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U.S. Responds to Canadian Failure to Cure Breach of the Softwood Lumber Agreement

WASHINGTON, D.C. – United States Trade Representative Ronald Kirk expressed disappointment today with Canada’s failure to cure its breach of the 2006 Softwood Lumber Agreement between the United States and Canada (SLA) and Canada’s decision to pursue further arbitration proceedings.

On February 26, 2009, a tribunal operating under the auspices of the LCIA (formerly the London Court of International Arbitration) issued its decision on a remedy in the softwood lumber arbitration in which Canada was found to have breached the SLA by failing to calculate quotas properly during the first six months of 2007. In that decision, the tribunal determined that Canada must cure the breach by March 28, 2009.

“Canada’s claim that it has complied with the arbitration tribunal’s decision regarding Canada’s obligations under the SLA is unfounded,” said Ambassador Kirk. “Canada’s offer to pay the United States Government US \$36.66 million does not cure the breach identified by the tribunal, and we are now reviewing our options and will decide soon on an appropriate response.”

The tribunal determined that, as an appropriate adjustment to compensate for the breach, Canada must collect an additional 10 percent *ad valorem* export charge on softwood lumber shipments from Eastern Canadian provinces until CDN \$68.26 million has been collected. (Based on the exchange rate at the time of the award, the U.S. dollar equivalent is \$54.8 million).

The SLA provides that if Canada fails to cure its breach within the time prescribed by the tribunal and does not make the compensatory adjustments determined by the tribunal, the United States may impose customs duties in an amount not to exceed the additional export charges that the tribunal has specified as compensation for the breach. The United States is now reviewing the options available and will make a decision shortly on an appropriate course of action.

On April 2, 2009, Canada requested that the LCIA tribunal determine whether Canada has cured its breach of the SLA. The United States is reviewing Canada’s request for arbitration and will respond at the appropriate time.

Background

Under the SLA, Canada agreed to impose export measures on Canadian exports of softwood lumber products to the United States. When the prevailing monthly price of lumber, determined per the Agreement, is above US\$355 per thousand board feet (MBF), Canadian lumber exports are unrestricted. When prices are at or below US\$355 per MBF, each Canadian exporting region has chosen to be subject to either an export tax with a soft volume cap or a lower export tax with a hard volume cap. The measures become more stringent as the market price of lumber declines. This month, the prevailing monthly price of lumber is US\$195 per MBF. Therefore, the Western Canadian provinces (referred to in the SLA as Option A Regions (including British Columbia and Alberta)) are subject to the maximum export charge of 15 percent and the Eastern provinces (referred to in the SLA as Option B Regions (including Ontario, Quebec, Manitoba, and Saskatchewan)) face the most stringent volume restraints provided under the Agreement in addition to an export charge of 5 percent (the maximum possible for those provinces).

The SLA includes an adjustment mechanism to ensure that the export volume caps are calculated appropriately under rapidly changing market conditions. The tribunal decided in March 2008 that Canada breached the SLA by failing to make downward adjustments for the Eastern provinces during the first half of 2007. Canada's failure to make the downward adjustments resulted in greater levels of shipments from Canada than were allowed under the Agreement, which exacerbated already difficult market conditions. In its decision, the tribunal agreed with the United States that, because Canada failed to make the required downward adjustments in the first half of 2007, Canada must provide a compensatory remedy in order to cure the breach. The tribunal rejected Canada's argument that it cured the breach simply by virtue of making the adjustment beginning in July 2007. The tribunal ordered Canada to cure its breach within 30 days, the maximum period permitted under the SLA, and suggested that one way to cure would be to begin applying the additional 10 percent *ad valorem* export charge during the 30 day period.

Under the SLA, if Canada fails to cure its breach in 30 days, Canada must make compensatory adjustments to the export measures, as determined by the tribunal. Specifically, the tribunal determined that Canada must collect an additional 10 percent *ad valorem* export charge on softwood lumber shipments from Eastern Canadian provinces until CDN \$68.26 million (US \$54.8 million at current exchange rates) has been collected. Under the SLA, if Canada fails to cure the breach and does not adjust the export measures, the United States is authorized to impose duties in an amount not to exceed the additional export charges that the tribunal has specified as compensation for the breach.

Canada's request for arbitration, dated April 2, 2009, states that it was filed pursuant to Article XIV, paragraph 29(c) of the SLA. Under this provision, if, after the expiration of the reasonable period of time to cure the breach, the party complained against considers that it has cured the breach, in whole or in part, such that the compensatory adjustments or measures should be modified or terminated, and the complaining party does not agree, then the party may commence a new arbitration to address the matter. The SLA provides that the LCIA shall appoint to the tribunal the same arbitrators comprising the original tribunal, to the extent they are available,

within 10 days after the request for arbitration is submitted. The SLA calls upon the tribunal to endeavor to issue its decision within 60 days after the submission of the request for arbitration.

The SLA entered into force on October 12, 2006, and is expected to remain in force for seven years, with the possibility of extension for an additional two years. The SLA provides for binding arbitration to resolve disputes between the United States and Canada regarding interpretation and implementation of the Agreement. Under the SLA, arbitration is conducted under the rules of the LCIA, and there is no appeal from the decision of the tribunal.

On January 18, 2008, the United States requested, through the Department of Justice, a second arbitration on a separate issue. Under the SLA, the United States and Canada committed not to take action to circumvent the commitments made in the Agreement. The SLA expressly states that providing certain grants or other benefits to Canadian softwood lumber producers circumvents the Agreement. Quebec and Ontario have put in place several assistance programs that provide grants or other benefits to softwood lumber producers that violate the SLA's anti-circumvention provisions. These include a number of grant, loan, loan guarantee, and tax credit programs, as well as so-called "forest management" programs and programs that promote wood production. A decision is expected in the second arbitration later in 2009.

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