Information Bulletin

NUMBER 103 • JUNE 2007

A CN CANADA – U.S. TRADE RELATIONS FORUM
APRIL 11, 2007
UNIVERSITY OF ALBERTA, EDMONTON

THE CANADA – U.S. SOFTWOOD LUMBER AGREEMENT OF 2006: THE EXPERIENCE OF THE WESTERN CANADIAN INDUSTRY UNDER THE SOFTWOOD LUMBER AGREEMENT OF 2006

Western Centre for Economic Research
School of Business, University of Alberta

Edited by Helmut Mach and Williams J. Shaw

The Western Centre for Economic Research gratefully acknowledges the support of CN and Alberta Sustainable Resource Development.

Western Centre for Economic Research
University of Alberta
Edmonton, Alberta
www.bus.ualberta.ca/wcer

with support from: The George M. Cormie Endowment

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Library and Archives Canada Cataloguing in Publication

CN Canada - US Trade Relations Forum (2007 : University of Alberta)
The Canada-US Softwood Lumber Argreement of 2006 : the experience of the Western Canadian industry under the Softwood Lumber Agreement of 2006.

(Information bulletin ; no. 103)
ISBN 978-1-55195-952-8

1. Softwood industry--Government policy--Canada. 2. Softwood industry--Government policy--United States. 3. Softwood industry--Canada. 4. Softwood industry--United States. I. University of Alberta. Western Centre for Economic Research II. Title. III. Series: Information bulletin (University of Alberta. Western Centre for Economic Research) ; no. 103
HF2651.S64C6 2007 382'.456741440971 C2007-903495-0

Proceedings: A CN Canada – U.S. Trade Relations Forum
April 11, 2007
University of Alberta, Edmonton

The Canada – U.S. Softwood Lumber Agreement of 2006: The Experience of the Western Canadian Industry Under the Softwood Lumber Agreement of 2006

Introduction

Helmut Mach, Western Centre for Economic Research
Director and CN Executive Professor for Canada US Trade Relations, University of Alberta

On April 11, 2007, the Western Centre for Economic Research organized and hosted a CN Canada-U.S. Trade Forum on the Canada-U.S. Softwood Lumber Agreement of 2006 at the School of Business, University of Alberta, Edmonton. The Forum brought together former Canadian and U.S. federal government softwood lumber negotiators, representatives of the Western Canadian softwood lumber industry, provincial government representatives, industry representatives, academics and students to review the experience of the Western Canadian softwood lumber industry after the first six months of operation and implementation of the Canada-U.S. Softwood Lumber Agreement, which came into force on October 11, 2006.

The Forum reviewed the SLA, its background and context, its negotiation, implementation and operation. Panellists brought their perspectives and views of its advantages and disadvantages. Discussion with the audience participants delivered further insights and information on company specific experiences.

It is hoped that the staging of this forum, the publication of the Proceedings, and the preparation of Conclusions and Recommendations, will assist government and industry policy makers and negotiators in the future operation, and potential modification of the Agreement.

The proceedings of the Forum are compiled here. The Conclusions and Recommendations have been formulated by and are the sole responsibility of the Western Centre for Economic Research.

Conclusions and Recommendations

Helmut Mach, Western Centre for Economic Research

The Canada – U. S. Softwood Lumber Agreement of 2006 is the latest in a series of measures that have affected softwood lumber trade between Canada and the United States over the last 25 years. Since 1982 there have been four countervailing duty actions alleging subsidization by Canadian governments of Canadian softwood lumber production. There has been one antidumping trade action as well. Intervening the trade actions was the 1986 Canada – U.S. Softwood Lumber MOU which lasted for five years and involved a 15% export tax. In the early 1990s, Canada and the United States established a Softwood Lumber Consultative Mechanism to provide a forum for bilateral, joint industry and government discussion. This evolved into formal negotiations for the Canada - U.S. Softwood Lumber Agreement of 1996 which included quota restrictions and fees and lasted until 2001. The current Canada – U. S. Softwood Lumber Agreement of 2006, the third in this 10-year litigation–managed trade agreement cycle, has now been in effect for some six months. It seemed an appropriate time to consider the operation of the Agreement, how it has been implemented, how the industry has reacted and coped, and what, if any, views were held by the industry regarding concerns, desired modifications and, ultimately, its future. Through the course of this forum we have heard a number of outstanding panellists, including former Canadian and U.S. federal government negotiators, industry leaders, and commentators. They brought a wealth of expertise and experience in the softwood lumber dispute between Canada and the United States and they offered exceptional insights and suggestions related to the Agreement. In considering the presentations and discussion, a number of conclusions and recommendations are offered for governmental and industry consideration:

1. The Canada – U. S. Softwood Lumber Agreement of 2006 is not a durable or long-term solution for Canadian and U.S. disputes over trade in softwood lumber.

2. Failing a major market change that would see sustained lumber prices recover to levels above US $355 per thousand board feet, it is very likely that the current Softwood Lumber Agreement will be terminated before its anticipated expiry date. This will be a result of either:

   a. industry inability to cope with punitive, retroactive application of export taxes resulting from volumes of exports exceeding surge limits and thus triggering extra export taxes; or,

   b. disputes involving challenges to provincial government forest management policies changes, with U. S. allegations of governmental subsidization serving to offset the effect of export taxes.

3. Early termination of the Agreement could be avoided if the United States is serious about its commitments stated in the letter from United States Trade Representative, Susan Schwab, dated September 12, 2006, which commits the United States to "an early discussion ... to facilitate the orderly operation of the agreement and ensure that it functions in a commercially viable manner." Ensuring that the agreement functions in a commercially viable manner would require modifications to some of the most troublesome aspects of the agreement including:

a. The elimination up the retroactive application of the export tax surcharges applied when exports exceed the surge limits. The Western Canadian industry cannot operate in a commercially viable manner if export taxes payable can be adjusted by as much as 50% retroactively for the entire month in which the sales took place. Monitoring the surge limits has forced companies to focus on monthly export levels rather than on medium and long-term company developments and improvements in productivity, developmental strategies, and enhanced competitiveness. Even then, monitoring by an individual company to control its own export levels might be meaningless as the actions of other companies could place the entire industry in a province in a punitive retroactive export tax situation.

b. The modification of the base period for calculation of exports from Alberta as the existing base period puts the province at a relative disadvantage. The Agreement did not sufficiently recognize that Alberta was just entering the phase of mountain pine beetle infestation and that increased harvest and production levels would be required to deal with the beetle damaged trees. The harvest and export levels of Alberta industry coping with the pine beetle infestation would probably result in Alberta always being at the level of exceeding its surge limits and thus always under a punitive retroactive export tax situation. This would make the Alberta industry commercially unviable.

4. Enhanced governmental -- industry collaboration is required if there is to be any prospect for the continued operation of the Agreement in a commercially viable manner. Industry requires a greater level of commitment on the part of governments. The government must:

a. work in the interests of the Canadian industry;

b. devote sufficient resources to the operation, administration and implementation of the Agreement;

c. provide all required information on a timely basis; and

d. engage the industry more fully in discussions of management and strategy related to actions associated with the Agreement.

It is essential that the federal government acts in a fashion that will instill a sense of confidence that it is working with, and on behalf of, the Canadian softwood lumber industry.

5. In anticipation of possible early termination of the Agreement, provincial governments should be preparing for a potential new trade dispute based upon allegations of subsidization of the industry through provincial forest practices. This means that provincial governments should consider and evaluate potential changes to, and implementation of, forest management practices in the context of the SLA and future trade disputes.

6. In anticipation of possible early termination of the Agreement, industry should be preparing for potential new trade disputes including allegations of dumping. Industry should be reviewing and, where necessary, ensuring that their sales practices provide the best possible defence against allegations of dumping practices.

7. The SLA provides the first opportunity for termination some 24 months after the entry into force of the agreement. Governments and industry should ensure that there is extensive dialogue and collaboration prior to that date, reviewing what, if any, changes have occurred to ensure the commercial viability of the Canadian industry under the agreement and to consider Canada's options.

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www.business.ualberta.ca/wcer

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The Canada – U.S. Softwood Lumber Agreement of 2006: The Experience of the Western Canadian Industry Under the Softwood Lumber Agreement of 2006

Opening Remarks

Helmut Mach, Western Centre for Economic Research
Director and CN Executive Professor for Canada US Trade Relations, University of Alberta

Good morning, and welcome to the CN Canada – U.S. Trade Relations Forum on the Canada – U.S. Softwood Lumber Agreement of 2006.

The Softwood Lumber Agreement of 2006 (SLA) is the latest in a series of measures that have affected softwood lumber trade between Canada and the United States over the last 25 years. Since 1982 there have been four countervailing duty actions alleging subsidization by Canadian governments of softwood lumber production. There has been one antidumping trade action as well. Intervening amongst the trade actions there has been the 1986 Canada U.S. Softwood Lumber MOU which lasted for five years and involved a 15% export tax. In the early 1990s, Canada and the United States established a Softwood Lumber Consultative Mechanism to provide a forum for bilateral joint industry and government discussion. This evolved into formal negotiations and led to the Softwood Lumber Agreement of 1996 which involved quota restrictions and fees. This agreement lasted until 2001. The current Softwood Lumber Agreement of 2006, the third in this 10-year cycle, has now been in effect for some six months. It seemed an appropriate time to consider the operation of the Agreement, how it has been implemented, how the industry has reacted and coped with it, and what, if any, views were amongst the industry regarding concerns, or desired modifications and, ultimately, its future. We have with us today a series of outstanding panellists, including former Canadian and U.S. federal government negotiators, industry leaders, and commentators with a wealth of expertise and experience in the softwood lumber dispute. I am sure they will provide exceptional insights and suggestions related to the Agreement.

At this time I would like to acknowledge the two main sponsors of this forum. First, CN Rail provides sponsorship to both the University of Alberta's School of Business and Faculty of Law, supporting professorships related to promotion of an understanding of Canada U.S. trade relations. Mr. Peter Marshall, Vice President of CN Rail, is here representing the company and will provide some comments.

Our second major sponsor it is the Alberta Ministry of Sustainable Resource Development. We are pleased to have the Honourable Ted Morton, Minister of Alberta Sustainable Resource Development, here to join us in this forum and provide remarks as well.

Honourable Ted Morton, Minister, Alberta Sustainable Resource Development

Good morning, thank you for inviting me to open your conference. I am pleased to be here, as much to listen as to frame the discussion that will follow my remarks. This is a very timely gathering as the Softwood Lumber Agreement is only six months old. The agreement brought a needed end to years of disagreement and litigation and brought a measure of predictability to lumber trade between Canada and the United States. But it is a mixed blessing, including here in Alberta. When I was named Minister of Sustainable Resource Development earlier this year, Alberta Premier Ed Stelmach handed me a list of priorities. One of the top items on that list is the mandate to implement an aggressive strategy to protect the health of Alberta's forests. To me, healthy forests include a healthy forest industry and healthy forest communities. The health of each of those three elements is debatable as I speak here today.

Meanwhile, our forest industry is facing tougher economic times due to a number of global market factors. Our forest communities face uncertainty due to the tougher economic climate for forest products, and the long-term uncertainty of pine beetle impacts on local industry. Alberta is taking aggressive action against the pine beetle, and in the process, working to build healthier forests for the future. We are working hard to identify and remove beetle-attacked trees in the province, and we are encouraging forest companies to change their harvesting plans to focus on at-risk and infested stands. We are also working with our forest products industry to address forestry competitiveness issues, to build a stronger forest industry and healthy forest communities.

Earlier this month, for example, Alberta updated the timber dues paid for softwood trees to better reflect industry's current market and financial conditions. To these forest health and industry health challenges, we add one more: ensuring that the actions we take fit the new context created by the SLA.

My hope for today's session is that your discussions will provide insights into how the SLA can help serve our need for forward-looking forest management decisions. I am very interested in the views of the main negotiators of that agreement, and the companies that are operating under its terms. I am especially interested in your opinions about how forest management in general, and mountain pine beetle response in particular, will be influenced by this new operating environment. The discussions today will lead to a report on the impact of the agreement and include recommendations to governments for ongoing management of softwood lumber trade between Canada and the United States. I look forward to both the report and recommendations, and commit to giving your views my full attention.

Alberta is committed to the SLA and will work with Canada, the U.S. and other provinces to ensure the agreement gives certainty to our industry with respect to open access to the U.S. market. Alberta will also work to ensure that, in dealing with our forest health challenges, we are transparent and will deal openly with the United States. Thank you.

Peter Marshall, CN
Senior Vice-President, Western Region

I am delighted to welcome delegates today to the Western Centre for Economic Research forum on the 2006 Canada – U.S. Softwood Lumber Agreement. Let me start by saying how pleased I am to see such a great turnout to the forum about this agreement between our two nations. I am especially pleased to see some of our major customers here today – we appreciate your business, and it is always a pleasure to be with you. CN in particular is pleased to sponsor this event. Our railway has been a major contributor to the study of Canada – U.S. trade relations, donating $1 million to the University of Alberta three years ago for that very purpose. And that is not surprising when you consider the importance of cross-border trade to CN. Fully 54% of CN's traffic moves across the international border. And a significant part of that traffic is made up of forest products. From lumber and panel board to pulp and paper, forest products account for more than a quarter (26%) of CN's revenue base.

Our recent expansions in British Columbia through the former BC Rail lines, and south through the former Illinois Central, have created a pipeline tailor-made for moving material from forest to market. For example, we can switch a 73-foot centrebeam lumber car from a mill in Prince George and deliver it 88 hours later to our reload facility in Chicago. Or, it will go further south to Memphis, for further transfer to builders in the key southern states. Those centrebeams, incidentally, are considered the Cadillac of the industry, and we have got more than 10,000 of them. It is especially rewarding to be a partner in the industry at this time, a time of both enormous challenges and opportunity. The softwood lumber business, like the trees it relies upon, is experiencing regrowth. How fast and how far it will grow will depend a lot on our two countries and our ability to maintain our trade relationship. So, on behalf of CN, I wish you a productive day and enlightening discussions on this issue of such great importance to our industry and our economy. Thank you.

Negotiators Panel

Helmut Mach, Western Centre for Economic Research

We will now turn to our first panel which will cover perspectives by former negotiators on this Softwood Lumber Agreement. Mr. Grant Aldonas and Mr. Doug Waddell were formerly the lead negotiators for their respective governments, the United States, and Canada, for the softwood lumber negotiations. Mr. Aldonas was Undersecretary of the U.S. Department of Commerce. Mr. Waddell was Assistant Deputy Minister, Trade Policy, of the Department of Foreign Affairs and International Trade Canada and Deputy Head of Mission of the Canadian Embassy in Washington, DC. They both led negotiating teams for their respective governments at times over the five-year negotiating history of the current agreement. To make it clear, however, neither were lead negotiators or employees of their respective governments during the final phase of the negotiations which produced the Agreement in 2006. Their history with the negotiating process will provide unique insights into the Agreement and I am sure their perspectives on the implementation and future of the agreement will prove most interesting.

Doug Waddell
Former Canadian Negotiator for the Softwood Lumber Dispute

I have been asked to set the stage for the discussion this morning by providing a brief overview of the Softwood Lumber Agreement 2006 (SLA). I have also been asked to provide a perspective on why the Agreement was concluded and to offer a view on its future.

The last 20-25 years of history, in my view, help to explain why the SLA was concluded and provide some insights into its future. This is the third agreement in 20 years. In 1986, Canada agreed to impose a 15% export tax on lumber exports to the United States. The federal government of the day imposed that agreement on the Canadian industry for two reasons: first, to remove a perceived impediment to U.S. Senate approval of fast-track trade negotiating authority for the negotiation of the Canada-United States Free Trade Agreement (CUFTA); and, second, to avoid the imposition of a countervailing duty on softwood lumber.

The 1986 agreement included a termination clause that was ultimately exercised for two reasons. First, Canadian governments found that the agreement's anti-circumvention provisions were unacceptably intrusive in the day-to-day business of managing the forest resource, and I think that is a reason to keep in mind as we look ahead in terms of the future of the current agreement. The second reason for exercising the termination clause in the 1986 agreement was the fact that the Canadian industry had opposed the agreement from the outset and maintained a sustained campaign to have it terminated.

There followed another countervailing duty investigation with the predictable affirmative findings of subsidy and injury. These determinations were successfully challenged by Canada using the now-in-place CUFTA Chapter 19 dispute settlement provisions. However, following the conclusion of that process in Canada's favour, the U.S. Government dragged its feet in meeting its obligation to refund $900 million

in duty deposits. So Canada again returned to the negotiating table and in 1996 agreed to impose a quota on exports of softwood lumber produced in British Columbia, Alberta, Ontario, and Quebec.

Again, there were, in my view, two principal reasons for concluding the 1996 agreement: first, to secure a refund of the $900 million in deposits; and, second, to avoid the initiation of another countervailing duty investigation. This was a five year agreement that survived the full term. It was supported by Canadian industry in 1996 but the quota allocation decisions were contentious and, by 2001, Canadian industry was opposed to any further extension of that agreement.

This brings us to the Softwood Lumber Agreement of 2006. The rationale for this agreement in 2006 was not, in my view, much different than it was in 1986 and 1996. From the perspective of the newly elected federal government, the SLA represented the resolution of a long-standing irritant in Canada-U.S. relations; a resolution that had eluded the previous government. By 2006, deposits had ballooned to more than US$5 billion. It was clear that even if Canada prevailed in the legal proceedings, the U.S. government would again refuse to refund those deposits unless ordered to by the U.S. courts. This would have posed a very difficult political problem for the Canadian government and would have called into question the value of Chapter 19 of the North American Free Trade Agreement (NAFTA).

A definitive outcome to the litigation was at least a couple of years away and the results could not be guaranteed. Moreover, even if Canada ultimately prevailed in the courts, the U.S. Coalition for Fair Lumber Imports (the U.S. Coalition) would still have the right under U.S. law to petition immediately for the initiation of yet another trade remedy investigation.

Settlement provided a degree of certainty for Canadian lumber producers and exporters by establishing an agreed upon border measure (rather than one that changed every few months as the result of whimsical administrative reviews from the commerce department). I will note here that the recent U.S. request for consultations concerning Canada's implementation of the SLA negates, in my view, some of the certainty that the agreement was intended to provide with respect to the border measure. The SLA also provided an assured refund of over 80% of the deposits for exports and a commitment of no new trade actions for the life of the agreement plus one year.

So, in summary, the reasons for concluding the 2006 SLA were not much different than those for previous agreements: broader Canada-U.S. relations considerations (as was the case in 1986); assuring refund of deposits which should have been automatic under the provisions of the NAFTA (as was the case in 1996); and avoiding imposition of countervailing duties and, in this case, anti-dumping duties (as was the case in 1986 and 1996).

Now, I will give just a brief overview of the 2006 SLA. The core of the agreement is a commitment by Canada to impose export taxes and quotas on exports to the United States if the prevailing monthly price of lumber as defined in the agreement is at or below US$355 per thousand board feet. Border penalties are suspended if the price of lumber is higher than US$355. The SLA provides for a choice between a straight export tax (Option A), which is the option selected by BC (both coast and interior) and Alberta; or a combination of export taxes at the lower level plus a quota (Option B), which is the option selected by Ontario, Quebec, Manitoba, and

Saskatchewan. Option A also incorporates a retroactive 50% increase in the tax in the applicable export tax for the month if in any month shipments exceed 110% of the base allocation for the region in question. With the current low prices for lumber, the most onerous penalties have been applied since the agreement was implemented last October.

Price/1000 board feet	Option A Export Charge	Option B Export Charge + Quota
Over US$355	0	0
US$336-355	5%	2.5%+regional share of 34% US consumption
US$316-335	10%	3%+regional share of 32% US consumption
US$315 & under	15%	5%+regional share of 30% US consumption

Option A: Export charge increased by 50% if shipments exceed 110% of base allocation

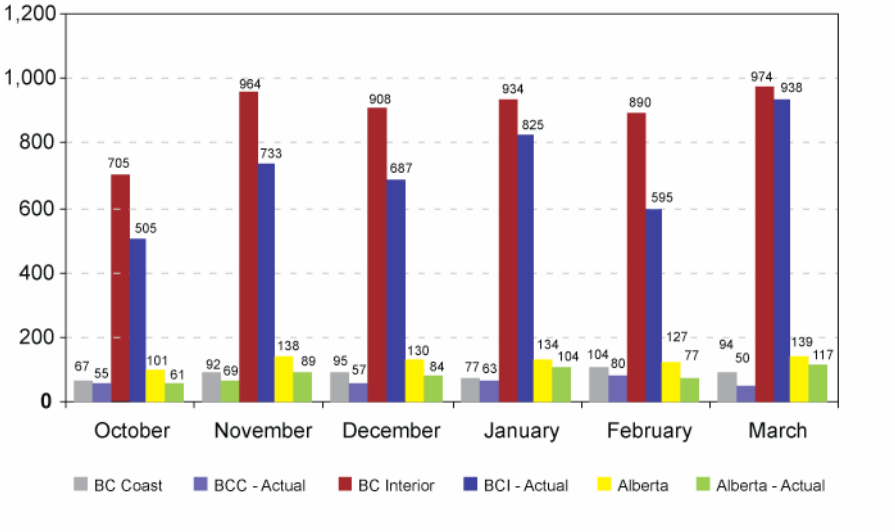
The total charges assessed on Alberta-origin lumber to the end of January 2007 were approximately $14 million, running at about $4 million per month (3.5 months). As you can see, the comparable figure for B.C. is $102 million and $133 million for Canada as a whole in the first 3.5 months the SLA was in place. The Federal Government collects that tax on behalf of the provinces and that tax will not be funded to the exporters of lumber.

Total Export Charge Assessed (to January 31)

Alberta	$14 million
BC Coast	$14 million
BC Interior	$88 million
Option B	$17 million
TOTAL	**$133 million**

This graph attempts to capture the state of play so far with respect to the provision of the SLA under Option A that relates to shipments within the 110% base period. As you can see, in February and March the shipments in the case of both B.C. and Alberta have just come in below the trigger level. In the case of March for B.C., the trigger volume was 974 and it came in at 938. Alberta's trigger was 139 and they came in at 117 for March.

October 2006 – March 2007
Option A Regions – Surge Trigger Volumes



The SLA also, as I mentioned, provided for refund of deposits. Deposits held by the U.S. Treasury at the time the agreement was implemented in October 2006 totalled approximately US$5.5 billion. Under the terms of the agreement, importers of record or Canadian exporters forfeited US$1 billion which was left in the U.S., the balance being refunded to Canadian companies. The SLA stipulated that of the US$1 billion, half would go to the U.S. Coalition (the source of the harassment under the remedy laws for the last 20-25 years), $450 million was designated for meritorious initiatives in the U.S., and $40 million was designated for initiatives of the bi-national industry counsel established under the agreement.

The SLA also provided for the revocation of the anti-dumping and countervailing duty orders as a precondition of implementation, and this did take place. Additionally, the agreement provided for the termination of the litigation. Although the parties envisaged termination of all litigation, as a precondition of the coming-into-force of the agreement, it became clear that some parties were not prepared to relinquish their legal cases. Therefore this provision was amended in October 2006 such that only a limited number of cases needed to be terminated to commit the agreement to come into force – so this is a work in progress. The U.S. government committed not to initiate any new investigations.

The SLA includes anti-circumvention provisions – both parties have agreed not to take action to circumvent obligations under the agreement. This will be a source of ongoing friction between the U.S. and Canadian governments, the parties to this agreement. The U.S. industry will be vigilant about changes by Canadian governments in policies and practices affecting the lumber sector to assess whether there is any basis for alleging the changes had the effect of offsetting the effect of the border measure.

Additionally, the SLA includes provisions for future exemptions from the export measures—I call this the "faint-hope clause"— exemptions based on agreed policy changes. The SLA commits the parties to make best efforts before April 2008 to

develop substantive criterion procedures for establishing if and when a region utilizes market-determined timber prices and management systems, therefore qualifying for an exemption from the border measures. Six months after implementation, substantive discussions have not yet been engaged – in my view, agreement is unlikely. There is also commitment by the parties to continue to pursue negotiations over the possible exemption from the border measures for lumber produced from timber harvested on private lands.

There are provisions in the SLA for cooperation and for dispute settlement – the parties have agreed to rely on non-North American commercial arbitrators to resolve disputes through a final and binding dispute settlement process.

The SLA is for seven years with an option to renew for two additional years. The SLA includes a termination clause: either party may at any time after April 2008 terminate by providing six months notice. The agreement does require a 12 month standstill on trade remedy action should either party terminate the agreement. In addition, there is a 12 month standstill on U.S. trade remedy action upon expiry of the SLA.

Turning to the road ahead, this agreement does not provide for a long-term, durable resolution of this decades-old dispute. There will be more disagreements. The March 30 request by the U.S. for consultations on a range of issues represents but the first volley. The anti-circumvention provisions protect the forest policy regimes in place as of July 2006, however any changes to the existing policy framework will be examined closely by the U.S. through the lens of whether they offset the stringent border measure.

Will the SLA operate full term? Canadian industry support for the agreement is lukewarm. There is room for better discussion by the Federal Government with industry on implementation issues. In my view, it is unlikely that the U.S. will exercise the termination provision. The SLA locks in a stringent border measure and the U.S. industry would be loath to give that away. Although the current Canadian Federal Government will not contemplate early termination, there will be advocates of early termination on the part of Canada. The reasons for dissatisfaction in Canada will again relate to the operation of the anti-circumvention provisions as they impact on forest policy decisions and the ongoing business of the provinces in managing the forest resource; to quota allocation issues in those regions that have opted for the quota border measure; to the retroactive imposition of penalty taxes with respect to Alberta and B.C., which have opted for Option A; and to disappointment with the lack of results in discussions of additional exemptions from the border measures. If the agreement survives seven years, there will be little support for its extension by an additional two. Thank you.

Grant Aldonas
William M. Scholl Chair in International Business, Center for Strategic and International Studies, Washington, D.C.
Former U.S. Negotiator for the Softwood Lumber Dispute

The current agreement is not sustainable for the same reason that the past SLAs have not been sustainable: it is hard for an agreement to continue to prevail given the constant change of underlying interests. As a result, the framework of the SLA is unlikely to match where business is going over time. Now is a good time to be talking about this issue given the recent filings by the U.S. government. Additionally, the difficult negotiations have been one of those tasks where it is so important to communities, and the politics are so fraught that government and industry throw their best people at resolving the issue. Clearly, this is a testament to the problem that the talent on both sides of the border has not been able to solve the issue.

Lumber is absolutely the most fascinating problem. I have litigated tax cases with the Internal Revenue Service in international taxes where the amount in issue was US$8 billion; I have been involved in international acquisitions and negotiated trade agreements on behalf of the U.S.; and I have yet to find a problem as interesting or vexing as lumber, both in terms of its politics and its economics. I think, in part, it is the economics that drives this because you have industries selling into an integrated North American market for the finished product but the patterns of resource ownership are so different on either side of the border. And we bring with that a legacy of the politics that have built up around that. I dare say that industries of both sides have been particularly adept at exercising their economic demands through the political process, and so the ability for these entrenched interests to drive policy direction on both sides of the border generates the confrontation that came to full flower in the early 1980s and has continued for 25 years. And it is something we are still grappling with.

But what are the reasons for the deal from the U.S. perspective and why did the U.S. government agree when it did? There were two main reasons for the deal from the perspective of the U.S. (although it should be noted that despite the bells and whistles, this agreement is much like other lumber deals). First was the settlement of outstanding litigation. This was a good thing from Canada's perspective because the SLA is designed to create stability and predictability in the market, combined with the guarantee, essentially, of duty-free or barrier-free access to a set percentage of the U.S. market. So there is a certain degree of stability in terms of the arrangement. For the U.S., the settlement of the outstanding litigation and the risks that continuing the litigation posed, in addition to the imposition of a restraint on Canadian exports particularly in the soft market, were important reasons for the U.S. in agreeing to the deal.

Now, the reason I think that is important and the reason I think the deal got done this way in some respects is the architecture was familiar to our industry. I have rarely met a group of people in my private or public life as risk averse in some respects as the folks who make up the U.S. Coalition. Every time we tried to push the envelope and suggest there was actually a better option out there by encouraging some degree of policy change in buying into a market-based solution where you

would compete, their instinct was to run for the shelter of a managed-trade arrangement. And that managed trade arrangement has been reproduced yet again. Part of it is understandable—in a system like this there are certain known risks and rewards not only in terms of what they expect to see in their own market but also what they expect to see in terms of the mechanics of implementing the SLA. So there are tools there that they had gotten used to using even in the context of living under one of these arrangements which will complicate our lives going forward and, at the end of the day, may lead to a breakdown in the arrangement.

The second thing worth saying about the deal from the U.S. perspective is that it is generous. The belts and suspenders in this particular version of the agreement, if you think about it from 1986 to 1996 to what we have now, are gold-plated from the perspective of the U.S. industry (particularly on the downside of a soft market). Which is, again, what they were always most interested in trying to get.

Why did the U.S. agree when it did under the circumstances? We have been at these negotiations over a four year period trying to encourage policy change rather than trying to reach one of these managed-trade arrangements. Given the risks, I think it really comes back to the question, why did the US eventually agree? Was it politics, economics, litigation? For me there are two basic answers, one of which will not be surprising, the other of which I think is surprising.

First, is the least surprising. Within the framework of the case, it was clear, except to the most optimistic (dare I say irrational) members of the U.S. Coalition, that the U.S. was playing the losing hand in the litigation. There were a number of ways that you could come at each decision, but the options were significantly narrower. And there was a substantial risk that as the U.S. worked its way down to the end game, what they would do is start to establish a series of precedents that would make it that much more difficult to bring trade cases in the future. Now, the game from the point of view of the trade bar in litigating these cases, not always with respect to lumber, is always to try and find ways in a particular industry in a particular dispute to narrow the discretion or scope of action for the Commerce Department. So much of what the litigation is designed to do is to take items away from the ability of the Commerce Department to make very creative interpretations of either the law or the margins to generate the kind of protection that the industry wanted at the end of the day. And what the industry could see was that as the litigation was continuing to unfold, those precedents were being set and gradually the room to bring future actions with respect to lumber was being narrowed.

I would also say this is even true of the threat of constitutional challenge which again was brooded about at the end. That constitutional challenge would fail. I represented the Canadian Government in the negotiation of the Free Trade Agreement with the U.S. and helped design Chapter 19. As part of that process, we had to offer advice about constitutionality of Chapter 19 and it came down to a point where we had gone through the law and issued our opinion that this was in fact constitutional. Meanwhile, there was a piece of litigation moving through the U.S. courts about our independent counsel statute. When the Supreme Court reached the issue regarding the independent counsel statute, what it did was vindicate the underlying law or course of law that we had reflected in our opinion. So I had a great deal of confidence after the decision about the independent counsel statute that any constitutional challenge against Chapter 19 would not ultimately prevail.

Now, as in any system, you could find a judge who might go one direction at the district court level, but the idea that this would survive in the face of this clearly consistent set of precedents at the Supreme Court level would be very surprising. As an old lawyer, I will say that much of what you have to do is get the judgment right and then make sure that you and your clients share a set of expectations about outcomes. One of the problems I felt, in discussions with the U.S. industry, was that there was not this type of relationship between counsel and the industry, one of shared expectations; in fact it was one of inflated expectations. But realism eventually prevailed and at the end of the day the U.S. recognized that they had to settle in part because they did not want to see the precedents come down the pipeline.

Now the second answer is more surprising to me, and more interesting. The answer, in my view, is that Prime Minister Stephen Harper asked President George W. Bush directly for an agreement, and he was willing to put his political capital behind the idea of an agreement to get some stability as part of the arrangement. That is relevant because I did not feel that the Chretien Government was actually willing to take this step, and I will say from the U.S. side that I do not think President Clinton was willing to take this step. I think the politics in advance of the 2004 election made sure that Carl Rove's perception of what we should be doing in response to certain constituencies was likely to prevail. I felt, and I do not know if this is fair, that much like we are with the Bush administration now in the U.S., you were at the tail end of Chretien's tenure (his government had gotten deep into the bench at some point, where people were more interested in their job, a little more risk adverse, a little less creative, and had a little less incentive to push something which is what this would take). It really did take a change, I think, in Canadian politics and pressure from the White House to be equally active in terms of a political response. There is no doubt that what President Bush wanted to do is to be helpful to Prime Minister Harper and find a way to contribute to warming relations between the U.S. and Canada after we had had a fairly significant freeze for a period of time. So that played into it as well. But it really came down to the Prime Minister asking, and putting his political capital behind it, knowing that some certainty in this market was probably better than continuing litigation for a period of time.

I would like to make a few comments about the SLA and then I want to talk about where we go next. In terms of the agreement, the thing that is most frightening is Doug Waddell's chart which I think is a wonderful way of describing the complexity of what has gone on. You actually have multiple standards for different regions in Canada, which is not unknown. This thing has so much complexity built in that, in fact, it is an incentive to litigation and an incentive to disputes—and that is what I worry about in terms of an eventual breakdown. I do not want to say that the March 30 filing is necessarily unjustified, I do not know enough about the facts. But I will say that it does not auger well for the SLA and it does seize on these very small things. Sometimes in the practice of law, the most important law is the law of misplaced concreteness—there is this way of getting down to very fine definitions that are thought to be helpful but that in fact become the source of future litigation and friction. Unless what we really do is truly have a meeting of minds about the underlying provisions, although I am always a bit sceptical in these lumber arrangements of this simply because the industry on both sides across the country (in Canada, East-West, and in the U.S., much more North-South) give divergent

opinions and assumptions even within the industries on both sides of the border. So that naturally generates a friction within the U.S. Coalition as well as an intense look at what is happening on the Canadian side of the border. And so I am not so sure that we will see seven years of this.

The question is what can we do in the meantime to create a better resolution? My own instinct comes down to something where I think what the parties should be doing with the $450 million they have set aside for new initiatives (from the forfeited US$1 billion) is to talk about export promotion, North American competitiveness, and especially, the single most important thing we could do, the creation of a log market.

The creation of an effective log market would narrow the options for complaining about the system, and I think it works. It plays into the changing nature of timber land ownership in the U.S. so that, for example, those who do milling well will focus on that. Both sides of the border would have an interest in the log market and the log market would give them a market price. It would also give smaller owners the ability to bargain for a larger market share.

At the end of the day, I think that the consolidation of the business on an international basis is the best option and it is important to encourage underlying economic changes that will resolve the softwood lumber issue in a way no agreement can.

Questions

Mark Crawford, Athabasca University: *Am I correct in saying that the stable market solution is possible without a convergence of patterns of ownership because it is possible to create a competitive log market without that?*

Grant Aldonas: Yes. I would lift the export controls on both sides. At the end of the day, while the complaint by the U.S. Coalition was about subsidies, it was really about the nature or bundle of bargaining rights held by individuals on either side of the border. Because there is a changing pattern of ownership in the U.S., there is a vested interest in pursuing a market solution. There were burdens that prevented businesses from adapting to changes in the economic environment and once some of these were removed, consolidation was encouraged. So there is a changing pattern, but a log market would be very helpful and difficult questions of resource ownership can be avoided.

Dan Wilkinson, Alberta Sustainable Resource Development: *Market demand has been stable in North America recently, but offshore people have been picking up in the industry. Is the U.S. concerned about offshore people coming in and will there be managed trade with some of these other countries?*

Grant Aldonas: No. Players outside North America are taking a larger share but they are not on an equal competitive turf. The idea that you have timber that is harvested illegally in Russia, processed in Lithuania, and shipped to the U.S. at low prices does not seem to worry the U.S. (But I think this is delusional.) The consequences of this are a bigger issue, but it would take something more. Consolidation on a North American basis would be the ultimate outcome.

Helmut Mach, Western Centre for Economic Research: *Would a log market development provide a means of facilitating an exit strategy from the SLA that would be broadly applicable across Canada rather than in particular provinces?*

Doug Waddell: It would be worth doing not from the point of view as an exit remedy that currently exists, but rather in terms of working toward a new dynamic or set of facts that would be relevant when the SLA ends. While the U.S. government seems to be sympathetic to this argument, the U.S. Coalition is not ready to go along with it. I do not see it happening in isolation during the life of the agreement.

Grant Aldonas: To reinforce the point made by Mr. Waddell, while the Bush administration remains in office, the pattern of Republican support is starting to look like that of Democratic support in the 1940s through the 1960s. This means that within the administration, the political sway of the South has gone up as the President's numbers have gone down. I would be sceptical of it because the folks who are most sensitive to things like market-based mechanisms are some of the individuals down South.

Kevin Edgson, Millar Western Forest Products Ltd.: *Is there a rationale for the exemption of the Maritimes and why did that rationale not apply to the B.C. Coastal region (given that the region also involves predominantly privately-held wood)?*

Doug Waddell: Atlantic Canada is, by definition, excluded to a large degree from managed agreements with the U.S. This is more an element of Canadian politics rather than U.S. politics. I have been impressed by the ability of Atlantic Canada industry to mobilize four governments and create hell if there is any suggestion of an agreement dealing with border measures that would apply to Atlantic Canada. It suited the U.S. industry methodology that Crown-owned timber was subsidized and so they were prepared to go along with the exemption for Atlantic Canada because in some respects it gave their position more respectability. There is a fairly integrated industry between Atlantic Canada and Maine, in some respects.

Grant Aldonas: The folks in Maine came after me in the same way that the folks in the Maritimes came after Mr. Waddell. It is because the footprint of the industry in the Maritimes really is on both sides of the border that they are exempt from the arrangement. Should this rationale apply to timber harvested from private lands? Absolutely, but you would want to go to a log market to wash this out of the system. You are thinking as much about what it means as about the incentive or disincentive it creates for future countervailing duty action.

Doug Waddell: Regarding the west coast situation, there is a subtext there in terms of not just negotiation with regard to the harvesting of private lumber, but also export control. If you are sitting in the U.S. southeast, it may not be obvious to your interests as a producer that progress on log export restrictions are going to work for you.

Jim LeLacheur, West Fraser Mills, Ltd.: *Regarding the U.S. Coalition, the old Coalition built up the price of its timberlands, enjoyed prime sales values, and now has an interest in getting a cheap log and promoting a log market with unrestricted free access. Can you see a new coalition in the U.S. starting, trying to get its value out of what it paid for timberland?*

Grant Aldonas: Yes. I am thinking about how to broaden the circle to bring more people into the discussion so that it more broadly reflects a variety of economic interests. I actually think it helps, particularly in the southeast, because you really do see a disparity in the bargaining power. That is where having a reference price in markets will make an enormous difference to the people who own the timber trying to secure the most they can out of their resource. That is where I think the value lies. Trying to put a market in place where they have a vested interest in protecting the operation of that market without something that jams up trade between the border is actually a good thing.

The Honourable Ted Morton, Alberta Sustainable Resource Development: *The integration of the Maine and Atlantic industry, is that at the level of ownership or at the level of supply?*

Grant Aldonas: Both. You have got timberland owned by American companies that are part of the Coalition and part of the dispute that goes north and south of the border. So there is integration at the level of supply. With the companies that we have, there is an enormous ability for them to effect their interests through the political process. It is the answer to ultimately solving the problem in one sense which is that those who are consolidated on a North American basis can recognize that there is more of a threat coming from sales of timber harvested under conditions that are not reflective of the way our timber companies in North America run their operations. Once you get consolidation, you start looking at more of the serious problems like that.

Industry Panel

Helmut Mach, Western Centre for Economic Research

Our second panel is composed of representatives of the Western Canadian softwood lumber industry. These individuals represent a very diverse group of participants in the softwood lumber industry in Canada, each providing a unique perspective.

Mr. Trevor Wakelin of Miller Western Products Ltd. will provide the perspectives of the Alberta industry. Besides representing his company, Mr. Wakelin has the difficult role of Chair of the Alberta Softwood Lumber Trade Council, representing the broad spectrum of Alberta softwood lumber producers. In his capacity, Mr. Wakelin has to reflect the interests of a broad diversity of participants in the Alberta forest industry, including small and medium-size companies, independent operators, integrated versus non-integrated operators, and large national and multinational operators. Mr. Wakelin represented Alberta industry views through the course of the negotiations.

Mr. Paul Perkins of Weyerhaeuser Company represents a US controlled company operating in both Canada and the United States. Weyerhaeuser did not support U.S. industry trade actions and, in fact, strongly encouraged a negotiated resolution of the softwood lumber trade dispute rather than continued litigation.

Mr. Ken Higginbotham of Canfor Corporation represents a Canadian company but one which also operates in United States, having recently acquired significant forest holdings in the U.S. Canfor is one of the largest softwood lumber producers in Canada. Canfor had a different perspective on the negotiating process having been one of the few Western Canadian companies that believed that a new quota arrangement rather than an export tax was the preferred option.

Mr. Hank Ketcham, CEO of West Fraser Timber Company Ltd, represents one of the largest softwood lumber producers in Canada. It also operates in United States, having pursued an aggressive acquisition strategy in the U.S. West Fraser, through the course of negotiations articulated a strong position in favour of advancing Canadian interests through continued litigation.

We are very privileged to have such a group of senior corporation representatives will have such a wealth of experience and background in the softwood lumber dispute with us. I am sure that these four individuals will provide their unique perspectives on the Agreement, including its future prospects.

Trevor Wakelin, Millar Western Forest Products Ltd.
Director, Fibre Resources

The underlying cause of this dispute over the last several decades has clearly been subsidy allegations—none of which have been proven in a court of law. So it is with some concern that we have ended up with an agreement that was worse than the previous agreements we have had, and worse than the countervailing and anti-dumping duties we were paying at the time. It has certainly been an honour to represent the Alberta industry over the last number of years. I think it has been six years now since the 1996 SLA expired. It has not been an easy process—in previous negotiations, Alberta was the forgotten child. In fact, in many cases it was as if Alberta did not exist. So I have attempted at least to bring the concerns and the issues that Alberta has in this industry forward at the negotiating table. I did do that, but with limited success you might say. Hence, the title of my presentation is the "Softwood Lumber Disagreement".

Our company dates back to the early part of the century. We are a privately-owned family operation. We constructed our first sawmill in the early 1920s. Subsequent to that, we have built several mills on the same site in Whitecourt, and we now have a fairly modern facility that was put in place in 2000. We have since built a BCTMP in Whitecourt and also purchased a Boyle sawmill in 1993. In Whitecourt, we mill about 135 million feet of lumber, and we produce about 300 million board feet of lumber and about 300,000 metric tons of pulp annually. We are by far the largest Alberta-based company and I think at last count (although the number changes) we had about the 18th largest lumber production in Canada.

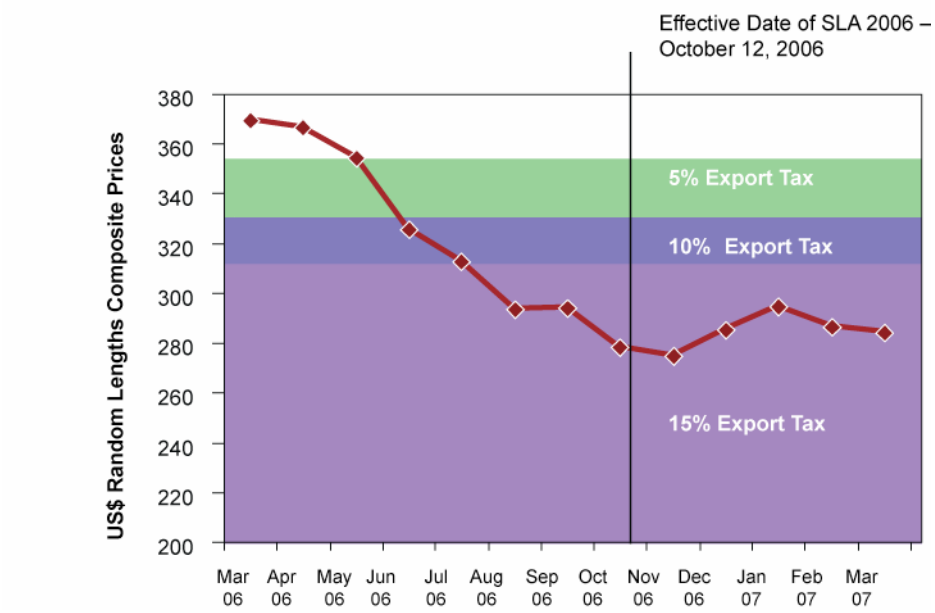
With regard to industry objectives for the SLA 2006, clearly we wanted to end the ongoing trade action. In the early part of the discussion, Mr. Grant Aldonas had indicated that there was no chance of success with managed trade. The only success we could have was through changed circumstances and, if we substantially changed our forest policy in Canada, then the U.S. Department of Commerce would revoke the duty orders. So we set about trying to achieve change, with no success, because the U.S. Coalition was clearly determined that was not a route that they were prepared to take. We also wanted to achieve free trade and we wanted to create a continental marketplace. It is interesting that Mr. Aldonas is now talking about a continental marketplace for logs, because at the time we were talking about a continental marketplace for lumber.

In addition, we wanted to obtain a long-term, durable solution. It had to be fair and equitable, and there was certainly no desire to renew the previous agreement. The Canadian industry was opposed to quotas and, specifically, the Alberta industry was very opposed to quotas due to the allocation issues that Mr. Waddell had indicated earlier. (It was felt that Alberta was somewhat left out and did not get a desirable quota.)

The Canadian strategy with respect to the softwood lumber issue was a two track approach: one of negotiation and one of litigation. It was felt that if we were not successful through negotiation, litigation should bring about an end to this dispute. I think we were all weary that an end to this dispute would only start a new one, Lumber V. We started that litigation process and it broke down several times. But finally in 2005, as litigation was coming to an end, Canada essentially walked away

from the table and said it was not prepared to negotiate any further (both government and industry). The litigation was through the World Trade Organization (WTO), the NAFTA dispute resolution process, and finally the Court of International Trade, whereby we were trying to ensure that we got a decision that would force the U.S. administration into complying with the NAFTA decisions. The litigation decisions were overwhelmingly in Canada's favour throughout. After August 2005, when Canada walked away, the government (which had become very political at the time) was adamant that they were not going to cave to the U.S. bullying tactics. It became clear that the U.S. was desperate for a negotiated settlement because they were going to lose in a court of law. Meanwhile, Canada's bargaining position was very strong, we felt, in August.

That was the reality in August 2005. We felt pretty confident that we could eventually negotiate a deal that was better than what we were currently forced to live with under the tax of 10% at the time. So obviously the Prime Minister thought that cutting this deal was a piece of cake. The Harper Government was sworn in on February 2006, and Mr. Harper made it clear from the outset that resolution of this dispute was a high priority. So much so that he announced in April that we had a new agreement and that the deal was a no quota and no tax deal. However, the SLA clearly reflected that if the market price of lumber dropped below $355 per thousand board feet, an export tax would apply along with lumber constraints. So at the time, it was true that at $370 per thousand, we were not subject to a quota or taxes. However, in the meantime, the prices dropped to $274 per thousand and we ended up suffering the consequences of this deal.



This shows it in graphical format. As you can see this shows that below $355, we are paying a tax. The framework of the agreement was put together at $370, the deal was implemented in October, and Alberta and B.C. have been paying a 15% tax ever

since. Eastern Canada was subject to only a 30% market share that at the beginning was agreed to be 34%.

So what happened? The Canadian government tells us that this is actually the way they saw it: our position of negotiation was somewhat less than favourable. This was certainly not the way we saw it, but that was the way they saw it and we got an agreement that reflected that.

What were the achievements through free trade? Well we got a dispute that was ended, albeit in our view, temporarily. We did not get free trade. We have no continental marketplace. And we sure do not have a long-term, durable, fair, and equitable deal. There is an escape clause that allows this deal to be abandoned within three years. We gave up $1 billion of our money to the U.S. And there is no end to U.S. protectionism in the foreseeable future.

Alberta's concerns were pretty clear from the outset: we did not support a quota. We did support a tax because it was felt by the industry here that it was fair and equitable for all. But in fact we got both a tax and a quota. The export tax of 15% was clearly higher than the duty rate we were paying at the time of 10%. Had we just waited a few more months, we would have had legal decisions indicating that the duty rates we were paying were *de minimus* and the duty order would have been revoked. Furthermore, we would have received all of our money back. Additionally, it concerned us that $500 million of the $1 billion had actually gone back to the petitioners, the U.S. Coalition, to fill their war chest for the next round of negotiations. And we never got the precedent-setting decisions that we wanted because the litigation was terminated.

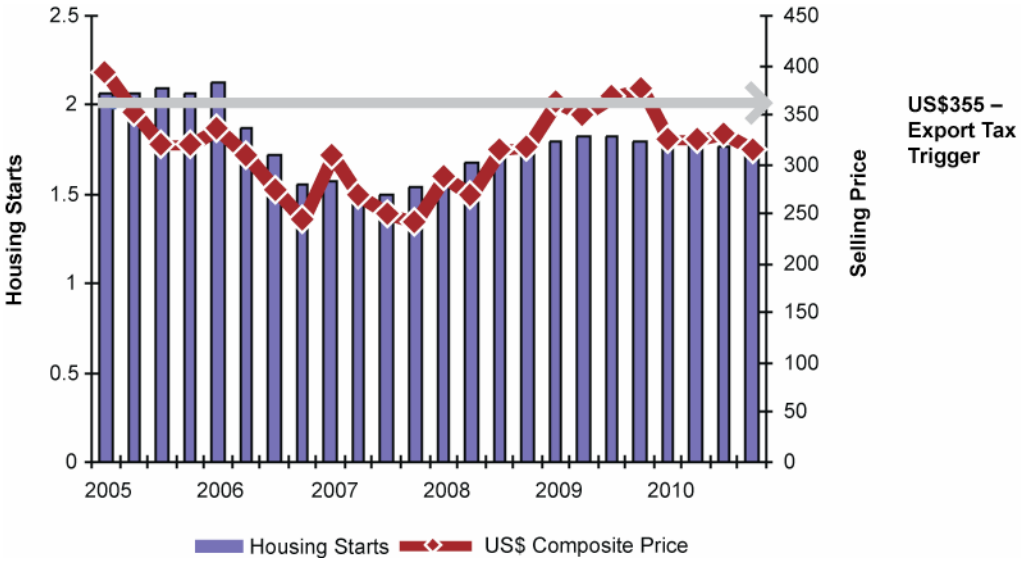
A clear concern is the U.S. dictating forest policy in Canada. This is a huge sovereignty issue for all Canadians: how could we let the US dictate to us how we should manage our resources? But we have and we are under intense scrutiny all the time from the U.S.

Our biggest concern going into the SLA was the oncoming epidemic of mountain pine beetle. We felt that the way the deal was structured would put us into a perpetual surge and, therefore, subject Alberta to increased tax penalties throughout the life of this agreement. This clearly puts the economic viability of our industry at stake. We had worked closely with the Federal Government in Washington, D.C. to try and address this problem about the market share for mountain pine beetle. But while the Federal Government indicated that they would see what they could do for us, we believe in results, and we did not get that.

The surge mechanism was discussed earlier by Mr. Waddell. Clearly we would have supported a border tax alone, but we have ended up with a cap, albeit a soft cap. The surge penalty itself is retrospective or retroactive and is excessively punitive. This makes it very difficult for us to manage our shipments when we do not know what tax we are going to be paying until after the end of the month. By the way, the surge penalty is not based upon individual companies, it is based upon the entire region. So if all companies' shipments into the U.S. at the end of the month go over the trigger, everybody pays an additional tax. This is a huge concern for us because we cannot afford to trigger this surge mechanism in today's marketplace. We are trying to manage it as best we can but it is going to become increasingly difficult as we deal with the mountain pine beetle.

We know that harvest levels in Alberta are going to increase due to the mountain pine beetle and there is no other market, so essentially we are dependent on the U.S. As a result of the mountain pine beetle, forests are dead in northern B.C., and it has come into Alberta in the Grande Prairie/Peace region. The government has been very aggressive in chasing the beetle, but the bottom line is that we are going to suffer the consequences of that increased harvest because it is almost certain that we are going to trigger the surge.

On the other hand, B.C.'s market share does reflect an increase for their mountain pine beetle because of the dates that were used to determine the market share. B.C. was already heavily into harvesting mountain pine beetle when they got their market share. We got our market share based on our historic shipments that were far less than what they are going to be going forward.

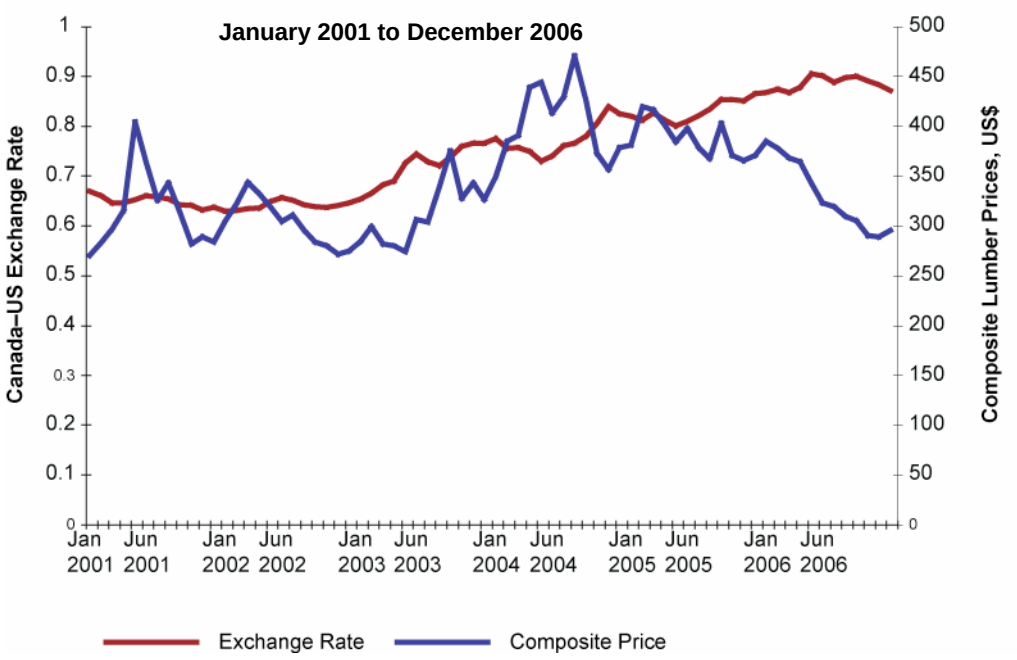


Source: RISI

We are facing a number of industry challenges in the context of the 2006 SLA. This graph tells a huge story with respect to industry challenges. You can see that in the early part of 2006 we were at record housing starts, but this has trailed right off and it looks like it is going to be lower for the next several years. Furthermore, the market price of lumber is projected to be below this line of $355 for the next four years. So essentially, in spite of the Prime Minister's prediction of no taxes, we are going to be paying tax throughout this period. This is a huge predicament for us. We are significantly worse off now than at the start of the last dispute.

On top of that, since 2001, we have seen a 25% decrease in revenues due to the appreciation of the Canadian dollar against the U.S. dollar. All of our shipments are in U.S. dollars, so every time the Canadian dollar appreciates, we are in further trouble.

We have an overheated economy, especially in Alberta, which has contributed to additional cost pressures. Overall, historically, the market share for Canada into the U.S. was about 34% and it is clearly declining. So this graph just demonstrates the plight we are in.



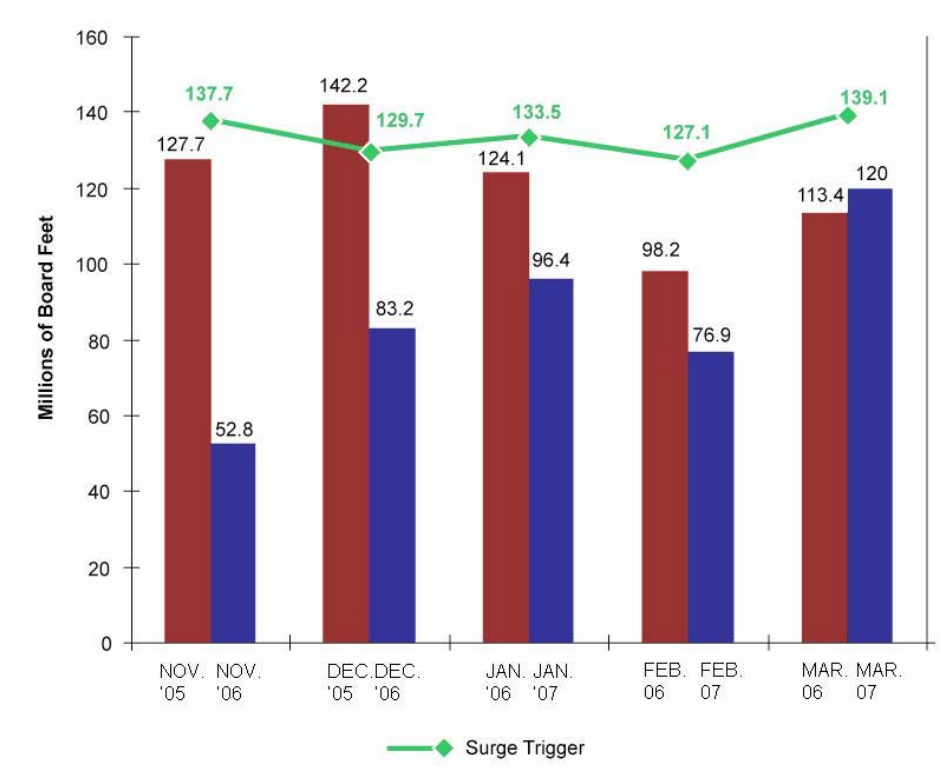
Source: Bank of Canada, RISI

As you can see, back at the beginning of the dispute, we had a dollar that was in the mid-60 cent range and that has now gone up to range in the mid-80 cents. At the same time, we have seen the market price of lumber drop dramatically. So with the situation today as it is, the profitability of the industry is adversely impacted.

We have seen a lot of sawmill closures on both sides of the border. We are seeing extended down time being taken – almost weekly now we see new announcements of additional down time being taken. There are increased shipments into the Canadian domestic market and of course we have had the 15% export tax ever since the SLA was implemented. We have also been subject to increased U.S. scrutiny on anything we do in Canada around forest policy. The U.S. market share is not being fully utilized now.

Additionally, we have got the softwood lumber interpretation issues. It was clear at the beginning of this agreement that there were going to be problems with the mechanics of the agreement but we were unable to deal with that before it was put in place. So there is the potential for arbitration.

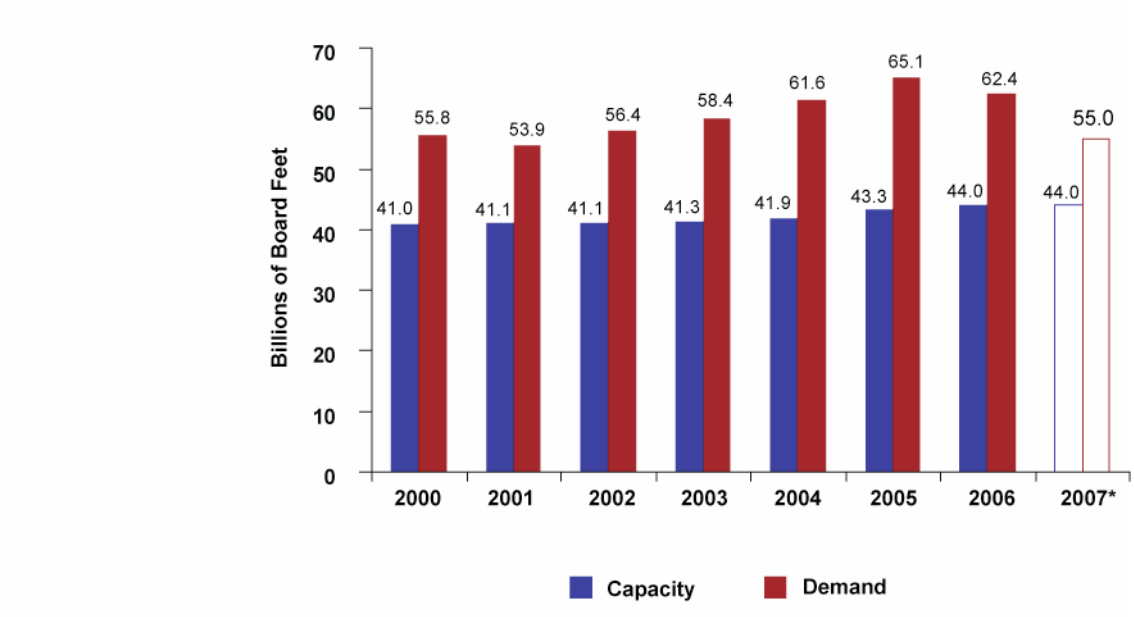
Alberta Shipments to the U.S.



This graph I wanted to include because it reflects the difference between November 2005 and November 2006 (when the SLA started). You can see that Alberta's shipments into the U.S. were dramatically lower in November 2006, than in November 2005. It is interesting to see that had we had this agreement in December 2005, we would have triggered the surge. This illustrates the concern that we had at the time. In Alberta, it is fair to say that there has been a push to move more product into Canada and maybe a little bit offshore. But now, with the domestic market being saturated, we are seeing more going into the U.S. and I think this is going to continue (as we continue creeping up towards that trigger).

Third-country imports are also a concern. Obviously now with this agreement, we are seeing that U.S. consumers are lobbying to get more imports from Europe to offset the more expensive wood that is coming in from Canada.

U.S. Capacity vs. Demand

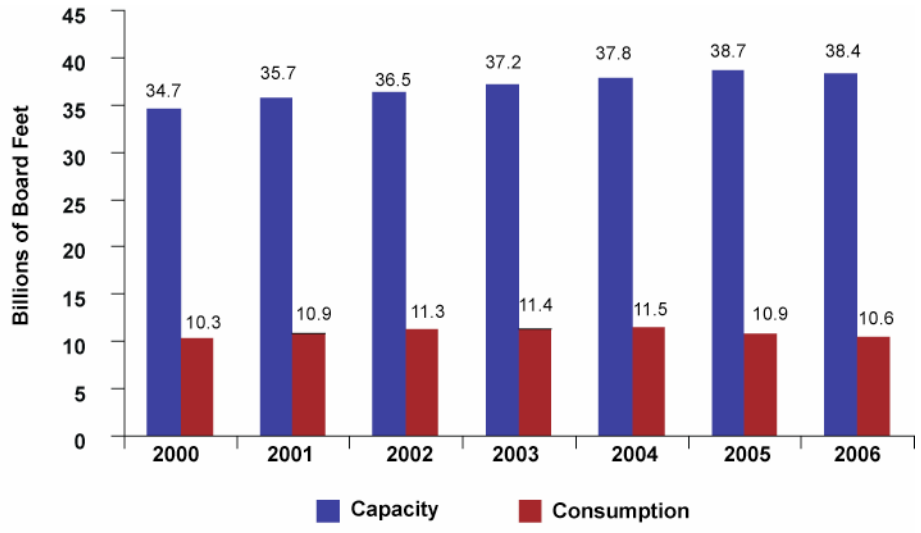


**Projected –lower demand due to reduced housing starts*

Source: RISI

This graph illustrates that there is a difference between capacity and demand in the U.S. and it is clear that the U.S. cannot meet its own demand. But what is interesting about this is that consumption has been declining and this trend is projected to continue in 2007. This is going impact how much volume we can ship to the U.S.—a big concern.

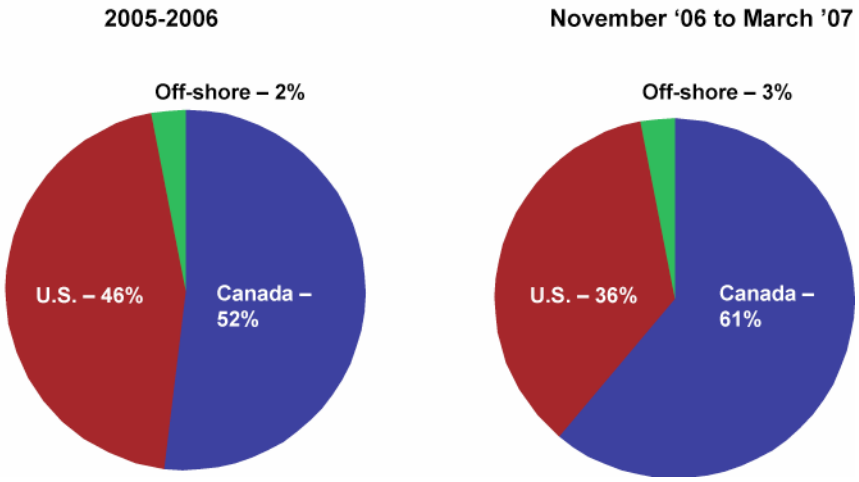
Canada Capacity vs. Demand



Source: RISI

You can see by the next graph that Canada and the U.S. should be working together instead of being in conflict all the time. The U.S. needs our shipments and we need the U.S. since our capacity far exceeds our consumption in Canada. So how are we coping? More companies are struggling to be profitable, even as market share volumes are declining. While duty refunds provide some relief, the strategy will be to try to move volumes away from the U.S. I am not sure whether every company will have the same strategy, but clearly we are going to try to move some volume offshore and get away from some of the commodity products being shipped to the U.S. and ship those to Canada. It is interesting to note that some of the smaller mills in Canada are being adversely impacted by the increased volume going into the national market.

Millar Western Lumber Shipments



This is a graph on Millar Western to show you what we have done. We have gone from shipping close to 50% of our product historically into the U.S. to 36%. We are trying to move more product offshore and more product into non-commodity specialty products in Canada (working with some secondary manufacturers). It is going to force further cost efficiencies and there is a strong potential for further industry consolidation. Additionally, the viability of some of the forestry dependent communities, of which there are 50 in this province, could be adversely impacted. As Karina Pillay-Kinnee, the Mayor of Slave Lake, stated in an AFPA News Release: "Slave Lake Town Council is very concerned about the impact of significantly lower market prices for our products…our town has already been affected by the indefinite shutdown of the local Tolko mill, and we are concerned about the long-term implications for an industry with deep roots in our community."

The predictions are that negative industry economics will continue and there will be further major restructuring, probably closures, and mergers and acquisitions are highly probable. The industry will continue working at finding further cost efficiencies. Despite the punitive nature of this agreement, the industry will continue to ship into the U.S. as there is no other marketplace. We believe that Lumber V is unavoidable because litigation was not seen through to the end. The deal will not

likely survive beyond three years and I think the cycle of disputes is going to continue for the foreseeable future. Additionally, in the coming years we are going to see some drop off of production in B.C. as a result of the mountain pine beetle. It would be nice if Alberta could pick up that shortfall, but under the current agreement we are restricted by the market and cannot enjoy any reduction from B.C.

If we had the chance to improve the SLA, what would we say in Alberta? First, provide us with an increased share of the market to cope with the mountain pine beetle which is coming at us this winter. Second, we need to fix the surge mechanism so that it would only apply to volumes beyond the surge, not on all of the volumes. Third, we should be able to include some ability to carry forward unused market share. And, finally, there should be an exemption for lumber produced from private-purchased wood. The bottom line is that the Canadian lumber industry is going to look a lot different going forward as a result of the most recent Softwood Lumber Agreement.

Paul Perkins, Weyerhaeuser Company
Vice President, Policy and Planning, Canadian Operations

I have titled my presentation "A Weyerhaeuser Perspective", but I would probably be more honest in entitling it "Paul Perkins' Perspective". It may be pretty hard to get a Weyerhaeuser perspective right now. I did intercept an email yesterday from one of our accounting staff who has been charged with tracking surge in quota. It read: "Aren't you enjoying the seven years of certainty and peace on the softwood trade fight. Unleash the lawyers."

I would start out by saying a little more on Weyerhaeuser. We are the largest lumber producer in North America. At the time of the SLA, we were roughly 1/3 Canada, 1/3 U.S. west coast, 1/3 U.S. south. We are also a very large landowner in the U.S. south and the U.S. west. We have been in Canada for about 48 years now. Weyerhaeuser was involved in 1981/82 at the start of this issue and so we have had a lot of time to reflect on it.

For us, the root cause does come down to the issue between public land management and private land management, and the value proposition in the system that is driven by private land management. In honesty, as we looked over the lumber cycle, historically-speaking, if we could find comparable mills in the regions in question, the return on investment was not very different over the cycle. But during the low points in the cycle, there was a difference between the return in the U.S. and the return in Canada. Canada did show an intensity to run lumber in low markets which forced the prices down. And in a private land system in the U.S. south, what we called stickiness, there were a lot more small private land owners and they did take logs off the market which in fact held up the log pricing in the U.S., forcing the margins in the sawmills to be reduced. So over that cycle, there was an issue—it is an issue that has kept reappearing and it is what feeds the U.S. Coalition. Mr. Aldonas talked about the changes in timber owner management in the U.S., and this is one of the areas, as a company, we are very engaged in right now. So when I am talking about this right now, you have to put it in the perspective of Weyerhaeuser and where we sit today.

One thing I would say at the outset is that we were definitely an advocate for an agreement. We did not believe that litigation would in fact ever get us to a commercial reality. We were conditioned by the 20 years of history and realized that at some point there was going to be a negotiation. We did, however, advocate keeping it simple. This agreement is anything but simple. So as you look forward, I think you have to keep that in mind as well. I am going to talk about our experiences so far, give you a comparison to our expectations, what adjustments we have made in our business practices, our plans for the future, and the viability of the business long term.

In terms of our experiences so far, I will begin with the positives. The return on duties went faster than we expected. There were fewer problems. However, from the point where the duties were returned forward, we have experienced some more frustrating issues. Perhaps the most troubling, and maybe in hindsight we should have anticipated it, were the debates with the Federal Government over the interpretation of the SLA. The most significant of these was around the application of

the consumption adjustment factor to the Option A provinces. The wording of the SLA clearly, and we have all read it this way, applied the consumption adjustment factor to the quotas of the Option B provinces. For unknown reasons, the Federal Government was reluctant to support the wording and seemed unable to make the decision to simply manage this element according to the language. The governments of B.C. and Alberta had to step up and make a major issue with Ottawa. This comes back to the other point that Mr. Waddell made about the influence of the provinces in this whole process, and we talked in that context of the Maritimes. But clearly it was the pressure of B.C. and Alberta that got Ottawa to move on this. We all know that this issue has recently become part of the formal request for consultation; in part I believe it is because of the slowness of the Federal Government to react and to work with the wording of the SLA that this has become the issue that it has today.

In terms of our daily operations, the biggest change would be a change in our focus on shipments. We always had a focus on shipments, but we were essentially focused on minimizing our finished goods inventory at the month end, trying to ensure we got all the loadings possible. The new focus throughout the month, but particularly towards the month end, is managing those shipments. We were in Option B provinces as well (although I put that in the past tense now). During these past six months, as most of you are probably aware, Weyerhaeuser in Canada has gone through some major shifts with the Domtar acquisition and, in fact, only have minimal volumes in Saskatchewan at this point. So when we were operating in Option B provinces, we were focused very much on quota management. In the Option A provinces, we are watching the surge numbers and towards the end of the month we are pushing orders out, or if it appears the provinces may go over the trigger, we deliberately hold orders. The obvious problem is that we may adjust our production, but if others do not do the same, we still go into surge and, in fact, face retroactive penalties. It has not happened yet, but it is out there as a major threat and a major issue that we are all watching.

With the focus on shipments, one of the frustrations is the accuracy of the federal reports on daily shipments. For example, the March figures for B.C. Interior were 97% several days before month end, only to drop back to 95% due to a posting error. Then it came back up to 97%. There is a lot riding on these numbers so our focus on these periods has changed. It is an interesting phenomenon that as the rules change, the game changes—so we are all watching those rules. The history so far has indicated that these numbers tend to adjust towards the end of the month and pull the figures back. I will talk a little more on cancels and corrects which are part of our business but these seem to mitigate towards the end of the month. One of the issues again is the delay in closing these months out, so you still have the legacy of perhaps going over in hindsight so there has been a significant delay in closing past months with the federal figures. So that retroactive threat remains out there. For a company like ours, that is close to a $1 million swinger that we are holding on the books.

Management of the SLA has had a cost and complexity. I would say that the Department of Foreign Affairs and International Trade and the Canada Revenue Agency have been sympathetic, however, being sympathetic does not get the job done. They have not been able to work out an effective way of aligning the shipment information with the revenue stream data. This seems to us to be an irrational desire to have everything tie back to the export permits, resulting in a very difficult task for

individual companies. I am sure it frustrates the Federal Government as well, but one of our continual problems is the need to cancel and correct orders, either because of last minute tally changes, substitutions at the mill level, or what we call pricing corrections. Our cancels and corrects are actually less than 3% of our orders but that is still a big deal when it comes down to moving this through. This is a minor frustration, but again it is the permit structure itself which requires us to declare the date that a car will cross into the U.S. market. We cannot control the date that the car crosses the border, yet they insist we must fill this field out. So again, I raise it just as one the practicalities and pragmatisms of working under this agreement.

I guess the biggest frustration from our perspective is that the Federal Government seemed to view the signing of the SLA as the end of the issue—it was really the start. The Federal Government seemed unable to get its head around the fact that they needed to form some type of panel to facilitate industry advice to the government going forward. In fact, this needed to be a priority. From our perspective, the Federal Government disappeared with respect to this issue.

In terms of comparing this to our expectations, I started out telling you that we did not have a high expectation of this agreement at the beginning. We wanted an agreement, we believed an agreement was a necessity, but we also understood that managed trade was going to be ugly (having lived through previous incarnations of the SLA). Managed trade is not fun to work with and it results in unintended consequences. But, as I said at the start, we had even lower expectations of the legal process and we did not see the legal process as resolving the relevant issues. What we did expect was that signing the SLA was only the start and, as I mentioned, we were surprised the Federal Government did not seem to recognize this as well.

In the first few months after the signing, with the exception of getting the deposits back, we saw a real sense of complacency, for lack of a better word. We got the sense that we had to fight for everything or anything that would make the SLA function better for us or even the way we thought it was intended. In this fight, our provincial government was our strongest ally. When the issues are as significant and as clear, they have more leverage in Ottawa than we do as an industry, and I think that is an important lesson for all of us.

With regard to the adjustments we made to our business practices, I talked about the change in Weyerhaeuser earlier. Clearly as Weyerhaeuser was going through a major adjustment in terms of our Canadian operations, the Domtar acquisition was really a fine paper merger. It essentially removed us from any of the quota (Option B) provinces. I want to honestly say that the SLA played no part in this decision; this was all about the future of the fine paper business. The sawmills in Ontario and Saskatchewan were simply assets that were best aligned with pulp and paper assets. While we had argued with Ontario and Saskatchewan that they should opt for Option A, they ultimately went to Option B. We felt the restrictions on volume were going to be too onerous and that we would be better as an Option A company in those provinces. Our biggest adjustment, which I have already discussed, is the focus on shipments. In addition, we probably spent more time looking at the returns from alternative markets and looking particularly at product line changes.

What does this say for the longer term? We are still going to try and focus on understanding the fundamentals of this agreement and how it is going to impact buying patterns as well as supply. And since it comes down to customers, we must

also consider how we can continue to serve our customers within the framework of the SLA. We still believe that all of these agreements lead to unintended consequences. We do not know what the unintended consequences of this particular agreement will be but we do know there will be some. We are going to continue to look at those to see that we do not get blindsided.

Now, in terms of the SLA and the viability of western Canadian industry, the last six months have probably been more about the market than about the SLA. In the future, I think that other factors will play a much larger role in shaping our viability than this agreement. The fundamentals of fibre supply, cost competitiveness, exchange rates, and overall U.S. demand will be much larger factors. In addition to these, the future of our pulp sector's competitiveness will play a much larger role in our overall viability under the SLA. The agreement will be there; it will influence our viability; but it will not be the main theme in terms of our overall competitiveness.

To emphasize the market issue, we are here today to talk about lumber. We do not have an agreement on oriented strand board (OSB). But if you take a look at current OSB prices on a percentage basis against what has happened to them over the last six months, you will find it is worse than lumber.

Ken Higginbotham, Canfor Corporation
Vice President Forestry and Environment

I thought that a little bit of background about Canfor's position and role in this whole process might be important. We are a company that believes in free trade in lumber and in market-based public policies. That does not necessarily mean that we have not made some difficult decisions around how to position ourselves relative to this dispute with the U.S. Canfor was heavily involved in supporting the legal cases and the legal costs. I think a lot has been said about where we were headed with legal cases but costs were enormous. Canfor spent somewhere in the vicinity of $50 million on the legal cases that were carried out on behalf of large groups of the industry and then, of course, we all helped in Washington D.C. by having our own legal counsel (for which, of course, to some extent we still pay). But we supported those cases at the WTO, the NAFTA, and the Court of International Trade.

As has been pointed out, Canada won most of the cases, but we are one of those companies that felt there was another investigation waiting in the wings and we were not going to satisfy the U.S. Coalition. So Canfor also supported efforts to obtain a negotiated solution. We do not like managed trade anymore than anyone else. But with the passion of the Coalition and the way U.S. trade law is written, we felt that we were going to continue to have investigations and deposits placed in anticipation of duties going forward. So it is not our ideal to have managed trade, but we felt all along that it was a reality we were going to have to face up to.

We are also a company that wants certainty. And while managed trade is a perverse kind of certainty, at least it provides something around which to develop rational business plans. Not all companies agree with that and some would argue against my assertion that it gives us the opportunity to plan rationally around the rest of our business. The desires of the Coalition have already been talked about by others and so I do not need to get into that particularly. But the desire to have high lumber prices, what some people have referred to as greed, is where subsidy is embedded. It is where the issues are embedded that Mr. Perkins talked about in regard to the differences between a public land model and a private land model. They want higher prices. They want us to have a limited amount of the market share in the U.S., somewhere less than 34% presumably. And they also claim, of course, that we have flawed public policy in Canadian jurisdictions. In other words, it is a different way of saying that we do not have market-based public policies around management of our public timber lands. It is interesting, and I will not go into it, but the Coalition argues that they just want to have fairness, but when we do put market-based public policies in place (for example, going to market-based timber pricing and so forth), they will immediately find another issue on which to base their concern about Canada.

In terms of Canfor's role in negotiations, we think that we had somewhat of a unique role to play in Canada. At one point we left the B.C. Lumber Trade Counsel. We did so, not because we did not like to be around the folks that were at the table with us there, but because our Chief Executive Officer felt strongly the need to be able to speak out on certain matters in a public context and at the negotiating table. It also meant that we did not necessarily have to be constrained by the consensus

model that tends to be associated with the trade tables. We did, however, continue to work with the B.C. Lumber Trade Counsel and the Alberta Softwood Lumber Trade Counsel. We continued to put our money into the legal cases that were being carried out and our colleagues were kind enough, for the most part, to allow us to be at the table when the B.C. Lumber Trade Counsel was talking. We also maintained a close involvement with the Government of Canada and the Government of B.C., both at the political and officials levels. In addition, we supported what we referred to as the McKenna Framework in 2005, and then the Emerson/Wilson efforts that started up in 2006, based on the framework that McKenna and others had been involved in.

It has already been said that this agreement is complex. That leads me to some scattered thoughts about the 2006 SLA. We wanted an agreement that was simple, but we did not get that. I want to mention a couple things with regard to the dispute settlement process: 1) I am not sure we know what consultation really means and we are in the midst of a consultation period with respect to four complaints that the U.S. industry and, therefore, the U.S. Government have with us; and 2) we are supportive of the concept of independent judges (the non-north American judges) should we get into arbitration. However, whenever it comes to judges, one is never sure of what they are going to decide. (As Keith Mitchell, a lawyer, pointed out, that even if you have absolute rightness on your part and the other side has absolute incorrectness on their part, you still only have a 75% chance of winning because you do not know who your judge is going to be.) This is of some concern to us.

It was a foregone conclusion in our company that we would have implementation issues with respect to the SLA – we expected this. They result from different interpretations – things that did not appear in the agreement, things that were not contemplated, and so forth. There are regional differences in the actual application of the SLA, in terms of the Option A and Option B regions. This means that different parts of the country are going to think differently about how the SLA is going. In that regard, it is easy for us because we do not have any operations in Ontario to criticize the government aid package there (currently one of the subjects of consultation). We also tend to be critical of the Quebec aid package even though we have a Quebec operation that is a Quebec border mill and exempt from the SLA. One of the challenges for us is to make sure that the operation in Quebec exists within the overall Canfor structure in a way that will maintain its exempt position rather than being put into the same basket as the rest of the company.

The look-back issue, as it is referred to in B.C., otherwise known as the surge retroactivity issue, is of tremendous importance to us. I might mention one thing that is critically important with regard to this issue: as we reach the end of the first quarter of this year, our accounting department has begun to tell us that we probably have to think somewhat about whether or not we need to start to make statements about the fact that we could have liabilities even going back into January for this year, given that we are a public company.

We are uncertain about the role of industry in consultation. If I were the Federal Government, I would probably not want to talk to the industry. We have been difficult over the years and we cannot come to common positions—it is pretty clear why they may not want to involve us in consultations. We have an abundance of confidence in the Alberta and B.C. governments and, in speaking for industry, we would like them to play a role. This may be my own paranoia, but we are somewhat

concerned about the Government of Canada playing the politics of the SLA. This might mean convincing the U.S. that the aid packages from Ontario and Quebec are okay but the use of unadjusted figures for the regional allocation for the 34% market share is not. And, therefore, the Federal Government might give us up in order for the votes somewhere down the road that they would like to have in Ontario and Quebec. This is something we are concerned about.

I do want to indicate quickly that there other issues that are driving our business today that in many respects the SLA is impacting but that are important in their own right. There is the mountain pine beetle, impacts on costs in logging, impacts on the mill in recovery and productivity, impacts on the premium lumber that we produce, and so forth. We are starting to see impacts in the marketplace where just the perception of blue lumber being put into trusses, for example, regardless of the fact that the mechanical strength of the wood is there, is enough for people to say they are not going to buy beetle wood anymore.

We are of course in a period of market deterioration. I do not know if we are as negative as Mr. Wakelin in terms of how long he thinks this will last, but we do not have a whole lot of confidence. In B.C., we face huge uncertainties around First Nations that are related to treaty or lack of treaty issues, along with government allocating timber to First Nations groups. We believe that consolidation, rationalization, capitalization, and the use of the deposits are very important factors that have already been talked about but ones that are really important to a company like ours where we have, sitting in the bank, approximately $500 million as a result of the deposits coming back. Everyone is asking what we are going to do with the amount. In B.C., we also have ongoing issues with regard to a stumpage system that does not track the declining value of the beetle-killed timber in a timely way.

We are also facing the 'Green Revolution' that has not been mentioned much. We have governments trying to outdo themselves in terms of climate change policy announcements. My concern is that the policy announcements appear to be going in an opposite direction from lumber concerns, rather than coinciding with each other. But there are also issues in terms of possible diversification that may be opportunities for us in the future. The government of B.C. is very much into promoting bio-energy in industry whether it be electrical power production, ethanol production, or whatever. The beetle-killed timber has produced a huge amount of fibre that may be involved in bio-energy production and we have to decide as a company whether or not we are going to participate in that business beyond the minimal amount that we have at the present time.

I bring up these four issues (beetles, market pricing for lumber and other solid wood products, lack of aboriginal treaties and the 'Green Revolution') because they are all, at the moment, very important to the softwood lumber industry, especially with a 15% border tax. Unfortunately, at the time of the SLA 2006's inception, these issues were not as pertinent as they are now. As a result, they were not really factored into the agreement. This goes back to what Mr. Aldonas said earlier, that it will be difficult to live with a static agreement that is unable to adapt in a dynamic softwood lumber industry. These issues will not be as concerning if lumber prices rise above $355/mfbm, but, until this happens, the softwood lumber industry faces significant challenges in dealing with these issues under the current agreement.

Thank you very much.

Hank Ketcham, West Fraser Timber Co. Ltd.
President and CEO

The SLA, which is just six months old, is very complex, and includes a variety of untested rules. Several key issues were left open when the agreement was struck, with an agreement that those issues would be settled by further negotiation or through bi-lateral panels.

But before I talk about what the SLA means to our industry, I would like to share with you my views about how we ended up with this agreement in the first place. I think there are four key reasons. First, the NAFTA failed to live up to its promise. Second, the cohesion of the Canadian industry was broken. Third, the battle took a significant financial toll, drawing more than $5 billion out of our industry. Near the end, many companies saw a settlement as a means of survival. And finally, politics came into play.

The softwood lumber dispute was a major test of the NAFTA. Millions of dollars were spent on legal fees by the Canadian industry. Canadian interests were consistently successful at the NAFTA dispute panels but American interests, including the U.S. Department of Commerce, took whatever steps they could to drag the dispute out. This included challenging the validity of the NAFTA itself. The drive for a settlement arose for a couple of reasons.

First, many of the Canadian participants could not see any light at the end of the NAFTA tunnel. And second, some companies worried that winning this dispute would simply start the process all over again as U.S. interests would file a new action against our industry as soon as possible. This should be a concern to all of us who assumed that the NAFTA was a means of guaranteeing fair access to the U.S. market. Let us remember, however, that while the process has been excruciatingly slow and costly, the NAFTA did ultimately work. We were on the verge of winning this case on its merits when the Canadian government – with the support of the majority of the Canadian industry – settled with the U.S.

The U.S. Coalition not only alleged that government subsidies supported the Canadian industry but also argued that Canadian firms were selling lumber either below cost or below the Canadian domestic price, which would constitute dumping. The result was that companies were initially assessed anti-dumping margins ranging from 2% to 13%. This had the effect of imposing different economic burdens on different companies. This also had the effect of dividing Canadian producers in terms of how best to deal with the American sanctions which ultimately weakened our resolve.

In 2006, the lumber business experienced a sharp downturn. Some Canadian companies that had been prepared to fight the good fight until the key issues were resolved found themselves in difficult economic circumstances. Several of them began to see a settlement of the dispute as an economic lifeline. With over $5 billion already on deposit in the U.S., a settlement that would see even some of that amount refunded began to look good to a number of the Canadian companies.

And finally, the minority Conservative Government adopted the settlement of this dispute as a priority which, I believe, led the Canadian Federal Government to give away more than it needed to and, perhaps, more than it intended. So in spite of

the fact that no government subsidy of the Canadian industry has ever been proven, the Canadian government agreed to leave $1 billion of our money behind in the U.S. and to impose a tax and quota scheme over much, but not all, of the Canadian industry. In essence, we have negotiated a three-tiered trade agreement.

Our company took a consistent position throughout the dispute. We preferred a reasonable and fair settlement to the expensive, time-consuming, and seemingly endless legal proceedings. But we also felt that the strength of the Canadian case gave us an opportunity to establish, through the courts, certain legal precedents that would help us in future disputes and move us closer to real free trade with the U.S. The settlement reached between the two governments precluded the establishment of some key legal precedents. So, on the whole, I feel this agreement fell short of what we could have accomplished.

But since we are now six months into this new agreement, I will try to give you my perspective on some of the key issues we will have to deal with going forward.

First and foremost, British Columbia instituted a new stumpage regime for timber in 2006. Stumpage is now based on the auction price of certain timber sales rather than having to rely on the market price of lumber. This radical departure from past practice was intended to respond to American criticism of our traditional pricing system. Predictably, the U.S. gave B.C. no credit for this very substantial policy change. But as the beetle-killed timber in the interior of the Province deteriorates, our new stumpage system should respond to the declining value of the timber. This was an important negotiating point for the B.C. Government and its industry and has been explicitly provided for in the SLA.

This brings us to the issue of so-called 'off ramps.' The agreement allows for exclusion from the SLA for any region that can satisfy the U.S. that it has implemented policies that negate the alleged subsidies. Given B.C.'s experience in the infamous policy bulletin process – promoted by the Department of Commerce – we have every reason to be extremely cautious about U.S. intentions with respect to off ramps. However, the fact that different regions have the ability to negotiate individual off ramps concerns me because it again opens the process to political manipulation and could create suspicion and instability between regions.

As mentioned earlier, we now have a three-tiered trade system in place in Canada. The Atlantic Provinces are completely exempt from the SLA even though those provinces were accused of dumping along with the rest of the country. B.C. and Alberta operate under Option A which imposes a significant tax on that region. In addition, a significant surge tax comes into effect if the Option A provinces exceed predetermined shipment levels. The other provinces have elected to operate under Option B which imposes a quota and low tax rate on their U.S. bound shipments. Obviously, different regions now have significantly different economics than they did before the SLA came into effect. Regional differences in tax regimes will cause inefficiencies in the marketplace. For example, during the two-tiered 1996 SLA when the Atlantic Provinces were exempt from the agreement, they shipped all of their production, and sometimes more, to the U.S. market rather than supply their traditional local markets at the discounted Canadian price. Other Canadian production from B.C. to Quebec moved in to supply Eastern Canada. This created a very inefficient model. When the previous SLA ended in 2001, rational marketing returned. The current three-tiered system will likely see history repeat itself with

similar behaviour returning. However, at this stage it is difficult to predict what additional changes will occur.

Irrespective of the market inefficiencies created by the three-tiered system, the whole concept of different regimes for different regions is patently unfair. The new systems will rebalance – in ways not yet understood – the competitive playing field within Canada. Let us remember that this dispute was supposedly about subsidy and dumping. Because Canada has consistently prevailed on the issue of subsidies, the threat of an ongoing dumping margin was the compelling reason for settlement for some companies. This is why I have never understood the rationale for a total exemption for certain provinces.

With respect to the Option A system under which both BC and Alberta have chosen to operate, not only do we face a very punitive tax under current market conditions but we are also subject to a surge tax if the region ships more than a specified volume of lumber in a given month. This surge tax is a retroactive tax applied to past shipments. For example, in April, B.C. and Alberta are subject to a 15% base tax on our shipments to the U.S. If we over ship our target volume during the month, we will be subject to a 7.5% surge tax applied to our April shipments. This tax is nearly impossible to manage. The retroactive nature of the surge creates fear and irrational behaviour. This in turn causes inefficiencies in marketing and transportation.

Another concerning aspect of this agreement is the anti-circumvention clause. Clearly the intent of a clause like this is to ensure that the letter and spirit of the SLA are not compromised. However, as we know from experience, this clause can allow our American competitors to challenge virtually all policy and program changes undertaken in Canada during the life of the SLA. The U.S. has raised subsidy and circumvention issues a number of times since the current deal became active and is already seeking formal consultations with Canada. This means we could be one step away from arbitration. If arbitration fails, the deal could simply fall apart or sanctions could be levelled on the offending region.

One further aspect of the SLA that creates a great deal of uncertainty is the cancellation clause. In essence, either side can cancel the SLA with six months notice after it has been in place for 18 months. In other words, we really have a three year deal which can be extended for another five to seven years if neither party cancels. This does not give the Canadian industry the security and stability it was looking for.

The SLA mandates the establishment of a Softwood Lumber Committee to deal with issues as they arise. This Committee is made up of representatives from the U.S. and Canadian governments. In turn, this Committee has appointed five working groups to deal with the following items: regional exemptions, logs from private lands, data collection and verification, customs and permit issues, and scope (i.e. exempt and non-exempt products). There is no doubt that these working groups will be active as the parties to the SLA begin challenging the interpretation and intent of all aspects of the agreement.

One issue the U.S. is currently challenging is the Canadian position on the so called 'look-back' provision. The Americans are attempting to include Option A regions under this provision. This provision was clearly intended to apply to Option B regions only – not to Option A regions. The fact that the U.S. would challenge this

provision sends a clear message that we have not yet entered a period of harmonious relations under the SLA.

As you can see, there are many aspects of the SLA I am concerned about. But my overriding concern relates to trying to run a commodity business in a managed trade environment. We are facing intense competition from the softwood lumber industry in Europe. Russia and South America are looming threats. Let us remember that under the previous quota regime from 1996-2001, Europe steadily increased its North American market share. Today, lumber prices are as low as they were during the recession of 1982. What this means is that the Canadian industry must have the ability to continue its efforts to improve productivity and reduce costs. The SLA must not be used by our friends south of the border to inhibit our push for improved competitiveness.

As we move forward under the SLA, we will find many pressure points and areas of disagreement. But if the SLA Committee can rise above politics and look objectively at the issues that come before it we may, for the first time, be able to resolve disputes in a fair and transparent fashion. If this should happen, then I believe the SLA can work to the benefit of both countries. If, on the other hand, this agreement is used to hamper industry or government initiatives designed to build a stronger and more competitive industry – while living within the spirit of the SLA – then this could be a short-lived agreement and the Washington lawyers may be back in business sooner than they think.

Let us hope that fairness, common sense, and goodwill prevail.

Questions

David Holhouse, The Edge Forest Business Magazine: *Would anyone support the idea of ending the SLA before its natural life should end or is it something you can live with?*

Trevor Wakelin: If market prices do not increase significantly during this three year period, it is hard to imagine anyone in industry that would want the SLA to continue. The agreement has not worked in getting prices up and has been punitive to the Canadian industry. The U.S. Coalition is still looking for reasons to fight, especially with respect to subsidies.

Hank Ketcham: Circumstances as they unfold will dictate whether we can live under the SLA with the U.S. It is very important that if the Canadian Federal Government is going to be negotiating in the future for industry, we must find some way to align our interests with the Federal Government so there is a good understanding of the implications of some of the clauses that go into these agreements before they are included. I do not think this happened this time.

The Honourable Ted Morton, Alberta Sustainable Resource Development: *What is the consumption adjustment factor and why it was important for B.C. and/or Alberta to make it an issue?*

Paul Perkins: The consumption adjustment factor was put in and the SLA clearly states that it was aimed at Option B provinces. It was to apply to a further reduction on the quota if the consumption actually deteriorated faster than anticipated. The East has some arguments about why you would not apply it because you are reaching back. Consumption is taken over a rolling 12 month period in the U.S. and again it is one of the trigger points in the SLA along with pricing. Clearly from the industry's perspective, it did not apply to Option A. The issue was one of the Federal Government delaying their interpretation of this and seemingly willing to open up the negotiations about the intent of the consumption adjustment factor. My contention is that, had they held up their hand immediately and said the "agreement reads X" and put the numbers out there based on that, there would have been less of an issue. They did not do this and left that month hanging and did not publish the month-end numbers. They made the question more obvious that there was a debate around it and I think this fuelled the U.S.'s view that they could make a case here.

The Honourable Ted Morton, Alberta Sustainable Resource Development: Explain the Quebec and Ontario aid packages.

Ken Higginbotham: One of the key elements of the SLA is the anti-circumvention clause and the aid packages in Quebec and Ontario are going to be questioned as to whether they circumvent the intent of the agreement. Canfor and West Fraser have disagreed on a number of things over time, but one place where Mr. Ketcham was a real champion, and unfortunately we lost, was that the U.S. wanted the anti-circumvention language to cover the forest industry, not just the lumber producing industry. So if the government of Ontario, for example, provided benefits through reduced power rates to the forest industry (pulp, paper, lumber, panels, and so forth), it could be argued that the SLA precludes this under anti-circumvention. So I am assuming that Quebec and

Ontario will both argue that their aid packages are comprehensive and that they help everyone in the rural parts of the province (and the lumber industry just happens to fit into this). The U.S. will argue that the language says if you benefit the forest industry regardless of products produced, it is circumvention.

Robert Ascah, ATB Financial: *Regarding value-added in the industry, to what extent are your companies looking at adding value to the lumber? Is this a solution to getting around some of the problems you are facing?*

Hank Ketchum: Canadians have to remember that the largest consumer of the type of lumber we make is the housing industry and R&R industry in the U.S. No matter how hard we try, we are dependent on the U.S. housing market for the predominant portion of our volume. We need to find all sorts of ways to make other products. But the way we make our money in this business is high volume, high recovery, and capital intensive sawmills. We cannot even find offshore markets to take a substantial proportion of our product. I think we make a big mistake as a government and as an industry in not making sure that while we look for those niche markets, we also do not take our eye off the ball of expanding the construction market in the U.S. It is very important to remember that as the beetle-killed timber comes into play, the lumber we will be making is even less desirable for the value-added industry.

Unknown: *The way the SLA is written, it discourages tenure holders from getting into the value-added area. Can you explain that?*

Trevor Wakelin: The way the SLA is structured, if you are a tenure holder, you do not qualify to get the benefits that are afforded to the independent manufacturers. So for all of the companies that currently make lumber from Crown land, there is no ability for us to get any exemptions under this particular agreement. So we would be paying the full tax and potentially a surge tax as well if we ended up going beyond the trigger.

Closing Remarks

Mike Percy, University of Alberta
Stanley A. Milner Professor and Dean, School of Business

It would be very difficult to do justice to the three hours of discussion and presentation that we have had. In terms of the themes that have come through, it is very clear from the perspective I think both of some of those involved in negotiations, but certainly those involved in the industry, that the SLA in fact is flawed, is unlikely to be sustained over the full seven years, and is extraordinarily complex. This complexity invites confusion over the elements and certainly invites litigation. In fact, in a sense, this is the very behaviour that the SLA was meant to remove. It was supposed to provide some degree of predictability and move away from some litigiousness in this area of trade.

One suggestion that arose was the necessity of moving away from continued confrontation in softwood lumber and toward some degree of alignment of interests on both sides of the market. A solution in terms of cross-border log markets and some market-based mechanism that would lead to a degree of convergence of deliberate log prices was seen as one way of moving us to a world of less confrontation. In that context, we heard a bit about the Maritimes and Maine as perhaps being at least an example that is consistent with the notion that this degree of cross-border trade and pricing of logs could lead to some degree of agreement. There is also a profound pessimism then as to the sustainability of this agreement.

Certainly, as well, you heard from the industry panellists that the SLA itself deflects them from the business of doing business and, in fact, focuses on the business of managing volumes of trade on a month-end basis that is not a productive use of time. We see this type of behaviour in industries characterized by marketing boards and the like where there is a lot of time and effort spent on managing to compliance as opposed to managing to markets. Additionally, what we are seeing through this agreement is the worst of both worlds in terms of concerns over tax and concerns over quota and the necessity then to manage month-end to prevent worst case scenarios from emerging. Clearly, given the productivity problem that Canada has in general, focusing good management talent on managing month-end volumes and shipments is probably not the most productive use of managerial talent, to put it mildly.

You also heard that in the context of this agreement, we are in this perfect storm in terms of economic conditions. On the one hand we have every indicator of what is known as the 'Dutch disease' both in Alberta and B.C., in terms of rising nominal wages, rising service sector prices and the like, driven by expansion and booming sectors in the resource sector (for example, oil and gas, and the Olympics in the case of B.C.). On the cost of production side, there is tremendous squeeze. There is a slumping housing market in the U.S., a high Canadian dollar, and we are left with a productivity level consistent with a lower Canadian dollar. Then you overlay that with the U.S.'s focus on Canada exports and the capacity offshore to continue to grow their share of the market and it makes you profoundly pessimistic about this

industry in the longer term. Housing prices at some point will bounce back. We may see prices above the US$355 trigger point, but the next two to three years (or at least the next two years) are going to be profoundly difficult for the industry and this agreement neither provides the peace that would allow the industry to focus on competitiveness, nor has it allowed a predictability in terms of the industry gaining the capacity to strategically position itself.

So at least I heard that perhaps from the perspective of some, this agreement was better than poking an eye out with a pointed stick but there were no ringing endorsements that this was an agreement that was going to solve the problems. What you heard come through from the negotiators and the industry panelists is that the agreement that did emerge captured many of the defects of the agreements of 1986 and 1996 with virtually no benefits. As well, the 2006 SLA certainly did not reflect the relatively strong bargaining position that Canada enjoyed prior to this agreement being signed. Those are my concluding observations.

I would like to thank CN for their support of the Western Centre for Economic Research, and also Alberta Sustainable Resource Development for their support. I would like to thank the Minister for Alberta Sustainable Resource Development, the Honourable Ted Morton, for attending the Forum.

Participant Biographies

Grant D. Aldonas

Grant Aldonas holds the William M. Scholl Chair in International Business at CSIS. Previously, he had a distinguished career in law, business, and international economic policy, including service at senior levels in the U.S. government. Mr. Aldonas came to CSIS from Akin Gump Strauss Hauer & Feld, where his practiced focused on international trade, investment, corporate governance, and corporate social responsibility. While at Akin Gump, he served as chairman of the U.S. arm of Transparency International. Before joining Akin Gump, he served in the Bush administration as the Commerce Department's under secretary for international trade from 2001 to 2005, where he was one of the president's principal advisers on international economic policy and managed a federal agency of 2,400 employees with offices in 80 countries and a budget of $350 million. In his role as under secretary, he also served as a member of the board of the Overseas Private Investment Corporation and as executive director of the President's Export Council.

Prior to his service in the administration, Mr. Aldonas was chief international trade counsel to the Senate Finance Committee. During his tenure, Congress passed a number of significant trade bills, including the Trade and Development Act of 2000, Permanent Normal Trade Relations for China, legislation replacing the Foreign Sales Corporation provisions of the Internal Revenue Code, and a series of tariff bills.

Before entering public service, Mr. Aldonas was a partner with the Washington, D.C., law firm of Miller & Chevalier where his practice focused on international trade, tax, government procurement, and international litigation. He also served as counsel to the Bipartisan Commission on Entitlement and Tax Reform and as an adviser to the Commission on U.S.-Pacific Trade and Investment. He was appointed chair of the American Bar Association's Task Force on Multilateral Investment Agreements and served as vice chair of the ABA Section of International Law and Practice's Committees on Trade and Foreign Investment. Mr. Aldonas began his career as a Foreign Service officer, serving tours in Mexico, the Department of State, and the Office of the U.S. Trade Representative.

He continues to serve as an adjunct professor of law and member of the board at the Georgetown University Law Center. He also continues his role as principal managing director of Split Rock International, a Washington, D.C.–based consulting and investment advisory firm, and as a member of the board of the Center for International Private Enterprise and the Global Fairness Initiative. Mr. Aldonas received his B.A. in international relations in 1975 and his J.D. in 1979 from the University of Minnesota.

Ken O. Higginbotham

Ken Higginbotham was appointed Vice-President, Forestry and Environment of Canfor in June 2005. Prior to that, Mr. Higginbotham was Vice President Forestry, Environment and External Relations.

Born in Denver, Colorado and raised in Twin Falls, Idaho, Ken Higginbotham received both a Bachelor and Masters of Science degree in Forestry from Utah State University and a Doctorate in Plant Ecology from Duke University.

While completing his university education, Mr. Higginbotham spent two years working with the U.S. Forest Service and as a Research Assistant at Utah State University. His career in academia began in 1974 at the University of North Carolina as an Assistant Professor in the Department of Botany and subsequently the University of Alberta from 1975 to 1988 as an Associate Professor in the Department of Forest Science.

Ken Higginbotham was appointed the Director of the Forest Research Branch for the province of Alberta in 1988 and in 1989, he was appointed the Assistant Deputy Minister in the Land and Forest Service of Alberta. Mr. Higginbotham first joined Canfor in 1995 as the Vice-President and Chief Forester.

Hank Ketcham

Hank Ketcham was born in Portland, Oregon, and raised in Seattle Washington. He graduated from Brown University in Providence, Rhode Island in 1972. After graduation he began working for West Fraser Timber Co. Ltd. as a lumber shipper and has stayed with the company ever since. He has held various positions for the company, including sawmill general manager and vice president of administration. In 1996 he was appointed Chairman, President and Chief Executive Officer, a capacity he still holds. He is also the director of the Forest Products Association of Canada (FPAC), a former chairman of the Council of Forest Industries (where he served three terms), a founding member of the Forest Alliance of British Columbia, and a director for the Toronto Dominion Bank.

Mr. Ketcham presently lives in Vancouver, British Columbia with his wife Janice and their three children, Matthew, Allison and Pamela.

Helmut Mach

Helmut holds a B.Com. and an M.B.A. from the University of Alberta. He completed the Alberta Public Service Senior Executive Development Programme, the U.S. International Visitors Programme from the U.S. State Department, and the Intensive Programme on the European Union from the College of Europe.

Helmut comes to the WCER with 33 years of experience with the Government of Alberta. Most recently he was with the Alberta Ministry of International and Intergovernmental Relations where he was the Alberta Trade Representative responsible for trade policy and negotiations, co-ordination and dispute management, and for both international and internal trade agreements and matters. He represented and pursued Alberta's interests in the negotiations for the Canada-US Free Trade Agreement, the NAFTA, the Uruguay Round of Multilateral Trade, the

World Trade Organization Doha Development Agenda, and the Free Trade Agreement of the Americas.

Peter Marshall

Peter Marshall was appointed Senior Vice-President, Western Region in January 2004. He oversees all Sales and Operations in the region, which covers CN's business in B.C. Alberta, Saskatchewan, Manitoba and Northwestern Ontario.

Prior to assuming his current leadership role, Mr. Marshall completed a comprehensive development program where he took on a variety of highly focused operations assignments. Mr. Marshall's work was largely centered on Transportation but also covered Engineering, Mechanical aspects, and business support services.

Mr. Marshall joined CN in 1997 as Vice-President, Bulk Commodities, responsible for CN's Coal, Sulphur, Grain and Fertilizer Marketing functions. In April 1999, he was appointed Vice-President, Prairie Division, where he was responsible for the railroad operations, as well as the Marketing and Sales Group for CN's Canadian-based Grain and Fertilizer customers. In July 2001, Mr. Marshall transferred to Chicago and was appointed Vice-President, Midwest Division, as well as overseeing the Gulf Division on an interim basis. In January 2003, he became Vice-President, Gulf Division, with overall responsibility for the division's Operations, Mechanical, Sales and Engineering functions.

Prior to joining CN, Mr. Marshall held a succession of senior management positions at Imperial Oil, a division of EXXON. He holds a business degree from Queen's University, Kingston, Ontario.

Ted Morton

Ted Morton was elected to his first term as a Member of the Legislative Assembly of Alberta for the constituency of Foothills-Rocky View on November 22, 2004. On December 15, 2006, he was sworn in as Minister of Sustainable Resource Development and appointed a member of the Agenda and Priorities Committee and the Cabinet Policy Committee on Resources and the Environment.

Dr. Morton obtained his bachelor of arts in political science from Colorado College in 1971, his master of arts in political science from the University of Toronto in 1975 and his PhD in political science from the University of Toronto in 1981. He began his teaching career as an instructor at Assumption College in Worcester, Massachusetts, from 1978 to 1981. From 1981 to 2004 he was a professor with the University of Calgary and a visiting professor with a number of institutions including Colorado College; Institute for American Universities at Aix-en-Provence; Université de Montreal; University of Connecticut; and University of Melbourne..

Dr. Morton also served as director of policy and research, office of the Leader of the Official Opposition, Parliament of Canada, in 2001. In 1998 Dr. Morton was elected as a Senator-in-waiting in Alberta's second-ever Senate election.

Dr. Morton has received several career awards and distinctions including Phi Beta Kappa and Pi Gama Mu, Colorado College; Best Non fiction Book of 1992, Alberta Writers' Guild); Bora Laskin National Fellowship in Human Rights (1995); recognized in *Maclean's* Guide to Canadian Universities (2001) as one of 20 most popular professors at the University of Calgary; runner-up, Donner book prize for

best book on Canadian public policy published in 2000; and visiting research scholar's award, University of Melbourne.

He and his wife, Patricia, have three children. In his spare time Dr. Morton enjoys hunting, fishing, gardening, golfing and skiing.

Michael Percy

Dr. Percy has been an active member of the University community since he joined the Department of Economics at the University of Alberta in 1979. He is the author and co author of four books and numerous articles on public policy, international trade and economic development. Mike has served on the editorial boards of the Canadian Journal of Economics and also Forest Science and has been an active commentator on current public policy issues. He is also active as a guest speaker and has taught in a number of professional development programs.

A native of Banff, Alberta, Dr. Percy received his Bachelor of Arts (Honours) from the University of Victoria and his Master of Arts (Economics) and Doctoral degree (Economics) from Queen's University.

Mike Percy was appointed dean of the School of Business in July 1997 and reappointed for a second term in July 2001.

Dr. Percy also serves as a member of the board of EPCOR and is chair of their Governance Committee. He also serves on the board of the Edmonton Chamber of Commerce and currently serves as President. As well, Mike serves on the board of Matrikon, Tolko Forest Products and the Alberta Science and Research Authority.

Dr. Percy took academic leave in 1993 and served one term as a member of the Legislative Assembly, Province of Alberta, and as Liberal Party Finance Critic until March 1997. He served as co chair of the Premier's 1997 Economic Growth Summit. Mike has participated in several health care funding review panels for the province and acted as a consultant to various provincial governments on issues related to economic development, and to United Nations agencies.

Paul K. Perkins

Born in Yellowknife, N.W.T., Paul Perkins has lived most of his life in North Vancouver. He graduated with a Bachelor of Arts degree from the University of British Columbia.

Following university, he worked for MacMillan Bloedel from 1966-1979 in a variety of marketing sales positions, including five years with MacMillan Jardine in Singapore and Kuala Lumpur.

Mr. Perkins joined Weyerhaeuser Canada in 1979, and was appointed Vice President Sales and Distribution in 1984. He was named Vice President Marketing and Corporate Planning in 1988. In 1999 he was appointed Vice President, Forestlands and Strategic Planning. In January, 2003 he assumed the role of Vice President, Policy and Planning for Weyerhaeuser Canadian operations.

Paul is a past president of the Canadian Wood Council, and a former chairman of the N.F.P.A. Market Expansion Committee. He is a past chairman of the Sustainable Forestry Certification Working Committee. Paul served as a director of Forest Engineering Research Institute of Canada FERIC.

Mr. Perkins received the Canadian Pulp and Paper Association's Hart Award for Excellence in 1997. Paul received the Hart Award for recognition of his contribution

towards the 1996 completion of the national Standards of Sustainable Management (SFM) approved by the independent Canadian Standards Association (CSA). The purpose of the certification initiative was to meet customer needs for assurance that Canadian Forests are managed in a sustainable way.

Paul is currently on the advisory committee for Forestry Innovation Investment Ltd. (FII) is responsible for British Columbia's investments to promote BC's forest products to the global marketplace. He is also Weyerhaeuser's representative for the Canadian Forest and Wood Product's Coalition on the 2010 Olympics.

Paul has been closely involved in the Canadian softwood lumber issue for almost 20 years, and was the Team Leader for Weyerhaeuser's issue team working on the latest chapter of the dispute which culminated in the Softwood Lumber Agreement 2006. Paul has recently been appointed to the Canadian side of the 12-person North American Lumber Industry Council which is the group created out of the SLA 06 to manage the $50 million earmarked to grow the North American market for forest products and build stronger cross-border partnerships and trust within the industry.

Doug Waddell

Mr. Waddell retired from the Public Service of Canada in 2004 after a career spanning thirty five years. He had numerous assignments in trade policy and Canada/United States trade and economic relations with the Departments of Industry, Trade and Commerce and, after a government re-organization, the Department of Foreign Affairs and International Trade. Mr. Waddell was Assistant Deputy Minister for Trade, Economic and Environmental Policy in the Department of Foreign Affairs and International Trade (2001-2003) and Deputy Head of Mission at the Canadian Embassy in Washington, DC (1996-2001).

Trevor Wakelin

Trevor is the Director of Fibre Resources for Millar Western Forest Products Ltd., a family-owned company that is based in Edmonton, Alberta, owns and operates a pulp mill and two lumber mills, and conducts woodlands operations supplying the fibre requirements of all three facilities on the basis of sustainable forest management principles. Trevor's career in the forest sector spans more than forty years, encompassing woodlands management experience in three Western Canadian provinces, as well as in his native New Zealand.

Trevor has taken an active role in contributing to the work of industry organizations and the management of industry/government issues in areas such as the softwood lumber trade dispute, enhanced forest management, certification, integrated landscape management and stumpage and tenure reviews. He currently serves as chair of the Alberta Softwood Lumber Trade Council, as a director of the Canadian Lumber Trade Alliance, and as president of the Forest Resource Improvement Association of Alberta (FRIAA). He is a past president of the Alberta Forest Products Association (AFPA) and has served the AFPA since 1998 as a director and since 1986 as chair and member of numerous committees.