

In the LCIA
No. 81010

THE UNITED STATES OF AMERICA,

Claimant,

v.

CANADA,

Respondent.

UNITED STATES SECOND CORRECTED STATEMENT OF THE CASE

NON-CONFIDENTIAL

GREGORY G. KATSAS
Assistant Attorney General

JEANNE E. DAVIDSON
Director

Of Counsel:

WARREN H. MARUYAMA
General Counsel
United States Trade Representative
600 17th Street, N.W.
Washington, D.C. 20508
UNITED STATES

JOAN E. DONOGHUE
Principal Deputy Legal Adviser
United States Department of State
2201 C Street, N.W.
Washington, D.C. 20520
UNITED STATES

REGINALD T. BLADES, JR.
PATRICIA M. MCCARTHY
Assistant Directors
CLAUDIA BURKE
Senior Trial Counsel
MAAME A.F. EWUSI-MENSAH
GREGG M. SCHWIND
DAVID S. SILVERBRAND
ANTONIA R. SOARES
STEPHEN C. TOSINI
Trial Attorneys
United States Department of Justice
Commercial Litigation Branch
Civil Division
1100 L Street, N.W.
Washington, D.C. 20530
UNITED STATES
Tel: +1 (202) 514-7300
Fax: +1 (202) 514-7969
national.courts@usdoj.gov;
Reginald.Blades@usdoj.gov

December 23, 2008

Attorneys for Claimant,
The United States of America

TABLE OF CONTENTS

	Page
STATEMENT OF THE CASE OF THE UNITED STATES OF AMERICA	1
I. Introduction	1
A. History Of The Dispute	4
II. Relevant Provisions Of The SLA	6
A. The Anti-circumvention Provision	7
B. Exceptions	8
C. Remedy Provisions	9
III. Six Ontario And Québec Programs Circumvent The SLA	11
A. Ontario's Forest Sector Prosperity Fund Benefits Ontario Lumber Producers	11
1. Facts	11
2. The FSPF Provides Grants And Benefits To Softwood Lumber Producers And Meets None Of The SLA's Exceptions	13
3. Canada Must Counteract The Consequences Of The Breach	16
B. The Ontario Forest Sector Loan Guarantee Program Benefits Ontario Softwood Lumber Producers	17
1. Facts	17
2. The FSLGP Benefits Ontario Softwood Lumber Producers And Meets No Exceptions	20
3. Canada Must Counteract The Consequences Of The Breach ...	22

TABLE OF CONTENTS (Cont'd)

	Page
C. The Ontario Forest Access Road Construction And Maintenance Program Benefits Ontario Softwood Lumber Producers	24
1. Facts	24
2. The Road Program Benefits Ontario Softwood Lumber Producers And Meets None Of The SLA Exceptions	27
3. Canada Must Counteract The Effects Of The Breach	32
D. Québec's C\$425 Million Forest Industry Support Program Benefits Québec Softwood Lumber Producers	33
1. Facts	34
2. Québec's PSIF Benefits Softwood Lumber Producers And Meets No Exceptions	35
3. Canada Must Counteract The Consequences Of The Breach	38
E. Québec's Forest Management Measures Benefit Softwood Lumber Producers	40
1. Facts	40
2. Québec's Forest Management Measures Benefit Softwood Lumber Companies And Meet No Exceptions	41
3. Canada Must Counteract The Consequences Of The Breach ...	44
F. Québec's Capital Tax Credit	45
1. Facts	45
2. The Capital Tax Credit Benefits Softwood Lumber Producers And Meets No Exceptions	47

TABLE OF CONTENTS (Cont'd)

	Page
3. Canada Must Counteract The Effects Of The Breach	48
IV. Proposed Remedies For Canada's Breach Of the SLA	50
A. Remedy I: A Straightforward Means To Compensate For Canada's Breach	50
B. Remedy II: An Economics-Based Means To Compensate For The Breach	52
V. Conclusion	55

SECOND CORRECTED STATEMENT OF THE CASE OF THE UNITED STATES OF AMERICA

1. Pursuant to the Tribunal's letter dated August 6, 2008, claimant, the United States, respectfully submits this statement of its case. The statement of the case consists of this brief; the expert report of Tom L. Beck of the Beck Group, C-1; the expert report of Robert H. Topel, of Chicago Partners, C-2; exhibits C-3 - C-42; and authorities CA-1 - CA-9.

2. This brief contains the following sections: an introduction discussing the nature and history of the dispute; a discussion of the relevant provisions of the 2006 Softwood Lumber Agreement ("SLA" or "Agreement"); a discussion of the six Ontario and Québec programs that breach the SLA; proposed remedies for these breaches; and a conclusion.

I. Introduction

3. This case concerns Canada's breach of the SLA, a bilateral agreement between the United States and Canada that resolved longstanding litigation regarding Canadian exports of softwood lumber to the United States. *See* C-3.¹ After years of painstaking settlement negotiations, the United States agreed in the SLA to return approximately US\$5 billion in collected antidumping and countervailing duty deposits and to forgo the imposition of additional antidumping and countervailing duties in exchange for Canadian-imposed export measures designed to regulate Canadian softwood lumber exports to the United States. SLA, art. III, VI, VII.

¹ The United States has attached exhibits to its Statement of the Case in accordance with Procedural Order No. 1, dated April 18, 2008. For the most part, when the United States' experts have cited and appended documents as attachments to their reports, the United States cites to those attachments rather than adding duplicative attachments. For citations to the SLA, C-3, we refer directly to the SLA and not to the exhibit number.

4. The export measures constitute the heart of the SLA. Effectively replacing the system of antidumping and countervailing duties that had been imposed upon Canadian lumber imports to the United States, the export measures attempt to control the volume of lumber entering the United States by either assessing a charge or imposing a quota restriction on exports when the United States price of lumber is low.²

5. In the SLA, Canada agreed that neither Canada *nor any of its provincial governments* would take any action to circumvent the SLA. SLA, art. XVII. Absent certain exceptions, Canada circumvents the Agreement if it provides grants or other benefits to producers or exporters of Canadian softwood lumber.³ *Id.*

6. The provincial governments of Ontario and Québec have provided grants and other benefits to their respective softwood lumber producers and exporters in breach of the SLA.

7. In particular, Ontario and Québec have instituted and administered the following programs that circumvent the SLA:

- A. The Ontario Forest Sector Prosperity Fund, which provides grants to softwood lumber producers to support and leverage new capital investment projects;
- B. The Ontario Forest Sector Loan Guarantee Program, which provides financing to softwood lumber producers at non-market terms to support and leverage new capital investment projects, often in concert with the Forest Sector Prosperity Fund;
- C. The Ontario Forest Access Road Construction and Maintenance Program, which is a C\$75 million program designed to reimburse softwood lumber

² Importantly, Canada administers these charges and quotas, not the United States. All charges are paid to the Canadian federal government, and Canada is responsible for reporting its collected export charges and quota calculations on a monthly basis. SLA, art. VII.

³ The anti-circumvention provision prohibits benefits to “producers and exporters.” For ease of reference, we generally refer to “producers” in this brief.

producers for costs incurred constructing and maintaining forest access roads used for harvesting lumber;

- D. Québec's C\$425 million Forest Industry Support Program, which provides financing to softwood lumber producers on non-market terms in the form of loan guarantees and interest-free loans;
- E. Québec's so-called Forest Management Measures, established to provide C\$700 million in benefits to softwood lumber producers in the form of a tax credit of 90 percent for investments in access roads and bridges and other funding for reforestation, fire fighting, and pest control; and
- F. Québec's Capital Tax Credit, which provides investment incentives to the forest sector in the form of a tax credit of 15 percent for purchases of new manufacturing and processing equipment.

8. These programs represent a vast effort on the part of Ontario and Québec to provide grants or other benefits directly to softwood lumber producers — benefits that offset the effect of the export measures administered by the federal government. As demonstrated by the attached report of industry expert Tom L. Beck, this effort includes a large-scale grant program, two significant loan programs that make financing available to lumber producers, two tax credit programs, and two programs that directly transfer production costs from the softwood lumber industry to the provincial governments. C-1 at 3-8.⁴ Because none of these programs satisfies any of the exceptions in the SLA, Canada, by virtue of the actions taken by the Québec and Ontario provincial governments, has breached the SLA.

9. If the Tribunal finds a breach, the SLA provides that the Tribunal “shall” make two determinations: first, it determines a reasonable period of time for Canada to cure its breach; and, second, it determines appropriate compensatory adjustments to the export measures in an amount that remedies the breach if Canada fails to cure the breach within the reasonable period

⁴ “C-1 at ___” refers to page(s) of the expert report of Tom L. Beck. “C-1, Att. ___” refers to attachments to Mr. Beck’s report.

of time. SLA, art. XIV, ¶¶ 22-23. The United States has no objection to the Tribunal granting Canada the full 30 days from the date of award in which to cure the breach. SLA, art. XIV, ¶ 22(a). Notably, a cure can take any form, as long as it is acceptable to both parties.

10. In addition to determining a reasonable period of time to cure the breach, the SLA also provides that the Tribunal “shall determine” in its award compensatory adjustments to the export measures. To aid the Tribunal in this task, we have proposed two sets of compensatory adjustments. Both proposed remedies constitute appropriate compensatory adjustments to the export measures and both are in an amount that remedies the breach.

A. History Of The Dispute

11. Softwood lumber is wood sawn from coniferous trees, and is used primarily for home building. The United States and Canada both have significant softwood lumber industries. For nearly two centuries, there has been trade in softwood lumber between the United States and Canada, as well as disputes concerning that trade. The most recent dispute began in 2001, after the previous 1996 Softwood Lumber Agreement expired. At that time, the United States Department of Commerce determined that Canadian imports of softwood lumber were subsidized by Canada and sold at less than fair value in the United States, and the United States International Trade Commission determined that Canadian imports materially injured the United States industry. Based upon these two determinations, the United States imposed trade remedies in the form of antidumping and countervailing duty orders.⁵

⁵ As further background information, it is noteworthy that both the United States and Canada have laws that address injurious dumping and subsidization of imported goods. The United States trade laws provide relief to domestic producers and manufacturers by assessing duties on imports of competitive products that are sold in the United States at less than fair value (antidumping duties), or that are unfairly subsidized (countervailing duties) by the government of the exporting country, and are materially injuring the domestic industry. 19 U.S.C. §§ 1671,

12. Canadian interests (including the Canadian federal and provincial governments and Canadian producers and exporters), as well as the United States industry, challenged various aspects of the imposition of these trade remedies. These challenges were brought, with varying results, before the United States Court of International Trade, the North American Free Trade Agreement (“NAFTA”) Art. 1904 binational panels and extraordinary challenge committee, the World Trade Organization (“WTO”), other United States courts, and other NAFTA arbitral panels.

13. Throughout this time, Canada and the United States struggled to amicably resolve the dispute. After several years of negotiations, the two nations signed the SLA on September 12, 2006, to permanently settle the burdensome and protracted multi-forum legal proceedings that had persisted for two decades. Under the Agreement, the United States retroactively revoked antidumping and countervailing duty orders applied to softwood lumber imported into the United States from Canada, and refunded all antidumping and countervailing duty cash deposits collected pursuant to those orders – totaling approximately US\$5 billion – and agreed not to impose other trade remedies. *See* SLA, art. III-IV. In exchange, Canada agreed to impose export measures – a mixture of volume restraints and export charges – and promised not to “take any action having the effect of reducing or offsetting the Export Measures.” *See* SLA, art. VII; art. XVII, ¶ 1. Export charges are imposed, collected, and retained by Canada. SLA, art. VII. Because the export charges are administered and retained by Canada, it is especially important

1673 *et seq.* (CA-1). When the United States signed the SLA, it agreed to forego these trade remedies in exchange for Canada’s agreement to impose the export measures.

Similarly, Canadian trade laws address “dumping and subsidizing.” *See generally* Annual Report for the Canadian International Trade Tribunal (“CITT”) for Fiscal Year 2007 (“CITT Report”), available at <http://www.citt-tcce.gc.ca/doc/english/Publicat/ar2h_e.pdf> (CA-2).

that the collected charges not be funneled back to lumber producers. The anti-circumvention provision acts as a safeguard to prevent this.

II. Relevant Provisions Of The SLA

14. The governing law is the SLA and applicable customary international law, including customary international law applicable to the interpretation of treaties. Article 31 of the Vienna Convention on the Law of Treaties, May 23, 1969, 1155 U.N.T.S. 331 (“Vienna Convention”) (CA-3) codifies customary international law on the interpretation of international agreements between state parties.⁶ Article 31(1) of the Vienna Convention provides that “[a] treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.” In discussing Article 31, the International Court of Justice has recognized that “[i]nterpretation must be based above all upon the text of the treaty.”⁷

⁶ The International Court of Justice has determined that Article 31 codifies customary international law. *See, e.g., Kasikili/Sedudu Island (Bots. v. Namib.)*, 1999 I.C.J. 1045, 1059 (Dec. 13) (CA-4).

The Vienna Convention applies by its terms to “treaties between States.” Vienna Convention, art. 1. The Convention defines a “treaty” as “an international agreement concluded between States in written form and governed by international law.” Vienna Convention, art. 2, ¶ 1. Although the Agreement is not a “treaty” for purpose of Article II, § 2 of the United States Constitution, the provisions of the Vienna Convention nonetheless should be used to interpret the Agreement because they codify customary international law on the interpretation of international agreements.

⁷ *Territorial Dispute (Libyan Arab Jamahirya v. Chad)*, 1994 I.C.J. 6, 22 (Feb. 3) (CA-5).

15. The Vienna Convention permits use of:

supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of article 31, or to determine the meaning when the interpretation according to article 31: (a) leaves the meaning ambiguous or obscure; or (b) leads to a result which is manifestly absurd or unreasonable.

Vienna Convention, art. 32.

A. The Anti-circumvention Provision

16. In exchange for both the return of US\$5 billion and the retroactive revocation of antidumping and countervailing duty orders, Canada agreed to settle all of its multi-forum legal proceedings and impose export measures on lumber exports to the United States from all of Canada's major exporting regions. These export measures are the central mechanism of the Agreement, requiring Canadian producers to pay export charges or to follow quota restrictions on exports, or both, whenever the prevailing price of lumber is US\$355 or less per thousand board feet ("MBF"). SLA, art. VII. This system of export measures replaced the United States' imposition of trade remedies and encourages (and in some cases, compels), the Canadian lumber industry to limit exports to the United States when the price of lumber falls below a particular price.

17. To maintain the integrity of the Agreement, both parties agreed not to take "any action to circumvent or offset the commitments under the SLA, including any action having the effect of reducing or offsetting the Export Measures or undermining the commitments set forth in Article V." SLA, art. XVII, ¶ 1.⁸

⁸ Article V sets forth the United States' obligation to refrain from imposing any trade remedies as long as the SLA is in force. SLA, art. V.

18. Any “[g]rants or other benefits” that Canadian federal, provincial, or local governments provide on a *de jure* or a *de facto* basis to its softwood lumber producers or exporters “shall be considered to reduce or offset the Export Measures,” and thereby circumvent the commitments Canada made under the SLA. SLA, art. XVII, ¶ 2. In other words, the parties agreed that any grant or other benefit made to Canadian softwood lumber producers or exporters *per se* offsets the export measures and circumvents the agreement.

B. Exceptions

19. There are five enumerated exceptions to the *per se* rule articulated in Article XVII, ¶ 1: (1) provincial timber pricing or forest management systems as they existed on July 1, 2006; (2) other governmental 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; (3) actions or programs for the purpose of forest or environmental management, protection, or conservation subject to certain exceptions; (4) payments or other compensation to First Nations to address or settle claims; and, (5) measures that are not specific to the forest products industry. SLA, art. XVII, ¶ 2(a)-(e).

20. First, “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(a).

21. Second, “other governmental 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,” are not considered to reduce or offset the export measures. SLA, art. XVII, ¶ 2(b). To meet this exception, the program must be, first, *non-discretionary*. A non-discretionary act is one that an authority has a duty to take. In contrast, “the concept of discretion

refers to decisions where the law does not dictate a specific outcome, or where the decision-maker is given a choice of options”⁹

22. The non-discretionary program must also be in the form and the total aggregate amount in which it *existed* and was *administered* on July 1, 2006. SLA, art. XVII, ¶ 2(b). This means that the form of the program, the total amount allocated to the program, and the administration of the program, must not have changed since July 1, 2006.

23. Third, “actions or programs . . . for the purposes of forest or environmental management, protection, or conservation . . . or to facilitate public access to and use of non-timber 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,” shall not be considered to reduce or offset the export measures. SLA, art. XVII, ¶ 2(c). On its face, this exception refers to actions taken that do not affect, undermine, or counteract the market pricing of timber. In other words, forest management actions that facilitate public access to and use of non-timber resources are excepted as long as they do not affect the price of timber.

24. Fourth, “payments or other compensation to First Nations to address or settle claims,” shall not be considered to reduce or offset the export measures. SLA, art. XVII, ¶ 2(d).

25. Fifth, “measures that are not specific to the forest products industry” shall not be considered to reduce or offset the export measures. SLA, art. XVII, ¶ 2(e).

C. Remedy Provisions

26. If the Tribunal determines that any of the six challenged programs constitutes a “grant or other benefit” that does not satisfy any of the enumerated exceptions, then the Tribunal

⁹ *Baker v. Canada* (Minister of Citizenship and Immigration), 1999 S.C.J. No. 39 (S.C.C.) (CA-6); see also *United States v. Gaubert*, 499 U.S. 315, 322 (1991) (CA-7).

will have found that Canada breached the Agreement. The SLA then provides that the Tribunal “shall” make two additional determinations in its award decision. SLA, art. XIV, ¶ 22.

Specifically, paragraph 22 of Article XIV states:

If the tribunal finds that a Party has breached an obligation under the SLA 2006, the tribunal *shall*:

(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 (emphasis added). That is, the Tribunal simultaneously is to identify a reasonable period of time for the breaching party to cure its breach and is to determine the appropriate adjustments to the export measures to compensate if the breaching party fails to cure the breach within the reasonable period of time established by the Tribunal.

27. The Tribunal performs both tasks simultaneously so that the breaching party is aware of both the time it has to cure the breach and the consequence of its failure to timely cure. Notably, the SLA leaves to the parties the initial determination of the form and substance of an acceptable cure, which can take any form and need not be in the form of export measures. The Tribunal determines only a reasonable period of time to cure and alternative compensatory adjustments to the export measures if the breaching party fails to cure in that time.

28. Article XIV then explains that the “compensatory adjustments that the tribunal determines under paragraph 22(b)” shall consist of, if Canada is the breaching party, the imposition of or increases in export charges, or the imposition of volume restraints or reduction in export volumes permitted under volume restraints. SLA, art. XIV, ¶ 23(a). These

compensatory adjustments to the export measures “shall be in an amount that remedies the breach.” SLA, art. XIV, ¶ 23.

29. If a dispute were to arise as to whether the breach has been cured or remedied, Article XIV provides additional mechanisms to resolve any such dispute. SLA, art. XIV ¶¶ 27-32.

III. Six Ontario And Québec Programs Circumvent The SLA

A. Ontario’s Forest Sector Prosperity Fund Benefits Ontario Lumber Producers

30. The Forest Sector Prosperity Fund (“FSPF”) provides millions of Canadian dollars in targeted grants to Ontario’s lumber producers in direct contravention of the anti-circumvention provisions of the SLA. The Ontario Ministry of Natural Resources (“Ontario MNR” or “Ministry”) has explicitly acknowledged that the FSPF is a grant program. Because the program provides grants to Ontario softwood lumber producers and because it does not fall within any of the exceptions listed in Article XVII, the program falls within the anti-circumvention provision and constitutes a *per se* breach of the SLA. Accordingly, in addition to ceasing the administration of the program, Canada must either cure its breach within a reasonable period of time or impose compensatory adjustments to the export measures that remedy the breach.

1. Facts

31. The Ontario FSPF was announced as a response to the May 2005 Final Report of the Minister’s Council on Forest Sector Competitiveness (“Final Report”). *See* C-1, Att. AJ; C-1, Att. S; C-4 at 2.

NON-CONFIDENTIAL

32. In the Final Report, the Ontario MNR identified various challenges to the competitiveness of the forest sector globally and domestically, including the need to create a more favorable climate for investment in the forest sector given these competitive challenges. C-1, Att. S at 1-3. To this end, the Minister proposed a grant program (which later became the FSPF), as well as a loan guarantee program (discussed in section III.B). C-1, Att. S at 30-33. The express intent of the grant program, as articulated in the Final Report and in subsequent announcements concerning the program, is to provide “grants to the forest sector” that “support and leverage new capital investment projects.” C-1, Att. AJ; *see also* C-1, Att. S at 30-33.

33. Specifically, the Ontario FSPF is designed to support investment in particular areas, namely:

- value-added manufacturing;
- improved fibre efficiencies;
- energy conservation and co-generation;
- load management and electricity generation from biomass;
- advanced materials handling/efficiencies;
- new environmental technologies;
- associated infrastructure needs (such as hydro lines, rail lines, etc.); and
- worker training for transition to forest sector skill sets.

C-1, Att. AJ.

34. At its inception, Ontario anticipated that the FSPF would provide C\$150 million in grants over three years. C-1, Att. AJ; C-4 at 2. The program was to be managed by the MNR’s Forest Sector Competitiveness Secretariat (“Secretariat”), which would evaluate and process the applications for FSPF grants. C-4 at 4; C-1, Att. AG.

35. On June 30, 2006, the Ministry announced that it would be issuing a grant pursuant to the program, “a grant of C\$2 million to Grant Forest Products Inc. for a C\$20-million coated structural board facility.” C-1, Att. AH. [

NON-CONFIDENTIAL

] *Compare* C-28 [

] *with* C-5 [

]. Since then, the Ontario MNR has issued grants totaling C\$38,770,770. C-1 at 66 (Table 26). *See also* C-1, Att. AL (listing projects supported); C-6 [
]; C-7 (announcing C\$600,000 grant to Long Lake Forest Products); C-8 (announcing C\$430,000 grant to Black Loon Millworks, Inc.); C-9 (announcing C\$700,000 grant to Olav Haavaldsrud Timber Company Ltd.).

2. The FSPF Provides Grants And Benefits To Softwood Lumber Producers And Meets None Of The SLA's Exceptions

36. The Ontario FSPF provides numerous benefits directly to producers of Canadian “softwood lumber products.” SLA Annex 1A, ¶ 1; *see* C-1 at 64-67, Tables 26-27. Accordingly, there can be no dispute that the grants distributed through the FSPF constitute “[g]rants or other benefits that a Party, including any public authority of a Party, . . . provide[s] on a *de jure* or *de facto* basis to producers or exporters of Canadian Softwood Lumber Products.” SLA art. XVII, ¶ 2. Because the FSPF does not fall within any of the SLA’s enumerated exceptions, it constitutes “action” that reduces or offsets the Export Measures (*id.*, ¶ 1), thereby circumventing the SLA.

37. Specifically, the Ontario FSPF, which provides grants to lumber companies for capital improvements, is not a “provincial timber pricing or forest management system[],” that could qualify for the exception in paragraph 2(a). SLA art. XVII, ¶ 2(a).

38. Nor is the Ontario FSPF an “action[] or program[] undertaken by a Party, including any public authority of a Party, for the purpose of forest or environmental management,

NON-CONFIDENTIAL

protection, or conservation,” which could qualify it for the exception in paragraph 2(c). SLA art. XVII, ¶ 2(c). To the contrary, Ontario itself concedes that the program was limited to projects related to energy conservation and generation, improvements in the efficiency of forest products production, value-added manufacturing, and worker training. C-1, Att. AJ.

39. The Ontario FSPF is not a “payment[] or other compensation to First Nations to address or settle claims,” that falls under the exception in paragraph 2(d). SLA, art. XVII, ¶ 2(d). And, because the Ontario FSPF is specifically targeted to the forest industry, it cannot qualify for the exception in paragraph 2(e) for “measures that are not specific to the forest products industry.” SLA art. XVII, ¶ 2(e).

40. Finally, as demonstrated below, the Ontario FSPF does not provide benefits on a non-discretionary basis and, therefore, is not exempt under paragraph 2(b). Government discretion is exercised at nearly every stage of the FSPF application process. C-1, Att. AK at 2; C-1, Att. AJ at 2; C-1 at 63-64, 67-68. The ultimate approval authority is vested in the MNR. C-1 at 64.

41. The first step in the application process is the submission of an application. C-1, Att. AJ, at 2. Applications are not automatically approved. *Id.* Rather, they are evaluated many times, through many channels. *Id.* At each stage, evaluators exercise their judgment by relying on subjective criteria to either recommend or not recommend the application. *Id.* Upon receipt of the application by the MNR, the Forest Sector Competitiveness Secretariat (“Secretariat”) evaluates the proposal and determines whether to *recommend* submission of the project to a third-party due diligence provider. C-1, Att. AJ at 2 (“Step 3”). In evaluating the proposal, the Secretariat considers several subjective criteria including the social and economic benefits to the province. *See* C-1, Att. AK, at 2; *see also* C-2, Att. AJ, at 1. Priority is given to [

NON-CONFIDENTIAL

] ¹⁰ C-4 at 3.

42. Next, the application is forwarded to a third-party due diligence provider for an independent review. The due diligence provider issues a report concerning various subjective criteria, including the applicant's business case, potential risks of government investment, the financial stability of the applicant, and recommended terms and conditions for providing the grant. C-1, Att. AJ at 2 ("Step 4"). Upon receipt of the due diligence report, the Secretariat determines whether to *recommend* that the Forest Prosperity Fund Approval Committee [] recommends that the Minister make a grant and in what amount. ¹¹ See C-1, Att. AJ at 2 ("Step 5").

43. The Secretariat's recommendation is then presented to the Forest Prosperity Fund Approval Committee for a recommendation to the Minister, again applying the same subjective

¹⁰ Documents concerning specific projects highlight the discretionary nature of the program. For example, the process for approving the [] grant to [] involved evaluating numerous subjective criteria. Specifically, []

] C-11 at ON-CONF-00378-00379. [I

] C-12 at 8, 9.

¹¹ Again, documents provided by Canada related to the FSPF grants confirm the discretionary nature of the evaluation process. [T

] See C-

13 at 8, 9.

NON-CONFIDENTIAL

criteria and exercising judgment in evaluating the project in light of those criteria.¹² C-1, Att. AJ at 2 (“Step 5”).

44. Not only does the Secretariat (through the [] the due diligence provider, and the Forest Prosperity Fund Approval Committee [] utilize discretion at each step of the process, applying subjective criteria and exercising judgment about whether to recommend a project, but the MNR itself uses discretion in determining whether to adopt the recommendation of the Secretariat. C-1, Att. AJ at 2 (“Step 6”). This multi-tiered recommendation process does not necessarily lead to ultimate acceptance of the application. The very fact that each stage results in mere recommendations illustrates the fundamentally discretionary nature of the process. *See* C-1 at 63-64 (citing Att. AJ, Att. AK at 2). Accordingly, because the program is discretionary, it does not fall within the paragraph 2(b) exception.

3. Canada Must Counteract The Consequences Of The Breach

45. Because the Ontario FSPF provides grants to lumber producers and does not fall within any of the enumerated exceptions, Canada has breached the SLA. To remedy the breach, Canada must, first, cease administration of the program, including taking any necessary official actions both at the federal and provincial levels. Additionally, Canada must remedy the effects of the breach. Accordingly, if Canada fails to cure the breach within the reasonable period of time determined by the Tribunal, the remedy must take the form of compensatory adjustments to the export measures, which the Tribunal will determine in its award.

¹² [

] *See* C-14.

46. To aid the Tribunal in determining appropriate compensatory adjustments to remedy the effects of the Ontario FSPF, we propose two remedies in section IV.

47. The first remedy is very straightforward, targeting only the grants to softwood lumber producers and the resulting investments made possible by those grants. With respect to the first remedy, Mr. Beck has determined that, between October 2006 and August 2008, Ontario used the FSPF program to make grants to its softwood lumber producing companies totaling C\$38.77 million. *See* C-1 at 6 (Table 3), 66 (Table 26). These grants, used in concert with loan guarantees under the Ontario Forest Sector Loan Guarantee Program (see discussion at section III.B), enabled and resulted in capital investments by softwood lumber producing companies totaling C\$210.5 million. *Id.* at 66 (Table 26).

48. As Mr. Beck explains, “[t]he grants provided under the [FSPF] directly reduce the out-of-pocket expense related to a particular investment, and is therefore a significant benefit to the forest sector companies that take advantage of this program.” *Id.* at 64. Appropriate adjustments to export measures to compensate for Canada’s breach should account for the fact that the breach resulted not only in the making of grants, but also softwood lumber company investments that would not have otherwise been made, absent the grants.

49. The second remedy is proposed by expert economist Robert H. Topel. Professor Topel is a renowned economist from the University of Chicago School of Business. He has held positions in both teaching and research over the course of the past 28 years, and has published numerous articles in the academic literature. C-2. The remedy targets the effect of the FSPF on both capital formation and the marginal costs of Ontario lumber production, as well as the subsequent effect on market prices. This second remedy considers the grants and investments made to date as well as the on-going effects of those investments, and then imposes an export

NON-CONFIDENTIAL

charge designed to return market prices to the level that would have occurred in the absence of the program.

B. The Ontario Forest Sector Loan Guarantee Program Benefits Ontario Softwood Lumber Producers

1. Facts

50. The Forest Sector Loan Guarantee Program (“FSLGP”) provides millions of dollars in loan guarantees to Ontario’s lumber producers in direct contravention of the anti-circumvention provisions of the SLA. Because the program provides benefits to Ontario softwood lumber producers and because it does not fall within any of the exceptions listed in Article XVII, it constitutes an action that offsets the export measures and, therefore, constitutes a breach of the SLA. Accordingly, 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 that remedy the breach.

51. In 2005, the Ontario MNR announced the FSLGP as part of a series of initiatives worth C\$1 billion and intended to “address[] the competitiveness challenges faced by the Ontario forest sector.” C-15 at 1; *see also* C-18. Under the program, the provincial government made available C\$350 million in loan guarantees over five years to “support and leverage new capital investment” in the forest industry. C-15 at 1; C-1, Att. AG. [

] *See* C-16; C-17; C-1, Att. S at 30-33. The purpose of the FSLGP, like that of the Ontario FSPF, is to encourage capital investment. The [of the FSLGP are:

NON-CONFIDENTIAL

[

]

C-10 at 2.

52. The application for a loan guarantee under the Ontario FSLGP is identical to the application for Ontario FSPF grant benefits. C-15; C-1, Att. AK. The application states that loan guarantees (1) can be for a term of two to five years; (2) will generally range from C\$500,000 to a maximum of C\$25 million; (3) can be for up to 100 percent of the project loan; and (4) entail a “[g]uarantee fee” of 0.5 or 1.0 percent. C-15 at 2. Ultimate approval authority is vested with the MNR. C-1 at 64.

53. Loan guarantee applications undergo a screening and evaluation process by the Ontario MNR consisting of eight steps, including an evaluation of a detailed project proposal. C-15 at 2. If an applicant is approved for a guarantee, the Ontario MNR will enter into an agreement with the lender to guarantee the loan. *Id.* At each stage, the Ontario MNR exercises discretion to determine whether to approve a given proposal.

54. The first assistance under the Ontario FSLGP was announced on September 22, 2006, when softwood lumber producer Tembec, Inc. was awarded a C\$8 million loan guarantee for a new facility to be located in northern Ontario. C-1 at 63; C-1, Att. AI. As of September 2007, the Ministry had received 55 applications for benefits under the Ontario FSPF and FSLGP that, if approved, would translate into more than C\$1.5 billion in new forest sector investments. *See* C-18.

55. In September 2007 press releases, the Ontario government announced that it had made 17 offers under the FSPF and FSLGP, offers that it expected “will lead to about [C]\$356

NON-CONFIDENTIAL

million in investment based on accumulated government support of over [C]\$89 million.” C-18; C-19. As of late 2008, Ontario announced that it had approved over C\$42 million in loan guarantees to forest sector companies, including softwood lumber producers. C-1, Att. AL.

56. As Canada’s own documents demonstrate, the Ontario FSLGP benefits the lumber producers [] C-40 at ON-CONF-07230 (emphasis added). Mr. Beck explains in his report that, “[e]specially in an economic climate where financial institutions are reluctant to make loans to an industry sector whose business prospects are judged to be negative, a government loan guarantee program can help induce banks to make loans they otherwise would not make.” C-1 at 65.

2. The FSLGP Benefits Ontario Softwood Lumber Producers And Meets No Exceptions

57. Like the FSPF, the Ontario FSLGP circumvents the SLA by providing a financial benefit to softwood lumber producers. Furthermore, the FSLGP is not exempt from the SLA’s anti-circumvention provisions. Indeed, on their face, exceptions (a), (c), (d), and (e) do not apply. The Ontario FSLGP is not a “provincial timber pricing or forest management system[,]” which could qualify it for the exception in paragraph 2(a). SLA art. XVII, ¶ 2(a). It is not an “action[] or program[] undertaken by a Party, including any public authority of a Party, for the purpose of forest or environmental management, protection, or conservation,” that could qualify for the exception in paragraph 2(c). SLA art. XVII, ¶ 2(c). [

] C-10 at 4. In addition, the FSLGP is not a “payment[] or other compensation to First Nations to address or settle claims,” that could qualify for the exception in

NON-CONFIDENTIAL.

paragraph 2(d). SLA, art. XVII, ¶ 2(d). And, the FSLGP specifically targets lumber producers, making it ineligible for the exception in paragraph 2(e). *Id.* ¶ 2(e).

58. Finally, like the FSPF, the FSLGP is discretionary and, therefore, cannot qualify for the exception in paragraph 2(b). In fact, the program is based upon the same discretionary statute, employs equally subjective criteria, and uses the same discretionary approval process as the FSPF. C-15; C-1, Att. AJ; C-10 at 2. For example, the criteria applied by the MNR in evaluating applications for the FSLGP include whether the proposed project will provide

[

] C-15.

59. Moreover, Ontario's administration of the FSLGP includes an additional layer of discretion beyond that exercised in the administration of the FSPF. [

] C-10 at 7-8, 18. As

Canada's documents demonstrate, [

] *Id.* at 8. The Ontario MNR is also explicitly directed to use "discretion" to determine [

] C-10. Further, the Ontario MNR applies subjective criteria [

] C-10 at 6-7.

60. The Ontario FSLGP provides substantial benefits to softwood lumber producers by enabling them to obtain capital for investment at below-market rates. Because the program does not fit any of the SLA exceptions, the program's administration after the effective date of the SLA constitutes a breach of the anti-circumvention provisions of the Agreement.

3. Canada Must Counteract The Consequences Of The Breach

61. The Ontario FSLGP provides valuable loan guarantees to lumber producers and does not fall within any of the enumerated exceptions. Accordingly, Canada has breached the SLA. To remedy the breach, Canada must, first, cease administration of the program, including taking any necessary official actions both at the federal and provincial levels. Additionally, Canada must provide retroactive relief to remedy the effects of the breach. If Canada fails to cure the breach within the reasonable period of time determined by the Tribunal, the remedy must take the form of compensatory adjustments to the export measures, which the Tribunal will determine in its award.

62. To aid the Tribunal in determining appropriate compensatory adjustments to remedy the effect of the Ontario FSLGP, we propose two remedies in section IV.

63. With respect to the first remedy, Mr. Beck has determined that, between October 2006 and August 2008, Ontario used the FSLGP program to guarantee loans to its softwood lumber producing companies totaling C\$17.7 million. *See* C-1 at 6 (Table 3), 64 (Table 26). These guarantees, used in concert with grants under the Ontario FSPF (*see* discussion in section III.A), enabled and resulted in investments by softwood lumber producing companies totaling C\$210.5 million. *Id.* at 66 (Table 26). Appropriate adjustments to export measures to compensate for Canada's breach should account for the fact that the breach resulted not only in the loans, but also in larger softwood lumber company investments.

64. It is customary to value a loan guarantee based on the difference between the amount the company paid for the loan under the government-provided guarantee and what it would have paid for the loan in the market, absent the guarantee. Thus, the benefit would

NON-CONFIDENTIAL

ordinarily be measured by comparing interest, fees, and other financing costs paid for the guaranteed loan to those same costs for a non-guaranteed loan.

65. In this case, Ontario has not provided documents showing the terms of the loans obtained under the FSLGP. Therefore, Mr. Beck is not able to calculate the value of the loan guarantees using the customary methodology. The United States requested this information from Canada in its document requests.¹³ The Tribunal should consider that only Canada is in a position to provide the missing information and that the United States requested in its document requests; accordingly, it is appropriate to draw an adverse inference and estimate the benefit of the loan guarantees to be the total value of the loans. IBA Rules of Evidence, art. 9, ¶ 4 (“If a party . . . fails to produce any document ordered to be produced by the Arbitral Tribunal, the Arbitral Tribunal may infer that such document would be adverse to the interests of that Party.”).

66. Moreover, the FSLGP benefits lumber producers not only [] but also by inducing banks to make

¹³ See Procedural Order No. 4 and Redfern Schedule (May 20, 2008). Pursuant to Request No. 6(vi), the United States requested “All agreements regarding FSLGP loan guarantees, including, but not limited to agreements between loan recipients, the MNR, and/or any financial institution.” *Id.* The Tribunal granted this Request, ordering Canada to produce the documents or redacted versions of the documents:

Grants the Claimant's request subject to Canada receiving consent from third-party submitters. If a third-party does not give its consent, Canada shall produce the relevant documents with only the third-party confidential business information redacted. In case that third-party consent has not yet been requested and/or received, Canada shall ensure that such consent is immediately requested upon receipt of the present Order. Ontario shall have sixty days to determine third-party consent and to prepare limited redactions for documents where consent is not obtained. The accuracy of any redactions shall be verified by an independent advisor to be appointed by the Tribunal after consultation with the Parties.

Id.

loans to companies in a troubled sector that the banks otherwise would not make at all. C-1 at 64-65 (citing Att. AU at ON-CONF-07230). Therefore, it is appropriate to value loan guarantees as the total value of the loans induced under the program.

67. The second remedy, proposed by Professor Topel, targets the effect of the program on both capital formation and the marginal costs of Ontario lumber production, as well as the subsequent effect on market prices. This second remedy considers the grants and investments made to date as well as the continuing effect of those investments, and then imposes an export charge designed to return market prices to the level that would have occurred in the absence of the program.

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

68. The Ontario Forest Access Road Construction and Maintenance Program (“road program”) reimburses the Ontario lumber producers for millions of dollars in costs associated with constructing and maintaining forest access roads, in direct contravention of the anti-circumvention provisions of the SLA. Because the program provides grants to Ontario softwood lumber producers and because it does not fall within any of the exceptions listed in Article XVII, the program circumvents the export measures and, therefore, breaches the SLA. Accordingly, 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 that remedy the breach.

1. Facts

69. In a February 22, 2006 press release, the MNR announced the road program, which it described as “a significant new investment in the province’s forest sector.” C-1, Att.

AG; *see also* C-31 at ON00617790-92 (MNR correspondence discussing road program announcement); C-32 at ON00618120 (listing the road program as one of the MNR programs “[s]upporting industry”). Under the road program, C\$75 million in funding was made available to reimburse forest companies for costs incurred for constructing and maintaining primary and secondary forest access roads. C-20 at 5; C-21 at ON00617879-80; C-32 at ON00618127; C-41. Construction and maintenance of primary and secondary forest access roads (also referred to as logging roads) are essential to the production of softwood lumber because heavy logging trucks depend on the roads to remove cut logs from forests. C-1, Att. S at 20. Companies are reimbursed a maximum of 100 percent for their primary road costs and 50 percent for their secondary road costs. C-1, Att. AG; C-20 at 9; C-33 at ON00617894; C-32 at ON00618127. Eligibility for reimbursement under the program requires forest companies holding “sustainable forest licenses” (“SFLs” or “licenses”) to enter into a legal agreement with the MNR. *See* C-22 (attaching Road Construction and Maintenance Agreement).¹⁴

70. As with the FSPF and FSLGP programs, the Final Report issued by the Minister’s Council on Forest Sector Competitiveness provided the impetus for the road program. C-1, Att. S at 20-21; *see also* 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-20 at 4 (road program overview citing Council Recommendation 3).

¹⁴ In Ontario, publicly-owned (or Crown) forest is divided into “management units” for purposes of managing the forest. *See* C-23 at 1. Most management units are managed by individual forest companies under a “sustainable forest license.” *Id.* The MNR grants these licenses to forest companies to harvest timber from Crown lands. *Id.* Subject to MNR regulations and approvals, the license holder is responsible for forest management planning, harvest operations, access road construction, forest renewal and maintenance, monitoring, and reporting. *Id.*

71. The Final Report stated that Ontario's delivered wood costs were "among the highest" in the world. C-1, Att. S at 8-9; *see also id.* at 20 (characterizing the "challenge" as "bring[ing] the delivered cost of wood in Ontario into line with the global average"). The report also recognized that the road construction and maintenance costs, historically borne by lumber producers, were a "major drag on competitiveness and are making harvesting in some areas uneconomic." *Id.*

72. In light of the competitive challenge of delivered-wood costs to lumber producers, the Final Report concluded that the MNR's "[s]trategic [d]irection" should be to ensure "greater fairness in the way road costs are shared between government and the forest products industry." *Id.* Accordingly, "[t]he Council recommend[ed] that the provincial government assume its proportional share of the costs of building and maintaining the public access road network in provincial Crown forests; and that the proportion be defined as 100 [percent] of primary road costs, and 50 [percent] of secondary road costs." *Id.* In 2005, the MNR committed C\$28 million to an earlier version of the program, which applied only to the maintenance of primary forest roads. C-1, Att. AG; C-4 at ON-CONF-07204; C-36; C-37.

73. However, the road program was enhanced and expanded on July 14, 2006 to cover the construction of primary roads *and* the construction and maintenance of secondary roads. This expansion included an increased budget totaling C\$75 million.

74. The purpose of the road program is 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"); C-33 at ON00617883 (explaining that the "[i]ntention of [the] program is to assist in overall reduction of wood cost"); C-33 at ON00617896 ("MNR perspective is that all beneficiaries of wood fibre should receive the downstream benefits of lower delivered wood

NON-CONFIDENTIAL

costs.”); C-33 at ON00617900 (defining “Guiding Principles” to mean that “[r]eimbursement of road construction and maintenance costs must have a direct impact on delivered wood costs”); C-32 at ON00618131 (the expectation is that the road program will “reduce delivered wood costs”).

75. Ontario did not implement the expanded and enhanced road program until July 14, 2006, two weeks after the SLA’s July 1, 2006 cutoff 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 . . .”).

**2. The Road Program Benefits Ontario Softwood Lumber Producers
And Meets None Of The SLA Exceptions**

76. The road program benefits Ontario softwood lumber producers by reimbursing logging companies (who are primarily responsible for cutting and extracting lumber from the forest) for the construction and maintenance of primary and secondary forest access roads. This reimbursement, in turn, reduces the costs of producing softwood lumber in Ontario.

77. As demonstrated, the MNR promoted the program as providing a tangible benefit to Ontario’s softwood lumber producers by reducing delivered-wood costs. The MNR went so far as to characterize the road program as “an industry relief program.” C-33 at ON00617898. Tellingly, when announcing the new program in February 2006, the MNR stated that the program’s purpose was “to *offset costs* for 100 [percent] of primary roads construction and maintenance and 50 [percent] on secondary roads.” C-32 at ON00618127 (emphasis added). Indeed, the MNR specifically referred to the initial, smaller-scale road program as a [

.] *See* C-4 at ON-CONF-07210 [

NON-CONFIDENTIAL

]; *see also* 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”); C-4 at ON-CONF-07210 [

]

78. In fact, softwood lumber producers themselves acknowledged the benefit realized from the program. The same day the MNR issued its February 2006 press release announcing the road program, a major Ontario softwood lumber producer commented that “[t]he funding announced today, along with the announcement of last summer, will combine to have a positive effect on delivered fibre costs. This is very good news for both [our company] and the industry.” C-26.

79. The road program provides a targeted financial benefit to softwood lumber producers by removing a significant financial burden from the primary logging companies — the costs of constructing and maintaining primary and secondary forest access roads required to remove cut logs from forests. C-1, Att. S at 20; *id.* at 9 (“[d]elivered wood costs include those costs incurred by industry bringing wood from the forest to the mill. Components of those costs include building and maintenance of roads . . .”).

80. In the past, the Ontario forest industry had been solely responsible for the construction and maintenance of the roads. C-1, Att. S at 20. By introducing the road program, Ontario’s purpose was to benefit lumber producers by “allow[ing] for the government to share in the construction and maintenance costs incurred by the forest industry on primary and secondary roads.” C-31 at ON00617790; *see also* C-24 at ON00617862 (“Based on the expenditure

forecasts provided by all SFLs last fall, we are confident that the total [C]\$75.0 million will be reimbursed to the industry.”); C-33 at ON00617899 (defining “key principle” to mean that “MNR will provide available funding for reimbursement of costs of eligible road construction and maintenance activities performed by the forest industry”) (emphasis omitted).

81. The road program permits primary logging companies, and thus the softwood lumber producers who manufacture lumber from the logs, to recognize a cost savings. *See* C-1, Att. AG (MNR stating that it was providing “funding or savings to the industry” through, among several initiatives, making C\$75 million available for construction and maintenance of forest access roads).

82. By virtue of the expanded program administered on July 14, 2006, Ontario softwood lumber producers received an incremental benefit from the program of C\$67.3 million from the enactment of the SLA through fiscal year 2007-2008. C-1 at 73 & Table 28. Through fiscal year 2008-2009, the program is expected to provide an incremental benefit of C\$105 million to softwood lumber producers. C-1 at 74, Table 29.

83. Because the road program benefits lumber producers, it is deemed “to reduce or offset the Export Measures” in violation of Article XVII of the SLA. SLA, art. XVII, ¶ 2. Furthermore, because the program meets none of the exceptions in paragraph 2 of Article XVII, the program circumvents the Agreement.

84. Several exceptions are inapplicable on their face. For example, the program does not constitute a provincial timber pricing or forest management system. *See* SLA, art. XVII, ¶ 2(a). It does not involve environmental management, protection, or conservation; or provide a payment to First Nations. *See id.* ¶¶ 2(c), (d). Nor does the road program fall within the

remaining exceptions because the program is not in the form and total aggregate amount as it existed on July 1, 2006, and it is specific to the forest products industry. *See id.* ¶¶ 2(b), (e).

85. The road program does not *exist* “in the form and total aggregate amount in which [it] existed and [was] administered on July 1, 2006” in several important respects. *Id.* ¶ 2(b). The initial program that was announced in 2005 is substantially different from the enhanced program announced in February 2006 and approved after July 1, 2006. The 2005 program had a different purpose, title, and amount allocated than that of the program administered after July 1, 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 only primary roads. C-1, Att. AG. In contrast, the 2006 program 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* C-20 at 5-6 (showing differing funding levels and scope of the road-building programs announced in 2005 and 2006, respectively).

86. In addition, distinct agreements govern each program, highlighting the inherent differences between the two programs. *Compare* C-25 (2005-06 Road Maintenance Agreement) *with* C-22 (2006-07 Road Construction and Maintenance Agreement); *see also* C-20 at 7 (stating that the program announced in 2006 “builds on [the] 05/06 agreement,” and that there will be a “[r]evised agreement based on [the] new announcement”); C-35 at ON00617762-617764 (“The draft ‘Road Construction and Maintenance Agreement’ has been revised to reflect the new and expanded road construction and maintenance program and [to] address required alterations from the previous year’s agreement.”).

87. These distinctions are significant because the 2006 road program was not *administered* until July 14, 2006. *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”). Therefore, the road program could not have been administered in the same way on July 1, 2006 as it was administered on July 14, 2006. SLA, art. XVII, ¶ 2(b).

88. Moreover, because the primary objective of the road program is to reduce delivered-wood costs, it cannot fall within the exception carved out for facilitation of public access to and use of non-timber forest resources. *See id.* ¶ 2(c). As demonstrated, the road program was intended to assist forest sector competitiveness given that Ontario’s delivered-wood costs were making harvesting “uneconomic.” C-1, Att. S at 8-9, 20; *see also* C-32 at ON00618119; C-20 at 4. Because the purpose and effect of the program are tied specifically to the forest sector, the program cannot be characterized as “facilitation of public access to and use of non-timber forest resources.”

89. Finally, the road program does not satisfy exception 2(e) because it is a measure “specific to the forest products industry.” SLA, art. XVII, ¶ 2(e). Forest roads are built and maintained by logging companies for the purpose of accessing and removing timber for use by lumber producers. *See* C-1, Att. S at 9, 20. As noted above, the costs associated with road construction and maintenance historically have been borne by the logging companies. *Id.* at 20. Because the road program lifts the burden of these costs from the logging companies – and by extension from the costs incurred by the rest of the forest industry in the manufacture of its products – the measure is “specific to the forest products industry.” Indeed, a year-end review of the 2005 program characterized it as “an industry relief program.” C-33 at ON00617898. And

NON-CONFIDENTIAL

numerous other Ontario documents illustrate that the road program was designed to be forest-industry specific — in particular, to reduce delivered wood costs.¹⁵

3. Canada Must Counteract The Effects Of The Breach

90. The road program permits Ontario to reimburse its lumber producers and other forest sector companies for the costs associated with building and maintaining forest access roads to give the companies improved access to their primary resource, softwood timber. The program transfers costs formerly borne by lumber producers to the provincial government. C-1 at 4. Because the road program provides a benefit to the Canadian softwood lumber producers and does not fall within any of the enumerated exceptions under the SLA, Canada has violated the Agreement.

¹⁵ See C-1, Att. AG (stating that the road program and other investments in the forest sector “will reduce the cost of wood delivery by [C]\$4 per cubic metre on average over the next three years”); C-26 (estimating that the road building initiative alone would result in a cost reduction of [C]\$2.90 per cubic meter of delivered wood); C-31 at ON00617790 (“allow[ing] for the government to share in the construction and maintenance costs incurred by the forest industry on primary and secondary roads”); C-33 at ON00617883 (explaining that the “[i]ntention of [the] program is to assist in overall reduction of wood cost”); C-35 at ON00617862 (expressing “confiden[ce] that the total [C]\$75.0 million will be reimbursed to the industry”); C-33 at ON00617896 (“MNR perspective is that all beneficiaries of wood fibre should receive the downstream benefits of lower delivered wood costs.”); C-33 at ON00617899 (defining “key principle” of the road program to mean that “MNR will provide available funding for reimbursement of costs of eligible road construction and maintenance activities performed by the forest industry”) (emphasis omitted); C-33 at ON00617900 (defining “Guiding Principles” to mean that “[r]eimbursement of road construction and maintenance costs must have a direct impact on delivered wood costs.”) (emphasis omitted); C-32 at ON00618119-20 (characterizing the C\$75 million road program and other “newly created programs” as being “designed to assist the forest industry”); C-27 at ON00617751-617752 (MNR letter to Ontario Forest Industries Association describing the 2005 program as “present[ing] a great opportunity to begin assisting the forest industry in address[ing] competitiveness issues and in particular immediately reducing delivered wood costs”); C-38 at 8 [

].

91. To remedy the breach, Canada must, first, cease administration of the program, including taking any necessary official actions both at the federal and provincial levels. Additionally, Canada must provide retroactive relief to remedy the effects of the breach. If Canada fails to cure the breach within the reasonable period of time determined by the Tribunal, the remedy must take the form of compensatory adjustments to the export measures, which the Tribunal will determine in its award.

92. To aid the Tribunal in determining appropriate compensatory adjustments to remedy the effect of road program, we propose two remedies in section IV.

93. The first remedy is very straightforward, targeting only the net benefit to softwood lumber producers. As Mr. Beck has determined, the enhanced and expanded road program resulted in reimbursements in the amount of C\$67.3 million over and above what was disbursed under the previous program — this is an appropriate measure of the breach. *See* C-1 at 73, Table 28 (quantifying the net benefit to producers).

94. The second remedy proposed by Professor Topel targets the effect of the road program on both capital formation and the marginal costs of Ontario lumber production, as well as the subsequent effect on market prices. This second remedy considers the grants and investments made to date, as well as the continuing effects of those investments, and then imposes an export charge designed to return market prices to the level that would have occurred in the absence of the program.

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

95. Québec's C\$425 million Forest Industry Support Program ("PSIF") provides millions of dollars to assist forest sector companies with capital-financing and asset-acquisition

projects.¹⁶ This program is a grant or other benefit that Québec provides 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. Accordingly, the program circumvents the commitments Canada made under the SLA, in violation of Article XVII, ¶ 1. 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 that remedy the breach.

1. Facts

96. In October 2006, Québec implemented a plan 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. The program, called a loan or financing “envelope” in various government documents, was originally included as part of the Finance Minister’s March 2006 proposed budget. *See* Canada’s Response To Request For Arbitration ¶ 17(b) (“Canada admits that in March 2006 Québec issued its 2006-2007 Budget Plan, which included a supplement to Investissement Québec’s general authorization to provide loans and loan guarantees.”); C-1, Att. AB at 3, 6; C-1, Att. T at 13; C-1, Att. U at § 6, p. 7. However, the program was not implemented until October 2006. *See* C-1, Att. AB at 1, 3, 6; C-1, Att. AD at 4.

97. The precursor to the PSIF, proposed in March 2006, was designed to offset antidumping and countervailing duties and intended to “foster investment and modernization projects that will improve the productivity and competitiveness of Québec forest companies.” C-1, Att. U at § 6, p. 7. Shortly after the presentation of the March 2006 budget, however, the United States Trade Representative and the Canadian Trade Minister announced an agreement on

¹⁶ The PSIF acronym is derived from the program’s French title, Programme de Soutien à L’industrie Forestière.

the core terms of a new softwood lumber agreement that would eventually become the SLA. No loans were made under the Québec forest sector loan program until after the SLA came into effect — that is, after October 12, 2006. C-1 at 54 (citing Att. AR at QC002037, p. 10).

98. On October 20, 2006, following the SLA's entry into force, the Government of Québec announced that it was making available C\$425 million in financing. C-1, Att. AB at 1, 3, 6. Québec completely changed the nature of the program described in March 2006 from a program that assisted companies affected by duties (duties that were later returned by the United States pursuant to the SLA), to a program that would provide financing to forest sector companies for: (1) working capital financing projects and consolidation projects; and (2) investment and asset acquisition projects. C-1 at 52; C-1, Att. AB at 3, 6; C-1, Att. AD at 4. No project obtained financing under the program before October 12, 2006. Further, the Québec Finance Minister admitted in his 2007-2008 budget that the program was not implemented until the fall of 2006. C-1, Att. W. at 34.

2. Québec's PSIF Benefits Softwood Lumber Producers And Meets No Exceptions

99. Québec's PSIF program, administered through a state-owned corporation called Investissement Quebec, has already provided significant benefits to 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.

100. Between implementation in October 2006 and Investissement Québec's Annual Report in May 2007, the program had authorized C\$54 million in loans to make possible C\$122

million in forest sector projects. C-1 at 53 (citing Att. AR at QC002037 at p. 10). This was only the start of the massive program. In the next year's Annual Report, Investissement Québec reported that "169 financing operations" had been authorized, totaling C\$150 million in financing and C\$377 million in forest sector projects. *Id.* (citing Att. AQ at 9).

101. Through FY 2008-2009, the PSIF program has made loans and loan guarantees of C\$191.7 million. C-1 at 55 (Table 23). During this same period, this financing has resulted in total forest sector investments of C\$766.8 million. *Id.* at 55 (Table 24). Investissement Québec stated in its 2007-2008 Annual Report that "[a]ll the objectives set for the Support for the Forest Industry Program (PSIF) were greatly surpassed, particularly when it comes to the number of authorized financing operations." *Id.*, Att. AQ at 18.

102. The favorable, non-market-term financing provides a benefit to Canadian softwood lumber producers and exporters not only because it helps companies obtain loans from financial institutions, but also because it induces lenders to take actions that they would not otherwise take. C-1, Att. AB at 6; C-1 at 38-41. These are benefits targeted at the forest products industry. Accordingly, they are deemed to reduce or offset the export measures under the SLA, art. XVII, ¶ 2, and, therefore, circumvent Canada's obligations under the SLA, in violation of art. XVII, ¶ 1.

103. The PSIF does not meet the exception (b) requirements. C-1 at 54. First, the program was not implemented in any form before July 1, 2006. Although the province announced in March 2006 that it would make available a C\$425 million "envelope," that benefit was originally designed to offset antidumping and countervailing duties. No financing was authorized until *after* the SLA had entered into effect and *after* the program's purpose had substantially changed. After the SLA was signed in October 2006, the province announced that

it still intended to pay out C\$425 million, *but for different purposes*. It was only after the current program was implemented in the fall of 2006 that Québec began approving financing for forest sector projects. C-1 at 51-53; C-1, Att. AB at 3, 6. Thus, the PSIF was not “administered” until well after July 1, 2006.

104. Second, the program goals and conditions were changed after July 1, 2006. The form of the program changed markedly after the cutoff date, with different objectives, different award criteria, and a new administrative mechanism. C-1 at 53 (citing Att. AD at 3); C-1 at 39-40 (citing Att. AB at 6, Att. AD at 4). Under these circumstances, the program did not exist and was not administered in October 2006 “in the form of and in the total aggregate amount in which it existed and was administered on July 1, 2006.” SLA, art. XVII, ¶ 2(b). Thus, the PSIF is not exempt from the anti-circumvention prohibition in the SLA.

105. Finally, the PSIF makes loans and loan guarantees on a discretionary basis. C-1 at 54. Decisions regarding which projects to fund, what type of assistance to provide, what fees and interest to charge, and whether to defer interest, are necessarily discretionary. The substance and evaluation of these undefined criteria are left to government officials. C-1 at 54 (citing Att. AR at QC00001). For example, an Investissement Québec brief describing the PSIF program includes the requirement that the business must have a good financial structure, adequate management, qualified staff and a solid organization. *Id.* These subjective criteria must be evaluated before a company is eligible to receive financial assistance.

106. Indeed, all programs administered by Investissement Québec are discretionary. The Act Respecting Investissement Québec and La Financier du Québec provides that the government may mandate the agency to grant assistance to programs that the government considers of major economic significance and allows Investissement Québec to make financial

assistance dependent upon conditions or contractual obligations. R.S.Q., c.I-16.1, s.28, CA-8.

The minister has discretion under the Act Respecting the Ministère des Ressources Naturelles et de la Faune (“the MRNF Act”) to award or not to award benefits. R.S.Q., C.M-25.2, s.15, CA-9.

107. In announcing the PSIF program in October 2006, Québec claimed that the PSIF measures were consistent with the SLA because they “are rooted in government policies that existed prior to July 1, 2006, since they are consistent with the Budget Speeches of the spring of 2005 and the spring of 2006.” C-1, Att. AB at 3. However, consistency with government policy does not satisfy an exception. As discussed above, the relevant test is whether the program is non-discretionary and exists and is administered in the same form as it was on July 1, 2006. SLA art. XVII, ¶ 2(b). Quebec’s PSIF program does not satisfy this exception.

3. Canada Must Counteract The Consequences Of The Breach

108. The PSIF encourages investment in the softwood lumber industry by providing financing and loan guarantees to softwood lumber producing companies that show prospects for development and growth. Because the program provides a benefit to softwood lumber producers and does not fall within an exception under the SLA, Canada has violated the Agreement.

109. To remedy the breach, Canada must, first, cease administration of the program, including taking any necessary official actions both at the federal and provincial levels. Additionally, Canada must provide retroactive relief to remedy the effects of the breach. If Canada fails to cure the breach within the reasonable period of time determined by the Tribunal, the remedy must take the form of compensatory adjustments to the export measures, which the Tribunal will determine in its award.

110. To aid the Tribunal in determining appropriate compensatory adjustments to remedy the effect of the program, we propose two remedies in section IV.

111. With respect to the first remedy, Mr. Beck has determined that the program resulted in loans and loan guarantees in the amount of C\$191.7 million from 2008-2009. *See* C-1 at 51-55. Using the value of the softwood lumber company investments made possible through the program, the PSIF has resulted in \$766.8 million in new investments through 2009.

112. It is customary to value a loan guarantee as the difference between the total amount the company pays for a loan with a government-provided loan guarantee and what the firm would have paid for a comparable commercial loan that the company could actually obtain on the market without the guarantee. Thus, the benefit would ordinarily be measured by comparing interest, fees, and other financing costs paid for the guaranteed loan to those same costs for a non-guaranteed loan.

113. In this case, our review of the documents reveals that Québec has not provided documents showing the terms of the financing obtained under the PSIF. Therefore, Mr. Beck is not able to calculate the benefit of the loan guarantees using the customary methodology. The United States requested this information in its document requests. The Tribunal should consider that Canada is in a position to provide the missing information that the United States cannot obtain and that the United States requested in its document requests; accordingly, it is appropriate to draw an adverse inference and estimate the benefit of the loan guarantees to be the total value of the loan.

114. The second remedy, proposed by Professor Topel, targets the effect of the PSIF program on both capital formation and the marginal costs of Québec lumber production, as well as the subsequent effect on market prices. This second remedy considers the grants and investments made to date as well as the on-going effects of those investments, and then imposes

an export charge designed to return market prices to the level that would have occurred in the absence of the program. IBA Rules of Evidence, art. 9, ¶ 4.

E. Québec's Forest Management Measures Benefit Softwood Lumber Producers

115. 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. This program is a grant or other benefit that Québec provides on a *de jure* or *de facto* basis to the producers or exporters of softwood lumber products and, thus, is deemed to offset or reduce the export measures, SLA, art. XVII, ¶ 2. Accordingly, the program circumvents the commitments Canada made under the SLA, in violation of Article XVII, ¶ 1. 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.

1. Facts

116. In October 2006, the government of Québec unveiled programs in which the provincial government would assume costs previously borne by the producers and exporters of softwood lumber products. Included among the programs are: (1) 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 industries; and (2) a reduction of the cost of logging operations by providing new benefits for reforestation, fighting forest fires, and pest control. *See also* C-1, Att. AB at 2, 5; C-1, Att. AD at CAN_CONF_0000005-5. When announced, these programs had an estimated cost of C\$ 497 million over 2-4 years. C-1 at 41.

117. The programs announced in October 2006 echoed Québec's March 2006 proposed budget, which had announced "[f]inancial [i]nitiatives [t]o [s]upport [t]he [f]orest [s]ector," C-1, Att. U at § 6, p. 5, by "enhanc[ing] the profitability of forest sector activities." *Id.* at § 6, p. 8. Among the programs proposed in March 2006 were C\$210 million in measures "to reduce the cost of operations and silvicultural investments" and C\$100 million for a refundable tax credit of 40 percent for the construction of and major repairs to forest access roads and bridges. C-1, Att. U at § 6, pp. 8-9; C-1, Att. T at 13. In October 2006, Québec raised the 40 percent tax credit for forest road construction to 90 percent. C-1, Att. AB at 2, 5; C-1, Att. AD at CAN_CONF_00000015. Accordingly, as of July 1, 2006, Québec had not implemented any of the programs.

118. The statutory authority for the programs is derived from the MNRF Act. R.S.Q., c. M-25.2, s.15. Section 15 of the MRNF Act provides, "The Minister may, in the exercise of his functions, grant subsidies. He may also, with the authorization of the Government, grant any other form of financial assistance." *Id.* Legislation to increase the tax credit did not receive final assent until December 2006. C-1, Att. V at 112, §§ 156-57 (increasing credit from 40 percent to 90 percent); C-1, Att. V at 220 (enactment date).

2. Québec's Forest Management Measures Benefit Softwood Lumber Companies And Meet No Exceptions

119. These programs benefit softwood lumber companies by reducing operating costs and increasing investments. The proposed budget provided that "[f]unding of [C]\$210 million will be allocated to reduce the cost of operations and silvicultural investments assumed by the forest sector." C-1, Att. U at § 6, p. 8. Similarly, the stated rationale for the tax credit was "[t]o help forest companies reduce supply costs." C-1, Att. U at § 6, p. 9. Thus, these incentives

provide financial benefits to Canadian softwood lumber companies, which must be deemed to reduce or offset the effect of the export measures under SLA Article XVII, ¶ 2, in contravention of SLA Article XVII, ¶ 1.

120. Mr. Beck has evaluated the Quebec Forest Management Measures as three separate components: a refundable road tax credit, silvicultural investment measures, and funding for forest fire suppression and pest control. C-1 at 40-50. Mr. Beck estimates that the measures will benefit the Canadian softwood lumber industry by collectively providing C\$345.6 million in post-SLA benefits to softwood lumber producing companies through FY 2008-2009 (ending March 31, 2009). C-1 at 40-50 (Tables 17, 20, 21); and 55 (Tables 23-24). Because the measures benefit softwood lumber producers, they offset export measures and, therefore, breach the SLA.

121. Further, none of the SLA's exceptions applies. Several exceptions are inapplicable on their face. For example, the program does not involve environmental management, protection, or conservation; or provide a payment to First Nations. *See* SLA, art. XVII, ¶¶ 2(c), (d). Nor does the program fall within the remaining exceptions because the program is not (despite its title) a forest management program, it existed and was administered differently after July 1, 2006, and it is specific to the forest products industry. *See* SLA, art. XVII, ¶ 2(a), (b), (e).

122. First, although the program is labeled "forest management," it is not directed at forest management. The programs are designed to increase the profitability of companies in the forest sector industry, including softwood lumber companies. *See* C-1, Att. AB at 5, 8 (admission that programs provide "financial incentives to support the forest sector" by "enhanc[ing] the profitability of forest sector activities"); C-1, Att. U at §6, p. 5, 8; C-1, Att. T at

NON-CONFIDENTIAL

13. In any event, because the program is designed to reduce operating costs, it “undermin[es] or counter[acts] movement toward market pricing of timber.” SLA, art. XVII, ¶ 2(c). Therefore, the “forest management system” exception in Article XVII, ¶ 2(a) does not apply.

123. Second, the measures did not exist “in the form and the total aggregate amount in which they existed and were administered on July 1, 2006” and, therefore, do not qualify for the Article XVII, ¶ 2(b) exception. The relevant legislation, the October 2006 press release accompanying the announcement, and the 2007-2008 Québec Budget indicate that the tax credit was increased from 40 percent to 90 percent *no earlier than October 2006*. C-1, Att. AB at 2, 5; C-1, Att. AD at CAN_CONF_0000006; C-1, Att. AE at 6; C-1, Att. V at 112, §§ 156-57; C-1, Att. V at 220. In fact, the Finance Minister’s 2007-2008 budget admitted, “[t]o foster the rapid recovery of Québec’s forest sector, the government implemented, in the fall of 2006, a support plan providing [C]\$1.4 billion in assistance over the period 2007- 2010.” C-28 at 34. Moreover, the 90 percent tax credit was not enacted into law until December 2006 in a bill passed and assented to in the National Assembly. C-1, Att. V at 112, §§ 156-57; C-1, Att. V at 220.

124. Third, Québec has suggested that these programs comply with the SLA because they do not “specifically target the softwood lumber sector” and are “rooted in government policies that existed prior to July 1, 2006.” C-1, Att. AB at 3. However, the relevant test under exception (e) is whether the program is “not specific to the forest products industry.” SLA, art. XVII, ¶ 2(e). [

] C-1, Att. AB; C-1, Att. AD at CAN_CONF_0000001; C-1, Att. T at 13; C-1, Att. U at § 6 pp. 5-8; C-28 at 34. Moreover, consistency with existing policies and goals is immaterial. The programs were not implemented until the fall of 2006 and, therefore, did not exist and were not administered before the SLA’s cutoff date of July 1, 2006.

3. Canada Must Counteract The Consequences Of The Breach

125. Québec's forest management measures benefit softwood lumber producers by reducing operating costs and increasing competitiveness. Accordingly, Canada has breached the SLA. To remedy the breach, Canada must, first, cease administration of the program, including taking any necessary official actions both at the federal and provincial levels. Additionally, Canada must provide retroactive relief to remedy the effects of the breach. If Canada fails to cure the breach within the reasonable period of time determined by the Tribunal, the remedy must take the form of compensatory adjustments to the export measures, which the Tribunal will determine in its award.

126. To aid the Tribunal in determining appropriate compensatory adjustments to remedy the effect of the program, we propose two remedies in section IV.

127. With respect to the first remedy, Mr. Beck has estimated that Québec provided benefits totaling C\$345 million by means of the program through fiscal year 2008-2009. Appropriate adjustments to export measures to compensate for Canada's breach should account for these benefits.

128. The second remedy proposed by Professor Topel targets the effect of Québec's program on both capital formation and the marginal costs of Québec lumber production, as well as the subsequent effect on market prices. This second remedy considers the investments made to date as well as the on-going effects of those investments, and then imposes an export charge designed to return market prices to the level that would have occurred in the absence of the program.

F. Québec's Capital Tax Credit

129. 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 export measures. 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.

1. Facts

130. In the March 23, 2006 Budget Speech, the Minister of Finance announced a 15 percent tax credit on investments in manufacturing and processing equipment through 2009 “[t]o make our forest sector companies even more competitive.” C-1, Att. T at 13; C-29 at QC0000088. The 15 percent tax credit was included in the 2006-07 Budget Plan. C-1, Att. U at § 6, p. 5.

131. On November 8, 2006, the Québec government proposed legislation in connection with the 15 percent tax credit. *See* C-1 at 34 (citing Att. V at 177-78). Canada's Response To Request For Arbitration, ¶ 16(a) (“Quebec provides corporations other than financial institutions with a capital tax credit of 15 percent of eligible expenses related to the acquisition of manufacturing and processing equipment”). The bill was passed on November 30, 2006, and the legislation received final assent on December 6, 2006. The program applies retroactively to capital assets purchased after March 23, 2006. C-1, Att. V at 177-78; C-1, Att. AA at § G, p. 3 (discussing “the 15 [percent] capital tax credit for *primary wood processing activities*”) (emphasis added); *id.* at § G, p. 8 (“The assistance plan for the forest industry announced in the 2006-2007 Budget raised the rate of the capital tax credit to 15 [percent] for manufacturing and

processing machinery and equipment *used in primary processing of forest products* and acquired before January 1, 2010.”) (emphasis added)).

132. The Québec Finance Minister announced in February 2007 that the application period for the capital tax credit would be extended through December 31, 2012 “to enable forest-sector companies to plan their investment projects over a longer term.” C-1, Att. W at 34; C-1, Att. X at 7-8. “The rate of the capital tax credit is 15 percent for an eligible investment incurred in the forest sector after March 23, 2006, and before January 1, 2013, for manufacturing and processing equipment used primarily in the activities of the sawmill and wood preservation industry, the veneer, plywood and engineered wood product manufacturing industry (excluding the structural wood product manufacturing industry), and the pulp, paper and paperboard mill industry.” C-30 at QC000055.

133. The stated purpose of the capital tax credit is to “reduce the cost of acquiring manufacturing and processing equipment by 15 [percent]” by “offset[ting] the tax on capital normally payable on new investments” and “offset[ting] or substantially reduc[ing] this tax on all other existing assets.” C-1, Att. U § 6, p. 10. Québec estimated that the measure would reduce taxes paid by companies by C\$120 million over four years. C-1, Att. U § 6, p. 5, 11. The one-year extension of the 15 percent forest sector tax credit was projected to add C\$6 million in additional benefits. C-1 at 35 (citing Att. AA at § G, p. 4).

134. Table 12 of Mr. Beck’s expert report summarizes 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. On November 23, 2007, Quebec announced that the 15 percent capital tax credit – previously available only for forest sector manufacturing – was amended to apply to all manufacturing. Mr. Beck estimates that, through November 23, 2007,

NON-CONFIDENTIAL

[] in credits were granted to softwood lumber producing companies under the 15 percent forestry sector tax credit program, a figure that includes an “excess credit” of \$3,744,281. *Id.* at Table 13 (citing Att. AS at QC-C-098644 - QC-C-099141, QC-C-100655 - QC-C-100763). “Excess credit” refers to the fact that the tax credit was increased from 5 percent to 15 percent for forest sector investments after the SLA entered into force. The “excess credit,” then, is the amount of credit received by softwood lumber producing companies in “excess” of what they would have received under the pre-existing 5 percent credit.

2. The Capital Tax Credit Benefits Softwood Lumber Producers And Meets No Exceptions

135. The capital tax credit offsets the export measures by providing a benefit to softwood lumber producers and exporters. The credit was first proposed in Québec’s 2006 budget, in which the Finance Minister expressly identified the targeted purpose of the credit. C-1, Att. U § 6, pp. 10-11. He stated: “[I]n the case of forest companies, the government is sending a clear message to the heads of these companies: if they invest, they can eliminate their tax on capital for many years, not just on new investments, but on all their assets. . . . By making available the funds forest companies need to carry out their projects, the government is contributing to speeding a return to profitability” *Id.* at 11. In fact, in the 2006-2007 Minister of Finance’s Budget Plan, Québec stated the purpose as follows: “[T]he government is announcing a C\$925 million plan over four years to help improve the competitiveness of the *wood processing industry*” C-1, Att. U at § 6 (emphasis added).

136. None of the exceptions to the anti-circumvention provision applies. Several exceptions are inapplicable on their face. The program does not involve provincial timber pricing or forest management; environmental management, protection, or conservation; or

providing a payment to First Nations. *See* SLA, art. XVII, ¶¶ 2(a), (c), (d). Nor does it fall within the remaining exceptions because it was enacted after the July 1, 2006 cutoff date and is specific to the forest products industry. *Id.* ¶¶ 2(b), (e).

137. In order to be implemented, new tax credits require amendments to the Taxation Act. C-1 at 34. The amendments relevant to the 15 percent tax credit appeared in Bill 41, which was introduced on November 8, 2006. *Id.* (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 premier *proposed* the credit in March 2006 is immaterial. The tax credit could not have been in existence or have been administered until it was legally authorized in December 2006. *Id.*

138. Nor does the tax credit program (prior to November 23, 2007) satisfy exception (e), which applies to “measures that are not specific to the forest products industry.” SLA, art. XVII, ¶ 2(e). The 15 percent tax credit program is specific to the forest industry. C-1 at 33-34 (citing Att. § U 6, p. 5, Att. AR at QC003700, QC003444, QC003501). In announcing the program in March 2006, the Minister of Finance indicated that only “[f]orest sector investments” would be eligible for the 15 percent capital tax credit. C-1 at 33 (citing Att. AR at QC003700).

3. Canada Must Counteract The Effects Of The Breach

139. Québec’s capital tax credit is a breach of the SLA. To remedy the breach, Canada must, first, cease administration of the credit, including taking any remaining official actions both at the federal and provincial levels. Additionally, Canada must remedy the effects of the breach. If Canada fails to cure the breach within the reasonable period of time determined by the Tribunal, the remedy must take the form of compensatory adjustments to the export measures, which the Tribunal will determine in its award.

140. To aid the Tribunal in determining appropriate compensatory adjustments to remedy the effect of the program, we propose two remedies in section IV.

141. With respect to the first remedy, Mr. Beck has determined that the program resulted in benefits to softwood lumber companies in the amount of C\$3,744,281. *See* C-1 at 38. Appropriate adjustments to export measures to compensate for Canada's breach should account for these benefits.

142. The second remedy, proposed by Professor Topel, targets the effect of Québec's program on both capital formation and the marginal costs of Québec lumber production, as well as the subsequent effect on market prices. This second remedy considers the grants and investments made to date as well as the on-going effects of those investments, and then imposes an export charge designed to return market prices to the level that would have occurred in the absence of the program.

IV. Proposed Remedies For Canada's Breach Of the SLA

143. As stated previously, if the Tribunal determines that Canada has breached the SLA, the parties have agreed under the SLA that the Tribunal in its award decision will

- (1) identify a reasonable period of time for the breaching party to cure its breach; and
- (2) determine appropriate compensatory adjustments to the export measures to be imposed if the breaching party fails to cure the breach within the reasonable period of time.

144. This section proposes two concepts of remedy to aid the Tribunal in determining appropriate compensatory adjustments to the export measures if Canada fails to cure its breach. First, we propose a straightforward remedy tied to the amount of the benefits conferred by Ontario and Quebec under the breaching programs. Second, we propose a more complex remedy designed by economist Robert H. Topel to counteract the effects of the breaching programs on market prices.

A. Remedy I: A Straightforward Means To Compensate For Canada's Breach

145. The first concept of remedy is based upon the imposition of an additional export charge on Ontario and Québec softwood lumber exports to compensate for the tax credits, grants, and other benefits provided to softwood lumber producers in breach of the SLA. As described previously in the sections of our brief discussing the programs, Mr. Beck has evaluated and

quantified the results of the Ontario and Québec programs in his expert report. The results from Mr. Beck's expert report are summarized in the table below.

Summary of Benefits of Breaching Programs to Softwood Lumber Producing Companies

Program	High Case Estimate of Results/Benefits (C\$)	Low Case Estimate of Results/Benefits (C\$)
Ontario FSPF and FSLGP (Combined)	\$639.3 million (through FY 2008/09 and using total investments; C-1, Table 31)	\$56.4 million (only through 8/13/08 and using only grants and guarantees; C-1, Table 30)
Ontario Road Building Program	\$105.0 million (net benefit through FY 2008/09; C-1, Table 31)	\$67.3 million (net benefit only through FY 2007/08; C-1, Table 30)
TOTAL ONTARIO	\$744.3 million	\$123.7 million
Québec Capital Tax Credit	\$3.7 million (C-1, Table 13)	\$3.7 million (C-1, Table 13)
Québec Forest Management Measures	\$345.6 million (using estimates through FY 2009; C-1, Table 24)	\$92.6 million (using only Quebec documents; C-1, Table 25)
Québec Forest Industry Support Program (PSIF)	\$766.8 million (using total investment value through FY 2008/09; C-1, Table 22)	\$191.7 million (using only Loan Envelope value through FY 2008/09; C-1, Table 22)
TOTAL QUEBEC	\$1.116 billion	\$288.0 million
TOTAL ONTARIO + QUEBEC	\$1.860 billion	\$411.7 million

146. Considering the consequences of Canada's breach, we respectfully request that the Tribunal determine that an appropriate remedy consists of imposing an additional export charge that will result in collecting at least C\$123.7 million on Ontario softwood lumber exports and an additional export charge that will result in collecting at least C\$288.0 million on Québec softwood lumber exports.

147. The Tribunal should also determine the rate at which this additional export charge is to be collected on softwood lumber exports from Ontario and Québec. That is, the Tribunal should determine an amount per export volume unit (most likely MBF) at which the additional export charges are to be collected over a reasonable period of time designed to collect the full amount, recognizing that if export volumes exceed expectations, the full amount may be collected sooner, and if export volumes are less than expected, collecting the full amount may take longer.

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

149. This remedy assumes 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 cease administering the breaching programs at that time, 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 24-25, 30-31.

B. Remedy II: An Economics-Based Means To Compensate For The Breach

150. We also propose a second conceptual framework for a remedy based upon the work of Professor Topel. Professor Topel is a renowned economist from the University of Chicago School of Business. He has held positions in both teaching and research over the course of the past 28 years, and has published numerous articles in the academic literature. C-2 at 3-4.

151. Professor Topel has determined that the challenged programs constitute "economic subsidies" to lumber companies' investment in new capital, "economic subsidies"

that have the effect of increasing investment and lowering the costs of lumber production in Ontario and Québec. C-2 at 5. This reduction in production costs occurs both now and in the future for as long as the useful life of the new capital. *Id.* at 4-5.

152. Professor Topel has also concluded that the challenged programs have affected Canadian and United States lumber producers. *Id.* at 4-5. As a result of the increased investment, Canadian producers in Ontario and Québec enjoy lower marginal costs of production both now and in the future; simultaneously, United States producers suffer losses due to the lower prices that have already occurred as well as the continuous losses caused by lower future prices. *Id.*

153. Therefore, Professor Topel's concept of remedy targets the effect of the programs on both capital formation and the marginal costs of lumber production, as well as the subsequent effect on market prices. *Id.* at 20. This second remedy considers the grants and investments made to date as well as the on-going effects of those investments and, then, imposes an export charge designed to return market prices to the level that would have occurred in the absence of the breaching program. *Id.*

154. Professor Topel calculates the current and future increase in total investment and capital stock made possible by the programs, then uses these results to estimate the current and future costs of production and market prices. *Id.* at 21-22. Professor Topel, then, calculates the effect of the program on capital formation in Ontario and Québec and the implied effect on market prices. *Id.* at 23-24. Finally, he proposes a remedy consisting of an additional export charge designed to correct market prices for the breach. *Id.* at 25-31.

155. Although the effects of investment subsidy programs are less direct than simple government payments to softwood lumber producers, such programs are equally effective in artificially reducing the costs of production to lumber producers. *Id.* at 21. Programs such as

those in Ontario and Québec increase investment in new capital, artificially raise the capital stock in the provinces, and reduce current and future prices over the life of the assets. This reduction in costs directly affects market prices. *Id.*

156. To estimate the effects of the breaching programs, Professor Topel calibrates a market equilibrium model of investment in the softwood lumber industry. *Id.* at 21-22. His model draws its parameters from published empirical research on the Canadian and United States markets, and accounts for the dynamic effects of future market outcomes. *Id.* Professor Topel is then able to calculate the effects of the challenged programs on lumber prices in the United States and the overall costs to United States producers. *Id.* at 23-24.

157. Professor Topel proposes remedies consisting of additional export charges to counteract the lost U.S. producer surplus and the reduced market prices caused by the challenged programs. He states that the impact of the breaching programs – reduced market prices for softwood lumber – can be remedied by assessing appropriately designed taxes on Canadian producers. *Id.* at 25-26.

158. Ideally (from an economic perspective), the additional export charge would be assessed on (1) all production from Ontario and Québec, not only exports to the United States; or (2) all exports from Canada, not only exports from Ontario and Québec. *Id.* at 27-28. However, the SLA calls upon the Tribunal to award adjustments to the export measures, which necessarily are applied only to exports. The SLA further provides that in the case of a breach attributable to a particular region, the Tribunal determines the compensatory adjustments to that region.

159. Therefore, Professor Topel has proposed a remedy that targets only exports to the United States from Ontario and Québec. These remedies are presented as a percentage of the export price. For example, during the first year of the remedy period, the additional tax on

Ontario and Quebec exports is 2.1462 percent (assuming Canada ceases administering the programs), or 3.6567 percent (if Canada does not). *Id.* at Ex. 7.

160. Professor Topel notes that while appropriate export charges can restore lumber prices to their “but-for levels,” the export charges would not fully offset the past loss to U.S. producers. *Id.* at 26. He estimates that this lost producer surplus will total approximately C\$110 million as of the end of 2009. *Id.* at 26, 30. Accordingly, if the Tribunal determines that this second remedy is appropriate, it should also determine appropriate additional adjustments to export measures to collect this additional amount from Ontario and Quebec.

V. Conclusion

161. 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.

162. If the Tribunal finds 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 breaches and respectfully requests that the Tribunal also identify appropriate compensatory adjustments to the export measures that remedy Canada’s breach.

163. With respect to the cure period, the United States has no objection to the Tribunal determining that 30 days would be a reasonable period of time for Canada to cure the breach.

164. 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\$123.7 million on Ontario softwood lumber exports and at least C\$288.0 million on Quebec softwood lumber

exports; the Tribunal determine a rate at which the additional export charge is to be collected; and the Tribunal determine further adjustments to export measures should Canada not cease administering the programs the Tribunal finds to have breached the SLA (REMEDY I); or

b. The Tribunal determine that appropriate adjustments to export measures consist of imposing additional export charges on Canadian softwood lumber exports, in accordance with the remedies proposed by Professor Topel; and the Tribunal determine that appropriate adjustments to export measures also include additional export charges required to collect the lost U.S. producer surplus as calculated by Professor Topel (REMEDY II).

Respectfully submitted,

GREGORY G. KATSAS
Assistant Attorney General.

Jeanne E. Davidson
by Reginald T. Blades, Jr.
JEANNE E. DAVIDSON
Director

OF COUNSEL:

WARREN H. MARUYAMA
General Counsel
United States Trade Representative
600 17th Street, N.W.
Washington, D.C. 20508
UNITED STATES

JOAN E. DONOGHUE
Principal Deputy Legal Adviser
United States Department of State
2201 C Street, N.W.
Washington, D.C. 20520
UNITED STATES

Reginald T. Blades, Jr.
REGINALD T. BLADES, JR.
PATRICIA M. MCCARTHY
Assistant Directors
CLAUDIA BURKE
Senior Trial Counsel
MAAME A.F. EWUSI-MENSAH
GREGG M. SCHWIND
DAVID SILVERBRAND
ANTONIA R. SOARES
STEPHEN C. TOSINI
Trial Attorneys
United States Department of Justice
Commercial Litigation Branch
Civil Division
1100 L Street, N.W.
Washington, D.C. 20530
UNITED STATES
Tel: +1 (202) 514-7300
Fax: +1 (202) 514-7969
national.courts@usdoj.gov;

23

December ~~23~~ 2008

Attorneys for Claimant,
The United States of America

CERTIFICATE OF SERVICE

I certify that I caused to be sent, by overnight courier, discs containing this United States Second Corrected Statement of the Case (Non-Confidential), as well as paper copies, to the members of the Tribunal, and to the legal representative of Canada on December 23, 2008.

A handwritten signature in black ink, appearing to read "G. M. Schwind", written over a horizontal line.

GREGG M. SCHWIND