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

COMMENTS OF THE UNITED STATES ON RESPONSES OF CANADA AND THIRD PARTIES TO QUESTIONS FROM THE PANEL FOLLOWING THE SUBSTANTIVE MEETING OF THE PANEL

May 3, 2005

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).

1. Canada continues to confuse a general regulatory environment, on the one hand, with specific mandates imposed upon Crown tenure holders as a condition for obtaining tenure, on the other. As the United States has previously explained, such mandates alter the equation between buyers and sellers in the marketplace. Whether the parties to these transactions have opposing economic interests is irrelevant because the mandates imposed by the government fundamentally restrict the parties' ability to negotiate the terms and conditions of an agreement. As such, these transactions are not conducted at arm's length.

2. Each of the government-mandated restrictions Commerce identified – appurtenancy, local processing requirements, and wood supply agreements – dictate to the harvester those entities to which it must sell or control the disposition of the harvested timber. The seller thus cannot act in its best interests when selecting from among potential buyers. A clear example of this is an appurtenancy clause that requires that all or a specified amount of a tenure holder's timber be processed in a specified mill. Similarly, wood supply agreements restrict harvesters' choices in disposing of Crown timber by requiring those harvesters to sell to particular parties. Domestic processing requirements also restrict the ability of log sellers to obtain freely the best offers in the marketplace by limiting the disposition of the harvested timber.

3. Canada acknowledges that these mandates exist. However, Canada offers no explanation as to why it considers these mandates – which go to the very essence of the issue examined by Commerce – to be indistinguishable from government regulation that affects all buyers and sellers on the market generally, such as laws governing antitrust, taxation and workplace safety. General regulations cannot be equated with government mandates that impose severe restrictions on a seller's *ability* to negotiate with all potential buyers on equal terms and to obtain full economic value on the market of the good being sold.

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".

4. To try to bring its claims within the Panel's jurisdiction under Article 21.5 of the DSU – which is limited to a review of the existence or consistency of measures taken to comply – Canada claims that there exists no measure taken to comply, supposedly because Commerce issued the first assessment review results. Yet there is a fundamental inconsistency between that view and Canada's challenge to the measures taken to comply – the Section 129 Determination. If, in fact, the Section 129 Determination – the measure taken to comply – had been rendered non-existent, Canada's request that the Panel review it would make no sense. In fact, however, the Section 129 Determination establishes that the imposition of countervailing duties is appropriate under the SCM Agreement and corrected the only WTO inconsistency found by the original panel and the Appellate Body. Therefore, as Canada implicitly acknowledges, there exists a measure taken to comply – the Section 129 Determination – and, because there is disagreement as to whether that measure is consistent with the SCM Agreement and the GATT 1994, Canada appropriately is asking this Panel to review it.

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.

5. Contrary to what Canada claims, in *Australia – Leather*, the fact that the grant repayment was conditioned on the provision of the new non-commercial loan was central to the panel's finding that the two actions were "inextricably linked elements of a single transaction", and that, therefore, no withdrawal of the subsidy had occurred.[1] The United States recalls that it was Canada that relied on *Australia – Leather,* using it as an illustration of what "inextricably linked" means in the context of an Article 21.5 proceeding.[2] Because the "inextricable link" in that dispute stands in marked contrast to the lack of any such link in this dispute, Canada is now trying to distance itself from its own citation.

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.

6. The "*ad hoc*" nature of the ban imposed in *Australia – Salmon* is one of the several factors that distinguished that Article 21.5 dispute from this one. That the U.S. countervailing duty law provides interested parties with the opportunity on an annual basis to request assessment reviews (independently of any WTO dispute or of any Section 129 implementation), and that the United States is statutorily obliged to conduct such a review if properly requested –

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

[2] Canada Second Written Submission, at 21.

is relevant to whether the results of such assessment reviews are or are not "measures taken to comply."

7. Canada's response misses the mark. First, to demonstrate that an action is a "measure[] taken to comply" with DSB recommendations and rulings, it is not sufficient merely to make allegations as to the "substance" of the action: just because a complaining Member believes the "substance" of an action is contrary to a covered agreement or otherwise contrary to the complaining Member's expectations does not automatically turn that action into a "measure[] taken to comply." Such a view is consistent with Canada's desire to sweep a broad range of disparate measures into Article 21.5 proceedings, but it is not consistent with the specific jurisdiction provided for in Article 21.5. Nor, contrary to Canada's characterization, is it the U.S. view that whether a measure is "taken to comply" is purely a question of the domestic process, and therefore self-judging. Rather, the United States requested that the Panel make a preliminary ruling request regarding whether the first assessment review results are "measures taken to comply", based on the facts before it. Those facts demonstrate that the first assessment review results are not "measures taken to comply."[3]

8. Second, Canada's speculation as to what Commerce had "time" to do in the first assessment review is irrelevant. The first assessment review was nearly half over before the recommendations and rulings were even adopted, and was proceeding apace while Commerce was still determining the information that would be required to conduct the pass-through analysis recommended by the DSB during the 10-month "reasonable period of time." Indeed, had the assessment review not been extended as a result of its complicated nature, Commerce would have issued the final results well before the reasonable period of time expired.

9. Third, as discussed above, the statutory timing of the first administrative review underscores that it is not a "measure[] taken to comply," as does the fact that it involves sales and subsidies during a different time period from that of the final investigation determination (April 1, 2000 - March 31, 2001 (period of investigation)/April 2002 - March 31, 2003 (period examined for the first assessment review)). That the U.S. Statement of Administrative Action ("SAA") suggests that Commerce might be able to implement recommendations and rulings in an assessment review in lieu of a separate Section 129 proceeding is irrelevant: in this dispute, the recommendations and rulings were implemented through just such a separate Section 129 proceeding.

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[3] We note that Canada continues to assert that Commerce did not conduct a pass-through analysis in the first assessment review. Although the results of the assessment review are not properly subject to this Panel's review, Commerce did, in fact, conduct a pass-through analysis in the assessment review. *See Notice of Preliminary Results of Countervailing Duty Administrative Review: Certain Softwood Lumber Products from Canada*, 69 Fed. Reg. 33204, 33208 - 09 (June 14, 2004) (Exhibit CDA-10); *Notice of Final Results of Countervailing Duty Administrative Review and Rescission of Certain Company-Specific Reviews: Certain Softwood Lumber Products From Canada*, 69 Fed. Reg. 75917 (December 20, 2004) and accompanying Issues and Decision Memorandum, at 6 - 7, Comments 10 and 11. Exhibits CDA-8 and CDA-11).

10. Finally, Canada's response to this question further confirms its belief that Article 21.5 permits the initiation of a targeted, 90-day, Article 21.5 compliance proceeding – a proceeding that is limited to reviewing the existence or consistency of "measures taken to comply" – with respect to any separate, independent assessment review, now or in the future. Article 21.5 of the DSU, appropriately, does not permit this result.

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).

11. Canada does not dispute that the express language of paragraph 167(e) of the Appellate Body Report states that Commerce's "failure to conduct a pass-through analysis in respect of *arm's length* sales of *logs* by tenured harvesters/sawmills to *unrelated* sawmills is inconsistent . . ." with certain WTO obligations.[4] As noted by Canada, the United States recognizes that the parties' dispute concerns the interpretation of the term "arms' length."

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).

12. The subject matter of Article 21.5 disputes is determined by both the Panel's terms of reference and the express limitations of Article 21.5. In this dispute, the Panel's terms of reference are to review the matter referred to the DSB in Canada's panel request.[5] Canada's panel request contained four specific legal claims. It alleged that the United States had failed to comply with the DSB's recommendations and rulings by incorrectly:

a. "limiting the category of transactions reviewed in the 'pass-through' analysis to sales of logs by independent harvesters to unrelated sawmills, excluding transactions between harvesters/sawmills and unrelated sawmills, contrary to the DSB's recommendations and rulings;"

b. "presuming, without an appropriate 'pass-through' analysis, that certain transactions between independent harvesters and unrelated sawmills were not at arm's-length and that a 'pass-through' of the alleged benefit occurred;"

c. "applying the results of the 'pass-through' analysis to a countervailing duty cash deposit rate invalidated as a result of judicial review proceedings conducted in accordance with U.S. law, and failing to apply the results to a valid rate;" and

d. "failing to conduct a 'pass-through' analysis in the final results of the first administrative review."

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[4] Appellate Body Report, para. 167(e) (emphasis on "logs" in original, other emphasis added).

[5] WT/DS257/15.

13. The first two of these claims relate to the universe of sales to which Commerce applied its pass-through and competitive benefit analysis. The third relates to the rate adjusted as a result of the pass-through analysis, and the fourth relates to the assessment review. None of these claims relates to whether, once Commerce determined which sales to examine for "pass through", Commerce used appropriate log price benchmarks in determining whether the subsidy, in fact, passed through.

14. Nor, as alleged by Canada, is the United States confusing "claims", *i.e.*, the legal basis of the complaint, with the "legal arguments" in support of those claims. Canada's "arguments" with respect to the benchmark issue do not support any of the claims in the panel request. Rather, they address a different claim – a claim not included in the panel request – that Commerce did not measure the pass-through amount correctly.

15. Canada responds that in its panel request, it identified the Section 129 Determination as being inconsistent with Articles 10 and 32.1 of the SCM Agreement and Article VI:3 of the GATT 1994, and that this reference "identified its challenge to the pass-through benchmarks.". But this sentence does not, contrary to Canada's argument, identify any challenge to benchmarks. Rather, that sentence only identified the purported "measures" at issue. Canada's claims were identified in the previous paragraph, which did not include any claim related to the benchmark issue. Thus, the belated claim related to benchmarks is not part of this Panel's terms of reference.

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).

16. As discussed below in the U.S. comment to Canada's response to question 26, and as further explained by the United States in response to question 5,[6] whether a transaction is an arm's-length transaction depends upon the facts and circumstances surrounding the transaction. Commerce's arm's-length analyses are informed by many variables, including the facts before it and relevant definitions. Commerce relies on no single definition, but as previously noted in the U.S. response to question 5, the definitions of the term "arm's length" presented by the parties 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. As Canada acknowledges, the SAA definition of "arm's length" aligns with other definitions of the term in describing an arm's length transaction as one occurring between parties acting in their own interests. Here, the appurtenancy, domestic processing requirements, wood supply agreements, and other restrictions on the terms of the log sales affected the ability of parties to the transactions to bargain freely with whomever they choose or to bargain on terms not encumbered by these restrictions. Commerce's Section 129 Determination thus fully accords with the arm's-length definition in the SAA.

[6] U.S. Answers to Panel Questions, at Question 5 (April 29, 2005); Section 129 Determination, at Comment 2.

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.

17. Canada's response underscores the case-by-case, fact-intensive nature of the "arm's length" inquiry. Although there is a common purpose behind the inquiry – *i.e.*, to determine whether the subject transactions were conducted on a market basis between parties having roughly equal bargaining power, with no party under outside control, and with no party's ability to freely join or leave the transaction in any way restricted – Commerce examines the specific facts and circumstances to determine whether transactions are at "arm's length" in a particular context.

18. The arm's-length standard Commerce employs in antidumping cases to determine whether affiliated party sales can be used for normal value purposes does not limit Commerce's ability to examine the facts and circumstances surrounding the log sales subject to Canada's claim that no subsidy passed through to determine whether they were arm's-length transactions. Commerce's examination of whether affiliated party sales can be used for normal value purposes does not address whether sales between *unaffiliated* parties are considered to be at arm's length. Rather, it is focused solely on affiliated party transactions.[7] All parties agree, however, that the DSB's recommendations and rulings did not find that Commerce should examine affiliated party transactions.

19. Moreover, the relevant considerations in an arm's-length analysis for normal value purposes are very different from the relevant considerations in an arm's-length analysis for countervailing duty "pass-through" purposes. In particular, in the normal value context – unlike in the pass-through context – the actions of governments generally play no role in determining whether a particular affiliated party transaction is considered to be at arm's-length. Significantly, in none of the Federal Register notices cited by Canada is there any indication of an allegation, much less evidence of government mandates or actions such as those evident in this case that affected the nature of the transactions between those parties. Indeed, Canada's long list of citations to preliminary antidumping duty determinations and reviews, where there is no indication of such mandates, merely serves to highlight the unusual level of control in lumber transactions.

20. Not only is the arm's-length analysis for normal value purposes not determinative of the arm's-length issue in a countervailing duty proceeding, Commerce has found it to be different from the arm's-length analysis for certain antidumping determinations, in particular, the valuation of inputs in measuring the cost of production. As Commerce has stated, "These tests are employed for different purposes in analytically distinct areas of dumping analysis."[8]

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[7] *See Affiliated Party Sales in the Ordinary Course of Trade*, 67 Fed. Reg. 69186, 69187 (November 15, 2002) (Exhibit CDA-81).

[8] 67 Fed. Reg. at 69194.

21. Canada also cites to several recent Section 129 countervailing duty determinations in which Commerce implemented DSB recommendations and rulings by determining whether certain privatizations of European steel companies were at arm's length and for fair market value. Once again, the factual circumstances surrounding those transactions are distinguishable from the present situation. In particular, the sale of a government-owned company or its assets presents very different issues and concerns from the sale of a subsidized good.

22. In the privatization cases, because one of the parties to the relevant transaction was a governmental entity, the issue of direct or indirect government control was considered in the first part of Commerce's analysis, *i.e.*, it was taken into account in determining whether the parties to the transaction were related. As Commerce stated in a Section 129 determination relied upon by Canada, "The three remaining stable shareholders were directly or indirectly government-controlled and, hence, related to the seller."[9] In that case, Commerce's determination that the parties were unrelated included a determination of lack of government control, so there was no need for a second, separate analysis to determine whether the transaction was at arm's length.

23. Canada fails to recognize that in each of the arm's-length inquiries described above, the examination is to determine whether the freedom of the parties to bargain is restricted in any way by outside control. There simply is no single arm's-length test that answers this inquiry . Indeed, as Canada itself acknowledges:

> By providing general criteria to determine whether there is an arm's length relationship between unrelated persons for a given transaction, it must be recognized that all encompassing guidelines to cover every situation cannot be supplied. Each particular transaction or series of transactions must be examined on its own merits.[10]

24. An arm's length analysis is a fact-intensive inquiry and each of Commerce's examinations described above is equally valid for the purpose intended.

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".

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[9] *See Issues and Decision Memorandum for the Section 129 Determination: Corrosion-Resistant Carbon Steel Flat Products from France; Final Results of Expedited Sunset Review of Countervailing Duty Order*, at 5 (October 23, 2003) (Exhibit CDA-74).

[10] *See* IT-419R Providing the Meaning of Arm's Length: Section 251 and 252 of the Income Tax Act (August 24, 1995), para.15. Exhibit US-14.

25. Commerce did not "reject" record evidence from any provincial government because the purchasing sawmill paid the government stumpage charge. To the contrary, Commerce specifically requested that the Canadian respondents identify those transactions in which the purchasing sawmill paid the government stumpage fee.[11] As the United States has noted previously, not all of the Canadian respondents provided the requested information to Commerce.[12]

26. As indicated in the U.S. written submissions, oral statement, answers to Panel's questions, and Section 129 Determination,[13] for those transactions in which the purchasing sawmill pays the government the Crown stumpage fee, the benefit goes *directly* to that sawmill, so pass through of the benefit is not implicated.[14] Where the purchasing sawmill paid the stumpage fee to the government, there was no need for Commerce to conduct a pass-through analysis.

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

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[11] *See* Letter from Department of Commerce to Embassy of Canada, August 17, 2004, Supplemental Pass-Through Questionnaire, page 5 at 9(e), page 6 at 1, page 8 at 2, page 10 at 3(c); page 12 at 4(c) (Exhibit CDA-23); Letter from Department of Commerce to Embassy of Canada, October 5, 2004, Second Supplemental Pass-Through Questionnaire, page 5 at 7, page 7 at 1, page 10 at 8, page 11 at 3, 13 at 2. Exhibit CDA-24.

[12] British Columbia, by way of example, failed to identify that portion of the sales subject to its pass-through claim. British Columbia September 15 Questionnaire Response, at 10 (Exhibit US-4). British Columbia October 25 Pass-Through Response, at BC-PT-17 -19 (Exhibit US-9). *See also*, Draft Section 129 Determination, at 9, 13 (discusses Alberta's and Ontario's responses to Commerce's request for this information and Commerce's analysis of the same). Exhibit CDA-6.

[13] U.S. Second Written Submission, paras. 23, 30-31; Oral Statement of the United States, at 54; Draft Section 129 Determination, at 5-6, 8-13 (Exhibit CDA-6); Section 129 Determination, at 4-5, Comment 5 (Exhibit CDA-5); U.S. Answers to Panel Questions, at questions 8, 16, 17 (April 29, 2005).

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

proceedings?

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?

27. The United States reaffirms its views on the situations presented by the Panel, and only notes that Canada's responses are circular, in asserting, in essence, that the measures in question are measures taken to comply as long as they are, in fact, measures taken to comply. Further, that Canada apparently sees no distinction between the two scenarios presented by the Panel highlights Canada's view that – contrary to the text of Article 21.5 – there are few or no limits on what Article 21.5 panels can review.

28. Two comments on the EC's response, however, are in order. First, the EC asserts, at paragraph 3, that there are only two important differences between Article 21.5 panel procedures and other panel procedures: the accelerated schedule and the provision for original panel members to serve on the Article 21.5 panel. But the EC has forgotten the most important distinction: other panels review any measure properly cited in the panel request, whereas the jurisdiction of Article 21.5 panels is strictly limited to a review of the existence or consistency of "measures taken to comply" with DSB recommendations and rulings.[15]

29. Second, perhaps because of this critical omission, the remainder of the EC's response argues, with no support or justification, that Article 21.5 proceedings "cover any further dispute that relates to the original dispute."[16] This reading of Article 21.5 is entirely inconsistent with a

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[15] Appellate Body Report, *Canada – Measures Affecting the Export of Civilian Aircraft*, WT/DS70/AB/R, adopted August 20, 1999, para. 36 ("*Canada – Aircraft*"). The EC has also neglected to mention another important difference: that, unlike other disputes, consultations, which would be appropriate in the case of assessment reviews, which focus on different factual records from investigations determinations, are not a prerequisite to Article 21.5 proceedings.

[16] *See, also,* EC Response to Panel Questions, paragraph 7, "the rationale of Article 21.5 . . . provides for a determination in substantive terms of whether a measure relates to the original dispute." The EC also introduces, in paragraphs 6 and 9, the municipal law concept of *res judicata* in connection with these proceedings, apparently attributing this concept to the Appellate Body report in *European Communities – Anti-Dumping Duties on Imports of Cotton-Type Bed Linen from India – Recourse to Article 21.5 of the DSU by India*, WT/DS141/AB/RW, adopted 24 April 2003. The United States does not see the relevance of this concept in Article 21.5 proceedings, and notes that, contrary to the EC's

proper interpretation of Article 21.5. Indeed, such a reading would lead to a result directly contrary to the text of Article 21.5. As the Appellate Body specifically noted in *Canada – Aircraft*, 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."[17] Indeed, in *EC – Bed Linen*, India included in its Article 21.5 panel request a number of measures taken by the EC that were related to the original dispute: for instance, a redetermination of injury that resulted from the EC's recalculation of antidumping duties consistent with the DSB's recommendations and rulings. Yet, the EC there asserted, and the panel agreed, that those measures could not be included in the Article 21.5 proceeding because they were not "measures taken to comply."[18]

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citations, the Appellate Body never refers to *res judicata*.

[17] *Canada – Aircraft*, para. 36.

[18] *See, e.g.*, Panel Report, *European Communities – Anti-Dumping Duties on Imports of Cotton-Type Bed Linen from India – Recourse to Article 21.5 of the DSU by India*, WT/DS141/RW, adopted 24 April 2003, as modified by the Appellate Body Report, WT/DS141/AB/RW, ((*"EC – Bed Linen (Panel)*"), paras. 6.20 - 6.22.