United States - Final Countervailing Duty Determination With Respect to Certain Softwood Lumber From Canada (WT/DS257)

Recourse to Article 21.5 of the DSU by Canada

RESPONSE OF THE UNITED STATES TO QUESTIONS FOLLOWING THE SUBSTANTIVE MEETING OF THE PANEL

April 29, 2005

A. QUESTIONS TO US

1. We understand the US to argue that the rulings and recommendations of the DSB require, or at least permit, the arm's length analysis undertaken by USDOC in the context of determining whether or not a pass-through analysis was required.

Please explain how this arm's length analysis results from the rulings and recommendations of the DSB?

Does the US only rely on the report of the Appellate Body, or also that of the Panel? Please explain how the substance of the Panel / Appellate Body reasoning supports this distinction.

Assume the distinction was not initially drawn by the Panel. Why should the Panel make that distinction now, bearing in mind that parts of the Panel report dealing with pass-through were upheld without modification by the Appellate Body? Are the unmodified parts of the Panel report also relevant to interpreting the rulings and recommendations of the DSB? Please explain.

The Appellate Body's summary of the participants' arguments does not appear to contain any distinction between arm's length transactions and transactions between unrelated parties. Did the parties present arguments to the Appellate Body regarding any distinction between arm's length transactions and transactions between unrelated parties? Did the parties present arguments to the Appellate Body regarding the meaning of the phrase "arm's length"? If so, please provide details of the parties' arguments regarding this issue.

1. First, and foremost, the relevant DSB recommendations and rulings were that Commerce's failure to conduct a pass-through analysis "in respect of *arm's length sales"* of logs to "*unrelated"* sawmills is inconsistent with the SCM Agreement and the GATT 1994.[1] On its face, this ruling makes a distinction between "arm's length sales", on the one hand, and sales to "unrelated" sawmills, on the other. This is not the only place in the panel and Appellate Body reports that a distinction is drawn between sales that are "arm's length" and sales that are between "unrelated" parties; and, in fact, as discussed further below, the United States emphasized throughout the original dispute and the Appellate Body review that not all sales

[1] Appellate Body Report, para. 167(e) (emphasis added).

between unrelated persons are at "arm's length", that conditions that attached to transactions between unrelated entities could render those transactions non-arm's length.

2. In its notice of appeal, the United States challenged the entirety of the findings of the original panel that Commerce had to conduct a pass-through analysis with respect to transactions between producers of subject merchandise.[2] The Appellate Body, aware of the distinction between sales between "unrelated" parties and "arm's length" sales, specifically upheld only a finding that Commerce should have conducted such a pass-through analysis with respect to *arm's length* sales to unrelated sawmills. This is precisely the inconsistency that Commerce therefore addressed in its Section 129 Determination. In this context, in the light of U.S. arguments before the original panel and the Appellate Body challenging Canada's arm's length interpretation, and in the absence of any finding that the concepts are the same, the DSB's specific dual reference to (1) "arm's length" sales to (2) "unrelated" sawmills must have meaning.

3. As just noted, both the Appellate Body Report and the Panel Report make specific reference to the terms "arm's length" and "unrelated". As further set forth below, the United States explained its position with respect to the "arm's length" issue in its written submissions, answers to questions, and oral statements to the original panel, and made reference to its position in its oral statement to the Appellate Body. These documents clarified the distinction between Canada's repeated allegation that the record contained sufficient evidence of arm's-length sales upon which the United States could base a pass-through analysis (because the sales were between unrelated parties), and the United States' position that as a consequence of a "myriad of provincial restrictions" many of those transactions might not be arm's-length transactions.[3]

4. Although the original panel did not specifically address the distinction between "arm's length" and "unrelated" in its conclusions, the original panel was aware of the parties' differing views. The Panel Report summarizes the position of the United States that many of the transactions that Canada was claiming were arm's-length transactions may not be arm's-length by virtue of the government mandates present in the provincial stumpage systems. In its written submissions and responses to the original panel's questions, the United States explained its position with respect to "arm's length" in the context of the proceedings relating to the final investigation determination. Then, as now, Canada argued that the record contained the information necessary for Commerce to deduct the subsidy attributable to "arm's-length" sales.[4] Then, as now, the data that Canada refers to obscure the fact that the data could be relied upon

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[2] WT/DS257/8.

[3] Oral Statement of the United States, para. 36 (February 11, 2003).

[4] Canada First Written Submission (to the original panel), paras.58, 62 (December 19, 2002).

for little more than information about affiliation between parties to the log transactions.[5] The United States responded then, as now, that the information that Canada relied upon was not determinative of whether the transactions were at "arm's length" without an investigation of the "specific relationships and transactions that may be at issue."[6]

5. Indeed, in its oral statement to the original panel at the first substantive meeting on February 11, 2003, the United States expressly stated that the evidence suggested that not all of the sales Canada was claiming as arm's length were arm's length because "the record demonstrates that there are a myriad of provincial restrictions on tenure holders, including requirements to process timber locally or in specific mills."[7]

6. Thereafter, in its second written submission to the original panel, the United States reiterated its argument that – despite Canada's assertions based on mere affiliation – there was no record evidence establishing that transactions between harvesters and sawmills were at arm's length.[8] In its answers to the panel's questions in connection with the second substantive meeting, the United States, refuting Canada's argument that there were "scores" of arm's length transactions, stated that

> there are a number of legal restrictions (e.g., local processing requirements) that call into question whether any transactions for the timber covered by these tenures could be considered to be at "arm's length". . . Finally, as noted above, tenure holders are required to process the timber they harvest, or equivalent volume, in their own mills. Thus, many of the alleged arm's-length sales are, in fact, simply log trades or swaps among tenure holders.[9]

7. In the initial paragraph summarizing Canada's pass-through claim, the original panel characterized that claim, in part, as follows:

> Canada claims that by not investigating whether alleged subsidy benefits from stumpage programmes were passed through in *arm's-length* transactions between timber harvesters

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[5] Canada First Written Submission (to the original panel), paras.58, 62, fn. 120 (December 19, 2002) (referring to the Norcon Survey that states, "[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).

[6] First Written Submission of the United States (to the original panel), para. 113, fn. 145 .

[7] Oral Statement of the United States, para. 36 (February 11, 2003).

[8] Second Written Submission of the United States (to the original panel), fn. 104 (referring to footnote 113 in its first written submission) (March 6, 2003).

[9] U.S. Answers to the Panel's Questions in Connection with the Second Substantive Meeting (to the original panel), paras. 13-15. (April 4, 2003).

and *unrelated* sawmills, and between sawmills and *unrelated* re-manufacturers, . . . [10]

The original panel goes on to repeat in that summary of Canada's factual argument that there was record evidence demonstrating such arm's-length transactions.

8. In summarizing the argument of the United States, the original panel noted the position of the United States that "the many restrictions imposed on tenure holders, including requirements to process timber locally, 'suggests that all or most of the sales by independent loggers may not be at arms'-length.'"[11] The panel repeated the United States' position in paragraph 7.94 when it notes the U.S. argument that the transactions between tenured timber harvesters to unrelated lumber producers "'may not be' at arms'-length."[12]

9. As evident in paragraph 7.95, however, the original panel's findings did not depend upon whether or not the sales claimed by Canada were, in fact, arm's length sales. The original panel in its subsequent discussion concerning sales of logs or lumber by tenured harvester-sawmills to sawmills or re-manufacturers did not address the parties' differing arm's-length interpretations. Although the original panel was aware of the United States' arm's-length position it did not specifically address the issue in its conclusions.[13]

10. For its part, the Appellate Body did not reference "arm's length" and "unrelated" only in the "Findings and Conclusions" section of the Appellate Body Report.[14] Indeed, references which appear to distinguish between the two concepts appear, for example, in paragraphs 123, 124, 127, 128, 143 155, 156, and 157. The United States argued that this distinction existed in its oral statement to the Appellate Body, referring to its arguments to the original panel.[15]

11. In sum, in view of the distinctions drawn between "arm's length" sales and sales to "unrelated" parties in these proceedings; the fact that the United States appealed the entirety of the original panel's findings with respect to transactions between producers of subject merchandise; the fact that nowhere does either the original panel or the Appellate Body find that the distinct concepts of "arm's length" and "unrelated" are synonymous; and the Appellate Body's specific finding that the pass-through analysis was only necessary for "arm's length" sales, the United States properly implemented the recommendations and rulings with respect to pass-through.

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[10] Panel Report, para. 7.68 (emphasis added).

[11] Panel Report, para. 7.76 referring to United States First Oral Statement, para. 36.

[12] Panel Report, para. 7.94.

[13] Panel Report, para. 7.99.

[14] Appellate Body Report, para. 167(e).

[15] Oral Statement of the United States (to the Appellate Body), para. 21 (November 20, 2003).

2. With regard to para. 19 of the US second written submission, please clarify what is meant by the phrase "other conditions" in the penultimate sentence of that paragraph.

12. The complete sentence in paragraph 19 of the Second Written Submission of the United States reads, "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." The term "government mandates" refers to the appurtenancy, local processing requirements, and wood supply agreements that are, in fact, required by the various provincial governments. The term "other conditions" refers to the log purchase agreements discussed in paragraph 22 of the Second Written Submission of the United States that result from the Crown stumpage systems. "Other conditions" also refers to those situations in which the purchasing sawmill pays the Crown stumpage fee directly to the government and situations in which there are fiber exchange agreements pursuant to which parties exchange equivalent volumes of wood fiber to meet appurtenancy and other harvesting requirements.

3. USDOC appears to have based the scope of its section 129(b) re-determination on the definition of "sawmill" set forth at footnote 151 of the Appellate Body's report. No such definition was contained in the Panel's report. Does the US consider that footnote 151 limits the scope of the DSB's recommendations and rulings, even when the Appellate Body upheld - without modification - the Panel's findings? Please explain.

13. In accordance with the DSB's recommendations and rulings,[16] Commerce requested information relating to the portion of the total volume of Crown timber entering sawmills reported by the provinces claimed to be (i) "sold in arm's-length transactions by tenure holders that did not own a sawmill . . ." and (ii) "sold in arm's-length transactions by tenured timber sawmills to sawmills that do not have tenure . . ."[17] With respect to the former category, consistent with the Panel Report, Commerce did not designate the purchaser. With respect to the second category, however, Commerce took into account the distinction made by the Appellate Body between tenure holding sawmills and non-tenure holding sawmills and limited the purchasing sawmills to those without tenure. This distinction made by the Appellate Body is clear from its specific definition of the term "sawmill" as an "enterprise that . . . does not hold a stumpage contract. . . "[18] compared to its definition of "*tenured* timber harvester/sawmill" as "an enterprise holding a stumpage contract that fells trees and produces logs, and also processes logs

[16] Panel Report, at para. 7.99; Appellate Body Report, at para. 167(e).

[17] Exhibit CDA-3, at 10, 11 (questions 1 and 2).

[18] Appellate Body Report, fn. 151.

into softwood lumber."[19] Using its defined terms, the Appellate Body only upheld the original panel's finding that Commerce should have conducted a pass-through analysis with respect to transactions between *tenured* timber harvester/sawmills and unrelated, *non-tenure* holding sawmills. By contrast, where the original panel's findings were not appealed, *i.e.*, with respect to the first transaction category, Commerce conducted that portion of its pass-through analysis in accordance with the Panel Report.

14. As noted in response to question 1 above, although the original panel does not appear to have defined "sawmill" in the same way as the Appellate Body, the United States appealed the original panel's findings with respect to whether Commerce had to conduct a pass-through analysis with respect to transactions between producers of subject merchandise.[20] The Appellate Body specifically found that such a pass-through analysis was necessary only with respect to sales from tenured timber harvester/sawmills to non-tenure holding sawmills. Therefore, the United States properly implemented the DSB's recommendations and rulings by following the specific direction issued by the Appellate Body.

4. At para. 57 of its first written submission, Canada asserts that USDOC (in respect of the first assessment review) "restricted its request in its initial questionnaire to the volume and value of Crown logs sold by independent harvesters to softwood lumber producers ('by any person or company that did not own or operate a sawmill' or 'by non-mill-owning tenure holders')." Please comment.

15. As discussed in response to Question 3 above, in the context of the Section 129 Determination, Commerce requested information relating to two categories of transactions. Specifically, Commerce requested information relating to logs (i) sold by "tenure holders that did not own a sawmill . . ." and (ii) "sold in arm's-length transactions by tenured timber sawmills to sawmills that do not have tenure . . ."[21] Commerce's request for information encompasses transactions between tenured timber harvester/sawmills and sawmills. Consequently, in the context of the Section 129 Determination, Canada is incorrect in arguing that Commerce did not request data relating to transactions between sawmills.

5. Please comment on the dictionary definitions of "arm's length" set forth at footnote 54 of Canada's first written submission. Does the US accept these definitions? How did USDOC define the term "arm's length"? Which definition of "arm's length" was USDOC relying on?

16. Initially, it is important to recall that the term "arm's length" is not used or defined in the SCM Agreement. Rather, the term was used by the parties, during the course of the dispute, and in the DSB's recommendations and rulings to delineate when a pass-through analysis was

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[19] Appellate Body Report, fn. 150 (emphasis added).

[20] WT/DS257/8.

[21] Exhibit CDA-3, at 10, 11 (questions 1 and 2).

appropriate. An arm's-length analysis is a fact-intensive analysis that is conducted on a case-by-case basis. Commerce's arm's-length analysis was informed by many variables, including the facts before it and relevant definitions. No single definition was relied upon but as noted below the definitions of the term "arm's length" have a common thread, *i.e.*, arm's-length transactions are characterized by parties that are free to negotiate with one another on market terms without outside control. The record facts establish, however, that the provincial governments impose restrictions and requirements on the log sales such as appurtenancy, local processing requirements, and wood supply agreements that impede a harvester's ability to negotiate freely with willing purchasers in the marketplace, and instead, compel the harvester to sell to particular customers. Indeed, the provincial governments' provision of the good, *i.e.*, the standing timber, is conditioned on the existence of such requirements. Because these transactions are subject to such outside control, the parties to the transactions are bound in a manner that they may not otherwise have been bound. Thus, Commerce determined that they were not arm's-length transactions. As set forth in the U.S. oral statement, Commerce is not requiring a market place free from regulation as a prerequisite for finding transactions to be arm's length. However, because these mandates and conditions substantially control timber transactions in Canada, they were fundamental to Commerce's arm's-length analysis.

17. Footnote 54 of Canada's first written submission refers specifically to two definitions of "arm's length": those in the Sixth Edition of Black's Law Dictionary and the New Shorter Oxford English Dictionary (1993) (the latter definition is referenced in the Second Written Submission of the United States, at footnote 21). The version of Black's Law Dictionary relied upon by Canada defines "arm's length" as a "transaction . . . negotiated by unrelated parties, each acting in his or her own self interest; the basis for a fair market value determination." The term "fair market value" is, in turn, defined as "the amount by which property would change hands between a willing buyer and a willing seller, *neither being under any compulsion to buy or sell* and both having reasonable knowledge of the relevant facts."[22]

18. The Black's Law Dictionary definition of "arm's length" referenced by Canada is consistent with the Black's Law Dictionary (7th Edition) definition referenced by the United States in footnote 21 of its Second Written Submission – each definition leads to the conclusion that a truly arm's-length negotiation is one where the parties may negotiate freely without compulsion, either from the party with whom they are bargaining or other parties. Thus, even following Canada's arguments to their logical end, an independent harvester should only be viewed as operating at arm's length from purchasing sawmills if the harvester is able to freely negotiate and is under no compulsion to sell, *i.e.*, neither party controls the other and the parties have roughly equal bargaining power.

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[22] Black's Law Dictionary 537 (5th ed 1979) (emphasis added). (Exhibit U.S. – 13). This is consistent with the "arm's length" concept under Canadian law as well, which recognizes that certain transactions between unrelated persons may nevertheless be non-arm's length transactions "depending on all the circumstances." See IT-419R Providing the Meaning of Arm's Length: Section 251 and 251 of the Income Tax Act (August 24, 1995)(Exhibit U.S. – 14).

19. Significantly, the DSB recently adopted recommendations and rulings that support the U.S. understanding of "arm's length".[23] Specifically, in *Korea – Commercial Vessels*, the panel found that in such a situation where the buyer dictated the source of a payment refund guarantee, there was "a risk that the [payment refund guarantee] 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 be if the shipyard were able to shop around and compare offers from alternative suppliers," and thus, those transactions were not appropriate market benchmarks.

6. Please comment on Canada's argument (para. 63, first written submission) that "none of the factors identified by the USDOC alters the fact that sellers of Crown logs attempt to obtain the best price available in transactions with unrelated purchasers. These factors do not make the transacting parties act in accordance with interests other than their own, nor do they align the parties' otherwise opposing objectives regarding the outcome of the transaction."

20. The issue is not whether the transacting parties have the desire or incentive to maximize their returns from their Crown logs, but whether they have the ability to obtain market value for their logs. The conditions and restrictions imposed upon tenure holders who sell Crown logs to unrelated parties effectively prevent sellers of Crown logs from obtaining such value. Specifically, Commerce identified factors in the provincial stumpage systems that limit, restrict, or otherwise affect the ability of the parties to the transactions to negotiate freely a market price for logs with willing purchasers in the market place. Under certain of these arrangements, the provincial governments require as a condition of obtaining Crown tenure that an applicant negotiate a contract with another party regarding the disposition of the timber from the tenure. While the buyer's and seller's interests may not be aligned, their freedom with respect to the sales transaction has been significantly constrained by such government mandates. If the government restricts a seller's ability to obtain a market price from any bidder in the marketplace by, for example, mandating to whom he can sell, the seller may have an incentive but does not have the ability to obtain the best price.

7. Please comment on Canada's argument that USDOC failed to demonstrate that the five factors affected the outcome of transactions (para. 61 (referring also to note 53), Canada's first written submission). Did USDOC demonstrate such effects? If so, where?

21. Commerce did not look at the effect of the government mandates and other conditions upon the transactions because there was no need for Commerce to do so. The DSB delineated the pass-through analysis as involving certain log transactions conducted at arm's length between unrelated parties. As discussed further in its written submissions, the oral statement and the Section 129 Determination, Commerce determined that transactions subject to these

[23] *See Korea – Measures Affecting Trade in Commercial Vessels*, WT/DS273, adopted April 11, 2005, para. 7.135 ("*Korea – Commercial Vessels*")(also discussed in footnote 21 of the Second Written Submission of the United States).

government mandates are not arm's-length transactions. Because these transactions did not meet the threshold requirement in the DSB's recommendations and rulings that they be arm's length, there was no need for Commerce to undertake any additional analysis in the context of its pass-through investigation.

8. At para. 41 of its rebuttal submission, Canada asserts that "[a]n independent harvester will extract from a sawmill the full market value of what it provides to the sawmill (i.e., the log), regardless of who 'writes the check'", because "[a]lthough the party writing the check may affect the observed log price, it will never affect the value paid by the sawmill for the logs." Please comment.

22. Canada misses the point. As discussed in the U.S. submissions, oral statement, and Section 129 Determination, the United States considers that, when one (or more) of the factors identified by Commerce are present in a given transaction, the provincial government, the entity providing the financial contribution, does not permit the independent harvester to "extract from a sawmill the full market value" of the log.

23. The issue of "who writes the check" in this context raises a different issue, *i.e.*, the issue of who is the subsidy recipient. The subsidy benefit is the payment of less than adequate remuneration for the good provided by the government – the standing timber. Where the tenure holder transfers both the good and the obligation to pay remuneration to the government for the good to a third party, the third party receives the benefit. Thus, when the purchasing sawmill – the log-buying lumber producer – pays the Crown stumpage fee to the government, the benefit goes *directly* to that sawmill. Because the independent harvester never received the benefit, no "pass through" of the benefit occurred and, thus, no pass-through analysis is required.

9. USDOC found that log export restrictions "do[] not necessarily preclude the existence of arm's-length transactions in Canada". Is this consistent with USDOC's determination that transactions are not arm's length when "[b]uyers and sellers of logs are not free to bargain with whomever they chose (sic) or to bargain on terms not encumbered by government mandates" (First Assessment Review, Issues and Decision Memorandum, pages 46 and 47)? Please explain.

24. As set forth in Comment 4 of the Section 129 Determination, log export restraints, while limiting the commercial interchange between Canadian companies and companies outside of Canada, less directly affect the individual log transactions examined by Commerce. While log export restraints may have a general effect upon the market, the effect is less direct than that of government mandates and other conditions that are required for the provision of the good, and restrict a log seller's bargaining power with respect to the specific transactions Commerce examined. Based upon the facts before it, therefore, Commerce drew a distinction between government regulation that may have an effect on transactions generally versus those government mandates that directly impact the specific transactions Commerce examined. Therefore, Commerce's log export restraint position does not conflict with its position concerning the government mandates and other conditions that attach to the log sales examined by Commerce.

10. At para. 56 of its first written submission, Canada asserts that Alberta "[stood] ready to collect and supply []additional information [concerning transactions between tenured sawmills] on an expedited basis". How did USDOC respond to this offer?

25. Commerce did not request information concerning transactions between tenure holding sawmills and tenure holding sawmills because such transactions were not encompassed within the two categories of transactions identified in the DSB's recommendations and rulings.

11. At para. 44 of its second written submission, the US explains that transactions between tenured sawmills need not be investigated for pass-through because "tenure-holding sawmills are direct subsidy recipients". Was this explanation provided by USDOC in either the Section 129(b) re-determination or the First Assessment Review? If so, where?

26. As the Section 129 Determination noted, that Determination implemented the DSB's recommendations and rulings, which expressly delineated the two categories of transactions for which Commerce was to conduct a pass-through analysis.

12. Were any of the import entries subject to the cash deposit determined by the Section 129 Determination also subject to final assessment under the First Assessment Review? If so, which ones?

27. No. Entries subject to the Section 129 Determination cash deposit rate entered the United States on or after December 10, 2004. The first assessment review resulted in an assessment rate for entries that entered the United States during the period May 22, 2002 to March 31, 2003.

13. Please comment on the "Trigger Dates and Effect on CVD Rates Paid on Imports" and "Softwood Lumber - Operation of U.S. Retrospective system" documents submitted by Canada during the Panel's substantive meeting with the parties.

28. The documents submitted by Canada are confusing, and contain considerable irrelevant and incorrect information. Notably, the documents do not address the Panel's request at the panel meeting to clarify (1) which subsidies and sales information were examined for the final countervailing duty investigation determination; (2) which subsidies and sales information were examined for assessing countervailing duties as a result of the first assessment review; and (3) the extent to which there was overlap between the two sets of data.

29. The answers to these questions are straightforward: these two sets of data are entirely distinct, and there is no overlap. Briefly, to impose a countervailing duty under Article 19.1 of the SCM Agreement, the United States had to conduct an investigation and make a final determination (1) as to the "existence and amount of the subsidy" and (2) that the subsidized imports are causing or threatening injury. The U.S. International Trade Commission found a threat of injury on May 16, 2002. Commerce made the required final determination of the

existence and amount of the subsidy on March 21, 2002, based on subsidies and sales information during the period April 1, 2000 through March 31, 2001. Both the "subsidy" and "injury" prerequisites being satisfied, the United States imposed the countervailing duty, *i.e.*, published the order, on May 22, 2002.

30. To implement the DSB's recommendations and rulings in this dispute, which concerned the final investigation determination, the United States collected additional information relating to the same period covered by the final investigation determination, April 2000 – March 2001. As discussed in its written submissions and oral statement, as a result of the pass-through analysis, the cash deposit requirement for entries entered after December 10, 2004 (the date the United States Trade Representative directed Commerce to implement the Section 129 Determination), was reduced from 18.79% to 18.62%.

31. In May 2003, Canada, among others, requested an assessment review to determine the countervailing duties that would actually be assessed, or levied, on entries during the period May 22, 2002 - March 31, 2003. Commerce initiated that assessment review on July 1, 2003. For the purposes of this assessment review, Commerce examined subsidies and sales during a completely separate and later period than the period covered by the final investigation determination – April 1, 2002 through March 31, 2003 (in conformance with a request by Canada, the most recently completed Canadian fiscal year) – to be assessed on entries made from May 22, 2002, the date of the order, through March 31, 2003. The result of the first assessment review was a countervailing duty rate to be assessed on these entries of 16.37% *ad valorem*.

32. It is worth noting that the cash deposit rate calculated as a result of the final investigation determination (18.79%) (and, similarly, the Section 129 Determination (18.62%)) will be assessed as the final countervailing duty on entries if no party requests an assessment review of those entries. As noted above, however, Canada's request for the first assessment review will result in the entries made during the period May 22, 2002 through March 31, 2003 being assessed in accordance with the final results of the first assessment review.

33. In sum, the two sets of data are separate – indeed, separated by a period of over a year – and there is no overlap.

34. By contrast, and as noted above, there is much that is incorrect, irrelevant, and confusing in the two documents submitted by Canada. For instance, the first three pages – of six pages – of "Trigger Dates and Effect on CVD Rates Paid on Imports" and the left side of the "Softwood Lumber - Operation of U.S. Retrospective system" time line address only provisional measures that are not at issue at all (and, indeed, were terminated long before this dispute even started), and a NAFTA proceeding that has not resulted in a final decision. Indeed, that separate domestic law proceeding is irrelevant to this proceeding. Further, there are numerous incorrect statements in the documents, such as the allegation that the cash deposit rate from the first assessment review was 17.18% (page 4) (when that rate was amended subsequently to16.37%); and the assertion that companies not requesting an assessment review were assessed a rate of 18.79% (this statement is misleading. The first assessment review, like the investigation, was conducted

upon an aggregate basis and covered all Canadian companies except those companies specifically excluded from the countervailing duty order. Thus, with that limited exception and except for the companies that received a zero or *de minimis* rate as a result of the first assessment review, all entries for that period of review are subject to an assessment rate of 16.37%). Further, Commerce does not understand why Canada states, at page 5 of the "Trigger Dates" document that "it is not clear" whether the Section 129 Determination cash deposit rate was actually implemented. Commerce issued instructions to U.S. Customs and Border Protection relating to the Section 129 Determination rate with an effective date of December 10, 2004.

14. Please comment on Canada's oral argument (during the afternoon session) that USDOC's five factor test confuses the threshold issue of whether or not to conduct a pass-through analysis with the substantive issue of whether or not a benefit was actually conferred on the log purchaser (as a result of the transaction taking place on below-market terms).

35. Commerce did not confuse the threshold issue of whether to conduct a pass-through analysis with the substantive issue of whether or not a benefit was actually conferred on the log purchaser. Consistent with the DSB's recommendations and rulings, the only transactions examined for competitive benefit were *arm's-length* log sales between unrelated parties. Commerce's arm's-length analysis – under which it examined government mandates and other conditions that were either imposed upon or which attached to the subject transactions – ensured that only arm's length transactions were subject to a competitive benefit analysis. The DSB's recommendations and rulings, by limiting that analysis to arm's-length transactions, reflect that where transactions were not conducted at arm's-length, the subsidy bestowed on the input producer benefits the producer of the processed product. Where Commerce determined that the sales were at arm's length, and therefore might not have passed through the subsidies, it analyzed whether the purchasers received a competitive benefit. Commerce's threshold arm's-length inquiry is, thus, consistent with the DSB's recommendations and rulings.

15. Please explain the significance of the amendment to the US second written submission set forth in para. 64 of the US oral statement.

36. In its oral statement at paragraph 64, the United States requested that the word "unsubsidized" be deleted from paragraph 39 of its second written submission because one of the provincial sources that Commerce relied upon in developing benchmarks for its pass-through analysis contained Crown logs as well as private logs.

16. Please explain the US assertion that (1) payment of the stumpage fee by purchasing sawmills and (2) fibre exchange agreements are "not exclusively arm's-length issues" (para. 23m, US second written submission). To what extent are they (at least partly) arm's length issues? If they do not relate exclusively to the issue of whether or not the relevant transactions were made at arm's length, what other issue do they relate to?

37. As discussed in response to question 8 above, in the written submissions and oral

statement of the United States, and in the Section 129 Determination, when the purchasing sawmill – the log-buying lumber producer – pays the government the Crown stumpage fee, the benefit goes *directly* to that sawmill, so pass through of the benefit is not implicated and no pass-through analysis is required.[24] Fiber exchanges, on the other hand, are exchanges between Crown tenure holders, which often involve simple exchanges of, for instance, logs for chips, to meet appurtenancy and other harvesting requirements. These exchanges are a mechanism for tenured sawmills to deal with various government restrictions concerning the disposition of the harvested timber and are not log sales.[25] For these reasons, Commerce determined that these types of transactions did not involve a potential pass through of a subsidy benefit.

38. Whether the purchasing saw mill pays the stumpage fee also affects the arm's-length nature of the transaction. Specifically, like the appurtenancy, local processing requirements, and wood supply agreements, restrictions and conditions are imposed upon the parties to these transactions, which may limit their ability to negotiate freely with one another.

17. Please comment on Canada's argument that no subsidy was provided to a downstream sawmill paying the stumpage fee because the relevant financial contribution in this case is the provision by government of standing timber, and no standing timber was provided to the downstream sawmill (para. 29 of Canada's oral statement).

39. Canada confuses the subsidy benefit with the financial contribution. The financial contribution is the provision by the provincial government of the standing timber. The lumber producer receives a subsidy benefit each time it pays below-market prices, *i.e.*, less than adequate remuneration, for the harvested trees. When the provincial governments sell timber for less than adequate remuneration there can be more than one beneficiary. Indeed, this is the premise underlying a pass-through analysis.[26] The transaction in which the purchasing sawmill pays the stumpage directly to the Crown is indistinguishable from the transaction in which the sawmill draws from its own tenure and pays a third party to harvest the timber. When a lumber producer harvests timber from its own provincial tenure and pays less than adequate remuneration to the province, there can be no question that the benefit flows directly to that lumber producer regardless of whether the lumber producer hires a third party to harvest. Similarly, where the purchasing sawmill gets the timber and pays the stumpage fee directly to the government, merely paying the independent harvester a fee for harvesting and hauling, the purchasing mill receives the benefit.

18. Please comment on Canada's argument that "Canadian respondents provided pricing data that was representative of ... arm's-length transactions ... and

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

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

[26] Panel Report, para. 7.91; Appellate Body Report, para. 143.

... more than sufficient to conduct a pass-through analysis" (para. 41, Canada's oral statement).

40. First, and most significant, as discussed throughout the written submissions and the oral statement of the United States, the sole determinant for Canada in characterizing transactions as "arm's length" was whether the parties were affiliated or not. Consequently, many of the transactions encompassed in Canada's statement referenced above are not arm's-length transactions because of the government mandates and other conditions that are present in the Canadian stumpage systems that limit or otherwise restrict the negotiating ability of the parties. Commerce was denied the opportunity, in certain instances, to examine many of these transactions to determine whether they truly were arm's length because the Canadian parties failed to provide Commerce with information that it requested concerning the existence of government mandates and other conditions affecting the transactions.

41. By way of example, British Columbia failed to provide Commerce with information that it requested that would have allowed Commerce to analyze the log sales that British Columbia characterized as "arm's length" despite Commerce limiting certain of its requests to only those companies that participated in the Norcon Survey.[27] Manitoba similarly failed to substantiate its claim that a certain volume did not pass through because it failed to provide necessary data to Commerce.[28] Although one company did provide data, those data were for sales arising after the period of investigation, and thus were not included in Commerce's analysis.[29]

42. Alberta was in a slightly different posture from either British Columbia or Manitoba. Alberta responded to Commerce's questionnaires informing Commerce that the majority of its log transactions involved the situation where the purchasing sawmill paid the stumpage fee directly to the government. As previously explained, those sales did not require a pass-through analysis. There were, however, sales that were not subject to such a condition, for which certain mills and harvesters provided data, that Commerce determined were arm's-length sales. For those sales Commerce completed its pass-through analysis.

43. Ontario had similar data infirmities. Certain mills and harvesters, however, responded to Commerce's pass-through appendices and provided Commerce with necessary information that enabled it to complete its pass-through analysis for those sales determined to be at arm's length.[30]

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[27] U.S. Second Written Submission, at 30-33 and accompanying footnotes; Section 129 Determination, at 11 (Exhibit CDA – 5); Draft Section 129 Determination, at 10-11 (Exhibit CDA – 6).

[28] Draft Section 129 Determination, at 12 (Exhibit CDA-6).

[29], U.S. Second Written Submission, at fn. 52; Draft Section 129 Determination, at 11-12 (Exhibit CDA – 6).

[30] Section 129 Determination, at Comment 8 (Exhibit CDA – 5); December 6, 2004, "Pass-Through" Analysis Calculations for the Province of Ontario, at 2-4. Exhibit U.S. – 6.

44. In sum, as evidenced in the written submissions and oral statement of the United States and the Section 129 Determination, when the Canadian respondents provided information about log sales between unrelated parties that Commerce subsequently determined to be at arm's length, Commerce completed its pass-through analysis and, where appropriate, removed the value of those sales from the numerator of the *ad valorem* subsidy calculation (which resulted in lowering the country-wide subsidy rate). Canada's characterization, by contrast, which deems every transaction between unrelated parties as being at "arm's length" and, thus, treats data concerning those sales as "sufficient to conduct a pass through analysis" ignores the reality of the Canadian stumpage system. Commerce, as the investigating authority, could not, however, ignore the facts before it.

45. Second, to the extent the focus of this argument is actually on the claim that the pricing data submitted by Canada is "representative" of arm's-length sales and that Commerce was required to conduct a pass-through analysis based on "average" or "representative" data, Canada is wrong. Neither the DSB, the SCM Agreement nor the GATT 1994 dictates the data that must be accepted or the methodology to be used by a Member in conducting a pass-through analysis. The issue is not whether the United States could have used alternate data or an alternate methodology, but whether the United States acted consistently with the SCM Agreement and the GATT 1994 in conducting its pass-through analysis. Canada has failed to demonstrate that the United States' pass-through analysis is inconsistent with any U.S. WTO obligation. Moreover, as set forth above, substantively, the statement that such pricing data is "representative" of "arm's length transactions" is inaccurate.

B. QUESTIONS TO CANADA

19. Please comment on USDOC's statement that, with regard to Dr. Kalt's arguments regarding government influence in the market, "respondents neglect to distinguish between government actions that generally regulate the marketplace and those that mandate particular outcomes" (First Assessment Review, Issues and Decision Memorandum, page 47).

20. Please comment on the statement in para. 15 of the US oral submission that "the very fact that Canada is ... challenging the Section 129 Determination shows that Canada believes that it is of ongoing effect and relevant to the issue of compliance".

21. Please comment on para. 22 of the US oral statement, concerning the US argument that the subsidy repayment in Australia - Leather was specifically and directly conditioned on the subsidy recipient receiving a non-commercial loan.

22. Please comment on paras 24 of the US oral statement, concerning the possibility of distinguishing ad hoc actions from actions taken pursuant to domestic law requirements.

23. Please comment on the US assertion that "[t]here is no dispute between the parties that for a transaction to be eligible for consideration in Commerce's

pass-through analysis, the DSB determined that the transaction must be between unrelated parties and be at arm's length" (para. 42, US oral statement).

24. Please comment on the US assertion that Canada failed to identify its challenge to the pass-through benchmarks in its panel request (para. 56 of US oral statement).

25. Please provide further clarification of your argument that the US pass-through test is "contrary to the criteria for arm's-length transactions under U.S. law" (para. 3 of Canada's oral statement).

26. In respect of para. 21 of Canada's oral statement, please give examples of cases in which the US "routinely used" the "arm's length standard" set out under US law.

27. At para. 32 of its first written submission, Canada asserts that "USDOC rejected record evidence from Alberta, British Columbia and Ontario because, in some log transactions, the purchasing sawmill paid the government stumpage charge rather than the independent harvester". Please clarify what Canada means by USDOC allegedly "reject[ing] record evidence".

C. QUESTIONS TO BOTH PARTIES

28. Please comment on the EC's argument that if the Panel rejects consideration of the first assessment review as a compliance measure, "no measure taken to comply existed" (para. 7 of EC oral statement).

46. The EC's concluding remark is based on the false premise that the Section 129 Determination ceased to exist once the results of the first assessment review were issued. This premise is wrong, for all of the reasons explained in the oral statement of the United States, at paragraphs 14 - 19.

D. QUESTIONS TO ALL PARTIES AND THIRD PARTIES

29. Assume a countervailing duty under a prospective system was found inconsistent with Article 1 of the SCM Agreement. Assume that inconsistency was then remedied in a re-determination, to the satisfaction of the complaining Member, without the latter having recourse to Article 21.5 proceedings. Then assume that an interim / changed circumstances review was conducted in respect of that measure several years later, in which the very same Article 1 inconsistency was repeated by the investigating authority. Could the original complaining Member initiate Article 21.5 proceedings against that interim review ? Please explain. Would it make any difference if the earlier re-determination had itself been subject to Article 21.5 proceedings?

47. It is difficult to assess hypothetical scenarios such as that in the question, given the numerous unknowns concerning, for example, the nature of the measures, the nature of the

breaches, and the nature of the proceedings in question. For these reasons, the United States cautions against drawing conclusions on fact patterns not actually at issue in this proceeding, and which are not themselves within the terms of reference. Having said that, the United States would find it difficult to see how a completely separate review, conducted on an independent schedule, and undertaken independently of and for reasons unrelated to any recommendations and rulings of the DSB, would be a "measure taken to comply." Certainly the assessment review at issue in this dispute is not a measure taken to comply.

30. Assume that, instead of conducting a re-determination, the respondent Member simply terminated the offending measure after the initial dispute settlement process. Then assume that, six months later, a second measure is taken against the same exports, and on the basis of the same Article 1 violation. Could Article 21.5 proceedings be initiated against that new measure, at least in respect of the Article 1 violation? Please explain. Would it make any difference if the new measure were introduced not six months, but one year, 18 months, or two years after the original measure was terminated?

48. The United States reiterates the difficulty of responding to hypothetical questions, about which many "facts" are unknown. In any event, the scenario in question is completely different from that presented in this dispute for all of the reasons described by the United States in its request for a preliminary ruling and in its oral statement.

31. Please comment on the arguments in Canada's second written submission concerning how to define the scope of an Article 21.5 proceeding.

49. WTO Members, in negotiating the DSU, agreed that the expedited procedures of Article 21.5 would only be available in two circumstances, *i.e.*, to review (1) the existence, or (2) the WTO-consistency, of "measures taken to comply." For this reason, the text of Article 21.5 states that it applies *only* "[w]here there is disagreement as to the *existence* or *consistency with a covered agreement* of measures taken to comply with the recommendations and rulings" of the DSB. As the Appellate Body has stated, Article 21.5 proceedings "do not concern just *any* measure of a Member of the WTO; rather Article 21.5 proceedings are limited to those 'measures *taken to comply*' with the recommendations and rulings of the DSB."[31]

50. The United States understands that Canada would prefer to have the choice of seeking expedited panel review under Article 21.5 for every separate assessment review that Canada may request, now or in the future. But Members simply did not provide that the special, focused procedures under Article 21.5 would be available for any claim for which the complaining party believes that it would be more convenient to use Article 21.5: it is available only with respect to "measures taken to comply" with DSB recommendations and rulings.

51. For all of the reasons set forth in the U.S. written submissions and oral statement, the first

[31] Appellate Body Report, *Canada – Measures Affecting the Export of Civilian Aircraft*, WT/DS70/AB/R, adopted August 20, 1999, para. 36.

assessment review results are simply not "measures taken to comply." They are in no sense "inextricably linked" to either the DSB recommendations and rulings or to the Section 129 Determination. To the contrary, the first assessment review was undertaken for a different purpose entirely, on a different timetable (it was nearly half over before the recommendations and rulings were even adopted), involved a different set of sales and subsidy data, and would have been conducted regardless of whether there had even been a WTO dispute with respect to the final investigation determination. Further, contrary to Canada's claims, the first assessment review in no sense rendered the Section 129 Determination "non-existent": the Section 129 Determination established that the imposition of countervailing duties was proper, and resulted in an adjustment of the cash deposit rate.

52. The United States will not repeat here all of the arguments in its oral statement which respond to Canada's arguments in its second written submission. One final point, however, is worth emphasizing:

53. Canada's second written submission, and, to a degree the EC's written submission as well, implies that the Panel should consider relevant the fact that the United States, unlike Canada and the EC, has a retrospective system of countervailing duty collection. The implication is that, because the United States provides an opportunity for parties to request an assessment review to determine the duties to be assessed on prior import entries, this Panel should expand the scope of Article 21.5 proceedings to include assessment reviews.[32] Such a view is mistaken: there is nothing in the DSU or the SCM Agreement that would permit a different interpretation of "measures taken to comply" for those Members that employ a retrospective duty assessment system, rather than a prospective one. When this point was raised by the United States at the hearing, Canada was quick to note that it was not challenging the retrospective nature of the U.S. duty assessment system.

54. In a related matter, in the last paragraph of its oral statement, Canada asks the Panel, under Article 19.1 of the DSU, to "suggest" how the United States could implement its recommendations, and includes among the suggestions that the United States "refund" countervailing duties. Such a suggestion would be inappropriate, because, although panels have expertise in the WTO agreements, it is the implementing Member that is in the best position to determine how best to implement recommendations and rulings within its own system.

55. In sum, the first assessment review results are not "measures taken to comply" and therefore fall outside the Panel's jurisdiction.

[32] *E.g.*, Canada's Second Written Submission, para. 27; EC Third Party Submission, para. 29.