UNITED STATES – FINAL COUNTERVAILING DUTY DETERMINATION WITH RESPECT TO CERTAIN SOFTWOOD LUMBER FROM CANADA

Recourse to Article 21.5 of the DSU by Canada

(WT/DS257)

SECOND WRITTEN SUBMISSION
OF
THE UNITED STATES

March 31, 2005

I. Introduction

1. On March 10, 2005, the United States filed its First Submission and Request for Preliminary Ruling. Pursuant to the Panel's working procedures, the United States is now filing its rebuttal submission.

2. To implement the recommendations and rulings of the Dispute Settlement Body ("DSB") in *United States – Final Countervailing Duty Determination With Respect to Certain Softwood Lumber From Canada*,[1] on December 6, 2004, the U.S. Department of Commerce ("Commerce") issued a revised determination ("Section 129 Determination").[2] In accordance with those recommendations and rulings, in the context of its Final Determination,[3] Commerce determined the amount of the subsidy that passed through the purchase transaction with respect to certain arm's-length log sales between unrelated parties. Ultimately, Commerce's analysis of log sales demonstrated to be at arm's length resulted in a C$28,344,121 reduction in the numerator of the *ad valorem* subsidy rate, which had the effect of reducing the country-wide subsidy rate from 18.79 percent *ad valorem* to 18.62 percent *ad valorem*.[4] Commerce's Section 129 Determination is consistent with the DSB's recommendations and rulings, the *Agreement on Subsidies and Countervailing Measures* ("SCM Agreement") and the *General Agreement on Tariffs and Trade 1994* ("GATT 1994"), and the Panel should so find.

3. In this proceeding, however, Canada is asking the Panel to find that the United States is subject to conditions and restrictions that are nowhere to be found in the SCM Agreement or GATT 1994, that were not part of the DSB's recommendations and rulings, and that are entirely otherwise unwarranted. In so doing, Canada attempts to deflect attention away from its own failure in many instances to provide Commerce with the data necessary to conduct the analysis recommended by the DSB. Neither Canada's attempt to prevent Commerce from conducting a meaningful pass-through analysis, nor its failure to provide the requested data, however, translates into a failure by the United States to comply with the DSB's recommendations and rulings or results in a measure that is inconsistent with the SCM Agreement or the GATT 1994.

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[1] Appellate Body Report, WT/DS257/AB/R, adopted 17 February 2004, ("Appellate Body Report"); Panel Report, WT/DS257/R, adopted 17 February 2004 ("Panel Report").

[2] *Section 129 Determination: Final Countervailing Duty Determination, Certain Softwood Lumber from Canada*, December 6, 2004 ("Section 129 Determination") (Exhibit CDA-5). The Section 129 Determination was implemented on December 10, 2005, at the request of the Office of the United States Trade Representative. *See Notice of Implementation Under Section 129 of the Uruguay Round Agreements Act; Countervailing Measures Concerning Certain Softwood Lumber Products From Canada*, 69 FR 75305 (December 16, 2004). Exhibit CDA-7. For summaries of provincial claims and the results of Commerce's pass-through determination, *see* "Draft Decision Memorandum" In the Matter of the Section 129 Determination on the Final Countervailing Duty Determination with Respect to Certain Softwood Lumber from Canada ("Draft Section 129 Determination"), November 19, 2005, at 8-15 (Exhibit CDA-6). Any modifications to Commerce's analysis are discussed in the Comment section of the Section 129 Determination. "Section 129" refers to the provision of the Uruguay Round Agreements Act that provides procedures for implementing certain DSB recommendations and rulings with respect to countervailing duty investigations.

[3] *Notice of Final Affirmative Countervailing Duty Determination and Final Negative Critical Circumstances Determination: Certain Softwood Lumber Products from Canada*, 67 Fed. Reg. 15545 (April 2, 2002), as amended, 67 Fed. Reg. 36070 (May 22, 2002) ("Final Determination"). Exhibit US-1.

[4] Section 129 Determination, at 1. Exhibit CDA-5.

4. As described below, and contrary to Canada's arguments, Commerce conducted its pass-through analysis consistently with the DSB's recommendations and rulings, and the resulting measure at issue is consistent with the SCM Agreement and the GATT 1994.

II. Commerce Conducted a Pass-Through Analysis That is Consistent with the DSB's Recommendations and Rulings and with the SCM Agreement and GATT 1994

5. Canada does not challenge Commerce's general approach of reducing the numerator of the *ad valorem* subsidy rate calculation to eliminate subsidies attributed to arm's-length sales in which no benefit was passed through. Instead, Canada complains that Commerce, rather than conducting a pass-through analysis, "presumed" pass through. A foundation of Canada's "presumption" argument is its assertion that Commerce must adopt an unreasonable definition of the term "arm's length"[5] that would prevent Commerce from conducting a meaningful analysis of whether, in fact, sales are at arm's length. Consequently, whenever Commerce determined that a transaction was not at arm's length, according to Canada's unreasonable definition of arm's length, Commerce improperly "presumed" pass-through of the subsidy. Additionally, Canada argues that Commerce "presumed" pass-through by disregarding aggregate data submitted by Canada[6] and excluding from its analysis sales between tenure-holding sawmills.[7] In making its arguments Canada ignores the necessarily company-specific nature of the analysis undertaken by Commerce and the actual findings of the DSB, including the specific definitions of the categories of companies for which a pass-through analysis had to be performed. As set forth below, Commerce properly conducted its pass-through analysis.

A. Commerce Issued Questionnaires to Obtain Data Necessary to its Analysis

6. To conduct its pass-through analysis, Commerce first had to obtain data from Canada[8] supporting Canada's claim that a portion of the total volume of Crown logs processed into lumber – as reported by Canada – should be reduced to account for arm's-length log sales between unrelated parties in which no benefit passed through. Because Commerce had conducted the original investigation on an aggregate basis and not on a company-specific basis and had not previously conducted such a pass-through analysis, the administrative record did not contain evidence supporting Canada's claims.

7. In the original investigation, Commerce calculated the subsidy benefit from Provincial Crown timber programs by assessing the extent to which each Province sold timber for less than

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[5] First Written Submission of Canada, February 24, 2005 ("First Written Submission of Canada"), paras. 38, 59-65.

[6] First Written Submission of Canada, para. 58.

[7] First Written Submission of Canada, para. 54-55.

[8] First Written Submission of Canada, para. 6. As acknowledged by Canada, "Section 129 proceedings may involve the issuance of new questionnaires . . . ."

adequate remuneration. This subsidy benefit is the numerator, which is divided over the relevant sales of lumber and by-products that benefit from the subsidy, the denominator, to determine the countervailable *ad valorem* subsidy rate. Commerce needed specific information and data to calculate any adjustment to this subsidy benefit numerator to account for potentially arm's-length sales of Crown logs between unrelated parties in which the subsidy did not pass through. Specifically, Commerce needed the volume of the log sales in Canada during the period of investigation ("POI") for which Canada sought a pass-through analysis. Additionally, to determine whether the reported log transactions were between unrelated parties, Commerce required information concerning any affiliation between the buyer and seller of the logs. Further, Commerce required information concerning government-mandated restrictions and other factors that could limit or control the terms of the sale, and thus undermine the arm's-length nature of the sale. Finally, to conduct the "competitive benefit" analysis, through which Commerce measured whether and to what extent any subsidy passes through, Commerce required specific data on prices, species, size, grade, quality, discounts delivery terms, and payment terms.

8. Therefore, Commerce asked Canada, through questionnaires, to identify the volume of log sales subject to its pass-through claims, and to provide specific information necessary to determine whether log sales were between unrelated parties and at arm's length. This would allow Commerce to identify transactions that were eligible for the last phase of the analysis (competitive benefit). The requested information related to, *inter alia*, the relationship between the parties to the specific transactions (such as whether the parties were affiliated) and the circumstances surrounding the subject sales.

9. On April 14,[9] August 17,[10] and October 5, 2004,[11] Commerce issued questionnaires and supplemental questionnaires to Canada with respect to this issue. Commerce notified Canada in its initial questionnaire that if a province was claiming that any portion of the volume of Crown logs reported in the numerator[12] was sold in arm's-length transactions and was between unrelated parties and required an analysis to determine if the purchasing sawmill received a subsidy benefit, the province was required to provide an explanation of how the volume was calculated and documentation supporting its claims.[13] The Canadian provincial governments provided

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[9] *See,* Letter from Department of Commerce to Embassy of Canada, April 14, 2004, Pass-Through Questionnaire. Exhibit CDA-3.

[10] *See,* Letter from Department of Commerce to Embassy of Canada, August 17, 2004, Supplemental Pass-Through Questionnaire. Exhibit CDA-23.

[11] *See*, Letter from Department of Commerce to Embassy of Canada, October 5, 2004, Second Supplemental Pass-Through Questionnaire. Exhibit CDA-24.

[12] The numerator of Commerce's final subsidy calculation consisted of the total benefit received, which was calculated based on the total volume of Crown timber harvested during the POI that actually entered and was processed by sawmills, as reported by each of the provinces.

[13] In accordance with the DSB's recommendations and rulings (Panel Report, at para. 7.99; Appellate Body Report, at para. 167(e)), Commerce specifically requested information relating to the portion of the total volume of Crown timber entering sawmills reported by the provinces claimed to be "sold in arm's length transactions by tenure

questionnaire responses on May 21, 2004. Although the provincial governments provided certain information that had been requested, the responses were incomplete.

10. Therefore, on August 17, 2004, Commerce issued a supplemental "pass-through" questionnaire in which it informed Canada that its May 21, 2004, responses were deficient in a number of respects and that the "information provided in the questionnaire response is insufficient for the Department to complete its 'pass-through' analysis."[14] In that supplemental questionnaire, Commerce requested additional and clarifying information from the provincial governments and from independent harvesters and mills with respect to log sales that they claimed were at arm's length. Responding to Canada's complaint that certain of its requests could not be answered because the provincial governments lacked access to certain data, Commerce modified its requests for information.

11. Notably, Commerce attached a pass-through appendix to the supplemental pass-through questionnaire and requested that the provincial governments provide the appendix to the independent harvesters and sawmills involved in the log sales for which a pass-through analysis was requested. In the pass-through appendix Commerce requested information directly from the sawmills and independent harvesters concerning affiliations and corporate relationships, as well as information relating to the terms of the sales, including log sales data and purchase contracts.[15]

12. On September 15, 2004, the Canadian parties submitted their responses to this supplemental questionnaire. Certain sawmills and independent harvesters submitted responses to the pass-through appendix. However, notwithstanding Commerce's earlier notice to Canada that in the absence of the requested data Commerce might not have sufficient data to complete its pass-through analysis, Canada once again provided incomplete responses to Commerce's data requests. Canada posited two reasons for its failure to respond properly to Commerce's requests: first, it claimed that certain of the requests were voluminous and that it was burdensome for it to collect the data; second, it claimed that certain information requested by Commerce was not relevant.[16]

13. On October 5, 2004, Commerce issued a second supplemental pass-through questionnaire

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holders that did not own a sawmill . . ." and "sold in arm's- length transactions by tenured timber sawmills to sawmills that do not have tenure . . ." Exhibit CDA-3, at 10, 11 (questions 1 and 2).

[14] Exhibit CDA-23.

[15] Exhibit CDA-23, at 1 and Pass-Through Appendix - 1.

[16] *See, e.g.,* CDA-23, at 6 (Ontario question 1); Response of the Government of Ontario to the Department's August 17, 2004 Supplemental Pass-Through Questionnaire (September 15, 2004), at ON-PASS-2, -3 ("Ontario September 15 Pass-Through Response"). Exhibit US-3. *See also*, Response of the Government of British Columbia to the Department's August 17, 2004 Supplemental Questionnaire Concerning Pass Through of the Alleged Benefits (September 15, 2004), at 10 ("British Columbia September 15 Pass-Through Response"). Exhibit US-4.

and a supplemental pass-through appendix. Because the provincial governments failed to respond adequately to Commerce's earlier questionnaires, Commerce again requested clarifying and additional information. As noted in its second supplemental pass-through questionnaire, Commerce modified certain of its requests, where practicable, in response to Canada's claim that to provide the information was burdensome.[17] With respect to Canada's claim that certain information was not relevant, Commerce reiterated to Canada that it needed the data to conduct the DSB's recommended analysis. The Canadian parties submitted a response to the second supplemental questionnaire on October 25, 2004.

14. By refusing to provide certain of the data requested by Commerce, Canada was and is attempting to restrict Commerce's ability to conduct a meaningful pass-through analysis. Canada contends that Commerce's arm's-length analysis should be nothing more than a simple determination of whether the parties to the transaction are unrelated. Indeed, Canada argues that Commerce erred in not relying upon Canada's "aggregate" data – data that (although limited to sales between unrelated parties) fails to address factors other than affiliation that could render the transactions something other than arm's length. As discussed below, Commerce's arm's-length analysis properly included examination of issues beyond mere affiliation.

B. Commerce Properly Conducted Its Arm's-Length Analysis as Part of Its Pass-Through Analysis

15. Commerce first analyzed the information provided by Canada to determine whether the sales were between related parties. If they were, no further analysis was conducted, because the DSB's recommendations and rulings concerned only sales between unrelated parties.[18] Commerce next analyzed the sales between unrelated parties to determine if they were at arm's length. Canada challenges this necessary step in its entirety, in the apparent and mistaken belief that all sales between formally unrelated parties are necessarily at arm's length. Therefore, according to Canada, by even analyzing whether such sales are, in fact, at arm's length, and then eliminating sales that fail the arm's-length test from the pass-through analysis, Commerce is somehow illegally "presuming" pass-through. This is incorrect. Indeed, it is Canada that is "presuming" no pass through for all sales between unrelated parties. Further, there is nothing in the SCM Agreement, the GATT 1994, or the DSB's recommendations and rulings that suggests

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[17] In the second supplemental questionnaire, Commerce further modified its requests. By way of example, in response to the Government of British Columbia's ("GBC") statement that it did not have access to log purchase agreements for the transactions claimed to be at arm's length, Commerce limited its request to those sawmills that participated in the Norcon Survey that was prepared at the GBC's request. Exhibit CDA-24, page 5 at 6. With respect to a the Government of Alberta's ("GOA") concern that it could not provide all copies of tenure agreements relating to commercial timber permits ("CTPs"), Commerce limited its request to tenure agreements associated with coniferous timber quotas ("CTQs") and certain CTPs that were identified by Commerce. Exhibit CDA-24, page 8 at 1. Similarly, Commerce modified its requests for timber return data from the GOA to those portions containing the text relating to the payment of the stumpage dues. Exhibit CDA-24, page 9 at 7.

[18] Canada has not challenged Commerce's affiliation determinations. First Written Submission of Canada, para. 74, fn. 66.

that Commerce's analysis of whether sales are at arm's length should be so severely limited, or indeed, eliminated.

1. Commerce's Approach to Determining Whether Sales are at "Arm's Length" – Involving Factors Other Than Mere Affiliation – is Consistent with the DSB's Recommendations and Rulings, the SCM Agreement, and the GATT 1994

16. Canada claims that Commerce "applied a contrived standard"[19] in determining whether its claimed log sales were at arm's length. However, the term "arm's length" is not used or defined in the text of the SCM Agreement; thus, it is unclear on what basis Canada makes its claim that the standard Commerce applied is "contrived." The Appellate Body concluded in this dispute that both the SCM Agreement and the GATT 1994 require that, where subsidies are bestowed directly on producers of an *input* product, while countervailing duties are to be imposed on *processed* products, "*and where input producers and downstream processors operate at arm's length*," Commerce must establish that the benefit is passed through to the downstream processor.[20] Therefore, where the two producers do not operate at "arm's length", no determination of the amount of the subsidy passing through the transaction is required because the subsidy bestowed on the input producer benefits the producer of the processed product. Whether the entities operate "at arm's length" involves more than just a question of formal affiliation; it involves an analysis of whether one party effectively "controls" the other or whether the parties have roughly equal bargaining power.[21] In other words, if one of the parties controls the other or their dealings are not between entities of equal bargaining power, neither the SCM Agreement nor the GATT 1994 require that the amount of the subsidy passing through the transaction be determined; rather, the investigating authority may regard the subsidy

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[19] First Written Submission of Canada, para. 59.

[20] Appellate Body Report, para. 146 (emphasis on "arm's length" in original).

[21] *See* BLACK'S LAW DICTIONARY, Seventh Edition (West Group 1999) at 103 ("Of or relating to dealings between two parties who are not related or not on close terms and who are presumed to have roughly equal bargaining power; not involving a confidential relationship. . . ."). Exhibit US-5. *See also*, THE NEW SHORTER OXFORD ENGLISH DICTIONARY, Thumb Index Edition (Oxford University Press 1993) at 114 ("without undue familiarity; (of dealings) with neither party controlled by the other"). Exhibit CDA-18.

In the specific context of a dispute concerning countervailing duties, *see* Panel Report, *Korea - Measures Affecting Trade in Commercial Vessels*, WT/DS273 (March 7, 2005), para. 7.135. *(*European Communities' challenged certain Korean subsidies as prohibited subsidies under Articles. 3.1 and 3.2 of the SCM Agreement). In determining the appropriateness of a market benchmark, the panel considered whether purchasing negotiations were at arm's length when the buyer was able to dictate the source from which a shipyard was to procure an advanced payment refund guarantee (APRG). According to the panel, "[i]n such cases, the designation of the APRG-provider by the buyer means that there is a risk that the APRG is not negotiated at arm's length, since the shipyard is a captive buyer. The rate paid by the shipyard might therefore be higher than it would if the shipyard were able to shop around and compare offers from alternative suppliers."

bestowed on the input as benefitting the processed product.[22]

17. Thus, the issue is not merely one of affiliation. In this regard, the DSB's recommendations and rulings themselves recognize a distinction between arm's length and affiliation presenting arm's-length sales as a subset of sales between unrelated entities. Specifically, the DSB ruled that Commerce should have conducted "a pass-through analysis in respect of *arm's length sales* of *logs* . . . to *unrelated* sawmills."[23] This is completely inconsistent with Canada's contention that an arm's-length analysis requires nothing more than a determination of affiliation.[24]

18. Commerce properly examined, in its pass-through analysis, whether the parties to the log sales were related through common ownership and also whether any of the circumstances surrounding the log sales affected the nature of the sales to such an extent that they could not be considered arm's length. Initially, and as discussed above, Commerce examined whether any of the log sales at issue were between affiliated parties. Consistent with the DSB's recommendations and rulings, when Commerce found that sales were between affiliated parties, it performed no further pass-through analysis.[25] If the sales were between unaffiliated parties, Commerce examined the circumstances surrounding the transactions as part of its "arm's length" analysis.

19. Commerce properly examined the circumstances surrounding the sales Canada reported as occurring between unrelated parties. Although Canada objects to Commerce's approach, Canada can point to no language in the SCM Agreement, the GATT 1994, or the DSB's recommendations and rulings that establishes the *per se* affiliation analysis advanced by Canada. Indeed, the record evidence demonstrates that many of the sales that Canada claims are arm's-length sales are affected by government mandates and other conditions that render those sales not at arm's length or otherwise ineligible for the pass-through analysis. These will be discussed in the following section.

2. The Record Demonstrates that Under the Canadian Stumpage System, Many of the Circumstances of the Sales are Controlled by Government Mandates and Other Conditions

20. Canada's simplistic *per se* approach is divorced from the reality of the Canadian stumpage system. With respect to many transactions, record information demonstrates that certain government-mandated restrictions and other factors controlled, limited, or otherwise

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[22] *See* Appellate Body Report, para. 143 ("Where the input producers and producers of the processed products operate at *arm's length*, the pass-through of input subsidy benefits from the direct recipients to the indirect recipients downstream cannot simply be presumed; . ..") (underscored emphasis added).

[23] Appellate Body Report, para. 176(e) (emphasis added, except that emphasis on "logs" is in original.)

[24] Appellate Body Report, para. 124. (emphasis added).

[25] Section 129 Determination, at 4. Exhibit CDA-5.

affected the log sales, warranting Commerce's determination that they were not conducted at arm's length or, in some instances, were not sales at all.

21. Specifically, record evidence demonstrates that the provincial governments impose restrictions upon log sales that affect many of the transactions that Canada reported as arm's-length sales. Commerce identified two such categories of government-mandated restrictions: (1) limitations on log sales that are contained in Crown tenure contracts, such as appurtenancy and local processing requirements, and (2) wood supply agreements.[26] Canada does not suggest that such governmental mandates do not exist, but instead submits that such mandates do not affect the arm's-length nature of the transaction between the parties.[27] According to Canada, the fact that the government dictates the disposition of Crown timber by dictating to whom a seller must sell has no bearing on the actual terms of sale – so long as parties are not formally affiliated, any transaction between them must be considered at arm's length. Despite Canada's protestations to the contrary, under both categories of government-mandated restrictions, log sellers are not free to act in their best interests to choose and negotiate among potential buyers. Where the provincial governments limit the ability of a seller to sell freely and instead dictate to whom the seller must sell, Commerce reasonably determined, consistent with any reasonable reading of the term "arm's length," that the affected sales were not at arm's length.[28]

22. Further, based on the record, Commerce determined that there was an additional factor[29] – other than the above government-mandated restrictions – that affected many of the Canadian log sales such that they could not be considered to be at arm's length. The actual structure of certain log purchase agreements[30] empowered the purchasing sawmill to control so many aspects of the transaction that Commerce determined that transactions covered by such purchase agreements could not be considered to be arm's length. Specifically, with respect to certain log purchase agreements, the sawmill actively manages all aspects of harvest and delivery. With respect to others, the sawmill finances or provides other goods or services as part of the transaction.[31] To enable Commerce to distinguish log purchase agreements that do represent arm's-length log sales from those that do not, it was necessary for Commerce to review the purchase agreements themselves.

23. Although not exclusively arm's-length issues, Commerce identified two additional

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[26] Section 129 Determination, at 4. Exhibit CDA-5.

[27] First Written Submission of Canada, paras. 62-64.

[28] *See, e.g.,* Panel Report, *Korea - Measures Affecting Trade in Commercial Vessels*, WT/DS273 (March 7, 2005), para. 7.135 ("captive buyer" creates risk that the transaction is not at arm's length.).

[29] Commerce identified three additional factors affecting its pass-through analysis. However, as discussed above, two of the three factors are not exclusively arm's-length issues.

[30] Section 129 Determination, at 5. Exhibit CDA-5. The log purchase agreements that were provided to Commerce are proprietary documents. However, Commerce can state generally that these agreements contained vastly differing conditions and terms of sale. As evidenced by Commerce's reduction in the numerators of Alberta, Ontario and Saskatchewan, there were log purchase agreements that did satisfy Commerce's pass-through analysis.

[31] Section 129 Determination, at 5. Exhibit CDA-5.

factors affecting its pass-through analysis – factors that Canada contends should have had no bearing upon Commerce's analysis. Specifically, Commerce determined that in certain transactions the purchasing sawmills pay the Crown stumpage fees directly to the government for logs obtained from independent harvesters. Because the vehicle by which the Crown bestows the subsidy is through the administered stumpage programs, when the purchasing sawmill pays the Crown directly for the stumpage, the purchasing sawmill directly receives the benefit and "pass-through" is not at issue.[32] Additionally, excluded from Commerce's analysis were fiber exchanges between Crown tenure holders, which often involved simple exchanges of, for instance, logs for chips, to meet appurtenancy and other harvesting requirements. These exchange agreements are a mechanism for tenured sawmills to deal with various government restrictions concerning the disposition of the harvested timber and are not log sales.[33]

24. The record was replete with evidence that demonstrated that certain government-mandated restrictions and other factors controlled, limited, or otherwise affected the log sales (in fact rendering some of them not sales at all), supporting Commerce's determination to examine more than simple affiliation in analyzing whether sales were at arm's length for the purpose of its pass-through analysis.

C. Commerce Appropriately Required That Canada Provide Company-Specific Information to Determine Whether the Transactions for Which a Pass-Through Analysis Was Requested Were Eligible for Such Analysis

25. Canada contends that Commerce improperly disregarded "aggregate" data that it submitted containing sales information from the provinces that generally identified the purchasers and sellers and the volume and value of sales that Canada identified using its *per se* test as arm's-length transactions.[34] Canada also complains that Commerce refused to rely upon certain "sample" data. As discussed above, however, Commerce correctly determined that the arm's-length component of its pass-through analysis required more than just a determination concerning whether parties were affiliated. Additionally, Commerce correctly determined that other factors affected the pass-through analysis. Thus, Commerce required specific information on each transaction for which Canada requested a pass-through analysis, which necessitated that Canada provide more than just its aggregate data and, in some cases, more than its self-selected sample data.[35] This follows not only from the very nature of the inquiry, but also from the

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[32] Section 129 Determination, at 5. Exhibit CDA-5.

[33] Section 129 Determination, at 5-6. Exhibit CDA-5

[34] First Written Submission of Canada, paras. 8, 76.

[35] Commerce did not disregard "sample" data provided by Canada. To the contrary, in response to certain concerns expressed by Canada, Commerce permitted Canada to submit subsets of data responding to its questionnaires. As noted previously, for example, with respect to British Columbia, Commerce limited its request for log purchase agreements to the 74 sawmills that participated in the Norcon Survey that was prepared at the GBC's request. Exhibit CDA-24, page 5 at 6. With respect to the Government of Alberta's ("GOA") concern that it could not provide all copies of tenure agreements relating to commercial timber permits ("CTPs"), Commerce

DSB's recommendations and rulings themselves.

26. The DSB's recommendations and rulings required that Commerce determine whether transactions between independent harvesters and sawmills, as well as between tenured harvesters/sawmills and sawmills, "passed through" the benefit from subsidies provided to the independent harvesters or tenured harvesters/sawmills. This is a company-specific issue, *i.e.*, an issue that is specific to each combination of log buyer and log seller, and the DSB recognized it as such.

27. Specifically, for instance, the Appellate Body referred to "the producer of the input" and "the producer of the product processed from the input," finding that, "it would not be possible to determine whether countervailing duties levied on the processed product are *in excess* of the amount of the total subsidy accruing to that product, without establishing whether, and in what amount, subsidies bestowed upon the producer of the input flowed through, downstream, to the producer of the product processed from that input."[36] While noting that the United States, in accordance with Article 19.3 of the SCM Agreement, had conducted an aggregate countervailing duty investigation, both the original panel and the Appellate Body found that this did not excuse Commerce from examining whether the *individual transaction* between the input supplier and the producer passed through the subsidy benefit. Thus, "before being entitled to impose countervailing duties on a processed product, for the purpose of offsetting an input subsidy, a Member must first determine, in accordance with Article 1.1, that a financial contribution exists, and that the benefit conferred directly on *the input producer* has been passed through, at least in part, to *the producer* of the processed product."[37]

28. Finally, the Appellate Body was unequivocal that, where the input transaction is *not* at arm's length, there is no need for the investigating authority to analyze whether the subsidy passed through:

> Where countervailing duties are used to offset subsidies granted to producers of input products, while the duties are to be imposed on *processed* products, and where input producers and downstream producers operate at *arm's length*, the investigating authority must establish that the benefit conferred by a financial contribution directly on input producers is passed through, at least in part, to producers of the processed product subject to the investigation.[38]

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limited its request to tenure agreements associated with coniferous timber quotas ("CTQs") and certain CTPs that were identified by Commerce. Exhibit CDA-24, page 8 at 1. Similarly, Commerce modified its requests for timber return data from the GOA to those portions containing the text relating to the payment of the stumpage dues. Exhibit CDA-24, page 9 at 7.

[36] Report of the Appellate Body, para. 141 (emphasis in original).

[37] Report of the Appellate Body, para. 154 (emphasis added).

[38] Report of the Appellate Body, para. 147 (emphasis in original).

Commerce implemented these findings by requesting the data necessary to establish whether each independent harvester or tenured harvester/sawmill sold logs at arm's length to each sawmill. Such company-specific information was necessary for Commerce's analysis of whether, in any particular transaction, the subsidy was passed through from the input producer to the producer of the subject merchandise. Indeed, the Appellate Body acknowledges this fact when it reasoned that the administering authority should determine "whether, and in what amount, subsidies bestowed upon the *producer of the input* flowed through, downstream, to the *producer of the product* processed from that input".[39]

29. Canada errs when it states that Commerce "ignored entirely the original panel's view that company-specific data are not necessarily required to conduct [sic] pass-through analysis."[40] The original panel said nothing of the sort. In response to U.S. arguments to the effect that there is a mismatch between an investigation conducted on an aggregate basis and the company-specific nature of the pass-through issue, the panel simply found that pass through can indeed be examined during an aggregate investigation.[41] The panel did not suggest that company-specific information should not be used to analyze whether there was a pass-through of subsidies.

30. Where parties provided the requisite information, Commerce was able to conduct its pass-through analysis.[42] For instance, although the Government of Ontario did not identify all transactions in which the stumpage was paid by the purchasing sawmills rather than the harvesting tenure holders, eight Ontario harvesters and mills did provide such company-specific information in response to Commerce's questionnaires.[43] Using the data provided by those companies, Commerce was able to conduct its pass-through analysis for those sales found, in light of the factors identified in the section above, to be at arm's length.[44] Similarly, with respect to Alberta, eight companies provided Commerce with company-specific data, including sample purchase contracts, information identifying those transactions for which the mill paid the stumpage directly to the Crown, and information concerning purchases from private lands.[45] Just as it did for Ontario, using the company-specific data provided by the Alberta companies, Commerce was able to conduct its pass-through analysis for those sales found to be at arm's length. Commerce was able to conduct its analysis as well with respect to certain company-

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[39] Report of the Appellate Body, para. 141 (emphasis added).

[40] First Written Submission of Canada, para. 58 (citing Panel Report, at para. 7.98).

[41] Report of the Panel, para. 7.98.

[42] By way of example, at the request of Commerce, Ontario identified the quantity of sales that were sold to the purchasing mill subject to wood supply agreements. Exhibit CDA-23, at question 2; Ontario September 15 Pass-Through Response, at On-PASS-4, question 2 referring to ON-PASS-6, ON-PASS-7. Exhibit US-3. Because Commerce determined that volume of sales not to be at arm's length, no further analysis was conducted with respect to those sales.

[43] December 6, 2004, "Pass-Through" Analysis Calculations for the Province of Ontario, at 2-4. Exhibit US-6.

[44] Section 129 Determination, at Comment 8. Exhibit CDA-5.

[45] December 6, 2004, "Pass-Through" Analysis Calculations for the Province of Alberta, at 2-5. Exhibit US-7.

specific data that it received in response to the pass-through appendices provided to Saskatchewan.[46]

31. In many instances, however, Canada failed to provide the requisite information despite repeated requests that it do so. For example, although Commerce limited its request for tenure agreements containing domestic processing or other mandated requirements to those companies that participated in the Norcon Survey, British Columbia failed to provide the copies that Commerce requested.[47] British Columbia did, however, provide *samples* of such tenure agreements, but the domestic processing requirements included in the samples that British Columbia submitted varied widely.[48] Although British Columbia argued that the domestic processing requirements contained in the tenure agreements were outdated, standardized, or otherwise inapplicable during the POI, it failed to provide any record evidence demonstrating that the requirements were not in force during the POI.[49] As a consequence, Commerce was not able to rely upon the sample agreements provided by British Columbia to support its pass-through claim. Additionally, British Columbia failed to identify that portion of the sales subject to its pass-through claim in which the sawmills pay the Crown stumpage fee directly to the government rather than paying the independent harvester from whom they obtained the logs.[50] Finally, although British Columbia did provide certain log purchase agreements it failed to provide the underlying tenure agreements.[51] There were similar deficiencies with respect to Manitoba,[52] and to lesser degrees with respect to Alberta, Ontario and Saskatchewan.[53] Where Canada failed to provide the information requested, Canada prevented Commerce from

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[46] December 6, 2004, "Pass-Through" Analysis Calculations for the Province of Saskatchewan, at 2. Exhibit US-8.

[47] Exhibit CDA-24, at 3.

[48] Exhibit CDA-6, at 10.

[49] *See* Exhibit CDA-24, at 5, question 5; Response of the Government of British Columbia to the Department's October 5, 2004 Supplemental Questionnaire Concerning Pass Through of Alleged Benefits (October 25, 2004), at BC-PT-3, -4, -15. ("British Columbia October 25 Pass-Through Response"). Exhibit US- 9.

[50] British Columbia September 15 Questionnaire Response, at 10 (Exhibit US-4); British Columbia October 25 Pass-Through Response, at BC-PT-17 -19 (Exhibit US-9). *See also*, Draft Section 129 Determination, at 10-11(Commerce summarizes the data that British Columbia failed to provide). Exhibit CDA-6.

[51] Draft Section 129 Determination, at 11. Exhibit CDA-6.

[52] Manitoba failed to substantiate its claim that 8.70 percent of the Crown log harvest did not result in a pass-through of subsidies because its data deficiencies precluded Commerce from conducting its pass-through analysis. Draft Section 129 Determination, at 11-12. Exhibit CDA-6. Although one company did respond to Commerce's pass-through appendix, the sales data provided by that company were for sales arising after the POI so Commerce determined that it was not appropriate to include those sales in its analysis. Draft Section 129 Determination, at 12. Exhibit CDA-6. Canada now argues – but has offered no evidence support its assertion – that those sales were not outside the POI. First Written Submission of Canada, para. 85, fn. 96.

[53] As evidenced by the Section 129 Determination, although there were some data issues with respect to Alberta, Saskatchewan, and Ontario that precluded Commerce from conducting its pass-through analysis with respect to the entire volumes for which these provinces claimed no pass through, Commerce was able to use data that had been provided and determined that a certain benefit did not pass through.

completing its pass-through analysis.[54]

32. The truth is that, although Canada prevailed before both the original panel and the Appellate Body in arguing that Commerce was required to conduct this pass-through analysis, Canada apparently was unprepared to support many of its claims of no pass through with necessary evidence. Instead, Canada seeks to undermine Commerce's ability to conduct a full examination of the pass-through issue. Commerce – reasonably and in accordance with the DSB's recommendations and rulings – found that the subsidy benefit passed through where the evidence indicated that the input transaction was not at arm's-length or where the transaction otherwise was ineligible for a pass-through analysis because it was not a sale or because the purchasing sawmill paid the stumpage to the Crown. Where Commerce found the input transaction to be a sale at arm's length, Commerce completed the pass-through analysis required by the recommendations and rulings.

33. As demonstrated by the Section 129 Determination, when Canada properly supported its claims, Commerce was able to, and did, conduct its analysis. Commerce did not improperly "presume" pass-through – to the contrary, as set forth above, Commerce conducted a pass-through analysis in compliance with the SCM Agreement, the GATT 1994, and the recommendations and rulings of the DSB.

D. Commerce Used Appropriate Benchmarks in its Pass-Through Analysis

34. Canada criticizes Commerce benchmarks but fails to allege any inconsistency with a provision of the SCM Agreement, the GATT 1994, or the DSB's recommendations and rulings. Thus, the Panel should reject Canada's argument on this basis alone.

35. In any event, Commerce selected appropriate benchmarks. Where Commerce – upon examining record evidence – determined that the input transaction was at arm's length, it proceeded to determine whether there was a competitive benefit: *i.e.*, whether the benefit "passed

[54] Contrary to Canada's argument, Commerce was in fact precluded from conducting its pass-through analysis with respect to the log sales contained in the Norcon Survey – a survey that Canada contends demonstrates that 11.6 percent of Crown logs consumed in British Columbia mills were purchased from independent harvesters that held tenure. First Written Submission of Canada, para. 79. Although Canada submits that it provided transaction-specific data, it continually failed to provide necessary information concerning government-mandated restrictions and other conditions that Commerce required to complete its analysis. The Norcon Survey and the data that Canada refers to in Annex I of its first written submission obscure the fact that the data could be relied upon for little more than information about *affiliation* between parties to the log transactions. Indeed, as explained in the Norcon Survey itself, "[f]or purposes of this survey, arm's length log purchases were defined as logs purchased by a lumber manufacturer from a person with which it is not affiliated applying the definition of 'affiliated persons' contained in" U.S. law. Exhibit CDA- 31, at 2. As the United States demonstrates above, however, affiliation is only one component of the pass-through analysis. The remaining 6.2 percent referenced by Canada apparently represent transactions between tenure-holding sawmills. First Written Submission of Canada, para. 79. As discussed below, such transactions were not part of the DSB's recommendations and rulings.

through". As previously explained, a subsidy provided to the producer of an input product confers a competitive benefit on a downstream purchaser of the input when the price paid for the subsidized input is lower than the a market determined benchmark price for the same product. In selecting a market determined benchmark, Commerce used, where possible, the actual company-specific prices that the purchasing mill paid for logs harvested from private lands and for imported logs.[55] Where those data were not available, Commerce relied on publicly available prices for logs harvested from private lands and logs imported into the province.[56]

36. Commerce's competitive benefit analysis demonstrated that many of the arm's-length log sales during the POI in Alberta, Ontario, and Saskatchewan, were made at prices below the benchmark prices, and therefore conferred a competitive benefit to the purchasing sawmills. As a result of Commerce's competitive benefit calculations, therefore, only some portion of the Crown harvest volume originally included in the numerator is excluded from the numerator of the revised subsidy calculations.

37. Canada now contends that Commerce relied on benchmarks that do not reflect "a comparison to the marketplace"[57] because they were unrepresentative of both the species harvested and of the prices paid in each province for logs used in lumber production. Canada is incorrect. The benchmark prices Commerce used were observable market-determined prices for logs that were sold in Canada. These prices corresponded to the same species of logs sold in each province for which a competitive benefit analysis was conducted and were otherwise representative of market prices.

38. For Alberta, Commerce used company-specific prices the mills paid for logs harvested from private lands in the province and logs they imported into the province. Where those company- specific prices were not available, Commerce used the weighted-average price published in the annual 2000 Timber Damage Assessment (TDA) survey conducted by KPMG.[58] For Ontario, Commerce used a weighted-average price of transactions for timber harvested from private lands, as reported in the KPMG the "Delivered wood costs" schedule of the KPMG Report on Ontario Softwood Timber Costs and Sources, April 1, 2000 to March 31, 2001, dated June 22, 2001.[59] For Saskatchewan, which did not provide any company-specific or published provincial log prices, Commerce used a weighted-average price of the domestic and import

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[55] *See*, e.g., Exhibit CDA-23, at 3, 6, 8, 10, 12 and pass-through appendix; Exhibit CDA-24, at 3, 6, 8, 11, 13 and supplemental pass-through appendix.

[56] Final Section 129 Determination, at 6. Exhibit CDA-5.

[57] First Written Submission of Canada, para. 67.

[58] *See, e.g.*, December 6, 2004, "Pass-Through" Analysis Calculations for the Province of Alberta, at 2. Exhibit US-7.

[59] December 6, 2004, "Pass-Through" Analysis Calculations for the Province of Ontario, at 1-4. Exhibit US-6.

prices for spruce-pine-fir (SPF), as reported by Alberta, Manitoba, Ontario, and Quebec.[60]

39. In sum, Commerce used as benchmarks observable market-determined prices for logs that were sold in Canada from unsubsidized sources to determine whether and to what extent a subsidy passed through in arm's length sales of logs between unrelated parties. For the reasons described above, the benchmark prices Commerce used to conduct its competitive benefit analysis properly reflected market conditions in Canada during the POI.

E. Commerce Did Not "Presume" Pass-Through

40. As demonstrated above, Commerce thoroughly investigated Canada's claims that no subsidy passed through as a consequence of certain transactions. As a result of its analysis, Commerce removed from the numerator of its *ad valorem* subsidy calculation any subsidy benefits it determined did not pass through in arm's length log sales between independent harvesters and sawmills and between unrelated tenured timber harvesters/sawmills and sawmills. Commerce thus ensured that its Section 129 Determination provided for a countervailing duty only with respect to the benefit from countervailable subsidies demonstrated to exist. Canada's attempt to characterize Commerce's analysis as a "presumption" of pass through is not supported by the record.

41. Indeed, as noted earlier, it is Canada that is "presuming." Under Canada's theory, when it comes to pass-through, responding parties can control the analysis. If the country under investigation chooses to provide proper evidence supporting its pass-through claim, authorities are able to conduct their analysis and, depending upon the determination, reduce the *ad valorem* rate. However, if the country chooses not to provide necessary information, according to Canada, the authorities are precluded from conducting their analysis and must presume no pass-through – *i.e.*, presume that no subsidy is bestowed on the subject merchandise. Consequently, under Canada's theory, once a country under investigation raises a pass-through issue, it would be in a position simply to refuse to provide any evidence supporting its claim, because the authorities would be prohibited from including any of the claimed volume in their calculations.

42. From Canada's perspective, there is a certain simplicity in its argument – Commerce should simply accept Canada's unsubstantiated assertions. For instance, because British Columbia informed Commerce that 11.6 %[61] of the log sales were between unrelated parties, according to Canada, Commerce must automatically find that the benefit for that associated volume of log sales did not pass through and must be removed from the numerator. However, nothing in the DSB's recommendations and rulings, the SCM Agreement, or the GATT 1994 requires that the investigating authority simply accept assertions of the country under

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[60] December 6, 2004, "Pass-Through" Analysis Calculations for the Province of Saskatchewan, at 2. Exhibit US-8.

[61] First Written Submission of Canada, para. 79.

investigation. To the contrary, the DSB recommended that Commerce *conduct* a pass-through analysis. Commerce did so and based its determination upon what the record evidence *demonstrated* the facts to be and not upon what Canada *presumed* the result should be for sales between all unrelated parties.

F. Commerce Properly Investigated Categories of Sales Identified by the DSB

43. According to the DSB's recommendations and rulings, Commerce should investigate transactions between independent harvesters and sawmills,[62] as well as between tenured harvesters/sawmills and unrelated sawmills.[63] Although Canada claims that Commerce "inexplicably excluded information of transactions in which the purchasing sawmill had tenure"[64] there is nothing inexplicable about it, as these transactions were not part of the DSB's recommendations and rulings. In this respect, there was a specific definition of both "tenured timber harvester/sawmill" and "sawmill." "Tenured timber harvester/sawmill" was defined as "an enterprise holding a stumpage contract that fells trees and produces logs, and also processes logs into softwood lumber."[65] "Sawmill" was defined as "an enterprise that processes logs into softwood lumber and *does not hold a stumpage contract*."[66]

44. Given these precise definitions that bear directly upon the DSB recommendations and rulings with respect to pass-through, Commerce properly limited this aspect of its pass-through analysis to arm's-length log sales by an enterprise holding a stumpage contract that fells trees and produces logs, and also processes logs into softwood lumber, to an enterprise that processes logs into softwood lumber and does not hold a stumpage contract, *i.e.*, tenured timber harvester/sawmills to unrelated, non-tenured sawmills. As the DSB recommendations and rulings recognized, tenure-holding sawmills are direct subsidy recipients. It is entirely appropriate therefore to include the volume of logs processed by those sawmills in the total subsidy calculation.

G. Commerce Properly Calculated the Revised Rate

45. Contrary to Canada's arguments that Commerce somehow applied its results to an "invalidated" countervailing duty rate,[67] Commerce properly calculated the revised rate by removing from the numerator of the *ad valorem subsidy* rate calculation the volume of log sales

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[62] The United States did not appeal the Panel's findings with respect to arm's-length log sales between tenured timber harvesters not owning sawmills and sawmills. Appellate Body Report, fn. 157.

[63] Appellate Body Report, para. 167(e); *see* CDA-3, at questions 1 and 2.

[64] First Written Submission of Canada, para. 55.

[65] Appellate Body Report, fn. 150.

[66] Appellate Body Report, fn. 151 (emphasis added).

[67] First Written Submission of Canada, para. 10.

determined not to have passed through.[68] The numerator of the *ad valorem* subsidy rate was reduced by C$28,344,121. The revision reduced the only rate that was before the original panel and Appellate Body, *i.e.*, the 18.79 percent *ad valorem* rate calculated in the Final Determination, to 18.62 percent *ad valorem*.[69] With the exception of this limited pass-through analysis, there are no outstanding DSB recommendations or rulings that would have required further modification of the *ad valorem* rate calculation.

III. The Results of the First Assessment Review are Not Within the Panel's Jurisdiction

46. The United States reiterates its request, set out in its submission of March 10, 2005, that the Panel preliminarily rule that the results of the first assessment review are not "measures taken to comply" and therefore are outside Panel's jurisdiction in this proceeding. In particular, the United States noted in its preliminary ruling request that original investigations and assessment reviews are different processes with different administrative records that serve distinct purposes.[70] In this case, the assessment review was initiated at the behest of Canada, among others, eight months before the recommendations and rulings in this dispute were adopted.

47. This is not a situation like that presented in *Australia – Automotive Leather*, in which a WTO-inconsistent subsidy was both withdrawn and "regranted" in another form on the same day, in "inextricably linked elements of a single transaction."[71] Rather, the assessment review is a completely separate proceeding, based on a different record, designed to assess countervailing duties – a proceeding, moreover, that can be requested by Canada at regular intervals well into the future. Finally, it cannot be seriously asserted that, where there have been DSB recommendations and rulings with respect to the imposition of supplemental duties on a product, any subsequent proceedings related to those duties are "measures taken to comply". A previous

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[68] *See* December 6, 2004, Country-wide Rate Calculations Net of Subsidy Benefits That Did Not Pass-Through - Revised as a Result of Comments Submitted by Parties to the Proceeding, at 2-8. Exhibit US-10.

[69] *See Notice of Implementation Under Section 129 of the Uruguay Round Agreements Act; Countervailing Measures Concerning Certain Softwood Lumber Products From Canada*, 69 FR 75305 (December 16, 2004). Exhibit CDA-7.

[70] *See* Appellate Body Report, *European Communities - Anti-Dumping Duties on Imports of Cotton-Type Bed Linen from India - Recourse to Article 21.5 of the DSU by India*, WT/DS141/AB/RW, adopted 24 April 2003, para 123. "(the imposition and collection of anti-dumping duties under Article 9 is a separate and distinct phase of an anti-dumping action that necessarily occurs after the determination of dumping, injury, and causation under Articles 2 and 3 has been made.") Footnotes omitted. Although there is no specific corollary to Article 9 of the Antidumping Agreement in the SCM Agreement, the SCM Agreement recognizes that Members may conduct assessment proceedings to determine the final amount of countervailing duty to be assessed. *See* Footnote 52 of the SCM Agreement.

[71] Panel Report, *Australia – Subsidies Provided to Producers and Exporters of Automotive Leather – Recourse to Article 21.5 of the DSU by the United States*, WT/DS126/RW and Corr.1, adopted 11 February 2000, para. 6.50.

panel has already found this not to be the case, in *EC – Bed Linens (Panel).*[72] In sum, the United States reiterates that the results of the first assessment review are neither "measures taken to comply" with recommendations and rulings, nor do they render actual measures taken to comply "non-existent".

IV. The Panel Should Not Make the Specific Recommendations Sought by Canada

48. In its first submission, Canada has asked the Panel to make certain findings and recommendations in the event that it agrees with Canada. Specifically, Canada asks that the DSB find that the imposition of duties by the United States is inconsistent with the SCM Agreement and the GATT 1994 and recommend either that the United States refund the duties collected to offset the amounts determined to pass through or revise its measure to be consistent with the relevant agreements and refund the duties to the extent they exceed the amount of the subsidy determined to have passed-through.[73]

49. The Panel should decline to make such recommendations. The text of DSU Article 19.1 is unequivocal regarding the recommendation that a panel is to make in such a case: "Where a panel or the Appellate Body concludes that a measure is inconsistent with a covered agreement, it *shall* recommend that the Member concerned bring the measure into conformity with that agreement." (Emphasis added). In short, the recommendations that Canada seeks here are not authorized by the DSU.

V. Conclusion

50. For the reasons stated above, Canada's claims against the measure taken to comply with the DSB's recommendations and rulings have no basis in the SCM Agreement, the GATT 1994, or the recommendations and rulings of the DSB. Thus, the United States requests that the Panel find that the United States properly implemented the recommendations and rulings of the DSB and that the Panel reject Canada's claims in their entirety.

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[72] *See* Panel Report, *European Communities - Anti-Dumping Duties on Imports of Cotton-Type Bed Linen from India - Recourse to Article 21.5 of the DSU by India*, WT/DS141/RW, adopted 24 April 2003, as modified by the Appellate Body Report, WT/DS141/AB/RW, para. 6.15.

[73] First Written Submission of Canada, para. 72.