures applied to Québec softwood lumber exports to compensate for the effects of the Québec benefit programs. The same straightforward method can be used to determine a remedy specific to Québec. According to DFAIT data, monthly exports from Québec have averaged 132,000,000 board feet over the past 24 months.[82] Again, the export price during that period has averaged $260 per thousand board feet of lumber.[83] As shown in the table below, depending on the rate of collection and the amount to be collected, the remedy period may last from 2 years to 19 years.

Québec-Specific Remedy		
Adj. to Export Measures (Rate of Collection)	**Period Required To Collect High Case (C$379.0 million)**	**Period Required To Collect Low Case (C$112.4 million)**
5 percent	18 years	5.5 years
10 percent	9 years	3 years
15 percent	6 years	2 years
20 percent	4.5 years	1.5 years

281. Given the expected remaining life of the SLA, we respectfully request that if the Tribunal determines a Québec-specific remedy, the best alternative is to apply an adjustment of 20 percent to Québec softwood lumber exports (if the Tribunal finds that the High Case is

[82] *See* published DFAIT data at http://www.international.gc.ca/controls-controles/softwood-bois_oeuvre/index.aspx?lang=eng.

[83] Based upon Random Lengths Weekly Framing Lumber Composite Prices for the past 24 months. This information is publicly available.

appropriate) or 10 percent (if the Tribunal finds that the Low Case is appropriate). Further, the Tribunal should state in its remedy that the adjustment to Export Measures is to remain in place until the entire amount is collected.

C. Professor Topel's Economic Model Provides A Reasonable Estimate Of The Effects Of Canada's Breach On United States Producers

282. Canada responds briefly in the last section of its brief to the remedy proposed by Professor Robert Topel. Stmt. Defence ¶¶ 447-65. In his initial report submitted with the United States' Statement of the Case, Professor Topel calculates adjustments to Export Measures designed to restore United States producers and compensate for the harm caused by Canada's benefit programs. C-2.

1. Professor Topel Analyzes One Component Of A Comprehensive Remedy

283. An appropriate remedy under the SLA must be a comprehensive remedy that is consistent with the SLA, honors the general principle in international law requiring "full reparation" for wrongful acts, and insures that Canada is not able to benefit from its breach. Providing grants or other benefits to Canadian producers is not merely a technical violation deserving of only some nominal consequence. Accordingly, Canada's obligation to "cure the breach" not only requires Canada to discontinue the breaching programs and to recoup the benefits distributed to the softwood lumber industry, but also to "wipe out" current and future effects of the breaching programs.

284. A comprehensive approach to remedy considers both the benefits realized by Canadian softwood lumber producers and harm to United States producers. The straightforward remedies based upon the analysis of Mr. Beck comprehensively wipe out the benefits to Canadian producers provided in breach of the SLA. In contrast, Professor Topel's calculations

examine and remedy *only* the harm to United States producers caused by Canada's breach. In this way, Professor Topel's work demonstrates harm to the United States, but is only one component of the comprehensive remedies that we recommend in the preceding sections.[84]

285. Moreover, Article XIV and Article XVII of the SLA do not confine a remedy for a party's circumvention of the SLA to compensation for harm to United States producers. In fact, Article XVII defines circumvention in terms of "grants or other benefits" to Canadian softwood lumber producers, regardless of harm to United States producers. Accordingly, it is appropriate to determine a remedy that not only considers the harm to United States producers, but more broadly compensates for the benefits and investments realized by Canadian producers as a result of Canada's breach. Our proposed remedies do this.

2. Canada's Criticisms Of Professor Topel's Methodology Are Not Valid

286. Canada offers a report of its long-time economist Joseph Kalt to dispute the methodology of Professor Topel in measuring harm to United States producers. R-2. Canada asserts that Professor Topel has made four errors that, in Canada's view, "could lead to greatly inaccurate results": 1) relying upon Mr. Beck's allegedly overstated benefit calculations; 2) allocating benefits to the reduction of capital costs for lumber operations; 3) assuming that benefits provided under the breaching programs reduce the cost of new investments; and 4) assuming that the program benefits result in increased productivity. Stmt. Defence ¶ 449.

287. While Canada claims that the purported errors "could" lead to inaccurate results, Canada does not state whether, in its view, this has happened. In fact, despite all of Canada's

[84] In our Statement of the Case, we presented Professor Topel's work as a separate remedy proposal. Stmt. Case, ¶¶ 144, 150. However, as explained in this section, it is more appropriate to consider Professor Topel's remedy as a component of a comprehensive remedy that compensates for both harm to United States producers and benefits to Canadian producers. Our proposed adjustments to Ontario and Quebec exports satisfy these criteria.

speculation that Professor Topel's model does not capture every permutation of the breaching programs and the lumber market, Canada has not proposed an economic model or remedy concept that it claims is superior to Professor Topel's analysis.

288. In his attached Response Report, Professor Topel addresses each of the purported weaknesses identified by Canada. C-44. Professor Topel's bottom line conclusion remains unchanged: the Ontario and Québec programs are economic subsidies to capital formation and, as such, lower the cost of production, increase the volume of lumber produced, and decrease prices in the United States. C-44 at pp.7-11. The negative effect on prices caused harm and continues to cause harm to United States producers. *Id.* Although Canada takes issue with certain aspects of Professor Topel's economic modeling, Canada is unable to undermine the economic validity of his analysis because his work honors indisputable bedrock principles of standard economics.

289. Regarding Canada's well-worn claim that Mr. Beck has overstated the benefits provided by the Ontario and Québec programs, Mr. Beck has made several reasonable adjustments to his calculations based upon new evidence produced by Canada with its Statement of Defence, as well as a detailed review of the tens of thousands of documents related to the Québec PSIF program. C-43, pp. 14, 43-46. Professor Topel explains in his report that his economic model is sufficiently flexible to incorporate these adjustments. C-44, ¶ 4,n.3, ¶ 34.

290. In challenging Professor Topel's model, Canada attempts to steer the Tribunal away from the statements of its high-ranking officials, statements that make clear that the intent of the programs was to provide incentives for investments in the softwood lumber sector. *See, e.g.*, C-1, Att. AD. Instead of explaining the statements from its officials, Canada ignores them.

291. For example, Canada argues that not every dollar of every expenditure made under the breaching programs directly reduces the cost of investment in softwood lumber production. Stmt. Defence, ¶¶ 452-53, 459-60. Yet Canada does not explain the statements of its own government officials that the programs were intended to have this exact effect. Canada's argument appears to be one of degree. Canada questions whether program benefits reduce the cost of investment *dollar for dollar* and whether the programs *directly* reduce the cost of investment, but Canada does not dispute that the programs reduce the cost of investment by some amount.

292. Professor Topel explains that his model properly considers the effects of the economic subsidies on the cost of investment. C-44, ¶ 23. Professor Topel also states that, as a matter of standard economics, an increase in demand for one joint product (such as pulp and paper) will lead to a decrease in the price of the other (softwood lumber). C-44, ¶¶ 13-15. Consistent with its scattershot approach, Canada identifies no better alternative to Professor Topel's model.

293. Canada then argues that Professor Topel incorrectly assumes that expenditures under the breaching programs "continue indefinitely." Stmt. Defence ¶¶ 461-62. Canada's criticism evinces its misunderstanding of economic subsidies. Professor Topel stated in his initial report that the breaching programs, because they are subsidies to investments in capital, "will reduce incremental costs both currently and over the future life of the durable assets." C-2, ¶ 39.

294. Professor Topel's model, therefore, is forward-looking in that it accounts for the value of these investments over future periods. C-2, ¶ 41. Professor Topel also assumed conservatively that lumber producers expected that the programs would remain in place

indefinitely. C-2, ¶ 43. This assumption leads to a smaller calculation of investments in capital – and a smaller remedy – than if Professor Topel had assumed that producers expected the programs to be only temporary. *Id.* Therefore, Canada's criticism misconstrues Professor Topel's assumption and, because it targets an assumption that is favorable to Canada, is confusing.

295. Canada then argues that there will be no increase in production or increase in exports if volume restraints imposed by the SLA become binding some time in the future. Stmt. Defence, ¶ 462.[85] This is not accurate. At the outset, quotas under the SLA – which apply only to Option B regions such as Ontario and Québec – have not been binding in over 18 months, and exports have been generally averaging well under the quotas.[86] Last month, Ontario was at 50 percent of its Quota, and Québec was 75 percent of its quota.

296. Further, as a matter of basic economics, the benefit programs will continue to affect lumber production and prices even in months when quotas become binding. Canada's argument does not account for how the behavior of Option A regions, whose exports to the United States are never limited by quotas, will be affected when the exports from Option B regions are limited by quotas. C-44 at ¶ 33. Therefore, even when quotas are binding, the increased production will increase supply in all of Canada, which will permit greater exports from Option A regions, thus depressing lumber prices in the United States.

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[85] A volume restraint (or quota) is understood to be "binding" when it actually restricts a province's exports to a volume below what the province would have otherwise without the quota. For example, if a province's quota for a particular month were 100 million board feet, and the province intended to export only 80 million board feet of lumber, the quota did not alter the province's exports and, therefore, was not binding. Conversely, if the province would have exported 120 million board feet, but was limited by the quota volume, the quota was binding.

[86] *See* http://www.international.gc.ca/controls-controles/softwood-bois_oeuvre/index.aspx?lang=eng (Canada (DFAIT) published Quota Utilization Reports).

CONCLUSION

297. The United States respectfully requests that the Tribunal determine that Canada breached the SLA by enacting and administering the six Ontario and Québec programs discussed above and declare that each of these programs breaches the SLA.

298. If the Tribunal finds that Canada has breached the SLA regarding any one of these programs, the United States respectfully requests that the Tribunal determine a reasonable period of time for Canada to cure the breach and respectfully requests that the Tribunal also identify appropriate compensatory adjustments to the Export Measures that remedy Canada's breach.

299. With respect to compensatory adjustments to the Export Measures, the United States respectfully requests that:

a. The Tribunal determine that appropriate adjustments to Export Measures consist of additional export charges that will result in the collection of at least C$217 million on Ontario and Québec exports of softwood lumber to the United States; the Tribunal determine a rate at which the additional export charge is to be collected; and

b. The Tribunal determine further adjustments to Export Measures, in addition to those requested above, should Canada not discontinue the programs the Tribunal finds to have breached the SLA.

Respectfully submitted,

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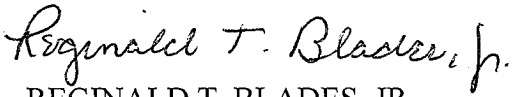
JEANNE E. DAVIDSON
Director



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April 3, 2009

CERTIFICATE OF SERVICE

I certify that I caused to be sent, by overnight courier, paper copies of the UNITED STATES CORRECTED REPLY MEMORIAL (Non-Confidential), to the members of the Tribunal and to the legal representative of Canada on April 3, 2009. A copy of the UNITED STATES CORRECTED REPLY MEMORIAL (Non-Confidential) has also been sent by electronic mail on April 3, 2009 to the members of the Tribunal and to the legal representative of Canada.

CLAUDIA BURKE