United States - Preliminary Determinations with Respect to Certain Softwood Lumber from Canada

WT/DS236

EXECUTIVE SUMMARY OF THE
SECOND WRITTEN SUBMISSION OF THE
UNITED STATES OF AMERICA

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I. INTRODUCTION

1. Over the course of this proceeding, the issues have been focused and the facts clarified. If there was ever a doubt, the United States has now demonstrated that the Canadian provincial governments provide timber to lumber producers – that is a financial contribution under the WTO *Agreement on Subsidies and Countervailing Measures* ("SCM Agreement").

2. The United States and the European Communities ("EC") also share the view that, in appropriate circumstances, the benefit from the government's provision of a good may be measured by comparison to commercially available world market prices, consistent with Article 14(d) of the SCM Agreement. Even Canada agrees that the use of import prices may be appropriate in certain circumstances. Therefore Article 14(d) does not prohibit the use of world market prices in appropriate circumstances.

3. There has, however, been much debate over whether the Commerce Department's recourse to such prices in this case was appropriate. In the end, as discussed below, the evidence demonstrates that the Commerce Department's use of U.S. stumpage prices commercially available to Canadian lumber producers was entirely consistent with the SCM Agreement.

4. The United States has also amply rebutted Canada's claim that the Commerce Department inflated the amount of the subsidy benefit by failing to take into account so-called "independent loggers." The Commerce Department's preliminary determination that the Canadian provincial stumpage systems provide a subsidy to lumber producers was therefore entirely consistent with U.S. obligations under the SCM Agreement.

5. Thus, we come full circle to where we began. "No Member should cause, through the use of any subsidy . . ., adverse effects to the interests of other Members, i.e. . . . injury to the domestic industry of another Member."[1] When one Member causes injury to the domestic industry of another Member through the use of *any* "specific" subsidy, the injured Member has the right to take countervailing measures. The U.S. right to impose provisional measures to counteract the injurious effects of billions of dollars of imports of subsidized Canadian lumber should therefore not be denied.

II. ARGUMENT

A. The Commerce Department's Preliminary Determination that the Canadian Provincial Governments Provide a Good to Lumber Producers Is Consistent with Article 1.1(a)(1)(iii) of the SCM Agreement

6. It should be beyond dispute that the provincial governments are providing a good – timber – to lumber producers, within the meaning of Article 1.1(a)(1)(iii) of the SCM Agreement. This conclusion is inescapable under any definition of "good" in any language. It should also be beyond dispute that when a government gives a company the right to take a good, whether it is the right to take widgets from a government warehouse or timber from government land, the government is "providing" that good within the meaning of Article 1.1(a)(1)(iii). The

[1] Article 5, SCM Agreement.

Canadian provincial governments give tenure holders the right to take timber off Crown land and, thus, give them the timber itself. The only logical conclusion is that, in doing so, the provincial governments are providing a good within the meaning of Article 1.1(a)(1)(iii).

7. Canada's attempts to obfuscate this simple fact rely on logically flawed arguments, and ignore the basic principles of treaty interpretation reflected in Article 31 of the *Vienna Convention on the Law of Treaties*. For example, Canada asks the Panel to infer from the use of the phrase "imported goods" in Article 3.1(b) of the SCM Agreement and the word "products" in Parts III and V of the SCM Agreement, that "goods" can only mean traded goods that fall within the GATT 1994 Article II schedules. The fact that "products" are goods and "imported goods" are goods does not, however, logically give rise to the inference that nothing else can come within the meaning of "goods."

8. To sustain its strained interpretation, Canada simply ignores the most relevant aspect of the ordinary definition of "goods" in the source it relies upon, which is the inclusion of "growing crops, and other identified things to be severed from real property." Moreover, Canada's attempt to narrow the ordinary meaning of "goods" would render superfluous the only express limitation in the text itself, i.e., the exclusion for "general infrastructure." If "goods" were intended to be read as narrowly as Canada suggests, it could never encompass *any* infrastructure (e.g., a building, road, etc.), let alone general infrastructure. "Goods" must include some infrastructure, otherwise the specific exclusion in Article 1.1(a)(1)(iii) is superfluous. Thus, the very existence of that express limitation demonstrates that the Members intended "goods" to be read in accordance with its ordinary meaning and therefore to include things other than those listed in the GATT 1994 tariff schedule.

9. In addition, Canada's arguments are premised on the notion that the only thing at issue here is an intangible "right" granted by the provincial governments, which Canada then proceeds to totally divorce, analytically, from the object of the right granted. Under Canada's theory, form is everything: what something is called (e.g., an "exploitation right") is more important than what it actually is. In Canada's truncated analysis, if the government has granted a right, the inquiry stops, regardless of what the "right" entitles the holder of the right to do. By ignoring substance, Canada concludes that, while granting a right may constitute a financial contribution, it can never constitute the provision of a good. However, as the *Export Restraints* panel stated:

> We believe, in particular, that the appropriate way to conceive of a "financial contribution" is purely as a transfer of economic resources by a government to private entities in the market, without regard to the *terms* of the transfer.

10. Thus, it is in fact the "right," i.e., the terms under which the provinces transfer timber to lumber producers, that is irrelevant. To determine whether there is a financial contribution, the treaty interpreter should look at the reality of what actually occurs. In the case of provincial tenures, what actually occurs is that the provincial governments grant tenure holders the right "to take" a tangible good – timber – off the land. The right "to take" is, in fact, the mechanism (or

terms) by which the government "provides" the timber, i.e., places the timber at the disposal of the lumber producer. The provincial governments are therefore providing goods within the meaning of Article 1.1(a)(1)(iii) of the SCM Agreement.

11. Canada concedes that offering steel producers the opportunity to load and haul (i.e., "to take") iron ore from a government stockpile would constitute the provision of goods. In reality, there is no meaningful difference between giving lumber producers the right to take trees off Crown land and giving steel producers the right to take iron ore from a government stockpile. While Canada may disagree, the United States is confident that the steel producers and the lumber producers would not.

12. The reality of the provincial tenure systems is readily apparent. The evidence demonstrates that companies obtain tenures for the sole purpose of obtaining timber, not to manage the forest. Tenure holders acquire nothing under the tenure but timber, and pay stumpage fees only on the amount of timber actually harvested. These facts leave no doubt that through the tenure systems the provincial governments are "providing" a "good" – timber.

B. The Commerce Department Properly Measured the Benefit from Provincial Stumpage Systems Under Article 14(d) of the SCM Agreement

13. Canada has made several claims with respect to the Commerce Department's measurement of the benefit from provincial stumpage systems. In this section, the United States will address Canada's claims concerning the Commerce Department's selection of a market benchmark for stumpage.

1. The Use of Commercially Available World Market Prices Is, in Appropriate Circumstances, Consistent with Article 14(d) of the SCM Agreement

14. As discussed in the U.S. prior submissions, Article 14 of the SCM Agreement sets forth guidelines for determining the benefit conferred by a financial contribution. Prior panel and Appellate Body reports have defined a benefit as some form of advantage that would not otherwise be available in the marketplace, absent the financial contribution. The guidelines in Article 14(d) should therefore be interpreted to achieve an appropriate comparison of the financial contribution to the marketplace, i.e., a comparison that would identify the artificial advantage resulting from the government's financial contribution.

15. Article 14(d) does not purport to address every conceivable scenario in which a benefit must be determined. For instance, some types of financial contributions are not addressed at all in Article 14 (e.g., grants and debt forgiveness). Thus, authorities have the discretion to develop appropriate methodologies. It is the view of the United States that an appropriate methodology is one that is consistent with the guidelines in Article 14, considered in light of the object and

purpose of Article 14 to compare the financial contribution to what would be available to the recipient in the market absent the financial contribution.

16. With respect to the provision of a good, Article 14(d) of the SCM Agreement states that the comparison should be made "in relation to prevailing market conditions for the good [] in question in the country of provision . . . ." There is no dispute that the basis for the comparison described in Article 14(d) is the prevailing market conditions in the country under investigation. What constitutes prevailing market conditions is also described in Article 14(d), i.e., "price, quality, availability, marketability, transportation and other conditions of purchase or sale." Where the United States and Canada disagree is in defining what constitutes the universe of permissible market benchmarks that could be used to measure the adequacy of remuneration "in relation to prevailing market conditions" in the country under investigation, consistent with Article 14(d).

17. As the EC stated: "[t]he expression 'market conditions in the country of provision' in Article 14(d) of the SCM Agreement is sufficiently broad to allow the consideration of world market prices." In particular, as noted above, the concept of commercial "availability" is expressly incorporated in Article 14(d). The use of "commercially available" world market prices is also expressly sanctioned in item (d) of the Illustrative List of Export Subsidies, and has been endorsed by the Appellate Body. Prevailing market conditions in the country of provision may therefore encompass prices commercially available on the world market to purchasers in the country under investigation. Commercially available world market prices can therefore be used as a market benchmark, in appropriate circumstances, consistent with Article 14(d).

18. As the EC points out, the issue therefore is not whether Article 14(d) permits the use of commercially available world market prices (such as U.S. stumpage prices) *per se*, but rather whether it was appropriate to do so in this case. The facts discussed below demonstrate that the Commerce Department's use of commercially available U.S. stumpage prices was appropriate in this case and therefore consistent with Article 14(d) of the SCM Agreement.

2. There Is No Evidence of a Market Benchmark in Canada

19. When considering the entire universe of potential market benchmarks, the United States agrees that prices within the country under investigation should be used whenever possible. Use of prices within the country under investigation is, however, not always possible. The obvious example, which the EC noted, is the case of a government monopoly for the good in question. In such a case there is no "market" benchmark price. That example is no different in principle from the circumstances of this case. The provincial governments control 85 to 95 percent of the market for timber. There is extremely limited information on non-government prices and the evidence indicates that non-government prices are suppressed by government prices. There is therefore no "market" benchmark price in Canada that could measure the benefit. That conclusion is not based on theory, it is based on the record evidence.

20. First, only three provinces provided any private price data in response to the Commerce Department's questionnaire. Canada's claim that there was "extensive evidence" related to private markets in those provinces is simply not supported by the record. The limited data provided by the provinces was inadequate for purposes of establishing a market benchmark. For example, as the United States explained in its response to the Panel's questions, Alberta stated that it does not have any data on private timber used in sawmills. The so-called "extensive" data provided by Alberta was a two-page excerpt from a KPMG survey, which contained a single estimated stumpage value derived from some price data for log sales. Moreover, Alberta acknowledged that the estimated value was based on information that did not distinguish between private and *Crown* timber.

21. Ontario and Quebec submitted market surveys. However, the Ontario survey was flawed in several respects (e.g., it provided no information on quality or grade). Moreover, there was substantial evidence on the record, including statements by an official in Quebec's Ministry of Natural Resources, that government prices suppressed private prices in the provinces. In fact, one Canadian group said that "downward pressure on the price of private wood is built into the system." The influence of a dominant owner has been recognized in other markets as well. A study of stumpage trends in South Australia notes:

> Of the total [productive forest land] . . . [a]bout 70 per cent of the resource is publicly owned. The percentage of the publicly owned resource was even higher in the past. Hence it is likely that stumpage for public pine logs has held a dominating influence on stumpage for similar logs sold by private growers in [South Australia].

22. The remainder of the evidence that Canada cites consists of evidence that does not actually pertain to private prices. That evidence instead largely pertains to whether the provinces recover their costs and earn a profit when they sell timber. The government's profitability is, however, not the issue. It is now well settled that the cost to the government is irrelevant in measuring benefit. Moreover, the purported fact that the provincial governments made a profit does not establish that they sold Crown timber at market prices. The information provided therefore does not address the relevant inquiry, i.e., whether provincial prices for timber are more advantageous than those that would have been available to lumber producers on the market absent the provincial governments' financial contribution.

23. As the above analysis of the record demonstrates, there was insufficient evidence of "market" prices in Canada to form a benchmark. As the EC asked, "which other benchmark should be used in [such a case]?" The United States agrees with the EC that, in the absence of market prices in Canada, the use of other prices commercially available to Canadian lumber producers on world markets is a reasonable alternative. As demonstrated below, stumpage prices for comparable timber in the United States are commercially available to lumber producers in Canada.

3. U.S. Stumpage Prices Are Commercially Available to Canadian Lumber Producers

24. Canada agrees that some prices commercially available on the world market, specifically import prices, can provide a benchmark consistent with Article 14(d). Canada argues, however, that it is impossible for there to be import prices in this case. Canada does not claim that Canadian producers cannot or do not harvest timber in the United States, or that U.S. timber cannot be imported into Canada. Canada simply reverts to its argument that the provincial governments are providing a "right," not timber, and that a "right" cannot be imported. Once again, in Canada's view, form is all that matters. As the United States has amply demonstrated above, the provincial governments are not merely providing rights, they are providing timber. U.S. timber can be, and in fact is, imported into Canada.

25. More importantly, Canadian lumber producers can and do purchase U.S. timber on the stump for harvesting and import into Canada. The SCM Agreement states that "commercially available means that the choice between domestic and imported products is unrestricted and depends only on commercial considerations." Canadian lumber producers have virtually unrestricted access to U.S. stumpage for import into Canada. U.S. stumpage is therefore commercially available to Canadian lumber producers. Because U.S. stumpage prices are commercially available to Canadian lumber producers, they fall within the universe of benchmarks that can be considered for purposes of measuring the benefit from provincial stumpage, consistent with Article 14(d) of the SCM Agreement.

26. In fact, based on commercial considerations, U.S. stumpage prices are the most reasonable world market prices to use because the terrain, topography and species mix for U.S. timber in border states are most comparable to those in Canada, and because the record shows that Canadian companies do in fact purchase U.S. timber. In fact, virtually all of Canada's timber imports come from the United States.

27. Furthermore, it is reasonable to conclude that U.S. stumpage prices represent appropriate market-based benchmark prices to measure whether provincial prices confer an artificial advantage. The observed price difference for Canadian and U.S. stumpage does not reflect differences in inherent market characteristics in Canada versus the United States. Rather, it reflects the fact that the Canadian system precludes price arbitrage for timber. There is a fully integrated North American *lumber* market that coexists with a largely segregated North American *timber* market. Canada exports over half of its total lumber production to the United States, but only three percent of its timber production. The United States exports little lumber to Canada, but exports nearly six times as much timber. The low volume of timber trade between the two countries is the result of domestic processing requirements in Canada that limit the flow of Canadian logs southward, and the advantageous stumpage prices in Canada inhibit the flow of U.S. logs northward. The segregated timber market in North America allows for virtually no price arbitrage in timber markets across the border.

28. The unusual nature of the situation in the North American market is evident when compared to the substantial amounts of lumber and timber exports from other countries with major timber and lumber industries. More importantly, the data indicates that U.S. stumpage prices are comparable to prices in Australia, New Zealand, Finland and Chile.

29. The Commerce Department's use of prices for comparable U.S. timber that is commercially available to lumber producers in Canada was therefore appropriate in this case. Moreover, in establishing the market benchmark, the Commerce Department took into account other market conditions prevailing in Canada for timber, such as species, quality and tenure obligations. The market benchmark that the Commerce Department used in the Preliminary Determination was therefore consistent with Article 14(d).

C. The Commerce Department Properly Calculated the Total Amount of the Subsidy to Producers of the Subject Merchandise

30. Canada alleges that the Commerce Department improperly assumed that the benefit from a financial contribution to one entity accrued to another entity. These allegations pertain to three distinct situations: (1) logs harvested by one sawmill and then sold in arm's-length transactions to other sawmills; (2) lumber sold in arm's-length transactions to companies that produce remanufactured lumber products; and (3) timber harvested by independent loggers who sell at arm's-length to lumber mills. In each case, the allegations do not withstand close scrutiny.

31. In the first two situations, all of the alleged recipients of the financial contribution and the benefit are producers of the subject merchandise. As discussed previously, in an aggregate case no further analysis of these situations is necessary to perform the aggregate calculation. The numerator (total benefit to the subject merchandise) is properly matched to the denominator (total sales of the subject merchandise). The precise amount of the benefit received by a specific producer would only be determined in a company-specific review.

32. Canada's claim with respect to the third situation rests on the assertion that the provincial governments provide a significant volume of Crown timber to independent loggers who then sell the timber at arm's-length to lumber mills. In response to the Panel's questions on this issue, the parties have provided record evidence concerning the operation of provincial tenures, and, in particular, the restrictions that the provinces impose on who may acquire a tenure and what the tenure holder may do with the harvested timber. While it is not the Panel's task to conduct a *de novo* review of those facts, a careful analysis of this evidence demonstrates that it does not support Canada's claim that lumber producers acquire a significant volume of timber from independent loggers.

33. First, as the United States has previously demonstrated, the potential volume of timber provided by so-called "independent" loggers is small. Canada's "evidence" to the contrary relies in large part on confusing or irrelevant statistical data. For example, Canada claims that "large numbers of harvesters" are independent loggers. The number of harvesters is, however,

irrelevant. The issue is not how many independent loggers there are, but rather whether they provide a significant *volume* of Crown timber to lumber producers. Moreover, it is irrelevant if the harvester is "independent" if the mill owns the license (or is tied to the license contractually, as in Ontario).

34. The record demonstrates that the vast majority of the Crown softwood sawlog harvest is, in fact, under tenure to sawmills. This fact is obscured by Canada's province-specific data. For example, instead of estimating the volume of softwood sawlogs harvested by independent loggers in British Columbia, which is the relevant data, Canada estimates the volume of "timber" harvested by companies "not owning sawmills." "Timber" includes hardwood as well as softwood, and pulpwood as well as sawlogs. Moreover, it is completely irrelevant that some portion of the Crown timber was harvested by a tenure holder owning a pulpmill rather than a sawmill, if that timber was not used to make subject merchandise. The relevant fact is that more than 83 percent of the British Columbia Crown softwood timber harvest is provided under tenures that require the tenure holder to own a sawmill.

35. Canada's statements with respect to the potential universe of "independent loggers" in Quebec are perhaps the most difficult to understand because they are almost entirely irrelevant. The issue is the percentage of the *Crown* harvest of softwood sawlogs that is provided to lumber mills by independent harvesters. In Quebec, 99 percent of the Crown harvest is provided under Timber Supply and Forest Management Agreements ("TSFMA"). The Quebec Forest Act states that "[n]o one except a person authorized under Title IV to construct or operate a wood processing plant is qualified to enter into" a TSFMA. The harvest from Federal lands, which is minuscule (less than 1 percent), and private lands is irrelevant to the benefit calculation, as is the fact that there are 40,000 registered woodlot owners. Given the TSFMA requirements, it is virtually impossible to have a significant percentage of independent loggers harvesting Crown timber in Quebec.

36. Similarly, in Saskatchewan, more than 86 percent of softwood sawlogs were harvested by tenure holders that own sawmills and process their own timber, and in Manitoba, approximately 95 percent of the softwood sawlogs were provided directly to sawmills. Alberta also stated that "[a]ll forms of commercial tenure own and operate sawmills."

37. Second, to the extent there may be a small portion of Crown timber harvested by entities that do not own processing facilities, transactions between those entities and the lumber mills are not at "arm's-length." A truly arm's-length negotiation is one where neither party is under any outside control or influence, either from the party with whom they are bargaining, or other parties.

38. Canada claims that tenure holders are free to sell their logs to unrelated mills. In fact, the record evidence demonstrates the contrary. For example, Quebec indicated that there were essentially no arm's-length transactions involving Crown timber sold by independent loggers to sawmills. Moreover, the record establishes that all of the provinces generally require that Crown

timber be processed in a mill within the province. Each province also imposes other restrictions that impede a harvester's ability to negotiate freely and that compel the harvester to sell to particular customers. For example, in Ontario, as a condition of the license, tenure holders are required to sign "wood supply agreements," in which they agree to supply specific quantities of wood to specific mills. The licenses also provide that the Ministry of Natural Resources can direct excess log production to specific mills. In British Columbia, major licensees are required by law to process their logs or an "equivalent volume" of wood in their mills. Similarly, in Alberta, all licenses on the record specify a particular fixed volume that must be processed in a specific mill. Moreover, the evidence shows that the so-called independent loggers often operate as employees or contractors for tenure holders. In addition, Canada's claim of significant "sales" by independent harvesters includes transactions that are, in fact, "swaps."

39. In light of this evidence, the only reasonable conclusion is that there are no true arm's-length transactions for Crown timber between independent loggers and lumber mills. There is therefore no basis for Canada's claim.

D. The Preliminary Critical Circumstances Finding Is Consistent with the SCM Agreement

40. As fully discussed in the U.S. prior submissions, Canada has failed to make a *prima facie* case that the Commerce Department's preliminary critical circumstances finding was inconsistent with the SCM Agreement. The Commerce Department's imposition of provisional measures in this case on merchandise entered during the 90-day period prior to the publication of the Preliminary Determination was in fact fully consistent with the text of Article 20 of the SCM Agreement, as well as with its object and purpose.

41. Article 20.1 expressly provides that the prospective application of provisional measures and final duties is "subject to the exceptions set out in this Article." Article 20.6 provides such an exception, stating that a Member may assess final, definitive duties retroactively for a period "not more than 90 days prior to the date of application of provisional measures" if critical circumstances are present. As discussed in the U.S. prior submissions, retroactive provisional measures (including suspension of liquidation and cash deposits or bonds) are essential to enable a Member to avail itself of the special remedy provided under Article 20.6. It is therefore the view of the United States that a Member may impose retroactive provisional measures if there is a reasonable basis to believe or suspect at the time of the preliminary determination that critical circumstances exist.

42. With respect to Canada's remaining critical circumstances claims, the United States will, at this time, rely on its prior submissions.

E. U.S. Laws Governing Reviews Are Consistent with the SCM Agreement

43. No reviews have been requested, much less denied, in this case because the United States has not yet imposed definitive countervailing duties. Canada simply claims that the U.S. laws governing such reviews are inconsistent with the SCM Agreement. Under established WTO jurisprudence, however, a Member's law breaches that Member's WTO obligations only if the law *mandates* action that is inconsistent with those obligations. If the law provides discretion to authorities to act in a WTO-consistent matter, the law, as such, does not breach a Member's WTO obligations.

44. For the reasons fully discussed in the U.S. prior submissions, the U.S. laws that Canada challenges clearly do not mandate action inconsistent with U.S. WTO obligations. U.S. law instead gives the Commerce Department broad discretion to conduct reviews in a WTO-consistent manner.

III. CONCLUSION

45. For the reasons set forth above, the United States requests that the Panel reject Canada's claims in their entirety.[2]

[2] Canada asserts violations of Articles 10 and 32.1 of the SCM Agreement, which are dependent on the more specific claims addressed herein. The dependent claims are therefore also without merit for the reasons stated above.