

**ANNEX B**

**Submissions of the United States**

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## ANNEX B-1

### FIRST SUBMISSION AND REQUEST FOR PRELIMINARY RULING OF THE UNITED STATES

10 March 2005

#### I. Introduction

1. On 6 December 2004, the US Department of Commerce ("Commerce") issued a revised determination ("Section 129 Determination")<sup>1</sup> that implemented the recommendations and rulings of the Dispute Settlement Body ("DSB") in *United States – Final Countervailing Duty Determination With Respect to Certain Softwood Lumber From Canada*.<sup>2</sup> The recommendations and rulings of the DSB at issue relate to Commerce's decision not to conduct a pass-through analysis with respect to certain arm's-length sales of logs in its Final Determination.<sup>3</sup>

2. As discussed further below, Commerce's Section 129 Determination fully implements the recommendations and rulings of the DSB, and is consistent with the *Agreement on Subsidies and Countervailing Measures* ("SCM Agreement") and the *General Agreement on Tariffs and Trade 1994* ("GATT 1994"). The Panel should find, therefore, that Canada's claims are unfounded.

3. In addition, as set out below, the United States requests a preliminary ruling that the final results of the first assessment review<sup>4</sup> of the countervailing duty order on softwood lumber from Canada, cited by Canada in its request for the establishment of a panel<sup>5</sup>, are not "measures taken to comply" with the recommendations and rulings of the DSB under Article 21.5 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* ("DSU"). Therefore, these results fall outside the scope of Article 21.5, and this Panel lacks jurisdiction to review them.

4. As provided for in the Panel's working procedures, the United States will be providing a rebuttal submission on 31 March 2005.

#### II. Procedural History

5. On 2 April 2002, Commerce published the Final Determination, finding that provincial stumpage programmes in Canada provided a countervailable subsidy to Canadian lumber producers

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<sup>1</sup> *Section 129 Determination: Final Countervailing Duty Determination, Certain Softwood Lumber from Canada*, December 6, 2004 ("Section 129 Determination") (Exhibit CDA-5). "Section 129" refers to the provision of the Uruguay Round Agreements Act that provides procedures for implementing certain DSB recommendations and rulings with respect to countervailing duty investigations.

<sup>2</sup> Appellate Body Report, WT/DS257/AB/R, adopted 17 February 2004, ("Appellate Body Report"); Panel Report, WT/DS257/R, adopted 17 February 2004 ("Panel Report").

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

<sup>4</sup> An "administrative review", in US parlance.

<sup>5</sup> WT/DS257/15, citing *Notice of Final Results of Countervailing Duty Administrative Review and Recission of Certain Company-Specific Reviews: Certain Softwood Lumber Products from Canada*, 69 Fed. Reg. 75,917 (Dep't Commerce December 20, 2004) (Exhibit CDA-8) and *Issues and Decision Memorandum: Final Results of Administrative Review: Certain Softwood Lumber Products from Canada*, December 13, 2004.

and that certain non-stumpage programmes provided countervailable subsidies.<sup>6</sup> Commerce did not conduct a pass-through analysis in the Final Determination.

6. On 3 May 2002, Canada requested consultations with the United States and thereafter the DSB established a panel pursuant to Article 6 of the DSU ("original panel").

7. On 29 August 2003, the original panel found that Commerce's failure to conduct a pass-through analysis in the Final Determination with respect to arm's-length sales to unrelated sawmills and lumber remanufacturers was inconsistent with Articles 10 and 32.1 of the SCM Agreement and Article VI:3 of the GATT 1994.<sup>7</sup> However, the Appellate Body in its 19 January 2004, report reversed that aspect of the original panel report relating to Commerce's decision in its investigation not to conduct a pass-through analysis in respect of arm's-length sales of lumber by tenured harvesters/sawmills to remanufacturers.<sup>8</sup>

8. The Appellate Body upheld, however, the original panel's finding that Commerce acted inconsistently with the SCM Agreement and GATT 1994 by failing in the Final Determination to conduct a pass-through analysis in respect of arm's-length sales of logs by tenured harvesters/sawmills to unrelated sawmills.<sup>9</sup> On 17 February 2004, the DSB adopted its recommendations and rulings.<sup>10</sup>

9. On 5 March 2004, the United States notified the DSB of its intention to implement the recommendations and rulings of the DSB.<sup>11</sup> Thereafter, the United States and Canada established a ten-month "reasonable period of time" ending 17 December 2004, within which the United States agreed to implement the recommendations and rulings of the DSB.<sup>12</sup>

10. On 19 November 2004, Commerce issued a draft Section 129 Determination and provided an opportunity for parties to comment. On 6 December 2004, Commerce issued the Section 129 Determination, which revised the original countervailing duty investigation determination and implemented the DSB's recommendations and rulings, effective for imports on or after 10 December 2004. On 16 December 2004, the notice of implementation was published in the Federal Register.<sup>13</sup>

11. On 17 December 2004, the United States informed the DSB that it had complied with the DSB's recommendations and rulings by properly conducting its pass-through analyses of certain arm's-length log sales occurring during the period of investigation ("POI").

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<sup>6</sup> The Final Determination subsequently was amended on May 22, 2002.

<sup>7</sup> Panel Report, para. 7.99.

<sup>8</sup> Appellate Body Report, para. 167(f). The United States did not appeal the Panel's findings with respect to arm's-length log sales between tenured timber harvesters not owning sawmills and sawmills. Appellate Body Report, fn. 157.

<sup>9</sup> The other issues either appealed by the United States or Canada were decided in favor of the United States. Appellate Body Report, para. 167.

<sup>10</sup> DSB, Minutes of Meeting (17 February and 19 March, 2004), WT/DSB/M/165, 30 March 2004, at 4(a), para. 49.

<sup>11</sup> WT/DS257/12, 9 March 2004.

<sup>12</sup> WT/DS257/13, 30 April 2004.

<sup>13</sup> *Notice of Implementation Under Section 129 of the Uruguay Round Agreements Act; Countervailing Measures Concerning Certain Softwood Lumber Products From Canada*, 69 FR 75305 (16 December 2004). Exhibit CDA-7.

### III. Preliminary Ruling Request with Respect to the Final Results of the First Assessment Review

12. The United States requests a preliminary ruling that the final results of the first assessment review of the countervailing duty order on softwood lumber from Canada, cited by Canada in its request for the establishment of a panel in this dispute<sup>14</sup>, are not "measures taken to comply" with the recommendations and rulings of the DSB under Article 21.5 of the DSU. Therefore, these results fall outside the scope of Article 21.5, and this Panel lacks jurisdiction to review them.

#### A. Article 21.5 Proceedings are Limited to "Measures Taken to Comply" With the DSB's Recommendations and Rulings

13. The subject matter of these proceedings is determined by the Panel's terms of reference and by Article 21.5 of the DSU, which provides that recourse be had to dispute settlement procedures "[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*." (emphasis added). Therefore, as the Appellate Body has stated, "[p]roceedings under Article 21.5 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."<sup>15</sup>

14. Although the complaining party in an Article 21.5 proceeding decides the scope of its request for panel establishment, including the measures it wishes to challenge, it is the responsibility of the Article 21.5 panel to determine whether the measure identified is or is not a "measure[ ] taken to comply".<sup>16</sup> If it is not, the measure falls outside of Article 21.5, and the panel lacks jurisdiction to review the measure. As the panel in *EC – Bed Linens* stated, it is neither the complaining nor the responding party that decides which measures are taken to comply: "Rather", said the panel, "this is an issue which must be considered and decided by an Article 21.5 panel".<sup>17</sup> That panel concluded that "[t]o the extent a party may have challenged, in a request for establishment of an Article 21.5 panel, measures which were not 'taken to comply' by the implementing Member, it is our view that a Panel may decline to address claims concerning such measures".<sup>18</sup>

15. And, indeed, in the *EC – Bed Linens* dispute, the panel granted the EC's preliminary ruling request to exclude from consideration certain antidumping duty measures taken by the EC that were cited by India, but that the panel found were not "taken to comply". In that dispute, in which the EC was found to have incorrectly calculated dumping duties in an investigation of bed linens from India, the EC voluntarily applied the revised calculation method to antidumping duties imposed on Pakistan and Egypt. After concluding that no duties should be imposed on bed linens from those sources (as a result of the recalculation), the EC re-examined whether imports from India, considered alone, caused injury to the domestic industry. The EC concluded that they did, and therefore affirmed the imposition of dumping duties on bed linen from India. India challenged this finding of injury and the resulting imposition of duties on bed linen from India as a WTO-inconsistent measure "taken to comply" under Article 21.5.

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<sup>14</sup> WT/DS257/15, citing *Notice of Final Results of Countervailing Duty Administrative Review and Recission of Certain Company-Specific Reviews: Certain Softwood Lumber Products from Canada*, 69 Fed. Reg. 75,917 (Dep't Commerce 20 December 2004) (Exhibit CDA-8) and *Issues and Decision Memorandum: Final Results of Administrative Review: Certain Softwood Lumber Products from Canada*, 13 December 2004.

<sup>15</sup> Appellate Body Report, *Canada – Measures Affecting the Export of Civilian Aircraft*, WT/DS70/AB/R, adopted 20 August 1999, para. 36.

<sup>16</sup> 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 Linens (Panel)*"), para. 6.15.

<sup>17</sup> *EC – Bed Linens* (Panel), para. 6.15.

<sup>18</sup> *EC – Bed Linens* (Panel), para. 6.17 (emphasis in original).

16. The panel, in deciding not to review the latter measure, stated that

[T]he fact that the EC, subsequent to its re-examination of the dumping determinations with respect to imports from Egypt and Pakistan, and in the context of a review initiated on the request of Eurocoton, carried out an analysis of whether injury was caused by imports from India alone does not, *ipso facto*, establish that Regulation 696/2002 is a measure "taken to comply". Rather the opposite would seem to be the case – that Regulation would seem to be an entirely new determination, reached as a result of events subsequent to the EC having adopted a measure to comply with the DSB's recommendation.<sup>19</sup>

17. In sum, Article 21.5 proceedings are limited to "measures taken to comply" with the DSB's recommendations and rulings. As discussed below, the final results of the first assessment review are not "measures taken to comply" and therefore this Panel should decline to review those results.

**B. The Final Results of the First Assessment Review Are Not "Measures Taken to Comply"**

18. As discussed above, before the original panel, Canada challenged Commerce's Final Determination in the countervailing duty *investigation* on softwood lumber from Canada.<sup>20</sup> After the DSB adopted its recommendations and rulings, and within the agreed "reasonable period of time", the United States made a redetermination – the Section 129 Determination – in which it conducted a "pass through" analysis and recalculated the countervailing duty rate.<sup>21</sup> The new reduced rate was applicable to entries of subject merchandise on or after 10 December 2004.<sup>22</sup>

19. In this Article 21.5 dispute, Canada states that the Section 129 Determination is a "measure [ ] taken to comply with the recommendations and rulings" of the DSB and alleges that it fails to implement the recommendations and rulings of the DSB.

20. But Canada also includes, without explanation, a completely separate Commerce determination, *i.e.*, the results of an *assessment review*, among the "measures taken to comply" which it asks the Panel to examine under Article 21.5. The results of this assessment review are, in no sense, "measures taken to comply" with the recommendations and rulings of the DSB concerning the Final Determination in the original countervailing duty investigation.

21. As an initial matter, original investigations and assessment reviews are different processes which serve distinct purposes. The purpose of an investigation is to determine the existence, degree, and effect of any alleged subsidy; the purpose of an assessment review is to determine the amount of duty to be assessed on previous imports of subject merchandise and the estimated countervailing duty rate to be applied to future imports. Indeed, the distinction between countervailing duty investigations and assessment procedures is explicitly recognized in the SCM Agreement.<sup>23</sup>

22. In May 2003, Canada (among other interested parties) requested such an assessment review, covering entries of subject merchandise during the period 22 May 2002, through 31 March 2003. The resulting assessment review was not taken to comply with the recommendations and rulings of the

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<sup>19</sup> *EC – Bed Linens* (Panel), para. 6.20 (emphasis added).

<sup>20</sup> Panel Report, paras 2.1-2.4.

<sup>21</sup> Section 129 Determination. Exhibit CDA-5.

<sup>22</sup> *Notice of Implementation under Section 129 of the Uruguay Round Agreements Act: Countervailing Measures concerning Certain Softwood Lumber from Canada*, 69 Fed. Reg. 75,917 (Dep't Commerce 16 December 2004). Exhibit CDA-7.

<sup>23</sup> *See, e.g.*, SCM Agreement, fn. 52.

DSB. Rather, it resulted from a *separate* affirmative request by Canada, among others, that Commerce review *new* sales and subsidies data for the purposes of assessing countervailing duties for imports during the review period and of setting a new estimated countervailing duty rate for subsequent imports. US law required Commerce to conduct this assessment review once Canada, among others, requested it.<sup>24</sup>

23. Indeed, the assessment review was initiated on 1 July 2003, *eight months* before the recommendations and rulings in this dispute were adopted. This review proceeding, therefore, had nothing whatsoever to do with "implementing" the DSB's recommendations and rulings. For obvious temporal reasons, the results of this assessment review – which was initiated before the DSB issued its recommendations and rulings – cannot be considered "measures taken to comply".

24. Article 21.5 proceedings are by their nature more focused and limited than other panel proceedings under Article 6.2 of the DSU. Notably, instead of six months, the DSU anticipates that Article 21.5 proceedings will normally take no more than 90 days.<sup>25</sup> Canada, for its part, has underscored this aspect of these proceedings by systematically opposing any extensions of time in this proceeding.<sup>26</sup> For this reason, Article 21.5 proceedings are intended to focus, not on *any* measure cited by the complaining Member – as is the case for other dispute settlement proceedings – but only on *measures taken to comply* with DSB recommendations and rulings. It is beyond the scope of such a limited 90-day inquiry to fully examine an entirely new set of assessment review results based on a wholly new administrative record, consisting of new sales, new imports, potentially new respondents and potentially new subsidy programmes.

25. In sum, in this Article 21.5 proceeding, the Panel lacks jurisdiction to review the final results of the assessment review cited by Canada because these results are not "measures taken to comply" with the DSB's recommendations and rulings, adopted on 17 February 2004, related to Commerce's Final Determination in the original countervailing duty investigation.

#### **IV. Canada Bears the Burden of Proving its Claims**

26. It is well-established that the complaining party in a WTO dispute bears the burden of coming forward with argument and evidence that establish a *prima facie* case of a WTO inconsistency.<sup>27</sup> If the balance of evidence and argument is inconclusive with respect to a particular claim, Canada, as the complaining party, must be found to have failed to establish that claim.<sup>28</sup> Canada has not met its burden in this proceeding.

27. With respect to the standard of review, Article 11 of the DSU sets forth the standard of review for this Panel. Article 11 calls for panels to "make an objective assessment of the matter before it, including an objective assessment of the facts of the case and the applicability of and conformity with the relevant covered agreements ... ."

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<sup>24</sup> See 19 USC 1675(a). Exhibit US-2.

<sup>25</sup> Compare Articles 12.8 and 21.5 of the DSU.

<sup>26</sup> Recall, *e.g.*, statements by the Canadian representative during the Panel organization meeting of 14 February 2005, as well as paragraph 2 of Canada's letter of 15 February 2005, to the Panel regarding its draft working procedures and timetable.

<sup>27</sup> See, *e.g.*, Appellate Body Report, *United States – Measures Affecting Imports of Woven Shirts and Blouses from India*, WT/DS33/AB/R, adopted 23 May 1997, page 14; Appellate Body Report, *European Communities – Measures Concerning Meat and Meat Products (Hormones)*, WT/DS26/AB/R, WT/DS48/AB/R, adopted 13 February 1998, para. 104; and Panel Report, *Korea – Definitive Safeguard Measure on Imports of Certain Dairy Products*, WT/DS98/R, as modified by the Appellate Body, adopted 12 January 2000, para. 7.24.

<sup>28</sup> See, *e.g.*, Panel Report, *India – Quantitative Restrictions on Imports of Agricultural, Textile and Industrial Products*, WT/DS90/R, as affirmed by the Appellate Body, adopted 22 September 1999, para. 5.120.

28. With respect to disputes involving a determination made by a domestic authority based upon an administrative record, the Appellate Body, in *Cotton Yarn*, summarized the role of a panel under Article 11 as follows:

[P]anels must examine whether the competent authority has evaluated all relevant factors; they must assess whether the competent authority has examined all the pertinent facts and assess whether an adequate explanation has been provided as to how those facts support the determination; and they must also consider whether the competent authority's explanation addresses fully the nature and complexities of the data and responds to other plausible interpretations of the data. However, panels must not conduct a *de novo* review of the evidence nor substitute their judgement for that of the competent authority.<sup>29</sup>

29. Thus, the Panel's task is to determine whether a reasonable, unbiased person, looking at the same evidentiary record as Commerce, could have – not would have – reached the same conclusions.

**V. Commerce Conducted a Pass-Through Analysis Consistent with the SCM Agreement, the GATT 1994, and the DSB's Recommendations and Rulings**

30. As described in detail in the Section 129 Determination, Commerce responded to the DSB's recommendations and rulings by conducting a pass-through analysis, first issuing questionnaires seeking record evidence to determine whether during the period of investigation there were arm's-length sales of logs by independent harvesters to unrelated sawmills and by tenured harvesters/sawmills to unrelated sawmills. Based upon its analysis of the record evidence, Commerce determined that there were such arm's-length log sales. For those arm's-length sales, Commerce then determined whether a benefit was passed through to the purchasing sawmills, using appropriate benchmarks, and removed from the numerator of the aggregate subsidy calculation any benefit that it found did not pass through to the purchasing sawmills.

31. Other sales, however, were determined not to be at arm's length, either because the record facts demonstrated that they were not or because Canada failed to provide sufficient record evidence that would have enabled Commerce to analyze those sales. Ultimately, Commerce's analysis of log sales demonstrated to be at arm's length resulted in a C\$28,344,121 reduction in the numerator of the *ad valorem* subsidy rate, which had the effect of reducing the country-wide subsidy rate from 18.79 per cent *ad valorem* to 18.62 per cent *ad valorem*.<sup>30</sup>

32. Canada now challenges Commerce's Section 129 Determination under Article 21.5 of the DSU. This challenge, however, has no basis in the SCM Agreement, the GATT 1994, or the recommendations and rulings of the DSB. Commerce's pass-through analysis was conducted in accordance with the recommendations and rulings of the DSB and is WTO-consistent, and Canada's claims must therefore fail.

33. First, Commerce did not "presume" pass-through. To implement the DSB's recommendations and rulings, Commerce sought data from Canada substantiating its claims that subsidies were not passed through. In some instances, the Canadian respondents provided the requested data and Commerce conducted the recommended analysis, using appropriate log prices as benchmarks. In other instances, however, despite repeated requests by Commerce, Canada failed to provide the necessary data. Lacking sufficient data, Commerce was not able to conduct its analysis for all of the log sales for which Canada requested such an analysis.<sup>31</sup>

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<sup>29</sup> Appellate Body Report, *United States – Transitional Safeguard Measure on Combed Cotton Yarn from Pakistan*, WT/DS192/AB/R, adopted 5 November 2001, para. 74.

<sup>30</sup> *Section 129 Determination, at 1. Exhibit CDA-5.*

<sup>31</sup> *E.g., Section 129 Determination, at 3 and 13 (comment 8).*

34. Second, Commerce properly investigated and made a determination concerning whether particular sales were at "arm's length." Contrary to Canada's arguments<sup>32</sup>, nothing in the SCM Agreement, the GATT 1994, or the DSB's recommendations and rulings supports Canada's argument that an arm's-length analysis should be restricted to, in essence, a *per se* test based on affiliation alone. Further, part of the DSB's recommendations and rulings related only to a particular category of arm's-length log sales: those between tenured harvester/sawmills and unrelated, non-tenured sawmills.<sup>33</sup> The scope of the DSB's recommendations and rulings should therefore not be broadened to include entities that were not part of those recommendations and rulings.

35. Finally, the results of Commerce's recalculation were applied to the only rate that was before the original panel and Appellate Body, *i.e.*, the 18.79 per cent *ad valorem* rate calculated in the Final Determination. Therefore, Canada's argument that Commerce applied the results of its pass-through analysis to a rate "which long before had been invalidated as a result of judicial review proceedings"<sup>34</sup> is without basis.

## VII. Conclusion

36. For the reasons stated above, Canada's claims against US implementation of the DSB's recommendations and rulings have no basis in the SCM Agreement, the GATT 1994, or the recommendations and rulings of the DSB. The United States therefore requests that the Panel find that the United States properly implemented the recommendations and rulings of the DSB and that the Panel reject Canada's claims in their entirety. Further, the United States requests that this Panel find that the results of the first assessment review fall outside the Panel's jurisdiction in this Article 21.5 dispute.

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<sup>32</sup> *E.g.*, First Written Submission of Canada, paras. 59 -65.

<sup>33</sup> *E.g.*, Appellate Body Report, para. 167(e).

<sup>34</sup> First Written Submission of Canada, para. 10.



## ANNEX B-2

### SECOND WRITTEN SUBMISSION OF THE UNITED STATES

31 March 2005

#### I. Introduction

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

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

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

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

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

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

<sup>4</sup> Section 129 Determination, at 1. Exhibit CDA-5.

United States to comply with the DSB's recommendations and rulings or results in a measure that is inconsistent with the SCM Agreement or the GATT 1994.

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

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

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

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

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

7. In the original investigation, Commerce calculated the subsidy benefit from Provincial Crown timber programmes by assessing the extent to which each Province sold timber for less than adequate remuneration. This subsidy benefit is the numerator, which is divided over the relevant sales of lumber and by-products that benefit from the subsidy, the denominator, to determine the countervailable *ad valorem* subsidy rate. Commerce needed specific information and data to calculate any adjustment to this subsidy benefit numerator to account for potentially arm's-length sales of Crown logs between unrelated parties in which the subsidy did not pass through. Specifically, Commerce needed the volume of the log sales in Canada during the period of investigation ("POI") for which Canada sought a pass-through analysis. Additionally, to determine whether the reported log transactions were between unrelated parties, Commerce required information concerning any affiliation between the buyer and seller of the logs. Further, Commerce required information concerning government-mandated restrictions and other factors that could limit or control the terms of

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<sup>5</sup> First Written Submission of Canada, February 24, 2005 ("First Written Submission of Canada"), paras. 38, 59-65.

<sup>6</sup> First Written Submission of Canada, para. 58.

<sup>7</sup> First Written Submission of Canada, para. 54-55.

<sup>8</sup> First Written Submission of Canada, para. 6. As acknowledged by Canada, "Section 129 proceedings may involve the issuance of new questionnaires . . . ."

the sale, and thus undermine the arm's-length nature of the sale. Finally, to conduct the "competitive benefit" analysis, through which Commerce measured whether and to what extent any subsidy passes through, Commerce required specific data on prices, species, size, grade, quality, discounts delivery terms, and payment terms.

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

9. On 14 April<sup>9</sup>, 17 August<sup>10</sup> and 5 October 2004<sup>11</sup> Commerce issued questionnaires and supplemental questionnaires to Canada with respect to this issue. Commerce notified Canada in its initial questionnaire that if a province was claiming that any portion of the volume of Crown logs reported in the numerator<sup>12</sup> was sold in arm's-length transactions and was between unrelated parties and required an analysis to determine if the purchasing sawmill received a subsidy benefit, the province was required to provide an explanation of how the volume was calculated and documentation supporting its claims.<sup>13</sup> The Canadian provincial governments provided questionnaire responses on 21 May 2004. Although the provincial governments provided certain information that had been requested, the responses were incomplete.

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

11. Notably, Commerce attached a pass-through appendix to the supplemental pass-through questionnaire and requested that the provincial governments provide the appendix to the independent harvesters and sawmills involved in the log sales for which a pass-through analysis was requested. In the pass-through appendix Commerce requested information directly from the sawmills and

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<sup>9</sup> See, Letter from Department of Commerce to Embassy of Canada, 14 April 2004, Pass-Through Questionnaire. Exhibit CDA-3.

<sup>10</sup> See, Letter from Department of Commerce to Embassy of Canada, 17 August 2004, Supplemental Pass-Through Questionnaire. Exhibit CDA-23.

<sup>11</sup> See, Letter from Department of Commerce to Embassy of Canada, 5 October 2004, Second Supplemental Pass-Through Questionnaire. Exhibit CDA-24.

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

<sup>13</sup> In accordance with the DSB's recommendations and rulings (Panel Report, at para. 7.99; Appellate Body Report, at para. 167(e)), Commerce specifically requested information relating to the portion of the total volume of Crown timber entering sawmills reported by the provinces claimed to be "sold in arm's length transactions by tenure holders that did not own a sawmill . . ." and "sold in arm's-length transactions by tenured timber sawmills to sawmills that do not have tenure . . ." Exhibit CDA-3, at 10, 11 (questions 1 and 2).

<sup>14</sup> Exhibit CDA-23.

independent harvesters concerning affiliations and corporate relationships, as well as information relating to the terms of the sales, including log sales data and purchase contracts.<sup>15</sup>

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

13. On 5 October 2004, Commerce issued a second supplemental pass-through questionnaire and a supplemental pass-through appendix. Because the provincial governments failed to respond adequately to Commerce's earlier questionnaires, Commerce again requested clarifying and additional information. As noted in its second supplemental pass-through questionnaire, Commerce modified certain of its requests, where practicable, in response to Canada's claim that to provide the information was burdensome.<sup>17</sup> With respect to Canada's claim that certain information was not relevant, Commerce reiterated to Canada that it needed the data to conduct the DSB's recommended analysis. The Canadian parties submitted a response to the second supplemental questionnaire on 25 October 2004.

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

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

15. Commerce first analyzed the information provided by Canada to determine whether the sales were between related parties. If they were, no further analysis was conducted, because the DSB's

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<sup>15</sup> Exhibit CDA-23, at 1 and Pass-Through Appendix - 1.

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

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

recommendations and rulings concerned only sales between unrelated parties.<sup>18</sup> Commerce next analyzed the sales between unrelated parties to determine if they were at arm's length. Canada challenges this necessary step in its entirety, in the apparent and mistaken belief that all sales between formally unrelated parties are necessarily at arm's length. Therefore, according to Canada, by even analyzing whether such sales are, in fact, at arm's length, and then eliminating sales that fail the arm's-length test from the pass-through analysis, Commerce is somehow illegally "presuming" pass-through. This is incorrect. Indeed, it is Canada that is "presuming" no pass through for all sales between unrelated parties. Further, there is nothing in the SCM Agreement, the GATT 1994, or the DSB's recommendations and rulings that suggests that Commerce's analysis of whether sales are at arm's length should be so severely limited, or indeed, eliminated.

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

16. Canada claims that Commerce "applied a contrived standard"<sup>19</sup> in determining whether its claimed log sales were at arm's length. However, the term "arm's length" is not used or defined in the text of the SCM Agreement; thus, it is unclear on what basis Canada makes its claim that the standard Commerce applied is "contrived". The Appellate Body concluded in this dispute that both the SCM Agreement and the GATT 1994 require that, where subsidies are bestowed directly on producers of an *input* product, while countervailing duties are to be imposed on *processed* products, "*and where input producers and downstream processors operate at arm's length,*" Commerce must establish that the benefit is passed through to the downstream processor.<sup>20</sup> Therefore, where the two producers do not operate at "arm's length", no determination of the amount of the subsidy passing through the transaction is required because the subsidy bestowed on the input producer benefits the producer of the processed product. Whether the entities operate "at arm's length" involves more than just a question of formal affiliation; it involves an analysis of whether one party effectively "controls" the other or whether the parties have roughly equal bargaining power.<sup>21</sup> In other words, if one of the parties controls the other or their dealings are not between entities of equal bargaining power, neither the SCM Agreement nor the GATT 1994 require that the amount of the subsidy passing through the transaction be determined; rather, the investigating authority may regard the subsidy bestowed on the input as benefiting the processed product.<sup>22</sup>

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<sup>18</sup> Canada has not challenged Commerce's affiliation determinations. First Written Submission of Canada, para. 74, fn. 66.

<sup>19</sup> First Written Submission of Canada, para. 59.

<sup>20</sup> Appellate Body Report, para. 146 (emphasis on "arm's length" in original).

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

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

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

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

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

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

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

20. Canada's simplistic *per se* approach is divorced from the reality of the Canadian stumpage system. With respect to many transactions, record information demonstrates that certain government-mandated restrictions and other factors controlled, limited, or otherwise affected the log sales, warranting Commerce's determination that they were not conducted at arm's length or, in some instances, were not sales at all.

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

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<sup>23</sup> Appellate Body Report, para. 176(e) (emphasis added, except that emphasis on "logs" is in original.)

<sup>24</sup> Appellate Body Report, para. 124. (emphasis added).

<sup>25</sup> Section 129 Determination, at 4. Exhibit CDA-5.

<sup>26</sup> Section 129 Determination, at 4. Exhibit CDA-5.

<sup>27</sup> First Written Submission of Canada, paras. 62-64.

consistent with any reasonable reading of the term "arm's length," that the affected sales were not at arm's length.<sup>28</sup>

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

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

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

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

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

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

<sup>31</sup> Section 129 Determination, at 5. Exhibit CDA-5.

<sup>32</sup> Section 129 Determination, at 5. Exhibit CDA-5.

<sup>33</sup> Section 129 Determination, at 5-6. Exhibit CDA-5

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

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

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

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

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

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<sup>34</sup> First Written Submission of Canada, paras. 8, 76.

<sup>35</sup> Commerce did not disregard "sample" data provided by Canada. To the contrary, in response to certain concerns expressed by Canada, Commerce permitted Canada to submit subsets of data responding to its questionnaires. As noted previously, for example, with respect to British Columbia, Commerce limited its request for log purchase agreements to the 74 sawmills that participated in the Norcon Survey that was prepared at the GBC's request. Exhibit CDA-24, page 5 at 6. With respect to the Government of Alberta's ("GOA") concern that it could not provide all copies of tenure agreements relating to commercial timber permits ("CTPs"), Commerce limited its request to tenure agreements associated with coniferous timber quotas ("CTQs") and certain CTPs that were identified by Commerce. Exhibit CDA-24, page 8 at 1. Similarly, Commerce modified its requests for timber return data from the GOA to those portions containing the text relating to the payment of the stumpage dues. Exhibit CDA-24, page 9 at 7.

<sup>36</sup> Report of the Appellate Body, para. 141 (emphasis in original).

<sup>37</sup> Report of the Appellate Body, para. 154 (emphasis added).



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

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

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

30. Where parties provided the requisite information, Commerce was able to conduct its pass-through analysis.<sup>42</sup> For instance, although the Government of Ontario did not identify all transactions in which the stumpage was paid by the purchasing sawmills rather than the harvesting tenure holders, eight Ontario harvesters and mills did provide such company-specific information in response to Commerce's questionnaires.<sup>43</sup> Using the data provided by those companies, Commerce was able to conduct its pass-through analysis for those sales found, in light of the factors identified in the section above, to be at arm's length.<sup>44</sup> Similarly, with respect to Alberta, eight companies provided Commerce with company-specific data, including sample purchase contracts, information identifying those transactions for which the mill paid the stumpage directly to the Crown, and information concerning purchases from private lands.<sup>45</sup> Just as it did for Ontario, using the company-specific data provided by the Alberta companies, Commerce was able to conduct its pass-through analysis for those sales found to be at arm's length. Commerce was able to conduct its analysis as well with respect to certain company-specific data that it received in response to the pass-through appendices provided to Saskatchewan.<sup>46</sup>

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<sup>38</sup> Report of the Appellate Body, para. 147 (emphasis in original).

<sup>39</sup> Report of the Appellate Body, para. 141 (emphasis added).

<sup>40</sup> First Written Submission of Canada, para. 58 (citing Panel Report, at para. 7.98).

<sup>41</sup> Report of the Panel, para. 7.98.

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

<sup>43</sup> 6 December 2004, "Pass-Through" Analysis Calculations for the Province of Ontario, at 2-4. Exhibit US-6.

<sup>44</sup> Section 129 Determination, at Comment 8. Exhibit CDA-5.

<sup>45</sup> 6 December 2004, "Pass-Through" Analysis Calculations for the Province of Alberta, at 2-5. Exhibit US-7.

<sup>46</sup> 6 December 2004, "Pass-Through" Analysis Calculations for the Province of Saskatchewan, at 2. Exhibit US-8.

31. In many instances, however, Canada failed to provide the requisite information despite repeated requests that it do so. For example, although Commerce limited its request for tenure agreements containing domestic processing or other mandated requirements to those companies that participated in the Norcon Survey, British Columbia failed to provide the copies that Commerce requested.<sup>47</sup> British Columbia did, however, provide *samples* of such tenure agreements, but the domestic processing requirements included in the samples that British Columbia submitted varied widely.<sup>48</sup> Although British Columbia argued that the domestic processing requirements contained in the tenure agreements were outdated, standardized, or otherwise inapplicable during the POI, it failed to provide any record evidence demonstrating that the requirements were not in force during the POI.<sup>49</sup> As a consequence, Commerce was not able to rely upon the sample agreements provided by British Columbia to support its pass-through claim. Additionally, British Columbia failed to identify that portion of the sales subject to its pass-through claim in which the sawmills pay the Crown stumpage fee directly to the government rather than paying the independent harvester from whom they obtained the logs.<sup>50</sup> Finally, although British Columbia did provide certain log purchase agreements it failed to provide the underlying tenure agreements.<sup>51</sup> There were similar deficiencies with respect to Manitoba<sup>52</sup>, and to lesser degrees with respect to Alberta, Ontario and Saskatchewan.<sup>53</sup> Where Canada failed to provide the information requested, Canada prevented Commerce from completing its pass-through analysis.<sup>54</sup>

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<sup>47</sup> Exhibit CDA-24, at 3.

<sup>48</sup> Exhibit CDA-6, at 10.

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

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

<sup>51</sup> Draft Section 129 Determination, at 11. Exhibit CDA-6.

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

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

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

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

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

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

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

35. In any event, Commerce selected appropriate benchmarks. Where Commerce – upon examining record evidence – determined that the input transaction was at arm's length, it proceeded to determine whether there was a competitive benefit: *i.e.*, whether the benefit "passed through". As previously explained, a subsidy provided to the producer of an input product confers a competitive benefit on a downstream purchaser of the input when the price paid for the subsidized input is lower than the a market determined benchmark price for the same product. In selecting a market determined benchmark, Commerce used, where possible, the actual company-specific prices that the purchasing mill paid for logs harvested from private lands and for imported logs.<sup>55</sup> Where those data were not available, Commerce relied on publicly available prices for logs harvested from private lands and logs imported into the province.<sup>56</sup>

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

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

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<sup>55</sup> See, e.g., Exhibit CDA-23, at 3, 6, 8, 10, 12 and pass-through appendix; Exhibit CDA-24, at 3, 6, 8, 11, 13 and supplemental pass-through appendix.

<sup>56</sup> Final Section 129 Determination, at 6. Exhibit CDA-5.

<sup>57</sup> First Written Submission of Canada, para. 67.

38. For Alberta, Commerce used company-specific prices the mills paid for logs harvested from private lands in the province and logs they imported into the province. Where those company-specific prices were not available, Commerce used the weighted-average price published in the annual 2000 Timber Damage Assessment (TDA) survey conducted by KPMG.<sup>58</sup> For Ontario, Commerce used a weighted-average price of transactions for timber harvested from private lands, as reported in the KPMG the "Delivered wood costs" schedule of the KPMG Report on Ontario Softwood Timber Costs and Sources, 1 April 2000 to 31 March 2001, dated 22 June 2001.<sup>59</sup> For Saskatchewan, which did not provide any company-specific or published provincial log prices, Commerce used a weighted-average price of the domestic and import prices for spruce-pine-fir (SPF), as reported by Alberta, Manitoba, Ontario, and Quebec.<sup>60</sup>

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

#### **E. Commerce Did Not "Presume" Pass-Through**

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

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

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

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<sup>58</sup> See, e.g., 6 December 2004, "Pass-Through" Analysis Calculations for the Province of Alberta, at 2. Exhibit US-7.

<sup>59</sup> 6 December 2004, "Pass-Through" Analysis Calculations for the Province of Ontario, at 1-4. Exhibit US-6.

<sup>60</sup> 6 December 2004, "Pass-Through" Analysis Calculations for the Province of Saskatchewan, at 2. Exhibit US-8.

<sup>61</sup> First Written Submission of Canada, para. 79.

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

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

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

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

#### **G. Commerce Properly Calculated the Revised Rate**

45. Contrary to Canada's arguments that Commerce somehow applied its results to an "invalidated" countervailing duty rate<sup>67</sup>, Commerce properly calculated the revised rate by removing from the numerator of the *ad valorem* subsidy rate calculation the volume of log sales determined not to have passed through<sup>68</sup>. The numerator of the *ad valorem* subsidy rate was reduced by C\$28,344,121. The revision reduced the only rate that was before the original panel and Appellate Body, *i.e.*, the 18.79 per cent *ad valorem* rate calculated in the Final Determination, to 18.62 per cent *ad valorem*.<sup>69</sup> With the exception of this limited pass-through analysis, there are no outstanding DSB recommendations or rulings that would have required further modification of the *ad valorem* rate calculation.

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

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

<sup>63</sup> Appellate Body Report, para. 167(e); *see* CDA-3, at questions 1 and 2.

<sup>64</sup> First Written Submission of Canada, para. 55.

<sup>65</sup> Appellate Body Report, fn. 150.

<sup>66</sup> Appellate Body Report, fn. 151 (emphasis added).

<sup>67</sup> First Written Submission of Canada, para. 10.

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

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

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

47. This is not a situation like that presented in *Australia – Automotive Leather*, in which a WTO-inconsistent subsidy was both withdrawn and "regranted" in another form on the same day, in "inextricably linked elements of a single transaction".<sup>71</sup> Rather, the assessment review is a completely separate proceeding, based on a different record, designed to assess countervailing duties – a proceeding, moreover, that can be requested by Canada at regular intervals well into the future. Finally, it cannot be seriously asserted that, where there have been DSB recommendations and rulings with respect to the imposition of supplemental duties on a product, any subsequent proceedings related to those duties are "measures taken to comply". A previous panel has already found this not to be the case, in *EC – Bed Linens (Panel)*.<sup>72</sup> In sum, the United States reiterates that the results of the first assessment review are neither "measures taken to comply" with recommendations and rulings, nor do they render actual measures taken to comply "non-existent".

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

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

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

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

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

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

<sup>73</sup> First Written Submission of Canada, para. 72.

**V. Conclusion**

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

**Exhibit List**

Number	Name
US-3	Response of the Government of Ontario to the Department's 17 August 2004 Supplemental Pass-Through Questionnaire (15 September 2004) (relevant pages).
US-4	Response of the Government of British Columbia to the Department's 17 August 2004 Supplemental Questionnaire Concerning Pass Through of the Alleged Benefits (September 15, 2004) (relevant pages).
US-5	BLACK'S LAW DICTIONARY, Seventh Edition (West Group 1999) at 103 (definition "arm's length").
US-6	6 December 2004, "Pass-Through" Analysis Calculations for the Province of Ontario
US-7	6 December 2004, "Pass-Through" Analysis Calculations for the Province of Alberta
US-8	6 December 2004, "Pass-Through" Analysis Calculations for the Province of Saskatchewan
US-9	Response of the Government of British Columbia to the Department's 5 October 2004 Supplemental Questionnaire Concerning Pass Through of Alleged Benefits (October 25, 2004)(relevant pages).
US-10	6 December 2004, Country-wide Rate Calculations Net of Subsidy Benefits That Did Not Pass-Through - Revised as a Result of Comments Submitted by Parties to the Proceeding



## ANNEX B-3

### ORAL STATEMENT OF THE UNITED STATES

21 April 2005

#### Introduction

1. Good morning, Mr. Chairman and members of the Panel. Thank you for agreeing to serve as panelists in this proceeding and for the opportunity to appear before you today.
2. We recognize that our statement is lengthy, which flows from the fact that this is our first opportunity to respond to Canada's second submission. We were disappointed that Canada opposed our request for sequential second submissions in this proceeding, which would have helped to avoid this situation. We thank you in advance for your time and attention as we deliver our statement.
3. We will begin this morning by addressing Canada's response to our preliminary ruling request. Then we will explain how the United States properly implemented the recommendations and rulings of the DSB by conducting the appropriate pass-through analysis.

#### Preliminary Ruling Request

4. As you know, the United States has requested a preliminary ruling that the results of the assessment review are not "measures taken to comply" pursuant to DSU Article 21.5, and are therefore outside this Panel's jurisdiction. As our request notes, the assessment review was a proceeding separate from both the original countervailing duty investigation determination challenged by Canada and the Section 129 Determination at issue here, was initiated prior to the DSB's adoption of recommendations and rulings in this dispute, and had nothing to do with complying with the recommendations and rulings of the DSB.
5. In an attempt to justify sweeping the separate assessment review results into its Article 21.5 panel request, Canada has resorted to relying on the supposed "broad" scope of Article 21.5 and "wide discretion" of the Panel to review measures under Article 21.5.<sup>1</sup> Canada also argues that a failure to include the assessment review results in this compliance proceeding would be contrary to the overall "purpose" of Article 21.5 proceedings.<sup>2</sup>
6. But the issue is simpler than Canada would have us believe. Either a measure is taken to comply – and falls within the terms of Article 21.5 – or it is not, and is thus not within this Panel's jurisdiction. As the Appellate Body stated in *Canada – Aircraft* – and none of the reports cited by Canada are to the contrary – 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."<sup>3</sup>
7. Let us review the facts. Canada's original request for consultations concerned the *final countervailing duty investigation determination* published on 2 April 2002, and its panel request alleged errors in that final investigation determination.<sup>4</sup> The original panel's findings with respect to

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<sup>1</sup> E.g., Canada Second Written Submission, paras. 7 - 8.

<sup>2</sup> Canada Second Written Submission, paras. 6, 26 - 30.

<sup>3</sup> Appellate Body Report, *Canada – Measures Affecting the Export of Civilian Aircraft*, WT/DS70/AB/R, adopted 20 August 1999, para. 36.

<sup>4</sup> WT/DS257/3, 19 August 2002.

pass-through related solely to that final investigation determination. The Appellate Body stated that “[b]efore the Panel, Canada challenged a number of aspects of the final determination by [the Commerce Department] that led to the imposition of duties”<sup>5</sup> and the Appellate Body’s findings and conclusions – including those with respect to the need for a “pass-through” analysis – thus related only to that final investigation determination.

8. Therefore, to implement the DSB’s recommendations and rulings, Commerce issued a new determination – the Section 129 Determination – that revised the original final investigation determination by conducting the recommended pass-through analysis. By correcting the only “inconsistency” identified by the DSB with respect to the final investigation determination, the United States fully implemented the recommendations and rulings of the DSB to bring the measure into compliance with the SCM Agreement.

9. Long before there were any DSB recommendations and rulings to implement, and pursuant to long-standing, standard procedures, Commerce initiated the first assessment review, at the request of Canada, among others. The purpose of the assessment review was to determine the precise countervailing duties that would be levied on particular entries of merchandise entering the United States after the United States had already imposed the countervailing duty measure (in US parlance, after the publication of the countervailing duty order). This assessment review would have been conducted regardless of the existence of any dispute challenging the original investigation determination and it was nearly half over when the recommendations and rulings in this dispute were adopted.

10. Thus, Canada’s repeated assertions that Commerce itself “purported” or “alleged” that it conducted the assessment review to implement the DSB’s recommendations and rulings are inaccurate and have no basis.

11. Canada cannot deny that – in contrast to the assessment review – Commerce initiated the Section 129 proceeding for the specific purpose of addressing the DSB’s recommendations and rulings. Indeed, the agreement of the parties on the “reasonable period of time” to implement the recommendations and rulings in this dispute was negotiated in the light of, and specifically refers to, the US procedures for implementing WTO reports<sup>6</sup> – that is, the Section 129 procedures.

12. Faced with the undeniable fact that the assessment review results were not taken to comply with the DSB’s recommendations and rulings, Canada instead argues that the Panel should nonetheless consider them in this proceeding, because the assessment review results either (a) somehow rendered the Section 129 Determination “non-existent” or (b) were “inextricably linked” to the recommendations and rulings of the DSB.

13. Neither of these assertions is true.

*The assessment review results did not render the Section 129 Determination “non-existent”*

14. First, in no way did the assessment results render the Section 129 Determination non-existent. The final investigation determination challenged by Canada – a determination of the existence and the amount of the subsidy – established one of the prerequisites under Article 19.1 of the SCM Agreement for the imposition of a countervailing duty. That investigation determination did not establish the amount of duties that would be levied, or assessed, on the imports; that task is undertaken as part of the separate assessment review. The final investigation determination simply

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<sup>5</sup> Appellate Body Report, *United States – Final Countervailing Duty Determination with Respect to Certain Softwood Lumber from Canada*, WT/DS257/AB/R, adopted 12 February 2004, para. 1 (“Appellate Body Report”).

<sup>6</sup> WT/DS257/13.

established one of the bases for imposing countervailing duties. The Panel should recall in this connection that the remedy Canada sought in the dispute before the original panel was the revocation of the countervailing duty order, which was based in part on the final investigation determination.

15. The Section 129 Determination, in implementing the recommendations and rulings of the DSB with respect to the final investigation determination, confirmed that the resulting imposition of countervailing duties on 22 May 2002, was consistent with the SCM Agreement. The assessment review could not, and did not, render that Section 129 Determination non-existent. Indeed, the very fact that Canada is, itself, challenging the Section 129 Determination shows that Canada believes that it is of ongoing effect and relevant to the issue of compliance.

16. Further, the Section 129 Determination was fully implemented, and revised the original final investigation determination in every respect necessary to implement the recommendations and rulings of the DSB. For instance, the Section 129 Determination revised the cash deposit rate established by the final investigation determination – a cash deposit rate that, under US law, stays in effect unless and until a party requests an assessment review. If no assessment review is requested, countervailing duties are assessed at the cash deposit rate.

17. Canada's allegation that the Section 129 Determination was "rendered non-existent" appears to be an allusion to the argument that the United States made in the dispute *Australia – Leather*, where withdrawal of the subsidy was non-existent. The situation there, however, is not at all analogous to the facts of this dispute.

18. First, in *Australia – Leather*, the United States was arguing that the panel should review whether a prohibited subsidy had actually been withdrawn, as specifically required by Article 4.7 of the SCM Agreement, when the repayment of a grant had been contingent on the simultaneous grant of a loan on non-commercial terms. In contrast, this proceeding involves the question of whether a measure has been brought into conformity with a WTO agreement.

19. Second, the *Australia – Leather* panel concluded that the subsidy had not been withdrawn at all, because the supposed repayment and the non-commercial loan were, in effect, a single transaction in which the subsidy simply shifted form. By contrast, in this dispute, the Section 129 Determination and the assessment review results are separate and independent actions. The simple fact is, the Section 129 Determination was made to bring the measure in dispute into conformity with the SCM Agreement as recommended by the DSB, whereas the assessment review was conducted for a completely unrelated reason. As such, the assessment review in no way affects that result of the Section 129 Determination, and Canada has not shown otherwise.

*The Results of the Assessment Review are not "Inextricably Linked", either to the Section 129 Determination, or to the Recommendations and Rulings of the DSB.*

20. In the alternative, Canada uses three WTO reports to argue that the assessment results are "inextricably linked" to the recommendations and rulings of the DSB, and therefore should be considered "measures taken to comply". These reports, however, only demonstrate further how the assessment review is not within the scope of this Article 21.5 proceeding.

21. We've just discussed one of those disputes, *Australia – Leather*, in which the panel reviewed both the measure that Australia claimed was taken to comply – the repayment of a subsidy grant – and another measure that Australia claimed was not taken to comply – the new non-commercial loan. The panel in that dispute concluded that the subsidy had not been withdrawn, because the supposed

repayment and the non-commercial loan were, as Canada quotes the panel, “inextricably linked elements of a single transaction.”<sup>7</sup>

22. But, as we mentioned, that situation is very different from this one. In *Australia – Leather*, the repayment of the grant by the grant recipient was specifically and directly conditioned on the grant recipient receiving the non-commercial loan – there would have been no repayment at all if there had been no loan. It was on that basis that the panel found that the loan was “inextricably linked to the steps taken by Australia in response to the DSB’s rulings in [that] dispute, in view of both its timing and nature.”<sup>8</sup>

23. In this dispute, by contrast, there is no such connection between the Section 129 Determination and the assessment review results: they were not in any sense contingent on one another, nor were they in any sense part of a single transaction. The assessment review would have taken place regardless of whether there was a Section 129 proceeding under way, and, indeed, regardless of whether there even was a WTO dispute.

24. Canada similarly cites to the dispute *Australia – Salmon*, in which, in response to DSB recommendations and rulings, Australia modified its ban on salmon imports to permit imports that satisfied certain criteria. In what was obviously a response to the modification of the ban, Tasmania, one of Australia’s sub-federal units, imposed its own ban. The Tasmanian ban did not arise from a proceeding initiated as a matter of domestic law requirements, irrespective of any WTO challenge. Rather, it was an ad hoc action taken after the DSB had made recommendations and rulings against an Australian import ban and after Australia had taken action to modify the ban. All of the evidence – both in terms of timing and subject matter – pointed to these bans being truly “inextricably linked”. Therefore, that panel properly found that the Tasmanian ban was a measure taken to comply.

25. By contrast, in this case, the assessment review was initiated

- upon request of the parties (including Canada), *eight months before* the DSB’s recommendations and rulings were even adopted,
- pursuant to a US statutory provision that requires initiation upon request on a specific schedule and under specific deadlines, and
- for the purpose of assessing countervailing duties on entries not previously examined – not for the purpose of implementing any recommendations or rulings.

Unlike the obvious “close connection” in *Australia – Salmon*, there is nothing that links the assessment review to the recommendations and rulings of the DSB in this dispute.

26. Finally, Canada tries to distinguish the findings in *EC – Bed Linens* from this dispute, claiming that the panel excluded the results of a review from that Article 21.5 proceeding because that review did not deal with the same “subject matter” as the original determination. Canada also cites *EC – Bed Linens* as establishing that it is appropriate for this Panel to review Commerce’s actions with regard to a subsequent time period characterized by new data, including completely different import entries.

27. To the contrary, however, the *EC – Bed Linens* dispute demonstrates that a new determination that was made in a subsequent segment of an antidumping or countervailing duty proceeding – and

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<sup>7</sup> 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 11 February 2000, para. 6.50 (“*Australia – Leather*”).

<sup>8</sup> *Australia – Leather*, para. 6.5.

not made to implement recommendations and rulings of the DSB – falls outside the jurisdiction of Article 21.5 panels. For instance, the fact that measures taken to comply might involve new facts does not justify expanding Article 21.5 proceedings to encompass measures not taken to comply. Indeed, this Appellate Body discussion cited by Canada has nothing to do with the question of what constitutes “measures taken to comply”, but rather the question of whether those measures are “consisten[t] with a covered agreement”.

28. In sum, the assessment review that Canada has attempted to sweep into this Article 21.5 proceeding has nothing in common with those measures considered to be “inextricably linked” or “closely connected” in other disputes. To the contrary, the assessment review results have no relation at all to either the Section 129 Determination or the recommendations and rulings. They are simply not measures taken to comply and are therefore outside this Panel’s jurisdiction.

*Contrary to Canada’s arguments, respecting the jurisdictional mandate of Article 21.5 does not “ignore the purpose of compliance proceedings”.*

29. Canada has failed to show that the assessment review is a measure taken to comply in that it is “inextricably linked” to the recommendations and rulings of the DSB. Nor has Canada shown that measures taken to comply do not exist because the assessment review rendered the Section 129 Determination non-existent.

30. Canada therefore resorts to the argument that limiting the Panel’s review only to the measures taken to comply – that is, not sweeping the separate assessment review into the Article 21.5 basket – somehow ignores the “purpose of compliance proceedings”. The United States disagrees, for reasons which we will discuss shortly. But regardless, a baseless reference to the general “purpose of compliance proceedings” cannot direct a result that is not supported by a good faith reading of the text, in its context and in light of the object and purpose of the DSU.

31. Further, the United States does not understand how properly applying DSU Article 21.5 can result in “ignor[ing] the purpose of compliance proceedings”. Contrary to Canada’s arguments, with respect to the only claim found to be WTO-inconsistent – the pass-through analysis conducted in the final investigation determination – a review under Article 21.5 of the Section 129 Determination permits the prompt settlement of disputes: Canada complained about an inconsistency in the final investigation determination, and this Panel will review whether that inconsistency has been corrected.

32. What Canada appears to be seeking is to avoid the need to bring a separate WTO dispute against the United States on the separate assessment proceeding. Canada instead hopes to “kill two birds with one stone” – albeit improperly – by sweeping a review of the separate assessment proceeding into this Article 21.5 proceeding. Canada complains that having to initiate a separate dispute settlement proceeding with respect to an assessment review somehow ignores the purpose of compliance proceedings. However, in negotiating the DSU, Members agreed that the expedited procedures of Article 21.5 would only be available for two very specific questions: (1) the existence or (2) the consistency of measures taken to comply. Members did not agree that the special procedures under Article 21.5 would be available for any claim for which the complaining party felt it would be more convenient to use Article 21.5.

33. If Canada believes that an assessment review is conducted inconsistently with the SCM Agreement, it is within its WTO rights to request consultations with respect to that assessment review and, if appropriate, request a panel. Indeed, assessment reviews can present different legal issues and entail different obligations from final investigation determinations – in addition to involving completely different administrative records – that make a separate set of consultations entirely appropriate.

34. Moreover, Canada appears to suggest that the US system of retrospective duty assessments somehow compels the Panel, in the special case of the United States, to sweep the assessment review into this Article 21.5 proceeding.<sup>9</sup> But there is nothing in Article 21.5 or in the SCM Agreement that requires a different interpretation of “measures taken to comply” for those Members that employ a retrospective duty assessment system, rather than a prospective one.

35. Canada suggested this morning, in paragraph 33 of its oral statement, that the United States had somehow conceded that the assessment review was inconsistent with US WTO obligations. Canada bases this suggestion on the absence of an explanation in the US submissions or oral statement of the pass-through analysis in the first assessment review. This is untrue. The United States has not discussed the assessment review because it falls outside of this Panel’s jurisdiction. The United States does not in any sense concede that the pass-through analysis in the assessment review is inconsistent with WTO obligations.

### *Conclusion*

36. In sum, Mr. Chairman and members of the Panel, the results of the first assessment review are not “measures taken to comply” and therefore fall outside the Panel’s jurisdiction in this Article 21.5 dispute. Therefore, we reaffirm our request that the Panel so rule.

### **Pass-Through Analysis**

#### *Canada Bears the Burden of Proof*

37. It is important to recall that Canada bears the burden of establishing a prima facie case of a WTO inconsistency. In its panel request, Canada specifically refers to three separate provisions: Articles 10 and 32.1 of the SCM Agreement and Article VI:3 of the GATT 1994.<sup>10</sup> Although Canada concludes that the United States has acted inconsistently with these provisions, it has failed to demonstrate any such inconsistency or to describe why any of the specific actions that form the bases of its arguments are inconsistent with these provisions. For instance, Canada challenges Commerce’s arm’s-length analysis yet fails to identify how that analysis is inconsistent with any of the cited provisions. Similarly, Canada challenges the pass-through benchmarks Commerce relied upon yet once again fails to identify any way in which these benchmarks are inconsistent with the cited provisions. Consequently, Canada has failed to make its prima facie case and for that reason alone the Panel should reject Canada’s claims.

#### *The United States Properly Implemented the DSB’s Recommendations and Rulings*

38. The substantive issue facing this Panel is whether the United States properly implemented the recommendations and rulings of the DSB in conducting its pass-through analysis with respect to the final investigation determination. The answer is clearly “yes”. The positions of the United States with respect to its Section 129 Determination are more fully contained in our written submissions. This morning, we will not repeat all of the points made in those submissions but rather will briefly highlight what we consider to be significant issues as well as respond to the issues raised in Canada’s second written submission. As to those issues not raised in this oral statement, we refer the Panel to our written submissions.

39. Initially, we will briefly outline Commerce’s pass-through methodology. Next, we will discuss the nature of Commerce’s arm’s-length analysis and Canada’s attempt to truncate that analysis. Then we will focus upon Canada’s improper challenge to the benchmarks Commerce relied upon in conducting its pass-through analysis. Finally, we will address Canada’s peculiar claim that

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<sup>9</sup> Canada Second Written Submission, para. 27.

<sup>10</sup> WT/DS257/15.

US compliance with the express terms of the Appellate Body Report, was an effort by the United States to avoid its WTO obligations.

*Pass-Through Methodology*

40. The DSB determined that the United States acted inconsistently with certain of its WTO obligations when it failed in its final investigation determination to conduct a pass-through analysis with respect to two categories of arm's-length log sales between unrelated parties. To implement those recommendations and rulings Commerce was first required to obtain additional information from Canada relating to the POI. That information was requested through a series of questionnaires. Specifically, Commerce requested information relating to those log sales for which Canada was claiming that the subsidy did not pass through to the purchasing sawmill.

41. As a threshold matter, Commerce examined the data provided by Canada to determine whether the sales were between affiliated, that is, related, parties. Consistent with the DSB's recommendations and rulings, when Commerce found that the sales were between affiliated parties, it performed no further pass-through analysis. If the sales were identified as being between unaffiliated parties, Commerce examined the circumstances surrounding the transactions to determine whether the parties operated at arm's length. Where Commerce determined that the transaction was at arm's length, it next determined whether there was a competitive benefit, that is, whether the benefit "passed through" to the purchasing mill using market-determined benchmarks. Ultimately Commerce's analysis of arm's-length log sales between unaffiliated parties resulted in a reduction in the numerator of the *ad valorem* subsidy rate which in turn, had the effect of reducing the country-wide subsidy rate.

42. Consistent with the DSB's recommendations and rulings, Commerce conducted a pass-through analysis and based its determination upon what the record evidence demonstrated the facts to be.

*Commerce Properly Conducted its Arm's-Length Analysis*

43. There 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.<sup>11</sup> Canada does not challenge Commerce's affiliation determinations, so we will not discuss those threshold determinations. Rather, the dispute between the parties concerns the interpretation of the term "arm's length" – a term that is not defined in the text of the SCM Agreement.

44. The Appellate Body found that both the SCM Agreement and the GATT 1994 require that Commerce establish that the benefit is passed through to the downstream processor where subsidies are bestowed directly on producers of an input product while the countervailing duties are to be imposed on processed products, "and where the input producers and downstream processors operate at *arm's length*".<sup>12</sup> Thus, where the two producers do not operate at arm's length, no pass-through analysis is required because the subsidy bestowed on the input producer benefits the producer of the processed product. The United States properly determined that whether entities operate at "arm's length" involves more than simply an examination of formal affiliation – rather, it involves analysis of whether one party effectively controls the other or whether the parties have roughly equal bargaining power.

45. Canada, however, conflates the issues of affiliation and arm's length arguing that an arm's-length determination requires nothing more than a determination of affiliation. Indeed, Canada's *per se* approach to arm's length is set forth in paragraph 62 of its first written submission when it

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<sup>11</sup> Appellate Body Report, para 176(e).

<sup>12</sup> Appellate Body Report, para. 146 (emphasis in original).

states “that a transaction between unrelated parties is by definition an arm’s-length transaction”. Because Canada treats these disparate concepts as one, Canada contends that by analyzing whether such sales are, in fact, at arm’s length, and then eliminating sales that are not at arm’s-length from the pass-through analysis, Commerce somehow “presumed” pass-through. To the contrary, it is Canada that is presuming no pass through whenever there are sales between unaffiliated parties.

46. By contrast, the DSB recognized a distinction between arm’s length and affiliation in its recommendations and rulings, noting that Commerce should have conducted a “pass-through analysis in respect of *arm’s length* sales of *logs . . . to unrelated sawmills*”.<sup>13</sup> Canada’s approach which would end the analysis once affiliation is determined is thus inconsistent with the DSB’s recommendations and rulings.

47. In contrast, and consistent with the DSB’s recommendations and rulings, Commerce properly examined the circumstances surrounding the sales that Canada reported as occurring between unrelated parties to determine whether those transactions were at arm’s length. Where parties to a transaction are not free to bargain with whomever they choose or to bargain on terms not encumbered by government mandates and restrictions that were imposed as a condition of obtaining the logs in the first place, Commerce properly determined that such transactions were not at arm’s length.

48. The SCM Agreement, the GATT 1994 and the DSB’s recommendations and rulings do not require that Commerce’s arm’s-length analysis be constrained in the fashion proposed by Canada. Indeed, as previously noted, although Canada generally alleges that Commerce’s arm’s-length analysis is inconsistent with WTO obligations, it fails to cite to any specific WTO provision that supports its position that an arm’s-length analysis can be nothing more than an examination of affiliation.

49. As we will discuss next, the facts presented to Commerce demonstrate that under the Canadian stumpage system, many of the circumstances of the log sales are controlled by government mandates and other conditions that rendered those sales not at arm’s length or otherwise ineligible for the pass-through analysis.

*Commerce Properly Considered the Circumstances of the Sales in its Arm’s Length Analysis*

50. In our second written submission we detailed the government mandates and other conditions that Commerce identified in its Section 129 Determination as controlling, limiting or otherwise affecting the subject log sales. Briefly, the government-mandated restrictions include appurtenancy, local processing requirements, and wood supply agreements which dictate to the harvester those entities to which it must sell. These government mandates restrict the ability of a seller to act in its best interests when selecting from among potential buyers. Where parties are not able to negotiate freely, such sales could not be considered to be at arm’s length.

51. Additionally, certain log purchase agreements were such that the purchasing mill controls significant aspects of the transaction or provided other goods or services as part of the transaction so that sales under these agreements could not be arm’s-length sales. Canada does not deny the existence of these conditions (although the Government of British Columbia does contend, with no support, that it does not enforce the appurtenancy requirements contained in its tenure agreements). Rather, Canada argues that it is basic economics that these restrictions do not affect the arm’s-length nature of the transactions between the parties.

52. Canada’s view of introductory economics does not amount to a WTO obligation. **Canada’s argument glosses over the reality of the system created by these mandates and conditions.** By way of example, where a subsidy is provided to an input producer who can only sell to a particular

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<sup>13</sup> Appellate Body Report, para 176(e)(emphasis added, except that emphasis on “logs” is in original.)



purchaser, the purchaser is in a position substantially to dictate the price. Consequently, such a sale would not be at arm's length. The same result obtains where local processing requirements exist.

53. As noted above, these government mandates and other conditions are imposed as a condition of the tenures. Consequently, they go to the very heart of the issue Commerce is investigating. Contrary to Canada's assertion, as evidenced by the fact that Commerce has found arm's-length transactions in Canada's regulated market, Commerce is not requiring a marketplace free from regulation as a prerequisite for finding transactions to be at 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.

54. Finally, Commerce identified two additional factors – that are not exclusively arm's-length issues – that affected its pass-through analysis. Notably, for those transactions in which the purchasing mill paid the Crown stumpage fees directly to the government for logs obtained from the independent harvester, Commerce determined that no pass-through issue arose. Because the stumpage fee is the vehicle through which the Crown bestows the subsidy the purchasing sawmill *directly receives the benefit*. Canada misses the point when it argues that “[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.”<sup>14</sup> Unlike the transactions identified by the DSB, in these transactions the sawmill is the direct recipient of the subsidy and thus there is no need to examine whether the benefit passed through to the purchasing mill. Moreover, because the very essence of the pass-through analysis is determining with whom the benefit resides, Canada's analogy to a situation in which a party generally satisfies an outstanding lien on behalf of another is irrelevant.<sup>15</sup>

55. Additionally, Commerce properly excluded from its analysis fiber exchange agreements between Crown tenure holders, which often involved, by way of example, exchanges of logs for chips, to meet appurtenancy and other harvesting requirements. These exchange agreements are not log sales but rather are tools by which tenured sawmills satisfy their appurtenancy and local processing requirements. Because such exchanges are not “sales” at all, there was no need for Commerce to conduct an arm's-length analysis of the transactions.

56. In sum, Canada has not established that Commerce's arm's-length analysis is in any way contrary to the SCM Agreement, the GATT 1994 or the DSB's recommendations and rulings.

*The Panel Should Decline to Consider Canada's Challenge to Commerce's Benchmarks and in Any Event, Commerce Used Appropriate Market-Determined Benchmarks*

57. Canada criticizes Commerce's benchmarks as not reflecting “market” conditions, but has thus far failed in its written submissions to specify in what way the benchmarks were inconsistent with the SCM Agreement, the GATT 1994, or the DSB's recommendations and rulings. More significantly, Canada failed to even identify its challenge to the pass-through benchmarks in its panel request. Consequently, not only has Canada failed to make a *prima facie* case that there is a WTO inconsistency, this claim is outside the Panel's terms of reference.

58. In terms of the substance, and as explained in the second written submission of the United States, a subsidy provided to the producer of an input product confers a competitive benefit on a downstream purchaser of the input when the price paid for the subsidized input is lower than a market-determined benchmark price for the same product. Thus, to determine whether a benefit “passed through” to the purchasing mill, that is, whether there was a competitive benefit to the purchasing mill, Commerce required market-determined benchmarks. Canada does not dispute the

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<sup>14</sup> Canada Second Written Submission, para. 41 (emphasis in original).

<sup>15</sup> Canada Second Written Submission, para. 41.

necessity for such benchmarks but rather, argues that because Commerce's benchmarks include import prices, the benchmarks are not representative of market conditions in Canada.

59. In selecting market-determined benchmarks, Commerce used, where possible, the actual company-specific prices that the purchasing mill paid for logs harvested from private lands and for imported logs. Commerce requested in its supplemental pass-through questionnaires and accompanying pass-through appendices that Canada provide such data to assist Commerce in developing market benchmarks. As evidenced by Commerce's calculations, where those company-specific purchase data were available, Commerce used them. Where such data were not available, Commerce used publicly available prices for logs harvested from private lands and for imported logs.

60. Canada raises two separate challenges to the US benchmarks in its second submission. The first challenge relates solely to the benchmark developed for Saskatchewan. The second challenge relates to Commerce's inclusion of import prices in its benchmarks generally. We will discuss Canada's general challenge to the inclusion of import prices in the benchmarks before discussing Canada's specific challenge relating solely to Saskatchewan.

61. In developing its benchmarks, Commerce determined to use prices based on market conditions in Canada. Import log prices, like domestic log prices, reflect prices that purchasers in Canada paid for logs during the POI. Consequently, Commerce included import prices in its benchmarks. Despite the fact that these import prices are actual Canadian transaction prices, Canada argues that Commerce must ignore these prices. There is no basis, however, for doing so.

62. Moreover, Canada's claim that the import data are taken from an excessively broad tariff classification is misplaced. Canada collects data on several categories of imports of "wood in the rough . . . Other, coniferous" - "Poles," "Piles and fence posts," "Logs for pulping," and "Other," (the "Other" category is broken down by species).<sup>16</sup> Logs used for lumber production thus fall into this last category, which was the only category Commerce included in its benchmarks. **Although Canada speculates that other higher value products may also have been included in this last category, the evidence is to the contrary. For example, Canada states that imports of high-value veneer logs would also fall into this category. But Quebec - the province with by far the largest value of log imports - reported that veneer mills in Quebec used zero imported softwood logs during the period of investigation.<sup>17</sup> Additionally, contrary to Canada's statement in paragraph 46 of its second submission, pulp log imports were reported separately by Statistics Canada and were not included in Commerce's calculation.**

63. With respect to Saskatchewan, Canada provided no data regarding prices of private log sales in the province, and – as Canada notes – only very limited data on log imports. Accordingly, there was insufficient data on prices for logs purchased by sawmills in Saskatchewan. Commerce therefore developed a proxy based on prices paid by mills in Canada for logs of the same species as found in Saskatchewan. As elsewhere, Commerce treated all log purchases consistently, irrespective of whether they were purchased from domestic or imported sources.

64. In sum, the United States developed market-determined benchmarks which included import prices, where available, for use in its pass-through analysis. As previously noted, Canada has failed to allege any WTO inconsistency in Commerce's development of the benchmark.

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<sup>16</sup> GOC 17 October 2003, Questionnaire Response at Exh. GOC-GEN-51 (relevant pages). Exhibit US – 11.

<sup>17</sup> GOC 28 June 2001, Questionnaire Response, Exhibit QC-S-5, at QC-11, and Quebec Exhibit 5. Exhibit US – 12.

65. As a final point, there is an error in paragraph 39 of the second written submission of the United States. Specifically, the word “unsubsidized” should be deleted from the first sentence of that paragraph.

*Commerce Properly Investigated Categories of Sales Identified by the DSB*

66. As discussed in both our first and second written submissions, the two transaction categories subject to Commerce’s pass-through analysis were the transactions identified in the DSB’s recommendations and rulings. Consistent with those recommendations and rulings, Commerce properly conducted a pass-through analysis with respect to transactions between unrelated (i) independent harvesters and sawmills, and (ii) tenured timber harvesters/sawmills and non-tenured sawmills. Canada alleges that Commerce’s investigation of the second of these categories was nothing more than a “creative way” for the United States to avoid its obligation to conduct the pass-through analysis contained in the DSB’s recommendations and rulings.

67. Canada is wrong. The Appellate Body specifically defined the second category of transactions for which it recommended a pass-through analysis. The term “sawmill”, the purchasing mill in the second category, was defined as “an enterprise that processes logs into softwood lumber *and does not hold a stumpage contract*”.<sup>18</sup> The seller in the second category was specifically identified as a “tenured timber harvester/sawmill”.<sup>19</sup>

68. Canada, in effect, asks this Panel to find that in evaluating whether there is compliance with the DSB’s recommendations and rulings, the Panel should ignore the express language used in those recommendations and rulings. Canada’s approach makes no sense. Instead, consistent with the DSB’s recommendations and rulings, Commerce accorded those terms the definitions established by the DSB. This Panel should do the same.

**Conclusion**

69. In conclusion, we want to thank the Panel again for this opportunity to respond to Canada’s arguments in its written submissions, and we look forward to responding to any questions that the Panel may have.

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<sup>18</sup> Appellate Body Report, fn. 151 (emphasis added).

<sup>19</sup> Appellate Body Report, fn. 150 (emphasis added).