IN THE MATTER OF AN ARBITRATION UNDER CHAPTER ELEVEN OF THE *NORTH AMERICAN FREE TRADE AGREEMENT*

BETWEEN:

POPE & TALBOT, INC.

Claimant/Investor

and

THE GOVERNMENT OF CANADA

Respondent/Party

GOVERNMENT OF CANADA

CANADA'S REPLY TO INVESTOR'S POST-HEARING SUBMISSION

(Damages Phase)

December 21, 2001

Department of Foreign Affairs
and International Trade
Trade Law Bureau/JLT
Lester B. Pearson Building
125 Sussex Drive
Ottawa, Ontario
K1A 0G2

Tel: (613) 944-3046
Fax: (613) 944-0027

Table of Contents

PART A: OVERVIEW

1. The Investor's post-hearing submissions, like its damages submissions and evidence, fail to address the evidence and argument of Canada in its submissions and at the damages hearing.

2. In particular, the Investor ignores the critical point in this damages phase: the Investment lost no sales and therefore lost no revenue. The claim for incremental revenue has no basis in fact or reality.

3. Similarly, the Investor bases its claim for out of pocket damages largely on assertions by Counsel with no evidentiary foundation and no causal link to the breach. At most, the evidence supports only $US 82,936[1] of this claim. The balance of the claim remains unproven.

PART B: APPROACH TO VALUATION

4. The Investor reaffirms its request that damages be calculated using a delay claim methodology. It is clearly not asking the Tribunal to apply a lost profits (or any other) approach to valuation.[2]

5. Only Mr. Rosen advocated the delay approach. Mr Harder replied to that approach, and explained the problems with it. Mr Harder did not endorse Mr Rosen's methodology; nor should this Tribunal.

6. The delay claim is based on incorrect assumptions that were disproved by the evidence led by the Investor.

7. The delay theory requires proof that the shutdown resulted in a delayed sale of lumber.[3] It did not. There is no evidence that any sale was delayed. There is also no evidence that the Investment lost even a single sale.

---

[1] Canada's Post-Hearing Submissions, Tab 3.
[2] Investor's Post-Hearing Submission, paras 7-11.
[3] Investor's Post-Hearing Submission, para. 5 incorrectly states there was a delay in manufacture and sales. The evidence never disclosed even a single delayed sale.

8. To the contrary, Mr. Friesen confirmed that no sale was lost or delayed. The Investment's operating statements reaffirm this, showing that the Investment made sales throughout the period. It is also clear that the Investment maintained sufficient inventory to service sales. The Investment did not lose or suffer a delay in a single sale as it shipped from inventory during the December 1999 shutdown.[4]

9. Contrary to the Investor's submission at paragraph 8 of its post-hearing submissions, the record is clear that Mr. Rosen did not refer to Random Lengths simply to indicate a trend. In fact, he used Random Lengths to calculate the increased revenue the Investor alleges would have been earned but for the shutdown. As noted above, the company did not forego any revenue due to the shut down and hence the rest of the loss analysis is academic.

10. Even if one adopted the Investor's approach, the use of Random Lengths does not measure the actual impact of a delay in sales on the Investment. The Investment consistently realized higher prices than Random Lengths. Using the Investment's realized prices results in a more accurate quantification of the loss that might have accrued had there in fact been a lost sale.

11. Moreover, in February 2000, March 2000, May 2001 and June 2001, Random Lengths prices were equal to or greater than those in effect in December 1999 and January 2000. This means that even if Random Lengths prices are used in a loss analysis as Mr. Rosen did, the Investment did not suffer a revenue loss. The Investment should have

[4] Friesen Testimony, p. 107, Exhibits DC-4 and DC-5. Note also that at the end of December 1999 the Investment had approximately 32 million bf of lumber inventory. Between December 1999 and June 2001 the Investment's month end inventory volume did not decrease below 32 million bf. In March 2000, the investment increased its month end inventory volume to 52 million bf, and increase of 20 million bf from December 1999. In March 2001, the investment increased its month end inventory volume to 58 million bf, and increase of 26 million bf from December 1999. This trend in inventory volumes shows that at no time during the period did the Investment have insufficient inventory to meet sales demand.

been able to sell its allegedly delayed production for the same amount it otherwise could have in December 1999 and January 2000.

12. The evidence is clear that the Investor was able to sell the delayed production of approximately 14 million bf at a later date for a price that was equal to or greater than that which it would have received had the alleged delay not occurred.

13. If the delay claim is measured using the Investment's realized prices, as Mr. Harder did, the Investment did not suffer a loss. This is because subsequent to December 1999 the Investment realized selling prices which were equal to, or greater than those which it could have realized in January 2000 if the alleged delay had not occurred. The Investment's average realized price for the month of March 2000 was only US$ 1 per mbf less than the realized price it would have realized in January 2000 but for the alleged delay. In May 2001, the Investment's average realized price per mbf exceeded the January 2000 price it would have realized but for the delay.

14. Canada agrees with the Investor that the hotel room analogy is not applicable in this situation. For this analogy to be useful, one would need to prove that there were customers who would have rented the room, and therefore there was a lost sale and lost revenue. If the room would have been empty in any event, no loss occurred. In this case, the Investment is in the same situation as the hotel keeper who had no-one to rent the empty rooms - there is no loss.

15. Further, the hotel keeper differs from the lumber manufacturer because the hotel keeper cannot store rooms in inventory or draw from inventory to satisfy sales demand during a shutdown. Lumber is not a time-limited good although hotel rooms are.

16. As we know from the evidence, the Investment had inventory and completed every available sale by shipping from inventory or production. Given the evidence concerning the Investment's inventory levels, consumer demand and the strictures of the SLA, it is clear that the Investment sold everything it could sell economically. There were no unsatisfied orders or delayed deliveries.

PART C: INVENTORY AND EXCESS CAPACITY

17. Canada's position on the capacity of the Investment to draw from inventory or to use excess production capacity are fully set out in its post-hearing damages submission.

18. The submissions regarding inventory are not simply mitigation points. Rather, they show that there was no lost or delayed sale and no lost or delayed revenue because the Investment continued to ship from inventory during the shutdown. The evidence demonstrates that the Investment had inventory to draw from and did so.

19. The delay in production allowed the Investment to draw down inventory. If anything, this benefited the Investment, as it enabled the Investment to reduce carrying costs, without losing sales.

20. Nor is there any question of depleting inventory. To the contrary, the Investment's inventory levels returned to pre-December 1999 levels in just one month. Additionally, the Investor shut down its plants 5 times between March 2000 and March 2001, including a shutdown in March 2000 specifically to reduce inventory levels.[5] At no time during the period between December 1999 and March 2001 or June 2001 did the Investment's inventory decline below 14 million bf.

[5] Canada's Damages Counter-Memorial, Tab 17 and DC-4 & DC-5.

21. Canada also submits that the Investment's excess production capacity enabled it to make up any lost production. It is inconceivable that the Investment would have taken shutdowns after December 1999 if it did not have sufficient capacity to meet demand and make up any alleged delayed sales. Even with all of the shutdowns, the Investment was able to build its inventory to in excess of [redacted] in March 2000 and to [redacted] in March 2001. Contrary to the Investor's arguments, these facts show that the Investment had sufficient excess capacity to make up the delayed production of [redacted] at any time during the period January 1999 to June 2001.

PART D: CUT OFF DATE

22. The Investor's position on a cut off date is difficult to understand. In paragraph 11 it states "This delay continues to this day". This is similar to the point made by Canada. In theory, a delay claim could continue indefinitely into the future. However, in this case the delay does not continue to this day because the Investment was able to sell its lumber production at the same or at a greater price than it would have realized had the alleged delay not occurred.[6]

23. The point to note is that when one applies the delay approach to this claim, there is no lost revenue after May or June 2001. This is because the Investment either mitigated, or should have mitigated by selling the delayed production at prices equal to or better than the prices it would have received for such production in December 1999 and January 2000. As Canada demonstrated through the evidence of Mr. Harder and in its post-hearing submission, prices for the Investment's lumber in May and June 2001 were equal or better than prevailing prices in December 1999 and January 2000.

---

[6] Contrary to what the Investor suggests, there is no speculation necessary about the impact of the end of the Export Control Regime ("ECR") on the prices the Investment received for lumber. The Investment's financial statements show the sales prices which it received for lumber from December 1999 to June 2001.

24. Even if the Investor asserts correctly that the delay claim theoretically could continue indefinitely, it contradicts itself in paragraph 11 by urging the Tribunal to cut off the loss analysis at March 31, 2001 because the SLA ended.[7]

25. As Canada explained in its post-hearing submission, the cut off date of March 31, 2001 ignores the reality that the Investment continued to produce lumber and sell in a market that was no longer affected by the SLA. It is a totally artificial cut off date. There is no practical, logical or legal argument that would justify the alleged delay analysis ending on March 31, 2001. The Investor argues for cutting off the sales price analysis at the end of the ECR because to do so artificially creates an incremental loss for the Investment.

PART E: OUT OF POCKET CLAIM

26. The Investor makes no additional submissions concerning out of pocket claims. Canada's position is clear – these damages are largely unproven and should be rejected by the Tribunal without clear evidence of the quantum of damages incurred by reason of the verification review episode.

PART F: NOTES OF INTERPRETATION AND ARTICLE 1105

27. Canada's position on the effect of the Notes of Interpretation has been fully canvassed in previous submissions. In summary, there is no question of the Notes being retroactive. The Notes form part of the governing law for NAFTA Chapter 11 tribunals. They should be applied in this case as the Tribunal is acting prospectively under Article 1116 (or 1117) and must be satisfied that a breach of Article 1105 remains with respect to which damages can be awarded.

28. In paragraph 28, the Investor asks the Tribunal to complete its analysis of Article 1102, including the verification review episode. Canada submits

[7] Investor's Post-Hearing Submissions, para 16.

that there is no basis upon which to reopen consideration of the verification review and its compliance with Article 1102. This was never pleaded by the Investor, was not addressed at the hearing and is not the subject of a Note of Interpretation.

29. Consistent with its procedural order of October 29, 1999, the Tribunal rendered its decision on liability and has embarked upon the damage determination. There is no basis to return to the Article 1102 analysis.

PART G: CONCLUSION

30. The Investor has not proved any incremental loss of revenue. At most, the evidence supports only U.S. $82,936 in out of pocket expenses. An award of damages in excess of this amount is not warranted in this case.

ALL OF WHICH IS RESPECTFULLY SUBMITTED

Dated at the City of Ottawa, the Province of Ontario, this 21st day of December, 2001

Meg Kinnear

Brian Evernden