BEFORE THE
WORLD TRADE ORGANIZATION
APPELLATE BODY

United States - Final Countervailing Duty Determination With Respect to Certain Softwood Lumber Products from Canada

(AB-2003-6)

APPELLANT'S SUBMISSION OF THE UNITED STATES OF AMERICA

October 21, 2003

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SERVICE LIST

APPELLEE

H.E. Mr. Sergio Marchi, Permanent Mission of Canada

THIRD PARTIES

H.E. Mr. Carlo Trojan, Permanent Delegation of the European Commission
H.E. Mr. K.M. Chandrasekhar, Permanent Mission of India
H.E. Mr. Shotaro Oshima, Permanent Mission of Japan

I. INTRODUCTION AND EXECUTIVE SUMMARY

1. The United States appeals certain issues of law and legal interpretation in the report of the Panel on *United States–Final Countervailing Duty Determination with Respect to Certain Softwood Lumber from Canada* ("*Lumber Panel Report*"),[1] concerning the calculation of subsidies that gave rise to the imposition of countervailing duties on certain softwood lumber from Canada.[2]

2. First, the United States appeals the Panel's finding that, under Article 14(d) of the *Agreement on Subsidies and Countervailing Measures* ("SCM Agreement"), the United States was required to determine the benefit from the government provision of goods based on a comparison to *any* existing non-government prices in Canada.[3] The Panel's finding is based on an erroneous interpretation of Article 14(d).

3. Article 14 of the SCM Agreement explicitly states that it sets forth guidelines for calculating "the benefit to the recipient conferred pursuant to paragraph 1 of Article 1" of the SCM Agreement. The Appellate Body has stated that a government financial contribution confers a benefit if the financial contribution makes the recipient better off than it would otherwise have been absent that contribution, and that the marketplace provides the appropriate

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[1] *United States–Final Countervailing Duty Determination with Respect to Certain Softwood Lumber from Canada*, WT/DS257/R, circulated August 29, 2003 ("*Lumber Panel Report*").

[2] *See 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) ("*Final Determination*") (Exhibit U.S.-2); *see also Issues and Decision Memorandum: Final Results of the Countervailing Duty Investigation of Certain Softwood Lumber Products from Canada,* 26-33, 145-50 (March 21, 2002) (Exhibit CDA-1) ("*Issues and Decision Memorandum*").

[3] *Lumber Panel Report* paras. 7.43-7.65.

basis for comparison.[4] Article 14(d) states that the benefit from the government provision of goods must be determined "in relation to prevailing market conditions" in the country of provision. To determine whether the recipient is better off than it would otherwise have been absent the financial contribution, the "market conditions" must necessarily be commercial market conditions that are not determined or substantially influenced by the government's financial contribution.

4. Contrary to the plain meaning of this text and general principles of treaty interpretation, the Panel interpreted Article 14(d) in a manner that is fundamentally inconsistent with the concept of "benefit" in Article 1.1(b) of the SCM Agreement.[5] Specifically, the Panel concluded that Article 14(d) requires Members to determine the adequacy of remuneration using prices from any non-government suppliers in the country under investigation, even if the influence of the government, as a supplier, substantially impacts or even determines the non-government prices. The Panel reached that conclusion despite having acknowledged that this "could lead to a circular comparison of a government price with, in effect, itself" and lead to results that would "not necessarily be the most sensible."[6] As discussed below, it is the view of the United States that the Panel erred as a matter of law and legal interpretation. The United States therefore

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[4] Appellate Body Report, *Canada–Measures Affecting the Export of Civilian Aircraft*, WT/DS70/AB/R, adopted August 20, 1999, para. 157 ("*Canada-Aircraft Appellate Body Report*").

[5] Article 1.1 of the SCM Agreement states that a subsidy is deemed to exist if

> (a)(1) there is a financial contribution by a government . . .
> . . .
> and
> (b) a benefit is thereby conferred.

[6] *Lumber Panel Report*, para. 7.58.

requests that the Appellate Body reverse this aspect of the Panel's findings.

5. Second, the United States appeals the Panel's findings that the United States was required to conduct a "pass-through" analysis to determine the amount of the subsidy granted to the subject merchandise, and, indeed, to determine the amount of such subsidy attributable to a certain group of producers of the subject merchandise. The Panel's findings are based on the erroneous conclusion that sales of logs and lumber between Canadian softwood lumber producers may reduce the total, aggregate subsidy granted *directly* to the producers of the product under investigation, *i.e.*, softwood lumber.[7]

6. The Panel's findings have no basis in the SCM Agreement. As the Panel acknowledged, a "pass-through" analysis is required only where the subsidy has been bestowed directly on someone *other than a producer or exporter of the product under investigation*.[8] The "subsidies found to exist" in this case were all received *directly* by softwood lumber producers.[9] A pass-

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[7] The United States does not appeal the Panel's finding that, where the subsidy is received by independent harvesters, *i.e.*, entities that do *not* produce the product under investigation and operate at arm's length, a pass-through analysis would be required to determine if the subsidy received by the independent harvesters was indirectly bestowed on production of softwood lumber. *Lumber Panel Report*, paras. 7.94-7.95. The United States notes, however, that a binational panel, established under Chapter 19 of the *North American Free Trade Agreement* to review the final countervailing duty determination in this case ("Lumber NAFTA panel"), recently found that there was substantial evidence that the independent harvesters do not operate at arm's-length. *In the Matter of Certain Softwood Lumber Products from Canada, Final Countervailing Duty Determination*, Decision of the Panel, August 13, 2003, p. 64 ("*NAFTA Lumber Panel Report"*).

[8] *Lumber Panel Report*, para. 7.91.

[9] It is undisputed that, with exception of a small volume of that Crown timber that may have come from independent harvesters operating at arm's-length, the entire subsidy in the numerator of the subsidy calculation went directly to Canadian producers of softwood lumber. As noted above, the United States is not appealing the Panel's findings with respect to that portion of the subsidy that may have been granted directly to independent harvesters. To simplify the discussion of this issue, therefore, when the United States refers in this section to the

through analysis was therefore not required. The Panel's conclusion to the contrary is based on reading into the SCM Agreement and GATT 1994 an obligation that does not exist. The SCM Agreement and GATT 1994 require a determination of the subsidies to the production of "any merchandise" or a "product" in the country under investigation. The Panel expanded that obligation by interpreting "product" as limited to subsidies traceable to specific products from specific producers – what the Panel referred to as the "subject merchandise under investigation."[10] No such obligation exists. The Panel's findings are based on erroneous interpretations of the SCM Agreement and GATT 1994 and the United States therefore requests that the Appellate Body reverse them.

II. ARGUMENT

A. The Panel Erred in Interpreting Articles 14 and 14(d) of the SCM Agreement to Require that the Benefit be Measured with Reference to Prices That Are Substantially Influenced or Effectively Dictated by the Government's Financial Contribution

7. Article 1.1 of the SCM Agreement defines a subsidy in relevant part as a government financial contribution that confers a benefit. The financial contribution in this case is the provision of a good – timber – by the Canadian provincial governments.[11] Article 14 of the SCM Agreement contains guidelines that Members must follow in determining whether the

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"total" amount of the subsidy, it means the subsidy received directly by an entity that produces softwood lumber, not any portion that may have been received by independent harvesters that do not produce softwood lumber.

[10] *See,* e.g., *Lumber Panel Report*, para. 7.97

[11] Article 1.1(a)(1) of the SCM Agreement states that a "financial contribution" exists where, *inter alia*, "a government provides goods or services other than general infrastructure, or purchases goods." Article 1.1(a)(1)(iii) of the SCM Agreement. The Panel found that the United States' determination that the Canadian provinces are providing a good – standing timber – is consistent with Article 1.1(a)(1)(iii) of the SCM Agreement. *Lumber Panel Report*, para. 7.30.

government's financial contribution confers a "benefit" within the meaning of Article 1.1(b) of the Agreement. Article 14(d) of the SCM Agreement states that the government provision of a good does not confer a benefit unless the provision is made for less than adequate remuneration. Article 14(d) further provides that

> The adequacy of remuneration shall be determined in relation to prevailing market conditions for the good or service in question in the country of provision or purchase (including price, quality, availability, marketability, transportation and other conditions of purchase or sale).

8. The United States appeals the Panel's finding that Article 14(d) required the United States to determine the adequacy of remuneration for the government-provided timber based on *any* observed non-government timber prices in Canada, even prices that are substantially influenced or even effectively determined by the Canadian provincial governments' financial contribution. The Panel's finding is based on an erroneous interpretation of Article 14(d).

1. The Benefit Guidelines in Article 14(d) Must be Interpreted In a Manner Consistent with the Term "Benefit" in Article 1.1(b) of the SCM Agreement

9. Interpretation of the provisions of a treaty, of course, begins with the text itself. In accordance with the general principles of treaty interpretation, the text shall be interpreted "in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose."[12]

10. Article 14 of the SCM Agreement states that the "method used by the investigating

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[12] Article 31 of the *Vienna Convention on the Law of Treaties* ("Vienna Convention"); *see also* Appellate Body Report, *Japan–Taxes on Alcoholic Beverages*, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, adopted November 1, 1996, pp. 10-12; Panel Report, *United States–Sections 301-310 of the Trade Act of 1974*, WT/DS152/R, adopted January 27, 2000, para. 7.22

authority to calculate the benefit to the recipient conferred pursuant to paragraph 1 of Article 1" shall be consistent with the "guidelines" set out in that article. Thus, the text explicitly ties the guidelines in Article 14 to the term "benefit" in Article 1.1(b). The guidelines in Article 14 are the tools used to determine the existence of such a benefit. To properly interpret Article 14(d), therefore, it is necessary to consider the meaning of "benefit" in Article 1.1(b) of the SCM Agreement.

11. The SCM Agreement does not define the term "benefit,[13] but the Appellate Body stated in *Canada–Aircraft* that:

> We . . . believe that the word "benefit", as used in Article 1.1(b), implies some kind of comparison. This must be so, for there can be no "benefit" to the recipient unless the "financial contribution" makes the recipient *"better off" than it would otherwise have been, absent that contribution*. In our view, the marketplace provides an appropriate basis for comparison in determining whether a "benefit" has been "conferred", because the trade-distorting potential of a "financial contribution" can be identified by determining whether the recipient has received a "financial contribution" on terms more favourable than those available to the recipient in the market.[14]

The Appellate Body thus concurred with the panel in that case, which stated:

> [I]n our opinion the ordinary meaning of "benefit" clearly encompasses some form of advantage. . . . [The authority must] determine whether the financial contribution places the recipient in a *more advantageous position than would have been the case but for the financial contribution*. In our view, the only logical basis for determining the position the recipient would have been in absent the financial contribution is the market.[15]

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[13] Appellate Body Report, *United States–Countervailing Measures Concerning Certain Products from the European Communities*, WT/DS212/AB/R, adopted January 8, 2003, para. 97.

[14] *Canada–Aircraft Appellate Body Report*, para. 157 (emphasis added).

[15] Panel Report, *Canada–Measures Affecting the Export of Civilian Aircraft*, WT/DS70/R, adopted August 20, 1999, para. 9.112 (*"Canada-Aircraft Panel Report")* (emphasis added).

It is therefore well established that the very essence of the benefit analysis is to determine whether the recipient is better off than it would have been absent the government's financial contribution.

12. The Panel dismissed the Appellate Body's statements in *Canada–Aircraft* as irrelevant to an interpretation of Article 14(d). The Panel's rationale for ignoring the words of the Appellate Body was that they were merely a "general discussion about 'benefit' under Article 1.1(b) SCM Agreement" made in a different context (*i.e.*, a discussion of the "cost to government" versus "advantage to the recipient").[16]

13. The Panel's reasoning is fundamentally flawed. The general meaning of "benefit" under Article 1.1 is not only relevant, but central to benefit issues, in whatever context they may arise, and is expressly relevant to the meaning of Article 14. The Appellate Body itself stated that the context in which it made the statements in *Canada–Aircraft* concerning the meaning of the term "benefit" in Article 1.1(b) does not affect the relevance of those statements in other contexts in which the existence of a "benefit" is at issue.[17]

14. The explicit purpose of Article 14(d) of the SCM Agreement is to provide guidelines for

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[16] *Lumber Panel Report*, para. 7.54.

[17] Appellate Body Report, *United States–Imposition of Countervailing Duties on Certain Hot-Rolled Lead and Bismuth Carbon Steel Products Originating in the United Kingdom*, WT/DS138/AB/R, adopted June 7, 2000, para. 57, footnote 45 (noting that statements originally made in the context of a cost to government discussion were still relevant to discussion of the term "benefit"). Footnote 45 refers to a quote from paragraph 156 of the *Canada-Aircraft Appellate Body Report*, which immediately precedes the statements quoted above from paragraph 157 of that report. Because the discussion in both paragraphs 156 and 157 of the *Canada-Aircraft Appellate Body Report* concerns the interpretation of "benefit", the Appellate Body's comment about the relevance of its statements on that topic applies equally to the statements quoted above.

calculating the "benefit" from the government provision of goods or services, *i.e.*, for determining if the recipient is better off than it would otherwise have been, absent the government's provision of the goods or services. The Appellate Body's interpretation of "benefit" is therefore highly relevant in interpreting Article 14(d). The Panel was wrong to disregard it.

15. Contrary to the text of Article 14 of the SCM Agreement, the Panel divorced its interpretation of the guidelines in Article 14(d) from the very thing those guidelines address – the benefit to the recipient pursuant to Article 1.1(b). Contrary to the general principles of treaty interpretation, the Panel set Article 14(d) adrift, out of context. As a result, the Panel erroneously concluded that Article 14(d) requires Members to use any existing prices from non-government, domestic suppliers to determine the adequacy of remuneration, regardless of whether those prices are substantially influenced or even effectively determined by the government's provision of goods, *i.e.*, the very financial contribution at issue.

16. The Panel explicitly acknowledged the conundrum created by its interpretation of Article 14(d) of the SCM Agreement, noting that the United States correctly pointed out that such an interpretation of Article 14(d) "could lead to a circular comparison of a government price with, in effect, itself."[18] It is patently obvious that such a comparison cannot identify whether a benefit is "thereby conferred" by the government's financial contribution.[19] The Panel's interpretation of Article 14(d) of the SCM Agreement is therefore inconsistent with its very purpose, *i.e.*, to determine whether the recipient is better off than it otherwise would have been

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[18] *Lumber Panel Report*, para. 7.58.

[19] SCM Agreement, Article 1.1(b).

absent the government's financial contribution.

17. The Panel's interpretation of Article 14(d) of the SCM Agreement is, in fact, completely at odds with the concept of benefit, as articulated by the Appellate Body in prior disputes. The trade-distorting potential of a financial contribution cannot be identified by comparison to prices determined by that very financial contribution. Nevertheless, the Panel concluded that the "subtle problem of economic logic" created by its interpretation was inherent in the text of Article 14(d) of the SCM Agreement.[20] The United States disagrees.

2. The Text of Article 14(d) Provides for a Comparison to "Market Conditions" to Determine the Adequacy of Remuneration

18. As the Panel noted, Article 14(d) of the SCM Agreement states that the government provision of goods does not confer a benefit unless the government receives "less than adequate remuneration."[21] Article 14(d) does not define "adequate remuneration." As the Panel points out, "adequate" is a relative term, the ordinary meaning of which is "sufficient, satisfactory."[22] To interpret "adequate remuneration," therefore, it is necessary to consider in what context and for what purpose the remuneration must be sufficient or satisfactory. Recalling the Appellate Body's interpretation of "benefit," remuneration can be "adequate" only if it is sufficient to make the purchaser of the government goods no better off than it would otherwise have been absent the financial contribution.

19. As the Appellate Body has stated, the marketplace is the appropriate basis for comparison

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[20] *Id.*, paras. 7.58-7.59.

[21] *Lumber Panel Report*, para. 7.58; SCM Agreement, Article 14(d).

[22] *Lumber Panel Report*, para. 7.48, citing *The New Shorter Oxford Dictionary* ("*NSOD*"), edited by Lesley Brown, Clarendon Press – Oxford, ed. 1993, p. 26.

to determine whether a "benefit" has been "conferred," *i.e.,* to determine whether the recipient is better off than it would otherwise have been *absent the financial contribution*.[23] Consistent with that general principle, Article 14(d) states that the adequacy of remuneration must be determined "in relation to prevailing *market conditions*" for the goods in the country of provision.[24] As discussed below, following the Appellate Body's reasoning, the "market conditions" to which the government's remuneration is to be related must be commercial market conditions that are not determined or substantially influenced by the government's financial contribution.[25]

3. "Market Conditions" Must Be Commercial Market Conditions That Are Not Determined or Substantially Influenced by the Government's Financial Contribution

20. As noted above, the guidelines in Article 14(d) state that the adequacy of remuneration must be determined in relation to "prevailing market conditions" in the country of provision. As the Panel noted, the ordinary meaning of the term "prevailing" is "predominant in extent or amount," to be "prevalent" or to "exist."[26] The United States therefore does not disagree that "prevailing" market conditions are "market conditions 'as they exist' or 'which are predominant.'"[27] The United States strongly disagrees, however, with the Panel's interpretation of the term "market conditions." The Panel's reasoning on this point is circular and logically flawed. The Panel concluded that because the only word in Article 14(d) that qualifies "market

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[23] *Canada-Aircraft Appellate Body Report*, para. 157.

[24] SCM Agreement, Article 14(d) (emphasis added).

[25] *See* Panel Report, *Brazil–Export Financing Programme for Aircraft – Second Recourse by Canada to Article 21.5 of the DSU*, WT/DS46/RW/2, July 26, 2001, para. 5.29 ("*Brazil–Aircraft Panel Report*").

[26] *Lumber Panel Report*, para. 7.50, citing *NSOD* at 2347.

[27] *Lumber Panel Report*, para. 7.50.

conditions" is "prevailing," any conditions that prevail are "market conditions."[28] In effect, the Panel read Article 14(d) as if the text stated that adequate remuneration must be determined "in relation to prevailing conditions of sale for the good in question," without regard to whether the "prevailing" conditions are "market" conditions.

21. The issue of the proper definition of "market conditions" is, in fact, separate and distinct from the issue of whether such conditions prevail (*i.e.*, exist or predominate). Not all prevailing conditions are market conditions within the meaning of Article 14(d). For example, the government's prices for the goods are "prevailing" conditions. They are not, however, "market" conditions in the context of the comparison set out in Article 14(d) or the comparison would become nonsensical. As discussed below, the term "market conditions" must, consistent with the principles of treaty interpretation, be interpreted in accordance with its ordinary meaning, in context and in light of the object and purpose for which it is used.

22. As noted above, in *Canada–Aircraft*, the Appellate Body stated that the goal in comparing the government's financial contribution to the marketplace is to determine whether the recipient is better off than it otherwise would have been absent the government's financial contribution. In *Brazil–Aircraft*, the panel recalled that statement by the Appellate Body and, following that reasoning, concluded that "the 'market' to which reference must be made is the *commercial* market, *i.e.*, a market undistorted by government intervention."[29] In contrast, this Panel concluded that, where the government provides goods, the "market" to which reference must be made consists of *any* private transactions for the goods in question, *i.e.*, including

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[28] *Lumber Panel Report*, para. 7.51.

[29] *Brazil–Aircraft Panel Report*, para. 5.29 (emphasis in original).

transactions where the prices are effectively determined by the very financial contribution under examination. The logic of the *Brazil–Aircraft* panel's reasoning is unassailable; the logic of this Panel's reasoning is unsustainable.

23. This Panel dismissed the rationale of the *Brazil–Aircraft* panel as addressing a different question, which the Panel characterized as limited to whether "market" interest rate benchmarks for determining the benefit from government payments to offset interest expenses should include the rates on other government loans.[30] The statements of the *Brazil-Aircraft* panel were, however, made in a general discussion of "benefit" as previously interpreted by the Appellate Body. Although the specific issues in *Brazil–Aircraft* were different, the concept of "benefit" is the same, regardless of the type of financial contribution at issue. Thus, whether the government is making payments to offset credit expenses or selling goods, the benefit must be determined by reference to a market undistorted by the government's financial contribution. Only comparison to such a market can identify the "trade-distorting potential of a 'financial contribution.'"

24. The term "market conditions" in Article 14(d) does not necessarily mean a perfectly competitive or "pure" market (which rarely exists in any case). At the other extreme, however, there is absolutely no basis in the text of Article 14(d) to conclude that Members used the term "market conditions" to include market prices determined or substantially influenced by the very

[30] *Brazil–Aircraft* involved government payments to lenders who financed the export sale of regional aircraft, not loans. *Brazil–Aircraft Panel Report*, para. 5.27. The Panel found, however, that whether the payments to lenders conferred a benefit on *producers* of the aircraft depended upon the impact the government payments had on the terms and conditions of export credit financing available to purchasers of Brazilian regional aircraft. *Id.*, para. 5.28. The Panel concluded that the impact of the government payments must be determined by reference to commercial export credit terms.

government financial contribution at issue, *i.e.*, the government's provision of the goods in question.[31] Such an interpretation reads into Article 14(d) an obligation to compare what are, economically, two government prices, rather than a government price and a market price. Such an interpretation of Article 14(d) is therefore inconsistent with the meaning of "benefit" in Article 1.1(b) of the SCM Agreement. It is therefore also inconsistent with the terms of Article 14, which explicitly state that the purpose of the guidelines is to determine the "benefit" to the recipient.

25. Moreover, the provisions of Article 14 are explicitly designated as "guidelines" and they must be interpreted in accordance with the ordinary meaning of that word. A "guideline" is "a directing or standardizing principle laid down as a guide" to procedure or policy.[32] The fact that Members are obligated to follow the guidelines in Article 14 does not alter their character. Members have specifically designated the provisions in Article 14 as "guides" or "principles," not rigid rules that purport to contemplate every conceivable factual circumstance.[33]

26. The Panel implicitly recognized that "guidelines" have some inherent degree of

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[31] The European Communities described the proper benchmark under Article 14(d) of the SCM Agreement as "independent market-driven prices." Third Party Submission of the European Communities, para. 32 ("EC Third Party Submission"); *see also* EC Third Party Submission, para. 27.

[32] *NSOD*, at 1159 (Exhibit U.S.-12)

[33] This is also reflected in the text of Article 14(d), which states that the adequacy of remuneration must be determined "in relation to" prevailing market conditions in the country of provision. The Panel interpreted "in relation to" as synonymous with "compared to." "In relation to" is, however, a phrase with broader meaning, *i.e.*, the concept of "relating" A to B is broader than the concept of "comparing" A to B. The *NSOD* defines "in relation to" as meaning "as regards." In turn, it defines "as regards" as "concerning" and defines "concerning" as "in reference to." *NSOD,* at 467, 2526, 2534 (Exhibit U.S.-11). The Members' choice of the broader phrase "in relation to" is consistent with the text, context and purpose of Article 14(d) which establishes the provision as a "guideline."

flexibility. The Panel stated that

> where, for example, the government is the *only* supplier of the good in the country, *or where the government administratively controls all of the prices for the good in the country*, there would be no price other than the price charged by the government and thus no basis for the comparison foreseen in Article 14(d) SCM Agreement.[34]

27. The Panel therefore recognized that where only government prices or formal government price controls "prevail," the observed prices are not "market conditions" within the meaning of Article 14(d) of the SCM Agreement, despite the existence of transactions between private parties, *i.e.*, non-government suppliers and purchasers.[35] The Panel therefore acknowledged that the existence of private transactions does not necessarily mean that the prices are "market conditions," within the meaning of Article 14(d).[36] The United States agrees.

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[34] *Lumber Panel Report*, para. 7.57 (second emphasis added). The Panel's limitation to situations in which the government is the sole supplier is inconsistent with the ordinary meaning of "prevailing" market conditions. As the Panel noted, the ordinary meaning of the term "prevailing" is "predominant." Thus, there is no basis in the text for the Panel to conclude that the comparison envisioned by Article 14(d) is impossible only if the government is the sole supplier. Where the government is predominant in the market, the "prevailing" conditions are those set by the government, not the market.

[35] The Panel stated that, in such circumstances, [t]he only remaining possibility would appear to be the construction of some sort of a proxy for, or estimate of, the market price for the good in that country." *Lumber Panel Report*, para. 7.57. The Panel did not reach the issue of whether the specific methodology used by the United States would constitute an appropriate proxy. The Panel noted, however, that both Canada and the European Communities agreed that commercially available world market prices could provide an appropriate benchmark. *Id*., footnote 136.

[36] The Panel implied that the United States conceded the existence of a "private market." Although the United States acknowledged that there were sales of private timber in Canada, it argued that these were *not* market transactions within the meaning of Article 14(d) of the SCM Agreement because the prices were significantly distorted by the governments' timber sales. *United States – Final Countervailing Duty Determination with Respect to Certain Softwood Lumber from Canada*, First Written Submission of the United States, January 22, 2003, paras. 64-76; Answers of the United States of America to the Panel's Questions, February 24, 2003, paras. 15-21; *United States – Final Countervailing Duty Determination with Respect to Certain*

28. Whether specific prices constitute "market conditions" in the country of provision is a question of fact that must be decided on a case-by-case basis. The fact that the government is a significant supplier of goods does not, in itself, establish that all prices for the goods are distorted. The Panel acknowledged, however, that

> In the situation addressed by Article 14 (d) SCM Agreement, the government fulfils a role normally also played by private market players: it provides goods or services. In these situations, the government is acting on the market and, by so doing, may influence the private market. Whether and to what extent such government action influences the private market will of course depend upon the particular circumstances, but there could be cases in which that influence is substantial or even determinative of conditions in the private market. In such cases, a comparison of the conditions of the government financial contribution with the conditions prevailing in the private market would not fully capture the extent of the distortion arising from the government financial contribution, a result that in our view would not necessarily be the most sensible one from the perspective of economic logic.[37]

29. Nevertheless, the Panel found that, even where the government's actions are determinative of conditions in the private market, any observed prices constitute "market conditions," within the meaning of Article 14(d) of the SCM Agreement. The Panel, therefore, defined "market conditions" based on an arbitrary factual distinction, *i.e.*, whether the government formally controls prices in the private sector through administrative controls, or accomplishes the same results through the exercise of its market power as a dominant supplier of the good.

30. The Appellate Body should find that the Panel erred as a matter of law. The Panel's conclusion is inconsistent with the text of Article 14(d), which establishes a comparison that

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Softwood Lumber from Canada, Second Written Submission of the United States, March 6, 2003, paras. 28-32.

[37] *Lumber Panel Report*, para. 7.58.

relates the government's provision of goods to prevailing "market conditions." In context, and in light of the object and purpose of the benefit analysis as articulated by the Appellate Body, "market conditions" can only mean a market undistorted by the government's financial contribution. The Appellate Body should therefore reverse the Panel's conclusion that the United States' imposition of countervailing duties was inconsistent with its obligations under Articles 10, 14, 14(d) and 32.1 of the SCM Agreement.[38]

B. The Panel Erred, in Part, in Concluding That A "Pass-Through" Analysis was Required To Determine the Total Amount of the Subsidy to the Production of Softwood Lumber

31. The SCM Agreement provides that countervailing duties may be imposed in an amount not exceeding the "subsidy found to exist."[39] The SCM Agreement also recognizes that imports may be subject to countervailing duties without a determination that those specific imports benefitted from subsidies,[40] *i.e.*, that Members are not required to determine the "subsidy found to exist" on a company-specific or transaction-specific basis. It is, in fact, undisputed in this proceeding that an "aggregate" subsidy analysis, such as the one used by the United States, is permissible under the SCM Agreement.[41] Nevertheless, relying on an understanding of the

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[38] *Lumber Panel Report*, para. 7.65.

[39] SCM Agreement, Article 19.4.

[40] SCM Agreement, Article 19.3.

[41] As the Panel noted, Canada does not claim that the "aggregate" subsidy methodology used by the United States is *per se* inconsistent with the SCM Agreement. *Lumber Panel Report*, para. 7.82. In fact, Canada also uses this type of analysis. *See Statement of Reasons Concerning a Final Determination of Dumping and Subsidizing Regarding Certain Grain Corn Originating in or Exported from the United States of America, for Use or Consumption West of the Manitoba/Ontario Border*, Nos. 4237-88 AD/1242, 4218-10 CV/91 (February 5, 2001) ("Grain Corn Determination") (Exhibit U.S.-38). Similar to the U.S. investigation of softwood lumber, in the Grain Corn Determination Canada sent requests for information to the U.S. Government

meaning of "countervailing duty" in footnote 36 to Article 10 of the SCM Agreement,[42] the Panel read into the SCM Agreement an obligation to reduce the "subsidy found to exist" to account for the fact that some specific producers of softwood lumber may not have received a subsidy because they purchase log and lumber inputs from other softwood lumber producers. The Panel's finding has no basis in the text of footnote 36 and is in direct conflict with other provisions of the SCM Agreement. For the reasons discussed below, the Appellate Body should reverse these aspects of the Panel's findings.

32. Before proceeding with the legal arguments, it is useful to briefly summarize the United States' calculation of the countervailing duty rate at issue.

1. The Subsidy Calculation

33. The product investigated is certain softwood lumber. "Certain softwood lumber" includes all softwood lumber, whether primary lumber (*i.e.*, lumber that is produced when a log is processed for the first time) or "remanufactured" lumber (*i.e.*, primary lumber that undergoes some additional processing, such as cutting to odd lengths and planing).[43] There are a great number of softwood lumber producers in Canada. Those producers are referred to as either "sawmills" or "remanufacturers," depending upon their product mix.[44]

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regarding the aggregate amount of the subsidy and ultimately calculated an aggregate rate that would apply to all U.S. corn imported into Canada.

[42] SCM Agreement, Article 10, footnote 36, quoted in *Lumber Panel Report*, para. 7.87.

[43] All of the products at issue in this dispute are referred to collectively as "softwood lumber."

[44] According to StatsCan, if primary lumber products constitute the majority of the producer's production, the producer is referred to as a "sawmill." If the majority of the producer's production is remanufactured lumber products, the producer is referred to as a "remanufacturer." *See* Memorandum from Eric Greynolds to Melissa Skinner, Countervailing

34. The subsidy is the provincial governments' sale of timber for less than adequate remuneration. Because of the extremely large number of softwood lumber producers in Canada, it was impracticable for the United States to investigate individual companies. Rather, the United States calculated a country-wide *ad valorem* countervailing duty rate by dividing the total subsidy granted to all softwood lumber producers (the numerator) by total sales (the denominator). To calculate the total subsidy (the numerator) granted by each province, the United States multiplied the total volume of "Crown" softwood timber [45] that entered sawmills by the per unit amount of the provincial subsidy (*i.e.*, the difference between the provincial timber price and the benchmark price). This calculation was based on aggregate data provided by the provincial governments.

35. Economically, the benefit from the government provision of goods for less than adequate remuneration is equivalent to a cash grant.[46] Like a cash grant, therefore, the United States allocated the total subsidy over the total sales of all products resulting from the softwood lumber production process (the denominator), including products that were not the subject of the

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Duty Investigation of Certain Softwood Lumber Products from Canada: Verification of Questionnaire Responses Submitted by the Government of Canada, 5 ("GOC Verification Report") (stating classification may change based on the category of the majority of the firm's production) (Exhibit CDA-34).

[45] The term "Crown" timber is used to refer to timber owned by the provincial governments that is sold through various types of contracts, collectively referred to as "tenures."

[46] There is no economic difference between selling one million widgets, or one million cubic meters of timber at $2 below the market price, or giving the purchaser a $2 million dollar grant to buy the goods at market price. Moreover, the recipient receives the subsidy regardless of what it does with the goods. For example, when a sawmill harvests a tree and pays the province less than adequate remuneration, it has received a subsidy, regardless of whether it sells the log or processes it. Like a cash grant, the subsidy from the government provision of goods may properly be allocated over the value of all of the recipient's production.

investigation.[47] Thus, the total direct subsidy to softwood lumber producers was allocated evenly over the total value of the products they produce. The resulting ratio produced the *ad valorem* countervailing duty rate applied to imports of softwood lumber from Canada.

2. The SCM Agreement and GATT 1994 Provide that Countervailing Duties May Equal the Subsidy to the Production of the Product Under Investigation, Softwood Lumber

36. Article 10 of the SCM Agreement notes that a countervailing duty is a "special duty levied for the purpose of offsetting any subsidy bestowed directly or indirectly upon the manufacture, production or export of any merchandise, as provided for in paragraph 3 of Article VI of GATT 1994."[48] Article VI:3 of GATT 1994 states that no countervailing duty shall be levied on any product in an amount exceeding the estimated "subsidy determined to have been granted, directly or indirectly, on the manufacture, production or export of such product in the country of origin or exportation. . . ."

37. Recalling these provisions, the Panel stated that "the core of the pass-through issue is the subsidization of a product, *i.e.*, in respect of its manufacture, production or export. Where the subsidy is received by someone *other than the producer of the investigated product*, the question

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[47] The Panel therefore erred when it stated that the United States' methodology "unjustifiably assumes" that 100 percent of the subsidy received by a softwood lumber producer is attributable to the product under investigation when the producer may produce and sell other products. *Lumber Panel Report*, para. 7.97. In addition to sales of softwood lumber, the denominator included sales of co-products, *i.e.*, fuel wood, wood chips, particles, sawdust, waste, and scrap resulting from softwood products. Canada claimed that the United States should have also included certain "residual products" in the denominator, but the Panel did not reach that issue. The United States is re-examining that issue, however, in response to a remand by the Lumber NAFTA panel.

[48] SCM Agreement, Article 10, footnote 36.

arises whether there is subsidization in respect of that product."[49] The Panel therefore acknowledged that a "pass-through" analysis is required only where the subsidy is bestowed indirectly, *i.e.*, where the subsidy is received directly by someone *other than a producer of the product under investigation*.[50] In such cases, the pass-through, or "upstream subsidy," analysis is necessary to determine if some or all of the subsidy was bestowed "indirectly" on producers of the product under investigation. That was the issue before the GATT panel in the *Canadian Pork* dispute,[51] which was cited by this Panel in support of its reasoning.[52] The Panel's reliance on that dispute is, however, misplaced.

38. The *Canadian Pork* dispute concerned countervailing duties on fresh, chilled and frozen pork from Canada. Some of the subsidies being investigated, however, were subsidies granted directly to producers of live swine, not to pork producers. Live swine was not a product under investigation. The *Canadian Pork* panel emphasized that

> the parties did not dispute that Canada had granted subsidies to swine producers, that *swine producers and pork producers are separate industries operating at arm's-length* and that the subsidies granted to swine producers could have *indirectly* bestowed a subsidy on the production of pork.[53]

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[49] *Lumber Panel Report*, paras. 7.85 and 7.92 (emphasis added).

[50] *Lumber Panel Report*, para. 7.91.

[51] GATT Panel Report, *United States–Countervailing Duties on Fresh, Chilled and Frozen Pork from Canada*, DS7/R, adopted July 11, 1991 ("*Canadian Pork Panel Report"*).

[52] *Lumber Panel Report*, para. 7.92.

[53] *Canadian Pork Panel Report*, para. 4.3. The panel further noted that

> The sole issue in dispute between the parties is whether the United States acted consistently with Article VI:3 when it determined that a subsidy had been bestowed on the production of pork equal to the full amount of the subsidy granted to producers of swine based solely on the findings that the demand for

39. In contrast to the *Canadian Pork* dispute, the United States' countervailing duties on softwood lumber from Canada are based on subsidies granted *directly* to Canadian producers of softwood lumber. Because the subsidies were not received by someone *other than a producer of softwood lumber*, no pass-through analysis is required. In reaching a contrary conclusion, the Panel read into the SCM Agreement obligations that do not exist.

40. Consistent with the SCM Agreement and GATT 1994, the United States imposed countervailing duties that equal, but do not exceed, the total subsidy granted *directly* to the production of softwood lumber in Canada. The per unit countervailing duty rate is based on an allocation of the total subsidy to softwood lumber producers over total sales, both domestic and export, of the products they produce.[54] The resulting countervailing duty rate therefore does not overstate the subsidy to the production of softwood lumber in Canada.

41. The Panel, however, read into the SCM Agreement a requirement to take that analysis a step further. The Panel found that the United States was obligated to determine what, if any, portion of the total subsidies granted directly to softwood lumber production in Canada could be specifically traced to products entering the United States that were produced by companies that purchase logs or lumber from other lumber producers.[55] That is, according to the Panel, the "subsidy found to exist" is not the subsidy to the production of softwood lumber in Canada, as stated in the SCM Agreement, but rather some portion of that subsidy traceable to specific

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swine is substantially dependent on the demand for pork and that processing of swine into pork adds only limited value.

[54] In the case of export subsidies, the benefit is allocated only over export sales. The subsidies at issue in this case, however, were not export subsidies.

[55] *Lumber Panel Report*, para. 7.98.

products entering the United States. The Panel effectively expanded the obligation to determine the subsidy granted to production of a "product" to include an obligation to determine the subsidy granted to specific producers of that product. The Panel's conclusion is based on an erroneous interpretation of the "product" for which subsidies are to be measured.

3. The Product Under Investigation is Softwood Lumber from Canada

42. As noted above, the United States measured subsidies to the production of softwood lumber in Canada. The "product" under investigation – softwood lumber – includes both primary lumber and so-called remanufactured lumber.[56] There does not appear to be any dispute that, generally, when a sawmill produces primary lumber and sells it domestically, it still constitutes part of the "product" for which the subsidy is being measured, or to use the Panel's term, "subject merchandise under investigation."[57] The Panel found, however, that primary lumber sold by a sawmill to another Canadian softwood lumber producer – a remanufacturer – does *not* constitute part of the subject merchandise under investigation. According to the Panel, under those circumstances only the remanufactured product is part of the subsidized "product." Under the Panel's reasoning, therefore, what constitutes the "product" for which subsidies are being measured depends in part on what happens to the product after it is produced. There is no basis in the SCM Agreement or GATT 1994 for the Panel's finding, which was the foundation

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[56] Both "primary" and "remanufactured" lumber is produced by tenure-holding sawmills. The distinction the Panel drew between primary and remanufactured lumber is meaningless. The fact that some remanufactured lumber may be produced by companies that do not receive a subsidy is no different than the fact that some primary lumber may be produced by companies that do not receive a subsidy. In either case, it is a producer-specific issue. As discussed above, the SCM Agreement does not require a producer-specific subsidy finding as a prerequisite to imposing countervailing duties on a producer's imports.

[57] *Lumber Panel Report*, para. 7.97.

for its conclusion that a pass-through analysis was required.

43. As discussed above, Article 10 of the SCM Agreement and Article VI:3 of GATT 1994 refer to subsidies on, *inter alia*, the "production" of a "product" in a "country." The Agreements do not refer to subsidies attributable to specific producers, or transactions. The product under investigation is softwood lumber and the countervailing duties were based on subsidies to producers of softwood lumber in Canada. There is absolutely no basis in the SCM Agreement or GATT 1994 for the Panel's conclusion that the United States was required to reduce the "subsidy found to exist" by the amount of subsidies attributable to certain lumber products sold domestically, unless it could establish that those subsidies passed-through to an exported product. Subsidies received directly by softwood lumber producers constitute subsidies to the production of softwood lumber in Canada.[58] To calculate properly the per unit subsidies to Canadian softwood lumber production, it is simply necessary to allocate properly those subsidies over the value of the products produced, whether those products are sold domestically (and without regard to who the domestic purchaser is) or exported. That is precisely what the United States did in

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[58] The Panel stated that when a tenure holding lumber producer sells a log, not all of the subsidy it received when it purchased the timber can be allocated to the lumber. *Lumber Panel Report*, para. 7.97. The United States does not disagree. Under a proper allocation methodology the numerator and denominator must be calculated on the same basis. To calculate the numerator, the United States requested data on the volume of Crown timber that "entered sawmills," *i.e.,* processed timber. If unprocessed logs are not in the numerator, the issue is moot. In response to a remand by the Lumber NAFTA panel, however, the United States is currently re-examining the issue of whether the data provided for the numerator actually includes unprocessed logs. If so, the unprocessed logs may properly be included in the volume used to calculate the total subsidy received directly by softwood lumber producers (numerator) provided that the logs sales by those producers are also reflected in the allocation (denominator). For the reasons discussed above, there is no obligation to trace the portion of the subsidy allocated to lumber production, which was received directly by a softwood lumber producer, to specific products that entered the United States.

this case.

44. In selectively excluding softwood lumber products sold to certain domestic purchasers from the "subject merchandise," the Panel read into the SCM Agreement an obligation to trace the subsidies to a specific group of softwood lumber producers or products. No such obligation exists.

4. The SCM Agreement Does Not Require Members to Trace Subsidies to Certain Producers or Exported Merchandise or Dictate How Subsidies Are To Be Allocated

45. The Panel concluded that a pass-through analysis, the sole purpose of which is to determine whether specific producers received a portion of the subsidy, was required by the SCM Agreement. The Panel stated that the United States could not "absolve" itself of that obligation by using an aggregate methodology.[59] There is, however, no absolution involved because an obligation to trace subsidies to specific producers of products entering the United States, including those that purchase inputs from other softwood lumber producers, simply does not exist. The Panel's finding to the contrary is directly at odds with the SCM Agreement.

46. Article 19.3 of the SCM Agreement explicitly recognizes that exporters who were "*not actually investigated*" may be "*subject to*" definitive countervailing duties. The SCM Agreement, therefore, expressly contemplates that a Member, in an investigation, may adopt a methodology, such as an aggregate methodology, that may subject individual exporters or producers to countervailing duties without individually investigating those exporters or producers

[59] *Lumber Panel Report*, para. 7.98.

to determine whether or to what extent they actually received a subsidy.[60]

47. It is true that not all softwood lumber producers necessarily received, either directly or indirectly, a portion of the subsidy found to exist. The SCM Agreement, however, permits imposing duties on imports without a specific subsidy finding with respect to those imports. Moreover, the specific reason certain producers may not receive a portion of the subsidy is irrelevant. For example, some lumber producers may own their own land or purchase all of their timber from private landowners rather than from the government. Whatever the reason, the fact that some specific Canadian lumber producers may not share in the subsidy does not alter the total amount of the subsidy granted directly to the production of softwood lumber in Canada. There is simply no obligation in the SCM Agreement to determine what portion of the subsidies to the production of softwood lumber in Canada was received by specific producers of those products.

48. The Panel concluded that a pass-through analysis, the sole purpose of which is to

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[60] It is also common, when it is not practicable to investigate each producer individually, for Members to investigate a limited number of producers and then calculate a rate for "all other" producers based on the weighted average of the subsidy rates for the investigated producers. *See, e.g.*, Council Regulation (EC) 2026/97 of 6 October 1997 on Protection Against Subsidized Imports from Countries Not Members of the European Community, art. 15.3, 1997 O.J. (L 288) (Exhibit U.S.-39) (providing that countervailing duties applied to imports from exporters or producers that "were not included in the examination shall not exceed the weighted average amount of countervailable subsidies established for the parties in the sample"). The "all others" rate is imposed on imports from uninvestigated exporters even though those exporters may not have received any portion of the subsidy. Article 19.3 simply requires that Members provide companies an opportunity for an expedited review to determine a company-specific rate. The United States has conducted and is conducting such reviews in this case and its laws and regulations governing such proceedings have been found to be consistent with the SCM Agreement. *United States – Preliminary Determination With Respect to Certain Softwood Lumber From Canada*, WT/DS236/R, September 27, 2002, para. 7.159.

determine whether specific producers received a portion of the subsidy, was required by the SCM Agreement. As demonstrated above, there is no requirement to make such a determination. The Panel therefore erred as a matter of law. The Appellate Body should therefore reverse the Panel's finding that the failure to conduct a pass-through analysis in respect of logs and lumber sold by one softwood lumber producer to another was inconsistent with Article 10 and thus Article 32.1 of the SCM Agreement and with Article VI:3 of GATT 1994.[61]

III. CONCLUSION

49. For the reasons discussed above, the United States requests that the Appellate Body overturn the Panel's conclusion that:

1. the United States' determination of the existence and amount of the benefit was inconsistent with Articles 14 and 14(d) of the SCM Agreement and, therefore, the United States' imposition of countervailing measures on the basis of that determination was inconsistent with Articles 10, 19.1, 19.4 and 32.1 of the SCM Agreement and Article VI:3 of GATT 1994;[62] and

2. the United States' failure to conduct a pass-through analysis to account for sales of logs and lumber from one softwood lumber producer to another softwood lumber producer was inconsistent with Article 10 of the SCM Agreement and Article VI:3 of GATT 1994 and, therefore, the United States' imposition of countervailing duties in respect of such transactions was inconsistent with Articles 10 and 32.1 of the SCM Agreement and Article VI:3 of GATT 1994.[63]

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[61] *Lumber Panel Report*, para. 7.99.

[62] *Lumber Panel Report*, para. 8.1(b).

[63] *Lumber Panel Report*, para. 8.1(c).