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

Report of the Panel

The Report of the Panel on United States – Final Countervailing Duty Determination with Respect to Certain Softwood Lumber from Canada is being circulated to all Members, pursuant to the DSU. The report is being circulated as an unrestricted document from 29 August 2003 pursuant to the Procedures for the Circulation and Derestriction of WTO Documents (WT/L/160/Rev.1). Members are reminded that in accordance with the DSU only parties to the dispute may appeal a panel report. An appeal shall be limited to issues of law covered in the Panel report and legal interpretations developed by the Panel. There shall be no *ex parte* communications with the Panel or Appellate Body concerning matters under consideration by the Panel or Appellate Body.

Note by the Secretariat: This Panel Report shall be adopted by the Dispute Settlement Body (DSB) within 60 days after the date of its circulation unless a party to the dispute decides to appeal or the DSB decides by consensus not to adopt the report. If the Panel Report is appealed to the Appellate Body, it shall not be considered for adoption by the DSB until after the completion of the appeal. Information on the current status of the Panel Report is available from the WTO Secretariat.

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US – Softwood Lumber III	Panel Report, *United States – Preliminary Determinations with Respect to Certain Softwood Lumber from Canada*, WT/DS236/R, adopted 1 November 2002

I. INTRODUCTION

A. COMPLAINT OF CANADA

1.1 On 3 May 2002, Canada requested consultations with the United States pursuant to Article 4 of the Dispute Settlement Understanding ("the DSU"), Article XXII of the General Agreement on Tariffs and Trade 1994 ("GATT 1994"), and Article 30 of the Agreement on Subsidies and Countervailing Measures ("the SCM Agreement"), concerning the final affirmative countervailing duty determination by the US Department of Commerce ("USDOC") (File No. C-122839) issued on 25 March 2002, with respect to certain softwood lumber from Canada.[1]

1.2 On 18 June 2002, Canada and the United States ("the US") held the requested consultations, but failed to reach a mutually satisfactory resolution of the matter.

1.3 On 18 July 2002, Canada requested the establishment of a panel to examine the matter.[2] Canada subsequently withdrew that request, and on 19 August 2002 made a new request for establishment of a panel to examine the matter.[3]

B. ESTABLISHMENT AND COMPOSITION OF THE PANEL

1.4 At its meeting of 1 October 2002, the DSB established a panel in accordance with Article 6 of the DSU and pursuant to the request made by Canada in document WT/DS257/3.[4]

1.5 At that meeting, the parties to the dispute also agreed that the Panel should have standard terms of reference. The terms of reference are, therefore, the following:

> "To examine, in the light of the relevant provisions of the covered agreements cited by Canada in document WT/DS257/3, the matter referred by Canada to the DSB in that document, and to make such findings as will assist the DSB in making the recommendations or in giving the rulings provided for in those agreements".

1.6 On 4 November 2002, Canada requested the Director-General to determine the composition of the Panel, pursuant to paragraph 7 of Article 8 of the DSU. This paragraph provides:

> "If there is no agreement on the panelists within 20 days after the date of the establishment of a Panel, at the request of either party, the Director-General, in consultation with the Chairman of the DSB and the Chairman of the relevant Council or Committee, shall determine the composition of the panel by appointing the panelists whom the Director-General considers most appropriate in accordance with any relevant special or additional rules or procedures of the covered agreement or covered agreements which are at issue in the dispute, after consulting with the parties to the dispute. The Chairman of the DSB shall inform the Members of the composition of the panel thus formed no later than 10 days after the date the Chairman receives such a request".

[1] WT/DS257/1.
[2] WT/DS/257/2.
[3] WT/DS/257/3.
[4] WT/DS/257/4.

1.7 On 8 November 2002, the Director-General accordingly composed the Panel as follows:

Chairman: Mr. Elbio O. Rosselli

Members: Mr. Wieslaw Karsz
Mr. Remo Moretta

1.8 The European Communities, India and Japan reserved their third-party rights.

C. PANEL PROCEEDINGS

1.9 The Panel met with the parties on 11-12 February 2003 and 25 March 2003. The Panel met with third parties on 12 February 2003.

II. FACTUAL ASPECTS

A. THE USDOC INVESTIGATION

2.1 This dispute concerns the final countervailing duty determination made by USDOC on 21 March 2002 in respect of certain softwood lumber imports from Canada, classified under headings 4407.1000, 4409.1010, 4409.1090, and 4409.1020.

2.2 The investigation was initiated by USDOC on 30 April 2001, pursuant to an application filed with USDOC on 2 April 2001 (amended 20 April 2001 to add certain applicants). The applicants were the Coalition for Fair Lumber Imports Executive Committee; the United Brotherhood of Carpenters and Joiners; the Paper, Allied-Industrial, Chemical and Energy Workers International Union; Moose River Lumber Co., Inc.; Shearer Lumber Products; Shuqualak Lumber Co.; and Tolleson Lumber Co., Inc.

2.3 On 17 August 2001, USDOC published in the Federal Register a notice of preliminary affirmative countervailing duty determination, preliminary affirmative critical circumstances determination, and alignment of final countervailing duty determination with final antidumping duty determination. Provisional measures were imposed on the basis of a preliminary subsidy rate of 19.31 per cent.

2.4 On 2 April 2002, USDOC published in the Federal Register a notice of final affirmative countervailing duty determination. Definitive measures were imposed on the basis of a final subsidy rate of 19.34 per cent, with 19.25 per cent being the amount attributable to stumpage programmes. On 22 May 2002, USDOC published in the Federal Register a notice of amended final affirmative countervailing determination and notice of countervailing duty order, which decreased the final subsidy rate to 18.79 per cent as a result of corrections for ministerial errors. Of this amount, 18.70 per cent was attributable to stumpage programmes.

B. RELATED WTO PROCEEDINGS

2.5 At its meeting of 5 December 2001, the DSB established a panel, pursuant to a request by Canada, in respect of USDOC's preliminary determinations in the investigation at issue in this dispute. On 27 September 2002, that panel's report, *United States – Preliminary Determinations with Respect to Certain Softwood Lumber from Canada* (WT/DS236/R), was circulated to all WTO Members.[5]

[5] Panel Report, *US – Softwood Lumber III*.

III. PARTIES' REQUESTS FOR FINDINGS AND RECOMMENDATIONS

A. REQUEST OF CANADA

3.1 Canada requests the Panel to:

- find that the initiation of USDOC's investigation and the definitive countervailing duties imposed as a result violate Articles 10, 11.4, and 32.1 of SCM Agreement;

- find that USDOC's investigation and the Final Determination, and the definitive countervailing duties imposed as a result violate Articles 1.2, 10, 12.1, 12.3, 12.8, 14, 14(d), 19.1, 19.4 and 32.1 of SCM Agreement and Article VI:3 of GATT 1994; and

- recommend that the US bring its measures into conformity with its WTO obligations, including by revoking the countervailing duty order, ceasing to impose countervailing duties and refunding the countervailing duties imposed as a result of the *Lumber IV* investigation and the Final Determination.

B. REQUEST OF THE UNITED STATES

3.2 The United States requests that the Panel reject Canada's claims in their entirety.

IV. ARGUMENTS OF THE PARTIES

4.1 The arguments of the parties are set out in their written and oral submissions to the Panel, and in their answers to questions. The parties' arguments as presented in their submissions are summarized in this section. The parties' written answers to questions are set out in full as Annexes to this report. (*See*, List of Annexes, page v).

A. FIRST WRITTEN SUBMISSION OF CANADA

4.2 The following summarizes Canada's arguments in its first written submission.

4.3 At issue in this dispute are countervailing duties on certain softwood lumber products from Canada imposed on 21 March 2002, by USDOC pursuant to a final affirmative countervailing duty determination

1. The US Imposed Countervailing Duties On Practices That Are Not Countervailable Subsidies

4.4 Article 1.1 sets out the exclusive definition for what constitutes a subsidy for the purposes of the SCM Agreement. A subsidy has two discrete elements: (i) a financial contribution that (ii) confers a benefit. The US has not established the existence of a subsidy for the following reasons.

4.5 **USDOC erred in determining that provincial stumpage programmes "provide goods".** The US has imposed countervailing duties on practices that do not constitute a "financial contribution" within the meaning of Article 1.1(a)(1)(iii). In Canada, natural resources are, for the most part, the property of provincial governments. Many of these resources have traditionally been managed through the transfer of real property interests and exploitation rights. Forests are one among many of these resources; harvesting trees is but one aspect of the overall management of forestry resources. At issue in this dispute is the legal characterization of these forestry resources management systems.

4.6 Forestry management regimes in Canada reflect three critical considerations: (1) the land is publicly owned; (2) forestry resources such as air, water, wildlife, plants, trees and parkland may be put to a variety of uses; and (3) forestry resources must be carefully managed in the best interests of the public. Forestry resources are managed through a system of interlocking rights and obligations between the Crown and timber harvesters. This system of resource management is based most frequently on tenure and licensing agreements. The details of such tenure and licensing agreements vary, but they are all similar in that they are a complex bundle of rights and obligations, containing at a minimum: the right to harvest standing timber on Crown land or "stumpage"; service and maintenance obligations (*e.g.*, road-building, protection against fire, disease, and insects); implementation of forestry management and conservation measures, including silviculture; and payment of a volumetric "stumpage charge" that is levied upon the exercise of the harvesting right.

4.7 Stumpage takes two different forms in Canada: a real property right (generally referred to as a *profit à prendre*) or a licence to harvest standing timber. A *profit à prendre* is a form of real property right that conveys a non-possessory interest in the land to the recipient. A licence is a revocable right to do something on, or to the detriment of, the land of another that would otherwise not be permitted – in this case, the right to harvest standing timber.

4.8 A "financial contribution" exists where "a government provides goods or services other than general infrastructure". Interpreted in accordance with the principles of treaty interpretation in customary international law, "goods" refers to tradable items that are capable of bearing a tariff heading.

4.9 The ordinary meaning of "goods" is "tangible or movable personal property other than money; [especially] articles of trade or items of merchandise ‹goods and services›". The term "goods" excludes resources such as intangible property, *i.e.*, property rights, and real property. A *profit à prendre*, for example, is a real property right. The panel in *US – Softwood Lumber III* agreed that the ordinary meaning of "goods" is "tangible or movable personal property, other than money." Despite this, the panel adopted an interpretation of "goods" that was broader than the ordinary meaning of the term. Article 1.1(a)(1) (financial contribution) is drafted in precise terms. Article 1.1 (a)(1)(iii) does not refer to provision of "economic resources" or "property", but rather to "goods or services". As well, "goods or services" are not examples or species belonging to a bigger genus "economic resources". Real property and other resources or instruments of value do not fall under subparagraph (iii) unless they fit within the terms, "goods" or "services other than general infrastructure".

4.10 Article 3.1 provides relevant context. It defines "prohibited" subsidies as "subsidies within the meaning of Article 1". Article 3.1(b) includes the phrase "subsidies contingent … upon the use of domestic over imported *goods*" (emphasis added) in defining a particular prohibited subsidy. The use of the adjective "imported" to modify "goods" implies that the "goods" so modified may only be items that are capable of being "imported" – that is, traded across international borders or tradable items with an actual or potential customs classification. The proper conclusion is that the meaning of "goods" in both provisions is identical: tradable items with an actual or potential customs classification. Further, Parts III and V of the SCM Agreement refer to "products" or "imports". Given that Article 1.2 ties Article 1.1 to Parts III and V, the "products" or "imports" referred to in these Parts may not be interpreted to be different from the "goods" referred to in Articles 1 or 3 of the SCM Agreement.

4.11 The WTO Agreement also provides instructive context. Countervailing measures are provided for in Article VI of GATT 1994, as an exception to Article II. Therefore, the coverage of Part V of the SCM Agreement which imposes disciplines on countervailing duties and that of Article II of GATT 1994 must be the same. The SCM Agreement is one of the agreements set out in Annex 1A to the WTO Agreement. Annex 1A sets out "multilateral agreements on trade in goods". More important, the interpretative note to that Annex provides a rule of conflict between GATT 1994

and the covered agreements. A rule of conflict suggests a possibility of conflict and implies that the subjects or scope of coverage of the agreements are the same. Thus coverage of GATT 1994 and the agreements on trade in goods, including the SCM Agreement, must have the same scope. The panel in *US – Softwood Lumber III* used only one contextual element to support its view that "goods" has an "unqualified meaning". The panel believed that the only exception in Article 1.1(a)(1)(iii) is general infrastructure and this reinforced its view "concerning the unqualified meaning of the term goods." The panel rejected the contextual guidance offered by the use of "goods" and "products" in the SCM Agreement and the WTO Agreements as a whole.

4.12 The term "goods" in Article 1.1(a)(1)(iii) is equivalent to "products", and these terms are used throughout GATT 1994, the SCM Agreement and the other covered agreements to mean items on which tariff concessions may be given under Article II of GATT 1994. This is confirmed by the object and purpose of the SCM Agreement. The class of activity defined in Article 1.1(a)(1)(iii) to constitute a financial contribution within Article 1.1(a)(1) is discrete and carefully delineated. This demonstrates that the scope of Article 1.1(a)(1)(iii) is limited; the object of this provision is not to capture all potential in-kind transfers of economic resources that a government may provide. Furthermore, Article 1.1 provides a definition of a subsidy for the purposes of the SCM Agreement, and Article 1.1(a)(1) provides that a "financial contribution" is a constituent element of a subsidy. Subparagraphs (i) to (iv) of Article 1.1(a)(1) set out categories of activity that constitute a financial contribution for the purposes of the subsidy definition. Subparagraphs (i) to (iv) are carefully crafted and use precise terminology. If the object and purpose of Article 1.1(a)(1) were to bring all transfers of economic resources within the ambit of "financial contribution", there would have been no need to delineate specific categories of activity.

4.13 USDOC erroneously found that Canadian stumpage programmes constituted a financial contribution. Specifically, USDOC held that provincial tenure systems provide lumber producers with standing timber and that standing timber is a "good". According to USDOC even a license or right to harvest timber would constitute the provision of a good, because "goods" encompasses "all a person's legal rights of whatever description."

4.14 First, stumpage programmes involve the granting of rights to harvest standing timber pursuant to tenure and license agreements. "Goods" refers to tradable items with an actual or potential customs classification. Rights to harvest, the only thing provided by governments through stumpage programmes, are not "goods". Even assuming that stumpage programmes provide standing timber, stumpage programmes do not involve a financial contribution. Standing timber – *i.e.*, trees firmly rooted in the ground – is not a "good" within the meaning of Article 1.1(a)(1)(iii). Properly understood, a *profit à prendre* and a license to harvest standing timber are economic resources that are not "goods" within the meaning of Article 1. "Stumpage" – the right to exploit an *in situ* natural resource – is akin to the right to extract oil from public lands, quotas to harvest fish, or the right to exploit inland water and water currents. Second, standing timber is not a "good" within the meaning of Article 1.1(a)(1)(iii). Standing timber is an *in situ* natural resource that is not capable of being traded across borders.

4.15 The term "goods" in Article 1.1(a)(1)(iii) cannot be interpreted to include rights such as "stumpage", *profits à prendre*, and timber harvesting licenses. USDOC erred in determining that provincial governments provide goods to lumber producers and erred specifically in finding that standing timber is a "good". As stumpage does not involve a "financial contribution" USDOC's subsidy determination and the imposition of countervailing duties violates Articles 10, 19.1, 19.4 and 32.1 of the SCM Agreement and Article VI:3 of GATT 1994.

4.16 **USDOC's Use of "Cross-Border" Benchmarks to Determine and Measure a "Benefit" Violates the SCM Agreement.** Having concluded that the provinces provided goods, USDOC determined that this alleged financial contribution conferred a benefit by using selected short-term auction prices for the right to cut standing timber on specific tracts of public lands in the US or, in the

case of Québec, private timber sales in Maine, as benchmarks for comparison to Canadian provincial stumpage charges. Articles 1.1(b) and 14(d) of the SCM Agreement require the US to use in-country benchmarks to determine the existence and measurement of any alleged benefit. The Agreement does not permit the investigating authority to use cross-border (out-of-country) benchmarks, nor to reject benchmarks from within the country under investigation.

4.17 In the Preliminary Determination ("PD"), USDOC purported to establish that Canadian stumpage programmes conferred a benefit by comparing: (1) stumpage charges related to the exercise of the right to harvest; with (2) alleged prices for short term rights to cut standing timber on selected US public lands and private timber sales in Maine. USDOC did not modify this cross-border methodology in any material respect for purposes of the Final Determination ("FD"). In the FD, USDOC determined that Article 14(d) does not restrict the market benchmark to the country of export, but was intended to require that adequacy of remuneration be determined with reference to "comparable" market-based transactions.

4.18 USDOC sought to avoid the plain meaning of the Article 14(d) by focusing on the phrase "in relation to". It concluded that "in relation to" means "taking account of". USDOC also referred to the purported context provided by the illustrative list of conditions of purchase or sale set out in Article 14(d). After concluding that cross-border benchmarks were acceptable for determining "benefit", USDOC then rejected evidence of in-country benchmarks and asserted that US stumpage was a "reasonable benchmark". USDOC argued, erroneously: (1) Private prices in Canada are not market-based and cannot be used as benchmarks because a government-dominated market will distort the market; (2) US stumpage is an acceptable benchmark because it is commercially reasonable for Canadian producers to bid on US stumpage (that is, a natural resource not located within the political boundaries of Canada), and producers located within Canada "have access to US prices of stumpage"; and (3) US stumpage prices are world market prices that are available to Canadian producers. USDOC determined that the US benchmark prices were higher than the charges levied by Canadian provinces and concluded, as it had done in the PD, that Canadian stumpage charges conferred a benefit.

4.19 Article 1.1 of the SCM Agreement provides that a subsidy exists where there is a financial contribution by a government and "a benefit is thereby conferred". The Appellate Body considered the meaning of "benefit" in Article 1 of the SCM Agreement in *Canada – Aircraft* and found that a benefit under Article 1.1(b) suggests some form of comparison. The Appellate Body indicated that there could be no "benefit" unless this comparison demonstrated that the recipient was made "better off" than it would have been absent that contribution. Article 14(d) sets out guidelines for determining whether a benefit exists and how the amount of the benefit should be measured in cases involving the provision of goods. The text of Article 14(d) is unambiguous: "In the country of provision or purchase" means "in the country of provision or purchase." Nothing in the context, object and purpose or the negotiating history of Article 14 permits reading "in" as anything other than "in".

4.20 The recent panel report in *US – Softwood Lumber III*, confirms this interpretation. In that case, the panel found that the adequacy of remuneration in Article 14(d) must be determined in relation to *prevailing market conditions* for the good or service in question *in the country of provision or purchase*. According to the panel, this means that Article 14(d) requires that the prevailing market conditions to be used as a benchmark are those "in the country of provision" of the goods. The panel concluded that no other meaning could be ascribed to the reference to market conditions "in the country of provision". Therefore, the only benchmarks that may be used in a provision of goods context are those determined on the basis of prevailing market conditions in the country of provision. USDOC sought to avoid the plain meaning of "prevailing market conditions … in the country of provision" by interpreting the phrase "in relation to" to mean "taking account of". However, the panel in *US – Softwood Lumber III* disagreed with this interpretation. It found the phrase means "on the basis of" or "in comparison with". USDOC's interpretation effectively read out of the text of

Article 14(d) the clear and explicit reference to "in the country of provision", and turned the mandatory "shall" in Article 14(d) into the discretionary "may". Finally, any determination under Article 14(d) must consider the ordinary meaning of "adequate remuneration". The ordinary meaning of "adequate" is sufficient or satisfactory, not "maximum".

4.21 USDOC rejected evidence concerning in-Canada benchmarks for the alleged good, based on: (1) its unfounded assumption that it could legally reject in-country benchmarks; and (2) the unsupported factual conclusion that there are no usable market determined prices because prices were suppressed as a result of government involvement. USDOC also sought to avoid the prohibition in Article 14(d) against using out-of-country benchmarks by arguing that US stumpage prices are world market prices for stumpage available in Canada, and are therefore part of in-country prevailing market conditions. This conclusion is without foundation for three reasons.

4.22 First, USDOC asserted that US stumpage was purportedly *available* in Canada. Although a small quantity of logs harvested from some US comparison areas is exported to some Canadian provinces this, does not mean that the right to harvest US timber is somehow imported into Canada. USDOC consistently blurs the distinction between standing timber and logs. The record makes clear, however, that what is provided is either timber harvesting rights or "standing timber". Neither may be "imported" into Canada and neither is "available" in Canada. In fact, logs harvested from standing timber in the US comparison areas for over half of the exports subject to countervailing duties cannot be exported to Canada. Second, USDOC conceded that no world market price for stumpage existed when it found that there was not a single US price for stumpage or even a single price within individual US states. Third, prices outside the country of provision do not become acceptable because such prices are available in another country with allegedly "comparable market conditions." Even if market conditions in the US were "comparable", USDOC must base its determination on prevailing market conditions "in" the country.

4.23 The panel in *US – Softwood Lumber III* concluded that although "conditions of purchase or sale" and "availability" were listed as market conditions in Article 14(d) this did not mean that US stumpage was available to Canadian producers. It found that the fact that a good may also be bought on a market outside the country of provision, did not imply that the prices for that good in the other country become part of the market conditions "in the country of provision". The panel further noted that acceptance of the US argument would mean that the phrase "prevailing market conditions in the country of provision" refers to world market conditions. As the text of Article 14(d) did not support this conclusion it could not be correct. Instead the panel indicated that "availability" was an aspect of the market conditions existing in the country of provision. Finally, the panel noted that the US interpretation would effectively read out of the SCM Agreement the explicit reference to the country of provision, thereby violating the principle of effectiveness.

4.24 The US recourse to the same cross-border methodology in the FD consists again of simply substituting "prevailing market conditions" in the US for "prevailing market conditions" in Canada. This is the only way the US was able to determine the existence of a "benefit" and construct a subsidy rate of nearly 20 per cent.

4.25 A treaty interpreter must ensure that its interpretation of a treaty provision does not give rise to absurd or unreasonable results. An interpretation of Article 14(d) that would permit the use of cross-border comparisons would give rise to such unreasonable results for several reasons.

4.26 International borders affect market conditions and, in particular, prices; these effects are substantial and notoriously difficult to quantify. Political boundaries drive differences in government regulatory regimes, tax regimes, investment regimes, currency, banking and financial systems, business practices, and business climate. Government policies and other factors in different jurisdictions affect economic conditions, including wage rates, taxes, capital costs, labour costs and exchange rates.

4.27 Cross-border comparisons also do not reflect the effect of differences in the natural resource endowments between two countries. Prices of goods and services will generally differ between countries for reasons relating to comparative advantage. In *US – Softwood Lumber III* the panel found that USDOC's methodology for determining a benefit would lead to an automatic determination of subsidization in a resource-rich exporting country, even where the perceived price difference simply reflected the exporting country's comparative advantage.

4.28 A wide variety of other factors also affect forestry resources in different countries. These factors include differences in: timber characteristics and operating conditions such as the type, mix, quality and location of forest resources as well as costs of harvesting and transporting timber; measurement systems; and the rights and obligations associated with tenures such as the duration of harvesting rights and obligations associated with silviculture, road building and forest management responsibilities.

4.29 USDOC itself confirmed that cross-border comparisons are illogical in its own previous determinations in *Lumber I, II* and *III*. In each of these prior lumber cases, USDOC rejected the use of such comparisons on the basis that they simply could not be done. In particular, in *Lumber I* USDOC found that cross-border comparisons were "arbitrary and capricious" and that no unified North American market for stumpage existed. In this proceeding USDOC dismissed these decisions by claiming that they were made "in the context of a different legal framework." The change in law is irrelevant, however. All of the facts that led USDOC to reject the use of cross-border comparisons in the past still exist today.

4.30 In the FD, USDOC concluded there were no usable benchmarks in Canada that would allow USDOC to analyze whether Canadian stumpage programmes provided a benefit to the softwood lumber producers. This conclusion is contradicted by the record, which provided several in-country benchmarks as well as economic analysis of the adequacy of remuneration charged by provincial governments. This information included private timber sales, cost-revenue comparisons, an economic analysis of provincial stumpage charges, competitive auction prices, and private sector assessments of timber value.

4.31 Private Timber Sales - Canada provided substantial information regarding in-country sales of private stumpage, including private stumpage prices in Québec. In Québec, private forest lands account for 17 per cent of the total softwood sawmill supply. Private stumpage transactions in Québec are the basis for that province's parity approach, which Québec uses to determine the market value of standing timber on public land. The evidence before USDOC included three years of annual private stumpage surveys and the original survey results reporting private forest stumpage transactions in Québec. In response to questions from USDOC about the private forest in Québec, comprehensive economic data and analyses were submitted showing that private forest stumpage transactions in Québec occur in a large, open market consisting of hundreds of well-informed buyers and sellers, including competing private timber sources outside Québec.

4.32 Similarly, the information for Ontario demonstrated that the volume of private sales was significant, representing 7 per cent of total softwood stumpage sales. Canada submitted an expert study by Resource Information Systems Inc. (RISI) that provided a detailed assessment of the private market in Ontario. The RISI Study found that the private market in Ontario was competitive, efficient, and independent from the market for Crown timber. Another study of the private market in Ontario, prepared by Charles River Associates Inc., evaluated the market conditions for private timber sales, concluded that the prices for private timber were established by the "marginal" price for timber, and calculated the average price for private timber purchased by sawmills.

4.33 Competitive Auctions - The record also included information on competitive sales of stumpage by provincial governments, including information from B.C. on the volume and value of

competitive sales of stumpage through the Small Business Forest Enterprise Programme, which are made through competitive auction to the highest bidder.

4.34 Private Sector Assessments of Timber Value - Canada also provided information regarding the market values for standing timber based on an amalgam of public bid and private sale values. These market values are known as "timber damage assessments" (TDAs). Three industry sectors in Alberta, the oil and gas sector, the mining sector and the forest sector, jointly developed the TDA methodology. After a series of negotiations, all parties agreed on a TDA methodology to provide a fair and balanced estimate of the market value of Alberta's standing timber. The TDA data represent the full value of the resource, both because they come from this arm's-length process and because the prices used to develop TDA are from market transactions between unrelated buyers and sellers where each participant is free to decide not to buy or sell.

4.35 Evidence Demonstrating Consistency With Market Principles - Canada submitted information demonstrating that provincial stumpage systems collected more than adequate remuneration and were consistent with market principles. This information established that substantial profits were earned from the provision of timber harvesting rights. Evidence demonstrated, for example, that B.C. received adequate remuneration because it produced a return of 75 per cent of expenditures on its timber harvesting system. Consistent with market principles, this enormous profit on timber harvesting operations demonstrated that harvesters cannot be said to be receiving stumpage for "less than adequate remuneration". The other major producing provinces also showed substantial profits on their stumpage programmes – 35 per cent for Ontario, 67 per cent for Québec, and 25 per cent for Alberta.

4.36 Cost-revenue comparisons provided USDOC with in-country information to evaluate the adequacy of remuneration collected for rights to harvest Crown timber. As USDOC's existing practice and regulations confirm, this information is relevant to USDOC's adequacy of remuneration determinations. This analysis is consistent with the requirement in Article 14(d) that the provision of a good be for "adequate," not "maximum," remuneration. In addition, an analysis of the economics of B.C.'s stumpage system demonstrated that the province's stumpage system is administered consistent with market principles. B.C. stumpage charges are a volumetric levy imposed upon the exercise of previously conferred timber harvesting rights. The economic analysis shows that a profit-maximizing forestland owner would not impose a volumetric charge upon the exercise of those rights. Further, the tenure system imposes costs on tenure holders that they would not bear in a competitive market. Therefore, consistent with market principles, harvesters again cannot be said to be receiving stumpage for "less than adequate remuneration".

4.37 In the FD USDOC rejected "transaction-based" in-country Canadian benchmarks because of alleged "price suppression" allegedly resulting from government involvement in the marketplace. There is no basis for the rejection of in-country benchmarks in the SCM Agreement. Article 14(d) refers to "prevailing" market conditions. In this context, the meaning of "prevailing" is "as they exist". Nothing in the context, object and purpose or negotiating history of the SCM Agreement suggests that the "market conditions" referred to are those of a perfectly competitive market. In *US – Softwood Lumber III* the panel found that even if the alleged "price suppression" existed, this would not permit USDOC to reject in-country benchmarks. The panel concluded that Article 14(d) SCM Agreement did not require that prevailing market conditions be those of an "undistorted" market. It also concluded that USDOC provided no acceptable rationale for rejecting Canadian stumpage prices. Even assuming, *arguendo*, that Article 14(d) permitted the rejection of in-country benchmarks because of "price suppression", USDOC's evidence and analysis was clearly inadequate to establish that such distortion existed.

4.38 For these reasons USDOC's rejection of in-country Canadian benchmarks and reliance on "cross-border" US benchmarks is inconsistent with Articles 1.1(b) and 14(d) of the SCM Agreement. The US has therefore imposed countervailing duties in the absence of the required finding of

"subsidy" in violation of Articles 10, 14, 14(d), 19.1, 19.4 and 32.1 of the SCM Agreement and Article VI:3 of GATT 1994.

4.39 Evidence demonstrating no trade advantage - USDOC also had before it substantial evidence demonstrating that the provincial stumpage charges imposed in Canada do not increase the production of logs or lumber or lower their prices, or increase the quantity or lower the prices of lumber exports to the US, in comparison with the outcome in a market in which government is not involved. The SCM Agreement requires the investigating authority to consider the existence of a benefit and adequacy of remuneration in relation to the "prevailing market conditions" for the good in the country of provision. The prevailing market for standing timber is a natural resource market, which is an economic rent market. Rent markets have different characteristics than many other markets. This must be taken into account in making any determination of whether provincial stumpage systems confer a benefit.

4.40 Analyzing benefit in the particular market context under investigation is consistent with panel and Appellate Body interpretations of Article 1.1(b) and the object and purpose of the Agreement, which is to discipline subsidies, as defined in the SCM Agreement, that distort trade. All panel and Appellate Body decisions concerning Article 1.1(b) confirm that the word "benefit" implies a comparison that is *market-based*. As the Appellate Body has stated, this permits identification of any "trade-distorting potential." The analysis of remuneration in relation to prevailing market conditions in this case should therefore include a review of whether provincial stumpage fees or charges are capable of causing trade distortion in downstream markets. USDOC asserted that "the whole point" of the investigation was to "quantify and remedy" alleged distortion of the US market. In reaching these determinations, USDOC by its own admission ignored the economic evidence offered by Canada. Had USDOC analyzed, rather than assumed, the existence of trade distortion in the downstream markets for logs and lumber, it would have found that not only is there no benefit as measured by existing market comparators, but that economic analysis shows that there is no trade-distorting potential from provincial stumpage programmes, because positive stumpage charges neither increase production of logs and lumber nor lower their prices relative to a private competitive market.

4.41 **The FD impermissibly assumes a pass-through of an alleged subsidy.** This case requires an analysis of whether and to what extent alleged upstream subsidies benefited downstream producers. A significant portion of logs is sold by timber harvesters to unrelated lumber producers and other entities at arm's length. In addition, a great number of sales of logs and lumber inputs occur at arm's length between unrelated producers of subject merchandise.

4.42 In the FD, USDOC concluded that no subsidy pass-through analysis of any kind was required because the alleged subsidy is a subsidy "to the production of lumber rather than the production of timber or logs". With respect to producers of remanufactured lumber that do not hold provincial stumpage rights and that purchase lumber from stumpage holders at arm's length, USDOC concluded that as the case was conducted on an aggregate basis, "a review is the appropriate avenue to determine if there are specific companies that do not receive countervailable benefits."

4.43 Under the SCM Agreement, a "direct subsidy" exists where government makes a financial contribution that confers a benefit to the recipient of that contribution. Similarly, an "indirect subsidy" exists where a government "entrusts or directs" a private body to provide a financial contribution that confers a benefit to the recipient. If the recipient of a subsidy enters into transactions with other entities, an investigating authority may not *presume* that those other entities have benefited from the alleged subsidy. An investigating authority must always establish that both elements of the subsidy definition exist. In *US – Lead and Bismuth II*, the Appellate Body found that an authority must establish that a benefit has been conferred upon the recipient of the alleged subsidy, and may not *irrebuttably presume* that the benefit has been passed through a subsequent transaction. This analysis is even more apt in respect of original determinations where an investigating authority must establish

each element of a subsidy. In transactions that take place in the market and at arm's-length, the applicable presumption is that fair market value has been paid.

4.44 USDOC was required to find that the alleged subsidy to a harvester of timber was passed through to the downstream producer of subject merchandise. USDOC did not provide *any* analysis of *either* requirement of Article 1 in respect of downstream producers. USDOC did not establish that any "financial contribution" by government had been made to lumber producers or remanufacturers in respect of the inputs they purchased at arm's-length. USDOC also did not find that the alleged "benefit" was conferred to lumber producers or remanufacturers through downstream purchases.

4.45 Moreover, there was substantial evidence demonstrating arm's-length transactions between timber harvesters and lumber producers, *and* between lumber producers and remanufacturers, including: (1) In B.C. approximately 24 per cent of the timber from Crown licenses was harvested by companies that did not own sawmills. Similarly, in Ontario approximately 30 per cent of the softwood timber harvested from Crown lands was sold by tenure holders to third parties for processing; (2) At least 18 per cent of the volume of logs harvested in B.C. from Crown lands were purchased at arm's length; and (3) Numerous company exclusions filings demonstrated that arm's-length purchases of logs and lumber were significant. On this basis 230 companies applied for exclusion.

4.46 In *US – Softwood Lumber III* the US indicated that it knew that a portion of the logging companies did not own sawmills, and sell their logs in arm's-length transactions. The panel found that the US had conceded that pass-through analysis was required; it found that the US had violated its obligations under the SCM Agreement because USDOC had failed to consider evidence regarding arm's-length transactions and because an authority may not assume that a subsidy provided to producers of the "upstream" input product automatically benefits unrelated producers of downstream products (especially where there is evidence of arm's-length transactions between these entities). In the FD, USDOC ignored these facts and presumed that *all* producers of subject merchandise received countervailable subsidies in *all* cases. USDOC had the data to calculate and correctly deduct from the numerator the alleged benefit incorrectly attributed to arm's-length log and lumber sales. USDOC instead chose to presume the existence of a subsidy arising from such sales, and as a result, overstated the amount of the alleged subsidy (and the subsidy rate).

4.47 USDOC has therefore failed to establish the elements of a subsidy by failing to demonstrate a pass-through of financial contribution and benefit. Accordingly, the US has violated Articles 10, 19.1, 19.4 and 32.1 of the SCM Agreement and Article VI:3 of GATT 1994.

2. Canadian provincial stumpage programmes are not specific to certain enterprises

4.48 USDOC concluded that recipients under provincial stumpage programmes are limited to a group of industries; it found that this factor alone established the programmes as specific in fact. USDOC's finding was based on its definition of the term "group of industries", by which it meant those companies and individuals that use the programme.

4.49 Under Article 2, a subsidy may be determined to be specific to an enterprise, industry or group of enterprises or industries (certain enterprises) either in law or in fact. A subsidy is specific in law where a government expressly limits access to that programme to certain enterprises. Where a subsidy is not specific in law, a Member may still determine that it is specific to certain enterprises based on evidence of the factors listed in Article 2.1(c), subject to consideration of the diversification of economic activities in the jurisdiction and the length of time the programme has been in operation. Where these factors do not indicate that a Member is deliberately limiting access, the programme is not specific. Article 2.4 requires that any specificity determination be "clearly established" on the basis of "positive evidence". This exacting burden of proof requires both reasoned analysis and "positive evidence" supporting the factual conclusion. An investigating authority must therefore

correctly analyze and weigh all evidence of the factors set out in Article 2.1(c), as applied in a given case, in the light of the standard in Article 2.4.

4.50 The term "certain enterprises" is a defined term for the purposes of Article 2: "an enterprise, industry, or group of enterprises or industries". At issue in this case is the meaning of the terms "industry" and in particular "group of… industries". The meaning of "industry" is "[a] particular form or branch of productive labour; a trade, a manufacture". In the context of the WTO Agreement and the SCM Agreement this requires an examination of product-based criteria. Part V of the SCM Agreement provides that the term "domestic industry" "shall … be interpreted as referring to the *domestic producers as a whole of the like products* or to those of them whose collective output of the products constitutes a major proportion of the total domestic production of those products …" [emphasis added]. The term "domestic industry" thus refers to the producers on the basis of "products". The logical inquiry to be undertaken by the investigating authority of an importing Member is therefore whether the parallel foreign industry is subsidized on a specific basis. Accordingly, an "industry" in the sense of Article 2 is properly interpreted to refer to enterprises engaged in the manufacture of similar *products*. The nature of the output products is also an important link that holds "a group of enterprises or industries" together; in the absence of a product-based identification of industries, no "group of industries" may be found.

4.51 USDOC explained that the label "limited group of wood products industries" identified "pulp and paper mills and the saw mills and remanufacturers which are producing the subject merchandise". In concluding that the alleged benefits of stumpage programmes are limited to those entities specifically authorized to cut timber on Crown lands, USDOC's determination amounts to the statement that "stumpage is specific to those using stumpage", and assumes the ultimate conclusion under the "limited users" factor. USDOC's finding renders the specificity requirement redundant and inutile. This is achieved also by USDOC's use of the entire Canadian economy as a benchmark and finding that the majority of companies and industries in Canada do *not* receive benefits under these programmes. As a result of its circular reasoning, USDOC failed in particular to accurately determine the actual users of stumpage programmes and failed to address the record evidence that established that many enterprises and industries use stumpage programmes. USDOC also failed to analyze the industries that use stumpage programmes, based on the types of enterprises, in order to determine whether they properly constitute a "group of industries".

4.52 Canada submitted significant evidence pertinent to the specificity issue, including voluminous questionnaire responses and expert studies on factual issues relevant to specificity. These studies considered the number and types of industries using stumpage, the types of products produced by stumpage users, and the proportionate distribution of the wood fibre harvested in Canada to various product categories. These studies demonstrated that there were 23 separate classes of industries, producing over 200 products, that used stumpage programmes. They also showed that softwood lumber was not the dominant end use. Many producers of subject merchandise also produce products not subject to the investigation, and other stumpage users include, *inter alia*, producers of pulp and paper products, hardwood products, shakes and shingles, kitchen cabinets, furniture, and sporting gear. Moreover, by arguing that a subsidy programme that does not subsidize the "vast majority of companies and industries" is "specific", USDOC is stating a negative rather than determining the required positive – that the government has deliberately limited access to the programme to certain industries.

4.53 USDOC also failed to analyze whether stumpage programmes were specific in fact within the context of all four factors found in Article 2.1(c). In an analysis under Article 2.1(c), evidence must be analyzed and factors must be weighed in the light of differing explanations. The US has, by its own admission, recognized that it is the inherent characteristics of the alleged good that limit the number of users of the programme, rather than any deliberate government favouritism. In the light of the nature of the forestry resource in question, it is untenable to base a specificity finding on the "limited users" factor alone. To hold otherwise impermissibly merges the tests of Articles 1

(provision of a good) and 2 (government favouritism), by rendering the specificity requirement superfluous where the provision of a natural resource has been found to be a subsidy under Article 1.1.

4.54 The US specificity finding in the FD amounts to an irrebuttable presumption, based on the nature of the subject merchandise and the alleged "good" provided, that the alleged subsidy is specific. A determination of *de facto* specificity under Article 2.1(c) in this case would have required *at a minimum* examination of the other listed factors. Moreover, Article 2.1(c) mandates the consideration of economic diversification. Evidence of economic diversification in the Canadian provinces, and in particular in B.C., greatly reduces the weight to be given to the "limited users" factor in this case. When account is taken of the evidence of the diversity of provincial economies, the correct conclusion under the first factor is that, (1) stumpage programmes are not used only by two or three industries and, to the contrary, (2) stumpage programmes are widely available to more than a limited number of industries. Even if this were not the case, the lack of diversity of provincial economies and the inherent characteristics of stumpage would provide the reason.

3. USDOC's Calculation Methodology Impermissibly Inflates the Rate of the Alleged Subsidy and the Countervailing Duty

4.55 The US imposed countervailing duties in excess of the amount of the alleged subsidy to the subject merchandise. First, USDOC inflated the alleged subsidy rate by adopting an outdated and factually unsupportable "national" factor for converting US log volume measurements into Canadian log measurements in order to determine comparison prices for its illegal cross-border analysis. Second, USDOC calculated the total alleged benefit based on all Crown logs entering sawmills, rather than basing the alleged benefit on the log volume (less than 40 per cent of the total) that becomes softwood lumber, and then allocated that alleged benefit over the sales value of only certain products produced from the logs. The effect, again, was to overstate the alleged subsidy. Third, USDOC inflated the duty rate by understating the sales value of subject merchandise; it purported to calculate the subsidy rate on a "final mill" basis (including sales of remanufacturers), but contrary to the record evidence, devised a final mill sales estimate that largely excluded such sales. All of these actions inflated the amount of the alleged subsidy, thereby violating the SCM Agreement.

4.56 Countervailing duties may not be imposed in an amount that exceeds the subsidy. Article 19.4 of the SCM Agreement and Article VI:3 of GATT 1994 establish this fundamental discipline on countervailing duties. A countervailing duty so imposed also violates Articles 10 and 32.1, which provide that a countervailing duty may only be imposed in accordance with the provisions of the SCM Agreement and GATT 1994.

4. Conduct of the Investigation

4.57 In conducting the investigation, the US failed to provide the interested parties with critical information and evidence, failed to give notice of its use of information highly relevant to its determination, and failed to give interested parties an opportunity to present evidence, make presentations, and otherwise defend their interests. In imposing countervailing duties pursuant to an investigation that did not conform with Articles 12.1, 12.3 and 12.8 of the SCM Agreement, the US violated Articles 10 and 32.1 of the SCM Agreement.

4.58 As noted, in its illegal cross-border comparisons, USDOC used prices for short-term cutting rights on US state lands as the benchmarks against which to compare Canadian provincial stumpage charges, making the choice of a particular comparator state central to the determination of an alleged provincial subsidy. Yet in the cases of Alberta and Saskatchewan, USDOC switched the comparator state from Montana in the PD to Minnesota in the FD, without any notice to interested parties or opportunity to provide evidence or argument concerning the inappropriateness of the Minnesota benchmark. As the *Guatemala – Cement II* panel reasoned, "[d]isclosure of the 'essential facts'

forming the basis of a preliminary determination is clearly inadequate in circumstances where the factual basis of the provisional measure is significantly different from the factual basis of the definitive measure."

4.59 Similarly, USDOC failed to give interested parties the opportunity to present full evidence and arguments concerning information that was highly relevant to the calculation of the US benchmark price applied to Québec. Specifically, USDOC requested and obtained timely information from the Maine Forest Products Council (MFPC), yet withheld it from the record until Quebec formally demanded its production. USDOC then characterized the MFPC information as "untimely", yet subsequently accepted and relied upon two reports submitted by the petitioner to reject the MFPC information. Interested parties were given no opportunity to rebut the petitioner's reports.

5. Initiation of the *Lumber IV* Investigation

4.60 USDOC initiated the *Lumber IV* investigation, based on a finding that 67 per cent of the US softwood lumber producing industry supported the petition. Softwood lumber producers that brought or supported the petition are eligible to receive cash payments under the *Dumping and Subsidy Offset Act of 2000* (*Byrd Amendment*) for supporting the petition. Counsel for the petitioner, the Coalition for Fair Lumber Imports Executive Committee, used the prospect of *Byrd Amendment* payments as inducement to garner support for the petition. The investigation was therefore initiated on the basis of domestic producer support that was actively solicited by promise and prospect of a direct payment by the US government.

4.61 Article 11.4 requires Members to conduct an "examination" of the degree of support for an application and to "determine", on the basis of that examination, that the application has been made by or on behalf of the domestic industry. The words "determine" and "examination" denote, singly and collectively, an active consideration, assessment or weighing of evidence that results in a conclusion. This plain reading of the words is further confirmed by the context. In addition to "quantitative thresholds", Article 11 also provides that the original complaint of alleged injury to an industry must contain evidence that has to be substantiated. The obligation under 11.4 is therefore not simply on the applicants to present evidence of domestic industry support, but also on the investigating authority to conduct an objective determination and examination of the level of that support. The panel in *US – Offset Act (Byrd Amendment)* described the object and purpose of Article 11.4 as requiring an authority to examine the degree of support which exists for an application and to determine whether the application was thus filed by or on behalf of the domestic industry.

4.62 If Article 11.4 is to have any meaning, the "examination" of the degree of support for the petition and determination that the petition was made by or on behalf of the domestic industry must be objective and impartial. The countervailing duty order resulting from the *Lumber IV* investigation is subject to the *Byrd Amendment*. As payments by the US under the *Byrd Amendment* induce domestic producers to support such petitions, the US is precluded from making an objective and impartial examination and determination of the level of support among domestic producers for such petitions. This is consistent with the finding of the panel in *US – Offset Act (Byrd Amendment)*. That panel found that the low costs of supporting a petition coupled with the strong likelihood that all producers would feel obliged to keep open their eligibility for offset payments would mean that the vast majority of petitions would achieve the required level of support. The panel concluded that by requiring support for the petition as a prerequisite for receiving offset payments, the CDSOA in effect mandates domestic producers to support the application and renders the threshold test of Article 11.4 meaningless. Since the initiation of *Lumber IV* is inconsistent with Article 11.4, the US has, as a consequence, imposed countervailing measures in violation of Articles 10 and 32.1 of the SCM Agreement.

6. Administrative Reviews

4.63 Canada raised certain questions concerning the operation of US law on administrative reviews in the course of consultations. In particular, Canada asked whether individual producers and exporters may request and receive company-specific administrative reviews under US law. In its panel request, Canada claimed US law relating to administrative reviews violated Articles 10, 19.3, 19.4, 21.1, 21.2 and 32.1 of the Agreement and Article VI:3 of GATT 1994. Canada raised similar issues in the *US – Softwood Lumber III* case. In that proceeding, the US took issue with Canada's characterization of its law and stated that it had the discretion to conduct company-specific administrative reviews. The panel in *US – Softwood Lumber III* made findings in this regard substantially endorsing the US explanation of the source and extent of USDOC's discretion. The US confirmed these statements in the consultations held for this case. In the light of the foregoing statements and findings, it is Canada's understanding that the US possesses and will use discretion in the conduct of administrative reviews in a WTO-consistent manner. Canada reserves the right to advance additional arguments in respect of these claims, if its understanding of the US position is incorrect.

B. FIRST WRITTEN SUBMISSION OF THE UNITED STATES

4.64 The following summarizes the United States' arguments in its first written submission.

1. Introduction

4.65 The recurring theme of Canada's case is succinctly presented in its assertion that no countervailing duties may be imposed on government programmes "that are adopted in the context of a Member's broader economic and social policy framework, such as the sustainable exploitation of natural resources." Canada's assertion rings hollow when compared to the obligations undertaken by Members in the SCM Agreement.

4.66 Over 60 per cent of Canada's subsidized lumber is exported to the US. The countervailing duty provisions of the SCM are designed to ensure that, when Canada chooses to subsidize the production of lumber in the interest of social policy, the US lumber industry is not required to pay the price. The United States' right to impose countervailing duties to offset the subsidy on billions of dollars of injurious imports of Canadian lumber is protected in the SCM and, therefore, should not be denied.

2. Standard Of Review

4.67 Article 11 of the DSU sets forth the standard of review that applies to this case. Article 11 requires a panel to make an objective assessment of the matter before it and determine whether the identified measure is consistent with the provisions of the WTO agreement upon which the claim is based. In that regard, it is important to bear in mind that panels cannot add to or diminish the rights and obligations provided in the SCM or the GATT 1994. It is also well settled that a panel must not conduct a *de novo* review of the evidence nor substitute its judgment for that of the competent authority.

3. Argument

(a) Canada Bears the Burden of Proving Its Claim

4.68 The complainant in a WTO dispute bears the burden of proof. This means, as an initial matter, that Canada, as the complainant, bears the burden of coming forward with evidence and argument that establish a *prima facie* case of a violation. It also means that, if the balance of evidence

is inconclusive with respect to a particular claim, Canada must be held to have failed to establish that claim.

(b) The Final Countervailing Duty Determination Is Consistent with the SCM

(i) USDOC Properly Determined That Provincial Stumpage Programmes Constitute a "Financial Contribution"

Timber Is a Good within Article 1.1(a)(1)(iii) of the SCM

4.69 Article 1.1(a)(1)(iii) states that a financial contribution shall be deemed to exist where the government "provides goods or services other than general infrastructure." The SCM does not specifically define the meaning of "provides" or "goods." The Panel therefore should look to the ordinary meaning of these terms. The dictionary definition that Canada itself cites explicitly defines the term "goods" as encompassing all "property or possessions," including "growing crops, and other identified things to be severed from real property." "Goods" is similarly defined under Canadian law. Through their tenure systems, the Canadian provinces provide an "identified thing to be severed from real property," i.e., timber.

4.70 Canada makes the extraordinary contention that a good must be a tradeable product. Canada bases this conclusion on logically flawed arguments, and ignores the basic principles of treaty interpretation reflected in Article 31 of the *Vienna Convention on the Law of Treaties*. Canada asks the Panel to infer, from the use of the phrase "imported goods" in Article 3.1(b) of the SCM and the word "products" in Parts III and V of the SCM Agreement, that "goods" can only mean traded goods that fall within the GATT 1994 Article II schedules. The fact that "products" are goods and "imported goods" are goods does not, however, logically give rise to the inference that nothing else can come within the meaning of "goods."

Provincial Tenures "Provide" Timber

4.71 Canada argues that provincial governments are not providing timber to lumber producers, but rather are merely granting certain property rights in the timber: the right of access to, or the right to harvest, the timber. According to the *New Shorter Oxford English Dictionary*, however, "provides" means to "make available" in addition to "supply or furnish for use." Thus, even if provincial tenures are viewed as simply providing the right to access or harvest the timber rather than providing the timber itself, such a provision would still constitute the provision of a good within the meaning of Article 1.1(a)(1)(iii) of the SCM because the government is making the timber available to lumber producers.

4.72 A review of the facts further demonstrates that Canada is attempting to elevate form over substance. USDOC found, and the *US – Softwood Lumber III* panel agreed,[6] that from the tenure holder's point of view, there is no difference between the government granting a right to harvest timber and the government actually supplying the timber through the holder's exercise of this right. In fact, the only way to provide standing timber (the good in question) is by providing the right to harvest the timber. It should be beyond dispute that when a government gives a company the right to take a good, whether it is the right to take widgets from a government warehouse or timber from government land, the government is "providing" that good within the meaning of Article 1.1(a)(1)(iii) of the SCM Agreement.

[6] See Panel Report, *US – Softwood Lumber III*, para. 7.17.

(ii) The United States Properly Determined That Provincial Stumpage Programmes Provide a Benefit

A Benefit Is Something More Favorable Than the Market Would Provide Absent the Financial Contribution

4.73 The US, having properly determined that a financial contribution was provided to Canadian softwood lumber producers, was required to determine whether a benefit was "thereby conferred" within the meaning of Article 1.1(b) of the SCM Agreement. The SCM Agreement does not define the term "benefit." The meaning of the term as used in Article 1.1(b) has, however, been explored by previous WTO panels and the Appellate Body, which have established that a benefit is something better than the market would otherwise provide, absent the financial contribution, and that "the 'market' to which reference must be made is the *commercial* market, i.e., a market undistorted by government intervention."[7]

Comparing the Government's Price for a Good to the Fair Market Value of the Good in the Country of Provision Is Consistent with Article 14(d) of the SCM

4.74 Article 14 of the SCM contains guidelines for calculating a subsidy benefit, providing that "the provision of goods or services . . . by a government shall not be considered as conferring a benefit unless the provision is made for less than adequate remuneration." "Adequate remuneration" is not defined in the text of the SCM Agreement. In the context of Article 14(d), however, "adequate" remuneration must mean remuneration that is sufficient to eliminate any benefit. As discussed above, a benefit is something more favorable than would otherwise be available in the commercial market, i.e., fair market value. Logically, therefore, "adequate" remuneration is fair market value. Article 14(d) therefore provides that the benefit should be measured by comparing the government's price for goods or services with the fair market value of the goods or services in the country of provision.

4.75 The issue is what evidence may be used to establish that fair market value pursuant to the guidance in Article 14(d) of the SCM that adequate remuneration must be measured "in relation to prevailing market conditions . . . in the country of provision." Article 14(d) does not address the type of evidence to be used in evaluating the question of benefit. Observed prices in Canada were either unavailable or unreliable indicators of fair market value. Thus, after a thorough analysis to ensure comparability, the US used market prices for timber from the northern US border states as the starting point for the calculation of fair market benchmarks for each of the provinces, then analyzed the prevailing market conditions in Canada (e.g., obligations for road building, silviculture, and fire and disease protection) and adjusted the benchmark calculation accordingly to arrive at the fair market value of timber *in Canada*.

4.76 Canada itself acknowledged that price data from sources outside of the country of provision can be used as the basis for assessing fair market value in the country of provision. The issue at the heart of Canada's complaint is thus not whether Article 14(d) precludes the use of "out of country" prices (e.g., import prices) to assess fair market value in the country of provision. Rather, the issues at the heart of Canada's claim are questions of fact: (1) did the US have a reasonable basis to reject private prices in Canada as a basis for assessing fair market value; and (2) could price data for comparable timber in the northern United States provide a reasonable factual basis for assessing the fair market value of timber in Canada. As discussed below, the answer to both inquiries is yes; therefore, Canada's claim must fail.

[7] Panel Report, *Brazil – Aircraft (Article 21.5 – Canada II*), para. 5.29 (emphasis in original).

Private Prices in Canada Did Not Provide a Reliable Basis to Determine Fair Market Value

4.77 As noted above, the Appellate Body and previous WTO panels have found that "the marketplace provides an appropriate basis for comparison"[8] and that "the 'market' to which reference must be made is the *commercial* market, i.e., a market undistorted by government intervention."[9] Prices suppressed by the government's financial contribution do not represent a commercial market price against which a benefit can be measured because they do not represent a "market undistorted by government intervention."

4.78 In the present case, the US sought evidence on non-government prices for Canadian timber. The record evidence demonstrates, however, that the limited non-government price data submitted by the Canadian parties was inadequate and that such prices were significantly affected by the financial contribution itself, i.e., the supply of provincial government timber. These observed prices were therefore simply uninformative of adequate remuneration, i.e., fair market value.

Prices for Comparable Timber in Northern US States, Properly Adjusted, Provide a Reasonable Basis for Assessing the Fair Market Value of Timber in Canada

4.79 As discussed above, there was no appropriate market price data from Canadian sources on which to base a fair market value assessment. Canada's claims notwithstanding, starting with prices for comparable timber of the same species immediately across the border and adjusting those prices, as appropriate, for provincial market conditions is a reasonable basis to assess the fair market value of timber in Canada. An examination of the underlying facts and the assessment performed by the US in this case demonstrates this point.

4.80 It is undisputed that the North American market for lumber is highly integrated. Canada, in fact, exports over 60 per cent of its softwood lumber to the US. US and Canadian timber are therefore supplying the same North American demand for lumber products. Thus, because of the derived nature of timber prices, market prices for US timber are a logical and reasonable starting point for an assessment of the fair market value of Canadian timber. US timber is also commercially available to lumber producers in Canada. Canada does not contest the fact that Canadian mills actually do purchase US timber – both on the stump and as logs – and consume it in their mills in Canada.

4.81 To compensate for any differences in species mix, the US calculated species-specific fair market value benchmarks. The US also used averages – an average, species-specific fair market value benchmark for each province and an average administered price for each province – to account for other differences that may affect the value of specific stands of timber. The use of averages is an accepted and widespread aspect of Canadian stumpage systems. In addition, the US made appropriate adjustments to the US price data to arrive at an assessment of the fair market value of timber in Canada. As evidenced in the Final Determination,[10] the US conducted a thorough analysis of the conditions of sale in Canada and made necessary adjustments for obligations such as road building and silviculture that are conditions of sale in Canada. The result was a reasonable assessment of the fair market value of timber in Canada that is entirely consistent with Article 14(d) of the SCM Agreement.

[8] Appellate Body Report, *Canada – Aircraft*, para. 157.

[9] Panel Report, *Brazil – Aircraft (Article 21.5 – Canada II)*, para. 5.29 (emphasis in original).

[10] See 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) ("Final Determination") (US - 2).

The SCM Does Not Define "Benefit" in Terms of Increased Output or Lower Prices for the Subject Merchandise and Does Not Create an Exception for Natural Resource Inputs

4.82 Without any justification in the text of the WTO agreements, Canada asserts that the Panel should graft onto the SCM a special rule for financial contributions that take the form of a government provision of a natural resource that is fixed in supply. According to Canada, the conditions that prevail in such a market are such that no failure by the government to collect adequate remuneration can result in increased output or have an adverse trade impact. Thus, Canada claims that "any benefit analysis should assess" the trade effects of the subsidy.

4.83 This argument is completely without foundation in the SCM Agreement. Article 14, which is titled "Calculation of the Amount of a Subsidy in Terms of the Benefit to the Recipient," provides that the existence of a benefit to the recipient, not the existence of demonstrable trade effects, is determinative of whether a benefit exists for purposes of Article 1.1. Nothing in Article 14 describes benefit in terms of the effect on the output of the recipient. If the government makes a financial contribution, and the recipient obtains a benefit, then the definition of a subsidy in the SCM Agreement is fulfilled. What Canada asserts "should" be added to this definition cannot supersede the actual text of the SCM Agreement.

(iii) The United States Calculated the Subsidy Rate in a Manner Consistent with the SCM and GATT 1994

4.84 In industries, such as softwood lumber, with an extremely large number of producers, it is not feasible, in an investigation, to examine the subsidies received by each individual producer. As reflected in Article 19.3 of the SCM Agreement, Members are accorded the flexibility to conduct investigations other than on a company-specific basis. In this case, rather than investigate specific producers, the US examined the government subsidy programmes at issue and, based on data supplied by the provincial and federal governments, calculated the aggregate amount of all subsidies to producers of the subject merchandise (the numerator). The US then allocated the aggregate subsidies over all sales of merchandise that benefitted from the subsidies (the denominator).

4.85 This type of aggregate subsidy investigation is entirely consistent with the SCM Agreement, and Canada does not argue to the contrary. Rather, Canada argues that the manner in which the US calculated the countervailing duty is inconsistent with Articles 19.1 and 19.4 of the SCM Agreement, and Article VI:3 of GATT 1994. Canada has failed, however, to make a *prima facie* case.

4.86 Article 19.1 of the SCM requires a final determination of the amount of the subsidy and a final determination of injury as pre-conditions to the imposition of a countervailing duty. Article 19.1 does not, however, establish any requirements concerning how a subsidy or injury is to be determined. Those obligations are found elsewhere in the SCM Agreement.

4.87 Article 19.4 of the SCM establishes an upper limit on the amount of the countervailing duty that may be levied, i.e., the amount of the subsidy found to exist. The issue addressed by Article 19.4 expressly is the *levying* of duties *after* a subsidy has been "found to exist." The sole calculation requirement in Article 19.4 is a requirement to calculate the subsidy on a per-unit basis. Article 19.4 does not establish any other requirements concerning how the subsidy is to be calculated.[11] Canada, in fact, concedes that its claim under Article 19.4 is dependent upon the existence of an inconsistency with some other provision of the SCM that imposes obligations with respect to the subsidy calculation.

[11] Similarly, Article VI:3 of GATT 1994 establishes that the amount of the subsidy found is the upper limit on the amount of the countervailing duty that may be levied. Article VI:3 of GATT 1994 does not address how the subsidy is to be calculated.

4.88 Article 19.3 of the SCM establishes two obligations: (1) when countervailing duties are "imposed," they must be "levied" on a non-discriminatory basis; and (2) when an uninvestigated exporter is "subject to" countervailing duties, the exporter is entitled to an expedited review to establish an individual countervailing duty rate. Nothing in the text of Article 19.3 establishes any obligations concerning the methodology used to calculate the amount of the subsidy, either in the aggregate or with respect to a specific exporter.

4.89 Thus, while other provisions of the SCM contain obligations regarding the calculation of the benefit, Canada has failed to identify any such obligations in Article 19 or GATT 1994 in support of its claims concerning the subsidy calculation. It has, therefore, failed to establish a *prima facie* case of a violation.

4.90 Furthermore, to the extent Canada's claims relate to factual findings used to support the US methodology, the Panel may, of course, make an objective assessment of the facts. The Panel is not, however, charged with conducting a *de novo* review of the facts. Rather the Panel is to determine whether the US "evaluated *all relevant factors*, and . . . provided a *reasoned and adequate explanation* of how the facts support [its] determination."[12] The US findings of facts in this case were well supported and well reasoned.

(iv) Canadian Provincial Stumpage Subsidies Are Specific within the Meaning of the SCM

4.91 Under the SCM Agreement, a subsidy "shall be deemed to exist" where "there is a financial contribution by a government or any public body within the territory of a Member" and a benefit is thereby conferred. Pursuant to Article 1.2 of the SCM Agreement, a programme that otherwise meets the definition of a subsidy shall be subject to countervailing measures if it is "specific" within the meaning of Article 2 of the SCM Agreement. Article 2.1 of the SCM Agreement provides three principles that must be applied to determine whether a subsidy is specific to "an enterprise or industry or group of enterprises or industries" — referred to collectively by the SCM Agreement as "certain enterprises" — within the jurisdiction of the granting authority.

4.92 First, a subsidy is specific as a matter of law if the granting authority *explicitly* limits access to a subsidy to certain enterprises. Second, a subsidy is *not* specific as a matter of law where the granting authority establishes objective criteria or conditions governing eligibility for, and the amount of, a subsidy, provided that eligibility is automatic and the criteria or conditions are strictly adhered to. Third, even where the law under which the granting authority operates does not appear to create a *de jure* specific subsidy under the first two steps of the analysis, Article 2.1(c) of the SCM provides that other factors may be considered to determine if the subsidy is, *in fact*, specific. Thus, Article 2.1(c) establishes that, even if a subsidy has the "appearance" of being widely available throughout an economy, it may nevertheless be specific if, as a matter of fact, the subsidy is used only or predominantly or disproportionately by a limited number of certain enterprises.

4.93 The US acted consistently with its obligations under the SCM in finding that Canada's provincial stumpage programmes are specific. The subsidy at issue in this case is the provision of Crown timber to lumber manufacturers at below-market prices. Thus, the proper inquiry under Article 2.1(c) of the SCM is whether the actual recipients of Crown timber, whether considered on an enterprise, industry, or group basis, are limited.

4.94 The record clearly demonstrates that provincial stumpage subsidy programmes were used by a "limited number of certain enterprises" within the meaning of Article 2.1(c). The SCM does not define the term "limited number." As a factual matter, USDOC found that stumpage subsidy programmes were used by a single group of industries, comprised of pulp and paper mills, and the

[12] Appellate Body Report, *US – Lamb*, para.103.

saw mills and remanufacturers that produce the subject merchandise. Such a small number of users would count as "limited" by any reasonable definition.

4.95 Canada does not deny that there are no recipients of timber outside of the lumber and pulp and paper industries. Instead, it attempts to redefine the specificity test. Canada would have this Panel ignore the plain language of the SCM Agreement, and instead establish obligations and requirements that exist nowhere in the SCM Agreement. First, Canada attempts to read an intent requirement into the SCM Agreement, notwithstanding that nothing in the text requires any findings as to the granting authority's intent to limit a subsidy. To the contrary, the very purpose of Article 2.1(c) is to let the facts speak for themselves. Article 2.1(c) refers simply to whether a limited number of enterprises use a subsidy, not why that is so. Next, without any foundation in the SCM Agreement, Canada claims that subsidies are not specific if they are "adopted in the context of a Member's broader economic and social policy framework, such as the sustainable exploitation of natural resources." A "policy" exception would, however, obliterate the specificity requirement to the extent that *all* subsidies fall within some broader social or economic policy framework. Finally, Canada seeks to create an exception to Article 2 that would explain away a finding of specificity where "the *inherent characteristics* of the alleged good . . . limit the number of users of the programme, rather than any deliberate government favouritism." However, the "inherent characteristics" of the subsidized good are also not a factor under Article 2.1. The fact that a subsidized input has economic utility for a limited number of potential recipients does not and cannot exempt it from the disciplines of the SCM Agreement.

4.96 Canada also claims that the US undercounted the number of industries that used stumpage subsidies because it used an improper definition of the word "industry." Canada seeks to constrict the natural meaning of "industry" such that an industry would be identified not by the general class of products it produces, but by a particular product or narrow set of products. Canada further claims that a "group of industries" is similarly restricted to individual members that make similar products. There is absolutely no basis in the text, or logic, for Canada's argument. Canada's reading contradicts the ordinary meaning of the word "group," which in the context of Article 2.1 plainly and simply means "one or more" enterprises or industries; it does not require that all of its members be identical, or even similar, to be called a group.

4.97 The Panel should likewise reject Canada's argument that the term "domestic industry," as defined in Article 16.1 of the SCM Agreement, forms the context for understanding what is meant by "industry" in Article 2.1. Article 16.1 defines "domestic industry" within the context of the determination of the domestic "like product," whereas specificity determinations under Article 2 are not limited to particular "like products." There is no logical connection between defining the domestic industry that is injured by a specific imported product and determining whether a subsidy is limited to certain enterprises or industries.

4.98 Finally, the US explicitly found that "the subsidies provided by the[] stumpage programmes are not 'broadly available and widely used.' *The vast majority of companies and industries in Canada does not receive benefits under these programmes.*"[13] No matter how Canada attempts to subdivide or redefine the industries that received the subsidy, the simple fact remains that the Canadian economy as a whole and each of the provincial economies are large and diversified, and provincial stumpage programmes are used by a single group of forest product industries within those diverse economies. Canada's claims with respect to the economic diversification provisions of Article 2.1(c) therefore should be rejected by the Panel.

[13] Issues and Decision Memorandum: Final Results of the Countervailing Duty Investigation of Certain Softwood Lumber Products from Canada, 52 (emphasis added) (21 March 2002) (CDA-1).

(c) The Conduct of This Investigation Was Consistent with the Obligations of Article 12 of the SCM

4.99 The US conducted this investigation in full compliance with the obligations in Article 12 of the SCM Agreement. The US ensured that all parties were given notice of the information it required for the investigation, had ample opportunity to submit relevant information, had access to all information submitted to the US during the course of the investigation, and were informed of the essential facts under consideration. The US thus ensured that all interested parties had ample opportunity to defend their interests. Neither of Canada's two claims of error bears scrutiny under the facts of record.

4.100 The US fully complied with Articles 12.1, 12.3, and 12.8 of the SCM Agreement with regard to the selection of the benchmark for the stumpage programmes of Alberta and Saskatchewan. Consistent with Article 12.1, all interested parties were informed that the US required information on the US northern border states in order to choose appropriate benchmarks for the Canadian stumpage programmes. Because all information submitted to the US was actually served on all of the interested parties participating in the investigation, the US procedures were consistent with Article 12.3. Because the Preliminary Determination[14] announced that the United States was using US northern border states as the benchmarks for the Canadian stumpage programmes, set forth the criteria the US used in selecting the benchmarks, identified Minnesota as one alternative USDOC might use, and because all information submitted to the US regarding Minnesota was provided to all of the interested parties, the US informed the interested parties of the "essential facts under consideration" and therefore acted consistently with Article 12.8.

4.101 The US conduct was also in full compliance with the SCM with regard to the Maine Forest Products Council ("MFPC") letter. The US provided copies of the MFPC letter to all interested parties and afforded them the opportunity to submit information "that clarifies, corrects or rebuts" the information contained in that letter. By providing copies of the letter to all of the interested parties, the US ensured that it met the requirements of Article 12.1. Moreover, the opportunities to comment on and rebut the information more than met the requirements of Article 12.3. Beyond the requirements of Article 12.8, the US specifically identified the information contained in the MFPC letter as "important to certain issues in the proceeding, and relate[d] to an ongoing exchange of expert advice on a technical matter." The US, therefore, informed the interested parties that the information in the MFPC letter was part of the "essential facts under consideration," and specifically provided them with the opportunity to use this information in the presentation of their case, or to submit additional information to clarify, correct, or rebut this information. Thus, the disclosure took place in sufficient time for parties to defend their interests.

(d) The United States Initiated the Softwood Lumber Investigation Based on Adequate Domestic Industry Support Consistent with the Requirements of Article 11.4 of the SCM

4.102 The softwood lumber petition contained uncontested evidence establishing that US softwood lumber producers representing 67 per cent of total US softwood lumber production supported the petition. That level of industry support unquestionably satisfies the criteria in Article 11.4 of the SCM Agreement. Canada does not contest this fact.

4.103 Canada is not challenging the provisions of US law governing industry support, but rather the specific factual determination of industry support in this case. Nevertheless, the sole argument presented by Canada is the unsubstantiated claim that the very existence of the Continued Dumping

[14] Notice of Preliminary Affirmative Countervailing Duty Determinations, Preliminary Affirmative Critical Circumstances Determination, and Alignment of Final Countervailing Duty Determination with Final Antidumping Duty Determination: Certain Softwood Lumber Products from Canada, 66 Fed. Reg. 43186 (17 August 2001) (CDA-20) ("Preliminary Determination").

Subsidy Offset Act of 2002 induced support for the petition, thereby precluding an objective determination of industry support. In effect, Canada would inject a requirement into the SCM Agreement that investigating authorities examine the motives of prospective petitioners. In *US – Offset Act (Byrd Amendment)*, however, the Appellate Body unequivocally rejected this argument. Canada's claim is therefore without any support in the text of Article 11.4 or the facts of record.

4. Conclusion

4.104 Thus, the United States requests that the Panel reject Canada's claims in their entirety.

C. FIRST ORAL STATEMENT OF CANADA

4.105 The following summarizes Canada's arguments in its first oral statement.

1. Financial Contribution

4.106 "**Stumpage**" refers to the right of a harvester to enter into a forest owned by a province, select a tree and harvest it. Provincial governments transfer stumpage to harvesters through tenure agreements or licences. **Timber** refers to the standing tree. Harvesters cut down timber and process it into **logs** that are processed further to produce softwood **lumber** and a wide variety of other products. Lumber and certain products manufactured from lumber are the subject merchandise. Lumber and logs, which are physical, tradable items, are goods. Standing trees and timber-harvesting rights are not tradable or physical items; they are not goods. The fact that from each of these rights a good may be produced does not make the right a good in itself.

4.107 In general, the provinces own forests and trees and enter into tenure or licence agreements to transfer to private persons the right to harvest trees. In return for this right, these agreements require tree harvesters to undertake a broad range of forest management responsibilities and significant in-kind costs, as well as the payment of stumpage fees upon harvest.

4.108 At issue in this case, is the interpretation of the phrase "provision of goods" in Article 1.1(a)(1)(iii). The plain meaning of the word "goods" is movable, tangible personal property. In ordinary usage the term "goods" does not cover intangibles, such as intellectual property rights, or real property interests. "Goods" does not include all property, or everything that has economic value or is an economic resource.

4.109 This plain meaning of "goods" is further supported by the *context* of this term. Nothing in the WTO Agreement justifies interpreting "goods" to encompass everything of economic value. Equally, nothing in the *object and purpose* of the SCM Agreement requires this Panel to interpret the word "goods" as anything other than its ordinary meaning. As the panel in *United States – Export Restraints* noted, the SCM Agreement regulates *certain* government actions, but not others. The *objective* of the SCM Agreement in general and Article 1 in particular, was not to govern all transfers of economic resources by a government.

4.110 As a matter of law, "goods" are movable personal property; for the purposes of the WTO Agreement, they are tradable items that are capable of bearing a tariff classification.

4.111 In the facts of this case, timber harvesting rights are intangible real property interests. As such, they do not fall under the "provision of goods" heading of Article 1.1(a)(1). The only way to fit the rights in question, or indeed standing trees, into the term "goods" is to suggest that the term encompasses all a person's legal rights of whatever description. The WTO Agreement does not support this proposition.

4.112 A right to harvest standing timber cannot bear a tariff classification, as it cannot be traded across borders. The transfer of stumpage rights does not constitute the provision of goods.

2. Benefit

4.113 In the CVD FD, USDOC compared provincial stumpage charges with stumpage prices on selected lands in its own territory. USDOC found US prices to be higher and concluded that the stumpage charges conferred a benefit through this cross-border comparison.

4.114 This approach to determining and measuring benefit violates the SCM Agreement. The plain meaning Article 14(d) requires that benefit must be determined and measured on the basis of prevailing market conditions in the country of provision. This is a *legal* issue. It is not a factual debate.

4.115 Canada's position is based on the ordinary meaning of Article 14(d), which provides that: "[A]dequacy of remuneration *shall* be determined in relation to *prevailing market conditions* for the good … *in the country of provision.*.."[emphasis added]. Nothing in the context, object and purpose or the negotiating history of Article 14 permits reading "in" as anything other than "in". As the panel in *US – Softwood Lumber III* found: "Article 14 (d) does not just refer to "market conditions" in general, but explicitly to those prevailing "in the country of provision" of the good."

4.116 Article 14(d) requires the use of "prevailing market conditions … in the country of provision" to determine adequacy of remuneration. The ordinary meaning of the term "prevailing" is "as they exist". This requirement cannot be avoided by interpreting "in relation to" to mean "taking account of".

4.117 The SCM Agreement does not provide an authority with the discretion to reject in-country benchmarks. Instead, Article 14(d) requires the use of "prevailing market conditions … in the country of provision". Notwithstanding this requirement, USDOC rejected in-country benchmarks arguing that government involvement allegedly suppresses private market prices making them unusable.

4.118 The US argues that (1) the information submitted was "limited" and that (2) the "observed prices were simply uninformative of adequate remuneration" because they were "significantly affected by the financial contribution itself." Both arguments are without merit.

4.119 First, there is no question that USDOC had before it extensive evidence regarding the prevailing market conditions in Québec, Ontario, Alberta and BC. This evidence was not "limited". Canada also submitted information demonstrating that stumpage systems are operated in a manner consistent with market principles. This information showed that all of the provinces were making substantial profits on the management of their forests.

4.120 Second, the SCM Agreement does not permit dispensing with prevailing market benchmarks because of "price suppression". This was confirmed by the panel *US – Softwood Lumber III*. Moreover, the US did no analysis to arrive at the conclusion that price suppression existed.

4.121 The United States' most recent attempt to justify its cross-border comparisons consists of an entirely new argument that relies on word substitutions, and on so called "logic" to replace the law. The argument – that Article 14(d) requires is that the "fair market value" ("FMV") of timber in Canada is the appropriate benchmark for measuring the benefit – is *wholly new*. It is found nowhere in the Preliminary or Final Determinations, US law or in the SCM Agreement.

4.122 The argument is the latest in a series of changing positions that the US has taken over the course of this dispute. In *US – Softwood Lumber III*, the US moved from arguing "in" means "out" to

arguing "out" really means "in". In anther attempt to argue for the use of US prices as an appropriate benchmark the US again asserts that "out" really means "in" – but this time with several twists.

4.123 The US begins by arguing that a benefit determination is a "but for" analysis that involves comparing the government's price for a good with what the price for that good would have been absent the financial contribution. In a provision of goods context, however, the marketplace is the prevailing market as it exists. The panel in *US – Softwood Lumber III* confirmed this interpretation.

4.124 Building on this erroneous understanding of "benefit", the US turns to Article 14(d) itself and argues that: "[A] benefit is something more favorable than would otherwise be available in the commercial market, i.e., fair market value. Logically, therefore, "adequate" remuneration is fair market value." It then argues that it had to look elsewhere for prices to calculate FMV benchmarks because prevailing market conditions in Canada are "unreliable indicators" of FMV. In doing so it turns Article 14(d) into a provision that measures adequacy of remuneration by comparing the government price to a constructed FMV, rather than to in-country prevailing market conditions.

4.125 In a final effort to refashion the requirements for a determination of "adequate remuneration", the US asserts that FMV "must" be determined "in relation to" "conditions of sale". The replacement of "*prevailing market conditions*" by "*conditions of sale"*, is just another attempt by the US to again evade the plain meaning of "prevailing" which is "as they exist". The text of the agreement demands a determination that is grounded in existing Canadian market factors, not an adjustment to US prices based on an erroneous interpretation of "conditions of sale".

4.126 Interwoven through this is the now familiar argument that "in relation to" means "taking account of." Although the reasons for the US argument have changed, Canada's response is the same. The ordinary meaning of "in relation to" is "on the basis of". It is not "taking account of".

4.127 These word substitutions allow the US to interpret Article 14(d) as if it read: The fair market value shall be determined using a benchmark derived from a market undistorted by government intervention, taking account of conditions of sale for the good … in the country of provision.

4.128 According to the US, this metamorphosis is so compelling that there is "no dispute" about any of it. Every step of this so-called "logic" is in dispute. No amount of word substitution can change the fact that Article 14(d) requires a determination of adequacy of remuneration using in-country prevailing market conditions.

4.129 USDOC also improperly rejected economic analysis that demonstrates that stumpage charges provide no trade advantage to lumber producers or harvesters. USDOC explained in its CVD FD that its task was to "quantify and remedy" distortion of the US market that was at "the heart of this inquiry". In response, Canada provided USDOC with detailed economic evidence that demonstrated that stumpage programmes do not cause trade distortion.

4.130 USDOC then claimed that it could not examine this evidence because of its "complexity". The US now contradicts its own investigating authority by claiming that the evidence is not relevant to a "benefit" determination and that Canada is attempting to "graft" a special rule onto the SCM Agreement. Canada is doing no such thing. Rather, Canada provided evidence to USDOC regarding an issue that USDOC itself stated was central to this case.

4.131 Any benefit determination relating to stumpage systems must take into account the fact that the market in this case is a rent market. This approach is consistent with panel and Appellate Body interpretations of Article 1.1(b) and the object and purpose of the Agreement. The Appellate Body has confirmed that the word "benefit" implies a comparison that is *market-based* and stated that this allows for identification of any "trade-distorting potential." As such, the analysis of remuneration in

relation to prevailing market conditions in this case should include consideration of whether stumpage charges are capable of causing trade distortion.

3. Pass-through

4.132 The US purports to have determined that provinces subsidize those who *harvest standing timber*. The US has imposed countervailing duties on *lumber*. Record evidence demonstrates, and the US does not contest, that there are lumber producers who obtained log or lumber inputs from unrelated sources other than government. The question before the Panel therefore is whether the US may legally presume, *as it did*, that such producers benefited from an alleged *timber harvesting* subsidy.

4.133 Under Article 1, to establish that a person is "subsidized" an investigating authority must establish that the person received a financial contribution, and that this confers a benefit. Where lumber producers do not harvest timber but obtain inputs from upstream producers, any alleged subsidy is by definition indirect. An indirect subsidy is established by demonstrating the existence of both an indirect financial contribution under Article 1.1(a)(1)(iv), and a benefit under Article 1.1(b). The Appellate Body has confirmed that in a countervailing duty investigation, the existence of any subsidy may never be presumed. The panel in the *US – Softwood Lumber III* case came to the same conclusion, finding that the obligation to establish the existence of a subsidy is not excused by conducting an investigation on an aggregate basis. Articles 10, 32.1, 19.1 and 19.4 of the SCM Agreement require the US to establish the existence of a subsidy before it imposes countervailing duties.

4. Specificity

4.134 In the CVD FD, USDOC found stumpage to be specific in fact by relying solely on an incorrect and perfunctory application of the "limited users" factor under Article 2.1(c) of the SCM Agreement. The phrase "is specific to" in Article 2 establishes a legal standard. The standard is whether government is limiting access to a programme, in law or in fact, to certain enterprises. Analyzing whether a subsidy is specific in fact under Article 2 is not different from analyzing whether a subsidy is contingent on export performance in fact under Article 3.1(a). A member may find specificity in fact only where the total configuration of facts allows it to infer that government is deliberately limiting access to the programme.

4.135 As a threshold issue, the US determination on the "limited users" factor is wrong. First, it assumes the conclusion. The CVD FD asserts that stumpage programmes "are limited to those companies and individuals specifically authorized to cut timber on Crown lands." USDOC's determination says nothing regarding the industries that actually use stumpage, and more fundamentally, whether their number was limited.

4.136 Second, it fails to provide any legal analysis of the meaning of the terms "industry" or "group of industries". The record evidence demonstrates that the many industries in which these companies operate are *not* the only users of stumpage and that the actual users are *not* limited in number. Moreover, an industry must be identified for the purposes of specificity with reference to the products it produces. The US argument amounts to an assertion that the term "industry" means whatever it needs to find a programme specific.

4.137 Third, it compares the purportedly sole users of stumpage to the entire Canadian economy. Using the entire economy as a benchmark misinterprets Article 2, as it ignores the fact that the universe of eligible users under Article 2.1(b) can be something less than "everyone". The benchmark is the universe of eligible users.

4.138 The determination is wrong on the facts because record evidence demonstrates that enterprises in more than 23 classes of industries manufacturing 201 distinct products use stumpage. Finally, even if the US had been correct in finding that stumpage was used by a limited number of industries, that finding by itself could not establish *per se* that the programmes are specific in this case, as the US is required to provide legal and factual analysis on this point. As Canada demonstrated in its First Written Submission, the US failed to address in the CVD FD that the purported finding of "limited users" is explained by the nature of the alleged "good" and the nature of the economic diversification of provincial economies.

5. Calculations

4.139 Where the amount of a subsidy has been improperly calculated and illegally inflated, a countervailing duty imposed in that amount violates Article 19.4 of the SCM Agreement and Article VI:3 of GATT 1994. The US violated these obligations in three ways.

4.140 First, the US nearly doubled the amount of the alleged subsidy by using wrong conversion factors when comparing Canadian stumpage rates, calculated in dollars per cubic metre, to US timber prices, determined in dollars per thousand board feet.

4.141 Second, the US inflated the amount of the subsidy by considering the total volume of logs entering sawmill establishments as subsidized inputs into subject merchandise, even though not all of the output was subject merchandise. The US should have determined based on evidence the amount of the subsidy attributable to the volume of the log that actually goes into the production of the subject merchandise.

4.142 Third, the US inflated the per unit subsidy rate, and therefore the countervailing duties imposed by approximately US$120 million per year, by spreading the alleged subsidy over an incorrectly determined low sales value.

6. Conduct of the Investigation

4.143 In the CVD PD, the US used data from Montana to establish a benchmark rate for Alberta and Saskatchewan. These provinces objected to this choice, both on legal and factual grounds. In the CVD FD, USDOC selected Minnesota as the benchmark state. At no point were the affected provinces made aware of USDOC's choice of Minnesota as the benchmark state. As a consequence, the US violated Articles 12.1, 12.3 and 12.8.

4.144 With respect to Québec, the investigation was inconsistent with Article 12.3 in two respects. First, USDOC itself requested and received important information from the Maine Forest Products Council concerning its benchmark determination for Québec. It sat on that information for two months. This denied parties the opportunity to see relevant information. Second, USDOC accepted and relied upon new factual information submitted by the petitioners criticizing the Council's information. Interested parties were then denied the opportunity to prepare presentations on the basis of this relevant information.

7. Initiation

4.145 Canada does not consider it appropriate to press its claim set out in paragraph 1 of its panel request.

8. Administrative Reviews

4.146 Canada has not abandoned the claim in paragraph 3(b) of its panel request. Canada understands that the US believes that it has the discretion to conduct company-specific administrative

reviews in this case; that the US will use its discretion to conduct such reviews of requesting exporters; that rates obtained by individual exporters in expedited reviews will not be superseded by an aggregate rate in an administrative review. Canada may advance additional arguments if its understanding of the US position is incorrect.

D. FIRST ORAL STATEMENT OF THE UNITED STATES

4.147 The following summarizes the United States' arguments in its first oral statement.

1. Opening Statement of the United States of America at the First Meeting of the Panel

(a) Financial Contribution

4.148 The first legal issue in this dispute is whether Canadian provincial timber sales systems constitute the provision of a "good" within the meaning of Article 1.1(a)(1)(iii) of the SCM Agreement. The text and context of Article 1.1(a)(1)(iii), and the object and purpose of the SCM Agreement, all lead inexorably to the conclusion that standing timber is a "good."

4.149 Canada argues that "goods" is limited to items that are tradeable across borders and subject to tariff classification. To the contrary, the ordinary meaning of "goods" is broad, encompassing all property and possessions, including things to be severed from the land, such as standing timber. The sole exclusion in Article 1.1(a)(1)(iii) for "general infrastructure" underscores the intent that the provision sweep broadly. "Infrastructure" is not tradeable across borders. Nevertheless, infrastructure that is *not* "general" must fall within Article 1.1(a)(1)(iii). To conclude otherwise is to render the explicit exclusion for infrastructure that *is* "general" entirely meaningless.

4.150 The uncontested facts leave no doubt that the provinces sell timber. There is one reason and one reason only that companies enter into provincial timber contracts, which we generally refer to as "tenures." They do so to obtain the government-owned timber for their mills. Through tenures, the provinces are providing a good – timber – to lumber producers. Accordingly, the provinces provide a financial contribution within the meaning of Article 1.1(a)(1)(iii) of the SCM Agreement.

(b) Benefit

4.151 We turn to the methodology used to determine whether and to what extent the provinces confer a benefit on lumber producers through the sale of timber for less than adequate remuneration. This methodology poses two distinct issues. First, there is a question of legal interpretation of "benefit" within the meaning of the SCM Agreement. Second, there is the issue of the application of that legal concept to the particular facts of this case. It is imperative to examine the legal question before turning to the facts.

4.152 A financial contribution confers a "benefit" if it "makes the recipient 'better off' than it would otherwise have been, absent that contribution."[15] In determining whether a benefit has been conferred, the "marketplace" is the appropriate basis for comparison, i.e., the issue is whether "the recipient has received a 'financial contribution' on terms more favourable than those available to the recipient in the market."[16]

4.153 The guidelines in Article 14(d) of the SCM state that a benefit is conferred if the government provides the good for "less than adequate remuneration." Article 14(d) also states that the adequacy of remuneration shall be determined in relation to "prevailing market conditions" for the good in the country of provision. The concept of a comparison "market" therefore is central to the concept of

[15] Appellate Body Report, *Canada – Aircraft*, para. 157.
[16] *Id.*

"benefit" generally, and to adequate remuneration specifically. The *Brazil–Aircraft* panel concluded that the concept of a comparison market necessarily means a "*commercial* market, i.e., a market undistorted by government intervention."[17] The United States agrees.

4.154 As the EC states in its third-party submission, "market" conditions exist where prices are "determined by independent operators following the principles of supply and demand." Thus, as the EC implicitly acknowledges, not all observed prices are necessarily "market" prices. We agree. "Market" prices are prices between independent buyers and sellers in a competitive market where prices are determined by the forces of supply and demand. Such prices represent what is commonly referred to as "fair market value." It therefore follows logically that adequate remuneration is fair market value. That is also how the term adequate remuneration is defined in Canadian law.

4.155 Article 14(d) sets forth the principle underlying the adequate remuneration inquiry – it must be made "in relation to prevailing market conditions" in the country of provision. However, Article 14(d) does not set out rules governing the specific types of data that may be used in conducting that analysis.

4.156 Where reliable commercial market prices are available in the country of provision, ignoring such prices would be inconsistent with Article 14(d). Where, however, no such prices exist or are unreliable, an investigating authority may use prices commercially available on world markets as the basis for an assessment of the adequacy of remuneration, provided that those prices are informative as to the fair market value of the goods in the country of provision.

4.157 There is no real dispute that there are circumstances under which an investigating authority may look to sources *outside* the country of provision for data to assess the fair market value of goods *in* the country of provision. The *US – Softwood Lumber III* panel,[18] Canada, the EC and Japan have all implicitly or explicitly acknowledged this. The real issue in this dispute is what factual circumstances warrant the use of price data from sources outside the country of provision to determine the fair market value of goods in the country of provision.

4.158 To determine the adequacy of remuneration in the underlying investigation, the United States calculated province-specific, species-specific market benchmark prices for stumpage. The United States requested data on private market transactions for stumpage in each province for the purpose of calculating those market benchmark prices. Three of the six provinces – Alberta, Manitoba and Saskatchewan – did not provide *any* data on private market prices for stumpage. Thus, there should be no dispute that the United States acted consistently with Article 14(d) in using commercially available prices from sources outside Canada to determine the fair market value of timber in those provinces.

4.159 British Columbia ("B.C.") submitted a survey containing a few average prices. The volume of the private timber on which those averages were based, however, represented less than one-half of one per cent of the total timber harvested by the survey respondents. Moreover, the survey did not contain the detail or underlying support that would be necessary to calculate market benchmark prices. Ontario provided a limited survey and analysis of private stumpage sales in the province. Similarly, Quebec submitted an average price for private stumpage in the province, which was based on a survey.

4.160 The United States determined that there were no commercial market conditions – that is, a market undistorted by the government's financial contribution – in any of the provinces. The evidence, including the governments' dominant market share, the lack of incentive for sawmills to pay more for private stumpage than they pay the government, and statements by provincial officials

[17] Panel Report, *Brazil – Aircraft (Article 21.5 – Canada II*), para. 5.29 (emphasis in original).
[18] See Panel Report, *US – Softwood Lumber III* , para. 7.48.

and forestry economists concerning the impact of the government prices on the sale of private timber, is more than adequate to support that determination. Thus, although there is data on observed prices in certain provinces, the record demonstrates that those observed prices are not commercial market prices. Therefore, the United States acted consistently with Article 14(d) in using data from sources outside of Canada as the starting point for determining the fair market value of timber in Canada. Moreover, numerous adjustments were made to reflect conditions of sale in Canada.

(c) Calculation Issues

4.161 Canada claims that the United States was required under Article 19 of the SCM and Article VI:3 of the GATT 1994 to conduct an "upstream" subsidy analysis. Canada makes this claim with respect to two distinct situations.

4.162 With respect to remanufacturers: The United States determined the total amount of the benefit, but did not determine what portion of the benefit individual sawmills or remanufacturers received. The United States allocated the total subsidy benefit over all sales of the products resulting from the lumber production process. The total amount of the subsidy benefit does not change, however, regardless of how the benefit is allocated. Thus, allocating a portion of the benefit to remanufacturers cannot overstate the total subsidy benefit. Moreover, nothing in Article 19 precludes this method of calculation. Article 19.3 specifically contemplates that a producer's exports may be subject to countervailing duties without knowing whether or to what extent that particular producer received a benefit. Article 19.3 simply obligates Members to provide expedited reviews for such exporters to calculate individual subsidy rates.

4.163 With respect to the second "upstream" subsidy situation, i.e., the alleged independent loggers: This is the only situation that could have any impact on the *calculation* – rather than the allocation – of the total amount of the benefit to producers of the subject merchandise. The record evidence indicates, however, that sales by independent loggers could only account for a very small portion of the volume of Crown timber entering sawmills. In addition, the evidence suggests that all or most of the sales by independent loggers may not be at arm's-length. Moreover, an upstream subsidy analysis requires company-specific data and analysis. Canada's claim that the United States was required to conduct this type of company-specific analysis in the investigation is without foundation in Article 19 of the SCM or Article VI:3 of GATT 1994.

(d) Specificity

4.164 Pursuant to Article 2.1(c) of the SCM Agreement, a subsidy is specific when the *users* of the subsidy are limited to certain enterprises or industries or to a limited group of enterprises or industries. The users of provincial stumpage are limited to timber processing facilities, which constitute a very limited group of industries. In accordance with Article 2.1, therefore, the subsidy from provincial stumpage is specific. Canada's claims to the contrary are based on its own definition of specificity, not the definition in Article 2.1. Article 2.1 does not require an investigation into the motives of Members that provide subsidies, does not require an analysis of the number of products made by the users of the subsidy, and does not require that a subsidy be limited to the producers of the subject merchandise, or that a "group of industries" must share common characteristics.

2. Closing Statement of the United States of America at the First Meeting of the Panel

(a) Financial Contribution

4.165 Canada criticizes the United States' reliance on the definition of "goods" in *Black's Law Dictionary*, which cross-references the US Uniform Commercial Code ("UCC"). Canada, however, relies on that same definition. Nevertheless, Canada states that the UCC provision cross-referenced in *Black's* "expressly excludes" standing timber, "except in certain limited circumstances that do not

apply here." The UCC is, of course, not controlling in this forum. However, the relevant provision reveals that sales of standing timber are expressly "included" – not "excluded" – from the term "goods" as used in the UCC. We also refer the Panel to our first written submission, which quotes a similar definition of "goods" in the British Columbia Sale of Goods Act.

(b) Benefit

4.166 With respect to record evidence concerning private stumpage prices, Canada makes a number of statements at the first Panel meeting which we would like to comment on:

4.167 Canada asserts that Timber Damage Assessments are based on private transactions representing approximately 6 per cent of Alberta's timber harvest. According to Alberta's questionnaire response, however, only 1 per cent of the harvest in Alberta comes from private land.

4.168 Canada states that B.C. submitted evidence that demonstrates that B.C. operates its stumpage system consistent with market principles. That evidence merely established that B.C. made a profit on its timber sales, which does not mean that it is receiving adequate remuneration.

4.169 Regarding paragraph 58 of Canada's oral statement, we have several comments:

4.170 The Final Determination analyzes the reliability of Canadian private timber prices in detail.

4.171 The Economists, Inc. study that the United States relied on concludes that the "existence of an administered market that is willing to supply the preponderance of market demand at an artificially low price drives the price that can be attained in the non-administrative sector below the level that would obtain if the administered market were not subsidized."

4.172 The student thesis Canada refers to is actually a 1995 doctoral dissertation that analyzes data as recently as 1993.

(c) Market Distortion

4.173 Canada claims that the United States ignored Canada's evidence "and simply assumed trade distortion." Rather, the United States determined that US law does not require an analysis of whether a subsidy has market distorting effects. Likewise, there is no obligation in the SCM to find the existence of trade distortion to impose countervailing duties.

(d) Calculation Issues

4.174 Canada implies that Article 19.4 effectively imposes obligations with respect to the calculation of the subsidy. Canada, however, fails to cite to any language in Articles 10, 19.1, 19.4 or 32.1 of the SCM or Article VI:3 of the GATT 1994 establishing any such obligations.

4.175 Canada asserts that "there is no single log conversion factor", yet the Canadian Government itself publishes a single conversion factor. And if the United States had used Canada's published conversion factor, the calculated subsidy rate would have been greater.

(e) Administrative Reviews

4.176 With respect to administrative reviews, Canada improperly attempts to bring hypothetical future measures by the United States before this Panel. As the *US – Softwood Lumber III* panel stated,

"the WTO dispute settlement system allows a Member to challenge a law as such or its actual application in a particular case, but not its possible future application."[19]

(f) Conclusion

4.177 Canada went to great lengths to criticize the United States for interpreting the words in Article 14(d). For example, Canada criticized the United States for interpreting "adequate remuneration" to mean "fair market value" even though Canada's own regulations define adequate remuneration as "fair market value." Having criticized the United States for interpreting the language in Article 14(d), Canada then proceeded to criticize the United States for *failing* to interpret the specificity provisions in Article 2.1(c). In both instances, the United States interpreted the provisions in accordance with the ordinary meaning of their terms, in context, and applied the provisions accordingly.

E. SECOND WRITTEN SUBMISSION OF CANADA

4.178 The following summarizes Canada's arguments in its second written submission.

1. Financial Contribution

4.179 What is the scope of the word "goods" in Article 1.1(a)(1)(iii) of the SCM Agreement? The word "goods" in Article 1, read in context and in the light of the object and purpose of the WTO Agreement, has the same meaning and scope as the word "goods" elsewhere in the WTO Agreement. And elsewhere in the WTO Agreement, the word "goods" has the same meaning and scope as the word "products" in Article II of GATT 1994. Therefore, interpreted in accordance with the principles of treaty interpretation, the word "goods" in Article 1.1(a)(1)(iii) refers to tradable items that are capable of bearing a tariff classification.

4.180 May the transfer of tree harvesting rights by provinces properly be characterized as "provision of goods" by a government within the meaning of Article 1.1(a)(1)(iii)? Provinces enter into tenure agreements or grant licences to harvest timber. Under these tenures or licences, the harvester has certain proprietary interests in standing trees and must undertake a series of obligations, some of which are related to the land and others to the volume of harvest. Under these tenure agreements and licences, the trees to be harvested are not identified and many of the obligations must be performed regardless of any harvest. This transfer of a right to harvest standing trees does not amount to the provision of goods.

4.181 After having argued that "goods" includes all property, the US now states that this case is not about "intellectual property" or other property rights; that its earlier assertions about "goods" encompassing all property rights were arguments in the alternative. Again misrepresenting the nature of the transactions at issue, it continues to argue that living trees with roots firmly in the ground are "goods" for the purposes of the SCM Agreement.

4.182 In its closing arguments at the First Substantive Meeting, the US suggested that sales of "standing timber" are included in the definition of goods in the UCC. This definition is in turn reproduced, albeit imperfectly, in the Black's Law Dictionary as one definition for the term "goods". The US has not credibly contested Canada's Vienna Convention analysis of the word "goods". The only issue appears to be whether a particular definition of "goods", found in the UCC, supports the US position. It does not.

[19] Panel Report, *US – Softwood Lumber III* , para. 7.157.

4.183 The UCC definition of "goods" provides that, "'Goods' means all things, including specially manufactured goods, *that are movable at the time of identification* to a contract for sale and future goods. … The term does not include … *general intangibles*." [emphasis added]

4.184 The UCC further provides that, "A contract for the sale apart from the land …[of] other things attached to realty and capable of severance without material harm … or *of timber to be cut* is a contract for the sale of goods … whether the subject matter is to be severed by the buyer or by the seller even though it forms part of the realty at the time of contracting, and the parties can *by identification effect a present sale before severance*." [emphasis added]

4.185 First, this definition flatly contradicts the US assertion that "goods" somehow includes all property rights, including the right to harvest timber. The basic definition is that of movable things; and the basic definition expressly excludes "general intangibles". Second, the reference to "timber to be cut" is not part of the ordinary meaning. Rather, it is a special provision covering certain "things" that are *not* ordinarily "movable" and that would not, absent the clarification, be covered by the ordinary meaning of the word "goods". Third, what *is* included in the UCC definition is not "standing timber", but "timber to be cut". "Timber to be cut" refers to individual trees *identified* to be cut in a sales contract, as indeed expressly set out in this definition. This is to be contrasted with standing trees that are subject to tenure agreements and licences. Those trees may or may not be cut during the term of the tenure, but in any event are not specifically identified to be cut; after all, they may not even have been planted.

4.186 The inclusion of "timber to be cut" in the UCC definition of a "good" implies the exclusion of all other timber – that is, timber subject to tenures and licenses – from the scope of the UCC definition. In US law, therefore, standing trees are not "goods". And because the definition of the word "goods" in the UCC does not cover "intangibles", in US law the right to harvest does not amount to "goods".

4.187 The US relies heavily on its incorrect assertion that tenure agreements and licences are "timber sales contracts". The US supports this assertion by arguing that the tenure agreements and licences result in the timber harvesters owning felled timber and paying for that timber. Canada has demonstrated that there is a distinction between tenure agreements and licences on the one hand, and "sales of goods contracts" on the other.

4.188 Under the SCM Agreement, this distinction makes a crucial legal difference. A timber sales contract concerns a contract that identifies individual standing trees to be cut and hauled away. In contrast, a tenure or licence grants a right of harvest in an area of land in return for certain rights and obligations. No trees are identified to be cut – and in fact, due to disease, fire and environmental reasons, it may well be that no trees are cut. And yet, certain forest maintenance and fire protection obligations continue to run for the length of the tenure or licence in the area covered by the tenure or licence.

2. Benefit

4.189 Canada demonstrated that USDOC's rejection of valid in-country benchmark evidence and its choice of cross-border benchmarks to determine adequacy of remuneration is inconsistent with Articles 1.1(b) and 14(d) of the SCM Agreement. Canada's submissions are based on three complementary points:

- first, Article 14(d) requires the use of benchmarks that are based on prevailing market conditions in the country of provision;
- second, substantial evidence of prevailing market conditions in Canada that could have been used as benchmarks to determine "adequacy of remuneration" was improperly rejected; and
- third, the US has offered no valid defence of its actions.

4.190 Canada's response to the United States' most recent assertions follows the same structure.

4.191 The US claims that this is a dispute over the factual circumstances that warrant the use of price data from sources outside the country of provision. It is not. This is a *legal* dispute over whether the plain meaning of Article 14(d) requires that benefit be determined and measured on the basis of prevailing market conditions in the country of provision – in this case Canada.

4.192 Article 14(d) provides that where a government has provided goods, a benefit is conferred if remuneration is not "adequate". It also provides that, "[A]dequacy of remuneration shall be determined in relation to *prevailing market conditions* for the good … *in the country of provision*". [emphasis added]

4.193 First, the ordinary meaning of "in relation to" is "on the basis of" or "in comparison with". This phrase prescribes a comparison to "prevailing market conditions".

4.194 Second, the ordinary meaning of the term "prevailing" is "as they exist". Accordingly, Article 14(d) requires a comparison to *existing* market conditions.

4.195 Third, "in the country of provision" means "in the country of provision." It cannot refer to "prevailing market conditions" in *some other country.*

4.196 This interpretation is consistent with the Appellate Body's analysis of Article 1.1(b) in *Canada – Aircraft*. There, the Appellate Body found that in determining whether the financial contribution conferred a benefit on the recipient, the "marketplace is the appropriate basis for comparison." The Appellate Body also found that Article 14 provides context for Article 1.1(b). The marketplace, in a provision of goods context under Article 14(d), is the existing "market" in the country of provision.

4.197 Further contextual evidence that Article 14(d) does not permit cross-border comparisons is found in the Accession Protocol of China. The Protocol provides for the application of the SCM Agreement generally, but in language clearly indicating *exceptional* circumstances, it specifically permits the use of "methodologies for identifying and measuring the subsidy benefit which take into account the possibility that prevailing terms and conditions in China may not always be available as appropriate benchmarks." If Article 14(d) already permitted the consideration of conditions outside "the country of provision", Members would not have considered it necessary to provide for this exceptional treatment. This understanding is confirmed by the USTR on its official website.

4.198 In the CVD FD, USDOC concluded there were no usable benchmarks in Canada. This conclusion is flatly contradicted by the record. Canada provided extensive evidence to USDOC concerning prevailing market conditions in Canada. More specifically, this evidence included private timber sales, cost-revenue comparisons, an economic analysis of provincial stumpage charges, and private sector assessments of timber value. USDOC was obligated by Article 14(d) to use this evidence.

4.199 The reasons given by USDOC for rejection of this evidence are baseless. First, USDOC relied on the Preamble to its regulations to irrebutably presume price suppression. No analysis of actual price suppression was ever conducted. Second, the "economic" report which USDOC chose to use as support for its presumption of price suppression is purely theoretical and based on a flawed economic model. It did not include consideration of any actual transaction prices.

4.200 Canada submitted economic studies during the course of the investigation that demonstrated that it is the nature of the competition in the market that determines whether the market produces

market prices, not the size of the market. If the market has the indicia of a competitive market – which it does in this case – the size of the government presence does not affect private prices.

4.201 Finally, the US efforts to dismiss evidence provided on in-country benchmarks as either not useable or not representative, are not credible. This evidence includes evidence that satisfies the third benchmark – consistency with market principles – in the US regulations. The US itself confirmed that it uses this benchmark where "no world market price for [the goods in question are] commercially available in the countries under investigation". Here, there is no "world market price" for stumpage and US stumpage is not available in Canada. Accordingly, the evidence submitted by the Canadian provinces that demonstrated that their stumpage systems are operated in a manner consistent with market principles should have been considered by USDOC.

4.202 The US claim that it made adjustments that took into account the prevailing market conditions is not supported by the record. USDOC has admitted in previous lumber investigations that it would be "arbitrary and capricious" to use cross-border comparisons as it is not possible to identify a country or countries where some market conditions are the same as those in the country of provision and where all differences in market conditions can be identified and adjusted. These differences include: differences in economic conditions such wages, capital costs, taxes and government regulatory policies, comparative advantages in resources, timber characteristics, operating conditions, measurement systems and tenure rights and obligations.

4.203 Moreover, the US assertions respecting the adjustments that it did perform are incorrect. For example, the US claims that it "averaged the [US] price data by species to match the species in the relevant province." For several provinces there were little or no price data by species. In almost all (ninety-nine per cent) of the US sales used by USDOC as a benchmark for the B.C. coast, the purchaser bid a single lump-sum price for all timber of all species. The result of the use of these benchmarks was to overstate the value in the US sales of the lower-value species common in BC and other provinces.

4.204 In the case of Québec, adjustment categories considered by USDOC were not derived from an analysis of differences in market conditions between Québec's public forest and Maine's private forest, but from carefully surveyed cost differences between the public and private forests within Québec. If USDOC had attempted to analyze and compare market conditions in Québec and Maine, it would have discovered that much of the data needed to make necessary adjustments were unavailable.

4.205 In order to argue that it is "well established" that the Article 1.1(b) test for benefit is a "but for" test, the US focuses on the word "absent" in an excerpt from *Canada - Aircraft*. In doing so, the US both misinterprets the Appellate Body's statement and ignores the context of the sentence.

4.206 If the balance of the paragraph is considered, it is clear that the Appellate Body was saying that a "benefit", as used in Article 1.1(b), "implies some kind of comparison" and that the "marketplace" must be the basis for this comparison. The Appellate Body has therefore, directed a comparison that is to be informed by what the recipient could have actually obtained in the market and not a comparison to some artificial "undistorted" market, as the US asserts.

4.207 The Appellate Body then notes that, "Article 14, which we have said is the relevant context in interpreting Article 1.1(b), supports our view that the marketplace is an appropriate basis for comparison." As Article 14 provides relevant context in interpreting Article 1.1(b), the "marketplace" that is to be used for comparison purposes must be the markets referred to in Article 14. In a situation involving the government provision of goods, Article 14(d) refers to "*prevailing market conditions* … in the country of provision". Accordingly, in this situation this refers to the in-country market as it exists.

4.208 Even though the US now contends that it has never advocated a "hypothetical undistorted market", its arguments indicate the contrary. In the NAFTA proceeding, for example, it specifically describes adequate remuneration as, "the price that the purchaser would pay in an open and competitive market *but for the government's financial contribution*." [emphasis added].

4.209 Canada addressed what had been, to that point, the most recent attempt by the US to construct an argument that supported USDOC's use of US prices as the appropriate benchmark. Canada showed how the US was attempting, through an elaborate exercise in word substitution, to turn Article 14(d) into a provision that measures adequacy of remuneration by comparing the government price to a constructed "fair market value", rather than to prevailing market conditions in the country of provision.

4.210 The US has changed tack once again. It now asserts that where no "commercial market prices" exist in the country of provision or where they are "unreliable", an investigating authority may use, "prices commercially available on world markets as the basis for an assessment of the adequacy of remuneration provided that those prices are informative as to the fair market value of the goods in the country of provision". Accordingly, in the US view, the prices it uses *"outside"* the country of provision "to assess the fair market value of goods *in* the country of provision" need only to be available on the "world market" (and not in the country of provision). In support of this proposition, the US points to alleged acknowledgements by the *US – Softwood Lumber III* panel, Canada, Japan and the EC.

4.211 The US asserts that Canada has acknowledged that "the use of world market prices is appropriate in the case of a government monopoly for the good in question," and describes the EC regulation as providing that the use of world market prices is appropriate when "market benchmark prices in the country of provision do not exist or are unreliable." It goes so far as to claim that the "US regulations which Canada has not challenged establish essentially the same rule as that found in the EC regulation."

4.212 None of these sources supports the US position. First, the EC regulation refers to "world market" prices and "terms and conditions prevailing in the market of another country", and the US regulations to "world market price[s]", that are *available* to purchasers in the country of provision of the good. The United States' own regulation makes clear that before a "world market price" is used it must be "reasonable to conclude that such price would be *available* to purchasers in the country in question." Similarly, the EC regulation states that "when appropriate, the terms and conditions prevailing in the market of another country or on the world market which are *available* to the recipient shall be used."

4.213 Second, Canada has consistently taken the position that a price that is available to purchasers in the country of provision makes that price part of the prevailing market conditions in the country of provision. This is why Canada stated in *US – Softwood Lumber III* that in the context of a government monopoly over domestic production *import* prices for the same good if available to purchasers in Canada, could be used as a benchmark to measure adequacy of remuneration.

4.214 Third, the US mischaracterizes what was said by the Panel in *US – Softwood Lumber III*. In the paragraph cited by the US, the panel stated that "prices of *imported* goods in the market of provision can indeed form part of the prevailing market conditions in the sense of Article 14(d)". The Panel further stated that "the text of Article 14(d) SCM Agreement … does not provide for … a world market test".

4.215 Central to all of these positions is that regardless of whether domestic prices in the country of provision, "world market prices", import prices or other indicia of prevailing market conditions are used as benchmarks, such prices or conditions must be "available" in the country. If this requirement

is satisfied the benchmark will constitute part of the prevailing market conditions in the country of provision.

4.216 That is not the case here. US stumpage is not available in Canada. The good that USDOC contended was available in Canada at a world market price is *logs*, a product that is *produced from* standing timber. Canadian producers may purchase US timber "on the stump", but only where the stumps are – in the US. Stumpage is inherently local. The US is therefore reduced to arguing that prices in another country, not available in the country of provision, may be used because they are commercially available on the world market. This position is clearly inconsistent with the words of Article 14(d) and is not supported by Canada's earlier statements, the findings of the Panel in *US – Softwood Lumber III r*, or either of the EC or US regulations.

4.217 In its Closing Statement, the US asserts that it "did not simply assume trade distortion." Rather, it claims, it "determined that US law does not require an analysis of whether a subsidy has market distorting effects." At "the heart" of USDOC's final determination, however, was a conclusion that these charges result in countervailable market distortion in the US lumber market. According to USDOC, "the whole point of this investigation is to quantify and remedy the impact" of the Canadian "administered pricing" system on the US market, as its "mere existence" has "a resulting impact … on Canadian lumber production" that "distort[s] the US market." It may not now contend that "the heart" of the case – its "whole point" – was of no consequence to its determination.

3. Pass-Through

4.218 The pass-through issue in this case may be summarized as whether the US, in presuming rather than demonstrating the pass-through of the alleged stumpage subsidy to certain producers of subject lumber, has violated its obligations under the SCM Agreement and GATT 1994. The producers in question are those who buy log or lumber inputs at arm's-length. Canada has demonstrated in its submissions that a subsidy may never be presumed in a countervailing duty investigation. The US argument to the contrary is that the SCM Agreement allows it to presume the pass-through of a subsidy in aggregate investigations, regardless of any evidence establishing arm's-length transactions. However, there is no irrebuttable presumption in the SCM Agreement that allows a Member to disregard evidence establishing no subsidy. Because the US has failed to conduct any pass-through analysis regarding independent harvesters, the volume of Crown timber harvested by these entities and the amount of subsidy derived from that volume, for example, must therefore be excluded from the total amount of the subsidy. Further, no countervailing measure can lawfully be imposed on the products of lumber remanufacturers purchasing at arm's length.

4. Specificity

4.219 Even if the US had correctly determined that provincial stumpage programmes were a subsidy, it failed in the CVD FD to correctly determine that the programmes are "specific". The US finding under the "limited users" factor in Article 2.1(c) is incorrect. Even if there was a "limited number of users", the US nevertheless failed to determine that provincial stumpage programmes were "specific to certain enterprises" based on the total configuration of facts and evidence of the case.

4.220 Stumpage programmes are not used by a "limited number" of certain enterprises under Article 2.1(c). The record evidence in this case establishes that thousands of enterprises, in at least 23 standard industry categories, used provincial stumpage programmes during the period of investigation. The survey submitted by the Canadian parties showed that companies using provincial stumpage programmes during the period of investigation manufactured a minimum of 201 distinct products, many of which are not produced by USDOC's purported group of a "limited number of industries".

4.221 The US failed to analyze the record evidence regarding which enterprises and industries actually used and allegedly benefited from stumpage programmes. In the CVD FD, it simply asserted that "pulp and paper mills and the saw mills and remanufacturers which are producing the subject merchandise" were the sole users of stumpage programmes. While the US argues that "no other industries" use or allegedly benefit from stumpage, it can point to no evidence in support of its assertion. Indeed, this finding is directly contradicted by the US acknowledgement of significant amounts of log harvesting done by enterprises other than the supposed "sole users" of stumpage. The EC and Japan agree that the "limited users" finding is flawed.

4.222 Moreover, even if the US had properly identified the users of stumpage programmes, its impermissible use of the entire economy as a benchmark would mean that virtually all programmes would be specific, since virtually no programme is used by "everyone". In particular, every government programme involving the provision of a good would be specific. Unlike money, goods are not fungible and have a limited base of users who will expend the effort to procure the good. On the facts, therefore, the US determination is inconsistent with Article 2.1(c) and fails to satisfy the requirements of Article 2.4.

4.223 The existence of an alleged limited number of users does not *ipso facto* establish specificity in fact. The factors in Article 2.1(c) simply indicate that a subsidy may be specific despite being non-specific in law. A determination does not satisfy Article 2 unless it is clearly substantiated that the subsidy is in fact specific; this requires cogent reasoning and an assessment of all the evidence to translate a "limited users" finding into a determination that a government is restricting access to a subsidy in fact. Provincial stumpage programmes are not specific. The US failed to clearly substantiate its specificity determination, and has therefore violated its WTO obligations.

4.224 To determine that a subsidy is "specific " under Article 1.2 is to determine, under Article 2, that a government limits access to the subsidy to certain enterprises over other eligible enterprises. The ordinary meaning of the term "is specific to" is that the subsidy is made available to certain enterprises but not available to others. The specificity requirement is meant to capture instances where a government targets a subsidy to certain enterprises.

4.225 This is confirmed by the structure of Article 2.1; paragraph (c) must be read in the context of paragraphs (a) and (b). Under Article 2.1(a), a subsidy is specific in law where a government *explicitly* limits access to it. Article 2.1(b) provides an exception that where access is limited by objective and neutral eligibility requirements, the limitations do not establish the favouritism necessary to find specificity. Under Article 2.1(c), a subsidy is specific in fact where, instead of limiting access to a subsidy in law, a government does so through its implementation of the programme in fact. The "appearance of non-specificity", of which Article 2.1(c) speaks, is an appearance that government is *not* limiting access to a programme, when in fact it might be.

4.226 According to the US, specificity is deemed to exist where any one of the four factors in Article 2.1(c) is shown to exist without regard to why they might exist. This interpretation impermissibly reduces indicative factors to irrebuttable presumptions.

4.227 Article 2.1(c) provides that where there is an appearance of non-specificity in law, "other factors may be considered" to determine whether the government is limiting access to certain enterprises in fact. Unlike the US interpretation of paragraph (c), Canada's interpretation is based on the ordinary meaning of the word "specific", read in the context of paragraphs (a) and (b) and the chapeau of Article 2.1. For example, it would be nonsensical under Article 2.1(c) to find that a subsidy is specific in fact solely on the basis of "the manner in which discretion has been exercised by the granting authority in the decision to grant a subsidy", without any consideration of whether that manner directs the subsidy to certain enterprises. Likewise, the third factor is "the granting of disproportionately large amounts of subsidy to certain enterprises" by a government. Where there is no other explanation for the existence of such amounts, the inference under Article 2.1(c) is that the

government is directing the subsidy to certain enterprises. On a plain reading of the third and fourth factors, the analysis required under Article 2.1(c) goes to inferring government action in the application of the programme.

4.228 The specificity requirement deals with government action, and thereby requires direct evidence establishing such action. Where the government action limiting access to a programme is not explicit, evidence will necessarily be circumstantial – allowing an investigating authority to infer the targeting of a subsidy to certain enterprises based on the existence of the factors listed in Article 2.1(c). However, to "clearly substantiate" a determination under Article 2.4, an investigating authority must provide cogent analysis that establishes a high level of confidence. As the EC correctly observes, the distinction between *de jure* and *de facto* determinations is one of evidence; Article 2.1(c) does not create a different test for specificity. In assessing the evidence pertaining to the factors, the many reasons why there might be "limited users" or "predominant use", for example, are highly relevant. If these factors do not indicate government targeting action, the subsidy is not specific in fact.

4.229 The negotiating history surrounding Articles 1.2 and 2 of the SCM Agreement confirms Canada's interpretation that specificity relates to a determination that government action restricts access to the alleged subsidy. The specificity concept concerns government limitations on access, not simply patterns of "use" on the part of alleged recipients – the latter being merely indicative of the former.

4.230 The concept of "specificity" has been with the WTO and GATT for nearly two decades. It was first considered by the Committee on Subsidies and Countervailing Measures ("SCM Committee") in 1985, when the SCM Group of Experts provided it with *Draft Guidelines for the Application of the Concept of Specificity in the Calculation of the Amount of a Subsidy Other than an Export Subsidy* ("Draft Guidelines"). The Draft Guidelines set out a series of rules based on what government did to restrict the availability of a programme. Where access was restricted to certain enterprises based on non-neutral criteria, the programme was considered *de jure* specific. On *de facto* specificity, the lone paragraph (f) addressed government action affecting availability in terms of a "*de facto* deliberate[] granting [of] an advantage to certain industries." The draft language on *de facto* specificity evolved over the course of the Uruguay Round negotiations, but at all times remained concerned with the granting by government of selective access to a subsidy programme.

4.231 The US failed to convince other members to abandon the specificity requirement during the Uruguay Round. Accordingly, US countervailing duty law, the US application of the requirement in the CVD FD, and the US specificity arguments before this Panel, all attempt to re-write Article 2 of the Agreement for a "next-best" result: that a finding of "limited users" is dispositive of specificity. This interpretation of Article 2 is contrary to the ordinary meaning of the text of Article 2, read in context and in the light of the object and purpose of the Agreement and the negotiating record; it also renders the provision meaningless. The US has failed in the CVD FD to address the other explanations for any alleged pattern in the "use" of stumpage, and failed to explain why its incorrect finding of a "limited number of industries" means that stumpage is specific in fact to certain enterprises.

4.232 The US has also violated its obligations under the SCM Agreement because it failed to take into account, as explicitly required under Article 2.1(c), record evidence concerning the extent of diversification of provincial economies. In British Columbia, for example, forestry-related activity is responsible for a substantial share of economic activity. The value of forestry-related shipments totalled $C20.2 billion in 2000, accounting for more than half the value of all manufactured shipments in the province. Forestry product sales were valued at $C15.6 billion in 1998 and $C16.8 billion in 1997. Indeed, since 1995, forestry product shipments have represented approximately half the value of manufactured shipments in British Columbia. The significant share of manufacturing shipments translates to a substantial contribution to provincial gross domestic product. In 1999, the various

forest products industries accounted directly for 24 per cent of the goods-producing industries' provincial GDP, and 6 per cent of the total provincial GDP. The Final Determination does not even address this significant factual information.

5. Other Claims

(a) Calculations

4.233 The US did not correctly determine the amount of the subsidy, did not correctly calculate the subsidy per unit rate, and therefore applied countervailing duties at a rate in excess of the alleged subsidization per unit of the "subsidized and exported product." By imposing these countervailing duties the US violated Article 19.4 of the SCM Agreement. The errors of the US include:

- use of a manifestly incorrect log scale conversion factor;
- massive inflation of the subsidy amount used in the numerator in its subsidy per unit calculation; and
- understatement of the denominator in the flawed calculation methodology it chose.

4.234 In response to Canada's claims, the US simply argues that, "[t]he sole calculation requirement in Article 19.4 is a requirement to calculate the subsidy on a per-unit basis; Article 19.4 does not establish any other requirements concerning how the subsidy is to be calculated." The US position is untenable.

4.235 The US concedes that Article 19.4, "establishes an upper limit on the amount of the countervailing duty that may be levied" and that it requires calculation of the subsidy "on a per-unit basis." Thus, the US agrees with Canada that Article 19.4 establishes requirements in calculating a subsidy rate. However, the US claims that it has no obligation to *correctly* calculate that rate. The US is therefore arguing that a Member may impose countervailing duties at any rate it wishes, as long as it is not in excess of *a* subsidy per unit rate, *however arrived at*.

4.236 Article 19.4 is the sole provision establishing an upper limit to the countervailing duty rate to be imposed. Other provisions set out what constitutes a subsidy and what the total amount of that subsidy is; only Article 19.4 sets out any discipline on what the maximum *countervailing duty* rate may be. To give proper effect to Article 19.4, that discipline must require a per unit subsidy rate correctly calculated, based on a subsidy amount correctly derived, as against a practice correctly determined to be a subsidy.

4.237 The US alleges that the conversion factor mentioned in the Minnesota Public Stumpage Price Review and Price Index ("Price Report") "only applied to the data contained in Table 2", while the US used only "sawtimber data in Table 1." But the statement on the cover of the Price Report says that, "All reported volumes and values were converted to a sawlog and pulpwood basis for inclusion in Table 1."

4.238 Where "converted" data are based on a specific conversion factor, to ignore the specified factor is to render the data hopelessly distorted and therefore useless. In this case, as a result of the choice of conversion factor, subsidies were found where none existed; and, in any event, subsidies were found using an improper cross-border analysis. The use of a single, and incorrect, conversion factor highly inflated the alleged subsidy per unit rate.

4.239 A conversion factor was necessary in the first place because the US elected to compare tree volumes and values in certain US jurisdictions, to widely disparate trees across Canada. The effective use of a single factor for most of these conversions created significant distortions in the assessment of whether any stumpage benefit even exists, as well as in the subsequent subsidy calculations. The US had a draft report prepared by an economist of the US Forest Service on the record that demonstrates

the irrationality of its approach to conversion factors. The report notes that "[t]o properly compare prices, conversion factors must be tailored to the measurement system used in order to adjust for any bias that may have developed." The bias referred to is the tendency for contemporary prices expressed in board feet to underestimate lumber yield and boost stumpage prices to a degree that cubic measurements do not. In addition, the very publication that the US used to choose its conversion factors explicitly stated that smaller logs, like those in Canada, require use of much larger factors than the US used.

4.240 The alleged subsidy at issue was the provision of "timber" at less than adequate remuneration. The allegedly subsidized merchandise subject to the countervailing duty was softwood lumber and certain products manufactured from that lumber. The alleged subsidy per unit may not properly be calculated using more than the volume of wood actually used in the subject merchandise. The portion of a log that becomes sawdust is not used in the production of lumber; equally, logs destined for the production of posts are manifestly not used in the production of softwood lumber.

4.241 The alleged subsidy attributable to the subject merchandise was easy to trace and just as easy to calculate: out of the total volume of logs entering sawmills, the portion used in the manufacture of lumber created the only possible "subsidy" to the production of lumber and lumber products. Logs used in the production of posts or poles, and the portion of logs that ended up as chips, did not involve a subsidy attributable to softwood lumber.

4.242 An accurate calculation of the subsidy per unit rate of the exported product required that only the volume of logs used in the softwood lumber products be reflected in the numerator; the denominator would then be limited to the output lumber products from those logs. Because Article 19.4 refers to the subsidy per unit rate of the allegedly "*subsidized and exported* product", the proper starting point would have been for USDOC to have determined the correct amount of the subsidy attributable to the subject merchandise – softwood lumber products.

4.243 USDOC claims that it corrected for its overbroad numerator by expanding the denominator to include the value of the non-lumber products whose volumes had dramatically increased the numerator. USDOC failed to do this; however, even if it had, this approach would not cure the bias or the subsidy inflation. Non-lumber products account for a significant volume of products produced from softwood logs entering sawmills. Yet, typically, the value of non-lumber products such as chips or sawdust is low when shipped from the sawmill. Further, chips and sawdust are input products to other more expensive products such as pulp and paper. By including the volume of these non-lumber products while not accounting in the denominator for the full value of the products included in the numerator, the per unit subsidy calculation was significantly inflated.

4.244 The United States, having adopted a methodology that grossly inflated the subsidy amount, then did not include the value of all the non-lumber products in its denominator. It seriously understated the denominator because 1) it did not include softwood "residual" products produced in sawmills, and 2) it used a wholly inaccurate and understated sales value for remanufactured products.

(b) Conduct of the Investigation

4.245 With respect to its choice of Minnesota as benchmark state for Saskatchewan and Alberta, the US claims that the responding parties should have had notice of the possibility of that choice. For this reason, it argues, its failure to notify the responding parties of the change from Montana to Minnesota did not violate Article 12.8.

4.246 Canada recalls footnote 225 of the First Written Submission of the US. An oblique reference, *in a countervailing duty petition*, to the entirety of the US as a potential source of benchmark does not amount to the disclosure of the "essential fact" of Minnesota as a benchmark state by *the US*. Canada notes the new US argument that only a few of the fifty states were reasonably to be considered as

candidates for serving as benchmark. In this respect, Canada recalls the findings of the US in the Preliminary Determination in this case, where USDOC stated, "[I]nformation on the record indicates that stumpage in the United States along the border with Canada is comparable to Canadian stumpage …. we only compared stumpage prices in each Canadian province *with stumpage prices in states bordering that province*." [emphasis added]

4.247 Canada also recalls the statement of the US to the panel in *US – Softwood Lumber III*, "Even within the United States, not all timber prices are appropriate. … Commerce did not use prices from the large timber-growing areas in the southeast, *or from any non-contiguous state*, because as a matter of commercial reality, Canadian lumber producers do not consider it commercially viable to transport logs over that long a distance." [emphasis added]

4.248 The only notice given to the responding parties was that data from a state "bordering" the province in question would be used. A state that is at least 700 km from the closer of the two provinces is not a "contiguous" state. Minnesota is not a state that borders either Saskatchewan or Alberta. There was no notice of the choice of Minnesota as a benchmark state. The US violated Article 12.8.

F. SECOND WRITTEN SUBMISSION OF THE UNITED STATES

4.249 The following summarizes the United States' arguments in its second written submission.

4.250 The standard of review set forth in Article 11 of the DSU applies to disputes arising under the SCM Agreement. Article 11 requires a panel 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." In conducting this inquiry, the Panel may only address those provisions of the covered agreements that Canada cited in relation to specific claims in its request for the formation of a panel. With few citations to the record, Canada recites a laundry list of facts and figures in support of its arguments, failing to note the substantial record evidence that contradicts its arguments. Canada is asking the Panel to step into the shoes of USDOC and engage in a *de novo* review and evaluate the facts. It is well-established, however, that panels may not engage in such an exercise.

4.251 The parties' answers to the Panel's questions have confirmed that companies enter into tenure agreements with the provinces for the sole purpose of obtaining timber. In return for fulfilling the tenure obligations and paying the stumpage fee, the tenure holder acquires ownership of the timber, not a "right" to harvest timber.

4.252 The ordinary meaning of "goods" is broad and encompasses, at the very least, all tangible property, including "growing crops, and other identified things to be severed from real property." Simply labeling standing timber a "natural resource" does not remove it from the ordinary meaning of the term "goods." Canada has acknowledged that provincial tenures identify specific, defined areas of forest from which the tenure holder may harvest trees. The identified trees to be severed from provincial land fall squarely within the ordinary meaning of the term "goods."

4.253 Canada's argument suggests that tenures are simply about forest management obligations that, almost incidentally, also confer an intangible "right" to harvest. Canada's analytical approach is based on the flawed premise that the existence of a financial contribution is a matter to be determined from the government's perspective. However, a financial contribution, as defined in Article 1.1(a)(1)(iii) of the SCM Agreement, exists whenever the government provides a good. As the *US – Softwood Lumber III* panel recognized, the existence of a subsidy is determined from the perspective of the benefit to the recipient, not the perspective of the government. Specifically, the *US – Softwood Lumber III* panel found that in spite of the fact that the provincial governments have certain policy objectives, "the fact of the matter remains that from the harvesting company's point of

view, the only reason to enter into such tenure or licensing agreements is to cut trees for processing or sale."

4.254 As detailed in the United States' response to the Panel's questions, the record demonstrates that tenure holders do not acquire a freely transferable "right" to harvest. All provinces prohibit the transfer of tenures without government approval. Without any citation to record evidence, Canada asserts that the right to harvest is freely transferable, without approval. There is an obvious conflict, however, between the record evidence and Canada's suggestion that tenure holders may freely sell or subcontract the "right to harvest." Despite Canada's efforts to sever the right to harvest from the sale of the trees, the facts demonstrate that tenure holders are buying trees. In doing so, the provinces make a financial contribution within the meaning of Article 1.1(a)(1)(iii) of the SCM Agreement.

4.255 As the United States pointed out in its first written submission, the *Canada – Aircraft* panel stated that a benefit exists where "the financial contribution places the recipient in a *more advantageous position than would have been the case but for the financial contribution*." In reviewing that report, the Appellate Body affirmed that a benefit exists where "the 'financial contribution' makes the recipient '*better off*' *than it would otherwise have been, absent that contribution*." In determining the existence of a benefit, therefore, the issue is the position of the recipient "but for" or "absent" the government's financial contribution.

4.256 Moreover, the Appellate Body has stated that the point of comparison is "the marketplace," i.e., a benefit exists where the financial contribution is received on terms more favorable than those available in the market. Finally, as the United States has pointed out, following the reasoning of the Appellate Body in *Canada – Aircraft*, the *Brazil – Aircraft* panel concluded that the concept of a comparison market necessarily means a "*commercial* market, i.e., a market undistorted by the government's financial contribution."

4.257 Canada erroneously argues that the *Brazil – Aircraft* report is inapposite because that panel was considering Article 14(b) of the SCM Agreement, which establishes commercial lending rates as the benchmark for a government loan. The panel found that the financial contribution at issue was in the form of a non-refundable payment, however, rather than in the form of a loan. Thus, as Canada argued in that case, the payments at issue were "essentially grants." In the passage cited by the United States, the *Brazil – Aircraft* panel was not discussing Article 14(b) of the SCM Agreement. In fact, there is no reference at all to Article 14 of the SCM Agreement in the panel's report. Rather, the panel was discussing the concept of benefit generally. The panel's reasoning, which follows logically from the findings of the Appellate Body, is compelling. Only by comparison to a market undistorted by the government's financial contribution is it possible to determine whether the recipient is better off than it otherwise would have been absent the financial contribution. That is true regardless of the form of the financial contribution.

4.258 Article 14 does not redefine the concept of benefit in Article 1.1(b), as interpreted by the Appellate Body and prior panels. Article 14 merely provides guidelines that must be followed in establishing "methods" for applying that concept to particular types of financial contributions. Each guideline in Article 14, including Article 14(d), must therefore be interpreted in a manner that is consistent with the interpretation of the term "benefit" as used in Article 1.1(b) of the SCM Agreement.

4.259 When the government provides a good, Article 14(d) states that a benefit is conferred if the government receives "less than adequate remuneration" for that good. Applying the reasoning of the Appellate Body, "less than adequate remuneration" must mean a price less than would otherwise be available in the marketplace absent the government's financial contribution. The proper benchmark therefore is an independent market-driven price for the good, i.e., fair market value – which is also the standard applied under Canadian law.

4.260 Article 14(d) does not specify the type of evidence that must be used to establish the fair market value of goods in the country of provision. Rather, Article 14(d) establishes the general principle that adequate remuneration (fair market value) must be determined "in relation to prevailing *market* conditions" in the country of provision. There is no basis in the SCM Agreement to conclude that "benefit" means anything less when the government provides a good than when it makes any other type of financial contribution. Thus, "market" conditions must be interpreted in a manner consistent with the concept of benefit in Article 1.1(b) of the SCM Agreement. Following the reasoning of the Appellate Body and the *Brazil – Aircraft* panel, therefore, the point of comparison under Article 14(d) must be prevailing commercial market conditions, i.e., a market undistorted by the government's financial contribution, in the country of provision. It is the view of the United States that where such benchmark prices exist in the country of provision, they must be used. However, where such benchmark prices do not exist in the country of provision or are unreliable, a Member may, consistent with Article 14(d), rely on data from outside the country of provision to assess the fair market value of the goods in the country of provision. This is the case with respect to Canadian timber.

4.261 As the United States demonstrated in its response to the Panel's questions, the actual data on private stumpage prices is virtually non-existent for four of the six provinces. Canada does not dispute the fact that Manitoba and Saskatchewan did not provide any data on private stumpage prices. With respect to Alberta, as the United States explained in response to the Panel's questions, the record demonstrates that the Timber Damage Assessments ("TDAs") that Alberta provided are simply voluntary guidelines for settling disputes for damages. Moreover, TDAs are based on *log* prices and do not differentiate between private and Crown logs. With respect to B.C., Canada acknowledges that the evidence provided establishes that the private market for stumpage in B.C. is "limited" and that "nearly all private wood fibre sales are of logs rather than standing timber." The data on sales of standing timber accounted for only 0.1 per cent of the B.C. harvest.

4.262 Recognizing the lack of any private stumpage benchmark data for these four provinces (Alberta, B.C., Manitoba, and Saskatchewan), Canada continues to argue, without any basis in the SCM Agreement, that evidence demonstrating that the provinces made a profit on their timber sales suffices. A benefit, however, is not determined based on the cost to the government in making the financial contribution, e.g., whether the government incurred a loss. The issue is whether there is a benefit to the recipient.

4.263 With respect to Ontario and Quebec, as discussed in response to the Panel's questions, some data on private stumpage prices exists. However, prices that are distorted by the government's financial contribution do not reflect "market" conditions. It is undisputed that Canadian timber sales are overwhelmingly dominated by the provincial governments. The fact that the government is a price leader does not in and of itself establish the absence of independent commercial market conditions. As the Appellate Body has cautioned, however, governments have the ability to obtain certain results from the market by shaping the circumstances and conditions in which the market operates. The dominance of the government in the marketplace can, therefore, warrant further examination in determining the adequacy of remuneration for government-owned goods. Ultimately, as noted by the European Communities, the issue must be determined on a case-by-case basis.

4.264 The facts of this case demonstrate that the provincial governments not only dominate the Canadian timber market, but also that the governments do not participate in the market as commercial actors. Rather, the provincial governments administer the sale of the overwhelming majority of Canadian timber in a manner designed to further social policy goals. The evidence further demonstrates that, as a result, the administration of provincial timber sales systems distorts the small private timber market.

4.265 All of the provinces generally restrict the sale of Crown timber to purchasers that own a processing facility in the province. These local processing requirements artificially reduce the

demand for Crown timber. In addition, the vast majority of Crown timber is under some form of renewable ("evergreen"), long-term tenure. These tenures are not freely transferable. The existence of evergreen, non-transferrable tenures creates significant barriers to entry into the timber market. For example, Canada offers no support for its assertion that a newcomer in Quebec could obtain a provincial tenure, even though 100 per cent of the Crown timber is currently under tenure or reserved and not subject to harvest. Nor does Canada reconcile this claim with its subsequent statement that the vast majority of mills in Quebec are "shut out of the public forest." Moreover, "transfers" of tenure are, in fact, normally cases in which the entity that holds the tenure is acquired. No new tenure is created in such cases.

4.266 Other aspects of tenures artificially increase supply. For example, B.C. imposes minimum cut requirements and restricts mill closures, thus forcing tenure holders to harvest timber even in down markets and thereby artificially increasing the supply of Crown timber. Nevertheless, the record demonstrates that, during the period of investigation, tenure holders in all of the provinces except Alberta did not harvest their full AAC, thus demonstrating an ample supply of additional Crown timber available at administered prices.

4.267 Central to each of the provincial systems is, of course, administered rather than competitive pricing of that timber supply. The evidence demonstrates that the price leaders, i.e., the provincial governments, do not price to the market. Rather, they administer prices under systems designed to promote employment and keep mills operating even in down markets.

4.268 A study by Economists Inc. ("EI Study"), which the United States found compelling, addressed the impact of the administered provincial systems on the private market. The EI Study applied generally accepted economic analysis to demonstrate that when a single supplier controls the overwhelming portion of market share, that supplier will necessarily influence non-administered prices. It found that "[t]he lower the market share of the firms in the non-administered sector relative to the administered sector, the less the ability of the non-administered sector to raise price above the administered (subsidized) level." The essence of this analysis is that private (non-administered) sellers cannot increase prices significantly above administered price levels of the competing supply because, if they did, demand would shift to the administered sector. The study referred to record evidence establishing that provincial governments not only supply the vast majority of timber, but also are willing to provide yet more timber to the major licensees that comprise most of the demand. The study showed that if private landowners attempted to raise their prices significantly above government-set levels, the major licensees would rely relatively more on administered timber sales and less on private or auctioned timber. Therefore, while local variations will exist, overall the government price effectively sets the average province-wide price as well.

4.269 Canada criticizes this study and cites to other evidence it finds compelling. The issue, however, is not which evidence Canada finds persuasive. The issue is whether the record evidence supports the United States' determination. The EI Study and other record evidence, some of which is summarized in the United States' first written submission and oral statements at the first substantive meeting of the Panel, support that determination. There also is significant documentary evidence confirming this economic analysis and demonstrating that each provinces' system of public timber sales distorted private timber prices.

4.270 The evidence demonstrates that the provincial governments shape the timber market to achieve public policy goals, and that the government-controlled, public-policy driven sector of the timber market distorts the private timber market. There was therefore ample support for the United States' conclusion that there are no independent, market-driven timber prices available in Canada. The United States' use of data from other sources to assess the fair market value of timber in Canada was therefore warranted and was consistent with Article 14(d) of the SCM Agreement.

4.271 The evidence also supports the United States' decision to use timber prices in the northern United States, properly adjusted to reflect conditions of sale in Canada, as an alternative source for assessing the fair market value of timber in Canada. The rationale for the United States' choice of data for establishing market benchmarks is sound. As the United States explained in its first written submission, the value of timber depends on the demand for the downstream products. US and Canadian timber satisfies the same demand in the integrated North American lumber market, and Canada has no comparative advantage in serving that demand. In addition, the record demonstrates that US timber is commercially available to lumber producers in Canada. The US timber is also comparable to Canadian timber, and the United States established species-specific, province-specific benchmarks to conduct the comparison.

4.272 In response to the Panel's questions, Canada stated that out-of-country benchmarks that are available to purchasers in the country of provision would be suitable benchmarks because they "would then form part of prevailing market conditions 'in' the country of provision." As discussed in the Final Determination, the evidence demonstrates that US timber is, in fact, commercially available to lumber producers in Canada. Further, Canada asserts that the United States could have used an alternate methodology, i.e., evaluation of the government's prices based on evidence of the government's costs and profitability. The standard is not the cost to the government, but rather the benefit to the recipient. We have demonstrated that the use of prices for US timber in the northern United States, adjusted for differences in conditions of sale in Canada, is consistent with Article 14(d) of the SCM Agreement.

4.273 Canada cites to Articles 10, 19.1, 19.4, and 32.1 of the SCM Agreement and Article VI:3 of GATT 1994 as the basis for its calculation-related claims. As the United States previously indicated, Canada's claims under Articles 10, 19.1, and 32.1 of the SCM Agreement are necessarily derivative claims that cannot succeed because Canada has failed to establish that the United States has breached its obligations under another provision of the SCM Agreement.

4.274 Canada admits that neither Article 19.4 of the SCM Agreement nor Article VI:3 of GATT 1994 contain any obligation regarding the methodology a Member may use in calculating the *ad valorem* subsidy rate. None of the provisions of the SCM Agreement that Canada cited in support of its claim establish the calculation obligations Canada suggests the United States has violated. Given that a panel's terms of reference "establish the jurisdiction of the panel by defining the precise claims at issue in the dispute," and that the identification of the specific provision of the covered agreements is a "minimum prerequisite" for stating the legal basis of the claim, this Panel should reject Canada's attempts to bootstrap claims that the *ad valorem* rate calculation is inconsistent with other provisions of the SCM Agreement.

4.275 Article 19.4 of the SCM Agreement and Article VI:3 of GATT 1994 merely provide that the countervailing duty rate imposed may not exceed the amount of the subsidy the investigating authority has found to exist. Neither provision contains particular calculation obligations of the sort Canada asserts have been violated. Canada, therefore, has failed to present a *prima facie* case on this issue.

4.276 The United States' calculation of the *ad valorem* subsidy rate is consistent with the SCM Agreement and the evidence developed through the investigation. The United States included in the numerator the volume of provincial softwood timber entering sawmills, multiplied by the benefit per cubic meter. This method captured the total value of the subsidy provided to sawmills. The United States then allocated that benefit over all sales of products that resulted from the lumber production process. This methodology accounted for the fact that the production process yields other products as well as lumber.

4.277 The United States conducted this investigation on an aggregate basis, calculating the total benefit provided by each province, as discussed above. Canada does not dispute the United States'

authority to conduct this aggregate analysis, but it continues to assert that the United States was obligated to conduct a pass-through analysis to establish the amount of any benefit received by certain producers of the subject merchandise, i.e., independent remanufacturers.

4.278 In Canada's first response to the Panel's questions, it acknowledged that, "[w]here the timber harvester and the producer of subject merchandise are the same 'recipient' of the alleged subsidy, no pass-through analysis would be required." This fact pattern describes the vast majority of the producers of the subject merchandise and includes both sawmills and remanufacturers. Thus, Canada's statement acknowledges that the United States was not required to conduct a pass-through analysis for at least the vast majority of the lumber at issue.

4.279 Canada also fails to address Article 19.3 of the SCM Agreement, which specifically allows Members to apply definitive countervailing duties to exports of an uninvestigated exporter or producer as long as the exporter or producer may obtain an expedited review to establish its own rate.

4.280 Additionally, Canada overreaches when it contends that a "[s]ubsidy pass-through analysis is required in every instance where the subsidy found to exist is allegedly bestowed on one person while the countervailing duty is imposed on the products of another." Canada's attempt to read such an obligation into Article 19.4 of the SCM Agreement has no basis in the text. If Canada were correct, every time a Member investigates one or more companies and applies their subsidy rate to uninvestigated exporters or producers – a common practice – that Member violates the SCM Agreement. Such practices do not, however, violate the SCM Agreement, as evidenced by the last sentence of Article 19.3 of the Agreement.

4.281 Canada argues that the United States understated the denominator by failing to include the value of certain "residual products" in the denominator. Canada failed to submit any evidence from which the United States could separate the value of additional products resulting from the lumber production process from the broader residual products category. Accordingly, the United States did not include the residual products category in the denominator. Canada also disputes the value used to represent remanufactured products that the United States selected and used in the denominator. As noted above, the Panel should decline Canada's request to engage in a *de novo* review and re-weigh the evidence before the administering authority.

4.282 In its questions to the parties, the Panel requested Canada to address how the conversion factors that the United States used were based on "manifestly incorrect data." Canada failed to provide the information the Panel requested. Instead, Canada cited alternative sources of conversion factors. The existence of alternative sources, however, does not mean that the United States' selection was "manifestly incorrect."

4.283 Article 2.1(c) of the SCM Agreement contains clear and objective criteria for determining when a subsidy is specific. Where a subsidy programme is used by a limited number of "certain enterprises" – i.e., an enterprise, industry, or group of enterprises or industries – it is specific in fact. Other than considering the extent of diversification of economic activities and the length of time the subsidy programme has been operating, Members are not obligated to conduct any further specificity analysis.

4.284 The United States met its obligation to demonstrate that provincial stumpage subsidies are specific and thus actionable under the SCM Agreement. In the Final Determination, the United States found that the users of stumpage were a "limited group of wood product industries" that included "pulp and paper mills and the saw mills and remanufacturers which are producing the subject merchandise." The industries comprising this limited group fall squarely within the ordinary meaning of the term "industry," which identifies industries by general product, such as automobiles or textiles, or by the type of activity engaged in, such as mining or banking. Thus, the provincial stumpage subsidies are specific under Article 2.1(c) of the SCM Agreement.

4.285 Canada responds to this finding by attempting to rewrite the specificity test, seeking to redefine terms such as "industry" and "group," and to create exceptions that do not exist in Article 2. For example, Canada claims that the term "industry" requires a "product-based identification of industries," such that individual industries would be distinguished on the basis of a particular end product, or set of end products, that they make. By contrast, both in its ordinary meaning, and within the context of Article 2 of the SCM Agreement, "industry" is used broadly, referring to makers of a general class of products – such as "the steel industry" – regardless of the number or diversity of end products that the industry produces.

4.286 Canada itself admits, in response to question 27 from the Panel, that a subsidy to a single large industry *could* be found specific, even where its producers make a vast diversity of products, as in the steel, automobile, textile, and telecommunications industries. This admission contradicts Canada's argument that an "industry" must be defined narrowly on the basis of a particular end product or set thereof.

4.287 Canada likewise admits that a subsidy granted solely to auto and textile producers could be specific under Article 2.1, notwithstanding the dissimilarity of their end products. It nonetheless still insists that the two industries cannot form a single "group" of industries that is specific within the meaning of Article 2.1(c). Instead, Canada maintains that "the industries producing 'autos' and the industries producing 'textiles'" are actually "two groups of industries" that "appear to be a 'limited number' of certain enterprises," and thus specific. Notwithstanding Canada's acceptance of diversity in the product mix of an "industry," Canada finds such dissimilarity incompatible with its view of the term "group," which for Canada requires "similarity and relatedness" of output products. In its ordinary meaning, and in the context of Article 2 of the SCM Agreement, the definition of "group" is far more straightforward, meaning simply "more than one" enterprise or industry, without regard to the "similarity or relatedness" of their end products.

4.288 Canada continues to argue that each industry is defined by a narrow class of end products, claiming that the "immediate users of stumpage" include "at least 23 categories of industries, and the industries are as unrelated as lumber, agricultural chemicals, paper, and furniture." This argument is not only legally flawed, it rests on misleading evidence. Canada's key exhibit is a survey of forest product industries that lists 201 products made by tenure holders, categorized into 23 categories that Canada claims to be different industries. In reality, Canada's list of industries is little more than an exercise in hairsplitting – assigning multiple industries to a single sawmill based on its output.

4.289 The fact remains that the vast majority of tenures in Canada are entered into directly between the provincial governments and "wood processing facilities," and in most instances only wood processing facilities – such as sawmills that produce lumber – are eligible to obtain a tenure contract. The record clearly demonstrates that provincial stumpage is used by an extremely limited group of industries in Canada. Changing the definition of "industry" cannot change the objective facts.

4.290 The Panel likewise should reject Canada's attempt to create exceptions to the specificity test contained in Article 2.1(c) of the SCM Agreement. Nothing in the text of Article 2 permits an actionable subsidy to escape the disciplines of the SCM Agreement based on the intent of the granting Member or the "inherent characteristics" of a good provided at below market rates. Nor does Article 2 require the "limited number of certain enterprises" to be established relative to the "eligible users," as Canada claims. Finally, the Panel should dismiss Canada's contention that a finding on the "limited number" prong is not sufficient to support a determination of specificity under Article 2.1(c). Both the language and underlying logic of Article 2.1(c) make clear that it is unnecessary to make findings on all prongs of the test for a determination of specificity in fact. The provisions of the SCM Agreement are clear, and the United States has met those obligations. Canada should not be permitted to rewrite the Agreement in a manner more to its liking.

4.291 Canada claims that the United States' final decision, in response to comments from Canadian parties, to use data from Minnesota as the basis for calculating the market benchmarks for Alberta and Saskatchewan was inconsistent with Articles 12.1, 12.3, and 12.8 of the SCM Agreement. The United States' conduct of this investigation was entirely consistent with its obligations.

4.292 Canada's claim under Article 12.1 is premised on the assertion that parties were denied the right to present evidence because the use of alternative states, such as Minnesota, had not been an issue in this investigation. The use of northern US states generally, and the issue of the benchmark state to use for Alberta and Saskatchewan specifically, were very much at issue. Moreover, all parties had ample opportunity to present information and argument on this issue, as evidenced by Saskatchewan's proposal that the United States use Alaska instead of Montana.

4.293 Canada's claim under Article 12.3 of the SCM Agreement is equally unfounded. Canada has failed to cite to a single piece of record information on market benchmarks to which the parties were denied access.

4.294 Finally, Canada acknowledges that nothing in Article 12 suggests that an investigating authority must engage in endless cycles of notice and comment. Nevertheless, Canada's claim under Article 12.8 is based on the erroneous premise that Article 12.8 requires the investigating authority to provide an opportunity for notice and comment with respect to the final decision made on each issue before the determination becomes final. Nothing in Article 12.8 imposes such a requirement.

4.295 In the context of the SCM Agreement, the "essential" facts are those that are necessary to determine whether definitive measures are warranted. A market benchmark is certainly essential to a determination of adequate remuneration, but all of the facts "under consideration" with respect to the calculation of the market benchmarks were made known to the parties. Significantly, Article 12.8 of the SCM Agreement refers to the "essential facts *under consideration*." Thus, by its own terms, Article 12.8 is concerned with the ongoing investigative process during which the investigating authority is still "considering" the facts. Article 12.8, therefore, cannot be interpreted to apply to the investigating authority's final decision, at which point the issues have been decided and the facts are no longer "under consideration."

4.296 Article 12.8 does not impose any specific method of informing the parties of the "essential facts under consideration." Rather, it specifies that the process used must inform parties "in sufficient time for the parties to defend their interests." The United States' procedural rules are designed to guarantee a very open and transparent process in order to accomplish this goal, which was achieved in this case.

4.297 The record establishes that the United States provided parties with ample opportunity to provide information and argument on whether the Maine stumpage price should include studwood and pulpwood. Quebec submitted considerable information and argument on this very issue. In the end, the United States agreed with Quebec and adjusted the benchmark calculation accordingly. Canada claims, however, that the United States withheld information from the parties and denied them the opportunity to prepare presentations on the basis of that information, in violation of Article 12.3 of the SCM Agreement. The information allegedly withheld is the December 20, 2001, letter from the Maine Forest Products Council ("MFPC"). As discussed in response to the Panel's questions, this information was provided to the parties in time for them to prepare presentations on the basis of that information. Neither party was afforded an opportunity for sur-rebuttal and there is no obligation in Article 12 to provide such an opportunity.

4.298 The thrust of Canada's claim is a wholly unsubstantiated allegation that the United States intentionally withheld the MFPC Letter. The US regulations for the filing of information require the parties submitting the information to ensure that the information is placed on the record and provided to all interested parties. The MFPC Letter was not filed in accordance with those regulations.

Canada's claim that the United States acted inconsistently with Article 12.3 of the SCM Agreement must therefore fail.

4.299 For the reasons set forth above as well as in the United States' first written submission, oral statements at the first substantive meeting of the Panel, and first response to the Panel's questions, the United States requests that the Panel reject Canada's claims in their entirety.

G. SECOND ORAL STATEMENT OF CANADA

4.300 The following summarizes Canada's arguments in its second oral statement.

1. Financial Contribution

4.301 The ordinary meaning of "goods" is movable, tangible items. Immovables – such as buildings, roads, mineral deposits and trees in the forest – are not goods. Intangible rights, whether concerning intellectual property or real property, are not goods. In the facts of this case, tenure agreements and licences convey a right to harvest trees in a defined area. This is a right in respect of real property, and with that right come obligations that run regardless of any harvest; the right exists even in respect of trees that have not yet been planted. This right is in respect of an immovable – a standing tree – that is not a good; and it is a right in respect of something that may not even exist at the time the right is conveyed. It is an intangible and therefore not a good.

4.302 The ordinary meaning of "goods" excludes intangibles. An intangible right does not become a "good" just because it is a factor enabling the creation of a good. An intangible right does not become a "good" just because the right holder's objective is to produce a good. Harvesting rights permit the holders to produce logs; however, rights are distinct from the trees to which they attach. Harvesting rights are also distinct from the good, the log, which is not produced until the harvester invests the effort and incurs the significant costs of harvesting and processing standing timber into logs. The provision of rights is not the same thing as the provision of goods.

4.303 The ordinary meaning of goods also excludes immovables subject only to limited exceptions. Among these exceptions are growing crops and "timber to be cut" that is identified in a sales contract. A timber sales contract covers specific *trees*; it does not cover just *any* trees that are or may be found in an identified area. Tenure agreements do *not* relate to identified trees, but as conceded by the US in its Second Written Submission, they relate to an identified *area*. Non-identified trees, whether or not they are in an identified area, are "immovables" and because they do not fit within the exception, they are not goods. The provision of immovables is not the same thing as the provision of goods.

4.304 The definition of subsidy has two elements. Financial contribution relates to what the government does, benefit to what the recipient receives. Article 1.1(a)(1) does not require a determination as to what the recipient ends up with at the end of the day or why the recipient enters into a given relationship with a government; rather, it requires a determination as to what the government provides. The government, in this instance, does not provide "cut timber".

4.305 Harvesters subject to a tenure or licence assume a variety of forest management obligations for the period of the tenure or licence over the area covered by the tenure or licence. These obligations run regardless of the harvest of any trees. Tenures and licences do not involve the sale of anything – they involve the conferral of harvesting rights. The United States has admitted that tenures and licences involve identified areas. They do not involve identified trees. Standing trees under tenures and licences are not "goods" for the purposes of the SCM Agreement.

4.306 A right to harvest standing timber is an intangible interest in respect of real property and is therefore not "goods"; standing trees with roots firmly in the ground are immovables and therefore not "goods". Stumpage programmes do not provide goods and do not constitute a financial contribution.

2. Benefit

4.307 Article 14(d) requires that the adequacy of remuneration be determined and measured on the basis of "*prevailing* market conditions … *in* the country of provision". Accordingly, benefit must be determined on the basis of existing market conditions in Canada. Article 14(d) does not permit benefit to be determined and measured using benchmarks that are outside the country of provision. It also does not permit an investigating authority to measure adequacy of remuneration by comparing the government price to a hypothetical "fair market value".

4.308 This interpretation of Article 14(d) is consistent with the Appellate Body's analysis of Article 1.1(b) in *Canada – Aircraft*. In that case, the Appellate Body directed a comparison that is to be informed by what the recipient can obtain in the market. The Article 1.1(b) "market" in a provision of goods context under Article 14(d) is the actual "market" as it exists in the country of provision.

4.309 The US reliance on an extract from the second implementation panel in *Brazil – Aircraft* to argue that the comparison market must be a market undistorted by the government's financial contribution is misplaced. First, *Brazil – Aircraft* did concern the standard set out in Article 14(b). At issue in that case was whether the PROEX payments made by the Brazilian government to certain banks resulted in a benefit to purchasers of Brazilian aircraft. In order to determine this, the panel looked at the impact of the PROEX payments on the terms and conditions of the *export credit financing* available to the purchasers of these aircraft. Therefore, though unstated, this part of the decision did in fact turn on the standard set out in Article 14(b).

4.310 Second, the reference to an undistorted market should be seen in its proper context – that is, against the background of the original case. The panel determined in that case that the comparison must be to the market for commercial lending rates and not another government market. The panel did not find that a commercial or private market rate or price cannot be used as a benchmark if there is government involvement in the marketplace.

4.311 The Appellate Body's decision in *US – Countervailing Measures on Certain EC Products* also provides no support for the rejection by the US of the in-country evidence submitted by Canadian provinces. First, the Appellate Body's decision was made in a different context that did not consider the explicit language of Article 14(d). Second, while that case involved consideration of the presumption at issue in arm's-length sales by government, the plain language of Article 14(d) governs this case. In the present case, the SCM Agreement's plain language requires a benefit determination based on benchmarks that reflect the "prevailing market conditions … in the country of provision". This language establishes a clear rule, not a "presumption" that might be rebutted in limited circumstances.

4.312 The central issue before this Panel with respect to benefit is whether the SCM Agreement requires investigating authorities to use in-country evidence to determine adequacy of remuneration. Canada's purpose in presenting the in-country evidence on the record in this case is to demonstrate that (i) the record contained substantial evidence of prevailing market conditions in Canada that should have been used to determine adequacy of remuneration, and (ii) even if *arguendo* the US was permitted to reject this evidence, the reasons it offers fail to stand up to any objective scrutiny.

4.313 In its Second Written Submission, the US has again conceded that data on private stumpage in both Québec and Ontario exist. With respect to the TDAs, this data was developed by opposing commercial interests in Alberta to establish the market value of healthy standing timber. In addition, the four primary exporting provinces all provided evidence that showed that their stumpage programmes are administered consistent with market principles. Similarly, BC provided economic evidence that reinforced this conclusion. Finally, the United States' focus on alleged flaws in how

public timber prices are set is misplaced as these are irrelevant to the benchmarks required under Article 14(d).

4.314 The US rationalizes the rejection of in-country evidence by discussing certain forest management practices that allegedly demonstrate that the provinces distort private timber markets. In particular, the United States makes selective reference to appurtenancy requirements, alleged restrictions on the transfer of tenures and annual allowable cuts in specific provinces. None of these practices were the subject of the investigation. Further the Final Determination contains no analysis that demonstrates that the provinces' management of their stumpage programmes distorted the market. Rather, USDOC relied on the Preamble to presume price suppression and supported this presumption with anecdotal evidence and a flawed economic analysis. In any event, as the panel in *US – Softwood Lumber III* found, Article 14(d) does not allow an investigating authority to decline to use in-country prices because they may be affected by the government's financial contribution.

4.315 Article 14(d) requires that adequacy of remuneration be determined using prevailing market conditions in the country of provision. Market prices available on the world market can become part of prevailing market conditions "in" the country of provision where there are imports of the good into the country of provision. If there are imports at a given price, then the price is no longer an out-of-country price, but rather is part of the prevailing market conditions in the country of provision.

4.316 The US prices used by USDOC as benchmarks do not fall within this category. USDOC found that the subsidized "good" was either standing timber or the right to harvest standing timber. US stumpage is not, and cannot, be made "available" in Canada. Standing trees growing in the US cannot be harvested in Canada, and the right to harvest these trees growing in the US cannot be exercised in Canada. Logs are not timber-harvesting rights, nor are they standing timber. Standing timber in the US cannot be transported across the border, as it must be cut in the US.

4.317 Also, contrary to the United States' assertion, USDOC did not compare prevailing market conditions in Canada with those in the US. USDOC ignored a host of differences in market conditions, and as for the adjustments it did make, failed to adequately take into account differences between individual provinces and US comparison areas.

4.318 The US dismisses the provincial evidence demonstrating that stumpage programmes are operated in accordance with market principles as not relevant to a benefit analysis. This is so, it argues, because the "standard is not the cost to government, but rather benefit to the recipient." The US thus dismisses the third benchmark under the regulations it adopted to implement the results of the Uruguay Round. There is no question that the United States believed, at the time of adoption, that this benchmark was consistent with the analysis contemplated by Article 14(d), and was not, as the US now argues, based on a "cost to government" standard.

4.319 In using this benchmark over the last seven years and as recently as two weeks ago, USDOC has examined whether the government in question has covered its costs; whether it has earned a reasonable rate of return; and whether it applied market principles in setting its rates or prices. In considering these factors, USDOC has described its analysis as examining "whether the government's price was determined according to the same market factors that a private . . . [party] would use . . . ."[20] USDOC's current attempt to dismiss the third benchmark as irrelevant is contradicted by its consistent application of this benchmark since the regulations were promulgated.

4.320 USDOC also expressly refused to consider evidence demonstrating that provincial stumpage systems cannot confer a trade advantage. This economic evidence demonstrated that, for *in situ* natural resource markets, receipt of the input for a lower fee or charge does not affect the supply curve

[20] *Steel Wire Rod from Germany*, 62 Fed. Reg. 54,990, 54,994 (Dep't Commerce 22 Oct. 1997) (final determination).

for the exported product. In this instance, USDOC assumed the existence of trade distortion rather than considering evidence that demonstrated that there was no effect on the marginal cost or supply. This evidence demonstrates that provincial stumpage programmes neither increase the production of logs and lumber, nor lower their prices relative to a private competitive market.

3. Pass-through

4.321 The pass-through issue in this dispute is not simply about calculating the amount of the alleged stumpage subsidy; it is *first* about determining whether a subsidy exists. This means making the required determinations of an indirect financial contribution and of a benefit conferred thereby. The amount of a subsidy cannot be calculated, aggregated or allocated until a subsidy is first determined to exist.

4.322 The United States does not contest that arm's-length transactions exist and that no subsidy has been determined to exist in those instances. The United States impermissibly presumed subsidization in all cases other than alleged direct subsidization, asserting incorrectly that all producers of subject lumber were "direct recipients" of Crown stumpage. There is no exception in the SCM Agreement that allows a Member to presume subsidization in a countervailing duty investigation.

4.323 The United States has countervailed softwood lumber, not standing timber. The subject lumber products are a few examples of the many downstream products produced in many distinct industries that receive the alleged subsidy directly. If the subsidy to timber harvesters is presumed to have passed through to downstream producers of the subject lumber, then it must be presumed to have passed through to producers of *all* downstream products. The question then is how the stumpage subsidy could be limited to the mills upstream in the US specificity finding, when all products and industries downstream are presumed to have received it. US arguments on pass-through make US arguments on specificity impossible, and internally contradictory.

4. Specificity

4.324 There are two central errors in the US approach to specificity: first, it applied the wrong standard; and second, it incorrectly found that stumpage was used by a limited group of industries.

4.325 First, sole reliance on the "limited users" factor, as interpreted and applied by the United States, renders the specificity requirement meaningless. The factors set out in Article 2.1(c) do not, in and of themselves, establish specificity. Nowhere in that provision does it say, "a subsidy is de facto specific if one or more of the following factors exist"; nowhere does it say, "where the users of the subsidy are limited in number, no matter the reason, the subsidy shall be deemed to be specific". Article 2 requires not automaticity, but clear substantiation on the basis of positive evidence.

4.326 Second, the words "industry" and "group of industries" require an objective analysis of the record evidence in terms of the products produced by the users of a programme. In this case, an objective assessment of the products produced by the thousands of actual immediate users of stumpage identifies at least 23 standard categories of industries. When the analysis is extended to include indirect users of stumpage, as the US has done in its impermissible pass-through presumption, many more and varied industries are added.

4.327 The US interpretation reads the word "group" out of Article 2 altogether. However, as the United States itself put it recently in *US – Offset Act (Byrd Amendment)*, the issue is "how *small and homogenous* a group of beneficiaries must be in order to qualify as a 'a group of enterprises or industries'", not whether the subsidy is used by the entire economy, or simply by more than one enterprise or industry. The products produced by stumpage users are as numerous and diverse as those produced in the agricultural sector, which in the view of the United States is neither a "single

large industry" nor even a group of industries. Again, in *US – Offset Act (Byrd Amendment)*, the United States argued that groupings "such as 'all manufacturing' and 'all agriculture,' are too broad to qualify as a 'group of enterprises or industries' for specificity purposes." Stumpage is used by many varied industries because it is a right of access to exploit a natural resource. That natural resource is not altered in any way by governments.

4.328 Moreover, the purpose of countervailing duties is to protect domestic producers from injury caused by subsidized imports of like products. Logically, therefore, the level of aggregation used to identify the user industries for specificity purposes (through the products they produce) should be commensurate with the level of aggregation used to identify the allegedly injured domestic producers (through the products they produce). To do otherwise impermissibly concentrates for specificity purposes an otherwise broad alleged subsidy and imputes it solely to producers of the subject merchandise – exactly what the United States did in the Final Determination.

5. Calculations

4.329 Canada's Article 19.4 claims rest on two legal foundations. First, and as the US agrees, Article 19.4 requires that a countervailing duty rate must not exceed the subsidy per unit rate found in respect of exported and subsidized goods. Second, the subsidy per unit rate must be calculated correctly, based on a correctly determined subsidy amount, and a correctly determined subsidy. The United States disagrees. It argues that Article 19.4 requires nothing more than a reconciliation of a subsidy per unit rate, however determined, with the countervailing duty rate actually imposed. Such an outcome renders the obligation in Article 19.4 meaningless.

4.330 The Panel must determine whether the United States has met its legal obligation, under Article 19.4, to limit the amount of the countervailing duty rate to the correctly determined alleged subsidy per unit. The United States has a legal obligation to ensure that any countervailing duty imposed does not go beyond the purposes of a countervailing duty – to offset injurious subsidization. It may not escape its obligations by characterizing every issue as a matter that is within the unfettered discretion of investigating authorities.

6. Conduct of the Investigation

4.331 Canada's claims concerning the conduct of the investigation at issue are independent from its claims regarding the illegality of the Final Determination of subsidy. In conducting this investigation, the United States violated its obligations under Article 12, and the countervailing duties imposed on the basis of this tainted investigation therefore violate Articles 10 and 32.1 of the SCM Agreement.

4.332 First, USDOC determined that its benchmark states would border the relevant provinces. The US appeared before the WTO and argued that its benchmarks were valid because they were "contiguous" to the relevant provinces. The United States switched the benchmark state to compare with Alberta and Saskatchewan from Montana – a contiguous state – to Minnesota – a non-contiguous state – without giving interested parties notice or any opportunity to comment on the specific choice of the benchmark. The United States thus violated Articles 12.1, 12.3 and 12.8.

4.333 Second, a senior USDOC official specifically requested information vital to USDOC's use of Maine as a benchmark state for Québec. The Maine Forest Products Council sent a letter in response. USDOC did not put the letter on the record for months. The petitioners then submitted new evidence – and the United States admits that new evidence was submitted – in response to USDOC's request for comments on the letter. USDOC refused to permit interested parties to respond to the petitioners' new evidence despite the fact that USDOC relied on it in making its Final Determination. The United States failed to provide a timely opportunity to see relevant information; it failed to provide an opportunity for interested parties to prepare presentations on the basis of that relevant new information. It thus violated Article 12.3.

H. SECOND ORAL STATEMENT OF THE UNITED STATES

4.334 The following summarizes the United States' arguments in its second oral statement.

4.335 The record demonstrates that the provinces own timber and, through provincial tenures, provide timber to lumber producers. There should therefore be no question that the provinces provide a financial contribution within the meaning of Article 1.1(a)(1)(iii) of the SCM Agreement.

4.336 The ordinary meaning of "goods" includes standing timber. Canada's argument to the contrary is reduced to the assertion that tenures are not sales of "timber to be cut," within the meaning of the US UCC, even though the sole reason for acquiring a tenure is to harvest timber, and the tenure holder pays for and receives title to only the timber it cuts. Moreover, the UCC provides that the sale of timber to be cut is always a contract for the sale of goods, regardless of whether the timber is "identified" at the time of the contract. More to the point, however, the provinces "provide" a "good" within the meaning of Article 1.1(a)(1)(iii) of the SCM Agreement.

4.337 Canada also suggests, without citation to record evidence, that many tenures create freely transferable "rights to harvest." The record evidence establishes, however, that the provinces retain control over tenures, which cannot be transferred without the provinces' approval. The subcontracting of harvesting operations is not the sale or transfer of a "right to harvest." The tenure holder, not the subcontractor, remains at all times the province's contracting party.

4.338 It is the substance of what occurs in the provincial tenure systems that is controlling, i.e., whether a provision of goods takes place. As discussed in our previous submissions, the ordinary meaning of the terms "provides" and "goods or services other than general infrastructure" sweeps broadly. No matter how Canada characterizes provincial tenures, the fact remains that the provinces are providing timber to lumber producers. A financial contribution therefore exists.

4.339 The key legal issue in this dispute is whether Article 14(d) of the SCM precludes, in all cases, the use of data from sources outside the country under investigation to determine the adequacy of remuneration. As the Appellate Body has stated, the issue is whether "the 'financial contribution' makes the recipient 'better off' than it *would otherwise have been, absent that contribution*."[21] In other words, the Appellate Body recognized that in order to determine whether a financial contribution confers a benefit, it is essential to compare the position of the recipient with the financial contribution to what the position of the recipient would have been *absent* the financial contribution. Moreover, the Appellate Body's statement provides the context for the Appellate Body's conclusion that the point of comparison is the "marketplace." Thus, as the *Brazil – Aircraft* panel concluded, looking to the marketplace to determine whether the recipient is better off than it would otherwise have been absent the financial contribution necessarily means looking to a marketplace undistorted by the government's financial contribution.[22]

4.340 It is the view of the United States, as well as the European Communities, that Article 14(d) does not prohibit Members from relying on data from sources outside the country of provision to determine the adequacy of remuneration if reliable, market-driven pricing data does not exist in the country of provision. We will not repeat the arguments supporting that conclusion, but will comment on Canada's flawed three-pronged analysis of Article 14(d).

4.341 First, Article 14(d) provides that the adequacy of remuneration must be determined "in relation to" prevailing market conditions in the country of provision. Canada, however, substitutes "in relation to" with "on the basis of" or "in comparison with." The more reasonable interpretation is that the broader phrase "in relation to" was agreed to by Members because Article 14 explicitly sets

[21] Appellate Body Report, *Canada – Aircraft*, para. 157.
[22] Panel Report, *Brazil – Aircraft (Article 21.5 – Canada II*), para. 5.29.

out "guidelines," i.e., general principles, not detailed rules. "In relation to" is sufficiently broad to allow for various means of performing a comparison that relates to market conditions in the country under investigation, rather than limiting Members to analyses "on the basis of," or "in comparison with," certain types of data. Permitted methods can include analyses that rely on data from sources outside the country, if the data is probative of the fair market value for the good in the country of provision.

4.342 Second, Canada ignores the word "market" in the phrase "prevailing market conditions," as if any conditions are "market" conditions. The Panel, however, must give meaning to the word "market." In that regard, the logic of the *Brazil – Aircraft* Panel Report is compelling. In determining whether the government's financial contribution confers a benefit – i.e., whether the recipient is better off with the financial contribution than it would otherwise have been absent the financial contribution – the "market" conditions must be conditions that are undistorted by the government's financial contribution.

4.343 Third, adequacy of remuneration must be determined in relation to prevailing market conditions "in the country of provision." That begs the question, however, whether there are in fact "market" conditions for the good "in the country of provision" that provide probative evidence for determining adequacy of remuneration. Where such evidence does not exist in the country of provision, as in this case, nothing in Article 14(d) precludes a Member from relying on market data from sources outside the country that is probative of fair market value in the country of provision.

4.344 The importance of using market benchmarks, even if they are based on data from sources outside the country of provision, is underscored by Article 15(b) of the *Protocol on the Accession of the People's Republic of China*[23], which is cited, but misinterpreted, by Canada. The United States negotiated Article 15(b) of the China Protocol because the United States, along with other Members, recognized that China was in transition from a state-controlled economy to a market economy. Although Article 14(d) of the SCM permits the use of market data outside China, it only applies in countervailing duty cases under Part V of the SCM Agreement. Recognizing the importance of "market" benchmarks, the Members incorporated the language that Canada references in Article 15(b) of the China Protocol to clarify that external benchmark data can be used under Article 14(d) of the SCM Agreement, and also to ensure that such data can be used in proceedings under Parts II and III of the SCM Agreement.

4.345 Other provisions in the China Protocol likewise repeat obligations already binding on WTO Members. For example, the China Protocol provides that "China shall ensure that internal taxes and charges . . . shall be in conformity with the GATT 1994."[24] The inclusion of this provision does not mean that other Members need not ensure that their internal taxes conform to GATT 1994, yet this is effectively Canada's argument.

4.346 With respect to the facts of this case, the United States has, in its prior submissions and oral presentations, demonstrated that four of the six provinces did not provide private prices for timber that could be used for market benchmark purposes. Canada has failed to refute that fact. Rather, it argues that evidence that the provinces earn a profit on timber sales is sufficient to establish that they do not provide a benefit, even though those profit calculations do not include any cost or value for the trees themselves. More importantly, however, a sale for less than adequate remuneration – even a profitable one – confers a benefit.

4.347 The record evidence also demonstrates that the overwhelming state control of timber sales in Canada distorts sales in the private sector. Canada responds to this evidence by inviting the Panel to

[23] *See* Accession of the People's Republic of China: Decision of 10 November 2001, WT/L/432, Article 15(b) (23 November 2001) ("China Protocol") (CDA-139).

[24] China Protocol, Article 11(2) (US - 93).

conduct *de novo* review. Canada argues, for example, that the United States "ignored" evidence of market conditions in Canada. The record in this case demonstrates that the United States in fact considered and weighed all of the evidence and was persuaded by economic analyses, which are cited to in the Final Determination, and other documentary evidence that the state-controlled timber sales systems distorted the private market.

4.348 Canada also now states that it has "consistently taken the position . . . that a price that is available to purchasers in the country of provision makes that price part of the prevailing market conditions in the country of provision."[25] Given that US timber prices are available to purchasers in Canada, the United States' benchmark calculation is consistent with the position Canada now endorses. Canadian lumber producers can purchase US timber, cut it (or have it cut), and transport it to their mills in Canada.

4.349 The United States has also established that the calculation of the market benchmarks included appropriate adjustments for conditions of sale in Canada. Canada's attempts to call those adjustments into question do not withstand scrutiny.

4.350 Finally, Canada has not made a *prima facie* case that the United States erred in failing to conduct a market distortion analysis. Canada has failed to identify any obligation in the SCM to conduct such an analysis because no such obligation exists. The United States' benefit calculation is consistent with Article 14. Nothing further is required, and obligations that are not found in the Agreement may not be imposed on the United States.

4.351 Under Article 2.1 of the SCM Agreement, a subsidy is specific if it is used by a limited number of industries or group of industries. The unrefuted record facts demonstrate that provincial tenures are used by a very limited group of timber processing industries. To construct an argument that these provincial programmes are, nonetheless, not specific, Canada artificially inflates the very limited group of industries.

4.352 Canada interprets the term "industry" so narrowly that almost every product becomes an industry unto itself. Canada's dissection of the timber processing industries flies in the face of the ordinary meaning of "industry" as the term is used in Article 2. Moreover, Canada's position with respect to the timber processing industries is inconsistent with its acknowledgement that a subsidy used by a single large industry, such as automobiles or textiles, may be specific notwithstanding the diverse range of products the industry produces.

4.353 Canada also challenges the United States' specificity finding by inventing criteria that do not exist. Nothing in Article 2.1(c) requires an investigating authority to consider the government's intent or the "nature" of the good when determining whether a subsidy is specific. It is entirely permissible to find specificity based *solely* on the limited number of users.

4.354 Canada cites the negotiating history of the SCM in an effort to overcome the lack of any support in the text of Article 2.1(c) for its claim that Article 2.1(c) requires consideration of factors such as the "inherent characteristics" of the good and evidence of intentional targeting. In fact, the negotiating history that Canada cites demonstrates that such concepts ultimately were *not* adopted by the Members. The Members abandoned language on intent and "inherent characteristics" after the second Cartland draft, and such factors may not be read into the SCM Agreement.

4.355 The only additional factors that a Member must take into account under Article 2.1(c) are the extent of diversification of economic activities within the granting authority's jurisdiction and the length of time the subsidy programme has been in operation. No one argued that the number of subsidy recipients is limited because the programme had not been in operation long enough to be

[25] Canada's Second Written Submission, para. 41.

more widely distributed. The issue of economic diversification was raised only by British Colombia ("B.C."). The evidence B.C. submitted, however, demonstrated that the timber processing industries accounted for approximately 6 per cent of B.C.'s economy. Thus, based on B.C.'s own data, 94 per cent of B.C.'s economy did not use the provincial tenure system.

4.356 The United States' views on Canada's claims regarding the calculation of the ad valorem rate and the conduct of the investigation have been presented in our prior submissions and statements. We would like to make only a few additional points in response to Canada's second submission.

4.357 First, Canada mischaracterizes the United States' views on Article 19.4 of the SCM Agreement. Article 19.4 provides that the countervailing duty rate must be calculated on a per-unit basis. It also provides that the countervailing duty levied may not exceed the subsidy found to exist. That is the extent of the obligations in Article 19.4. The United States' argument that Canada has failed to identify any obligation in Article 19.4 to conduct an upstream subsidy analysis or to allocate subsidies by volume rather than by value is a far cry from arguing that a Member may impose countervailing duties at any rate it wishes. The fact remains, however, that Canada has failed to identify any obligation in Article 19.4 that supports its claim.

4.358 Second, the United States calculated the ad valorem duty rate by dividing the subsidy by the value of the output of the lumber production process. Canada argues that the numerator in that ad valorem rate calculation was impermissibly inflated by the inclusion of that portion of the Crown timber that ended up as products other than lumber. Canada's numerator argument is simply an argument that the United States was required to allocate the subsidy on the basis of volume rather than on the basis of value. As discussed previously, Article 19.4 simply obligates Members to calculate the countervailing duty rate on a per-unit basis. There is no requirement to allocate an input subsidy based on volume rather than value.

4.359 Third, Canada continues to suggest that the Minnesota Public Stumpage Price Report ("Minnesota Price Report") specifies a conversion factor of 6.25 for converting from thousand board feet to cubic meters. It does not. The Minnesota Price Report contains sawtimber prices reported in thousand board feet and pulpwood prices reported in cords. The price report contains a factor that Minnesota uses to convert between cords and board feet. The United States, however, only used the sawtimber prices, which are bid, sold, and reported in thousand board feet, and therefore needed to convert from board feet to cubic meters. The Minnesota Price Report does not contain such a conversion factor. We note, however, that the timber sales manual of the Minnesota Department of Natural Resources ("Minnesota Timber Sales Manual"), which publishes the Minnesota Price Report, was on the record. The Minnesota Timber Sales Manual provides a conversion factor of 3.48 cubic meters per thousand board feet. Canada does not, however, advocate using that conversion factor. Rather, Canada derived its own conversion factor from selected information in the Minnesota Price Report.

4.360 There is no one conversion factor that is universally accepted. The record evidence suggested a wide range of possible conversion factors, ranging from 3.48 to 8.51. The United States considered all of that evidence and provided a reasoned explanation for its decision to rely on the factors in the report by the International Trade Commission. The choice of conversion factor is therefore entirely consistent with the SCM Agreement.

4.361 Finally, Canada suggests that, even though the provinces knew the criteria the United States was using to select the benchmark states and had all the data on the states under consideration, Alberta and Saskatchewan were not on notice of the possibility that the United States could select a state more than 1,000 kilometres away. That assertion is contradicted by the record of the investigation. Alberta and Saskatchewan both argued that the United States should not use Montana as a benchmark state because of differences in the species mix. Saskatchewan also proposed using data from Alaska, which is more than 1,000 kilometres from, and obviously not contiguous with,

Saskatchewan. Thus, it is evident that the provinces knew that factors such as climate, terrain, and species mix – not proximity – were the key considerations, and that a non-contiguous state might be selected for the benchmark. The record of the investigation therefore establishes that the provinces knew the essential facts under consideration.

4.362 For the reasons discussed above and in our prior submissions and presentations to the Panel, the United States asks the Panel to dismiss Canada's claims.

V. ARGUMENTS OF THE THIRD PARTIES

5.1 The arguments of the third parties, the European Communities, India, and Japan, are set out in their written submissions and oral statements, and are summarized in this section. Third parties' answers to questions are annexed in full to this report (see List of Annexes, page v).

A. THIRD PARTY WRITTEN SUBMISSION OF THE EUROPEAN COMMUNITIES

1. Claims Relating to the Existence of a Subsidy within the meaning of Article 1 of the SCM Agreement

(a) Financial contribution

5.2 The European Communities agrees with the United States that the term "goods" includes any economically valuable right. The ordinary meaning of the word "good" is commonly defined as, *inter alia*, "property or possessions; esp. movable property, saleable commodities, merchandise, wares"[26] or "tangible or moveable personal property, other than money; esp., articles of trade or items of merchandise"[27]. Accordingly, the French text of the SCM Agreement uses the term "biens", which is defined, *inter alia*, as "domaine, possession, propriéte".[28] Finally, the Spanish version uses the word "bienes", which encompasses "inmobiliario" as well as "mobiliario.[29] From the ordinary meaning of the word "goods" it follows, therefore, that this term not only applies to "movable" but also to "immovable" goods, including "land".

5.3 This understanding is further corroborated by the immediate context in Article 1.1(a)(1)(iii) of the SCM Agreement, which refers to

> (…) goods or services *other than general infrastructure* (…)" (emphasis added)

5.4 According to this wording infrastructure such as streets, railways or channels – which are all immovable objects – are to be considered as a "good" to the extent that they are not "general". It follows *a contrario* that any "individual" immovable object that is provided by the government may also be covered by Article 1.1(a)(1)(iii) of the SCM Agreement.

5.5 The European Communities notes that the Panel in *US – Softwood Lumber III* confirmed that the phrase "goods or services other than general infrastructure"

> is intended to ensure that the term financial contribution is not interpreted to mean only a money-transferring action but encompasses as well an in-kind transfer of resources, with the exception of general infrastructure.[30]

[26] The New Shorter Oxford English Dictionary, 1993, Vol. I, p. 1116.
[27] Black's Law Dictionary, 7th edition, 1999.
[28] Le nouveau Petit Robert, 1998, p. 219.
[29] Moliner, Diccionario de uso del Espanol, 1988, p. 374.
[30] Panel Report, *US – Softwood Lumber III*, para. 7.24.

5.6 The European Communities considers that this clarifies that the term "goods and services" can also refer to immovable property or any other property right such as, e.g., intellectual property rights. Such interpretation is also supported by the purpose of Article 1.1(a)(1) of the SCM Agreement which is intended to cover a wide variety of financial contributions made by governments, which "will also exist if the government does not collect revenue which it is entitled to or when it gives something or does something for an enterprise or purchases something from an enterprise or a group of enterprises".[31]

5.7 Indeed, subsidies may take the form of very complex bundles of rights combining, e.g., rights to a movable or immovable good (e.g., land) a service (scientific or technical research) or intellectual property (patents, copyrights). Depending on the combination of different elements and the modes of supply, such transfers of economic resources, may involve the provision of "goods or services", or the foregoing of "government revenue". If such complex economic transactions were not covered by the disciplines of the SCM Agreement, there would be considerable scope for circumvention.

5.8 Regarding the specific question of whether stumpage is covered by Article 1.1(a)(1)(iii) of the SCM Agreement, the EC does not consider it necessary to comment separately on the different forms of stumpage rights (*profit à prendre*, servitudes, timber harvesting licenses, and similar rights), because they all involve economically valuable harvesting rights and USDOC explained in its final determination why such rights are goods or at least services within the meaning of Article 1.1(a)(1)(iii) of the SCM Agreement.

5.9 In short, the European Communities agrees with the United States that the stumpage programmes are financial contributions within the meaning of Article 1.1(a)(iii) of the SCM Agreement.

(b) Benefit

5.10 The key legal issue in this dispute is whether the United States has violated Articles 1 and 14 of the SCM Agreement by applying a "cross-border" methodology to establish and measure a benefit.

5.11 The European Communities considers that the determination of the correct market benchmark requires considerable care and would offer the following comments:

5.12 First, contrary to what the United States argues, the text of Article 14(d) of the SCM Agreement does not refer to "*fair* market value" or "*true* market prices" that are "independent of the distortions caused by the government's action".[32] Such analysis would contradict the explicit wording of Article 14(d) which requires the analysis of "*prevailing market* conditions in the country of provision" (emphasis added).

5.13 The adjective "prevailing", which means "as they exist"[33] clarifies that the investigating authorities have to base their benefit determinations on existing reference prices that the producer would have had to pay if it had to buy the goods (now provided by the government) from a different and independent seller in the country of provision, including imports.[34]

5.14 Read contextually with the term "*market* conditions" in Article 14(d) of the SCM Agreement (and other paragraphs of Article 14) the treaty language clarifies that only in situations where there are no *market* conditions, i.e., prices determined by independent operators following the principle of supply and demand, the in-country benchmark set out by Article 14(d), second sentence of the SCM

[31] Panel Report, *US – Softwood Lumber III*, para. 7.24.
[32] United States First Written Submission, paras. 42 ff, 72 (emphasis added).
[33] Concise Oxford Dictionary, Ninth Edition, p. 1084.
[34] Panel Report, *US – Softwood Lumber III*, para. 7.52.

Agreement does not apply. Only in such rare situations, the adequacy of the remuneration may be determined following a reasonable method according to Article 14(d), first sentence of the SCM Agreement, including, where necessary, world market prices.

5.15 Thus, as the Panel confirmed in *US – Softwood Lumber III*, Article 14(d) does not permit investigating authorities to dismiss actual in-country prices merely because they might be affected by the financial contribution.[35]

5.16 Second, the European Communities does not consider the reference by the United States to recent amendments of its Regulation (EC) 2026/97 relevant for the resolution of this dispute.[36] As noted by the United States, these amendments concern a situation where "no such prevailing market terms and conditions" exist and where, consistently with Article 14(d) of the SCM Agreement, investigating authorities may, therefore, apply an alternative benchmark.

5.17 By contrast, under its methodology as applied in the final determination on softwood lumber, the United States continues to consider itself entitled to dismiss existing alternative reference prices in the country of provision and to use petitioner's prices simply on the basis that in-country prices "were significantly affected by the financial contribution itself"[37]. This is different from establishing that there are no market conditions in the country of provision.

5.18 Thus, the problem with the "cross-border" methodology attacked by Canada is not that it eventually allows consideration of world market prices, but under which conditions recourse may be had to alternative benchmarks. The European Communities fully agrees with the panel *US – Softwood Lumber III* where it dismisses the "hypothetical undistorted market" methodology as contradictory with the text of Article 14(d) of the SCM Agreement. However, the European Communities would respectfully ask this Panel to clarify that there is no absolute rule prohibiting recourse to world market prices to determine the adequacy of the remuneration, if it can be established in exceptional cases that there are no prevailing market conditions within the meaning of Article 14(d) second sentence of the *SCM Agreement*, so that that rule cannot be applied in order to establish the existence of a benefit.

5.19 Finally, as to the correct application of the above rules to the final determination in this case, the European Communities as a third party is obviously not in a position to comment on the availability of independent market-driven prices for non-governmental stumpage (be it from private Canadian land or imported). However, the European Communities notes that USDOC itself acknowledged that private stumpage markets have a share between 2-17 per cent in Canada.[38] The sole rational for rejecting them in the final determination is the mere assertion that such prices are driven by the stumpage prices on Crown land, i.e., the flawed "hypothetical undistorted market" methodology.

5.20 The European Communities also notes that USDOC has recognised "extensive record evidence that Canadian lumber producers had actual imports of US logs and purchased US stumpage during the POI".[39] This finding in itself contradicts USDOC rejection of a competitive timber/and or lumber market in Canada.[40]

[35] Panel Report, *US – Softwood Lumber III*, paras. 7.50 and 7.52.
[36] United States First Written Submission, para. 55.
[37] United States First Written Submission, para. 65.
[38] Final Determination, p. 37 and 38. (CDA – 1).
[39] Final Determination, p. 40. (CDA – 1)
[40] Panel Report, *US – Softwood Lumber III*, para. 7.49, footnote 86.

(c) Failure to Examine and Determine the Existence of a Benefit to all Producers of the Subject Product ("Pass Through")

5.21 The European Communities agrees with Canada that the final countervailing duty determination is flawed because it assumes that the alleged financial contribution to timber harvesters through the stumpage rights conferred a benefit on the downstream producers of softwood lumber, although a significant portion of harvesting is done by entities operating at arm's-length from the lumber producers. Instead of conducting a "pass-through" analysis, USDOC applied an irrefutable presumption that the alleged benefit received by stumpage holders has passed through to all lumber producers harvesters.[41]

5.22 The United States does not contest that some producers of the subject merchandise operate at arm's-length, but defends itself by arguing that the final CVD determination was made on an aggregate basis under Article 19.1 and 19.3 of the SCM Agreement, thereby exempting the competent authority from making a "pass-through" analysis.[42]

5.23 The European Communities considers that the panel in *US – Softwood Lumber III* correctly found that neither Article 19 nor any other provision of the SCM Agreement authorises investigating authorities to depart from the requirement to correctly establish the amount of subsidisation if they chose to conduct the investigation on an aggregate basis.[43] As already clarified by the Appellate Body in *US – Lead and Bismuth II*[44], and confirmed by the panel in *US – Softwood Lumber III*, an authority may not assume that a subsidy provided to producers of the "upstream" input product automatically benefits unrelated producers of downstream products, especially if there is evidence on the record of arm's-length transactions between the two.[45] Thus, USDOC was "required to examine whether, in certain transactions covered by the investigation, some or all of the alleged benefit to the tenure holders from the stumpage programmes was passed through to the producers of the subject merchandise exported to the US".[46]

5.24 The Panel also correctly clarified that conducting the investigation on an aggregate basis versus a company-by-company basis is "irrelevant" to this issue and cannot dispense USDOC from its obligation to carry out a pass-through analysis so as to correctly establish the amount of the subsidy benefiting the producers of the subject merchandise, (i.e. the numerator).[47]

2. Conclusion

5.25 In short, the European Communities considers that the final determination now before this Panel correctly established the existence of a financial contribution within the meaning of Article 1.1(a)((1)(iii) of the SCM Agreement by interpreting the term "goods and services" so as to include any economically valuable right, *in casu*, the right to a good (whether that good is movable or immovable).

5.26 However, the measure before the Panel is inconsistent with Articles 1.1(b), 10 and 14 of the SCM Agreement because USDOC applied a flawed "hypothetical undistorted market" methodology to establish the alleged benefit and did not conduct a proper "pass-through" analysis to demonstrate that all producers of the subject merchandise received the alleged benefit.

[41] Canada First Written Submission, paras. 128, 129 and 135.
[42] United States First Written Submission, paras. 102-106.
[43] Panel Report, *US – Softwood Lumber III*, paras. 7.74 and 7.75.
[44] Appellate Body Report, *US – Lead and Bismuth II*, para. 68.
[45] Panel Report, *US – Softwood Lumber III*, para. 7.71.
[46] Panel Report, *US – Softwood Lumber III*, para. 7.69.
[47] *Ibid*., para. 7.77.

B. THIRD PARTY ORAL STATEMENT OF THE EUROPEAN COMMUNITIES

1. Financial contribution

5.27 The European Communities has already explained why it considers that the United States correctly established that the granting of stumpage rights is a financial contribution within the meaning of Article 1.1(a)(1)(iii) of the SCM Agreement, because that provision covers any economically valuable right.

5.28 This is in line with the ruling by the panel in *US – Lumber III* confirming that the phrase "goods or services other than general infrastructure"

> (…) encompasses as well an in-kind transfer of resources, with the exception of general infrastructure.[48]

5.29 The European Communities would like to reiterate that the term "goods and services" can also refer to immovable property or any other property right such as, e.g., intellectual property rights. Subsidies may take the form of very complex bundles of rights combining, e.g., rights to a movable or immovable good (e.g., land) a service (scientific or technical research) or intellectual property (patents, copyrights). Depending on the combination of different elements and the modes of supply, such transfers of economic resources, may involve the provision of "goods or services", or the foregoing of "government revenue". If such complex economic transactions were not covered by the disciplines of the SCM Agreement, there would be considerable scope for circumvention.

2. Benefit

5.30 The key legal issue in this dispute is whether the United States has violated Articles 1 and 14 of the SCM Agreement by applying a "cross-border" methodology, i.e., US prices as benchmark for the determination of a benefit.[49]

5.31 The European Communities agrees with Canada and the panel in *US – Lumber III*[50] that the US determination of benefit violated Article 14(d) of the SCM Agreement because the United States dismisses existing in-country prices merely because they might be affected by the financial contribution. However the European Communities is concerned that some of the findings of that panel might be misunderstood as an absolute rule prohibiting recourse to world market prices to determine the adequacy of the remuneration even if it can be established in exceptional cases that there are no prevailing market conditions within the meaning of Article 14(d) second sentence of the SCM Agreement.

5.32 The problem with the "cross-border" methodology attacked by Canada is not that it eventually allows consideration of world market prices, but under which conditions recourse may be had to alternative benchmarks. Article 14 (d), second sentence, does not apply, where there simply is no market. In such rare situations which must be properly established by the investigating authorities, the adequacy of the remuneration may be determined following a reasonable method according to Article 14(d), first sentence of the SCM Agreement, including, where necessary, world market prices.

3. Specificity

5.33 Canada also challenges the US finding that the stumpage programmes are *de facto* limited to "pulp and paper mills and the same mills and remanufacturers which are producing the subject

[48] Panel Report, *US – Lumber III*, para. 7.24.
[49] Final Determination, p. 40.
[50] Panel Report, *US – Lumber III*, paras. 7.50 - 7.52.

merchandise" and therefore *de facto* specific subsidies.[51] The European Communities considers that because this finding is based on the flawed determination of the beneficiaries of the alleged financial determination it cannot be upheld. However, in case the Panel were to consider the issue of specificity, the European Communities would like to note the following.

5.34 In essence, Article 2.1 of the SCM Agreement requires an investigating authority to determine that a subsidy is specific because its availability is either limited by law to certain enterprises (Article 2.1(a and b)), or the same limiting effect can be established on the basis of evidence concerning the use of the subsidy (Article 2.1(c)). The European Communities notes that USDOC did not make a *de jure* specificity determination although certain stumpage programmes were restricted to certain enterprises owning saw mills.[52]

5.35 Canada challenges the USDOC determination because it applies a general availability test, i.e., whether the use of the subsidy is limited to certain groups of industries as opposed to a subsidy that is "broadly available and widely used throughout an economy".[53]

5.36 The European Communities considers that the ordinary meaning of the terms "certain enterprises" in Article 2.1 of the SCM Agreement read in light of their context and their object and purpose, in essence, requires a "general availability" determination, that is a determination of whether a subsidy selectively benefits certain industrial sectors or certain enterprises, or is rather a broad economic policy measure, such as the reduction of corporate taxes.

5.37 The broad definition of "certain enterprises" in Article 2.1 of the SCM Agreement as "an enterprise or industry or group of enterprises or industries" indicates that the specificity determination must not precisely identify separate industries and sub-industries as required for the injury determination under Article 16. It is sufficient to show that the subsidy is made available or used only by a limited number of industries as opposed to the overall economy. The immediate context in Article 2.2 of the SCM Agreement confirms the "general availability" test by clarifying that the "setting or change of generally applicable tax rates" shall not be deemed to be a specific subsidy.

5.38 Canada also claims that consideration must be given to the fact that the limitation of users is due to the inherent characteristics of the good rather than any deliberate government favouritism.[54]

5.39 The European Communities fails to see any basis in the SCM Agreement for Canada's contention that Article 2.1 of the SCM Agreement excludes a specificity finding if the limitation of the use is due to the inherent characteristics of the good. Such an interpretation would lead to circumvention of the subsidy disciplines. Subsidy programmes could be tailored so as to benefit only certain industries that can use certain goods or services. Obviously stumpage rights are useless for the computer industry while the provision of research for computer chip materials would not be of interest for the softwood lumber producers.

4. Violation of Article 12.3 and 12.8

5.40 Turning now to the alleged violations of procedural due process rights, the European Communities would like to offer the following comments on the legal interpretations of Articles 12.3 and 12.8 of the SCM Agreement.

[51] Final Determination, p. 52. (CDA – 1)
[52] United States First Written Submission, footnote 193.
[53] Canada First Written Submission, paras. 149, 152, 161. Final Determination, p. 52. (CDA – 1)
[54] Canada First Written Submission, paras. 155, 156.

(a) Violation of Article 12.3 of the SCM Agreement

5.41 Canada claims that USDOC has not given timely opportunity to the respondents to see a report on the quality categories for logs in Maine and to rebut counter-reports prepared by the petitioners.[55]

5.42 The United States admits that only two months after it received the Maine report, that document was placed on the record and parties were given 10 days to comment after the record had already been closed.[56] In defence, the United States invokes the practicability clause in Article 12.3 of the SCM Agreement arguing that "it was simply not practical" to give Quebec an earlier opportunity to see the report in time to be able to also rebut the petitioners' counter reports.[57]

5.43 The terms "whenever practicable" in Article 12.3 of the SCM Agreement do not address the question of "whether" the investigating authority must grant access to the file, but exclusively the question of "when" to do so.

5.44 The term "timely" means "occurring, or made at an appropriate or suitable time; opportune; Occurring or appearing in good time, early".[58] A contextual reading clarifies that the time must be sufficient not only to *see* the information but also to *prepare presentations* on the basis of this information. The plural "presentations" supports that there must be possibility for at least one rebuttal.

5.45 Article 12.8 makes clear that, although the investigating authority is not required to make the file permanently accessible to the public, and to exchange in an endless cycle of comments and sur-rebuttals, it must grant access to the file as early as practicable, rather than, for example, once at the end of the investigation thereby excluding the possibility of making at least one counter-rebuttal.

5.46 A Member claiming that timely access to the record and sufficient time to make presentations is not practicable faces a heavy burden. The instances where a Member could refuse legitimately the possibility of timely access to the file would be "exceptional". The European Communities notes that the precise circumstances of the disclosure of the Maine report are still being clarified between the parties and is therefore not in a position to comment on whether there were such exceptional circumstances. However, merely claiming non-practicability is certainly not sufficient.

(b) Violation of Article 12.8 of the SCM Agreement

5.47 The second procedural violation concerns the disclosure of essential facts. Canada complains that USDOC switched from Montana stumpage prices, which it had used as benchmark for two Canadian provinces in the preliminary determination to Minnesota prices on which it based its final determination. Both parties agree that these stumpage prices are essential facts.[59] However, the United States appears to argue that the respondents were aware of the essential facts through the preliminary determination and that because the respondents "prevailed on this points" causing USDOC to switch to Minnesota prices, they cannot "credibly claim surprise"[60]

5.48 Article 12.8 of the SCM Agreement imposes upon the investigating authorities a duty "to inform" the interested parties. The ordinary meaning of that term ("to give knowledge of something", to tell", to acquaint with")[61] demands a positive action from the investigating authorities. The EC

[55] Canada First Written Submission, para. 220.
[56] United States First Written Submission, paras. 175-176.
[57] United States First Written Submission, para. 180.
[58] The New Shorter Oxford Dictionary, p. 3314.
[59] United States First Written Submission, para. 165.
[60] United States First Written Submission, paras. 164 and 169.
[61] Webster's New World Dictionary, Third College Edition.

agrees with the United States[62], that Article 12.8 does not prescribe any particular method of disclosure. Thus, for instance, the investigating authority may choose to make the disclosure in a written document sent to the parties (the usual practice in the EC) or in any other form. However, Article 12.8 of the SCM Agreement, requires a certain result: the interested parties must be informed of the facts "which form the basis for the decision whether to apply definitive measures". The Panel in *Argentina –Ceramic Tiles*, in interpreting the analogue provision in the *Anti-Dumping Agreement* clarified that the disclosure must contain

> the essential facts which, being under consideration, are anticipated by the authorities as being those which *will form* the basis for the decision whether to apply definitive measures. (emphasis added)[63]

5.49 Indeed, the relative clause "which *form* the basis for the decision whether to apply definitive measures" qualifying the phrase "essential facts under consideration" is of crucial importance for the correct interpretation of Article 12.8. The use of the term "form" indicates that the investigating authority is required to identify which facts will be relied upon in the final decision whether to impose measures.

5.50 Disclosure of the "essential facts" forming the basis of a preliminary determination is clearly inadequate in circumstances where the factual basis of the provisional measure is significantly different from the factual basis of the definitive measure. This was confirmed by the Panel ruling in *Guatemala – Cement II* clarifying that disclosure of the

> "essential facts" forming the basis of a preliminary determination is clearly inadequate in circumstances where the factual basis of the provisional measure is significantly different from the factual basis of the definitive measure.[64]

5.51 The European Communities considers that the United States cannot escape from its obligation by claiming that the switch between benchmarks is less significant than the switch between threat and actual injury in the Guatemala cement case. Decisive is only that the facts are "essential" to the final determination and whether the respondents knew that the Minnesota stumpage prices would form the basis of the final determination. That the facts relating to Minnesota were on the record does not change that appreciation. The respondents could not know that they would be "essential" for the final determination, as they had advocated other alternative benchmarks.

5.52 Finally, the United States cannot defend itself by invoking practicability concerns[65]. While Article 12.3 contains a "whenever practicable" exception, the obligation to disclose the essential facts under Article 12.8 is without qualification.

C. THIRD PARTY ORAL STATEMENT OF INDIA

5.53 This is one of half a dozen disputes raised by Canada on the same merchandise/product, *viz*., softwood lumber. As in other disputes, India has systemic interest in this dispute as well. In an earlier dispute, *US – Softwood Lumber III*, India expressed concerns on application by the US of 'cross-border' methodology to determine existence of benefit under Articles 1 and 14 of the SCM Agreement. We have similar concerns in this dispute as well.

[62] United States First Written Submission, para. 162.
[63] Panel Report, *Argentina - Ceramic Tiles*, para. 6.125.
[64] Panel Report, *Guatemala – Cement II*, para. 8.228.
[65] United States First Written Submission, para. 169.

5.54 More importantly, India has systemic concern about the Panel's decision to accept amicus curiae briefs and consider their arguments to the extent that such arguments raised by the parties and third parties to the dispute.

5.55 India considers that the WTO panels and the Appellate Body do not have a right to accept and consider any briefs or arguments submitted by anyone other than the parties or third parties to the dispute. WTO panels, however, under Article 13 of the DSU, could seek information or technical advice or opinion of any individual or body on certain aspects of the matter or factual issues concerning scientific or technical matter raised in a dispute. We do not consider that 'arguments' of uninvited bodies or individuals would fall into such category.

5.56 India is aware of the Appellate Body's view on amicus curiae briefs and the so-called "case law" developed by it. India does not agree with the Appellate Body's view that whatever is not prohibited by the DSU or other covered agreements is permissible and, therefore, the Appellate Body and the panels have authority to accept amicus briefs. There is no textual or other legal basis for such assertions. Therefore, India requests the panel refrain from accepting or considering the unsolicited amicus curiae briefs submitted to it.

D. THIRD PARTY WRITTEN SUBMISSION OF JAPAN

1. Introduction

5.57 The Government of Japan welcomes this opportunity to present its view in this proceeding on *United States - Final Countervailing Duty Determination with Respect to Certain Softwood Lumber from Canada.* This dispute concerns the countervailing duties imposed by the United States on certain Canadian softwood lumber products. Japan decided to participate in the current proceedings as a third party in view of the systemic importance of the dispute. The Canadian government has control in administration of wood production in Canada through the stumpage programme of public-owned forest, which covers most of forests in Canada, and Canada is the world largest wood exporting country, covering 20 per cent of world wood products exports. Japan respectfully requests the Panel to pay due attention to the fact that Canadian government has a strong influence on wood products market and thus the result of this dispute will have significant implications. Although Japan has no intention to argue on the assessment of underlying facts in the specific circumstances of this case, Japan would like to respectfully submit the following comments.

2. Legal Arguments

5.58 Japan considers that Canada must avoid trade distortion, when it tries to achieve sustainable management of its forestry resources through the stumpage programme. And Japan is of the view that the log price should be determined through the market mechanism in the trade between an independent tenure holder and an unrelated lumber mill, in the same way as the lumber price is determined. Having these in mind, Japan would like to submit the following points.

(a) Provision of "goods"

5.59 Canada argues that the stumpage programme is a system of interlocking rights and obligations between the Crown (provincial and federal governments) and harvesters[66]. It also insists that the stumpage programme provides "rights" rather than "goods[67]." It is true that "rights" are not "tangible

[66] Canada First Written Submission, para.25
[67] Canada First Written Submission, paras.21-58

or movable personal property other than money[68]", and cannot be categorized into tariff classification[69], as Canada points out.

5.60 However, the "right to harvest standing timber on Crown land[70]," which is given in exchange for the "stumpage (price paid for harvesting)," is equivalent to the property right of standing timber (except for land). Furthermore, such "right" is exercised during a specific period, to produce logs which are "tangible or movable personal property other than money". Therefore, it could be understood that, in this case, "provision of goods" is equivalent to "provision of property rights."

5.61 In this respect, *US – Softwood Lumber III* panel report acknowledges that "The word 'goods' in this context of 'goods or services' is intended to ensure that the term financial contribution is not interpreted to mean only a money-transferring action, but encompasses as well an in-kind transfer of resources, with the exception of general infrastructure[71]." In the context of Article 1.1 (a) (1) (iii) of the SCM Agreement, Japan considers that "goods or services" is a broad concept parallel to monetary transfer and, it is doubtful that the meaning of "goods" should be limited as Canada suggests. Since "goods" in Article 1.1 (a) (1) (iii) are provided by the government to domestic producers, Japan hesitates to interpret, as Canada does, that "goods" must be "tradable item with an actual or potential tariff classification" in general. Canada seems to base this claim on Article 3.1 (b). However, the provision covers only export subsidy.

(b) A Benefit Conferred

(i) "Cross-Border" Benchmarks

5.62 In order to determine if the stumpage programme could be understood as a "subsidy" as defined in the SCM Agreement, it is required to evaluate whether the programme constitutes a financial contribution by the Canadian government in providing "goods" as referred to in Article 1.1 of the SCM Agreement, and whether a benefit is conferred by the stumpage programme through proper method which complies with Article 14(d) of the SCM Agreement.

5.63 Article 14(d) provides that whether a benefit is conferred must be determined by comparing the price for the provision of goods or services and "adequate remuneration." It also provides that the "adequate remuneration" shall be determined in relation to prevailing market conditions for the good or service in question "in the country of provision". It is not disputed that USDOC used "Cross-border analysis" and this seems inconsistent with this article since it compared the stumpage in Canada with the stumpage (or price for standing timber) in the United States. In this case, however, it is noted that there is difficulty in finding market conditions to be compared in Canada, since most of forests in Canada is managed by the stumpage programme and private forest area is very limited, and even in the private forest area, as standing timbers are mostly harvested and produced into logs by owner companies, market of standing timbers rarely exists.

(ii) Stumpage Level

5.64 Even assuming that Cross-border comparison is permitted to be used to determine whether the stumpage is less than adequate remuneration, such comparison should not be conducted by simply comparing "stumpage" prices in Canada and those in the United States. It needs evaluation of various differences of their systems which affect their stumpage prices. The difference of forest management systems between the United States and Canada may be one of such factors to be considered. For example, if the Canadian government obligates harvesting

[68] Canada First Written Submission, para.31
[69] Canada First Written Submission, para.33
[70] Canada First Written Submission, para.26
[71] WT/DS236/R, para.7.24

companies to share the substantial part of the burden for sustainable forest management and thus the stumpage paid by those companies is kept low, the cost for fulfilling the obligation should be added on the price of Canadian stumpage for fairness of comparison.

(c) A Pass-through of an Alleged Subsidy

5.65 Regarding wood and wood products market, there is standing timber market, log market, lumber market, and processed wood products market. In each market, price is determined in accordance with the relationship between demand and supply. Therefore, in principle, product prices are determined in the market, independently from production costs.

5.66 Some Canadian softwood lumber is harvested and produced by lumber producers which hold stumpage rights. In this case, lumber producers would be able to produce lumber with lower costs, taking advantage of the stumpage programme. However, lumber producers in Canada do not necessarily ensure all log input supply from their own stumpage[72]. As Canada points out, some lumber producers may purchase logs from unrelated log harvesters that do not own a mill. In that case, even if the log harvesters produce logs at lower costs through the stumpage programme, the price would be determined in accordance with the relationship between demand and supply because the log sellers pursue the maximum profit. Therefore, it would be unreasonable to assume that logs with lower production costs are sold with lower prices in the arm's-length transactions between timber harvesters and unrelated lumber producers[73], resulting in a pass-through of the alleged subsidy to lumber producers. This would also apply to transactions of softwood lumber between lumber producers and final consumers. Further, since a wide variety of products are produced from softwood logs[74], the alleged subsidy would be passed through to other producers of wood products including pulp and plywood, if the subsidy is passed through to lumber producers.

5.67 The United States should fully investigate how much of the alleged subsidy is passed through to all producers of wood products in Canada and how much of it is passed through to softwood lumber producers in Canada through the stumpage programme, when imposing countervailing duty on Canadian softwood lumber. Japan expects that the Panel determines if the US final determination of countervailing duty is based upon sufficient analysis of a pass-through of an alleged subsidy, and how much of the alleged subsidy was passed through to lumber producers.

VI. INTERIM REVIEW

6.1 On 10 June 2003, the United States and Canada submitted a written request for review by the Panel of particular aspects of the interim report issued on 27 May 2003. Canada commented on the United States' request for interim review on 17 June 2003. The United States did not comment on Canada's request for interim review. Neither party requested an additional meeting with the Panel.

6.2 We have reviewed the comments presented by Canada and the United States and the reaction to the United States' comments by Canada and have finalized our report. We note in this regard that, throughout the report, we have corrected typographical and other clerical errors, including those identified in the parties' interim review comments.

6.3 Canada requested changes to the description of its argument concerning the definition of "goods" in the Uniform Commercial Code in footnote 80 of the interim report. In a similar vein, Canada requested changes to footnote 136 of the interim report to more accurately reflect Canada's argument concerning the use of prices that do not form part of the prevailing market condition in the country of provision. Finally, Canada further requested changes to paragraph 7.108 of the interim

[72] Canada First Written Submission, paras. 140 and 141
[73] They are inputs to the production of softwood lumber, the subject merchandise.
[74] Canada First Written Submission, para.127

report to more accurately reflect its argument concerning specificity. We have amended these footnotes and this paragraph to reflect the comments made.

6.4 The United States requested a change to the first sentence of paragraph 7.56 of the interim report concerning the United States' interpretation of Article 14 (d) SCM Agreement to more accurately reflect its position. The United States also requested a change to the first sentence of paragraph 7.132 summarizing the US argument concerning the factor provided in the Minnesota Price Review for conversions between board feet and cords. We have amended these paragraphs to reflect the comments made.

6.5 Finally, the United States also took issue with the Panel's discussion in paragraphs 7.81 through 7.99 of the interim report concerning the pass-through of the alleged subsidy. The United States commented that the Panel's characterization of the Canadian industry in paragraph 7.84 of the interim report was partly inaccurate as it suggested that re-manufactured softwood lumber products were only produced by re-manufacturers from lumber purchased from sawmills, although, the US noted, some such re-manufactured products also were produced by tenure holding Canadian sawmills. The United States stated that it was concerned that this alleged factual misunderstanding underlay the Panel's conclusion in paragraphs 7.97 and 7.98 of the interim report that the total subsidy provided through the provincial timber programmes to Canadian softwood lumber mills cannot be allocated across all sales (domestic and export) of the output of those mills (both primary and remanufactured lumber), absent an upstream subsidy analysis of certain of those transactions. In response to this US comment, Canada argued that this perceived factual misunderstanding provided no basis for reconsideration of the Panel's analysis since the US concern did not go to the circumstances of the Panel's substantive analysis in the cited paragraphs. Canada stated that while a few re-manufacturers have access to Crown timber, the vast majority do not.

6.6 We disagree with the US that our consideration of the pass-through analysis in respect of re-manufactured products is based on any misunderstanding of the factual situation, and note that the sentence commented on by the US is intended simply to describe what is meant by the term "re-manufactured products", and not, as the US suggests, to characterize the nature of the transactions for lumber inputs between sawmills and re-manufacturers. Our analysis and conclusion in respect of the pass-through issue explicitly indicate that the question is relevant only to those cases in which the recipient of any subsidy from stumpage sells inputs (logs or lumber) to unrelated downstream lumber producers producing the subject merchandise. Contrary to the US comment, we did not suggest that no re-manufactured products were produced by tenure-holding sawmills. Rather, our conclusion was that a pass-through analysis was required where that was not the case (and both parties acknowledged that some re-manufactured products were produced by re-manufacturers that did not hold tenure). We therefore did not consider it necessary to amend this part of our report.

VII. FINDINGS

7.1 Canada challenges the United States Department of Commerce ("USDOC") final countervailing duty determination with respect to certain softwood lumber from Canada ("USDOC Determination" or "Final Determination") of 21 March 2002. Canada brings seven claims against the USDOC Determination. The first three claims relate to the USDOC's finding that the Canadian stumpage programmes constitute financial contributions which confer a benefit on producers of the subject merchandise and are thus subsidies. The fourth claim concerns the USDOC's determination of specificity of the alleged subsidies. The fifth claim concerns various specific aspects of the calculation of the subsidy rate. The sixth claim is of a procedural nature and concerns the alleged failure by the USDOC to provide a timely opportunity to see all relevant information and to give adequate notice of the essential facts of the investigation. The seventh and final claim relates to the alleged inconsistent initiation of the investigation by the USDOC as a consequence of the application

of the Continued Dumping and Subsidy Offset Act of 2000 (the "Byrd amendment"). We will address these claims in the order they have been presented to us by Canada.[75]

A. CLAIM 1: INCONSISTENT FINDING OF THE EXISTENCE OF A FINANCIAL CONTRIBUTION

1. Arguments of the parties

(a) Canada

7.2 Canada considers that the USDOC erred in determining that "stumpage" is a financial contribution in the form of the provision of a good by the government.[76] According to Canada, stumpage is the conferral of the *right to harvest* standing timber. Canada submits that the conferral of this right to exploit an *in situ* natural resource cannot be equated to the provision of a good or a service by the government and therefore does not constitute a financial contribution in the sense of Article 1.1 (a) (1) (iii) of the Agreement on Subsidies and Countervailing Measures (the "SCM Agreement"). Canada claims that the USDOC, by imposing definitive countervailing measures without properly determining the existence of a subsidy, acted inconsistently with Articles 10, 32.1, 19.1, 19.4 SCM Agreement and Article VI:3 GATT 1994.

7.3 Canada is of the view that stumpage is not a good because the ordinary meaning of the term "good", as reflected in Black's Law Dictionary, is "tangible or movable personal property, other than money".[77] According to Canada, an intangible real property right such as stumpage is thus not a good. Canada submits that an intangible right does not become a good just because it is a factor enabling the creation of a good, nor because the right holder's objective is to produce a good. Moreover, in Canada's view, the term "goods" in the context of Article 1.1 (a) (1) (iii) SCM Agreement has the same meaning and scope as "goods" or "products" used elsewhere in the SCM Agreement and the WTO Agreement, in particular Article II of GATT 1994, i.e. tradable items with an actual or potential customs classification.[78] Canada submits that a right to exploit a resource cannot be traded across borders and cannot be assigned a tariff classification.[79]

7.4 Canada further argues that, even assuming that USDOC was correct that the stumpage programmes provide *standing timber* rather than the right to harvest such timber, the Canadian provincial stumpage programmes still do not involve a financial contribution. Canada argues that the ordinary meaning of "goods" is *movable*, tangible items, and that *immovables* such as trees in the

[75] In addition to these seven claims, we note that Canada's request for establishment of a Panel also included a claim relating to expedited and administrative reviews. Canada did not advance any arguments in respect of this claim, and therefore we will not address this undeveloped claim.

[76] USDOC Final Determination, p. 29. (CDA-1)

[77] Black's Law Dictionary, 7th ed. (St. Paul: West, 1999), p. 701. (CDA-16).

[78] Canada also points to Article 3.1 (b) of the SCM Agreement, which refers to the use of domestic over *imported* goods, as confirmation for its view that goods need to be capable of being imported and should therefore be tradeable. Canada asserts that the term "goods" does not include intellectual property rights, or services, as is evidenced by the fact that the GATS and TRIPS Agreements are not part of Annex 1. Canada is of the view that there is therefore nothing in the letter or the context of the WTO Agreement which justifies interpreting "goods" to encompass everything of economic value. Canada First Oral Statement, paras. 23 – 24.

[79] Canada notes that the Panel in the *US - Export Restraints* case confirmed that the SCM Agreement "was drafted with the express purpose of ensuring that not every government intervention in the market would fall within the coverage of the Agreement" (Panel Report, *US – Export Restraints*, para 8.63). According to Canada, the object and purpose of Article 1.1 (a)1(iii) SCM Agreement is not to capture all potential in-kind transfers of economic resources that a government may provide. The fact that the drafters used the term "provision of goods" rather than, "property rights" or "economic resources" confirms that the objective of the SCM Agreement was not to govern all transfers of economic resources. Canada First Oral Statement, paras. 25 - 26.

forest are not "goods".[80] Therefore, according to Canada, standing timber – i.e. trees firmly rooted in the ground - is not a "good" in the sense of Article 1.1 (a) (1) (iii) SCM Agreement, as it is an *in situ* natural resource that is not capable of being traded across borders.

7.5 Canada rejects the United States assertion that tenures and licences are merely contracts for the sale of goods because at the end of the day tenure and licence holders end up with a good (cut timber). Canada considers that the definition of subsidy has two elements, financial contribution and benefit. Financial contribution relates to what the government does, benefit relates to what the recipient receives. Article 1.1 (a) (1) (iii) SCM Agreement does not require the Panel to determine what the recipient ends up with at the end of the day or why the recipient enters into a given relationship with a government, but it requires a Panel to determine what the government provides. Moreover, the provision of stumpage rights cannot be equated to the sale of goods. According to Canada, a timber sales contract identifies individual standing trees to be cut and the resulting felled timber to be hauled away. In contrast, a tenure or licence grants a right of harvest in an area of land in return for certain obligations, but no trees are identified to be cut.[81] Stumpage rights are conferred and obligations are assumed regardless of whether any trees are actually cut, and even though the trees that are cut may not even have been planted at the time the rights and obligations are assumed. Tenures and licences, in Canada's view, do not involve identified trees, they involve identified areas. In sum, what the provinces provide is not simply trees in return for a fee, but harvesting rights in the context of tenures or licences that impose elaborate and long-term obligations on timber harvesters.[82]

7.6 In sum, Canada submits that the transfer of the right to harvest standing trees through the Canadian provincial stumpage programmes does not amount to the provision of a good within the meaning of Article 1 SCM Agreement. For these reasons, Canada claims that the USDOC determination of the existence of a subsidy in the form of the provision of a good through the Canadian provincial stumpage programmes is inconsistent with the obligation to make a proper subsidy finding before imposing countervailing measures as set forth in Article 10, 19.1, 19.4 and 32.1 SCM Agreement and Article VI:3 GATT 1994.

(b) United States

7.7 The United States submits that the USDOC determination that Canadian provincial stumpage programmes provide a financial contribution in the form of government provision of a good is consistent with Article 1.1 (a) (1) (iii) SCM Agreement. The United States is of the view that the Canadian stumpage programmes provide standing timber, and the stumpage programmes thus constitute the provision of a good in the sense of that Article. According to the United States, the ordinary meaning of the term "goods", as reflected in Black's Law Dictionary for example, includes an "identified thing to be severed from real property"[83] which clearly covers standing timber.[84] The

[80] Canada refers to Black's Law Dictionary to argue that the ordinary meaning of "goods" is "tangible or movable personal property other than money". Black's Law Dictionary, 7th ed. (St. Paul: West 1999), p. 701. (CDA-16). Canada argues that Black's Law Dictionary in fact reproduces, albeit imperfectly, the Uniform Commercial Code of the United States. Canada asserts that the UCC definition of "goods" excludes "general intangibles", and that the basic UCC definition of "goods" refers to movable things. Canada notes that the UCC specifically addresses "timber to be cut" in a separate provision, and that this phrase is limited to individual trees identified to be cut in a sales contract. In Canada's view, all other timber, such as standing trees which may or may not be cut during the term of the tenure and which in any event are not specifically identified, is thus excluded from the UCC definition of "goods". According to Canada, the UCC, if at all relevant, thus supports Canada's interpretation of the term "goods" in the SCM Agreement. Canada Second Written Submission, paras. 11 – 12.

[81] Canada Second Written Submission, para. 15.

[82] Canada Second Oral Statement, paras. 15 –19. Canada notes that a volumetric stumpage charge, also referred to as a stumpage fee, is not money paid to obtain the right to harvest timber, it is rather a levy on the exercise of the existing right to harvest timber.

[83] Black's Law Dictionary, 7th ed. (St. Paul: West, 1999), p. 701-702. (CDA-16).

United States asserts that the context in which the term "goods" is used in Article 1.1 (a) (1) (iii) SCM Agreement, i.e. "goods or services other than general infrastructure", confirms the broad meaning of the term. The United States asserts that it is evident from Article 1.1 SCM Agreement that the Members recognized that governments have a wide variety of mechanisms at their disposal to confer an advantage on specific domestic enterprises and that they intended to bring those mechanisms within the disciplines of the SCM Agreement. According to the United States, the fact that "products" are "goods" and that "imported goods" are necessarily also "goods", does not logically give rise to the inferences Canada is drawing that nothing else can come within the meaning of goods. Thus, the United States submits that while the term "goods" in Article 1.1 (a)(1) (iii) SCM Agreement certainly includes tradeable products, there is no basis to limit its meaning to such products when neither the text nor the context in which the term is used suggests such a limitation.

7.8 According to the United States, Canada is elevating form over substance when it argues that stumpage only confers the *right* to harvest timber. In the view of the United States, there is no meaningful distinction between the government granting a right to harvest timber and the government actually supplying the timber through the holder's exercise of that right.[85] The only way to provide standing timber (the good in question) is by providing the right to harvest the timber. According to the United States, the clear purpose of the programme is thus to provide timber to Canadian mills that make lumber or wood pulp.[86] The fact that tenure holders are required to fulfill certain forest management obligations as a condition of sale does not convert these sales of timber into forest management contracts or into the sale of a "right" to harvest.[87] The United States argues that all ownership rights in the forest remain vested in the Canadian provinces, and that the tenure holder only acquires ownership of the trees it harvests and pays for. The United States asserts that the record demonstrates that tenure holders do not acquire a freely transferable "right" to harvest, as all provinces prohibit the transfer of tenures without government approval.[88] In sum, the United States submits that, in spite of Canada's efforts to sever the right to harvest from the sale of the trees, the facts demonstrate that tenure holders are buying trees. Tenure holders are not forest management companies, they are mills which need timber. The provinces provide it and this, according to the United States, constitutes a financial contribution within the meaning of Article 1.1 (a) (1) (iii) SCM Agreement.

2. Analysis

7.9 Canada claims that the USDOC erred in finding that the provision of stumpage by Canadian provincial governments constitutes a financial contribution in the form of the provision of a good in the sense of Article 1.1 (a) (1) (iii) SCM Agreement. According to Canada, the USDOC thus failed to properly determine the existence of a subsidy to the producers of the subject merchandise as defined in Article 1 SCM Agreement, and the measures imposed on the basis of this flawed subsidy determination are therefore inconsistent with Articles 10, 32.1, 19.1, 19.4 SCM Agreement and Article VI:3 GATT 1994.

7.10 Canada's claim thus concerns the definition of a subsidy in Article 1.1 SCM Agreement, and the existence of a financial contribution under Article 1.1 (a) (1) (iii) SCM Agreement in particular. Our analysis of Canada's claim begins of course with the text of that Article. Article 1.1 SCM Agreement provides that:

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[84] The United States notes that the term "goods" is similarly defined in Canadian law, and refers in particular to the British Columbia Sale of Goods Act. (US - 4).

[85] The United States notes that the Panel in the case *US – Softwood Lumber III* agreed with this analysis. Panel Report, *US – Softwood Lumber III*, para. 7.17.

[86] In this respect, the United States notes that participation in the programme is restricted to Canadian mills or companies that have a contract with Canadian mills to process the harvested timber

[87] United States Second Written Submission, para. 17.

[88] United States Second Written Submission, para. 18. United States Response to Questions from the Panel at the First Meeting (Annex A-2), para. 19.

Article 1
Definition of a Subsidy

"1.1 For the purpose of this Agreement, a subsidy shall be deemed to exist if:

(a)(1) there is *a financial contribution by a government* or any public body within the territory of a Member (referred to in this Agreement as "government"), i.e. where:

(i) a government practice involves a direct transfer of funds (e.g. grants, loans, and equity infusion), potential direct transfers of funds or liabilities (e.g. loan guarantees);

(ii) government revenue that is otherwise due is foregone or not collected (e.g. fiscal incentives such as tax credits);

(iii) a government provides goods or services other than general infrastructure, or purchases goods;

(iv) a government makes payments to a funding mechanism, or entrusts or directs a private body to carry out one or more of the type of functions illustrated in (i) to (iii) above which would normally be vested in the government and the practice, in no real sense, differs from practices normally followed by governments;

or

(a)(2) there is any form of income or price support in the sense of Article XVI of GATT 1994;

and

(b) a benefit is thereby conferred."

7.11 In the Final Determination, the USDOC found that the Canadian provinces provide a good to Canadian producers of softwood lumber through the licence and tenure agreements concluded with companies that harvest standing timber. Canada focuses on the terms of the tenure agreements which confer *harvesting rights* to log producers. According to Canada, such a *right* is not a "good", it certainly is not timber. The United States is of the view that this is form over substance: what Canada is really doing is providing cheap timber to the lumber producers as it allows such producers access to cheap timber through agreements that provide harvesting rights.

7.12 The Final Determination first discusses the meaning of the term "stumpage" and examines the ordinary meaning of the term "goods" to conclude that "stumpage, i.e. timber, is a 'good' within the meaning of section 771 (5) (B) (iii) of the Act".[89] The USDOC then rejects the argument that the provincial governments are not providing timber (a good) but are merely granting a right to harvest timber as it considers that the sole purpose of the tenure systems is to provide lumber producers with timber.[90] The USDOC concludes that the provision of stumpage by the provincial governments constitutes the provision of a good under Section 771 (5) (D) (iii) of the Act.

[89] USDOC Final Determination, p. 29 (CDA-1).
[90] USDOC Final Determination, p. 29 - 30 (CDA-1).

(a) What do the stumpage programmes provide: the *right* to harvest or *standing timber* ?

7.13 Canada asserts that a tenure or licence carries current and future obligations such as forest management planning, fire protection, etc. which are independent of any harvest, and the right to harvest Crown timber is thus fundamentally different from the simple ownership right in trees. Canada argues that a timber sales contract identifies individual standing trees to be cut, while, in contrast, a tenure or licence grants a right of harvest in an area of land in return for certain rights and obligations, but that no specific trees are identified to be cut. The tenure agreements may even concern trees which have yet to be planted.

7.14 We asked Canada to explain what it considers to be the distinction between the provision of the right to harvest a tree and the right to own the harvested tree. In response, Canada stated that "most forms of tenure confer a right to harvest standing timber that is *in the nature of a proprietary interest*".[91] We read Canada's acknowledgement that the right to harvest timber is in the nature of a proprietary interest, to imply that the tenure holder which has the right to harvest the timber, in fact receives proprietary rights over the standing timber. Canada further discussed, in response to our questions, how various types of tenures or licences operate and when ownership of the timber is transferred to the tenure holder. In light of Canada's answers, it appears that the United States is correct when it argues that "there is no record evidence of stumpage contracts under which the contracting party (tenure holder or licensee) does not have ownership rights to the harvested timber".[92]

7.15 We also asked Canada whether the contractual rights to harvest could be sold without the permission of the provincial governments. Canada stated that the answer to this question varies from province to province, and it provided information concerning British Columbia, Alberta, Ontario and Quebec.[93] On the basis of this information provided by Canada we conclude that, in fact, in each province such rights cannot be sold without government permission, and that various types of tenures or licences are not transferable at all. We wish to emphasise that for purposes of Article 1.1 (a) (1) (iii) SCM Agreement, the exact legal nature of the stumpage contracts is not what is important. Rather, what is important for purposes of the Agreement is whether, through the stumpage programmes, the Canadian provincial governments are "providing a good" to the timber harvesters. We consider that, in essence, the stumpage programmes provide *standing timber* to the harvesters. Canada acknowledges that the provinces own the forests and the trees that grow in them.[94] The only way for harvesters to obtain the trees standing on government-owned Crown land for harvesting and processing is by concluding stumpage agreements (tenures or licences) with the governments concerning these trees. The only way for the government to provide the standing timber that it owns to the harvesters and the mills for processing is by allowing the harvesters to come on the land and harvest the trees. Such legal rights and obligations are transferred through the stumpage agreements. It is thus through the stumpage agreements that the governments provide the standing timber to the harvesters.[95] The price to be paid for the timber, in addition to the volumetric stumpage charge for the

[91] Canada Response to Questions of the Panel at the First Meeting (Annex A-1), para. 8. Also see for example Section 16 (2) of Alberta's Forests Act which provides in relevant part that "ownership of all Crown timber on land subject to a forest management agreement or forest management lease is, during the term of the agreement or lease, vested in the holder of the agreement or lease". (CDA-115)

[92] United States Response to Questions of the Panel at the First Meeting (Annex A-2), para. 9.

[93] Canada Response to Questions of the Panel at the First Meeting (Annex A-1), paras. 17 – 23.

[94] Canada First Oral Statement, para. 13.

[95] We note that this was also the view held by the Panel in the *US – Softwood Lumber III* case:

> "7.18 In sum, and in the context of Article 1.1(a) (1)(iii) SCM Agreement, we are of the view that where a government allows the exercise of harvesting rights, it is providing standing timber to the harvesting companies. From the perspective of the harvesting company the situation is clear: most forest land is Crown land, and if the company wants to cut the trees for processing or sale, it will need to enter into a stumpage contract with the provincial government, under which it will have to take on a number of obligations in addition to paying

trees harvested, consists of various forest management obligations and other in-kind costs relating to road-building or silviculture for example. In return, the tenure holders receive ownership rights over the trees during the period of the tenure.[96] In other words, with the stumpage agreements, ownership over the trees passes from the government to the tenure holders. Standing timber has thus been provided to the tenure holders.

7.16 This conclusion does not change whether one looks at it from the perspective of the recipient, the tenure holder, or from the perspective of the provider, the government. As noted by the Panel in the *US - Softwood Lumber III* case, from the perspective of the tenure holder, the only reason to enter into tenure agreements with the provincial governments is to obtain the timber.[97] The minimum cut requirements for tenure holders under certain stumpage programmes, the requirements to qualify as a tenure holder, such as the requirement to own a processing facility and other processing requirements, are just some examples that demonstrate that the provision and processing of standing timber is what the stumpage programmes are all about. This is not to say that the governments may not at the same time be pursuing certain other social, economic or environmental policies by imposing certain forest management obligations as conditions of sale. However, these conditions of sale or the costs that companies assume for obtaining the stumpage cannot alter the fundamental conclusion that the stumpage programmes provide standing timber, and not just a right to harvest such timber, to the tenure holders. In return, the tenure holders accept to pay a volumetric stumpage fee for the trees actually harvested and assume certain management and other obligations in order to obtain such timber.

7.17 In our view, the right to harvest standing timber is not severable from the right over the standing timber and providing the right to harvest timber is therefore no different from providing standing timber. In this respect we find illustrative the example given by the United States of someone who wants to buy the trees in his neighbour's backyard and the neighbour agrees that he can have the trees if he paints that person's house and pays him $100. As the United States correctly points out, "inherent in the contract is the buyer's right to cut down the trees and haul them away, if he fulfils the conditions of purchase, i.e., paints the house and pays the $100. Nevertheless, this is a contract for the sale of goods – the standing trees in the neighbour's backyard – not the sale of the 'right' to harvest the trees".[98]

7.18 We do not consider relevant the distinction that Canada makes between a contract which identifies individual trees to be cut, and an agreement concerning harvesting rights over a certain area of forest land. In our view, in both cases, trees are provided. In any case, it appears to us that, although a tenure agreement may not provide for a precise number of identified trees to be cut, the tenure holder knows all too well how many trees and which species of trees can be found on the area of land covered by his tenure.[99] In sum, we consider that in this context there is no meaningful

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> a stumpage fee for the trees actually harvested. We thus view the service and maintenance obligations, the obligations to undertake various forestry management, conservation and other measures, combined with the stumpage fees required by the stumpage agreements, as the price the tenure holder has to pay for obtaining and exercising its harvesting rights. (footnotes omitted)
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> Panel report, *US - Softwood Lumber III*, para. 7.18.

[96] This is evidenced for example in Alberta's Forests Act which provides that "ownership of all Crown timber on land subject to a forest management agreement or forest management lease is, during the term of the agreement or lease, vested in the holder of the agreement or lease". (CDA – 115). See Canada Response to Questions from the Panel at the First Meeting (Annex A-1), para. 11.

[97] Panel report, *US – Softwood Lumber III*, para. 7.16. We note that Canada acknowledged before that Panel that the main interest of tenure holders is the end-product of the harvest. Panel report, *US – Softwood Lumber III*, para. 7.16, fn. 46.

[98] United States Second Written Submission, para. 16

[99] In this regard, we note that there is a clear difference between tenure agreements concerning standing timber and the granting of extraction rights in the case of minerals or oil, or fishing rights where the owner of

distinction between the provision of a right to harvest timber and the provision of standing timber itself, and therefore find that the Canadian provincial stumpage programmes provide standing timber to the tenure or licence holders.

(b) Is standing timber a "good" in the sense of Article 1.1 (a) (1) (iii) SCM Agreement?

7.19 In order to determine whether the USDOC correctly found that through these stumpage programmes Canadian provincial governments provide goods in the sense of Article 1.1 (a) (1) (iii) SCM Agreement, we next consider whether standing timber is a "good" in the sense of Article 1.1 (a) (1) (iii) SCM Agreement.

7.20 Canada argues that standing timber, i.e., trees rooted in the ground, are not "goods" within the meaning of Article 1.1 SCM Agreement. In Canada's view trees do not fall within the ordinary meaning of the term "goods". Moreover, Canada is of the view that the term "goods" in the particular context of Article 1 SCM Agreement refers to tradeable products with an actual or potential tariff line and standing timber which cannot be traded across borders is therefore not a good in the sense of Article 1.1 (a) (1) (iii) SCM Agreement.

7.21 According to the United States, standing timber is clearly included within the broad ordinary meaning of the term "goods". In the view of the United States, the context in which the term is used in the WTO Agreement and the SCM Agreement in particular does not provide a basis to limit its application, for the purpose of Article 1.1 (a) (1) (iii) SCM Agreement, to products for which there is an actual or potential tariff line.

7.22 We recall that Article 3.2 DSU requires a panel to interpret the Agreement in accordance with customary rules of interpretation of public international law, which, it is well-accepted, include in particular Articles 31 and 32 of the Vienna Convention on the Law of Treaties. Article 31 of the Vienna Convention on the Law of Treaties provides that "a treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in light of its object and purpose". We will thus examine the ordinary meaning of the word "goods" used in Article 1.1 (a) (1) (iii) SCM Agreement – in its context and in light of the object and purpose of the Agreement.

7.23 The New Shorter Oxford Dictionary defines "goods" as, *inter alia*, "saleable commodities, merchandise, wares".[100] Black's Law Dictionary, to which both parties refer in search of the ordinary meaning of the term "goods", defines "goods" as follows:

> "1. Tangible or movable personal property other than money; esp. articles of trade or items of merchandise <goods and services>. The sale of goods is governed by Article 2 of the UCC. 2. Things that have value, whether tangible or not <the importance of social goods varies from society to society>.
>
> > "'Goods' means all things, including specially manufactured goods that are movable at the time of identification to a contract for sale and future goods. The term includes the unborn young of animals, growing crops, and other identified things to be severed from real property … . The term does not include money in which the price is to be paid, the subject-matter of foreign exchange transactions, documents, letters of credit, letter-of-credit rights,

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the right is not at all certain what and how much of it he will find, and what he pays for is the right to explore a particular site and the chance of finding something. In so noting, we do not mean to express a view as to what extent, if at all, this uncertainty would be relevant to a determination whether the granting of such extraction rights represented the provision of goods within the meaning of Article 1.1 (a) (1) (iii) SCM Agreement, an issue which is not before us.

[100] New Shorter Oxford Dictionary, edited by Lesley Brown, Clarendon Press Oxford, 1993, p.1116.

> instruments, investment property, accounts, chattel paper, deposit accounts, or general intangibles." UCC § 2 – 102 (a) (24).

7.24 The ordinary meaning of the term "goods" as "tangible or movable personal property other than money" is thus very broad and includes standing timber, as trees are tangible objects which are capable of being owned. This is further confirmed by the explanation in Black's Law Dictionary that a "good" includes "an identified thing to be severed from real property". Standing timber indeed seems to us to be an excellent example of an identified thing that can be severed from real property. We note that in its Sale of Goods Act, the Canadian province of British Columbia, the prime exporter of softwood lumber to the United States, itself defines "goods" as including "growing crops, […], and things attached to or forming part of the land that are agreed to be severed before sale or under the contract of sale".[101] In our view, this definition of a good certainly includes standing timber.

7.25 Article 31 Vienna Convention requires the interpreter to determine the ordinary meaning of the terms of the treaty *in their context and in the light of its object and purpose.* The immediate context of the term "goods" in Article 1.1 (a) (1) (iii) SCM Agreement is "goods or services, other than general infrastructure". We note that the term "goods" in this context is not qualified in any way and its use in the combination "goods or services", in our view, confirms that the term is to be understood broadly. We find further confirmation of this broad meaning in the fact that the drafters of the Agreement considered it necessary to explicitly exclude "general infrastructure". This implies that "goods or services" is sufficiently broad as to include "general infrastructure"; if not, there would have been no reason to explicitly exclude it. At the same time, "general infrastructure" is the only "good or service" which is excluded from the broad scope of Article 1.1 (a) (1) (iii) SCM Agreement. In our view, if the drafters had wanted to exclude other items such as natural resources or non-tradeable goods, they would have also explicitly excluded such "goods or services".

7.26 Article 1.1 SCM Agreement defines a subsidy for the purposes of the SCM Agreement. It provides that the first element of a subsidy is a "financial contribution by the government". Subparagraphs (i) through (iv) explain that a financial contribution can exist in a wide variety of circumstances including of course the direct transfer of funds.[102] A financial contribution will also exist if the government does not collect the revenue to which it is entitled or when it does something for ("provides a service") or supplies something to ("provides a good") a recipient. We are of the view that Article 1.1 (a) (1) (iii) SCM Agreement, in its context, clarifies that a *financial* contribution also exists where, instead of a money-transferring action, goods or services are provided. The context in which the term "goods" is used in Article 1.1 (a) (1) (iii) SCM Agreement as well as the purpose of Article 1 SCM Agreement in our view confirm the broad and unqualified meaning of the term "goods".

7.27 We consider Canada's interpretation, that the reference in Article 1.1 SCM Agreement to the provision of "goods" refers to tradeable products for which there is a tariff line, to be excessively narrow. We understand Canada to argue that, since on several occasions in the SCM and other WTO Agreements the term "goods" is qualified as "imported" or is understood to be tradable, and since for many goods there exists a tariff line, this necessarily implies that all "goods" have to be capable of being imported, and must therefore be tradeable.

7.28 We consider that the ordinary meaning of the term "goods", in its context and in light of the object and purpose of the Agreement, does not place the limitations on the meaning of the term suggested by Canada ("tradeable products with a potential or actual tariff line"). In our view, that in many cases in the GATT and the WTO Agreements the general term "good" is used as an equivalent of the term "products", does not imply that this is necessarily always the case. Precisely because of its broad ordinary meaning, the specific content of the term will be determined by the adjective

[101] Sale of Goods Act (British Columbia), RSBC 1996, ch. 410, section 1. (US –4)
[102] See also Panel Report, *US – Lumber III*, para. 7.24

accompanying the term as a sort of qualifier. In the absence of any such limitations placed on the term, as in Article 1.1 (a) (1) (iii) SCM Agreement, we consider that the term "goods" keeps its broad ordinary meaning. All that the text of Article 1.1 (a) (1) (iii) SCM Agreement suggests is that the goods or services are capable of being *provided* by a government; it does not address whether they can be imported or traded. The fact that the SCM Agreement relates to subsidies in the trade in goods context only, and does not cover services, does not mean that the "goods" provided by the government necessarily have to be goods that can be traded or that are covered by the GATT as products under Article II. We note in this respect that Article 1.1 (a) (1) (iii) SCM Agreement also mentions the provision of *services* by the government as constituting a financial contribution while the disciplines of the SCM Agreement, as discussed, only apply to trade in *goods*.

7.29 We agree with Canada that the definition of a subsidy in Article 1 SCM Agreement reflects the Members' agreement that only certain types of government action are subject to the SCM Agreement, and also that not all government actions that may affect the market come within the ambit of the SCM Agreement.[103] When the government provides goods or services, however, such action is clearly covered by the SCM Agreement. Standing timber, a physical and tangible object, is the log and lumber producers' prime input, and the action by the government to supply this input to the producers of logs and lumber, is the provision of a good and therefore covered by the SCM Agreement.[104]

7.30 In the absence of any textual basis for limiting the broad ordinary meaning of the term "goods" in the context of Article 1.1 (a) (1) (iii) SCM Agreement, we find that the USDOC Determination that the Canadian provinces are providing a financial contribution in the form of the provision of a good by providing standing timber to the timber harvesters through the stumpage programmes is not inconsistent with Article 1.1 (a) (1) (iii) SCM Agreement. We therefore reject all of Canada's claims of violation of the SCM Agreement and GATT 1994 in this respect.

B. CLAIM 2: INCONSISTENT DETERMINATION OF BENEFIT UNDER ARTICLE 14 (D) SCM AGREEMENT

1. Arguments of the parties

(a) Canada

7.31 Canada asserts that the USDOC found that Canadian provincial stumpage programmes conferred a benefit on Canadian stumpage holders by comparing the "price" paid for provincial stumpage *in Canada* with stumpage prices *in the United States.* Canada argues that such a cross-border analysis using transactions in a country other than the country of alleged provision of the good to determine the existence of a benefit, and measure it, is inconsistent with Article 1 and Article 14 (d) SCM Agreement. In Canada's view, for the purposes of Part V of the SCM Agreement, the proper benchmark in a provision of goods context is the home market price of a good, and not its price in some other market, nor some hypothetical construct. According to Canada, whether a "benefit" is conferred by the alleged provision of goods by the government through the stumpage programmes depends on whether the stumpage tenure or licence holders were better off than other purchasers who buy the same good from other sources *in Canada, the country subject to the investigation.*

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[103] Canada First Written Submission, para. 20. See Panel report, *US – Export Restraints*, para. 8.63.

[104] We note that the Panel in the *US – Softwood Lumber III* case came to a similar conclusion:
"7.29 […] Standing timber is the valuable input for logs which may be processed by sawmills into softwood lumber. In light of our finding that there is no basis in the text of the SCM Agreement to limit the term "goods" to tradeable products with a potential or actual tariff line, we consider that standing timber, trees, are goods in the sense of Article 1.1(a)(1)(iii) SCM Agreement". (footnotes omitted)
Panel report, *US – Softwood Lumber III*, para. 7.29.

7.32 Canada considers that the USDOC rejected record evidence pertaining to benchmarks in Canada for the alleged good provided, based on an unfounded assumption that it could legally reject in-country benchmarks and an unsupported factual conclusion that "there are no useable market-determined prices between Canadian buyers and sellers"[105] because prices were allegedly suppressed as a result of government involvement. In response to the US argument that private stumpage prices in Canada were distorted by the alleged government financial contribution and could therefore not be used as a benchmark, Canada submits that there is nothing in the text, context, or object and purpose of the Agreement that suggests that the market conditions referred to in Article 14 (d) SCM Agreement as the benchmark for measuring the adequacy of the remuneration received by the government for the good provided are those of a perfectly competitive market isolated from the effect of a financial contribution. According to Canada, by replacing "adequate remuneration" with "fair market value", the United States turns Article 14 (d) SCM Agreement into a provision that measures adequacy of remuneration by comparing the government price to a constructed "fair market value" rather than to the prevailing market conditions in the country of provision, contrary to the plain meaning of Article 14 (d) SCM Agreement.[106]

7.33 According to Canada, the record provided the USDOC with ample information regarding prevailing market conditions in Canada, such as private timber sales, cost-revenue comparisons, an economic analysis of provincial stumpage charges, competitive auction prices and private sector assessments of timber value.[107] In sum, Canada submits, there was sufficient useable information on the record concerning private stumpage prices which could have been, and should have been, used by USDOC in calculating the alleged benefit.

7.34 Canada rejects the United States argument that such Canadian price information could not be used because of alleged price suppression due to the Canadian government's involvement in the market. According to Canada, there is nothing in the SCM Agreement or WTO jurisprudence that mentions "price suppression" as a reason for dispensing with market benchmarks. Moreover, Canada submits, the USDOC did no analysis whatsoever to arrive at the conclusion that price suppression existed because of government presence in the Canadian market, but simply assumed that government market share demonstrated price suppression.[108]

7.35 Canada considers flawed the US argument that stumpage prices in the United States form part of the prevailing market conditions in Canada because US stumpage is available to Canadian loggers. According to Canada, stumpage prices *in the United States* cannot be considered to constitute part of the prevailing market conditions for stumpage *in Canada*. Canada is of the view that, even if in certain areas of the United States Canadian producers can legally bid on certain cutting rights in the United States, harvest US timber and import US logs for milling, US standing timber – the alleged good provided, not logs produced from the standing timber - is still not available "in" Canada. In addition, Canada argues, there are a number of factual differences between the rights and obligations involved in acquiring harvesting rights in the United States and in Canada which invalidate the use of US stumpage prices as a benchmark and which demonstrate that cross-border comparisons make no

[105] USDOC Final Determination, p. 36. (CDA-1)

[106] Canada First Oral Statement, para. 68.

[107] The actual information provided is discussed in detail in Canada's First Written Submission, paras. 94 – 110, and in Canada's First Oral Statement, paras. 50 - 54.

[108] Canada First Oral Statement, para. 58. According to Canada, the USDOC simply relied on the Preamble to its Regulations to presume price suppression based on government involvement in the marketplace (USDOC Final Determination, p.47 (CDA-1)). Canada argues that the economic report which the USDOC used as support for its presumption was purely theoretical and based on a flawed economic model, and most importantly, did not include consideration of any actual transaction prices. The remaining mainly anecdotal "evidence" relied on by the USDOC did not include any analysis of actual sales transactions either. Canada Second Written Submission, para. 26.

economic or common sense.[109] Canada asserts that the United States claim that it made adjustments to take into account these differences is not supported by the record.[110]

7.36 Finally, Canada argues that studies on the record demonstrate, consistent with classical economic theory, that the market for stumpage is an "economic rent" market, in which, for an input that is fixed in supply, such as an *in situ* natural resource like standing timber, the level of charges or fees for access to that resource will not lead to greater production of the output (logs or lumber), or lower prices for them than in a private competitive market. According to Canada, the USDOC ignored this evidence that stumpage charges do not provide lumber producers with an advantage in trade. In Canada's view, any determination of whether provincial stumpage systems confer a benefit must take into account the fact that the market at issue in this case is an economic rent market, and any analysis of adequate remuneration in relation to prevailing market conditions should have included a review of whether provincial stumpage fees or charges are capable of causing trade distortion in downstream markets, which the USDOC failed to do.

7.37 In sum, Canada argues that the USDOC Determination which found that the Canadian provincial stumpage programmes conferred a benefit was inconsistent with Articles 14 and 14 (d) SCM Agreement. Canada submits that, since the United States failed to make a proper subsidy determination in accordance with the SCM Agreement, the countervailing measures imposed on the basis of this flawed determination are inconsistent with Articles 10, 19.1, 19.4, 32.1 SCM Agreement and Article VI:3 GATT 1994.

(b) United States

7.38 The United States argues that a benefit is something better than the market would otherwise provide, absent the financial contribution. According to the United States, it is well established that a benefit from a governmental financial contribution is to be determined in comparison to the commercial market, and that the commercial market used for this comparison must, necessarily, be undistorted by the government's intervention.[111] The United States considers that the appropriate benchmark for measuring benefit in this case would normally have been the fair market value of timber in Canada.[112] However, the United States asserts, the record evidence demonstrated that the small non-government sector of the Canadian timber market was not a "commercial" market, i.e. a market undistorted by the government intervention, and Canadian private stumpage price information could thus not be used as the benchmark. Therefore, the USDOC used prices for comparable timber from alternate sources – the bordering regions of the northern United States – to determine the benefit

[109] Canada asserts that a wide variety of complex factors affect stumpage rates, such as locational characteristics, timber characteristics, measurement systems, operating costs, differences in economic conditions and tenure holders' rights and obligations. In Canada's view, the USDOC failed to make proper adjustments and ignored other obvious differences between the two markets. Canada discusses the problems relating to the use of US benchmarks in this case at length in its first written submission, paras. 82 - 91. Canada argues that this cross-border analysis is not consistent either with the USDOC's previous determination in the *Lumber I – III* cases, in which the USDOC explicitly recognized that cross-border comparisons are inherently "arbitrary and capricious" (CDA-26, *Lumber I*, p. 24, 168).

[110] Canada argues that if the United states had attempted to analyze and compare market conditions in Quebec and Maine for its cross-border analysis, it would have discovered that much of the data needed to make the necessary adjustments were unavailable. Canada Second Written Submission, para. 31.

[111] The United States refers to Appellate Body report, *Canada – Aircraft*, para. 157 and Panel report, *Brazil – Aircraft (Article 21.5 – Canada II)*, para. 5.29.

[112] According to the United States, "adequate remuneration" in the context of Article 14 (d) SCM Agreement must mean remuneration that is sufficient to eliminate any benefit. Benefit is something more favourable than would otherwise be available in the commercial market, i.e. fair market value. Logically, therefore, "adequate" remuneration is fair market value. United States First Written Submission, para. 42. The United States asserts that the proper benchmark is thus an independent market-driven price for the good, which is also the standard applied under Canadian law. United States Second Written Submission, para. 26. See Canadian Special Import Measures regulations, C.R.C SOR/84-927. (US –10).

conferred by the provision of standing timber from Crown land adjusted to reflect market conditions in Canada, in accordance with Articles 1 and 14 (d) SCM Agreement.

7.39 The United States asserts that Article 14 (d) SCM Agreement provides that the adequacy of the remuneration and the existence of a benefit must be determined "in relation to" the prevailing market conditions (such as the conditions of sale, price, etc.) in the country under investigation, i.e. "with reference to" or "taking account of" market conditions in the country of provision. The United States considers that Article 14 (d) SCM Agreement is silent on the data to be used to determine "adequate remuneration", and the choice of data is therefore up to the investigating authority. According to the United States, Article 14 (d) SCM Agreement does not restrict that data to "in-country" sources.[113] Rather, what is important is that the method used must result in a fair market value assessment that *relates to* conditions of sale (i.e. prevailing market conditions) in the country of provision. The United States argues that Members such as the European Communities[114] also permit the use in certain circumstances of prices on the world market to assess adequate remuneration, and that Canada itself acknowledges that, in case of a government monopoly, prices of imports could be used.[115] In addition, the United States submits, the object and purpose of the SCM Agreement, which is to provide a remedy to offset an artificial advantage provided by the government, requires an interpretation of Article 14 (d) SCM Agreement that permits the use of external evidence of fair market value when it is shown, based on positive evidence, that domestic prices are heavily distorted by the very financial contribution whose benefit is being measured.

7.40 The United States asserts that the limited non-government price data submitted by the Canadian parties in this case was inadequate[116] and that such prices were significantly affected by the financial contribution itself, i.e. the supply of provincial government timber. A price artificially suppressed by the government's financial contribution is not a "market" price, that is, a price between buyers and sellers responding to market forces of supply and demand.[117] According to the United States, the record demonstrates that Canadian government timber sales were dominant relative to private timber sales, ranging from 83 to 98 per cent of the total market, and that, given the circumstances, it would not have been reasonable to conclude that the small amount of private timber sales was unaffected by the dominant government-supplied timber.[118] The United States argues that studies by economists and other experts demonstrated that private timber prices in Canada were depressed and distorted by the overwhelming volume of government-supplied timber in the provinces.[119] The United States concludes that there did not exist a reliable source of market-

[113] The United States notes that the Panel in the *US - Softwood Lumber III* case acknowledged that import prices can be used to determine adequate remuneration. Panel report, *US – Softwood Lumber III*, para. 7.48.

[114] European Communities Third Party Submission, para. 29. Notification of laws and regulations under Article 32.6 of the Agreement, European Communities, G/SCM/N/1/EEC/2/Suppl.3 (18 November 2002). (US – 15).

[115] The United States refers to answers provided by Canada to questions from the Panel in the *US - Softwood Lumber III* case. (US – 17).

[116] The United States provides an overview of the information on non-government market prices submitted per province in its first written submission. United States First Written Submission, para. 66.

[117] United States First Oral Statement, para. 16. According to the United States, market prices are prices between independent buyers and sellers in a competitive market where prices are determined by the forces of supply and demand – not driven by the government's financial contribution. United States First Oral Statement, para. 15.

[118] United States First Written Submission, paras. 69 – 70. According to the United States, evidence demonstrates that the provincial governments administer prices under systems designed to promote employment and keep mills operating even in down markets, and are shaping the conditions under which the timber market in Canada operates, including artificially decreasing demand for and increasing the supply of Crown timber.

[119] These studies are referenced in the United States First Written Submission, footnotes 94 – 100. In addition, the United States notes that the tenure holders' needs can be met from their own provincial tenures and as a general rule, mills will thus not have to resort to the private market which suggests that private sellers must tailor their prices to the predominant government-administered price.

determined prices in Canada which could have been used by the USDOC as a basis for the benefit determination.

7.41 In the absence of a reliable source of market-determined fair market value prices in Canada, the USDOC used prices for comparable timber from alternate sources – the bordering regions of the northern United States – which are commercially available to Canadian lumber producers, as the "starting-point" for its fair value assessment, and made adjustments to those US prices (e.g. for the road-building, silviculture, and fire and disease protection obligations under Canadian stumpage contracts).[120] According to the United States, the USDOC made such adjustments based upon the "prevailing market conditions" in Canada to arrive at the fair market value of timber *in Canada*, in accordance with the text, context, object and purpose of Article 14 (d) SCM Agreement. The United States submits that the use of United States source data for comparable timber of the same species immediately across the border, as a starting-point, and adjusted as appropriate for provincial market conditions was justified and formed a reasonable basis to assess the fair market value of timber in Canada.[121]

7.42 Finally, the US submits that the SCM Agreement does not define benefit in terms of increased output or lower prices for the subject merchandise and does not create an exception for natural resource inputs as Canada is arguing on the basis of the economic rent theory. Rather, the "benefit" referred to in Article 1.1(b) SCM is a benefit to its *recipient*, and this benefit, whether it is cash or natural resource inputs, is in no way dependent upon the downstream effects of the subsidy. The United States argues that Canada failed to identify any obligation in the SCM Agreement to conduct a market distortion analysis as part of the benefit determination, and asserts that no such obligation exists.

2. Analysis

7.43 Canada's claim concerns the benchmark used by the USDOC for determining "benefit". According to Canada, the USDOC used stumpage prices *in the United States* as a benchmark for determining benefit to *Canadian* lumber producers, instead of non-government prices *in Canada*. Canada argues that as a matter of principle such a cross-border price analysis is not permitted under Article 14 (d) SCM Agreement, which requires that the prevailing market conditions in the country of provision, i.e. in Canada, be used as the benchmark for determining the adequacy of the remuneration received by the government for the good allegedly provided. In sum, Canada submits that Article 14 (d) SCM Agreement does not allow an authority to base its determination of benefit on market conditions or prices from outside the country under investigation, as the USDOC did.

7.44 The United States asserts that in this case it was not possible to assess the adequacy of the remuneration on the basis of in-country prices. According to the United States, the government completely dominates the stumpage market and there is evidence on the record of price suppression due to the government's involvement which makes it impossible to use the small amount of private stumpage prices as a basis for any comparison. In sum, the United States argues that although in-country prices are normally the preferred benchmark for determining benefit, in this case private market prices in Canada are not reflective of the "fair market value" of timber in Canada, due to the near-total dominance of the government in the Canadian timber market. According to the United States, it would be a completely circular reading of Article 14(d) SCM Agreement that the government-administered price for timber would need to be compared to the price charged by private

[120] United States First Written Submission, para 82. The United States notes in this respect that Canadian lumber producers can purchase US timber, cut it (or have it cut), and transport it to their mills in Canada, and that some Canadian mills have done so, in spite of the abundant supply of provincial timber available in Canada at below market prices. United States Second Oral Statement, para. 19.

[121] The United States provides a brief rebuttal of Canada's argument that there are too many practical differences in comparing Canadian and US timber prices in attachment 2 to its first written submission.

timber sellers in Canada, as these latter have no choice but to align their prices to the administered prices set by the government. Thus, in effect, a comparison of the government price with the private price would amount to a comparison of the government price with itself. Moreover, according to the United States, the USDOC used the US stumpage prices as a "starting-point" and adjusted such prices, to reflect Canadian "prevailing market conditions", and it thus acted in a manner consistent with Article 14(d) SCM Agreement. Finally, the United States argues that the provinces did not provide sufficient information on private stumpage sales in order for those to be used as a benchmark for determining benefit.[122]

7.45 Article 1 of the SCM Agreement provides that a subsidy in the sense of the SCM Agreement exists when a financial contribution, like the provision of a good or a service by the government, *confers a benefit*. Article 14 SCM Agreement, and Article 14 (d) SCM Agreement in particular, govern the benefit analysis an investigating authority is to perform in order to determine the existence and amount of a subsidy in cases, such as the one before us, where the financial contribution at issue consists of the provision of a good or service by the government. In this respect, we recall that the USDOC found that the Canadian provincial stumpage programmes provide a good, standing timber, to stumpage holders. Article 14 (d) SCM Agreement provides as follows:

Article 14

Calculation of the Amount of a Subsidy in Terms of the Benefit to the Recipient

> For the purpose of Part V, any method used by the investigating authority to calculate the benefit to the recipient conferred pursuant to paragraph 1 of Article 1 shall be provided for in the national legislation or implementing regulations of the Member concerned and its application to each particular case shall be transparent and adequately explained. Furthermore, any such method shall be consistent with the following guidelines:
>
> (a) government provision of equity capital shall not be considered as conferring a benefit, unless the investment decision can be regarded as inconsistent with the usual investment practice (including for the provision of risk capital) of private investors in the territory of that Member;
>
> (b) a loan by a government shall not be considered as conferring a benefit, unless there is a difference between the amount that the firm receiving the loan pays on the government loan and the amount the firm would pay on a comparable commercial loan which the firm could actually obtain on the market. In this case the benefit shall be the difference between these two amounts;
>
> (c) a loan guarantee by a government shall not be considered as conferring a benefit, unless there is a difference between the amount that the firm receiving the guarantee pays on a loan guaranteed by the government and the amount that the firm would pay on a comparable commercial loan absent the government guarantee. In this case the benefit shall be the difference between these two amounts adjusted for any differences in fees;
>
> *(d) the provision of goods or services or purchase of goods by a government shall not be considered as conferring a benefit unless the provision is made for less than adequate*

[122] We wish to note in this respect that there does not appear to be any dispute between the parties that the provinces were aware of the fact that such information had been requested.

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

7.46 Article 14 (d) SCM Agreement thus establishes that the provision of goods by a government shall not be considered as conferring a benefit unless the provision is made for less than *adequate remuneration*. The adequacy of the remuneration charged by the government shall be determined "*in relation to the prevailing market conditions for the good or service in question in the country of provision or purchase"*.

7.47 In accordance with the customary rules of interpretation of public international law, our analysis of Article 14 (d) SCM Agreement begins with the specific words of the provision, as the text is the most authentic expression of the intention of the drafters of the Agreement. We recall that Article 31 of the Vienna Convention on the Law of Treaties provides that "a treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in light of its object and purpose". As the Appellate Body has stated on various occasions, a proper interpretation is first of all a textual interpretation, and the task of interpreting a treaty provision must begin with the specific words of that provision.[123]

7.48 We note that the text of Article 14 (d) SCM Agreement provides that the standard for determining benefit is whether "adequate remuneration" has been received by the government providing the good. The term "adequate" is defined as "sufficient, satisfactory" in the New Shorter Oxford Dictionary.[124] It is clear that "adequacy" is a relative concept; what is "adequate" in one given set of circumstances is not "adequate" in another. The set of circumstances to which the term relates in Article 14 (d) SCM Agreement are the prevailing market conditions in the country of provision. In our view, the term "in relation to" - or "*par rapport aux*" in the French version of the text – in this context means "in comparison with"[125] and Article 14 (d) SCM Agreement thus provides that the prevailing market conditions in the country of provision are the benchmark against which to judge the adequacy of the remuneration received by the government for the stumpage provided.

7.49 The United States argues that the broad phrase "in relation to" allows for various means of performing a comparison that relates to market conditions in the country under investigation. The United States is of the view that Article 14 (d) SCM Agreement does not specify the methods for performing such an analysis or the types of data that may be used, because it sets out "guidelines", i.e. general principles, not detailed rules.[126] We do not consider that Article 14 (d) does not specify the data that may be used for determining adequate remuneration. To the contrary, Article 14 (d) SCM Agreement uses the term "shall" to indicate that adequacy of remuneration must be determined in relation to, i.e. compared with, the prevailing market conditions in the country of provision, and the data to be used are those which reflect the prevailing market conditions in the country of provision. The precise detailed method of calculation is not determined, in that sense Article 14 (a) – (d) SCM Agreement are guidelines, but the framework within which this calculation is to be performed is clearly determined and limited in a mandatory manner by the prevailing market conditions in the country of provision.

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[123] Appellate Body Report, *Japan – Alcoholic Beverages II*, page 18. Also see, for example, Appellate Body Report, *US – Offset Act (Byrd Amendment)*, para. 281.

[124] New Shorter Oxford Dictionary, Edited by Lesley Brown, Clarendon Press – Oxford, ed. 1993, p. 26.

[125] Harrap's Shorter French – English Dictionary, Chambers Harrap Publishers Ltd 1996, p. 761. The New Shorter Oxford Dictionary defines "in relation to" as "as regards", New Shorter Oxford Dictionary, Edited by Lesley Brown, Clarendon Press – Oxford, ed. 1993, p. 2534.

[126] United States Response to Questions from the Panel at the Second Meeting (Annex B-2), para. 23.

7.50 Article 14 (d) SCM Agreement refers the authority to the "prevailing" market conditions, i.e. the market conditions "as they exist" or "which are predominant"[127] in the country of provision. Therefore, according to Article 14 (d), the price of the good provided, its quality, availability, marketability, transportation and other conditions of purchase or sale which are used as the benchmark for determining the adequacy of the remuneration have to be such as are prevailing in the country of provision. In sum, a plain reading of the text of Article 14 (d) leads us to the initial conclusion that the market which is to be used as the benchmark for determining benefit to the recipient is the market of the country of provision, in this case Canada.[128]We note that the United States itself acknowledges that the adequacy of remuneration must be determined in relation to the prevailing market conditions "in the country of provision".[129] According to the United States, that begs the question whether there are in fact "market" conditions for the good in the country of provision that provide probative evidence for determining the adequacy of the remuneration. According to the United States, the Panel must give meaning to the word "market" and it asserts that the point of comparison under Article 14 (d) SCM Agreement must be prevailing *commercial* market conditions, i.e. *a market undistorted by the government's financial contribution*, in the country of provision.[130] The view of the United States thus appears to be that, when actual prices prevailing in the market are distorted by the government's financial contribution, and thus do not represent the "fair market value" of the goods in question, "prevailing market conditions" may be established on a basis other than actual prices prevailing in the country of provision.

7.51 As we have indicated above, our analysis has to be based on the text of the Agreement, as a proper interpretation is first of all a textual interpretation. The text of Article 14 (d) SCM Agreement does not qualify in any way the "market" conditions which are to be used as the benchmark. As such, the text does not explicitly refer to a "pure" market, to a market "undistorted by government intervention", or to a "fair market value". Rather, Article 14 (d) SCM Agreement identifies the market conditions which shall be used to determine adequacy of remuneration as those which are "prevailing" in respect of the price of the good, its quality, availability, marketability, transportation, and other conditions of purchase or sale, in other words, the market conditions "as can be found". Such market conditions must be those found in the country of provision, in this case Canada. Thus, the text of Article 14 (d) indicates that the analysis the authority is to perform is whether the government, when providing a good, is receiving a remuneration which is adequate, when compared to the price of the good in the market of that country, taking into account the quality of the good, its availability, marketability, transportation and other conditions of sale that apply in the country of provision. We see nothing in the text of Article 14 (d) that would justify disregarding those prices on the grounds that they were "distorted" or did not reflect the "fair market value" of the goods provided.

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[127] New Shorter Oxford Dictionary, Edited by Lesley Brown, Clarendon Press – Oxford, ed. 1993, p. 2347.

[128] We consider it relevant to recall in this respect the context of Article 14 (d) SCM Agreement. Article 14 SCM Agreement provides specific rules for calculating benefit in four situations of a financial contribution provided by the government. Articles 14 (b) and 14 (c) SCM Agreement concern the government's provision of a loan and a loan guarantee. In both cases, the benchmark to be used for the calculation of benefit is the "comparable commercial loan" and the "comparable commercial loan absent the government guarantee". The market for obtaining this loan is not limited to the market of the country of the government providing the loan or the loan guarantee. In the case of the government providing equity capital, the benchmark under Article 14 (a) SCM Agreement is the usual investment practice of private investors *in the territory of that Member*. Contrary to the two cases identified above, Article 14 (a) SCM Agreement thus specifically ties the usual investment practices to the territory of the Member making the investment decision. Similarly, under Article 14 (d) SCM Agreement, the Agreement explicitly and specifically limits the scope of the inquiry into the adequacy of the remuneration to the "prevailing market conditions in the country of provision". In our view, if the drafters of the Agreement had wanted to allow consideration of conditions outside the market in question, they could have explicitly done so, as they did in the case of loans and loan guarantees. They did not do so in the case of the government provision of a good.

[129] United States Second Oral Statement, para. 12.

[130] United States Second Written Submission, para. 27. United States Second Oral Statement, para. 11.

7.52 The United States finds support for its argument that the "prevailing market conditions in the country of provision" have to be those of a *commercial* market *undistorted by the government's financial contribution* in the report of the Appellate Body on *Canada – Aircraft* and in the report of the Panel in the case *Brazil – Aircraft*. According to the United States, only by comparison to a market undistorted by the government's financial contribution is it possible to determine the trade distorting potential of the subsidy by assessing whether the recipient is better off than it would otherwise have been absent the financial contribution.[131]

7.53 We recall that the Appellate Body in the *Canada – Aircraft* case clarified what it considers to be the analysis that is to take place in order to determine whether the financial contribution conferred a benefit to the recipient:

> "157. We also believe that the word "benefit", as used in Article 1.1(b), implies some kind of comparison. This must be so, for there can be no "benefit" to the recipient unless the "financial contribution" makes the recipient "better off" than it would otherwise have been, absent that contribution. In our view, the marketplace provides an appropriate basis for comparison in determining whether a "benefit" has been "conferred", because the trade-distorting potential of a "financial contribution" can be identified by determining whether the recipient has received a "financial contribution" on terms more favourable than those available to the recipient in the market." [132]

7.54 We agree with the general principle expressed by the Appellate Body that a benefit analysis is to be conducted against the background of the marketplace in order to determine whether the recipient was better off than it would have been absent the financial contribution. We note, however, that the language quoted above formed part of the Appellate Body's general discussion about "benefit" under Article 1.1 (b) SCM Agreement. The Appellate Body was not addressing the particular wording of the text of Article 14 (d) SCM Agreement. Nor was the Appellate Body in that case addressing the issue before us in this dispute. To the contrary, the Appellate Body's statement in *Canada – Aircraft* was made in the context of an argument by Canada that the Panel had erred in considering that the notion of "cost to government" was not relevant to the interpretation and application of the term "benefit". The Appellate Body decided that it was the marketplace, and not the cost to government, that was the appropriate basis for comparison; the question whether the term "market" means a market undistorted by the government's financial contribution was simply not before it, and there is no indication that the Appellate Body had any intention of addressing it. Thus, we do not consider that this statement of the Appellate Body, which related to the interpretation of a different article of the SCM Agreement and was made in the context of a very different issue than the one before us in this dispute, sheds much light on the issue before us here.

7.55 It is certainly correct that the Panel in the *Brazil – Aircraft* case stated that the "market" referred to "must necessarily be a 'commercial' market, i.e. a market undistorted by government intervention".[133] However, that Panel also was addressing a very different question from the one before us here. The Panel rejected a particular argument by Brazil by clarifying that the "market" to which reference was made should not include other governments' export credit practices, but only those of non-government entities, as it could well be that other governments were also granting export credits at a subsidized rate.[134] In other words, the thrust of the Panel's statement was that it would not

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[131] The United States asserts that "Applying the reasoning of the Appellate Body, 'less than adequate remuneration' must mean a price less than would otherwise be available in the marketplace absent the government's financial contribution". United States Second Written Submission, para. 26.

[132] Appellate Body report, *Canada – Aircraft*, para. 157.

[133] Panel Report, *Brazil – Aircraft (Article 21.5 – Canada II)*, para. 5.29.

[134] In particular, Brazil had argued that in order to establish whether the export credits granted by the government conferred a benefit compared to rates available in the marketplace, one should not distinguish

be appropriate to determine whether a particular financial contribution conferred a benefit by comparing the terms of that financial contribution with those of other government financial contributions. This is an eminently sensible proposition with which we cannot but agree. However, neither party in this case has suggested that the "prevailing market conditions" referred to in Article 14 (d) include other government financial contributions, and we thus fail to see how the ruling of the Panel in that case is relevant to the issue before us here.

7.56 The United States suggests that Canada's reading of Article 14 (d) SCM Agreement would lead to an absurd result, as it would preclude in all cases the use of data from outside the country of provision, even when no market conditions exist in the country of provision, thereby making it impossible to ever establish the existence of subsidization in case the government is the only player on the market.

7.57 We do not consider that our reading which is based on the text of the Agreement would lead to this absurd result. We do not exclude the possibility that it will in certain situations not be possible to use in-country prices. Certainly, in our view, in a situation where, for example, the government is the *only* supplier of the good in the country, or where the government administratively controls all of the prices for the good in the country, there would be *no* price other than the price charged by the government and thus no basis for the comparison foreseen in Article 14(d) SCM Agreement.[135] The only remaining possibility would appear to be the construction of some sort of a proxy for, or estimate of, the market price for the good in that country.[136] We emphasise that it has not been argued however that there are *no* private buyers and sellers of stumpage in Canada. In other words, it has not been argued that there is *no private market* for stumpage in Canada.[137] Neither has it been argued that the Canadian provincial governments administratively set the price for private stumpage. As the United States clearly stated, in-country prices were rejected because they were significantly affected by the financial contribution, and because the USDOC considered that the observed non-government prices were for that reason simply uninformative of adequate remuneration.[138] We therefore consider that the situation confronted by the USDOC was not one where there were no market prices.

7.58 We also recognize the more subtle problem of economic logic identified by the United States. The United States argues that the problem of reading the text of Article 14 (d) SCM Agreement to require that, as soon as there is a market, no matter how small or affected by the government intervention in the market, such market prices are to be used in determining the adequacy of the remuneration, is that it could lead to a circular comparison of a government price with, in effect,

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between commercial and non-commercial benchmarks in determining what interest rates prevailed in the "marketplace". Canada on the other hand had argued that reference should be made in this context to purely commercial transactions – *i.e.*, transactions not benefiting from official support – and Canada thus defined the "marketplace" to mean the purely commercial marketplace. The Panel rejected Brazil's argument and clarified that the "market" to which reference was made should not include other governments' export credit practices, but only those of non-government entitities, as it could well be that other governments were also granting export credits at a subsidized rate.

[135] This of course also assumes no or negligible imports of the good in question.

[136] We note that Canada itself agrees that in the context of a government monopoly over domestic production, import prices for the same good, which may or may not be "world market prices", if available to purchasers in the country of provision, could be used as a benchmark to measure adequacy of remuneration. Canada Second Written Submission, para. 41. The European Communities in its Third Party Submission clarifies that it considers that it should be possible to use world market prices "if it can be established in exceptional cases that there are no prevailing market conditions within the meaning of Article 14 (d) second sentence of the SCM Agreement, so that that rule cannot be applied in order to establish the existence of a benefit". European Communities Third Party Submission, para. 31.

[137] Indeed, as we will discuss later, the USDOC's Final Determination notes that private market sales of stumpage account for between 1 and 17 per cent of total stumpage sold in each province.

[138] United States First Written Submission, para. 65.

itself.[139]We acknowledge that the concern raised by the United States may be a legitimate one in certain cases. In the situation addressed by Article 14 (d) SCM Agreement, the government fulfils a role normally also played by private market players: it provides goods or services. In these situations, the government is acting on the market and, by so doing, may influence the private market. Whether and to what extent such government action influences the private market will of course depend upon the particular circumstances, but there could be cases in which that influence is substantial or even determinative of conditions in the private market. In such cases, a comparison of the conditions of the government financial contribution with the conditions prevailing in the private market would not fully capture the extent of the distortion arising from the government financial contribution, a result that in our view would not necessarily be the most sensible one from the perspective of economic logic.

7.59 That said, we do not believe that it would be appropriate for this Panel to substitute its economic judgement for that of the drafters. The Appellate Body has repeatedly emphasized, and we cannot but agree, that under Article 31 of the Vienna Convention on the Law of Treaties the interpretation of a treaty must be based on the text, as a proper interpretation is first of all a textual interpretation.[140] For all the reasons set forth above, we do not consider that Article 14 (d) can, consistent with customary rules of interpretation of public international law, be understood in the manner urged by the United States. We consider that our task is to interpret the applicable provisions as they exist and apply the text of the Agreement to the facts before us, not to rule on the economic logic of the text as it stands.

7.60 In sum, our conclusion on the basis of the text of Article 14 (d) SCM Agreement is that as long as there are prices determined by independent operators following the principle of supply and demand, even if supply or demand are affected by the government's presence in the market, there is a "market" in the sense of Article 14(d) SCM Agreement.[141] The problem raised by the United States of comparing in certain situations the government price with a market price significantly affected by the government's price, is in our view inherent in the text of Article 14 (d) SCM Agreement. We consider that, if the Members feel the rules as laid down in the WTO Agreements do not address certain situations in what they consider to be a satisfactory manner, they should raise this issue during negotiations. Our task consists of interpreting the Agreement to explain what it means, not what in our view it should mean, nor are we allowed to read words in to the text of the Agreement which are not there, even if we were to consider that the text inadequately addresses certain specific situations.

7.61 Applying our analysis to the facts of this case, we examined whether the USDOC had before it information concerning the prevailing market conditions in Canada and whether it relied on such

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[139] The United States argues that if the role of the government as the owner of an unlimited supply of the good is so predominant that the private sellers have no choice but to align their prices with those of the government, then the conclusion should be that the government has effectively set the price for the good throughout the market. In order to avoid this problem, the United States suggests that the word "market" in Article 14(d) SCM Agreement should be read at least to reflect a "bona fide, functioning" market. The United States argues that some sort of a proxy to estimate market conditions should be used where no "real" market conditions are directly observable.

[140] Appellate Body Report, *Japan – Alcoholic Beverages II*, pages 12 and 18. Appellate Body Report, *EC – Hormones*, para. 181; Appellate Body Report, *India – Patents (US)*, para 45; Appellate Body Report, *US – Shrimp*, para. 114; Appellate Body Report, *India – Quantitative Restrictions*, para. 94. Appellate Body Report, *US – Offset Act (Byrd Amendment)*, para. 281.

[141] We note that the Panel in the *US - Softwood Lumber III* case came to a similar conclusion:

> "7.53 We wish to note that even if in certain exceptional circumstances it may prove difficult in practice to apply Article 14 (d) SCM Agreement, that would not justify reading words into the text of the Agreement that are not there or ignoring the plain meaning of the text. In our view, the text of Article 14 SCM Agreement leaves no choice to the investigating authority but to use as a benchmark the market, for the good (or service) in question, *as it exists* in the country of provision."
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> Panel Report, *US – Softwood Lumber III*, para. 7.53.

information. We consider that the USDOC summarized the situation with regard to the existence of the private market in Canada as follows:

> "During the POI, total softwood harvested from Crown lands accounted for between approximately 83 and 99 per cent of all softwood timber harvested in each of the Provinces. Specifically, the Provincial, federal and private share of softwood timber harvests, by Province are:
>
> British Columbia – 90 per cent Provincial, less than 1 per cent federal, and almost 10 per cent private;
>
> Quebec – 83 per cent Provincial, and 17 per cent private;
>
> Ontario – 92 per cent Provincial and 7 per cent private;
>
> Alberta – 98 per cent Provincial, 1 per cent federal, and 1 per cent private;
>
> Manitoba – 94 per cent Provincial, 1 per cent federal and 5 per cent private;
>
> Saskatchewan – 90 per cent Provincial, 1 per cent federal and 9 per cent private."[142]

7.62 The USDOC Determination further provides that "Alberta, Ontario and Quebec have provided private stumpage prices for their respective Provinces. British Columbia provided stumpage prices set by government auction".[143]

7.63 As a factual matter, we therefore find that the USDOC acknowledged the existence of a private market for stumpage in Canada. It is clear therefore that we are not confronted with a situation where there are *no* market conditions in the country of provision which, for practical reasons would require the use of a proxy of some sort. Moreover, the USDOC Determination shows that the USDOC had before it private stumpage prices for four of the most important provinces. Our analysis is based upon the USDOC's establishment of the facts of record, as we are not to perform a *de novo* review. In spite of the many arguments made before us concerning the in-country price data, or the absence thereof, we find that there is no basis in the USDOC Determination for us to assume that the reason why such private price information was rejected and US stumpage prices were used instead was a lack of information concerning private stumpage prices. On the basis of the record, we find that the USDOC decided not to rely on the Canadian private stumpage prices, because it considered that "a valid benchmark must be independent of the government price being tested; otherwise the benchmark may reflect the very market distortion the comparison is intended to detect".[144] Based on this view, the USDOC reached the conclusion that "there are no useable market determined prices between Canadian buyers and sellers".[145] The USDOC decided to rely on stumpage prices in the United States instead.

7.64 In light of the fact that the USDOC acknowledged the existence of a private stumpage market in Canada, we find that the resort to US prices as the benchmark for the determination of benefit on grounds that private prices in Canada were distorted is inconsistent with Article 14 (d) SCM

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[142] USDOC Final Determination, p. 37 – 38. (CDA – 1)

[143] USDOC Final Determination, p. 36. (CDA – 1)

[144] USDOC Final Determination, p. 37. (CDA – 1). The USDOC further explains that in its view "The preamble to section 351.511 of the Regulations provides that, where a government has a dominant position in a market, the Department will avoid the use of private prices in determining the adequacy of remuneration. Where the market for a particular good is so dominated by the presence of the government, the remaining private prices in the country in question cannot be considered to be independent of the government price". USDOC Final Determination, p. 58. (CDA – 1)

[145] USDOC Final Determination, p. 36. (CDA – 1)

Agreement. As a consequence, we need not address the issue whether the USDOC had sufficient evidence of price suppression or conducted a proper analysis of the alleged distortive effect of the dominant government presence in the market. Nor need we address whether the proxy used by the United States for the prevailing market conditions in Canada was appropriate, i.e. whether the USDOC made proper adjustments to the US stumpage prices to reflect market conditions in Canada. Neither do we consider it relevant to rule on the argument made by Canada that any benefit analysis should include a determination of the potential trade advantage for the recipient of the subsidy.

7.65 For the reasons set forth above, we uphold Canada's claim that the USDOC failed to determine benefit in a manner consistent with Articles 14 and 14 (d) SCM Agreement and we therefore find that the USDOC's imposition of countervailing measures was inconsistent with the United States' obligations under Articles 14 and 14 (d) SCM Agreement as well as Articles 10 and 32.1 of the SCM Agreement as these countervailing measures were imposed on the basis of an inconsistent determination of the existence and amount of a subsidy.[146] In light of our finding, we do not consider it necessary to address Canada's additional claims regarding the consistency of the USDOC's actions with Articles 19.1 and 19.4 SCM Agreement and Article VI:3 of GATT 1994.

C. CLAIM 3: USDOC IMPERMISSIBLY ASSUMED A PASS-THROUGH OF THE ALLEGED SUBSIDY

7.66 Canada's pass-through claim is based on the *arguendo* assumption that stumpage provides subsidies, i.e., that stumpage constitutes a financial contribution in the form of provision of a good, and that that financial contribution confers a benefit. That is, Canada's claim is that even if stumpage does provide subsidies, the USDOC erred in not conducting a pass-through analysis in determining subsidization of softwood lumber in the case of certain upstream transactions for inputs. Notwithstanding our finding that the US failed to determine benefit in a manner consistent with Article 14 SCM Agreement, we address this claim adopting the same *arguendo* assumption for purposes of our analysis.

7.67 We note that the US seems to raise a jurisdictional challenge to Canada's citation of Article 1.1 SCM Agreement in connection with this claim. We address this jurisdictional issue in section VII.C.2(c), *infra*.

1. Arguments of the parties

(a) Canada

7.68 Canada claims that by not investigating whether alleged subsidy benefits from stumpage programmes were passed through in arms'-length transactions between timber harvesters and unrelated sawmills, and between sawmills and unrelated re-manufacturers, the United States countervailed subsidies the existence and amount of which it presumed instead of determined. In particular, Canada takes issue with the conclusions in the USDOC's final determination that, in respect of sawmills that purchase logs at arms'-length, no subsidy pass-through analysis was required because the alleged subsidy is a subsidy "to the production of lumber, not the production of timber or logs"[147], and in respect of re-manufacturers that purchase lumber from stumpage holders at arms'-

[146] Article 10 SCM Agreement provides that "Members shall take all necessary steps to ensure that the imposition of a countervailing duty on any product of the territory of any Member imported into the territory of another Member is in accordance with the provisions of Article VI of GATT 1994 and the terms of this Agreement. Countervailing duties may only be imposed pursuant to investigations initiated and conducted in accordance with the provisions of this Agreement and the Agreement on Agriculture".

Article 32.1 SCM Agreement states that "no specific action against a subsidy of another Member can be taken except in accordance with the provisions of GATT 1994, as interpreted by this Agreement".

[147] Canada First Written Submission, para. 130, citing USDOC Final Determination (CDA-1) p. 18.

length, that as the case was conducted on an aggregate basis, "a review is the appropriate avenue to determine if there are specific companies that do not receive countervailable benefits"[148].

7.69 According to Canada, the Appellate Body has confirmed, in *US – Lead and Bismuth II*, that in a countervailing duty investigation, the existence of a subsidy may never be presumed.[149] Furthermore, Canada notes, the Panel in *US – Softwood Lumber III* found in favour of Canada and against the US in respect of the pass-through issue in the preliminary countervailing duty investigation on softwood lumber.[150]

7.70 Canada further argues that where lumber producers do not harvest timber but obtain inputs from upstream producers, any alleged subsidy by definition must be indirect, and that indirect subsidization is established by demonstrating the existence of both an indirect financial contribution, through entrustment or direction under Article 1.1(a)(1)(iv), and a benefit under Article 1.1(b). According to Canada, USDOC made no finding in respect of financial contribution by government to lumber producers or re-manufacturers in respect of inputs purchased at arms'-length, nor did USDOC find that the alleged benefit was conferred to lumber producers or re-manufacturers through downstream purchases. Thus, Canada claims, the failure by the USDOC to establish the existence of a subsidy in respect of arms'-length transactions for lumber inputs violated the SCM Agreement.[151]

7.71 Canada argues that there was substantial record evidence demonstrating arms'-length transactions between timber harvesters and lumber producers, and between lumber producers and re-manufacturers: British Columbia, where approximately 24 per cent of the timber from Crown licenses was harvested by companies that did not own sawmills; Ontario, where some 30 per cent of the softwood timber harvested from Crown lands was sold by tenure holders to third parties for processing; British Columbia, where at least 18 per cent of the volume of logs harvested from Crown lands were purchased at arms'-length; and the fact that many companies applied for exclusion from the countervailing duty order on the grounds of having received no subsidies due to sourcing their log and lumber inputs at arms'-length.[152]

7.72 Canada argues that under SCM Articles 10, 19.1, 19.4, and 32.1, and GATT 1994 Article VI, a countervailing duty may be imposed only where it has been demonstrated that the producer of the subject merchandise has benefited from a "subsidy" as defined in SCM Article 1.1. Canada argues that the US presumed rather than demonstrated the existence of a subsidy where arms'-length transactions separated the recipients of the alleged financial contribution and the producers of the subject merchandise, that the US thereby acted inconsistently with Article 1.1, and thus violated: (1) Article 10 by failing to impose countervailing duties in accordance with the provisions of the SCM Agreement; (2) Article 19.1 by imposing countervailing duties in the absence of a final determination of the existence and amount of a subsidy; (3) Article 19.4 by levying countervailing duties in excess of the amount of the subsidy found to exist; (4) Article 32.1 by taking action against a subsidy not in accordance with the provisions of GATT 1994, as interpreted by the SCM Agreement; and (5) Article VI:3 of the GATT 1994 by imposing duties in the absence of an indirect subsidy finding.[153]

7.73 Canada, responding to the US argument, concludes on this point that the fact that the investigation was conducted on an aggregate basis did not excuse the USDOC for its failure to correctly establish the existence and amount of the alleged subsidy to producers of subject merchandise. Canada argues that, contrary to the US's characterization, the issue of pass-through is not simply about calculating the amount of the alleged stumpage subsidy, but rather, about whether a

[148] Canada First Written Submission, para. 131, quoting USDOC Final Determination (CDA-1) p. 19.
[149] Canada First Written Submission, para. 134 *et seq*.
[150] Canada First Written Submission , para. 139.
[151] Canada First Written Submission , para. 132 *et seq*.
[152] Canada First Written Submission , para. 140.
[153] Canada Response to Questions from the Panel at the First Meeting (Annex A-1), paras. 113-114.

subsidy exists. For Canada, the amount of a subsidy cannot be calculated, aggregated or allocated until a subsidy is first determined to exist.[154]

(b) United States

7.74 The United States characterizes this claim by Canada as an issue of calculation of the rate of subsidization (and hence the amount of countervailing duty), rather an issue concerning the existence of the subsidy. According to the US, the USDOC correctly established the overall amount of subsidy under the provincial stumpage programmes, as the per unit subsidy times the total quantity of Crown logs entering sawmills, on a province-by-province basis. Then, the US argues, because the USDOC performed its investigation on an aggregate basis, no pass-through analysis was necessary or required. Rather, the USDOC simply spread the total subsidy amount that it had calculated over the value of sales of the products produced from the "lumber production process". The US argues that requiring a pass-through analysis would effectively amount to requiring a company-specific analysis, which even Canada does not argue is required by the Agreement. In this context, the US further argues that the implication of Canada's argument in respect of pass-through would mean that a Member would violate the SCM Agreement every time it imposed a countervailing duty on an uninvestigated exporter or producer, although the last sentence of Article 19.3 makes clear that this does not constitute a violation.[155]

7.75 The United States argues that there are two basic situations in which Canada argues that a pass-through analysis is required. First is the case of a timber harvester that does not own a sawmill and sells logs to sawmills at arms'-length. Second is the case of re-manufacturers that purchase lumber from sawmills for use in their re-manufacturing operations.

7.76 In respect of the first situation, the United States considers that the existence of arms'-length log sales by harvesters who are not lumber producers might reduce the amount of subsidy from stumpage programmes that benefits the softwood lumber products produced from those logs, but that as a factual matter, the record demonstrates that the "vast majority" of Crown timber entering sawmills (i.e., the basis for the subsidy calculation) is obtained from the sawmills' own tenures. According to the US, any portion of that timber that was purchased from independent harvesters could only constitute a "comparatively small portion of the total"[156], and the many restrictions imposed on tenure holders, including requirements to process timber locally, "suggests that all or most of the sales by independent loggers may not be at arms'-length".[157] The US further argues that subsidies to independent companies can only be addressed through an examination of individual producers of the subject merchandise because of the necessity to examine the specific relationships and transactions that may be at issue, and that such a company-specific analysis is not required by the Agreement, nor does Canada make such a claim.[158]

7.77 Concerning the second situation, the United States provides a numerical example to explain why, in its view, no pass-through analysis is necessary in respect of sales of lumber to re-manufacturers.[159] According to the US, in an aggregate case, such a pass-through analysis is not required because the total subsidy amount from the sawmills' stumpage inputs is known, and can be used in its entirety as the appropriate numerator in the subsidization calculation. This numerator is then spread equally over a sales denominator consisting of the total amount of sales of the subject product produced by both first mills and re-manufacturers. Changing the denominator does not affect the total subsidy amount, but rather, only the rate of subsidization.

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[154] Canada Second Oral Statement, para. 56.
[155] United States Second Written Submission, para. 57 et seq.
[156] United States First Written Submission, para. 113.
[157] United States First Oral Statement, para., 36.
[158] United States First Written Submission, para. 113.
[159] United States Response to Questions from the Panel at the First Meeting (Annex A-2), paras. 23-27.

7.78 As for Canada's legal argument, the US argues that Canada has raised in its arguments before the Panel certain new provisions, in particular Article 1.1 SCM Agreement, which were not referred to in the Request for Establishment of a Panel in connection with this claim. The US also argues that the other provisions cited by Canada either do not contain the obligations asserted by Canada, or are completely dependent on such provisions.[160]

7.79 Concerning the various provisions of Article 19 SCM Agreement, the United States argues, first, that Article 19.1 SCM Agreement requires a final determination of the amount of the subsidy and a final determination of injury as pre-conditions to the imposition of a countervailing duty, but does not establish any requirements as to how a subsidy or injury are to be determined. Rather, these requirements are found elsewhere in the SCM Agreement. As for Article 19.4 SCM Agreement, the US argues that the role of this provision is to establish an upper limit to the amount of the countervailing duty that may be levied, i.e., the amount of subsidy found to exist. The issue addressed by Article 19.4 SCM Agreement is expressly the *levying* of duties *after* a subsidy has been "found to exist", according to the US. Furthermore, the sole calculation requirement in Article 19.4 is to calculate the subsidy on a per unit basis, and the US states that Canada concedes that its claim under Article 19.4 SCM Agreement is dependent upon the existence of an inconsistency with some other provision of the SCM Agreement that imposes obligations with respect to the subsidy calculation. Concerning Article 19.3 SCM Agreement (no violation of which is claimed by Canada), the US argues that this provision allows Members to conduct investigations other than on a company-specific basis, in that it foresees the possibility to levy countervailing duties on producers not individually investigated. Concerning the obligations in Article 19.3, the US argues that these are: (1) that when imposing countervailing measures, a Member must do so on a non-discriminatory basis; and (2) that when an uninvestigated exporter is subject to countervailing duties, it is entitled to an expedited review to establish an individual countervailing duty rate. As for Article VI:3 of GATT 1994, the US argues that it contains no obligation regarding the methodology that a Member may use in calculating the *ad valorem* subsidy rate.[161]

7.80 Turning to the other provisions cited by Canada in connection with the pass-through claim – Articles 10 and 32.1 SCM Agreement – the US argues that these are necessarily derivative of other claims, which Canada has failed to establish.[162] Thus, the US argues, Canada has not made a *prima facie* case of violation in respect of the pass-through claim.

2. Analysis

7.81 The basic question presented by this claim is whether USDOC was obligated to conduct a pass-through analysis in respect of the input transactions between timber harvesters (both those that produce lumber and those that do not) and unrelated sawmills, and between sawmills and unrelated re-manufacturers, and if so, whether this obligation can be found in any of the provisions cited in Canada's claim.[163] For Canada, failure to conduct such an analysis means that USDOC did not establish the existence of a subsidy in those cases. For the US, the provisions cited by Canada do not contain a requirement to conduct a pass-through analysis. On the substance, the US argues that the issue is one of calculation of the rate of subsidization, which the US maintains it has done correctly by specifying the total amount of subsidy to softwood lumber from the stumpage programmes, and then allocating that total over all relevant softwood lumber sales. Thus for the US, conduct of the investigation on this aggregate basis obviates the need to perform a pass-through analysis.

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[160] United States Second Written Submission, paras. 54-55 and footnote 96.
[161] United States First Written Submission, paras. 90-114.
[162] United States Response to Questions from the Panel at the First Meeting (Annex A-2), para. 31.
[163] We note that this claim only concerns such alleged arms'-length transactions between unrelated entities, as Canada has acknowledged that "[w]here the timber harvester and the producer of subject merchandise are the same 'recipient' of the alleged subsidy, no pass-through analysis would be required". Canada Response to Questions from the Panel at the First Meeting (Annex A-1), para. 110.

(a) Legal requirements concerning pass-through analysis

7.82 We thus must consider whether, under the provisions cited by Canada, the USDOC was required to conduct an analysis of the extent to which any (alleged) subsidy benefits from stumpage were passed through by timber harvesters when they sold logs to unrelated lumber producers or when they sold lumber to re-manufacturers. Here, it seems that the issue of "existence" of a subsidy and calculation of the rate of subsidization on lumber in practice are somewhat conflated in the case before us. In particular, we note that Canada does not challenge the USDOC's aggregate approach to determining subsidization, namely determining a total amount of subsidy provided through the stumpage programmes and then allocating that total subsidy amount over sales of the relevant products.[164] Thus, as a practical matter, given the methodology used by USDOC in the investigation, the question as posed by Canada of the "existence" of subsidization in the transactions at issue would manifest itself in the calculation of the aggregate rate of subsidization. In particular, if any subsidy amounts were improperly imputed to the subject merchandise, due to the absence of a pass-through analysis in respect of the transactions at issue, this would manifest itself as an overstatement of the aggregate rate of subsidization, as no company-specific rates would have been calculated. We note that the panel in *US – Softwood Lumber III* addressed this same issue.[165]

7.83 We now turn to an examination of the provisions cited by Canada in its pass-through claim, starting with Article 10 SCM Agreement and Article VI:3 of GATT 1994.

7.84 In considering Canada's pass-through claim in detail, we recall that countervailing measures are applied to imports of certain products (the subject merchandise), which in the countervailing duty investigation in dispute before us comprises softwood lumber products produced by sawmills from logs, and re-manufactured softwood lumber products produced by re-manufacturers from lumber obtained from sawmills. That is, countervailing duties are not levied on *companies* that have received subsidies, but rather are additional duties levied on imports of certain *products* in respect of the manufacture, production or export of which subsidization has been found ("subsidized imports" as referred to in the SCM Agreement)[166].

7.85 With this as background, we understand Canada's claim, in essence, to be that where upstream transactions between unrelated entities exist for inputs, any subsidies to the producers of those inputs cannot be assumed also to be subsidies to the downstream product under investigation. We note that Article 1.1, which contains the definition of a subsidy, and which Canada identifies as the underlying substantive basis of its claim, uses relatively abstract language as to what a subsidy *is*, but does not itself make the link between the existence of a subsidy as such and the subsidization *of a particular product*.[167] Indeed, while Article 1.1's reference to "benefit" certainly implies the existence of a recipient, Article 1.1 makes no reference to the nature of the recipient or its link to any particular

[164] Canada does challenge the product scope of the sales denominator used by the USDOC, however. See, section VII.E.1(b), *infra.*

[165] That panel noted that the US seemed to approach the issue of pass-through of benefits as if it could be resolved solely by correctly identifying the total value of relevant sales of the subject merchandise (softwood lumber) to use as the denominator of the subsidization calculation, so long as all of the entities whose sales were included in the denominator were producers of softwood lumber. The panel disagreed, finding that the issue of pass-through of benefits has to do in the first instance with correctly establishing the amount of the subsidy that benefits the producers of the subject merchandise, i.e., the numerator. The panel went on to say that where a producer of softwood lumber does not itself harvest logs, but instead buys logs or lumber from unrelated suppliers, any alleged subsidy from the stumpage programmes that may have benefited the producer of the upstream logs or lumber could only be included in the total subsidy amount to the extent that it has been established as a factual matter that the purchaser has received some or all of the benefit.

[166] As, for example, in Article 19.1 SCM Agreement, among many other references.

[167] In the sense of "subsidy bestowed … upon the production, manufacture or export of any merchandise" as per footnote 36 to Article 10 SCM Agreement, and Article VI:3 of GATT 1994. See also Article 19.4 SCM ("subsidized and exported product").

product. For us, the core of the pass-through issue is the notion of subsidization of a product, i.e., in respect of its manufacture, production, or export. Where the subsidies at issue are received by someone other than the producer of the investigated product, the question arises whether there is subsidization in respect of that product. The question before us in this claim, therefore, is whether any of the provisions cited by Canada require an investigating authority to make a determination linking subsidies (in the sense of Article 1.1) with a product subject to a CVD investigation.

7.86 Turning first to Article 10 SCM Agreement, Canada's argument is that in failing to establish the *existence* of a subsidy in the sense of Article 1.1 in respect of the upstream transactions at issue, the US failed to impose countervailing duties in accordance with the provisions of the SCM Agreement, a violation of Article 10 SCM Agreement, as that provision contains the general requirement to respect the provisions of Article VI of GATT 1994 and the SCM Agreement in applying countervailing measures. Canada further argues that by not establishing the existence of a subsidy, the US also violated Article VI:3 of GATT 1994 by imposing duties in the absence of an indirect subsidy finding.

7.87 Article 10 SCM Agreement reads as follows:

Article 10

Application of Article VI of GATT 1994 [footnote omitted]

> "Members shall take all necessary steps to ensure that the imposition of a countervailing duty[36] on any product of the territory of any Member imported into the territory of another Member is in accordance with the provisions of Article VI of GATT 1994 and the terms of this Agreement. Countervailing duties may only be imposed pursuant to investigations initiated [footnote omitted] and conducted in accordance with the provisions of this Agreement and the Agreement on Agriculture.
>
> [36] The term "countervailing duty" shall be understood to mean a special duty levied for the purpose of offsetting any subsidy bestowed directly or indirectly upon the manufacture, production or export of any merchandise, as provided for in paragraph 3 of Article VI of GATT 1994."

7.88 The first sentence of Article 10 makes explicit that, as Canada argues, imposition of a countervailing duty must be in accordance with Article VI of GATT and with the SCM Agreement. On its own, however, this does not shed much light on the question before us in this claim, i.e., whether a pass-through analysis is required to establish subsidization of the subject product where there are upstream transactions between unrelated parties. By contrast, we find footnote 36 to Article 10 to be illuminating. This footnote defines what a countervailing duty is, and in so doing makes explicit the link between a "subsidy" to a recipient in the sense of Article 1.1 and the manufacture, production or export of a *product* that is the subject of a CVD investigation and ultimately a countervailing duty. In particular, we note in this regard the phrase "any *subsidy bestowed directly or indirectly upon* the manufacture, production or export of *any merchandise*, as provided for in paragraph 3 of Article VI of GATT 1994".

7.89 Article VI:3 of GATT 1994 reads as follows:

> "No countervailing duty shall be levied on any product of the territory of any contracting party imported into the territory of another contracting party in excess of an amount equal to the estimated bounty or subsidy determined to have been granted, directly or indirectly, on the manufacture, production or export of such product in the country of origin or exportation, including any special subsidy to the transportation of a particular product. The term "countervailing duty" shall be understood to mean a

> special duty levied for the purpose of offsetting any bounty or subsidy bestowed, directly, or indirectly, upon the manufacture, production or export of any merchandise."

7.90 Thus, the definition of a countervailing duty that appears in the second sentence of Article VI:3 of GATT 1994 mirrors the definition in footnote 36 to Article 10 SCM Agreement, by referring to "any bounty or *subsidy bestowed, directly, or indirectly, upon* the manufacture, production or export of *any merchandise*". In other words, both of these provisions make explicit that there must be direct or indirect[168] *subsidization* in relation to the manufacture, production or export of a *product* for a "countervailing duty" in the sense of the Agreement and GATT Article VI to be imposed on that product.

7.91 The heart of the pass-through issue is whether, where a subsidy is received by someone other than the producer or exporter of the product under investigation, the subsidy nevertheless can be said to have conferred benefits in respect of that product. If it is not demonstrated that there has been such a pass-through of subsidies from the subsidy recipient to the producer or exporter of the product, then it cannot be said that subsidization in respect of that product, in the sense of Article 10, footnote 36, and Article VI:3 of GATT 1994, has been found. Thus, we find that a pass-through analysis is required by these provisions, both of which were cited in Canada's pass-through claim, where there are such upstream transactions. Given this conclusion, the US argument that none of the provisions cited by Canada requires a pass-through analysis fails.

7.92 Our analysis is consistent with the findings of the 1990 GATT Panel on *US – Canadian Pork*. In that dispute, Canada claimed that the USDOC's failure to conduct a pass-through analysis to determine the extent to which subsidies on live swine benefited production and exportation of pork products violated Article VI:3 of GATT 1947.[169] That panel found, as we do, that investigating authorities had the affirmative obligation to make a determination of subsidization in respect of *a product*, and could not simply assume such subsidization where the subsidies were bestowed in respect of a product (the input product) that was different from the *product subject to countervailing duty*, and where the input producers were unrelated to the producers of that subject merchandise.

(b) Pass-through analysis in the present dispute

7.93 We recall that in the present dispute, the US has not contended that it did conduct a pass-through analysis in respect of any of the upstream transactions at issue. Thus, the factual question of whether a pass-through analysis was conducted is not in dispute before us. Rather, the US argues that no such analysis was necessary given the particular circumstances of, and methodology used in, USDOC's softwood lumber investigation. We next consider these arguments by the US.

(i) Sales of logs by tenured timber harvesters to unrelated lumber producers

7.94 In respect of the first type of arms'-length transaction at issue before us, i.e., log sales to lumber producers by timber harvesters that do not produce lumber, the US acknowledges that any such sales could overstate the aggregate amount of subsidization of softwood lumber, but argues that in fact such sales accounted for only a "comparatively small" portion of the total, that they "may not be" at arms'-length, that in any event the US has no obligation to examine individual transactions in an aggregate case, and finally, that legally the provisions cited by Canada are inapposite. According to

[168] We note that Canada makes specific arguments as to what constitutes an "indirect" subsidy, and equates a pass-through analysis to an indirect subsidy analysis. We do not consider it necessary for the resolution of this claim to try to define or analyze the concepts of direct versus indirect subsidization. Rather, we consider Canada's Article 10 SCM and Article VI:3 of GATT claim to be about subsidization in respect of the manufacture, production or export of the product at issue, which these provisions make clear can be either direct or indirect.

[169] We note that the wording of Article VI:3 of GATT 1994 is identical to its analog in GATT 1947.

the US, the record evidence on these points is that the vast majority of Crown timber enters harvesters' own sawmills, and that the tenures are more than sufficient to meet the tenure holders' needs, that there were few if any such sales, and that in the investigation, Canada never attempted to submit information pertaining to such sales.

7.95 The US does not cite to any specific quantitative information from the record that establishes the volume of the possible arms'-length log sales at issue, nor does it argue that the USDOC made efforts to collect such information. The US instead seems to suggest that the burden was on Canada to present such evidence. We disagree. The obligation under Article 10 SCM Agreement and Article VI:3 of GATT 1994 to conduct a pass-through analysis in respect of production of softwood lumber from Crown logs purchased from unrelated harvesters falls on the US as the Member taking countervailing action. The US did not do so, and points to no factual basis in the record for its conclusion that such an analysis was not necessary. We thus find that in respect of the upstream log sales at issue, the US acted inconsistently with Article 10 SCM and Article VI:3 of GATT 1994.

(ii) Sales of logs or lumber by tenured harvester-sawmills to sawmills or re-manufacturers - Conduct of the investigation on an aggregate basis

7.96 We similarly disagree with the US reasoning in respect of the second category of transactions at issue, i.e., where logs are sold by a tenure-holding harvester-sawmill to another unrelated sawmill, or where lumber is sold by a tenure-holding harvester-sawmill to an unrelated lumber re-manufacturer. In its aggregate investigation, the USDOC deemed that a pass-through analysis in these types of transactions was not necessary because both the sellers and the purchasers of the inputs were themselves producers of softwood lumber, the subject merchandise. That is, according to the US reasoning, the issue of pass-through, which is about the subsidy amount numerator in a subsidization calculation, does not arise in an aggregate investigation where all of the producers selling the upstream inputs also are producers of subject merchandise, as any subsidy amounts from the stumpage programmes, if not passed through to the downstream log or lumber purchasers (who are lumber producers), will remain with the upstream log or lumber sellers (who likewise are lumber producers), thus benefitting their own production of softwood lumber, rather than that of their customers.

7.97 We are not convinced by this argument, however, which unjustifiably assumes in both situations that 100 per cent of any subsidy received by the tenure-holding harvester/sawmill is attributable to the softwood lumber products subject to investigation, when in fact the harvester/sawmill may produce and sell other products as well. Where logs rather than lumber are sold by a harvester/sawmill, then some portion of any subsidy that it receives under a stumpage programme is attributable to its production of logs (i.e., not all of the subsidy can be attributed to the other lumber products that it produces). If the subsidies attributable to the production of logs are *not* passed through to the lumber producer that purchases them, then those subsidies should not be included in the numerator of the subsidization calculation for *lumber*, as they can be said to have benefited production of the logs, but not production of the lumber produced from the logs by their purchaser. The same holds true where lumber is sold by a harvester/sawmill to a re-manufacturer whose products are exported to the US: some portion of any subsidy from stumpage is attributable to the harvester/sawmill's production of the lumber for re-manufacturing and some is attributable to the other products (including lumber) that the harvester/sawmill produces. Here, if the subsidies attributable to the lumber for re-manufacturing are not passed through to the re-manufacturer that purchases it, then those subsidies should not be included in the numerator of the subsidization equation, as in this situation it is the re-manufactured product, not the upstream lumber product, that is the subject merchandise under investigation. Thus, where the recipient of a stumpage subsidy sells inputs (logs or lumber) to unrelated downstream lumber producers producing subject merchandise, a pass-through analysis is the only way to determine whether the subsidies on the production of the inputs also are subsidies on the products *produced from* those inputs. Only if so can any subsidy

amounts attributable to the production of those inputs be included in the numerator of the subsidization calculation for the subject lumber products.

7.98 Thus, contrary to the US argument, the question of pass-through has to do with correctly identifying the subsidy amount attributable to the subject merchandise entering the US (the numerator). The fact that the US conducted the lumber investigation on an aggregate basis does not prevent and cannot cure the overall numerator (the aggregate subsidy amount from the stumpage programmes) from being overstated where upstream transactions for inputs between unrelated entities are present and subsidies have not been passed through. Moreover, the fact that the Agreement may, as a general matter, permit the conduct of countervail investigations on an aggregate basis cannot absolve the US from its legal obligation to conduct a pass-through analysis in a particular investigation to establish the subsidization in respect of the manufacture, production or export of the product being imported into the United States, where that product is produced from logs or lumber purchased from tenure holders by unrelated lumber producers. Furthermore, we are not convinced that the need to conduct a pass-through analysis for these transactions would necessarily or inevitably convert every aggregate case into a company-specific case.[170] Even if, in a particular case, it was not possible to conduct a pass-through analysis except by conducting the investigation on a company-specific basis, the basic requirement to determine subsidization in respect of the subject product where, in a particular investigation, upstream transactions between unrelated entities are present, must prevail. Finally, the fact that the USDOC is now conducting reviews of uninvestigated companies in response to individual requests fails adequately to address the problem, as it is *post hoc*, while the obligation to determine subsidization in respect of the product is a *precondition* for being allowed to apply a countervailing measure. Nor does the US argue that individual reviews in this case are being conducted for all producers potentially affected by the pass-through issue, meaning that the reviews by definition will not be able fully to address this problem, even after the fact.

(iii) Conclusion

7.99 We therefore conclude that, for the reasons set forth above, the USDOC's failure to conduct a pass-through analysis in respect of logs sold by tenure-holding timber harvesters (whether or not also lumber producers) to unrelated sawmills producing subject softwood lumber; and in respect of lumber sold by tenure-holding harvester/sawmills to unrelated lumber re-manufacturers was inconsistent with Article 10 and thus Article 32.1 SCM Agreement, and with Article VI:3 of GATT 1994. In light of our finding, we do not find it necessary to address Canada's pass-through claims pursuant to Articles 19.1 and 19.4 SCM Agreement. That is, having determined that the USDOC subsidization determination is inconsistent with the cited Articles, including because of the failure to conduct a pass-through analysis, and exercising the discretion implicit in the principle of judicial economy, we do not deem it necessary to examine whether the failure to conduct a pass-through analysis gave rise to further substantive inconsistencies with Articles 19.1 and 19.4 SCM Agreement.

(c) Has Canada introduced a new claim, i.e., a violation of Article 1.1, which is outside the Panel's terms of reference?

7.100 We recall that in respect of its pass-through claim, Canada refers to a number of provisions of the SCM Agreement and one provision of the GATT 1994, all of which, according to Canada, require a pass-through analysis where the recipient of the alleged subsidy is not a producer of the subject merchandise, specifically, where the producer of the subject merchandise obtains its inputs at arms'-length from a recipient of the alleged subsidy. For Canada, the central issue is the existence of a subsidy in the sense of Article 1.1 SCM Agreement: Canada alleges that USDOC assumed rather

[170] For example, inquiry into possible relationships between the entities concerned, and the use of sampling or other statistical techniques in respect of the relevant transactions at issue, might offer possible approaches to be explored.

than established the existence of a subsidy in respect of the arms-length transactions at issue, in violation of the cited provisions.

7.101 Canada's first reference to Article 1.1 SCM Agreement in the context of the pass-through issue appears in response to a question that we posed at our first substantive meeting with the parties. We asked Canada to summarize its legal argumentation in respect of each of the provisions that it cited in its request for establishment of a panel in respect of its pass-through claim, i.e., Articles 10, 19.1, 19.4 and 32.1 SCM Agreement, and Article VI:3 of GATT 1994. In response, Canada states, *inter alia*, that under these provisions, a countervailing duty may be imposed only where the investigating authority demonstrates that the producer of subject merchandise has received a "subsidy" in the sense of Article 1.1 SCM Agreement. Canada further states that where, in its view, the US presumed rather than demonstrated the existence of a subsidy, it "acted inconsistently with" Article 1.1 SCM, and "therefore violated" the cited provisions.[171]

7.102 The US counters, *inter alia*, by arguing that Canada is raising a claim outside the Panel's terms of reference by citing Article 1.1 SCM Agreement. The US argues that, by referring to Article 1.1 SCM Agreement in its answer to the Panel, Canada "seems to accept" that its claims under the above-cited provisions depend on a finding that the "calculation of the *ad valorem* subsidy rate" is inconsistent with Article 1.1 SCM Agreement. The US argues that while the US's actions were wholly consistent with that provision, the Panel need not reach this issue as this provision was not cited in the Request for Establishment in connection with the pass-through issue. In particular, the US argues that if a claim of a violation of one provision depends on a finding of violation of another provision, which latter was not cited by the complaining party in its request for establishment of a panel, the panel has no jurisdiction to resolve that claim.

7.103 We note here that Canada does not argue that it did cite Article 1.1 SCM in its Request for Establishment of the Panel in respect of the pass-through claim, so there is no disagreement between the parties on this point. Thus, if Canada's reference to this provision in its explanation of its pass-through claim does constitute a new "claim" of a "violation", as the US argues, then such a claim would clearly seem to be outside our terms of reference. The question before us therefore is whether this reference is or is not a new "claim".

7.104 The chapeau of Article 1.1 SCM Agreement explicitly states that the concept and definition of what constitutes a "subsidy", as set forth in that Article, applies to the entire Agreement.[172] Thus, it is clear that this most basic definition of the Agreement informs every other reference to "subsidy" in the Agreement. We understand from its response to our question that Canada is claiming that the US has violated the provisions it cites in its pass-through claim (Articles 10, 19.1, 19.4 and 32.1 SCM Agreement, and Article VI:3 of GATT 1994) by virtue of USDOC's failure to establish the existence of the subsidies or subsidization to which those provisions refer, which references by definition can only be to "subsidies" or "subsidization" in the sense of Article 1.1. For example, we understand Canada to argue that Article 19.1 requires, *inter alia*, a determination of the existence of a subsidy, which by definition must be a subsidy in the sense of Article 1.1.

7.105 We thus do not consider that Canada's reference to Article 1.1 in its response to our question constitutes a new "claim" of a "violation" of Article 1.1. Rather, we understand Canada, by this reference, to have clarified its view that all references to "subsidy" or "subsidization" in the provisions that it cites must be understood in the same sense as in Article 1.1, and in particular, that the cited provisions, by referring to "subsidies" or "subsidization", require the "existence" of a subsidy in the sense of Article 1.1 before a countervailing duty can be applied.

[171] Canada Response to Questions from the Panel at the First Meeting (Annex A-1), paras. 113-114.
[172] "1.1 *For purposes of this Agreement*, a subsidy shall be deemed to exist if:….." (emphasis added).

D. CLAIM 4: CANADIAN STUMPAGE PROGRAMMES ARE NOT SPECIFIC TO CERTAIN ENTERPRISES

1. Arguments of the parties

(a) Canada

7.106 Canada submits that, even if the USDOC had correctly determined that provincial stumpage programmes were a subsidy, it failed in the Final Determination to correctly determine that the programmes are *specific* subsidies within the meaning of Article 2 SCM Agreement. Canada asserts that the USDOC found that the provincial stumpage programmes are specific in fact because they were used by only a limited number of certain enterprises. Canada argues that, even if the programmes were used by a limited number of users, this does not suffice for a finding of specificity. According to Canada, under Article 2 SCM Agreement, a Member may find that the alleged subsidy is specific in fact only where the total configuration of facts and evidence relating to these factors points to a *deliberate* limiting of access to a certain limited number of enterprises or industries engaged in the manufacture *of similar products*.[173]

7.107 First, Canada asserts that provincial stumpage programmes are not used by a *limited number of certain industries*. Canada submits that the USDOC failed to accurately determine the actual users of the stumpage programmes and failed to address the record evidence that established that many enterprises and industries use stumpage programmes.[174] According to Canada, while some producers of the subject merchandise may use stumpage programmes, they are not the only users, and neither can the producers of the subject merchandise be considered as a single industry, as many producers produce multiple products, many of which are not subject to the investigation. Canada asserts that the USDOC Determination failed to address what the terms "industry" or "group of industries" mean. The USDOC applied a circular reasoning and simply grouped the users of the programme as one industry for the simple reason that they all use the programme. Canada asserts that an industry cannot be identified for purposes of specificity without reference to the end-products produced. Canada argues that the USDOC's circular reasoning effectively writes the specificity requirement out of the SCM Agreement, as all programmes are by definition used only by the users of the programme.

7.108 Second, Canada considers that, even if the programmes were used by a limited number of enterprises, this limited use is easily explained by the nature of forestry resources and the diversification of provincial economies. According to Canada, the inherent characteristics of the good provided limit the number of users of the programme, not any deliberate government favouritism, as is required under Article 2 SCM Agreement. Moreover, in Canada's view, a determination of *de facto* specificity under Article 2.1 (c) SCM Agreement in this case would have required at a minimum an examination of all four factors listed in that provision as well as the consideration of the extent of diversification of the economic activities in Canada.[175] Canada submits that where these factors do not indicate that a Member is deliberately limiting access to a programme

[173] Canada draws a parallel with *de facto* contingency on export performance under Article 3.1 SCM Agreement to argue that a Member may find *de facto* specificity only where the total configuration of facts allows it to infer that the government is deliberately limiting access to the programme. Canada refers to Appellate Body report, *Canada - Aircraft*, para. 167.

[174] According to Canada, studies on the record demonstrated that at least 23 separate and varied classes of industries, producing over 200 widely diverse goods, use stumpage programmes, and that softwood lumber production was not the dominant end use of the wood fibre harvested from Canadian forests.

[175] Canada argues that the USDOC for example failed to take into consideration that in British Columbia forestry-related activities are responsible for a substantial share of economic activity, in spite of the explicit obligation under Article 2.1 (c) SCM Agreement to take into account the economic diversification of provincial economies.

(that is, if the factors may be explained by other circumstances) then the programme is not specific.[176] In light of the nature of the forestry resource in question, Canada considers that it is untenable to base a specificity finding on the "limited-users" factor alone, as use of natural resources will always be limited in fact to those enterprises and industries that are capable of extracting the resource and processing it into a good. In sum, Canada considers that the legal standard established by Article 2 SCM Agreement is whether a government is limiting access to a programme, in law or in fact, to certain enterprises over other *eligible* enterprises. Canada is therefore of the view that the USDOC has rendered the specificity test and the limited-users factor redundant by using the entire Canadian economy as a benchmark and finding that the vast majority of companies and industries in Canada do not receive benefits under these programmes.[177]

7.109 Canada therefore submits that the USDOC determination of specificity of the alleged subsidy programmes is inconsistent with Article 2.1 (c) SCM Agreement and, since under Article 1.2 SCM Agreement the United States may impose countervailing duties only against subsidies found to be specific, the countervailing duties at issue thus violate Article 1.2, 10, 19.1, 19.4, and 32.1 SCM Agreement.

(b) United States

7.110 The United States considers that the USDOC's conclusion that the provincial stumpage programmes are specific in fact is consistent with Article 2.1 (c) SCM Agreement as these programmes are used by a limited group of industries consisting of the lumber and pulp and paper industries, while the vast majority of companies within Canada do not receive stumpage.[178] The United States asserts that there is no basis in the text of Article 2 SCM Agreement for Canada's arguments that a product based industry analysis should have been performed and that the USDOC was required to determine that it was the government's intention to limit the users of the programme to certain eligible enterprises only.

7.111 According to the United States, the USDOC's definition of a group of industries is based on the common practice of referring to industries by the general type of products they produce. The United States argues that the plain language of Article 2 SCM Agreement ("specific to certain *enterprises*") indicates that the specificity test is concerned not with *products*, but with *enterprises* and *industries*. According to the United States, the USDOC found that the stumpage programmes were used by a limited number of wood product industries consisting of the lumber and pulp and paper industry, which constitutes a limited group of industries. The United States submits that Canada's argument that the USDOC undercounted the number of industries that used stumpage subsidies because it used an improper definition of the word "industry" should thus be rejected.

7.112 The United States further considers that the text of Article 2 SCM Agreement does not require the authority to make any findings as to the granting authority's intent to limit a subsidy to certain eligible producers only, as Canada is suggesting, since the very purpose of Article 2.1 (c) is to let the facts speak for themselves. In the United States view, the fact that, due to its "inherent characteristics", a subsidized input has economic utility for a limited number of potential recipients

[176] Canada argues that the negotiating history surrounding Article 1.2 and 2 SCM Agreement confirms its interpretation that specificity relates to a determination that government action deliberately restricts access to the alleged subsidy. Canada Second Written Submission, para. 60.

[177] In Canada's view, using the entire economy of a Member as a benchmark misinterprets Article 2, since it ignores the fact that the universe of eligible users under Article 2.1 (b) SCM Agreement can be something less than "everyone" and still this subsidy would not be specific. The relevant benchmark must be the universe of *eligible* users, since Article 2.1 (b) contemplates a finding on non-specificity where a programme is limited pursuant to neutral and objective criteria.

[178] USDOC Determination, p. 51 – 52. (CDA-1). The USDOC found that the stumpage programmes were used by a single limited group of wood product industries, comprised of pulp and paper mills, and the sawmills and remanufacturers that produce the subject merchandise.

does not exempt the provision of this input from the subsidy disciplines of the SCM Agreement, nor does it mean that a further analysis is required to see whether actual use of that input is in fact restricted to some subset of the *potential* or *eligible* users.

7.113 The United States does not consider that all four factors mentioned in Article 2.1 (c) SCM Agreement need to be examined for a finding of *de facto* specificity. It suffices that the subsidy is used by a limited number of users for it to be considered specific under article 2.1 (c) SCM Agreement. The United States acknowledges that Article 2.1 (c) SCM Agreement provides that an investigating authority must take into account the extent of diversification of economic activities within the jurisdiction of the granting authority. According to the United States, this is so because a subsidy may be widely distributed within the economy, and yet appear specific, simply due to the limitations of the domestic economy where the subsidy was granted. The United States submits that the Canadian provinces are far from being un-diversified economies, and that the USDOC recognized this aspect of the specificity test in its finding that the majority of companies in Canada do not receive benefits under these programmes.

2. Analysis

7.114 Article 1.2 SCM Agreement provides that a subsidy is only countervailable if "such a subsidy is specific in accordance with the provisions of Article 2". Article 2 provides as follows:

Article 2

Specificity

2.1 In order to determine whether a subsidy, as defined in paragraph 1 of Article 1, is specific to an enterprise or industry or group of enterprises or industries (referred to in this Agreement as "certain enterprises") within the jurisdiction of the granting authority, the following principles shall apply:

(a) Where the granting authority, or the legislation pursuant to which the granting authority operates, explicitly limits access to a subsidy to certain enterprises, such subsidy shall be specific.

(b) Where the granting authority, or the legislation pursuant to which the granting authority operates, establishes objective criteria or conditions[2] governing the eligibility for, and the amount of, a subsidy, specificity shall not exist, provided that the eligibility is automatic and that such criteria and conditions are strictly adhered to. The criteria or conditions must be clearly spelled out in law, regulation, or other official document, so as to be capable of verification.

(c) If, notwithstanding any appearance of non-specificity resulting from the application of the principles laid down in subparagraphs (a) and (b), there are reasons to believe that the subsidy may in fact be specific, other factors may be considered. Such factors are: use of a subsidy programme by a limited number of certain enterprises, predominant use by certain enterprises, the granting of disproportionately large amounts of subsidy to certain enterprises, and the manner in which discretion has been exercised by the granting authority in the decision to grant a subsidy.[3] In applying this subparagraph, account shall be taken of the extent of diversification of economic activities within the jurisdiction of the granting authority, as well

> *as of the length of time during which the subsidy programme has been in operation.*
>
> 2.2 A subsidy which is limited to certain enterprises located within a designated geographical region within the jurisdiction of the granting authority shall be specific. It is understood that the setting or change of generally applicable tax rates by all levels of government entitled to do so shall not be deemed to be a specific subsidy for the purposes of this Agreement.
>
> 2.3 Any subsidy falling under the provisions of Article 3 shall be deemed to be specific.
>
> 2.4 Any determination of specificity under the provisions of this Article shall be clearly substantiated on the basis of positive evidence.
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>
> [2] Objective criteria or conditions, as used herein, mean criteria or conditions which are neutral, which do not favour certain enterprises over others, and which are economic in nature and horizontal in application, such as number of employees or size of enterprise.
>
> [3] In this regard, in particular, information on the frequency with which applications for a subsidy are refused or approved and the reasons for such decisions shall be considered.

7.115 In essence, we understand Canada to argue that for a subsidy to be specific under Article 2.1 (c) SCM Agreement, the granting authority must have *deliberately limited* access to the subsidy to a group of *enterprises producing similar products*. In particular, Canada argues that a subsidy which consists of the provision of a good which can only be used as an input by a particular industry should not be considered to be specific unless the granting authority has deliberately limited its use to a certain subgroup of enterprises in that industry. Under the facts of this case, Canada moreover argues that the USDOC finding that there were only a limited number of users of the stumpage programmes was flawed. In addition, Canada considers that the USDOC should have analysed the end-products of the industries it alleged were the users of the programme in order to determine whether they constituted a group of industries producing similar products.

7.116 We first address Canada's argument that a subsidy is specific only when the authority deliberately limits access of this subsidy to certain enterprises within the group of enterprises eligible or naturally apt to use the subsidy. In our view, Article 2 SCM Agreement is concerned with the distortion that is created by a subsidy which either in law or in fact is not broadly available.[179] While deliberate action by a government to restrict access to a subsidy that is in principle broadly available, through the use of discretion, could well be the basis for a finding of *de facto* specificity, we see no basis in the text of Article 2, and 2.1 (c) SCM Agreement in particular, for Canada's argument that if the inherent characteristics of the good provided limit the possible use of the subsidy to a certain industry, the subsidy will not be specific unless access to this subsidy is limited to a sub-set of this industry, i.e. to certain enterprises within the potential users of the subsidy engaged in the manufacture of similar products. Article 2 speaks of the use by a limited number of certain

[179] We note that the availability of a subsidy which is limited by the inherent characteristics of the good cannot be considered to have been limited by "objective" criteria in the sense of footnote 2 to Article 2.1 (b) SCM Agreement, i.e. "criteria or conditions which are neutral, which do not favour certain enterprises over others, and which are economic in nature and horizontal in application, such as number of employees or size of enterprise".

enterprises or the predominant use by certain enterprises, not of the use by a limited number of certain *eligible* enterprises. In the case of a *good* that is provided by the government - and not just money, which is fungible – and that has utility only for certain enterprises (because of its inherent characteristics), it is all the more likely that a subsidy conferred via the provision of that good is specifically provided to certain enterprises only. We do not consider that this would imply that any provision of a good in the form of a natural resource automatically would be specific, precisely because in some cases, the goods provided (such as for example oil, gas, water, etc.) may be used by an indefinite number of industries. This is not the situation before us. As Canada acknowledges, the inherent characteristics of the good provided, standing timber, limit its possible use to "certain enterprises" only.

7.117 We now turn to Canada's argument that the USDOC failed to properly determine that the stumpage programmes were used by only a limited number of industries. On the basis of the facts of this case, Canada argues that specificity should have been analyzed based on the end-products sold by the industry or industries using the programme. Canada argues that more than 200 separate products are manufactured by companies holding harvesting rights, together forming about 23 separate industries.[180] This, according to Canada, is hardly a "limited number of industries".

7.118 We note that the USDOC determined that

> "Benefits under these Provincial stumpage [programmes] are limited to those companies and individuals specifically authorized to cut timber on Crown lands. These companies are pulp and paper mills and the saw mills and remanufacturers which are producing the subject merchandise. This limited group of wood product industries is specific under section 771 (5A)(D)(iii)(I) of the Act" "[181]

7.119 We recall that a subsidy is specific under Article 2 SCM Agreement, if it is specific to an enterprise or industry or group of enterprises or industries (referred to in the SCM Agreement as "certain enterprises"). The SCM Agreement does not define an "industry" nor does it provide for any other rules concerning which enterprises could be considered to form an industry for the purposes of Article 2 SCM Agreement or whether a group of industries have to produce certain similar products in order to be considered a "group".

7.120 The *New Shorter Oxford Dictionary* defines an industry as "a particular form or branch of productive labour; a trade, a manufacture".[182] Both parties seem to agree that the common practice is to refer to industries by the type of products they produce.[183] It seems therefore that the term "industry" in Article 2 SCM Agreement is not used to refer to enterprises producing specific goods or end-products. Indeed, even Canada agrees that a single industry may make a broad range of end products and still remain a "industry" within the meaning of Article 2 SCM Agreement.[184] We note in

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[180] Exhibit CDA-73 provides an overview of these 23 allegedly separate industries and the 201 products. produced by these industries. We note that Canada considers as separate industries such industries as the "wooden kitchen cabinet and bathroom vanity industry" and the "wooden door and window industry" to mention just two.

[181] USDOC Determination, p. 52. (CDA-1). According to the USDOC, "whether we classify the users of the stumpage programs as sawmills and pulp mills, the primary timber processing group, the wood products industry, the forest products industries, the wood fibre user industry, the "industries" suggested by respondents, or any combination thereof, the subsidies provided by these stumpage programs are not "broadly available and widely used". The vast majority of companies and industries in Canada does not receive benefits under these programs." USDOC Determination, p. 52. (CDA-1).

[182] CDA-66, p. 1356. We note that this is a definition relied on by both parties.

[183] See United States First Written Submission, para. 150; Canada Response to Questions from the First Meeting (Annex A-1), para. 153.

[184] Canada Response to Questions from the First Meeting (Annex A–1), para. 149. By contrast, we find that the fact the domestic industry is defined in Article 16 SCM Agreement by reference to a particular

this respect that Canada considers that "it may be completely appropriate to find that producers of a wide variety of steel products (or automobile products or textile products, etc) are a group of "steel industries" (or "automobile industries", "textile industries", etc.) because of the similarity and the relatedness of their output products".[185] Canada also does not dispute that a subsidy limited to a single large industry (such as "steel", "autos", "textiles", "telecommunications", or the like) could be found specific, even though the producers make a diversity of products.[186]

7.121 The USDOC Determination considered that only a group of wood product industries, consisting of the pulp and paper mills and the sawmills and re-manufacturers which are producing the subject merchandise used the stumpage programmes. It does not seem that USDOC simply labelled an aggregation of producers as a group of industries merely because they use a particular programme. In our view, the opposite was the case. As Canada recognized, the stumpage programme can clearly only benefit certain enterprises in the wood product industries which can harvest and / or process the good provided, standing timber. In sum, the text of Article 2 SCM Agreement does not require a detailed analysis of the end-products produced by the enterprises involved, nor does Article 2.1 (c) SCM Agreement provide that only a limited number of *products* should benefit from the subsidy. In our view, it was reasonable of the USDOC to reach the conclusion that the use of the alleged subsidy was limited to an industry or a group of industries. We consider that the "wood products industries" constitutes at most only a limited group of industries - the pulp industry, the paper industry, the lumber industry and the lumber remanufacturing industry - under any definition of the term "limited".[187] We do not consider determinative in this respect the fact that these industries may be producing many different end-products. As we discussed above, specificity under Article 2 SCM is to be determined at the enterprise or industry level, not at the product level.[188]

7.122 Canada argues that there were other users of the programmes than the ones identified by the USDOC. We understand Canada to be arguing that not only "the pulp and paper mills and the saw mills and remanufacturers which are producing the subject merchandise" are using the stumpage programmes, but also the pulp and paper mills and the sawmills and remanufacturers which are *not* producing the subject merchandise. In our view, all these producers can reasonably be found to form part of the same industries, which produce both the subject merchandise and other merchandise. It is evident that in order to countervail a specific subsidy it is necessary that the subsidy benefits the producers of the subject merchandise, but that does not mean that the subsidies should be specific to these producers only, nor is it required under Article 2 SCM Agreement that the subsidy be specifically targeted at subsidizing only the subject merchandise of producers who produce both subject merchandise and non-subject merchandise.

"like product" does not provide useful context for the interpretation of the term "industry" in general in light of the different and specific purpose of this definition of domestic industry in the SCM Agreement. We note again that there is no definition of the term "industry" in general in the SCM Agreement.

[185] Canada Response to Questions from the First Meeting (Annex A-1), para. 150.

[186] Canada Response to Questions from the First Meeting (Annex A-1), para. 149.

[187] The New Shorter Oxford Dictionary defines "limited" as "confined within definite limits; restricted in scope, extent, amount, etc.; (of an amount) small". New Shorter Oxford Dictionary, Edited by Lesley Brown, Clarendon Press Oxford, 1993 ed., p. 1592.

[188] We consider therefore not determinative either the fact that a distinction may be made on the basis of the specific products produced into 23 industries, as Canada is suggesting. Irrespective of the question whether 23 industries could still be considered to be a limited number in absolute or relative terms, we are of the view that for the purposes of Article 2 SCM Agreement, it was entirely legitimate of the USDOC to group such alleged separate industries as the "wooden kitchen cabinet and bathroom vanity industry" and the "wooden door and window industry" together with other similar industries into a group of wood products industries. In a similar vein, it appears to us that, whether a "group" is required to produce similar products or not in order to be considered a "group" under Article 2 SCM Agreement, an issue which we need not and do not decide, the industries producing wood products are, in our view, obviously producing sufficiently similar products to be considered as a "group" of industries for the purposes of Article 2 SCM Agreement.

7.123 Canada also argues that an authority is required to examine all four factors mentioned in Article 2.1 (c) SCM Agreement in order to determine *de facto* specificity. We note in this respect that Article 2.1 (c) SCM Agreement provides that if there are reasons to believe that the subsidy may in fact be specific, other factors *may* be considered. The use of the verb "may" rather than "shall", in our view, indicates that if there are reasons to believe that the subsidy may in fact be specific, an authority *may* want to look at any of the four factors or indicators of specificity. We note the difference in language between Article 2.1 (c) SCM Agreement and, for example, Article 15.4 SCM Agreement concerning injury which provides that "the examination of the impact of the subsidized imports on the domestic industry *shall include* an evaluation of all relevant economic factors and indices having a bearing on the state of the industry *including* …", and then lists the factors which have to be included in the evaluation. Article 15.4 SCM Agreement is almost identical in language to Article 3.4 Anti-Dumping Agreement, which it is well established, contains an obligation on the part of the investigating authority to at a minimum examine and evaluate all factors listed in the provision.[189] In our view, if the drafters had wanted to impose a formalistic requirement to examine and evaluate all four factors mentioned in Article 2.1 (c) SCM Agreement in all cases, they would have equally explicitly provided so as they have done elsewhere in the SCM Agreement.[190] They did not do so. We conclude therefore that there was no obligation on the USDOC to examine whether disproportionately large amounts of the subsidy were granted to certain enterprises or the manner in which discretion has been exercised by the granting authority in the decision to grant a subsidy, the two factors mentioned in Article 2.1 (c) SCM Agreement which the USDOC did not explicitly examine.

7.124 We finally note that Article 2.1 (c) SCM Agreement provides that "[I]n applying this subparagraph, *account shall be taken of* the extent of diversification of economic activities within the jurisdiction of the granting authority, as well as of the length of time during which the subsidy programme has been in operation". While it is clear that the USDOC did not explicitly and as such address the extent of economic diversification in its Final Determination, we consider that in noting that "the vast majority of companies and industries in Canada does not receive benefits under these programmes"[191], the USDOC showed that it had *taken account of* the extent of economic diversification in Canada and its provinces, i.e. the publicly known fact that the Canadian economy and the Canadian provincial economies in particular are diversified economies. Although we understand the wood product industry to be an important industry for Canada, it is clear that the Canadian economy is more than just wood products alone. In light of the fact that, in our view, all that is required under the last sentence of Article 2.1 (c) SCM Agreement is that "account be taken of " the extent of economic diversification, we find that USDOC Determination complied with this obligation.

7.125 We find therefore that the USDOC determination that the stumpage programmes which are used only by a limited group of wood product industries are in fact specific, is not inconsistent with Article 2.1 (c) SCM Agreement and reject all of Canada's claims in this respect.

[189] Appellate Body report, *Thailand – H-Beams*, para. 128. Panel report, *EC – Tube and Pipe Fittings*, para. 7.304. Panel Report, *Egypt – Steel Rebar*, para. 7.36. Panel Report, *EC – Bed Linen*, para. 6.159; Panel Report, *Mexico – Corn Syrup*, para. 7.128.

[190] We note that it appears that on the basis of the facts before the USDOC, it was reasonable to conclude that certain of these factors, such as the granting of disproportionately large amounts of the subsidy to certain enterprises or the manner in which discretion has been exercised by the granting authority in the decision to grant a subsidy, were not relevant in this situation, and thus did not have to be examined.

[191] USDOC Final Determination, p. 52. (CDA-1).

E. CLAIM 5: INCONSISTENT CALCULATION OF THE AMOUNT OF SUBSIDIZATION

1. Claims and arguments of the parties

(a) Alleged improper conversion from US to Canadian log volume measurement system

(i) Canada

7.126 Canada claims that the USDOC inflated the subsidy amount (the numerator of the subsidization rate equation), and hence the rate of subsidization and the countervailing duties applied, by impermissibly using a "manifestly incorrect" conversion factor to compare US stumpage rates that it used as benchmarks with the Canadian Provincial stumpage rates. In particular, Canada claims that by using an inaccurate factor to convert the US log measurements to cubic meters, the amount of the alleged subsidy on lumber was inflated. As a result, Canada alleges, the countervailing duties imposed are in excess of any alleged subsidy on softwood lumber, in violation of Article 19.4 SCM Agreement and Article VI:3 of GATT 1994. Canada also alleges violations of Articles 10 and 32.1 SCM Agreement, on the basis of the alleged violations of Articles 19.4 SCM Agreement and VI:3 of GATT 1994.[192]

7.127 Stumpage volumes and prices in the United States are recorded in thousand board feet, while those in Canada are recorded in cubic meters. Because the United States used US stumpage prices as the benchmark against which to compare Canadian stumpage rates in order to determine the existence and amount of the alleged subsidies, the USDOC needed to apply a conversion factor to restate the US prices in cubic meters.

7.128 According to Canada, the USDOC erred by applying a single national average conversion factor to all provinces.[193] Canada argues that because log scales vary widely, depending on the diameter, taper, and length of the logs in question, no one average conversion factor can be applied. According to Canada, moreover, the conversion factor used by the USDOC is outdated, does not reflect the current harvest in any of the jurisdictions, or does not account for differences in scaling or utilization practices, and is not empirically verifiable.

7.129 In response to a question from the Panel concerning the basis for Canada's assertion that the data used by the USDOC were "manifestly incorrect", Canada submits a document of record, the "Minnesota Public Stumpage and Price Review", which Canada argues uses a much higher conversion rate than that used by USDOC in converting prices per thousand board feet to prices per wood volume.[194] According to Canada, the USDOC used the prices in the Minnesota Review but ignored its conversion factor, using instead the one that Canada believes to be "manifestly incorrect".

(ii) United States

7.130 The United States argues in the first place that the cited provisions do not contain substantive obligations in respect of subsidy calculations. Further, and in more specific response to this claim, the US argues that the question raised is purely one of fact, and that the USDOC considered the record evidence in respect of conversion factors in selecting the ones used in its investigation, and provided a reasoned explanation for this selection in its Final Determination. For the US, this fulfilled its obligations under the Agreement.[195] In this connection, the United States recalls, citing the Appellate

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[192] Canada First Written Submission, paras. 183 *et seq*.

[193] Canada acknowledges that the USDOC also used a second factor from Western Washington to convert stumpage rates for the coastal British Columbia calculation.

[194] Canada Response to Questions from the Panel at the First Substantive Meeting (Annex A-1), paras. 131-132.

[195] United States First Written Submission, paras. 117 *et seq*.

Body in the *US – Lamb* dispute[196], the standard of review under Article 11 of the DSU that in the US view, panels should apply in considering issues of fact in countervailing duty disputes. This standard of review is that panels should limit their consideration, in respect of questions of fact, to whether competent authorities have considered all of the relevant factors, and have provided a reasoned and adequate explanation of how the facts support their determination. In other words, panels should not conduct *de novo* examinations of the facts.

7.131 The United States describes the record evidence that was before the USDOC in respect of conversion factors. In particular, the parties submitted a range of proposed factors, from 3.48 to 8.51 cubic meters per thousand board feet, which had been developed specifically for the purpose of the investigation. According to the US, the USDOC decided, in view of the conflicting suggestions received from parties, to rely exclusively on published information prepared in the ordinary course of business by public agencies, as this would be the surest way to avoid using a biased conversion factor. There were two such sources in the record, and the US argues that USDOC found the older one to be more reliable, because it contained a detailed explanation of how the numbers in it were derived, whereas the newer one contained no such explanation. According to the US, the USDOC thus weighed the evidence and made a well-reasoned choice, which it fully explained in the Final Determination, and whether the Panel or Canada would have reached a different conclusion based on the same evidence is irrelevant.[197]

7.132 In specific response to Canada's arguments concerning the Minnesota Review, the US argues that the conversion factors referred to by Canada were only necessary to convert the price data in Table 1 of the Review, which are presented in dollars per thousand board feet, to those shown in Table 2, which are presented in dollars per cord (a measure of wood volume, not directly convertible to cubic meters).[198] The US argues that Canada failed to establish that the conversion factors used by the USDOC were flawed, and states that the existence of alternative sources does not mean that the USDOC's selection was manifestly incorrect. The US argues that were the Panel to reach such a conclusion, this would amount to an impermissible *de novo* review.[199]

(b) Alleged failure to account for the multiple uses of softwood logs produced from Crown timber

(i) Canada

7.133 This claim of Canada pertains primarily to the alleged overstatement of the numerator (subsidy amount) of the subsidization rate calculation. Canada claims that by failing to limit the numerator amount only to the amount of the alleged subsidy that could be said to have benefited logs used to produce softwood lumber, the USDOC overstated the numerator and thus the rate of subsidization. Canada notes that the standing timber, the alleged financial contribution in this case, is provided to producers of multiple downstream products, only one of which is the subject merchandise. According to Canada, the USDOC calculated the benefit amount at the point at which logs were sawn into lumber, when it had not yet apportioned the volume of logs between the subject and non-subject merchandise produced therefrom, and then allocated that (total benefit) amount over the sales value of softwood lumber. Canada argues that this impermissibly inflated the subsidization rate, and thus the countervailing duty rate, because it treated alleged subsidies in respect of inputs used to produce poles, posts, ties and a variety of other non-subject products as subsidies to the subject merchandise.

[196] Appellate Body Report, *US – Lamb*, para. 103.
[197] United States First Written Submission, para. 124.
[198] United States Response to Questions from the Panel at the First Meeting (Annex A-2), paras. 39-40.
[199] United States Second Written Submission, paras. 66-67.

7.134 In other words, Canada asserts, the USDOC put in the numerator the alleged subsidy to the whole log, then attributed that entire subsidy to only some of the products produced from that log, thereby mismatching the numerator and the denominator in such a way as to artificially inflate the rate of subsidization. For Canada, this alleged overstatement violated Articles 10, 19.4, and 32.1 SCM Agreement, and Article VI:3 of GATT 1994. Canada clarified in its arguments that it sees Article 19.4 SCM Agreement as the provision containing the substantive obligations in respect of calculation of the rate subsidization.[200]

(ii) United States

7.135 The United States argues again that, in the first place, and contrary to what Canada implies, Article 19.4 SCM Agreement does not contain any obligation to use a specific methodology to calculate the "subsidy found to exist". In addition, according to the US, the methodology proposed by Canada would in fact understate the amount of the subsidy, especially when combined with Canada's proposed methodology for the denominator. The US argues that when a sawmill receives a certain amount of subsidy by paying too low a price for the timber that it uses as its input, that subsidy benefits all of the products produced by that sawmill from the timber, not just the subject merchandise. Therefore, the US argues, the USDOC took the total subsidy amount received by sawmills through the allegedly subsidized timber and allocated it to all products (subject and non-subject) resulting from the processing of the timber. Thus, according to the US, the numerator and denominator are calculated on the same basis. The US asserts that Canada's claim amounts to an argument that the US was required to allocate subsidies on a volume rather than value basis. As such an obligation cannot be found in any of the provisions cited by Canada, the US argues, Canada has failed to make its *prima facie* case of a violation in respect of how the USDOC calculated the numerator.[201]

(c) Alleged understatement of the value of "final mill" sales

(i) Canada

7.136 Canada claims that the denominator used by the USDOC as the value of sales of subject merchandise by "final mills" is understated, leading to an impermissible inflation of the rate of subsidization, once again violating Articles 10, 19.4, 32.1 of the SCM Agreement and Article VI:3 of GATT 1994. Canada notes that in all past US softwood lumber cases, the USDOC calculated the rate of subsidization and assessed the countervailing duties, on a "first mill" rather than "final mill" basis.

7.137 The United States imposed the countervailing duty on the "final mill" value of the subject softwood lumber products, which includes the value of lumber shipped to end-users by "first mills" (i.e., those that process logs into lumber), plus the value added by lumber remanufacturers (those that purchase lumber products for further processing into other lumber products). Canada's claim concerns the USDOC's calculation of the amount of value added by the remanufacturers. On this point, Canada argues that the USDOC based its estimate of this value added on outdated and incomplete statistics provided by Statistics Canada at the request of the USDOC (in "GOC Exhibit 36" from the CVD investigation), in spite of having in the record what Canada views as verified, complete and up-to-date information derived by Canada from another source (a study by the Pacific Forestry Centre, or "PFC"). Canada asserts that the PFC information was the most accurate on the record concerning the factual point at issue, and that by ignoring this information, and relying instead on the much less reliable data provided by Statistics Canada, the US overstated the subsidization rate, in violation of the cited provisions. [202]

[200] Canada First Written Submission, paras. 189-194.
[201] United States First Written Submission, paras. 103-106.
[202] Canada First Written Submission, paras. 195-203.

(ii) United States

7.138 The United States argues that Canada is simply disagreeing with the USDOC's choice of which record data to rely on in estimating the value added by lumber remanufacturers. In the view of the US, the USDOC properly and thoroughly considered all of the relevant record evidence, and made a reasonable choice as to which data to use, and then provided in its Final Determination a reasoned explanation of that choice.

7.139 Concerning the USDOC's assessment of the evidence that was before it, the US argues that, contrary to Canada's characterization, the USDOC at verification found various flaws and shortcomings in the PFC study, leading it to conclude that the data in GOC Exhibit 36 were more accurate. In particular, at verification, the USDOC learned that the PFC data included products outside the scope of the investigation, as well as a value for kiln-drying (a service, not a good). By contrast, the derivation of the data in GOC Exhibit 36 was clear, according to the US, and the figures were able to be used to derive a ratio of remanufactured shipments from independent remanufacturers for the two provinces covered by GOC Exhibit 36, which ratio was then applied to the total Canadian lumber shipment values to estimate the value of remanufactured products.[203]

2. Analysis

7.140 In the light of our findings pursuant to Articles 10, 14, 14(d) and 32.1 SCM Agreement and Article VI:3 of GATT 1994 in respect of the USDOC's subsidy determination, we do not find it necessary to address Canada's calculation-related claims described above. That is, having determined that the USDOC determination in respect of subsidization is inconsistent with the cited Articles, and exercising the discretion implicit in the principle of judicial economy, we do not deem it necessary to examine whether certain methodological issues gave rise to further inconsistencies in respect of that determination.

F. CLAIM 6: FAILURE TO CONDUCT THE INVESTIGATION IN ACCORDANCE WITH ARTICLE 12 SCM AGREEMENT

1. Arguments of the parties

(a) Canada

7.141 Canada argues that the USDOC imposed countervailing duties based on an investigation that violated Articles 12.1, 12.3 and 12.8 SCM Agreement. In particular, Canada argues that the United states did not comply with its obligations under Article 12 SCM Agreement in regard to two aspects of the investigation concerning the change in the choice of benchmark state from the preliminary to the final determination and the use of information based on a letter of the Maine Forest Products Council.

7.142 First, Canada argues that the USDOC changed the US state used as the comparative basis for Alberta and Saskatchewan from the preliminary determination to the final determination without any prior notice to the interested parties in violation of Article 12.8 SCM Agreement.[204] Canada argues that the choice of the state which is used for the comparison with the stumpage prices of certain Canadian provinces, is clearly an essential fact which will form the basis for the determination that should have been disclosed to the interested parties in sufficient time for the parties to defend their interests and in any case before the final determination as required by Article 12.8 SCM Agreement. In addition, Canada argues, the interested parties were not given an opportunity to present evidence or

[203] United States First Written Submission, paras. 107-113.

[204] The benchmark state chosen at the time of the preliminary determination was Montana, while for the final determination, the benchmark state used was Minnesota.

prepare presentations regarding the appropriateness of the choice of Minnesota as the new benchmark state, and the USDOC therefore acted in a manner inconsistent with Articles 12.1 and 12.3 SCM Agreement.

7.143 Second, Canada argues that the USDOC failed to give interested parties the opportunity to present evidence and arguments concerning a letter from the Maine Forest Products Council (the "MFPC") that was relevant to the calculation of the US benchmark price applied to Quebec.[205] Canada asserts that this letter was not put on the record until two months after it had been received by the USDOC, and only after Quebec had requested the inclusion in the record of this information. Canada submits that because of the delay in putting the letter on the record, and the deadlines set by the USDOC for commenting on the MFPC information, USDOC deprived the province of Quebec of any meaningful opportunity to rebut new factual information contained in two reports filed by the petitioners concerning this letter, in violation of Article 12.3 SCM Agreement. Canada asserts that the petitioners' new information based on the MFPC letter was used by the USDOC, in spite of the fact that interested Canadian parties were denied the opportunity to present comments on this new evidence. Thus, Canada argues, the USDOC denied interested parties the timely opportunity to see the relevant information as required by Article 12.3 SCM Agreement and to prepare presentations on the basis of the relevant information. Canada submits that the USDOC therefore failed to conduct the investigation in a manner consistent with Article 12.3 SCM Agreement.

(b) United States

7.144 The United States submits that the investigation was conducted in full compliance with Article 12 SCM Agreement as all parties were given notice of the information required for the investigation, had ample opportunity to submit all relevant information, had access to all information submitted during the investigation and were informed of the essential facts under consideration.

7.145 First, with regard to the change of benchmark state, the United States argues that the selection of the benchmark for the stumpage programmes of Alberta and Saskatchewan was consistent with the requirements of Article 12 SCM Agreement. The United States asserts that both Canadian provinces challenged the use of data from the US state of Montana as the basis for the benchmark calculation in the preliminary determination, and notes that the USDOC ultimately agreed with these provinces' arguments and rejected data from Montana, using data from Minnesota instead.[206] The United States is of the view that USDOC was not obliged under Article 12 SCM to provide notice of the new benchmark state chosen and to allow for parties to, once again, comment on the choice of the benchmark state. According to the United States, nothing in Article 12 SCM Agreement imposes on the investigating authority an obligation to engage in an endless cycle of notice and comment. The United States considers that Article 12.3 SCM Agreement explicitly recognizes that information be provided "whenever practicable" reflecting the time constraints imposed on the completion of the investigation.

7.146 According to the United States, the USDOC preliminary determination announced that the United States was using US northern border states as the benchmarks for the Canadian stumpage programmes and set forth the criteria used in selecting such benchmarks. The USDOC identified Minnesota as a possible alternative, and all of the information regarding Minnesota was provided to all of the interested parties. For all these reasons, the United States submits that the interested parties

[205] Canada notes that there can be little debate about the relevance of the information as the USDOC itself requested the information and characterized the information as "important to some of the central issues in the proceeding". USDOC Final Determination, p. 61. (CDA-1). Canada First Written Submission, para. 222.

[206] The United States argues that these provinces thus took advantage of the opportunity to use record information to argue that the forests of Montana were not sufficiently similar to compare to those of Alberta and Saskatchewan, and thus that neither government can now claim surprise when the USDOC considered their arguments and agreed that Montana was not the appropriate benchmark.

were informed of the "essential facts under consideration" in accordance with Article 12.8 SCM Agreement.[207] The United States argues that Canada is really challenging the change in the basis for the legal determination between the Preliminary and the Final determination, and submits that there is no obligation under Article 12.8 SCM Agreement to inform interested parties of this change in the legal determination before the final determination.

7.147 Second, concerning the MFPC letter, the United States submits that the interested parties had access to the information contained in the letter in sufficient time to use it in the preparation of their legal arguments and the USDOC thus acted in accordance with Article 12.3 SCM Agreement.[208] The United States considers that interested parties were provided an opportunity to comment, and in the case of Quebec did comment, on information relevant to the benchmark for Quebec submitted by the Maine Forest Products Council. According to the United States there is no basis in the text of the SCM Agreement that interested parties should have been given additional time to respond to information submitted by petitioners to rebut the information in the MFPC letter[209], and Article 12.3 SCM Agreement does not require the United States to engage in an endless cycle of allowing each interested party to reply to every submission made by every other interested party.

2. Analysis

7.148 In light of our findings on Articles 10, 14, 14 (d), and 32.1 SCM Agreement, as well as Article VI:3 of GATT 1994, we do not find it necessary to address, in this context, Canada's claims under Article 12 SCM Agreement. That is, having determined that the measure at issue is inconsistent with the cited Articles, and exercising the discretion implicit in the principle of judicial economy, we do not deem it necessary to examine whether the investigation which led to the inconsistent measure was consistent with the procedural rules on evidence set forth in Article 12 SCM Agreement.

G. CLAIM 7: INCONSISTENT INITIATION OF THE INVESTIGATION

1. Arguments of the parties

(a) Canada

7.149 Canada argues that the USDOC failed to make an objective and impartial examination and determination of the level of support among domestic producers for the petition as required by Article 11.4 SCM Agreement since support of the domestic producers was actively canvassed with the promise, and the prospect of payments under the United States Continued Dumping and Subsidy Offset Act of 2000 (the "*Byrd amendment*").[210] According to Canada, for the obligation in Article 11.4 SCM Agreement to have any meaning, a Member's determination that the petition was made "by or on behalf of" the domestic industry must be objective and impartial, which it cannot be

[207] The US argues that the Panel in *Argentina – Ceramic Tiles* also found that "the requirement to inform all interested parties of the essential facts under consideration may be complied with in a number of ways" and that this obligation could be met "through the inclusion in the record of documents – such as verification reports, a preliminary determination or correspondence exchanged between the investigating authorities and the individual exporters – which actually disclose to the interested parties the essential facts …" Panel report, *Argentina – Ceramic Tiles*, para. 6.125.

[208] The United States explains that the reason why the MFPC letter was not put on the record earlier was simply because it was not filed in accordance with the USDOC Regulations.

[209] The United States asserts that the letter from petitioners of 4 March, attaching the report by the James W. Sewall company did not contain any new factual information which respondents should have been given an opportunity to comment on.

[210] Canada explains that under the "Continued Dumping and Subsidy Offset Act of 2000" the United States distributes the duties collected to domestic producers that bring or support countervailing duty petitions.

where a Member induces the subjects of the examination, through payment of cash rewards or the imposition of penalties to act in one way or another, as is the case with the *Byrd amendment*. Canada argues that a Member's authorities may not simply rely on quantitative criteria for the establishment of the level of domestic support, as was confirmed by the Panel in the *US – Offset Act (Byrd Amendment)* case. Canada submits that the investigation was initiated on the basis of domestic producer support that was actively solicited by the promise and prospect of a direct payment by the United States and as a result the USDOC initiated the investigation and imposed definitive countervailing duties in violation of Articles 10, 11.4 and 32.1 SCM Agreement.

(b) United States

7.150 The United States argues that the softwood lumber petition contained uncontested evidence establishing that US softwood lumber producers representing 67 per cent of total US softwood lumber production supported the petition and that the USDOC thus initiated the investigation based on adequate domestic industry support consistent with the requirement of Article 11.4 SCM Agreement. The United States asserts that Canada is injecting a requirement into the SCM Agreement that investigating authorities examine the motives of prospective petitioners. The United States points out that a recent Appellate Body report in the *US – Offset Act (Byrd Amendment)* case rejected that argument and overturned the Panel's ruling on which Canada is relying by concluding that Article 11.4 requires "no more than a formal examination of whether a sufficient number of domestic producers have expressed support for an application".[211] As the determination of industry support is an issue of quantity and not of quality, and since even Canada agrees that 67 per cent of the industry supported the petition, the United States submits that the investigation was initiated in accordance with Articles 10, 11.4 and 32.1 SCM Agreement.

2. Analysis

7.151 In light of Canada's statement at the first substantive meeting of the Panel with the parties that it does not consider it appropriate to press its claims as set out in paragraph 1 of its request for the establishment of a panel, we will refrain from addressing this claim and from making any ruling on this claim.[212]

VIII. CONCLUSIONS AND RECOMMENDATIONS

8.1 In light of our findings above, we conclude:

(a) that the USDOC's determination that provision of stumpage constituted a financial contribution in the form of the provision of a good or service was not inconsistent with Article 1.1 (a) (1) (iii) SCM Agreement, and we therefore *reject* Canada's claim that the United States' imposition of countervailing duties on the basis of that determination was inconsistent with Articles 10, 19.1, 19.4 and 32.1 SCM Agreement, and Article VI:3 of GATT 1994;

(b) that the USDOC's determination of the existence and amount of benefit to the producers of the subject merchandise was inconsistent with Articles 14 and 14(d) SCM Agreement, and we therefore *uphold* Canada's claim that the United States' imposition of countervailing duties on the basis of that determination was inconsistent with Articles 14, 14(d), 10 and 32.1 SCM Agreement; having reached this conclusion we apply judicial economy and therefore do not rule on Canada's allegations under this claim that the United States acted in a manner inconsistent with Articles 19.1 and 19.4 SCM Agreement and Article VI:3 of GATT 1994.

[211] Appellate Body report, *US – Offset Act (Byrd Amendment)*, para. 286.
[212] Canada First Oral Statement, para. 154.

(c) that the USDOC's failure to conduct a pass-through analysis in respect of upstream transactions for log and lumber inputs between unrelated entities was inconsistent with Article 10 SCM Agreement and Article VI:3 of GATT 1994, and we therefore *uphold* Canada's claim that the United States' imposition of countervailing duties in respect of such transactions was inconsistent with Articles 10 and 32.1 SCM Agreement and Article VI:3 of GATT 1994; having reached this conclusion, we apply judicial economy and do not rule on Canada's allegations under this claim that the United States imposed countervailing duties in a manner inconsistent with Articles 19.1 and 19.4 SCM Agreement; and

(d) that the USDOC's determination that the provincial stumpage programmes are specific was not inconsistent with Art. 2.1(c) SCM Agreement, and we therefore *reject* Canada's claim that the United States' imposition of countervailing duties on the basis of that determination was inconsistent with Articles 1.2, 2.1, 2.4, 10, 19.1, 19.4 and 32.1 SCM Agreement;

8.2 Having reached the conclusions set forth above that the USDOC Final Countervailing Duty Determination is inconsistent with Articles 10, 14, 14(d) and 32.1 SCM Agreement, and Article VI:3 of GATT 1994, we apply judicial economy and do not rule on:

(a) Canada's claims under Article 19.4 SCM Agreement and Article VI:3 of GATT 1994 concerning the methodologies used to calculate the subsidy rate; and

(b) Canada's claims of violation of the procedural rules of evidence set forth in Article 12 SCM Agreement.

8.3 In the light of Canada's statement at the first substantive meeting of the Panel with the parties that it does not consider it appropriate to press its claims under Articles 10, 11.4 and 32.1 SCM Agreement concerning the initiation of the investigation, we refrain from addressing and making a ruling on this claim.

8.4 Under Article 3.8 of the DSU, in cases where there is infringement of the obligations assumed under a covered agreement, the action is considered *prima facie* to constitute a case of nullification or impairment of benefits under that agreement. Accordingly, we conclude that, to the extent the United States has acted inconsistently with the provisions of the SCM Agreement and of GATT 1994, it has nullified or impaired benefits accruing to Canada under that Agreement. We recommend that the Dispute Settlement Body request the United States to bring its measure into conformity with its obligations under the SCM Agreement and GATT 1994.

ANNEX A

PARTIES' RESPONSES TO QUESTIONS FROM THE FIRST MEETING

ANNEX A-1

CANADA RESPONSE TO QUESTIONS FROM THE PANEL AT THE FIRST MEETING

(24 February 2003)

Q2. Could Canada please indicate what the stumpage fee covers, i.e, what the timber harvester pays for with the stumpage fee. Is it the right to own the harvested tree? The right to cut the tree? Both? Something else? In this context, please comment on the statement at paragraph 3 of the 12 February 2003 closing statement of the United States that "[t]he mills pay to get that tangible timber – not intangible rights – and they pay only for the timber they harvest".

Reply

1. A stumpage fee is not a price paid by tenure holders in return for "timber". This is because provinces transfer stumpage – the right to harvest trees on Crown land – in exchange for a number of obligations to be assumed by the tenure holder, one of which is the payment of a stumpage fee or charge after the timber is cut. The tenure holder thus "pays" for its right to harvest by accepting these obligations – the payment of the fee upon harvest as well as in-kind payments regardless of harvest.

2. From the perspective of both the provinces and the tenure holder, the distinction between the right to harvest and the end product has significant legal and economic consequences. A tenure or licence represents the right to current and future harvests. Tenure holders incur silviculture responsibilities and stumpage fees based on the amount of standing timber they harvest. A tenure or licence also carries current and future obligations such as forest management planning, fire protection, and insect and disease control. These obligations are independent of any harvest. Finally, in accepting a long-term tenure, a harvester accepts responsibility for transforming immovable or real property into movable personal property or goods, and to provide ongoing conservation and management services in respect of the real property.

3. In this way, the right to harvest standing timber granted by Canadian provincial governments is fundamentally different from a simple ownership right in harvested trees. A tenure holder incurs costs and risks that it would not incur if it simply purchased trees. Provincial governments require the discharge of several responsibilities before the right to harvest timber may be exercised. In contrast, the simple sale of short-term cutting rights on public lands in the United States concerns the harvest that is currently available. In addition, in US forests, the government undertakes many of the obligations that are borne by Canadian tenure holders.

4. Canada notes, of course, that the question of the existence of a financial contribution must be approached from the perspective of the alleged provider of the alleged good – in this case, the provincial governments. In this vein, it is instructive to note that outside the United States, most natural resources are owned by governments. When production decisions are turned over to the private sector, the question arises of the fiscal mechanisms by which governments should be compensated for the extraction or use of the resources. The practices by which governments levy charges on government-owned and privately managed natural resources vary greatly. They all involve similar issues.

5. The principal problem governments face in determining charges is the trade-off between production efficiency and ensuring a maximum return to the government. In a world of incomplete

information and imperfect markets, no fiscal mechanism guarantees both productive efficiency and maximum return.[1]

6. Governments use a wide variety of instruments to balance the tension between these two goals. The United States often relies on private ownership—based on prior transfer of the land itself—or on auctions for oil and gas, minerals, and standing timber on lands still in public ownership. Other governments use specialized fiscal devices, such as production-sharing arrangements, resource-rent royalties, and gross or net revenue sharing. In many instances, these charges are denominated as taxes rather than royalties or production charges. An example is the "resource-rent tax" or RRT in Australia.[2]

7. As the Australian RRT illustrates, these fiscal instruments generally do not and cannot collect 100 per cent of the resource rents. All of the levies governments use impose some penalty on production efficiency, and governments strive to develop fiscal mechanisms that will not stifle the incentive to produce.

Q3. Canada argues that there is a meaningful legal distinction, under the stumpage programmes, between the right to harvest and the right to own the harvested tree. Could Canada please indicate the significance, in concrete terms in respect of this dispute, of this distinction – i.e., are there any stumpage contracts where the timber harvester does not have ownership rights to the harvested timber? If so, please provide a specific description of these situations and an indication of their magnitude in relation to total stumpage.

Reply

8. In Canada most forms of tenure confer a right to harvest standing timber that is in the nature of a proprietary interest. The legal nature of this right, and the point at which the harvester owns the harvested tree varies depending on the form of tenure and the provincial jurisdiction.

British Columbia

9. Long-term tenure holders in British Columbia have the legal right to cut timber on a defined area of Crown land. The tenure holder owns the logs resulting from the harvest of standing timber. The right to harvest also includes a right of access to the land for that purpose. These two aspects constitute one integral interest in land described in the common law as a *profit à prendre*.[3]

Alberta

10. In Alberta the two forms of long-term tenure arrangements are the Forest Management Agreement ("FMA") and the Timber Quota. FMAs account for more than 60 per cent of the annual allowable cut in Alberta. Timber Quotas account for close to 30 per cent of the annual allowable cut.

11. The legal nature of FMAs is set out in Section 16(2) of Alberta's *Forests Act*:

[1] In the case of volumetric stumpage charges for the exercise of timber-harvesting rights in British Columbia, this trade-off is discussed and illustrated in Nordhaus 2001a. (Exhibit CDA-13)

[2] The Australian RRT is levied on net cash flows for oil and gas projects that achieve a specified return. The return was originally set at 15 percentage points above the long-term bond rate. The threshold rate compounds pre-tax cash flows until a positive cumulative cash flow emerges. At that point, a tax rate of 40 per cent is levied on resource rents. The government's share of net rents on a present value basis is therefore 40 per cent, while 60 per cent is retained by the producer.

[3] See footnote 12 of Canada's First Written Submission and Exhibits CDA-9 to CDA-12.

> *Except as against the Crown and subject to any agreement to the contrary, ownership of all Crown timber on land subject to a forest management agreement or forest management lease is, during the term of the agreement or lease, vested in the holder of the agreement or lease,* who is entitled to reasonable compensation from any person who causes loss of or damage to any of the timber or improvements created by the holder.[4] [emphasis added]

12. This provision confers a proprietary interest in the standing timber to the FMA holder. However, it does not convey complete ownership of the standing timber as the provision stipulates that the Crown retains its superior rights after the tenure is conferred. The FMA holder obtains full ownership rights in the harvested timber only after the harvest.

13. Timber Quotas give the tenure holder the right to harvest a percentage of the annual allowable cut in a particular forest area. These tenures do not convey a real property interest. Instead, the tenure holder receives a licence to cut a certain number of trees in an area if it meets certain obligations. Licences generally are issued every 3 or 4 years. Full ownership interest in the harvested timber vests in the quota holder when the timber is cut.

Ontario

14. In Ontario the province uses two major forms of licence to provide access to Crown timber: Sustainable Forest Licences and Forest Resource Licences. These licences provide a legal right to harvest standing timber, but do not confer a proprietary interest in land.[5] Ontario also differs from other provinces in that the ownership of harvested timber is not transferred to the harvester until all stumpage fees have been paid.[6]

Québec

15. In Québec the Crown timber supply is managed through a long-term form of tenure referred to as a Timber Supply and Forest Management Agreement ("TSFMA"). This form of tenure accounts for 99.4 per cent of the annual Crown softwood harvest. The provisions of the *Forest Act* govern ownership rights in the province.[7]

16. A TSFMA provides for the right to enter specified public lands and harvest a limited volume of timber as described in the agreement.[8] For each TSFMA, an annual forest management plan must be submitted to the Ministère des Ressources Naturelles for approval. After the plan is approved, the TSFMA holder receives a forest management permit that allows it to harvest specific cutting areas in accordance with the plan. The Québec *Forest Act* provides that this forest management permit confers harvesting rights that are immovable rights.[9] It also provides that ownership of harvested

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[4] *Forests Act*, R.S.A. 2000, Chapter F-22. (Exhibit CDA-115) Under section 1(l) of the *Forests Act*, the term "timber" means all trees living or dead, of any size or species and whether standing, fallen, cut or extracted.

[5] *Crown Forest Sustainability Act, 1994*, S.O. 1994, c. 25, at s. 36. (Exhibit CDA-116) *Black's Law Dictionary* defines a licence as follows:

A revocable permission to commit some act that would otherwise be unlawful; esp., an agreement (not amounting to a lease or profit à prendre) that it will be lawful for the licensee to enter the licensor's land to do some act that would otherwise be illegal, such as hunting game.

See: B.A. Garner, ed., *Black's Law Dictionary*, 7th Ed. (St Paul: West Group, 1999), at 931. (Exhibit CDA-117)

[6] *Crown Forest Sustainability Act, 1994*, S.O. 1994, c. 25, at s. 33. (Exhibit CDA-116)

[7] S.Q., Ch. F-4.1. (Exhibit CDA-118)

[8] *Ibid.*, at s.42.

[9] *Ibid.*, at s. 87.

timber vests in the harvester once logs reach the processing facility, or when the harvester pays the appropriate stumpage fee.[10]

Q4. Is it possible for a tenure holder to sell to another party its own contractual right to harvest, without the permission of the provincial government, and while maintaining its tenure contract in force? In other words, can someone enter into a stumpage contract and then sell off the rights to harvest under that contract?

Reply

17. The answer to this question varies from province to province.

British Columbia

18. In British Columbia tenures themselves are transferable with the approval of the provincial government. In fact, tenures are frequently traded. As well, a tenure holder may arrange a contract with a third party – usually a logging contractor who is already working on behalf of the tenure holder – that allows that third party to log a part of the tenure at his/her own risk and take the resulting profit or loss. In this scenario, the tenure holder is in effect assigning his/her initial ownership rights to a third party. Government approval is not required. The tenure holder remains ultimately responsible for the forest management obligations on the tenure, including road construction and maintenance, planning and silviculture.

Alberta

19. In Alberta, the tenure holder may sell or subcontract the right to harvest without seeking government permission. The tenure holder remains responsible to the government for all obligations. A tenure holder may also transfer tenure. Government approval is required, but this is routinely granted.

Ontario

20. In Ontario harvest licences are not property rights that can be sold. Where a business holding tenure is sold or sells assets (harvesting equipment, physical buildings, goodwill, etc.) the provincial government may consent to forest resource licences being transferred to the buyers of a business, and has regularly done so.

21. Tenure holders may enter into contracts under which the other contracting party receives their right to harvest. This may be done through the use of an "overlapping agreement" that is recognized by the provincial government.

Québec

22. In Québec, TSFMAs are not transferable to another party. TSFMAs are agreements between the province and a specific party. If the party to a TSFMA sells the related timber processing facility, the accompanying TSFMA is revoked and reverts to the province as the owner and steward of the public forest. A new TSFMA between the province and the new owner of the timber processing facility must be approved by the province and executed. There is no guarantee that an entity purchasing a timber processing facility will acquire the tenure that was previously associated with that facility.

[10] *Ibid.*, at s. 8.

23. In the recent examples of large scale timber processing facility acquisitions, applications to re-issue the same tenures to the new mill owner were presented to and approved by the Ministère des Ressources Naturelles after confirmation that the new owner had the necessary resources to ensure the continuing fulfilment of the obligations that run with the tenures and that the necessary forest plans were in place. In those cases, new TSFMAs were executed with the new timber processing facility owner. In all cases, TSFMAs are linked to the actual, residual supply needs of timber processing facilities and the parties' capacity to fully perform the duties and obligations that run with the tenures.

Q5. Concerning newcomers seeking access to stumpage:

(a) Could Canada please indicate how a newcomer seeking stumpage goes about obtaining it. Please discuss, *inter alia*, the availability of forested land that is not already subject to tenure contracts; the required capacities that the newcomer must have in order to obtain a tenure contract; how long it typically takes between an initial request from a newcomer and the execution of a stumpage contract; and any other relevant elements.

Reply

24. "Stumpage" is the right to harvest standing timber. It is transferred to harvesters as part of tenure agreements that generally require harvesters to assume a variety of obligations including road-building, silviculture and numerous other forest management responsibilities.

25. Canada understands the Panel to be asking how newcomers enter into tenure agreements and obtain stumpage as part of those agreements. Canadians have been harvesting forests for centuries and there are claims of one kind or another, whether through private ownership or tenure arrangements, on most accessible forests. Consequently, there are inevitable and obvious limits on the creation and availability of entirely new tenures, which imply grants of access to previously unclaimed stands of trees. Some new tenures are created, but the much more common phenomenon is trade, in one form or another, in already established tenures. Such trade is very common and very widespread. What follows is a discussion based on British Columbia, Alberta, Ontario and Québec. Together these provinces account for 96 per cent of lumber exports from Canada.

British Columbia

26. In British Columbia there are various ways for a "newcomer" to obtain stumpage rights. First, short-term tenures are advertised publicly and are open to application by registrants in the Small Business Forest Enterprise Programme ("SBFEP"). For one type of short-term tenure, registrants must be market loggers who do not own processing facilities.[11] The applications are awarded solely on the basis of the highest bid pursuant to an auction process. For the second type of short-term tenure, registrants cannot hold a major long-term tenure. Applications are awarded on the basis of a number of neutral factors including price. Hundreds of these short-term tenures are awarded each year under the SBFEP programme. These SBFEP tenures collectively accounted for about 12 per cent of the Crown harvest during the period of investigation. These licences are generally of one to two years duration, are not replaceable, and have no forest management obligations. The Ministry of Forests advertises the availability of new tenures and newcomers can then apply to participate in the bids for those new tenures.[12]

[11] See Response of the Government of British Columbia to US Department of Commerce 1 May 2001 Questionnaire (28 June 2001), Vol. 1 at BCIII-1 to III-3. (Exhibit CDA-119)

[12] *Ibid.*, Vol. 1 at BCIII-1; BCIV-50 to 51.

27. Second, long-term tenures may be and are purchased from existing tenure holders. Transfers of tenure in British Columbia are quite frequent.[13] A majority of British Columbia's major long-term replaceable tenures in fact have been transferred in market transactions since their issuance to the initial tenure holders.[14] This demonstrates that newcomers have access to stumpage rights in British Columbia through the acquisition of existing tenures. Numerous major US companies, for example, have obtained tenures in this manner.

28. In general, eligibility for concluding tenure agreements with the province is open to any legal or natural person satisfying easily met criteria. For example, US corporations can purchase and have purchased tenures in British Columbia and are also free to participate in the SBFEP programme. Transfers of tenure are subject to approval of the provincial government, which is generally granted.

Alberta

29. There are three types of commercial tenure arrangements in Alberta used to harvest coniferous timber: the long-term Forest Management Agreement (FMA) and the Timber Quota (already discussed above), and the short-term Commercial Timber Permit (CTP).

30. A newcomer seeking access to Alberta stumpage would have several options for obtaining it. First, approximately 4 per cent of Alberta's forests are not under tenure, and a newcomer could compete for new tenures that might be offered. Second, a newcomer could buy a company holding tenure or could buy that company's tenure. While provincial permission is required for tenure transfers, it is routinely granted. It is not uncommon for companies to be bought and sold, with their tenure rights being conveyed to the purchaser. During the period of investigation, for example, seven small Timber Quotas were transferred. Third, a newcomer could compete for the short-term permits (CTPs). These permits convey rights to cut timber for 3 to 5 years. They are issued either through open auctions, sealed tender or by direct sale in certain communities to the residents there. CTPs represent about 7 per cent of Alberta's annual allowable cut.

31. The basic eligibility criterion for entering into a tenure arrangement offered in Alberta for timber harvesting rights is that the person be 18 years of age. The process thereafter depends on the tenure type. Timber Quotas generally have been sold in auctions open to all, with no processing requirements attached. Timber Quota auctions are advertised ahead of time. A bidder must make a lump sum cash bid for the tenure, as well as commit to paying regulation stumpage dues and miscellaneous fees, and promise to undertake a variety of forest management obligations. It generally has taken less than 6 months between the advertisement for the Timber Quota and issuance of the Quota.

32. FMAs are not sold at public auction, but are entered into after a competitive selection process. The selection process considers which proposal is best able to fulfill the purpose of the FMA, which includes goals such as long-term utilization of the resource, protection of the environment, and government revenues and taxes. Typically, when large timber supplies afford the opportunity, the province advertises the availability of timber development areas. The province gives interested parties a specified period to analyze the resources in the area and prepare and submit their proposals for managing and developing it. The province reviews each proposal to ensure it addresses forest management objectives established by the province.

33. Once a company has decided on its timber development proposal, the province will incorporate a commitment based on that proposal into the FMA to ensure the timber is not wasted. However, the government does not encourage any particular type of facility and there are no

[13] See Response of the Government of British Columbia to US Department of Commerce 17 December 2001 Supplemental Questionnaire at Exhibit BC-S-168. (Exhibit CDA-120)

[14] *Ibid.*, at 3.

requirements that the FMA timber be used in the facility. In addition, subject to government approval, the company can change its development direction. The FMA process is detailed and therefore time consuming. On average, it might take 2 to 4 years from the advertisement of timber area to the completion of the FMA.

34. CTPs sold by auction or sealed tender are advertised ahead of time. These auctions/tenders generally involve per cubic metre bids, agreement to pay reforestation levies and miscellaneous charges, and limited forest management obligations. Directly-sold CTPs pay regulation stumpage fees, as opposed to bids, but otherwise are the same as their bid counterparts. CTP eligibility criteria beyond the basic age requirement noted above differ from area to area. Some sales include residency requirements, or require possession of a manufacturing facility, possession of logging equipment, or may require the bidder to have operated a CTP recently, and may exclude Timber Quota or FMA holders from bidding. In some cases, sales conditions may consider the need for support to small businesses in rural communities and therefore may ensure that only small operators bid. About half of the CTPs require the wood to be processed at a specified mill, which means that the winner would negotiate with the mill owner after winning the sale. The time between the notice of sale and the actual conferral of tenure averages is typically less than 3 months.

Ontario

35. Two general types of tenure arrangements govern timber harvests in Ontario: (1) Section 26 Sustainable Forest Licenses ("SFLs"), and (2) Section 27 Forest Resource Licenses ("FRLs"). In addition, while not constituting a form of tenure, the Crown also makes use of other forms of wood supply commitments, including Supply Agreements issued under Section 25 of the Crown Forest Sustainability Act ("CFSA"), Commitment Letters, and licences to harvest trees that are not in a Crown forest but are still reserved to the Crown.

36. Generally, to obtain any type of licence, an applicant must either own a forest resource processing facility (*e.g.*, a sawmill, pulpmill, veneer mill, etc.), or must have a market to supply wood to some type of forest resource processing facility. Licencees must be able to demonstrate their ability to fulfill their obligations under the licence (*i.e.*, meet environmental protection requirements, perform silviculture obligations, etc.).

37. Section 26 SFLs also require that the licence holder have the ability to meet the substantial obligations of the SFL's terms and conditions. The Ontario SFL holder must be able to ensure the delivery of a comprehensive planning and renewal programme, as required by the SFL. This includes, for example, obligations regarding forest management planning, performing inventories, annual work schedules, compliance activities, First Nations relations and providing information.

Québec

38. Most of the accessible forest land in Québec's public forest is covered by TSFMAs. Those areas represent 87.4 per cent of forests in the public forest, leaving 12.6 per cent as public forest reserves which are not subject to harvest. This does not mean that new market entrants have been unable to enter into TSFMAs with the province.

39. If a newcomer wishes to enter into a TSFMA with the province, it must own a timber processing facility and demonstrate that it is capable of fulfilling its obligations under the TSFMA. There are no restrictions as to who may own or operate a timber processing facility.

(b) Could Canada please indicate how often newcomers are granted stumpage – that is, how common an occurrence is this, versus the situation of long-standing tenure relationships that are renewed upon expiry.

Reply

40. Assured supply through long-term tenures is an essential feature of obliging companies to build roads, plant trees, and pay for forest fire protection and protections against insects and disease. Long-term tenures do not mean, however, a closed market. Mills open and close all the time, everywhere in Canada. They are bought and sold. Changes in mill ownership, the closing of old mills and the opening of new ones, always impact tenures. Changes in technology often drive mills out of business while stimulating the construction of new mills.

41. There are abundant examples of this fluidity. On a grand scale, in the last five years, Weyerhaueser, the largest lumber producer in North America, bought MacMillan Bloedel, what was then the largest producer in Canada. Donahue, which at the time was the largest producer in Québec, was bought by Abitibi Consolidated. Bowater, an American company, bought Alliance, one of Québec's largest producers, last year. International Paper, the leader and largest member of the US Coalition for Fair Lumber Imports, bought Weldwood in Canada. Louisiana Pacific is building a state-of-the-art mill in Ontario to access black spruce for specialized use. The notion that Canadian trees are controlled in perpetuity by an entrenched group of long-term tenure holders is a caricature of the Canadian market.

42. The situation in each of British Columbia, Alberta, Ontario and Québec is set out below.

British Columbia

43. Even though there are relatively few new long-term tenures awarded in British Columbia, new tenures can be made available from time to time. New tenures are advertised publicly and applications are examined and awarded on the basis of price and other relevant factors, such as First Nations employment. There are generally no restrictions on who can apply for such long-term tenures.

44. It should also be noted that the majority of long-term tenures do not "expire" prior to renewal but rather are renewable pursuant to evergreen provisions. Those long-term tenures are renewed (replaced) on a fixed periodic basis (such as every 5 years) so long as the terms of the agreement are honoured.

Alberta

45. As indicated in the response to question 5(a) above, newcomers have multiple opportunities to obtain stumpage under long-term tenure in Alberta. The province does not track the number of new companies that secure tenure, but there have been multiple instances where long-term tenures originally issued to one company have been transferred to another company. Recent examples of these transfers are West Fraser Timber's purchase of their FMA from Alberta Energy Company and Weldwood's purchase of their FMA from Sunpine Forest Products. (Weldwood was subsequently made a wholly owned subsidiary of International Paper). In the period of investigation alone, seven small Quotas were transferred.

Ontario

46. The Ontario Minister of Natural Resources has the right to amend licences and reallocate forest resources to other licensees. Significant reallocations have and continue to occur.

47. During the period of investigation (POI) in this case, four Section 26 Sustainable Forest Licenses (SFLs), twenty Section 27 Forest Resource Licenses (FRLs) and one Section 25 Supply Agreement were transferred in Ontario. In addition, between 1993 and 2001, approximately 5,774,600 cubic metres of the total available harvest during the POI (about 25 million cubic metres)

was reallocated without compensation to the original tenure holders. This reallocation over time constituted about 23 per cent of the harvest available during the POI. Lastly, Ontario is committed to a significant expansion of parks and protected areas. In 1994, the Crown began removing land from existing tenures in order to create new parks and protected areas. By March 31, 2003, 1.3 million hectares will have been removed for this purpose. The total 2.7 million hectares that will be removed represents a 9 per cent reduction in total area that was under tenure. Again, compensation was not provided to the tenure holders.

Québec

48. Between 31 March 1996 and 31 March 2001, a total of 75 TSFMAs were revoked for the following reasons: plant closures; sale of assets; change in needs; bankruptcy; and failure to respect silviculture obligations. In the same period of time, 70 new TSFMAs were entered into by the province, and 92 TSFMAs were renewed.

	31-Mar 1996-1997	31-Mar 1997-1998	31-Mar 1998-1999	31-Mar 1999-2000	31-Mar 2000-2001	Totals
New TSFMAs	34	9	8	13	6	70
Revoked TSFMAs	18	18	11	21	9	77
Renewed TSFMAs	69	18	3	1	1	92

Source: Ministère des Ressources Naturelles, 18 February 2003

49. As these numbers show, there is significant turnover in TSFMAs. Whenever a TSFMA is revoked, it is subject to reallocation. As mentioned above in response to Question 5(a), if a newcomer wishes to enter into a TSFMA with the province, it must own a timber processing facility and demonstrate that it is capable of fulfilling its obligations under the TSFMA. There are no restrictions as to who may own or operate a timber processing facility.

Q6. Could Canada please describe in detail what happens if a tenure holder does not meet its obligations under a tenure contract, including, specifically, road building and maintenance, forestry management obligations (silviculture, pest control, reforestation, etc.), minimum cut requirements, and timber processing requirements. In particular in respect of minimum cut requirements and timber processing requirements, can a tenure holder lose its tenure for failure to meet these requirements?

Reply

50. The details vary from province to province.

British Columbia

51. One key element of the bundle of rights and obligations represented by tenure agreements are tenure holder's forest management obligations. The province has the authority to impose severe penalties, including fines, for failure to meet obligations regarding road construction and maintenance, silviculture, protection and other forest management obligations, as set out in Sections 117 and 143 of the *Forest Practices Code of British Columbia Act*. In addition, the *Forest Act* provides for suspension (Section 76) or cancellation (Section 77) of a tenure agreement for failure to comply with the requirements of the *Forest Act* or the *Forest Practices Code of British Columbia Act*. If a tenure holder fails to meet its forest management obligations, it is subject to significant penalties, including fines and possible suspension or cancellation of the underlying tenure agreement itself. Although loss of the underlying tenure has never happened, it is a potential penalty for non-compliance.

52. Similarly, tenure holders are subject to potential loss of allowable annual cut for any failure to meet minimum cut requirements, as described in Section 66 of the *Forest Act*. In addition, tenure holders are also subject to loss of allowable annual cut for failure to meet any timber-processing requirement that may be applicable to a specific tenure. Minimum cut and timber-processing requirements are not applicable to all types of tenure. Moreover, processing requirements are applicable only as set forth in individual tenure agreements and are not required in all cases even for the same tenure types.

Alberta

53. No minimum cut requirements are enforced on any of the tenures available in Alberta.

54. If a tenure holder does not meet forest management, road maintenance or other similar obligations under a tenure contract, penalties would be imposed on the errant tenure holder. Some CTPs do tie the wood cut to particular mills, but these CTPs account for a very small percentage of the province's annual allowable cut. If the violations were severe and pervasive, Alberta could withdraw the tenure from the tenure holder. Alberta has found, on occasion, tenure holders to be in default and has imposed penalties including calling on performance bonds posted by the company. In these circumstances, the province has required these tenure holders to take remedial measures, including restoring the performance bonds, in order for the tenure holder to maintain their tenure rights.

Ontario

55. There are no processing requirements associated with the tenures available in Ontario. Licence holders are, however, generally required to indicate to the province that they have a market for the timber they intend to harvest. That market may be a facility in which they have an ownership interest or one in which they have no interest.

56. Ontario does not have minimum cut requirements.

57. With respect to tenure holders that breach their obligations (road building, forest management, etc.) in Ontario, the Crown has the right to pursue enforcement actions. A wide range of penalties and remedies are available to address any breach, including the potential denial of a tenure right or refusal to extend such a right. As a factual matter, Ontario has never encountered failures to meet tenure obligations so egregious as to revoke a tenure completely.

Québec

58. In Québec, there is no minimum cut requirement. If a tenure holder does not meet the obligations imposed under its tenure contract, it may lose its tenure. Québec indicated in its questionnaire response that several tenures were revoked during the fiscal year 1999-2000 for failure to respect tenure obligations (although unstated, at issue were silviculture obligations).

Q7. In the event that, *arguendo,* a Member were permitted under certain circumstances to use as a benchmark for the determination of benefit market conditions in a market other than that of the country of provision, what in Canada's view should have guided the USDOC's choice of such a benchmark assuming that it were permissible to disregard in-country prices?

Reply

59. As the question recognizes, Canada submits that a Member may only use market conditions in the country of provision to determine the adequacy of remuneration. If it were permissible to ignore in-country prices for private stumpage, however, Canada first notes that there was evidence on the

record that could have been used by Commerce as a benchmark in this case – evidence which Commerce has consistently used as a benchmark in cases where it has determined that no in-country prices exist. As set out in response to question 10, Commerce had extensive evidence before it that demonstrated that provincial stumpage systems are operated consistently with market principles. This evidence included a demonstration that the provinces earned substantial profits from timber harvesting sales during Commerce's period of investigation.[15]

60. Contrary to the United States' assertions, Commerce has consistently used this type of benchmark evidence where it has determined no in-country prices exist because the government has a monopoly or a near monopoly.[16] Furthermore, the United States' efforts to distinguish its previous practice from the circumstances of the present case must fail. In its Closing Statement at the First Oral Hearing the United States argued that it "only" resorted to this benchmark in these other cases because there was no world market price for the good or service in question that was commercially available in the countries in question. It is abundantly clear that there is no "world market price" for standing trees in the forest nor are standing trees in a forest in the United States "commercially available" in Canada. Thus, on the basis of the United States' own argument, if it were able to disregard in-country prices in this case, it should have considered the evidence the Canadian provinces submitted that to determine, "consistent with market principles", whether remuneration was adequate.

61. This being said, if it were permissible to use as a benchmark for the determination of benefit market conditions in a country other than the country of provision, Commerce should have determined whether the out-of-country benchmarks it used were available to purchasers in the country of provision. If these out-of-country benchmarks were available to purchasers in the country of provision they would then form part of prevailing market conditions "in" the country of provision. Here they did not, since neither timber harvesting rights nor standing timber in the United States is available in Canada.

62. In addition, Commerce should have determined whether the prevailing market conditions in the country used as a benchmark (here the United States) were the same as the prevailing market conditions in the country of provision, and if not, whether it would be possible to quantify the impact of the differences on relative in-country prices. In the case of stumpage, the market conditions affecting it include all of the factors that US agencies (such as those in the states of Maine and Wisconsin[17]) identify as critical for intra-jurisdictional comparisons, such as timber size and quality, terrain, distance from mills, and conditions of sale. Equally important, the investigating authority would have to identify all of the factors that necessarily affect price levels in different countries including cost of capital, prevailing wage rates, inflation rates, and different monetary, tax, labour and environmental regulations and policies. These factors make prices for most goods and services, and certainly for stumpage and other property rights, different in different countries. Here, the multitude of differences that exist because of the border make valid cross-border comparisons impossible to do, as Commerce itself found in all previous lumber investigations.

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[15] See Canada's First Written Submission at paragraphs 106-108. As is demonstrated there Canadian provinces earned substantial profits from their stumpage programmes. For instance, during the Period of Investigation, British Columbia earned a profit of C$541 million, representing a return of 75 per cent of expenditures. The other major producing provinces also showed substantial profits on their stumpage programmes – 35 per cent for Ontario, 67 per cent for Québec, and 25 per cent for Alberta See also PricewaterhouseCoopers Report (Exhibit CDA-47). See also Analysis of the Profitability of Standing Timber Sales in the Public Forests for the Québec Ministère des Resources Naturelles, attached to Letter of 7 January 2002 from Matthew J. Clark to Hon. Donald L. Evans. (Exhibit CDA-49).

[16] *Certain Hot-Rolled Carbon Steel Flat Products from South Africa*, 66 Fed. Reg. 50,412 (2001) (final determination) (Exhibit CDA-50); *Certain Hot-Rolled Carbon Steel Flat Products from Thailand*, 66 Fed. Reg. 50,413 (2001) (final determination) (Exhibit CDA-51); *Carbon and Certain Alloy Steel Wire Rod from Trinidad and Tobago*, 67 Fed. Reg. 55810 (2002) (final determination) (Exhibit CDA-52).

[17] See Canada's First Written submission, at para. 85, footnote 59.

63. The impossibility of valid cross border price comparisons underlies the reason why the Members, including the United States, made the choice to use only the actual market within the country being investigated to find a benchmark. Remaining within the country allows the benchmark to automatically take into account the natural comparative advantages or disadvantages that a country may enjoy as well as the effects on the market of that countries' monetary, tax, labour and environmental regulations and policies. These important market influences cannot be integrated into the benchmark if the benchmark comes from another country.

Q9. The USDOC final determination (Exhibit CDA-1), at pages 39-40, contains the following statements:

> **"…StatsCan data show that approximately 2.5 million cubic meters of softwood logs were imported into Canada during the POI, and each of the investigated Provinces imported US logs during the POI. …**
>
> **"This extensive record evidence that Canadian lumber producers had actual imports of US logs and purchased US stumpage during the POI would support basing our benchmark on tier one of the regulatory hierarchy [market prices from actual transactions within the country under investigation]. However, we do not have sufficiently detailed import prices on the record to use as the benchmark for all Provincial stumpage programmes. Therefore, we are using stumpage prices in the United States under tier two of the regulatory hierarchy [world market prices that would be available to purchasers in the country under investigation]."**

Reply

64. Canada would like to make several comments with respect to the excerpts from the Final Determination quoted in this question from the Panel.

65. First, the programmes found by Commerce to be countervailable subsidies were provincial stumpage programmes. Under these programmes, provinces transfer a right to harvest standing timber to timber harvesters. The "good" that Commerce claims was provided at a subsidized price is standing timber or the right to harvest such timber. It is not logs – whether imported or domestically produced. Commerce's benefit analysis, therefore, necessarily involved a determination of whether *stumpage* was provided by the provinces at less than adequate remuneration. There was ample evidence provided to Commerce by the provinces (as detailed in Canada's answer to question 10 below) that would have allowed Commerce to answer this question, without resort to import price data for logs.

66. Second, with the exception of imports of logs into Québec, the import of logs into Canada represent less than 1 per cent of the total annual harvest. In western Canada this is largely due to extensive log export bans that have been imposed by the United States.[18] With respect to log imports into Québec, the United States itself explained in its Second Written Submission to the panel in

[18] As noted in Canada's First Written Submission at paragraph 75, log export restrictions are in place for the public lands in Washington, Idaho and Montana that Commerce used as a benchmark for British Columbia, the source of 58 per cent of Canadian exports subject to countervailing duties.

United States – PD Softwood Lumber[19], that these imports, from Maine into Southern Québec relate to particular factors that are unique to this area.[20]

67. Third, determining "adequate remuneration" for any Canadian province based on prices of imported logs is an intractable problem. Complete data on the species and other characteristics of imports do not exist. Statistics Canada data are for a broad category of "wood in the rough" that is not limited to logs. Nor does the record contain all the necessary information concerning harvesting costs, which may be different, for example, because of differences in the terrain or in the distance to mill or market. There is therefore no valid means to estimate the harvesting and transportation costs that should be deducted for imported log prices as a measure of stumpage charges, even (incorrectly) assuming that in this case the necessary information about log imports were available by species, grade and other relevant criteria.

Q10. The parties seem to have very different views as to what the record evidence shows in respect of the existence or not of a private market for stumpage in Canada. Could the parties clarify for the panel what they consider the pertinent record evidence was, and why they consider that it was, or was not, representative and/or usable?

Reply

68. The record evidence in the underlying investigation that relates to the provincial stumpage markets may be broken down into two separate categories: (1) record evidence of prevailing market conditions in Canada including evidence of private markets for stumpage in Canada; and (2) information relating to alleged "price suppression" which Commerce claims was caused by significant involvement of the provincial governments in the Canadian market. Article 14(d) of the SCM Agreement provides that the former is central to a calculation of a benefit. The latter is not mentioned in this provision.[21] Canada nonetheless has provided information on both categories in order to assist the Panel in understanding this evidence.

Private Markets For Stumpage in Canada

69. The in-country benchmark evidence provided by Québec, Ontario, Alberta and British Columbia in this investigation (from which 96 per cent of exports of softwood lumber from Canada originate) was as follows:

Québec

70. Québec submitted a study prepared by independent forest consultants entitled *The Private Forest Standing Timber Market in Québec*.[22] The study concluded that the use of the Québec private market "as the basis for calculating public forest dues is … appropriate and justified",[23] because the private forest is an independent market with near perfect competition, that is free of distortion from government influence.[24]

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[19] United States – Preliminary Determinations With Respect to Certain Softwood Lumber From Canada, Report of the Panel, WT/DS236/R, adopted 1 November 2002 ("United States – PD Softwood Lumber").

[20] *United States – PD Softwood Lumber*, US Second Written Submission, at para. 27. (Exhibit CDA-121)

[21] United States – PD Softwood Lumber, at para. 7.52.

[22] See Response of the Gouvernement du Québec to US Department of Commerce 5 July 2001 Supplemental Questionnaire (August 3, 2001), Vol. 3, Exhibit QC-S-100 ("The Private Forest Standing Timber Market In Québec" ("Del Degan I")) (Exhibit CDA-29).

[23] Del Degan at 154.

[24] *Ibid.*, at Summary VIII and 152.

71. The study also examined the question of market size and representativeness, looking at numerous authoritative real-world examples and providing a case analysis of the US milk sector.[25] It concluded that it is the nature of the competition in a market that determines whether the market produces reliable prices, not the size of the market.[26]

72. The record evidence before Commerce also demonstrated the validity of the private prices used by Québec in setting public stumpage fees. In its own extensive verification of Québec's responses Commerce learned that Québec does not create the private timber prices used in the parity technique by administrative whim, but rather collects data on standing timber sales in the private forest in a rigorous, objective, and careful manner. The following verified facts describe the systematic way in which Québec collects the private prices:

- The Ministère des Resources Naturelles ("MRN") begins by collecting private forest standing timber prices through outside consultants[27] in the form of *annual surveys* of forestry companies that purchase standing timber in the private forest.[28]

- The consultants conducting the surveys perform on-site interviews and verify the information provided by reviewing source documents.[29]

- The annual surveys of private forest transactions cover at least 75 per cent of the approximately 150 private forest operators in Québec. The MRN also conducts a *complete census* of private forest contractors every three years.[30]

73. Commerce was presented with three years of the annual private forest stumpage surveys and census. Commerce was also presented with copies of the original survey results reporting private forest stumpage transactions in Québec.[31] As stated in its Verification Report, Commerce found no discrepancies in this information.[32] And, as the United States conceded in its First Written Submission "Quebec … *submitted actual prices from non-government transactions*."[emphasis added][33]

74. The record evidence also demonstrated the existence of two distinct and separate standing timber markets in Québec. The two markets have different suppliers and different purchasers. This separation exists in large part because the vast majority of Québec sawmills are shut out of the public forest. It also exists because, by law, the public forest in Québec may only operate as a *residual supply source*.[34] A sawmill in Québec must therefore look to the private forest and other external

[25] *Ibid.*, at 108-123 and Appendix 1.

[26] *Ibid.*, at 122-123 and 153.

[27] These outside consultants are firms that specialize in forest assessments, economic analysis, and forestry market surveys. See Response of the Gouvernement du Québec to US Department of Commerce 5 July 2001, Vol. 1 at 126. (Exhibit CDA-138)

[28] Response of the Gouvernement du Québec to US Department of Commerce 1 May 2001 Questionnaire (28 June 2001),Vol. 1 at 58. (Exhibit CDA-138)

[29] Response of the Gouvernement du Québec to US Department of Commerce 1 May 2001 Questionnaire (28 June 2001), Vol. 1 at 126-127. (Exhibit CDA-138)

[30] Response of the Gouvernement du Québec to US Department of Commerce 1 May 2001 Questionnaire (28 June 2001), Vol. 1 at 73. (Exhibit CDA-138)

[31] *Ibid.* at Exh. QC-S-66 (Exhibit CDA-32), QC Aug. 3 Supplemental Response at Exh. QC-S-90 (Exhibit CDA-33), and Memorandum from Eric Greynolds to Melissa G. Skinner, Countervailing Duty Investigation of Certain Softwood Lumber Products from Canada: Verification of the Questionnaire Responses Submitted by the Government of Québec (Feb. 15, 2002) ("Québec Verification Report") at 2 and Verification Exhibit 2 (Exhibit CDA-34).

[32] See, e.g., Québec Verification Report at 12, 14. (Exhibit CDA-34)

[33] US First Written Submission, at para. 66.

[34] Under Section 43 of the Québec Forest Act (Exhibit CDA-118), the public forest is subordinate to the private forest and to other external sources of supply. An applicant for a public tenure in Québec must justify

sources *before* the public forest may be used. This forces demand onto the private forest. Commerce verified data objectively demonstrating that the private forest in Québec is a premium market.

75. Further evidence of the existence and validity of the Québec private forest standing timber market is the longstanding and vigorous log trade between private landowners in the Northeastern United States and dozens of mills in Québec. During the exclusion process in this investigation, Commerce reviewed in detail the log sourcing of sixteen mills commonly referred to as "Border Mills."[35] Based on this examination, Commerce verified that approximately 73 per cent of the softwood logs purchased by those mills during the period of investigation came from the United States.[36] The reality of this trade belies United States' "suppression theory" that the Québec government's sale of timber distorts the prices in the Québec private forest standing timber market. This position makes no economic sense in light of the Québec Border Mills' long and active log trade with the United States, and in particular the state of Maine.[37]

Ontario

76. Ontario provided evidence of the existence of a private market by submitting information regarding the overall volume of private stumpage sales.[38] In addition, Ontario also submitted to Commerce an expert study by Resource Information Systems Inc. ("RISI") entitled "Ontario's Private Timber Market" that provided a detailed overview and assessment of the significant private market timber sales in the province.[39] In its Final Determination, Commerce acknowledged the existence of a private market in Ontario.

77. The information submitted regarding Ontario's private market was representative of the Ontario private market as a whole. The RISI study examined 129 specific transactions for the sale of one million cubic metres of timber. This volume amounts to more than one third of the estimated private timber market in Ontario.[40] This study – which contrary to US assertions, was not prepared for the purposes of litigation - provides a detailed analysis of actual private market prices in the province. The RISI Study concluded that:

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a need for public supply by proving that alternative private supplies are not available. Allocation of public forest land will only be allowed up to a level of supply not available from private sources.

[35] *See* Memorandum from The Team Office VI to The File, *Final Calculations for Companies Requesting Exclusion*, March 21, 2002. (Exhibit CDA-122)

[36] *Ibid.* at Appendix A page 1. This accounted for approximately 2.3 million cubic metres of softwood logs.

[37] Commerce correctly recognized in *Lumber III*, that the Québec Border Mills' log trade does not make economic sense if Québec private forest prices truly are suppressed:

> Finally, export restrictions, according to the Coalition's own argument, depress domestic prices relative to the export market. The Coalition *fails to provide a credible reason why mills in Québec and Ontario, which supposedly benefit from significantly underpriced domestic logs, would bother to buy such a significant volume of expensive US logs.*[37] [emphasis added]

See: *Lumber III*, 57 Fed. Reg. at 22,621. Since Commerce's *Lumber III* determination, the operation of the Québec private forest has not changed in any material manner except for accounting for a larger share of the total provincial softwood timber harvest (increasing from approximately 10 per cent to 17 per cent). (Exhibit CDA-28)

[38] This information was provided in Ontario's first questionnaire response to Commerce. Response of the Government of Ontario to US Commerce Department May 1, 2001 Questionnaire (28 June 2001) at Exhibit ON-STATS-1. (Exhibit CDA-36)

[39] RISI is an acknowledged leading source for independent economic analysis of timber markets throughout the world. *See* Letter from Hogan & Hartson L.L.P. to US Department of Commerce, dated 30 July 2001, regarding the Private Timber Market in the Province of Ontario which contains Resource Info. Sys. Inc., Ontario's Private Market (June 2001)). (Exhibit CDA-37)

[40] *Ibid.*, at 1. (Exhibit CDA-37).

> The results of the survey suggest that the market for private timber in Ontario appears to be both competitive and efficient. Buyers and sellers have the same information about market conditions, sellers produce homogeneous products, they are price-takers and they can enter and exit the market easily. Hence the market meets the classic definition of a competitive market. The market can also be classified as efficient given its low transaction costs and low level of government involvement. [41]

78. The RISI Study and the separate analysis of the softwood transactions by Charles River Associates ("CRA") provided Commerce with private transaction pricing information on both a transaction-specific and a weighted average basis.[42] In addition, the CRA Study evaluated the market conditions in Ontario for private timber sales and concluded that the prices for private timber were established by the marginal supply of timber within Ontario. It also calculated the average price for private timber purchased by sawmills during Commerce's period of investigation.

79. Commerce verified the accuracy and completeness of the submitted private transaction information. Commerce did not argue or claim that the pricing information contained in the RISI Study and used in the CRA Study was based on an unrepresentative sample of transaction prices for private stumpage in Ontario. Therefore, it was uncontested that these studies provided Commerce with private transaction information that reflected the pricing for private timber in Ontario. Finally, these studies both considered the effect of the involvement of the government of Ontario in the marketplace. In reality, Commerce's only reason for rejecting this evidence was its allegation of "price suppression".

Alberta

80. Alberta provided record information on the derived market value of mature standing timber. The Timber Damage Assessment ("TDA") value is made available in an annual consultant's report that is prepared for commercial interests. Although this TDA value has been characterized as a form of compensation it is calculated based on information derived from arm's length log transactions, combined with a smaller number of bids from competitive government auctions for stumpage in the same period, to determine the full value of the standing timber. The majority of the timber values are calculated using arm's length log transactions from public and private sources. The standing timber values used for TDAs are then derived by deducting the attendant logging and hauling costs.

81. The TDA valuation methodology was jointly developed by commercial interests in the oil and gas, mining and forestry sectors in Alberta in an effort to derive the proper valuation of mature standing timber that would be destroyed when energy and mining development occurs. The TDA values provide a basis for recompense to forest sector companies for this destruction. TDA stumpage values are highly reliable, as they have been calculated in the normal course of business by an independent consultant using a consistent procedure dating back to 1993.[43]

82. In 2000, TDA values were *derived* from data on wood volumes equivalent to 6 per cent of Alberta's harvest,[44] a portion of the harvest many times larger than the portion of Minnesota's timber

[41] *Ibid*., at 15.

[42] Dr. George Eads of CRA, a former Member of the US President's Council of Economic Advisors, was the principal author of the CRA Study.

[43] In addition, as Commerce officials noted at verification, the consultant spot-checks the data to confirm its accuracy. Verification of the Questionnaire Responses Submitted by the Government of Alberta (15 Feb. 2002), at p. 18-19. (Exhibit CDA-130)

[44] Response of the Government of Alberta to the US Department of Commerce 1 May 2001 Questionnaire, Alberta Vol 1 – Narrative Response and Appendix A (28 June 2001), at AB-X-15 (Exhibit CDA-123); Response of the Government of Alberta to the US Department of Commerce Supplemental Questionnaire (3 August 2001), at AB-SUP-5 (Exhibit CDA-124); Response of the Government of Alberta to the Department of Commerce 19 November 2001 Questionnaire (17 December 2001), Exhibit 63. (Exhibit CDA-45)

harvest which Commerce relied on for Alberta's comparison. The consultant compiled this data from 20 locations from across the province.[45]

British Columbia

83. In addition to economic analysis that demonstrated that British Columbia's stumpage system was administered in a manner consistent with market principles,[46] British Columbia provided evidence concerning the limited market for private stumpage in British Columbia. In order to respond to Commerce's request for information in this regard, the British Columbia lumber industry engaged consultants to survey whether mills had purchased any standing timber from private lands on the prices paid. That consultant's report indicated that nearly all private wood fibre sales are of logs rather than standing timber, and that 99,000 cubic metres of standing timber from private lands was purchased during the year 2000, which represents 0.1 per cent of the total B.C. harvest.[47]

84. British Columbia also provided evidence concerning competitive auctions are held under Section 20 of the Small Business Forest Enterprise Programme ("SBFEP"). As previously described, these Section 20 auctions are awarded to the highest bidder on the basis of price and amount to 6 per cent of British Columbia's harvest.[48]

Other Relevant Record Evidence From All Provinces

85. These four provinces provided information demonstrating that, consistent with market principles, they earned substantial profits from their stumpage programmes. This evidence demonstrates that harvesters cannot be said to be receiving stumpage "for less than adequate remuneration". Canada's First Written Submission at paragraphs 106-108, discusses this evidence in detail.[49]

86. In conclusion, Commerce had ample evidence of prevailing market conditions in Canada, including detailed economic analysis. This evidence clearly was not "limited", as the United States claims.

Price Suppression

87. Commerce rejected this in-country evidence on the basis that there were "no useable market-determined prices between Canadian buyers and sellers…" Its reason for this conclusion was that "the large government presence" in the market suppressed private prices, making it "difficult to find a market price that is independent of the distortions caused by the government's actions."[50] None of the sources relied on by Commerce to arrive at this conclusion d*emonstrated* "based on the facts and economics that the predominance of the government supply significantly distorts the market."[51]

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[45] Response of the Government of Alberta to the US Department of Commerce 19 November 2001 Questionnaire (17 December 2001), Exhibit 63, at 4. (Exhibit CDA-45)

[46] See Canada's First Written Submission at paragraphs 109-110.

[47] See Norcon Forestry Ltd. and PricewaterhouseCoopers L.L.P., "Survey of Primary Sawmills Arm's-Length Log Purchases in the Province of British Columbia," Addendum, "Arms-Length Purchases of Softwood Standing Timber from Private Lands," (attached to letter from Steptoe & Johnson, 21 December 2001) (Exhibit CDA-60). No information on grade or species of this minimal volume of private stumpage sold is available.

[48] Response of the Government of British Columbia to US Department of Commerce 1 May 2001 Questionnaire (29 June 2001) Vol. 1, at IV-46-66; Vol. 3, at Exhibit BC-S-1, attachments G-1 and G-2. (Exhibit CDA-42)

[49] See also answer to Question 7.

[50] Issues and Decision Memorandum: Final Results of the Countervailing Duty Investigation of Certain Softwood Lumber Products from Canada, 21 March 2001, at pp. 36-37 ["CVD FD"] (Exhibit CDA-1).

[51] *United States – PD Softwood Lumber*, US Answers to the Panel's 26 April 2002 Questions, at para. 88. (Exhibit CDA-137)

88. Commerce's finding of "distortion" and "price suppression" in the Final Determination relied heavily on the Preamble to its Regulations.[52] It described the Preamble as stating that "*if* the government provider constitutes a majority or a substantial portion of the market, *then* such prices in the country will no longer be considered market-based and will not be an appropriate basis of comparison for determining whether there is a benefit." [emphasis added][53] Thus, Commerce treated the Preamble as if it prescribes a *per se* rule that requires the rejection of in-country prevailing market conditions in any situation where the government is the majority provider of the good. Commerce therefore assumed price suppression without any factual or economic analysis.

89. Even if Article 14(d) permitted the rejection of in-country benchmarks on the basis of price suppression, the Preamble does not contain such a *per se* rule. Nowhere does the Preamble, the regulation itself or the statute, state that if the government constitutes a majority of the market then private prices will no longer be considered an appropriate basis for comparison. The Preamble merely invites an inquiry into whether a large government presence in the market may create distortion.

90. That type of analysis was never undertaken by Commerce. The "evidence" which the United States claims supports Commerce's finding of market distortion does not withstand even limited scrutiny.

91. The "economic" evidence relied on by Commerce to conclude that private market prices were suppressed consisted of a single report prepared by Economists, Inc. ('EI") for the petitioner.[54]

92. Although the EI report purports to provide an economic model of some provincial stumpage markets in Canada, it is entirely theoretical. It does not examine private market prices or transactions anywhere in Canada and consequently, does not demonstrate that there is actual "price suppression" in any province. It therefore, provides no support for Commerce's conclusion that "in each of the Provinces, the stumpage market is clearly driven by the government's control of the total softwood timber harvest".

93. Further even as a theoretical analysis the report is flawed. The economic model on which the report is based is premised on the erroneous assumption that Crown timber supply in the provinces increases as price increases.

94. The report commences with the proper assumption that the supply of Crown timber cannot supply the entire provincial market.[55] In the ensuing analysis, however, this assumption changes. The

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[52] The preamble provides that,

> While we recognize that government involvement in a market may have some impact on the price of the good or service in that market, such distortion will normally be minimal unless the government provider constitutes a *majority or, in certain circumstances, a substantial portion of the market. Where it is reasonable to* conclude that actual transaction prices are significantly distorted as a result of the government's involvement in the market, we will resort to the next alternative [benchmark] in the hierarchy. [emphasis added].

See: Countervailing Duties – Final Rule, 19 C.F.R. Part 351, or 63 Fed. Reg., 65,348 at 65,377. (Exhibit CDA-125)

[53] CVD FD, at 47. (Exhibit CDA-1) It is clear from the reports submitted to Commerce by Canada that it is the nature of the competition in a market that determines whether the market produces reliable prices, not the size of the market. Economically, the central question is not whether government presence is large, rather it is whether the "market" being analysed has the characteristics or essential indicia of a market. In this case, they do and thus they should have been considered by Commerce.

[54] R. Stoner and M. Mercurio, *Economic Analysis of Price Distortions in a Dominant-Firm/Fringe Market*" (4 January 2002) ("EI Report"). (Exhibit US-22)

report creates a second scenario in which "through some policy change, the 'supply schedule' in the administered sector is no longer unresponsive to price. Rather than a fixed administrative price P_A, the price (sic) in the administered sector responds positively to price."[56] Accordingly, the conclusions of the EI report are premised on: (1) an assumed "policy change" that does not exist; and (2) an assumption that the Crown timber supply will increase if the price of timber increases. As the record evidence flatly contradicts these assumptions this economic model simply does not stand up to even minimal scrutiny.[57]

95. As Canada noted in its First Written Submission and First Oral Statement the remaining evidence relied on by the United States to support "the conclusion that stumpage fees on public lands are the price driver for the stumpage markets in those Provinces" consisted of little more than the following anecdotal evidence. It is far from "substantial", as claimed by Commerce.

96. **First**, was a letter of the Québec Minister of Natural Resources to the President of the Fédération des producteurs de bois du Québec ("FPQ"), submitted to Commerce by the petitioner to argue that "private stumpage prices in Quebec are affected by the administratively-set price for public stumpage."[58]

97. This letter is a Government response to the private land owners' association's criticisms of the cost adjustments used to make public and private timber comparable in Québec's parity system, which itself is used for setting public land stumpage rates. The relevant portion of the letter relied upon by Commerce states:

> *Toutefois, je suis conscient que la tarification des bois des forêts publiques puisse avoir une influence indirecte sur le marché privé.*

98. The verb "puisse," as used in the letter, translated means "could" or "might". It does not translate into "does". Therefore, the above sentence, translated, reads:

> However, I am aware that public land stumpage charges [*could* or *might*] have an indirect influence on the private market.

99. This in itself demonstrates the United States' gross mischaracterization of the value and import of the letter. However, the context of the above passage is equally revealing: the statement is simply the reason given by the Minister as to why the Government of Québec continues to undertake meaningful dialogue with Québec private landowners. It is clearly not proof of "price suppression".

100. The **second** piece of "evidence" the United States alleges Commerce relied on to conclude that Québec private stumpage prices were distorted was a 1995 thesis by a university student that

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[55] The report states that, "firms in the administered sector *cannot* fulfill all market demand at the administered price"[emphasis in original] EI Report at 7. (Exhibit US-22)

[56] *Ibid*., at 8.

[57] In Ontario, for example, the CRA report demonstrates that private sellers sell softwood timber at prices higher than the Crown price. CRA report, at Attach 5 (Exhibit CDA-38). If the EI report's assumption were correct, Crown supply would expand to fill demand before the market would tolerate higher prices. Moreover, Québec and Ontario both imported softwood from the United States during the period of investigation. This indicates that the supply of timber is not sufficient to meet demand for these markets.

In addition, this economic analysis is completely inapplicable to Québec where there is not a "single stumpage market" sourced from both the private and public forests. Instead, the public and the private markets in Québec constitute two entirely separate and distinct markets for timber with marked differences in purchasers. This separation is reinforced by the provisions of Québec's *Forest Act*. See para. 74 above.

[58] Letter from J. Brassard, Ministre des Ressources naturelles, Gouvernement du Québec, to J.-C. Nadeau, Fédération des producteurs de bois du Québec, dated 12 July 2000. (Exhibit CDA-126). See CVD FD, at 38. (Exhibit CDA-1)

analysed forms of tenure in Québec.[59] Although the paper refers to sources as late as 1993 the only studies that substantively examine "price suppression" discuss the Québec stumpage regime that was replaced in 1989. Interestingly, in *Lumber III*, the Coalition (the petitioner in this case) made the same "distortion" argument regarding Québec private stumpage prices.[60] In commenting on the argument in that case, Commerce described the study relied on by the Coalition at that time as completely outdated and irrelevant since it examined a system that was replaced in 1989 by Québec's current system of 28 "biophysically and geologically homogeneous tariffing zones." It went on to say that "the evidence cited by the Coalition is either outdated and irrelevant or anecdotal…[61] Thus, in *Lumber III* Commerce rejected evidence that was arguably more current, reliable and relevant than the material it is now relying on to arrive at the opposite conclusion.

101. A **third** piece of evidence relied on by Commerce are statements made by Mr. Jean-Pierre Dansereau the Executive Director of the FPQ. In its verification report Commerce suggests that the Mr. Dansereau stated that his syndicate might lobby the Government of Québec because,

> [P]rivate wood lot owners have an interest in the level of stumpage fees because *if* the GOQ sets fees at an arbitrarily low level, it would depress stumpage fees and log prices …[emphasis added][62]

102. Commerce neglects to mention that this statement was made only with respect to *hardwood* lumber.[63] In Québec's rebuttal brief the province attached an affidavit of Mr. Dansereau that provides critical information on this conversation, noting that:

> The report fails to mention that my statements regarding the concern of private landowners as regards the level of private stumpage *is a matter of historic fact, that in recent years is relevant mainly to hardwood species, which are in oversupply in Quebec and have been for many years.*
>
> The report also fails to mention my statements *that softwood lumber and logs in Québec are now in undersupply, and have been for many years*, with the result that private prices for softwood lumber and logs have gone up and have been at a satisfactory level for many years. [emphasis added][64]

103. This affidavit confirms that this conversation only pertained to the effect that public stumpage *might* have on private hardwood timber prices. It also confirms that Commerce was informed that there was high demand for softwood in Québec during this period. This conversation cannot be relied upon to establish that "price suppression existed in this province". In fact, it establishes the opposite.

104. **Fourth**, with respect to Ontario, Commerce relied on a report prepared by the petitioner. That report purportedly relied on a survey of "marketing boards, logging contractors and foresters" in Ontario, yet conceded that, "Most people contacted refused to provide information."[65]

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[59] Luc Parent, "A Financial Strategy for the Development of Private Timber Lands in Quebec" (June 1995). See US Answers, at para. 40 and footnote 52. (Exhibit US-33). The study was not actually cited in the Final Determination. It was cited in the Preliminary Determination and in the United States' First Written Submission.

[60] *Certain Softwood Lumber Products from Canada*, 57 Fed. Reg. 22,570, 22,597 (Dep't Commerce 28 May 1992) (final determination). (Exhibit CDA-24).

[61] *Ibid*., at 22,598.

[62] Québec Verification Report, at 28-29. (Exhibit CDA-34)

[63] In the CVD FD, Commerce only conceded that Québec, "questions the accuracy of our verification report". *See:* CVD FD, at 38. (Exhibit CDA-1)

[64] Québec Rebuttal Brief, 1 March 2002, Exhibit 2. (Exhibit CDA-127)

[65] David Cox et al., Examining the Market Value of Public Softwood Timber in Canada 106-08 (27 July 2001). (Exhibit CDA-128)

105. There is no actual evidence in the record regarding the underlying survey. Further, the report contains neither a summary of survey responses nor any individual responses. In addition, no information was provided regarding how the survey was structured or its response rate, nor was a sample survey instrument attached. Accordingly it was impossible to confirm the facts allegedly supporting the report. In spite of this complete absence of facts, the strongest conclusion it could manage was that, "(s)tumpage prices in all of Ontario . . . *appear* to be *influenced* by Crown prices.''[emphasis added][66]

106. **Fifth**, with respect to British Columbia, Commerce pointed to a report prepared by environmentalists in B.C., to establish "price suppression" in that province.[67] This report does not analyse whether domestic benchmarks in BC are suppressed. Instead, the report argues that Crown stumpage is subsidizedusing a cross-border comparison that is even more inaccurate than that undertaken by the Commerce in the underlying investigation. In an attempt to support its methodology the report asserts that:

> [S]ince loggers bidding on Small Business sales have no choice but to dispose of their timber in an environment where timber prices are artificially low, even the bonus bids in the Small Business Programme will *tend to* underestimate timber value.[emphasis added][68]

107. This assertion was supported by no evidence or analysis whatsoever. This single sentence is the only sentence in the report that speaks of "price suppression" of domestic benchmarks.

108. Commerce pointed to no other evidence regarding "price suppression" in any other province.

109. As should now be clear there was ample evidence of in-country benchmarks for Commerce to consider in this case and simply no reasonable basis for Commerce to conclude that prices in Canada were "suppressed" or "distorted" by the fact of significant provincial government ownership of forestry resources.

Q11. With regard to its pass-through claim, could Canada clarify whether it is arguing that a pass-through analysis was required in all cases in the investigation, i.e. even in case of complete identity between the timber harvester and the sawmills (lumber producers); or does Canada consider that a pass-through analysis was required only in those cases where there allegedly existed arm's length transactions between timber harvesters and lumber producers and between lumber producers and remanufacturers?

Reply

110. Subsidy pass-through analysis is required in every instance where the subsidy found to exist is allegedly bestowed on one person while the countervailing duty is imposed on the products of another. Where the timber harvester and the producer of subject merchandise are the same "recipient" of the alleged subsidy, no pass-through analysis would be required.

111. The United States found subsidization (albeit incorrectly) only for those producers of subject lumber who participate in the stumpage programmes directly. Though a Member may average the amount of a subsidy found to exist over all such producers, it may not average its obligation to demonstrate that a subsidy exists over instances of direct participation and potential indirect

[66] *Ibid*, at 106.
[67] T.L. Green and L. Matthaus, *Cutting Subsidies or Subsidized Cutting?*, Report commissioned by BC Coalition for Sustainable Forestry Solutions (12 July 2001). (CDA Exhibit – 129)
[68] *Id.*, at 9.

participation. The relevant nexus for the imposition of countervailing duties on the merchandise of a given producer is direct participation in the alleged stumpage programme, not simply production of subject merchandise.

112. In this case, the United States admits to the existence of arm's-length transactions.[69] Because the United States has failed to conduct any pass-through analysis, the volume of Crown timber harvested by entities that did not produce subject lumber and the amount of subsidy derived from that volume, for example, must therefore be excluded from the numerator in the aggregate rate calculation. Likewise, no duty can lawfully be imposed on the products of lumber remanufacturers purchasing at arm's length.

Q13. Could Canada take the Panel through its analysis of each of the provisions it alleges have been violated by the failure of the USDOC to conduct a pass-through analysis, and indicate why it considers each of these provisions has been violated?

Reply

113. Under Article 1.1 of the SCM Agreement, a subsidy may be direct or indirect. A direct subsidy exists where the recipient of the alleged subsidy receives the financial contribution directly from the government. Where such direct relationship does not exist, then a Member must establish that the alleged recipient has received an indirect financial contribution that has conferred a benefit. A Member may not presume the existence of an indirect subsidy in such circumstances any more than it may presume the existence of a direct subsidy. Under Articles 10, 19.1, and 32.1 of the SCM Agreement and Article VI of the GATT 1994, a countervailing duty may be imposed only where an investigating authority demonstrates that the producer of subject merchandise has benefited from a "subsidy"; under Article 19.4, countervailing duties may be imposed only in respect of subsidies legally determined to have existed, and only at the amounts permitted by the SCM Agreement.[70] Where, therefore, a subsidy is alleged to have been bestowed on one person, and countervailing duties are imposed against the products of another, the "pass-through" of the subsidy from the one to the other must be established and may not be presumed.

114. The United States has acknowledged the existence of arm's-length transactions,[71] and is therefore under an obligation to demonstrate the existence of a "subsidy" in all such cases. Because the United States presumed rather than demonstrated the existence of a "subsidy" in those cases, the United States acted inconsistently with Article 1.1 of the SCM Agreement and therefore violated: (a) Article 10 by failing to impose countervailing duties in accordance with the provisions of the SCM Agreement; (b) Article 19.1 by imposing countervailing duties in the absence of a final determination of the existence and amount of a subsidy; (c) Article 19.4 by levying countervailing duties in excess of the amount of the subsidy found to exist; (d) Article 32.1 by taking action against a subsidy not in accordance with the provisions of GATT 1994, as interpreted by the SCM Agreement; and (e) Article VI:3 of the GATT 1994 by imposing duties in the absence of an indirect subsidy finding.

Q15. In paragraph 179 of its first submission, Canada argues that Article 19.4 SCM is violated where, for example, a countervailing duty is based on a subsidy calculation in which the amount of a subsidy is higher than permitted by the methodologies set out in the SCM Agreement. Could Canada explain what it considers to be the "methodologies set out in the SCM Agreement"? Could Canada also please explain the relationship of this argument to

[69] US First Written Submission, at paras. 106, 113; US Oral Statement, at para. 30. See also *United States – PD Softwood Lumber*, at para. 7.74.

[70] See, e.g., United States – Countervailing Measures Concerning Certain Products from the European Communities, WT/DS212/AB/R, 9 December 2002, at paras. 139, 147, and 149.

[71] US First Written Submission, at paras. 106, 113; US Oral Statement, at para. 30. See also *United States – PD Softwood Lumber*, at para. 7.74.

paragraph 121 of its oral statement: "…neither Article 19.4 nor Article VI:3 refers to a calculation methodology".

Reply

115. Neither Article 19.4 nor Article VI:3 refers to a specific calculation methodology for determining the amount of a subsidy or subsidy per unit rate. At the same time, various provisions of the SCM Agreement, as interpreted and applied by panels and the Appellate Body, set out general guidelines to be followed in determining a correct subsidy per unit rate as required by Article 19.4.

116. Article 19.4 provides:

> No countervailing duty shall be levied on any imported product in excess of the amount of the subsidy found to exist, calculated in terms of subsidization per unit of the subsidized and exported product. [footnote omitted]

117. It therefore requires that the maximum amount of a countervailing duty is limited to the per unit rate of subsidization on the allegedly subsidized and exported products. For Article 19.4 to have any meaning, the calculation of a per unit subsidy rate must be done correctly. That is, a countervailing duty may be imposed only to the extent that the rate reflects the subsidy attributable to the allegedly subsidized and exported product.

118. Article 19.4 incorporates four concepts, all of which are grounded in the provisions of the SCM Agreement: subsidy, amount of the subsidy, subsidization per unit, and countervailing duty. Because none of these concepts is defined in Article 19.4, it must be presumed that the provision incorporates by reference elements fundamental to subsidy and countervailing duty determinations found elsewhere in the SCM Agreement, and that those elements have in turn been correctly determined.

119. First, a countervailing duty imposed as against a practice that is *not* a subsidy within the meaning of Article 1 violates Article 19.4 to the extent that the countervailing duty rate exceeds the subsidy rate, which would be zero. Such a countervailing duty rate would not be imposed in accordance with the subsidy determination methodology set out in Article 1 of the SCM Agreement, and would be inconsistent with Article 19.4.

120. Second, where the amount of a subsidy has been impermissibly created or inflated by using incorrect benchmarks, by definition the subsidy per unit rate attributable to an allegedly subsidized and exported product is illegally inflated. Such a countervailing duty rate would be inconsistent with Article 19.4. One calculation methodology to determine that amount is set out in Article 14, which provides mandatory guidelines for the "calculation of the amount of a subsidy in terms of the benefit to the recipient". Article 14 sets out "methods" of determining the amount of the benefit to the recipient in paragraphs (a) to (d). Other methods have been developed and amplified in various panel, arbitration and Appellate Body reports.

121. Finally, even where a subsidy has been correctly determined to exist, and the amount has been correctly calculated, Article 19.4 imposes an obligation on a Member to calculate the rate by dividing the total subsidy (the numerator) by the total sales volume of all products to which the alleged subsidy is attributable (the denominator), to arrive at the per unit rate of subsidy on the allegedly subsidized and exported product. Or, where only a subset of those products are included in the denominator, only the portion of the subsidy attributable to that subset of products should be in the "numerator".

122. Article 19.4 is the only provision in the SCM Agreement (in conjunction with Article VI:3 of GATT 1994) that limits the level of the countervailing duty to the per unit subsidy rate. As such, Article 19.4 is the operative obligation in the context of Canada's calculation-related claims.

Q16. Could Canada please respond to the US argument that Article 19 SCM Agreement does not establish any requirements concerning how a subsidy is to be determined, and that such obligations are found elsewhere in the Agreement, in Article 14 in particular (US first submission, para. 95), a provision not invoked by Canada. Does Canada consider that Article 14 SCM Agreement is relevant to its claims concerning the calculation of the rate of subsidization by the USDOC?

Reply

123. Canada refers the Panel to its answer to question 15 which explains Canada's view of the relationship between Article 19.4 and other provisions of the SCM Agreement including Article 14. Article 14 goes to the measurement of the subsidy (the numerator in the subsidy rate calculation), while Article 19.4 expressly addresses the necessity of calculating a per unit subsidy rate, involving matching the numerator and denominator.

17. Assuming, *arguendo*, that the total amount of subsidy benefit has been determined in conformity with the Agreement, could both parties clarify what, in their view, was or should have been the product scope of the numerator and the denominator in the USDOC subsidization calculation?

124. Article 19.4 provides that the countervailing duty rate may not exceed the "subsidization per unit of the subsidized and exported product." A countervailing duty may be imposed, therefore, only in the amount of the alleged subsidy *attributable* to the subsidized and exported product.

125. This means that if the numerator is the total subsidies received by a producer, then the denominator must be all output products of that producer. In the facts of this case, the numerator of the subsidy per unit calculation is "all logs entering sawmills." Accordingly, the denominator should have been "all output products produced from those logs" – in other words, all products to which the subsidy may be attributed. In this case, Commerce excluded certain output products produced from those logs (certain "residual products"). By dividing the total subsidy by only a portion of the alleged subsidized products, Commerce inflated the subsidy per unit rate.

126. The following softwood products are produced from softwood log and lumber inputs in sawmill establishments:

(1) in-scope softwood lumber;

(2) softwood co-products resulting from the lumber production process (including chips, sawdust, etc.); and

(3) other non-scope "residual" softwood products (including any non-scope softwood products shipped from the sawmill establishment, for example, remanufactured products that were further milled in the same sawmill establishment, pallets, fuel wood, logs and particle board or wafer board that was manufactured on-site from the chips and sawdust resulting from the lumber production process).

127. In addition, a host of products are produced by remanufacturers of lumber who use softwood lumber products (from sawmills) as their input products. These *remanufactured lumber products* all result from the original softwood logs that entered sawmills. Commerce grossly understated the value

of these remanufactured products (in contradiction to the record evidence), thereby further understating the denominator and overstating the subsidy rate.

128. Of course the more accurate way to determine the subsidy per unit rate of the subject merchandise would have been to limit the numerator of the equation to only the volume of logs used in the production of softwood lumber (*i.e.*, the alleged subsidy directly attributable to the production of subject merchandise) and then to divide that amount by the value of softwood lumber products.

Q18. Could Canada please identify the relevant record evidence as to the products that it argues should have been included in the sales denominator of the subsidization calculation, and explain why those products should and could have been included.

Reply

129. In Canada's original questionnaire response, Canada provided provincial and country-wide shipment data (Statistics Canada survey data) for *in-scope softwood lumber* and *softwood co-products*.[72] Further, in its 21 December 2002, supplemental questionnaire response, Canada provided a country-wide estimate for *residual product* shipments from sawmills.[73] These data were verified by the Department and the verification exhibits are attached as Exhibit CDA-___.[74] In addition, in a submission dated 7 January 2002, Canada provided detailed estimates for shipments of *remanufactured products* as compiled by Natural Resources Canada's Pacific Forestry Centre.[75] These data were verified by Commerce and the verified values are attached at Exhibit CDA-___.[76]

130. As described in response to question 17, the four groups of products above are all produced originally from softwood logs. Consequently, since the numerator in the equation included all logs entering sawmills, then the denominator necessarily needed to include the output of those logs.

Q19. According to Canada, the USDOC used "manifestly incorrect data" (para. 132 Canada's oral statement) in its selection of a conversion factor which led to the inflation of the subsidy and amounts to a legal error. In Canada's view, was it manifestly incorrect of the USDOC not to accept the conversion factor suggested by Minnesota in its Public Stumpage Price Review and Price Index (CDA-113), when it is clearly noted in this Minnesota document that "the reader should use caution when comparing the prices shown in this report with actual prices received or expected on any specific timber sale. Individual sale prices will vary significantly from the averages shown in this report because of variability in both economic and physical conditions"? (CDA-113, p. IV.A)

Reply

131. The text in the Minnesota Public Stumpage Price Review and Price Index ("Price Report") to which question 19 refers in no way speaks to the applicability of the conversion factor that appears on the face of the Price Report. The purpose of the disclaimer cited in question 19 is simply to caution readers that the Price Report lists *average* prices per species. These average prices, of course, will differ somewhat from actual prices paid by specific purchasers of public timber in Minnesota, which

[72] Response of the Government of Canada to the US Department of Commerce 1 May 2001 Questionnaire (29 June 2001) at Exh. GOC-GEN-3. (Exhibit CDA-131)

[73] Response of the Government of Canada to the US Department of Commerce 26 November 2001 Questionnaire (21 Dec. 2001) at Exh. 41. (Exhibit CDA-132)

[74] Verification of the Government of Canada (23 January 2002) at Exhibit. 7 (all calculations) (Exhibit CDA-133); and Exhibit 13 (residual products) (Exhibit CDA-86).

[75] Estimated Added Value of Remanufacturer Shipments (8 January 2002). Exhibit CDA-134)

[76] Verification of the Survey of Secondary Manufacturing conducted at the Pacific Forestry Centre (15 February 2002), Exhibit CALC-1 (redacted public version). (Exhibit CDA-135).

are based on the specific economic conditions of each sale and the physical conditions of the particular stand. Actual transaction prices may be higher or lower than the average prices listed in the Price Report, and the Price Report cautions readers regarding this fact lest they assume that the listed price is what they will receive or pay in a sale. Therefore, it would be incorrect to infer anything about the validity of the conversion factor on the face of the Price Report from this standard disclaimer about average prices.

132. The front cover of the Minnesota Price Report also notes that all reported volumes and values (*i.e.*, sales prices) in the Price Report are predicated on the specified conversion factor. Any departure from the conversion factor underpinning the data in the Price Report renders the price data meaningless for comparison purposes – a basic fact that Commerce never addressed.

Q20. Could each party clarify how it sees the role of the Panel in respect of the calculation-related claims, in light of the Panel's standard of review?

133. The Panel's standard of review is set out in Article 11 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes*. Article 11 provides in relevant part as follows:

> [a] panel should 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, and make such other findings as will assist the DSB in making the recommendations or in giving the rulings provided for in the covered agreements.

134. The Appellate Body in *United States* – Transitional *Safeguard Measure on Combed Cotton Yarn from Pakistan* summarized "a panel's standard of review under Article 11 of the DSU in assessing whether the competent authorities complied with their obligations in making their determinations":

> This standard may be summarized as follows: panels 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 assessed 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.[77]

135. It would not be appropriate for this Panel to conduct a *de novo* review of the evidence. For instance, this Panel is not required to determine which conversion factors were appropriate (assuming that any are appropriate) to convert from thousand board feet to cubic metres. Rather, the question that the Panel may, and indeed is required to, address is whether Commerce examined all the pertinent facts, provided an adequate explanation of how the facts supported its determinations and addressed the complexities of the data. Commerce did not do so and the facts on the record firmly contradict the conclusions reached by Commerce. A review, in accordance with Article 11 of the DSU, of the conclusions of Commerce in the light of the evidence before it reveals that Commerce violated Article 19.4 in imposing countervailing duties in excess of the alleged per unit rate of subsidization.

Q23. The US argues that nothing in Article 12 SCM imposes on the investigating authority an obligation to engage in an endless cycle of notice and comment, and that Article 12.3 rather

[77] *United States – Transitional Safeguard Measure on Combed Cotton Yarn from Pakistan*, Report of the Appellate Body, WT/DS192/AB/R, adopted 5 November 2001, para. 74.

reflects the time constraints imposed on completion of the investigation, requiring only that relevant information be provided, "whenever practicable". Could Canada please react to this US argument that linking Articles 12.1 and 12.3 to 12.8 would create an endless cycle of notice and comment?

Reply

136. Nothing in Article 12 (or, indeed, in Canada's submissions) suggests that an investigating authority is required to engage in an endless cycle of notice and comment.

137. Each of Articles 12.1, 12.3 and 12.8 is aimed at information or evidence of varying degrees of importance to the investigation or final determination. And, depending on the importance of the information or evidence at issue, each provision contains internal qualifiers designed to limit its application.

138. In the facts of this case, the issue is whether the United States provided an opportunity to the Canadian interested parties to comment on *new* information and evidence. In respect of Canada's first claim, the United States failed to give interested parties *any* notice of its choice of benchmark state for Alberta and Saskatchewan prior to the Final Determination, let alone an opportunity to defend their interests. With respect to Québec, Commerce accepted and relied upon *new* evidence submitted by the petitioners without permitting *any* comments by interested parties. Canada's claims under Article 12 involve factual circumstances in which parties were denied any opportunity to comment, and not an "endless cycle of comment and rebuttal" as the United States claims. Accordingly, the hypothetical posed by the United States is not relevant to this dispute.

Q24. What in Canada's view is the temporal relationship between the obligation of Article 12.1 and 12.3 on the one hand and Article 12.8 on the other hand. In Canada's view, do the obligations of Article 12.1 and 12.3 continue to apply even after a disclosure under Article 12.8?

Reply

139. There is no "temporal" relationship between Articles 12.1 and 12.3, and Article 12.8. Specifically, nothing in Articles 12.1 and 12.3 or Article 12.8 suggests that compliance with Article 12.8 remedies violations of Articles 12.1 and 12.3 in the course of the investigation or that compliance with Article 12.8 obviates the need to comply with Articles 12.1 and 12.3.

140. Each of these provisions is an independent obligation. Each concerns information, evidence or facts of different degrees of importance to an ongoing investigation or to a final determination. For instance, Article 12.8 concerns disclosure of "*essential* facts under consideration which form the basis for the decision whether to apply definitive duties" while Article 12.3 concerns timely opportunities to see and prepare presentations on the basis of "*relevant*" information that is used in an investigation whenever practicable. It is possible, even after disclosure of essential facts under Article 12.8, for an investigating authority to come into possession of relevant information within the purview of Article 12.3. Article 12.8 should not be interpreted to reduce Articles 12.1 and 12.3 to inutility for any period following an Article 12.8 disclosure.

Q25. Could both parties comment on the views of the EC concerning Article 12.8 as presented in paragraphs 23 and 24 of the EC's oral statement ?

Reply

141. Paragraph 23 of the EC's oral statement concerns Article 12.3 of the SCM Agreement. Canada agrees with the EC that Article 12.3 imposes two distinct obligations on investigating

authorities: to provide timely opportunities both to *see* relevant information and to *prepare presentations* on the basis of that information. This accords with Canada's position as set out in paragraphs 211 and 212 of Canada's First Written Submission.

142. With respect to paragraph 24, Canada agrees that Article 12.8 does not require an investigating authority to engage in an endless cycle of notice and comment or comment and rebuttal. Canada further agrees that the disclosure of essential facts required by Article 12.8 must be done as early as is feasible so as to ensure that the parties have sufficient time to defend their interests. The EC is also correct in its analysis that the obligation to disclose essential facts under Article 12.8 is not limited or qualified by any considerations of practicability.

Q26. Could the parties please provide an overview of the dates of the communications concerning the MFPC report, and explain the nature of such communications in each case ? Could the US explain why this MFPC letter was not put on the record when it was received by the administration, and indicate where in the record these reasons are reflected? Please provide a copy of the USDOC regulations concerning submission and service of documents in countervailing duty investigations.

Reply

143. An overview of the dates of communications concerning information provided by the Maine Forest Products Council ("MFPC") and the nature of that information is provided in the timeline below.

144. The MFPC comprises the largest private timber owners in the state of Maine. MFPC members submit the data that is collected by the Maine Forest Service ("MFS") and appears in the MFS Stumpage Price Report. The MFS Stumpage Price Report was the sole source of pricing information used by Commerce in its subsidy calculation when it made the cross-border comparison of Québec public timber to Maine private timber. Thus, the information the MFPC provided was the single most important information Commerce received regarding the subsidy analysis it performed for Québec. The MFPC information directly contradicted Commerce's findings in the Preliminary Determination. It stated, among other things, that:

- The MFS Stumpage Price Report "is not a pricing tool and is not used as one by private landowners in Maine."

- The product described in the MFS Stumpage Price Report "as a 'sawlog' is a log having a butt diameter (inside bark) equal to or greater than 9 inches, the accepted and standard definition of a sawlog in Maine. In fact, most of the timber we sell for sawlogs yields logs with diameters greater than 9 inches. Logs with diameters of 10, 12, and 15 inches are the most common sawlog sizes in Maine."

- Less expensive pulpwood and studwood had to be included in any Maine benchmark.

- Expensive sawlogs not used in lumber production (*i.e.*, used in furniture production and high-end millwork) identified in MFS Stumpage Price Report should be removed from any Maine benchmark.

145. The MFPC told Commerce that they had compared two very different things and thereby grossly overstated the alleged subsidy being provided by the Québec government to its lumber producers. Moreover, the MFPC noted in their letter to Commerce that Commerce had acknowledged these errors in its calculation during their meeting with the MFPC: "But we recognize, *as did the*

Department, that the comparison in the preliminary determination was not apples-to-apples because, in Quebec, there is no sawlog, pulpwood, or studwood distinction.") [emphasis added].[78]

146. The US assertion that "a filing error" resulted in the MFPC information not being put on the record is not credible. The MFPC had met with the lead officials running the investigation on two occasions in Washington, D.C. during the investigation. The Deputy Assistant Secretary received the information sent by the MFPC. Commerce put the information on the record only when the Québec government independently became aware of its existence and made a request to that effect. Commerce then relied on new information filed by the petitioners, and denied Québec to an opportunity to comment on this new information.

[78] See MFPC 20 December 2001, Letter attached to Letter from US Department of Commerce to All Interested Parties (20 February 2002) at p. 4. (Exhibit CDA-100)

Handling of the Information from the Maine Forest Products Council

2001

14 May — MFPC first meeting with Commerce officials in Washington, D.C.

Commerce officials present at the meeting:

- Assistant Secretary of Import Administration
- Deputy Assistant Secretary, Group II
- Senior Director, Office IV, Import Administration
- Director, Office VI, Import Administration

14 May — NAFTA P.R. 88 — Ex Parte Memo commemorating meeting of 5/14

17 August — Preliminary Determination published

30 October — MFPC second meeting with Commerce officials in Washington, D.C. Commerce is told that their cross-border comparison in the Preliminary Determination between Québec public timber and Maine private timber is seriously flawed and dramatically inflates the subsidy rate. In the letter submitted by the MFPC on December 20, 2001, it states that Commerce officials at this meeting recognized that the comparison in the Preliminary Determination was not "apples-to-apples" because, in Quebec, there is no sawlog, pulpwood, or studwood distinction.

Commerce officials present at the meeting:

- Deputy Assistant Secretary, Group II
- Director, Office VI, Import Administration
- Special Assistant to the Assistant Secretary for Import Administration

31 October — NAFTA P.R. 554 — Ex Parte Memo commemorating meeting of 10/30

20 December — Certified letter with the MFPC information addressed to Deputy Assistant Secretary, Group II received by Commerce. The information explains in detail the flaws with the agency cross-border comparison. Among other errors, the MFPC notes that the term sawlog in Maine refers to a log with a diameter of at least 9 inches and that pulpwood and studwood must be included in any Maine benchmark.

2002

7 January — Investigation record officially closes

17 January — Last day to comment on or rebut factual evidence submitted on or before 7 January 2001

21-29 January — Commerce verification of Québec (during which Québec officials learn for the first time that Commerce has in its possession information from Maine private timber owners discussing the cross-border comparison in the Preliminary Determination (*i.e.*, the MFPC information)

8 February	Québec's written request for any information that Commerce has received from Maine landowners to be put on the record
15 February	Verification Report for Québec issued
20 February	Memorandum from the Director, Office VI, Import Administration circulated to parties attaching MFPC information. Memorandum characterizes the MFPC information as "important to certain central issues in the proceeding" but "untimely." No explanation from Commerce on how information it sought and received prior to the close of the record could be untimely.
1 March	Rebuttal briefs are submitted
4 March	Coalition files new factual information in the form of two expert reports attacking the substance of the MFPC information. Quebec is prohibited from commenting on this new information.
21 March	Final Determination due but not issued
25 March	Final Determination actually issued to the parties
2 April	Final Determination published

Q27. Could Canada please react to the US argument that in Canada's theory, an income tax exemption granted solely to two industries – the auto industry and the textile industry is not specific under Article 2.1 because the two industries in the group manufacture dissimilar products? Does Canada agree with the US proposition that Canada's approach concerning specificity would mean that even a subsidy limited to a single large industry – whether steel, autos, textiles, telecommunications or the like – could not be specific because of the diversity of products of each of those producers?

Reply

147. Canada is asked to react to the assertion of the United States that under Canada's reasoning, a subsidy granted solely to auto and textile producers, or to a "single large industry" such as steel or autos, would not be specific under Article 2.1. Canada can confirm that in principle such a subsidy could be found to be specific in either case.

148. The United States, however, makes general assertions about the import and consequences of Canada's submissions without in any way addressing the interpretation of the relevant provisions of the SCM Agreement. The provision at issue is Article 2 of the SCM Agreement and in particular, in this question, the words "industry" and "group of industries". The ordinary meaning of "industry" is "[a] particular form or branch of productive labour; a trade, a manufacture".[79] The ordinary meaning of "group" is "[a] number of people or things regarded as forming a unity or whole on the grounds of some mutual or common relation or purpose, or classed together because of a degree of similarity."[80] As explained in Canada's First Written Submission, these terms, read in context and in light of the object and purpose of the Agreement, require product-based identification of industries.[81]

[79] *New Shorter Oxford English Dictionary* (Oxford: Clarendon Press, 1993), at 1356. (Exhibit CDA-66)

[80] *Ibid.*, at 1151. (Exhibit CDA-136)

[81] Canada's First Written Submission, at paras. 159-162.

149. Applying the meaning of those terms to the hypothetical proposed by the United States, Canada does not dispute that a subsidy limited to what the United States calls "a single large industry" (such as "steel", "autos", "textiles", "telecommunications", or the like)[82] could be found specific, even though the producers make a diversity of products. These so-called "single large industries" may well fit the Article 2.1 definition of "certain enterprises". That term, as defined in Article 2.1, refers to "an enterprise or industry or group of enterprises or industries".

150. Under the facts of a particular case, it may be completely appropriate to find that producers of a wide variety of steel products (or automobile products, or textile products, etc.) are a group of "steel industries" (or "automobile industries", "textile industries", etc.) because of the similarity and relatedness of their output products. The fact that a government used the similarity and relatedness of the products of these "certain enterprises" to limit access to a subsidy programme would indeed be the type of government action the specificity test was designed to address.

151. Similarly, Canada does not claim that "an income tax exemption granted solely to two industries – the auto industry and the textile industry – is not specific ... because the two industries manufacture dissimilar products."[83] In a case like that posited by the United States, a tax exemption granted solely to two dissimilar industries may indeed be an instance of government rendering the subsidy "specific to certain enterprises". But such a finding would not flow from the United States' erroneous reasoning that those unrelated industries form a single "group" consisting of "all users" of the subsidy. If the evidence in the hypothetical case supports the conclusion, it may be reasonable to find that the "certain enterprises" that use the subsidy are the industries producing "autos" and the industries producing "textiles". Because Article 2.1(c) provides that "use of a subsidy programme by a limited number of certain enterprises" may indicate government targeting, and those two groups of industries appear to be a "limited number" of certain enterprises that the government has targeted, such a subsidy may indeed be specific to certain enterprises.

152. However, simply labelling an aggregation of producers as a "single large industry" merely because they use a particular programme, without any analysis of whether they are appropriately considered "certain enterprises", does not satisfy the requirements of Article 2. Under the United States' reasoning, one could easily refer to the "single large industry" of agricultural producers. But even the United States acknowledges, as a matter of law,[84] that the diversity of products produced by agricultural producers is sufficiently varied that agriculture is neither a "single large industry" nor even a group of industries.

153. By aggregating a potentially vast number of enterprises, industries, and groups of industries into a single "industry" through such labels as "autos", "textiles", or "steel", the United States impermissibly interprets the term "industry" without context.[85] The drafters of the SCM Agreement did not negotiate the language of Article 2 in a vacuum. Contrary to the US contention, Canada is indeed interpreting these terms consistent with the "common practice" of referring to industries by the type of products they produce.[86] And in contrast to the standardless approach advocated by the United States, the record evidence on specificity submitted by Canada is based on established, objective criteria. The Standard Industrial Classification in Canada is similar to multilateral systems

[82] US First Written Submission, at para. 152

[83] US First Written Submission, at para. 151.

[84] 19 C.F.R. § 351.502(d). (Exhibit CDA-74)

[85] The *Lumber III* Canada-United States Binational FTA Panel reviewing an almost identical *de facto* specificity finding did not accept this US approach. It found the determination in that case "circular, depending upon the identification and labelling of the group of stumpage users rather than upon a reasoned analysis of the actual businesses in which those users were engaged." For the Panel, this approach revealed "a mechanical and arbitrary exercise which is not supportable under US law." See FTA *Lumber III* CVD Panel (2d) at 39 (Exhibit CDA-68).

[86] US First Written Submission, at para. 150.

of industrial classification such as the United Nations *International Standard Industrial Classification of All Economic Activities* (ISIC),[87] and the *North American Industry Classification System* (NAICS).[88] This evidence demonstrates that immediate users of stumpage – that is, not taking into account the multiple downstream industries that purchase wood products as inputs – include thousands of enterprises in at least 23 categories of industries, and the industries are as unrelated as lumber, agricultural chemicals, paper, and furniture.

Q28. On specificity, could Canada please indicate whether, if a subsidy is used by only three companies, out of a total of 1 million, an "industry" analysis of the three users also would be required under Article 2 for a finding of specificity to be legal? In Canada's view, is it impossible to find specificity solely on the basis of a limited number of users ?

Reply

154. Article 2 does not require an industry analysis in all cases. The definition of "certain enterprises" encompasses enterprises as well as industries. An investigating authority may therefore determine that three companies are three "certain enterprises", without resort to an analysis of whether those three companies belong to a common industry.[89] Under Article 2.1(c), "use of a subsidy programme by a limited number of certain enterprises" is a factor that may be considered as an indication that a government has rendered a subsidy specific in fact. Canada's position is that a limited number of users may well be an indication of specificity, and in some cases, after analysis of all the relevant evidence, may even be sufficient for a specificity finding. But the mere fact that there might be a limited number of users does not, and cannot, create an irrebuttable presumption of specificity. Even in the hypothetical given, where only three companies are users, Article 2.1(c) does not support an interpretation that the subsidy programme will necessarily be found specific – for example, the fact that the subsidy is new may provide a perfectly reasonable explanation for a limited number of users, and indicate that there is no government targeting of certain enterprises.

[87] United Nations, *International Standard Industrial Classification of all Economic Activities*, Statistical Papers Series M No. 4, Rev. 3 (ISIC Rev. 3.1). See the following Internet site: http://unstats.un.org/unsd/cr/registry/regcst.asp?Cl=17&Lg=1. Under the ISIC, the mere reference to "autos", for example, refers to many different industries. See http://unstats.un.org/unsd/cr/registry/regcs.asp?Cl=17&Lg=1&Co=3410. The same is true for a reference to "textiles". See http://unstats.un.org/unsd/cr/registry/regcs.asp?Cl=17&Lg=1&Co=17.

[88] See in particular Statistics Canada's explanation of the NAICS at http://www.statcan.ca/english/Subjects/Standard/naics/1997/naics97-intro.htm.

[89] Canada notes, however, that the vast number of enterprises is uncontested in this case.

ANNEX A-2

UNITED STATES RESPONSE TO QUESTIONS FROM THE PANEL AT THE FIRST MEETING

(24 February 2003)

Q1. Does the US consider that the "good" provided through the stumpage programmes is the "right" to harvest timber or is it the standing timber itself. Could the US comment on the USDOC determination (p.30) that "the term 'goods' encompasses all 'property'. The term 'property' includes 'the right to possess, use and enjoy a determinate thing. In its widest sense, property includes all a person's legal rights of whatever description'. Therefore, the sale of a license or right to harvest timber also constitutes the provision of a good within the meaning of Section 771 (5) (B) (iii) of the Act."

Reply

1. As the United States stated in the *Final Determination*, "we determine that the Provincial governments provide a good (timber) to lumber producers within the meaning of Section 771(5)(B)(iii) of the Act."[1] It is therefore the view of the United States, as discussed in our first written submission and statements at the first panel meeting, that the provinces provide standing timber and that standing timber is a "good" within the ordinary meaning of that term.

2. In response to Canada's arguments that the provinces merely provided a "right" to harvest timber, the United States also stated in the *Final Determination*:

> Finally, we note that, even assuming *arguendo* that the Provinces are providing stumpage in the form of a license or right to cut timber, Section 771(5)(B)(iii) would still apply. As noted above, the term "goods" encompasses all "property". The term "property" includes "the right to possess, use, and enjoy a determinate thing (either a tract of land or a chattel). . . [and] [a]ny external thing over which the rights of possession, use, and enjoyment are exercised. . . . In its widest sense, property includes all a person's legal rights of whatever description." Black's Law Dictionary at 1232. Therefore, the sale of a license or right to harvest timber also constitutes the provision of a good within the meaning of Section 771(5)(B)(iii) of the Act.[2]

As stated in the quoted passage, this was an argument in the alternative, not the interpretation relied upon as the basis for the United States' determination. Although the passage demonstrates that the ordinary meaning of the term "goods" is sufficiently broad to encompass certain rights, it is the view of the United States that it is unnecessary for the Panel to reach the issue of whether the right to harvest timber in and of itself would constitute a "good" within the meaning of Article 1.1(a)(1)(iii) of the SCM Agreement because standing timber is unquestionably a "good" within the meaning of that Article.

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[1] *See Issues and Decision Memorandum: Final Results of the Countervailing Duty Investigation of Certain Softwood Lumber Products from Canada*, 30 (21 March 2002) (Exhibit CDA-1) ("*Issues and Decision Memorandum*"). The referenced provision of the US Trade Act is equivalent to Article 1.1(a)(iii) of the WTO *Agreement on Subsidies and Countervailing Measures* ("SCM Agreement").

[2] *Issues and Decision Memorandum*, at 29.

3. All sales transactions, including timber sales, entail the transfer of legal rights and obligations. A contract for the sale of semiconductors necessarily confers on the buyer the right to take the semiconductors. Likewise, to sell standing timber, the seller must give the buyer the right to cut the timber. In either sales transaction, the item sold (the semiconductor or standing tree) and the right to take the item are not severable.

4. In determining whether goods are sold under tenure contracts, *what actually occurs* must be taken into account.[3] Under the provincial tenure systems, the tenure holder pays only for the volume of trees it harvests, and those trees are the only things the tenure holder acquires. As Canada has acknowledged, timber is a "market asset" and through tenures the provincial governments relinquish ownership of those assets to the lumber companies.[4] All other rights of ownership of the land and everything on it remain with the province.[5] These facts support the United States' conclusion that tenures are contracts for the sale of a good – timber.

Q2. Could Canada please indicate what the stumpage fee covers, i.e, what the timber harvester pays for with the stumpage fee. Is it the right to own the harvested tree? The right to cut the tree? Both? Something else? In this context, please comment on the statement at paragraph 3 of the 12 February 2003 closing statement of the United States that "[t]he mills pay to get that tangible timber – not intangible rights – and they pay only for the timber they harvest".

Reply

5. The record evidence in the underlying investigation demonstrates that stumpage is payment for the actual timber. The tenure holder pays the stumpage fee after the timber is harvested and pays, on a volumetric basis, only for the timber it harvests.[6] As noted in the amicus submission by the Natural Resources Defense Council, the British Columbia ("B.C.") Supreme Court held that "[t]he Crown exerts its financial interest in the forests of the province through stumpage appraisal, a process which places value on timber harvested. Stumpage is the price a licensee must pay to the Crown for its timber."[7] This was confirmed by B.C. in its questionnaire response when it described its timber pricing system as "a means of charging specific stumpage according to the relative value of *each stand of timber being sold*."[8]

6. Moreover, tenure holders do not acquire ownership of the trees unless and until they harvest the trees, and payment for the cut timber has been made to the government. For example, the Government of Quebec acknowledged that it "sells standing timber" and that "stumpage is charged on the volume harvested, i.e., . . . after trees have been felled. Stumpage charges are not based on

[3] *See e.g.*, Panel Report, *Australia – Subsidies Provided to Producers and Exporters of Automotive Leather*, WT/DS126/R, adopted 16 June 1999, para. 9.45.

[4] Joint Case Brief Submitted to the Commerce Department on Behalf of the Government of Canada, Government of Alberta, Government of British Columbia, Government of Manitoba, Government of Ontario, Gouvernement du Quebec, Government of Saskatchewan, Government of the Northwest Territories, Government of the Yukon Territory, and British Columbia Lumber Trade Council, vol. 2, B6 (22 February 2002) ("Canada Case Brief") (Exhibit US-3).

[5] Response of the Government of Ontario to the Department of Commerce's 1 May 2001 Questionnaire, vol. 4, Exhibit ON-GEN-18, sec. 36 (28 June 2001) (Exhibit US-56).

[6] *Issues and Decision Memorandum*, at 29-30 (Exhibit CDA-1).

[7] *British Columbia v. Canadian Forest Products* (8 February 1999), Victoria 972176, (1999) BCJ 335 (B.C.S.C.), affirmed 2000 BCCA 456 (Exhibit US-57).

[8] Response of the Government of British Columbia to the Department of Commerce's 1 May 2001 Questionnaire, vol. 1, at IV-16 (28 June 2001) (emphasis added) (Exhibit US-58).

inventories of standing timber."[9] Thus, the facts demonstrate that the tenure holder is paying for the tree, not merely the right to cut the tree.

Q3. Canada argues that there is a meaningful legal distinction, under the stumpage programmes, between the right to harvest and the right to own the harvested tree. Could Canada please indicate the significance, in concrete terms in respect of this dispute, of this distinction – i.e., are there any stumpage contracts where the timber harvester does not have ownership rights to the harvested timber? If so, please provide a specific description of these situations and an indication of their magnitude in relation to total stumpage.

Reply

7. The United States wishes to clarify that when the Panel refers to "stumpage contracts where the timber harvester does not have ownership rights to the harvested timber", we interpret that as *not* including those situations in which the party to the stumpage contract (the tenure holder) pays a subcontractor to harvest the timber on its behalf. In those situations, the subcontractor (harvesting company) is not a party to the stumpage contract and does not have ownership rights in the timber. The subcontractor is simply providing a service to the tenure holder.

8. As is typical in a contract for the sale of goods, the record evidence demonstrates that the actual tenure holder or licensee obtains ownership rights to the timber it harvests, provided it pays the stumpage fee. For example, section 8 of the Quebec Forest Act provides that "[f]ull ownership of the timber authorized for harvesting under a forest management permit remains in the domain of the State until the timber is felled and delivered to the destination indicated in the permit [i.e., the sawmill owning the tenure], unless the prescribed dues are paid in full."[10] Likewise, section 33(1) of the Ontario Crown Forest Sustainability Act provides that "[p]roperty in forest resources that may be harvested under a forest resource license remains in the Crown until all Crown charges have been paid in respect of the resources."[11] Section 28(4) of the Alberta Forests Act also provides that "[t]he holder of a timber license or permit becomes the owner of timber authorized to be cut pursuant to the license or permit when the timber is actually cut by him or on his behalf".[12] The United States also understands that, under B.C. law, ownership of the objects covered by a profit à prendre (B.C.'s description of its tenure licenses) is acquired when the objects are "captured".[13]

9. There is no record evidence of stumpage contracts under which the contracting party (tenure holder or licensee) does not have ownership rights to the harvested timber.

Q4. Is it possible for a tenure holder to sell to another party its own contractual right to harvest, without the permission of the provincial government, and while maintaining its tenure contract in force? In other words, can someone enter into a stumpage contract and then sell off the rights to harvest under that contract?

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[9] Response of the Government of Quebec to the Department of Commerce's 21 November 2001 Questionnaire, at 5 (17 December 2001) (Exhibit US-59).

[10] Response of the Government of Quebec to the Department's 1 May 2001 Questionnaire, vol. 3, Exhibit QC-S-16 (28 June 2001) (Exhibit US-24).

[11] Response of the Government of Ontario to the Department of Commerce's 1 May 2001 Questionnaire, vol. 4, Exhibit ON-GEN-18, sec. 31(1) (28 June 2001) (Exhibit US-60).

[12] Response of the Government of Alberta to the Department of Commerce's 1 May 2001 Questionnaire, vol. 2, Exhibit AB-S-9 (28 June 2001) (Exhibit US-61).

[13] Jessica Clogg and Andrew Gage, A Legal Opinion Regarding the Report, "An Economic Analysis of Whether Long-Term Tenure Systems in British Columbian Provincial Forests Provide Countervailable Subsidies to Softwood Lumber Imported into the United States" by William D. Nordhaus, 3 (7 August 2001), appended to Letter from Natural Resources Defense Council to Donald Evans (August 13, 2001) (Exhibit US-62).

10. The record evidence demonstrates that all of the Canadian provinces place legal restrictions on the transfer of tenure harvesting rights.

British Columbia: Section 54 of the B.C. Forest Act provides that the written consent of the Minister of Forests is required for "the disposition of a [tenure] agreement or an interest in an agreement." Section 55 of the Act provides that failure to obtain consent may result in the cancellation of the timber license.[14]

Quebec: Section 39 of the Quebec Forest Act provides that "[a]greements are not transferable" and section 84(2) provides that the Minister of Natural Resources "shall terminate the [TSFMA] agreement without prior notice . . . where the agreement holder has made an assignment of his property." In fact, TSFMAs are not transferable even among sawmills owned by the same company.[15]

Ontario: Section 35 of the Ontario Crown Forest Sustainability Act provides that "[a] transfer, assignment, charge, or other disposition of a forest resource license," including any interest therein, is void without the written consent of the Minister of Natural Resources.[16]

Alberta: Section 28(2)-(3) of the Alberta Forests Act provides that "[n]o person shall assign" a tenure license without the prior written consent of the Minister for Sustainable Resource Development and that any assignment, to be valid, must be "an unconditional assignment of the entire interest of the assignor" in the tenure license.[17]

Saskatchewan: Section 31 of the Saskatchewan Forest Resources Management Act provides that "[n]o licence is to be assigned, transferred, charged or otherwise disposed of without the minister's written consent provided in accordance with the regulations".[18]

Manitoba: Section 12 of the Manitoba Forest Act provides that "[e]xcept as otherwise authorized or approved by the minister, and subject to such terms and conditions as he may consider fit to impose, a right to cut timber under this Act is not assignable or transferable."[19]

Q8. Concerning the subsidy calculation, the US argues that the USDOC used US price data as the "starting point" for an assessment of the fair market value of Canadian timber, and then made adjustments to the US price data for obligations such as road building and silviculture (as "conditions of sale" in Canada) to arrive at an assessment of fair market value of timber in Canada (US first submission, para. 79-82). The implication of this argument seems to be that the USDOC did not simply make an unadjusted "cross-border" comparison, but rather, that it adjusted the US prices to arrive at some sort of a proxy price, based on the US price, to use as the "market value" benchmark in Canada. However, Attachment 1 to the US First Written Submission seems to show that in fact the <u>unadjusted</u> US price was used as the benchmark for "market value" in Canada. While Attachment 1 makes clear that, on the "government price"

[14] Response of the Government of British Colombia to the Department of Commerce's 1 May 2001 Questionnaire, at vol. 7, Exhibit BC-S-36 (28 June 2001) ("B.C. 28 June Response") (Exhibit US-63).

[15] Response of the Government of Quebec to the Department of Commerce's 1 May 2001 Questionnaire, vol. 1, at 49 (28 June 2001) (Exhibit US-64).

[16] Response of the Government of Ontario to the Department of Commerce's 1 May 2001 Questionnaire, vol. 4, Exhibit ON-GEN-18, sec. 35 (28 June 2001) (Exhibit US-65).

[17] Response of the Government of Alberta to the Department of Commerce's 1 May 2001 Questionnaire, vol. 2, Exhibit AB-S-9 (28 June 2001) (Exhibit US-61).

[18] Response of the Government of Saskatchewan to the Department of Commerce's 1 May 2001 Questionnaire, Exhibit SK-S-13 (28 June 2001) (Exhibit US-66).

[19] Response of the Government of Manitoba to the Department of Commerce's 1 May 2001 Questionnaire, vol. 1, MB-S-13 (28 June 2001) (Exhibit US-67).

side of the equation, the stumpage fees were increased to account for the in-kind costs borne by Canadian harvesters under stumpage contracts, it seems to the Panel that such costs would have had to be included on that side of the equation, no matter what market benchmark was used (whether from inside Canada, from another market, etc.), simply to arrive at the total cost to the stumpage holder of the trees that it harvests on Crown land. As such, therefore, these adjustments seem to have nothing to do with adjusting the benchmark to which that government price is compared to determine the amount of subsidy benefit. Could the United States please comment.

Reply

11. Article 14(d) requires the investigating authority to determine the adequacy of remuneration "in relation to prevailing market conditions for the good or service in question in the country of provision . . . (including price, quality, availability, marketability, transportation and other conditions of purchase or sale)." Thus, in establishing a market benchmark price, the investigating authority must make adjustments to account for differences in prevailing market conditions to ensure a proper comparison between the government price and the market benchmark price. The United States made such adjustments in this case.

12. To minimize the need for adjustments, the United States sought data for comparable timber. Nevertheless, some adjustments were necessary. Species mix is an important market condition because the industry in a given area will seek to maximize the revenue based on the relative mix of very valuable species, such as douglas fir, and less valuable species, such as spruce. To take account of differences in species, the United States averaged the price data by species to match the species in the relevant province. Where the species mix was different between the benchmark state and province, the United States "re-mixed" the US species prices to reflect the relative species mix in the province, thus adjusting for the differing market conditions. The United States also made adjustments for other differences in market conditions, such as road building and silviculture requirements. As the Panel notes in its question, in the benchmark calculation, the United States made these adjustments to the Canadian stumpage price. The relevant issue is the difference between the benchmark price and the government price; therefore, it is mathematically irrelevant whether adjustments were made by adding adjustments to the government price, or subtracting them from the benchmark price.

13. While it is true that some adjustments may be necessary regardless of what market benchmark price is used, the adjustments made in this case would not necessarily be made if the market benchmark was different. The adjustments are dictated by what, if any, differences exist in the market conditions. For example, if the market conditions (species mix, road building and silviculture obligations, etc.) in the benchmark market were identical to those in the province, no adjustments to either price would be required. Similarly, if another benchmark market had been selected with other differences in market conditions from the selected benchmark market, the adjustments would differ as well.

Q9. The USDOC final determination (Exhibit CDA-1), at pages 39-40, contains the following statements:

> **"StatsCan data show that approximately 2.5 million cubic meters of softwood logs were imported into Canada during the POI, and each of the investigated Provinces imported US logs during the POI.**
>
> **"This extensive record evidence that Canadian lumber producers had actual imports of US logs and purchased US stumpage during the POI would support basing our benchmark on tier one of the regulatory hierarchy [market prices from actual transactions within the country under investigation]. However, we**

> **do not have sufficiently detailed import prices on the record to use as the benchmark for all Provincial stumpage programmes. Therefore, we are using stumpage prices in the United States under tier two of the regulatory hierarchy [world market prices that would be available to purchasers in the country under investigation]."**

Could the US please indicate in detail the reasons why the record did not contain "sufficiently detailed" import price data to use as the benchmark ? What did the USDOC do to obtain such data? Did it request such detailed data from Canada? Please indicate where in the record the relevant information on this point can be found (i.e., both any requests for, or other efforts to obtain, such information, as well as the data of record on import prices, and any memoranda or other documents discussing the problems with those data). If neither party has yet provided this part of the record to the Panel, could the US please submit it.

Reply

14. The provincial governments provide timber on the stump (i.e., standing trees). The market benchmark price must, therefore, also be a stumpage price. In theory, one could derive a stumpage price from log import prices, but it would be far more complex and, in all likelihood, less accurate, than using an actual stumpage price because of the need for complex adjustments. The United States did request data on average import prices for US logs. The United States did not, however, request the data necessary to derive stumpage prices from the US log import prices because it was able to obtain data for the US timber on the stump. Using the prices for US timber on the stump eliminated the need for the complex adjustments that would have been necessary if US. log import prices were used. The United States did, however, rely on the evidence of log imports, s well as evidence of Canadian purchases of US stumpage, to establish that the US timber is commercially available to Canadian lumber producers.

Q10. The parties seem to have very different views as to what the record evidence shows in respect of the existence or not of a private market for stumpage in Canada. Could the parties clarify for the panel what they consider the pertinent record evidence was, and why they consider that it was, or was not, representative and/or usable?

Reply

15. *Manitoba and Saskatchewan*: Manitoba and Saskatchewan did not provide any private stumpage price data.[20]

16. *Alberta*: According to Alberta's questionnaire response, only one per cent of the harvest in Alberta comes from private land.[21] Alberta did not provide any data on private stumpage prices. The "Timber Damage Assessments" ("TDAs") provided by Alberta do not represent private market prices for stumpage. In describing this data, Alberta stated:

[20] *See* Response of the Government of Manitoba to the Department of Commerce's 1 May 2001 Questionnaire, vol. 1, MB-55-MB-56 (28 June 2001) (Exhibit US-20); *see also* Response of the Government of Saskatchewan to the Department of Commerce's 1 May 2001 Questionnaire, SK-81-SK-82 (28 June 2001) (Exhibit US-21).

[21] Response of the Government of Alberta to the Department of Commerce's 19 November 2001 Questionnaire, vol. 1, Amended Table 1, Exhibit AB-S-1 (17 December 2001) (Exhibit US-68). That revised document demonstrates that Alberta had a private sawlog harvest of 1 per cent during the POI (138,154 private volume divided by 12,349,143 total volume equals 1.1 per cent).

> beginning in 1993, Alberta has had a consultant collect information on an annual basis on the value of arms *length log purchases in the province. This information, which does not differentiate between private and crown wood, has been used by the province to develop a means for mediating disputes* between timber operators and other industrial operators concerning the value of standing timber adversely affected by industrial operations.[22]

Moreover, in its rebuttal brief submitted to the Commerce Department in the underlying investigation, Alberta stated that the TDAs are "simply a set of voluntary guidelines outlining value calculations that can be used by private parties with rights on provincial land who are involved in negotiating appropriate compensation for damages one party has committed related to those activities."[23]

17. *British Columbia*: B.C. provided government auction data from (1) the small and very restricted Small Business Forest Enterprise Programme ("SBFEP"), and (2) a study prepared for purposes of the investigation which contained a very small number of selected prices (the "Norcon Study"). As previously noted, the SBFEP sales are government sales of Crown timber, not private sales. Moreover, the United States rejected SPFEP auctions prices because most potential bidders are excluded from participating in the auctions. The prices are therefore not representative of market prices.

18. On 26 July 2001, the United States issued a supplemental questionnaire requesting, in part, that B.C. "provide the volume and value by grade and species of softwood stumpage (standing timber) from private lands . . ."[24] The British Columbia Lumber Trade Council ("BCLTC") subsequently submitted the Norcon Study. The Norcon Study identified 99,779 cubic meters of private timber, which is 0.17 per cent of the 58,559,158 cubic meters of Crown timber harvested during the period of investigation, or 0.15 per cent of the 65,405,994 cubic meters of the province's total sawlog harvest for the period of investigation. In addition to the fact that the data represent a minuscule portion of the B.C. harvest, Norcon noted that "the data on purchases of private standing timber are not broken down by grade and species because such detail was not available".[25] Moreover, Norcon noted that "[n]one of these purchases to the best of Norcon's knowledge was made pursuant to a bid or tender process".[26] No additional information was provided. There was, therefore, more than sufficient reason for the United States' conclusion that the Norcon study did not provide a sufficient basis for establishing market benchmark prices.[27]

19. *Ontario*: On 30 July 2001, Ontario submitted a study conducted by Resource Information Systems, Inc. ("RISI").[28] The RISI survey, which was conducted for purposes of the investigation, collected data for both hardwood and softwood timber for all types of destination mills. Recognizing the limitations in this data, on 18 December 2001, Ontario submitted a study by Charles River

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[22] Response of the Government of Alberta to the Department of Commerce's 1 May 2001 Questionnaire, vol. 1, page AB I-8 (Exhibit US-69) (emphasis added).

[23] Rebuttal Brief of the Government of Alberta, vol. 2, at 65, fn. 94 (1 March 2002) (Exhibit US-55).

[24] Letter from Steptoe & Johnson LLP to Donald Evans (December 21, 2001) with attached *Survey of Primary Sawmills' Arm's Length Log Purchases in the Province of British Columbia* (prepared by PricewaterhouseCoopers LLP and Norcon Forestry Ltd.) ("Norcon Study") at 7-8 (Exhibit US-70). The chart contained on page 7, which identifies the region, the volume and value, is the sum total of the private price information provided.

[25] *Id.* at 8.

[26] *Id.*

[27] *Issues and Decision Memorandum*, at 76-77 (Exhibit CDA-1).

[28] Response of the Government of Ontario to US Department of Commerce 25 July 2002 First Supplemental Questionnaire (3 Aug. 2001), at ON-SUP-2 - ON-SUPP-8 (Exhibit CDA-39).

Associates ("CRA"),[29] which analyzed the RISI survey data relating solely to softwood timber going to sawmills. The only data on private softwood timber that CRA was able to extract from the RISI study related to 111,000 cubic meters of timber and this data was not species specific.

20. In addition, as noted in the *Final Determination*, the United States learned at verification that:

> large parcels of private land in the northern parts of Ontario, where the bulk of softwood timber is harvested, are owned by mills themselves or large integrated concerns that also hold SFLs and FRLs. Further, we learned that many of these private parcels have been managed for years by these concerns.[30]

21. *Quebec*: As noted in our first written submission[31], Quebec provided actual prices from non-government transactions. Substantial record evidence, however, demonstrated that the private stumpage prices in the provinces, including Quebec, do not represent "market" prices, i.e., prices undistorted by the government's financial contribution.

Q11. With regard to its pass-through claim, could Canada clarify whether it is arguing that a pass-through analysis was required in all cases in the investigation, i.e. even in case of complete identity between the timber harvester and the sawmills (lumber producers); or does Canada consider that a pass-through analysis was required only in those cases where there allegedly existed arm's length transactions between timber harvesters and lumber producers and between lumber producers and remanufacturers?

Reply

22. When a lumber producer harvests timber from its own provincial tenure and pays less than adequate remuneration to the province, there can be no question that the benefit flows directly to that lumber producer. As discussed further in response to Question 12, consistent with the SCM Agreement, that benefit may be allocated over the producer's total sales, and any portion of those sales that are exports to the United States may be subject to countervailing duties.

Q12. On remanufactured products, assuming subsidies were provided to lumber producers through stumpage programmes, and those lumber producers sold lumber at arms length to remanufacturers, whose products were the exported products, how and why in the US view would this situation NOT affect the subsidy amount (numerator) of the subsidization calculation? Please provide a concrete numerical example to illustrate your reasoning.

Reply

23. To answer the Panel's question the United States will use a hypothetical case involving one sawmill and one remanufacturer that purchases lumber from the sawmill at arm's length and then exports the remanufactured lumber to the United States. We will demonstrate how the subsidy calculation is performed on an aggregate basis, and then compare that calculation to the calculation that would be performed if the two companies were individually investigated.

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[29] Charles River Associates, *An Economic Analysis of the Appropriateness of Relying on Ontario's Private Timber Sales*, Exhibit ON-SUP2-12, Questionnaire Response of the Province of Ontario to the Department's Second Supplemental Questionnaire (18 December 2001) (Exhibit CDA-38).

[30] *Issues and Decision Memorandum*, at 98 (Exhibit CDA-1) (citations omitted).

[31] *See* First Written Submission of the United States, para. 66 (22 January 2003) ("US First Written Submission").

24. Aggregate Investigation: Based on data submitted by the government, the investigation establishes that the government has provided one million cubic meters of Crown timber to sawmills for $1/cubic meter less than the market price. The total subsidy benefit is, therefore, $1 million, but data on specific recipients of the benefit is unknown because company-specific investigations were not conducted.

Benefit: $1 million

Sawmill ➢Lumber sales of $1 million ➢Remanufacturer

↓ ↓

Lumber exports $9 million (Total sales $10 million)

Lumber exports $2 million (Total sales $2 million)

Countervailing Duty Calculation: $1 million (total benefit) divided by $12 million (total sales of products) equals an 8.33 per cent rate, which is applied to $11 million in exports of subject merchandise.

25. *Company-Specific Investigation*: The company-specific investigation establishes that one million cubic meters was harvested from a tenure held by the sawmill. Some sawmills are integrated, producing both milled and remanufactured lumber, and some remanufacturers have tenure. However, for purposes of this hypothetical, the remanufacturer is independent and does not hold tenure, and a company-specific analysis demonstrates that the sales of lumber from the sawmill to the remanufacturer did not result in any benefit accruing to the remanufacturer.

Sawmill ► Lumber sales of $1 million ► Remanufacturer

Benefit: $1 million

↓ ↓

Lumber exports $9 million (Total sales $10 million)

Lumber exports $2 million

Sawmill Countervailing Duty Calculation: $1 million divided by $10 million equals 10 per cent applied to $9 million in exports.

Remanufacturer Countervailing Duty Calculation: $0 divided by $2 million equals 0 per cent applied to $2 million in exports.

26. In both hypothetical cases, the duties do not exceed the subsidy benefit found to exist. The illustrations demonstrate that, although the company-specific subsidy rates differ from the aggregate subsidy rate, the total amount of the subsidy benefit remains unchanged because the basis for the subsidy, i.e., the volume of timber entering the sawmill, is unchanged. In the company-specific analysis, only the *company-specific* benefits (numerators) change, not the aggregate amount of the subsidy, because the allocation of the benefit is based on company-specific information. As the United States explained in its first written submission and oral statement,[32] however, the SCM Agreement does not require a company-specific analysis in an investigation.

27. The United States also notes that, in the hypothetical investigation of specific companies, as in the aggregate investigation, exporters of the subject merchandise that were not individually investigated could be subject to duties, consistent with Article 19 of the SCM Agreement, even

[32] *See*, US First Written Submission, at paras. 108-114; Oral Statement of the United States at the First Meeting of the Panel, para. 32 (11 February 2003) ("US First Opening Statement").

though those exporters may not have received any benefit. As the United States explained in its first written submission and oral statement,[33] subjecting uninvestigated companies to countervailing duties does not constitute an impermissible presumption that those companies received a subsidy benefit. Members routinely apply countervailing duties to exports from companies that were not individually investigated, as envisioned in Article 19.3, even though the producers may not have received any subsidy benefit or may have a subsidy rate significantly lower than the rate applied. Thus, if allocating some portion of the subsidy to remanufacturers that were not individually investigated and subjecting their exports to duties is inconsistent with the SCM Agreement, then Members are routinely violating the Agreement when they apply any subsidy rate to an exporter that was not individually investigated.

Q13. Could Canada take the Panel through its analysis of each of the provisions it alleges have been violated by the failure of the USDOC to conduct a pass-through analysis, and indicate why it considers each of these provisions has been violated?

Reply

28. In paragraph 129 of its first written submission, Canada claimed that the United States violated Articles 10, 19.1, 19.4, and 32.1 of the SCM Agreement and Article VI:3 of the *General Agreement on Tariffs and Trade* ("GATT 1994").

29. Article 19.1 of the SCM Agreement requires a final determination of the amount of the subsidy and a final determination of injury as pre-conditions to the imposition of a countervailing duty. Article 19.1 does not, however, establish any requirements concerning how a subsidy or injury is to be determined.

30. Article 19.4 of the SCM Agreement establishes an upper limit on the amount of the countervailing duty that may be levied, i.e., the amount of the subsidy found to exist. In other words, Article 19.4 expressly addresses the *levying* of duties *after* a subsidy has been "found to exist."[34] The sole calculation requirement in Article 19.4 is a requirement to calculate the subsidy on a per-unit basis; Article 19.4 does not establish any other requirements concerning how the subsidy is to be calculated.[35] Similarly, Article VI:3 of GATT 1994 establishes that the amount of the subsidy found is the upper limit on the amount of the countervailing duty that may be levied[36], but does not address how the subsidy is to be calculated.

[33] *See* US First Written Submission, at para. 109; US First Opening Statement, at para. 33.

[34] Article 20.3 of the SCM Agreement provides that, "[i]f the definitive duty is less than the amount guaranteed by the cash deposit or bond, the excess amount shall be reimbursed . . . ." The possibility that the duty actually levied may be lower than the definitive duty "found to exist" in the investigation unavoidably includes the possibility that the duty actually levied may be zero because, on examination in a review, the particular producer in question may be found not to have received a subsidy. Therefore, the SCM Agreement does not require that each exporter be found to have received a subsidy in order to be subject to countervailing duties.

[35] As the Panel recognized in Question 15, Canada, in fact, has conceded that its claim under Article 19.4 is dependent upon the existence of an inconsistency with some other provision of the SCM Agreement that imposes obligations with respect to the subsidy calculation. *See* Canada First Written Submission, at para. 179.

[36] Thus, for example, if a Member determines a subsidy of $12 per unit has been granted, the Member may not impose a countervailing duty of $20 per unit.

31. Although Canada also references Articles 10 and 32.1 of the SCM Agreement, because those claims are dependent on the other provisions cited by Canada, they must likewise fail.[37]

Q14. The US refers to recent amendments to an EC regulation to argue that other Members such as the EC also consider that in certain circumstances it is warranted to consider world market prices rather than in-country prices. Could the US please react to the EC's clarification in its third party submission that these amendments are not relevant for the resolution of this dispute since these amendments relate to a situation where there are no market conditions? Could the US please also react to the clarifications made in the EC's oral statement that its amended regulation applies only when there are no market conditions in the country of provision and that it "agrees with Canada and the panel in United States - Lumber (Provisional) that the US determination of benefit violated Article 14 (d) of the SCM Agreement" (EC oral statement para. 8). In the light of these clarifications by the EC, does it remain the US view the EC's regulation and practice support its position in this case?

Reply

32. In its third party written submission, the European Communities ("EC") states that "the problem with the 'cross-border' methodology attacked by Canada is not that it eventually allows consideration of world market prices, but under which conditions recourse may be had to alternative benchmarks".[38] The EC's regulation states that, "when appropriate", an alternative to prices in the country of provision may be used to measure the adequacy of remuneration. The preamble to the EC's regulation states that it is appropriate to consider world market prices where market benchmark prices in the country of provision "do not exist or are unreliable".[39] In its written submission and oral statement, the EC does not address the issue of unreliable prices. The EC does, however, argue that Article 14(d) permits consideration of world market prices where no "market" conditions exist, and it defines "market" conditions as "prices determined by independent operators following the principle of supply and demand."[40] The EC's interpretation of Article 14(d) of the SCM Agreement therefore supports the United States' position that where, as in the present case, there are no "market" prices in the country of provision, Article 14(d) permits the use of alternative benchmarks.

33. The EC concedes that "as a third party [it] is obviously not in a position to comment on the availability of *independent market-driven prices for non-governmental stumpage* (be it from private Canadian land or imported)".[41] The EC, however, does precisely that when it supports its argument with erroneous factual assertions such as "the USDOC rejected the use of *actual market prices*,"[42] and that the reason for such rejection was "the *mere assertion* that such prices are driven by the stumpage prices on Crown land."[43]

34. As discussed in our first written submission and oral statement[44], and in our responses to other questions from the Panel contained herein, the facts on the record of the investigation demonstrate that there were no "independent market-driven prices for non-governmental stumpage" available in

[37] *See e.g.*, Panel Report, *United States – Section 129(c)(1) of the Uruguay Round Agreements Act*, WT/DS221/R, adopted 30 August 2002, para. 6.133 (where consequential claims were rejected because the main claims were not successful).

[38] Third Party Submission by the European Communities, para. 31("EC Third Party Submission") (emphasis in original).

[39] S*ee* Notification of Laws and Regulations Under Article 32.6 of the Agreement, European Communities, G/SCM/N/1/EEC/2/Suppl.3 (18 November 2002) (Exhibit US-15).

[40] *Id*. at para. 27.

[41] *Id*. at para. 32 (emphasis added).

[42] *Id*. at para. 20 (emphasis added).

[43] *Id*. at para. 32 (emphasis added).

[44] *See* US First Written Submission, at paras. 64-76; US First Opening Statement, at paras. 23-26.

Canada. Most of the provinces failed to provide any price data on private stumpage sales or provided inadequate data. Moreover, the evidence established that the limited price data that was provided did not represent independent market-driven prices.

35. The EC characterizes the United States' reliance on evidence that prices for timber on private lands are driven by the administered stumpage prices for Crown timber as a "flawed hypothetical undistorted market" methodology.[45] On this point the United States strongly disagrees with the EC. We first note the inconsistency of this statement by the EC with its apparent recognition that the proper benchmark is "independent market-driven prices". Moreover, as discussed in our first written submission and oral statement[46], the United States has never advocated a "hypothetical undistorted" market standard. Nevertheless, to determine whether a benefit exists, the point of comparison must be prices that are determined by market forces, not the government's financial contribution. The United States fails to see how a price artificially suppressed by the government's financial contribution can be considered an "independent market-driven price". To argue that the United States is required to use such prices turns the SCM Agreement on its head, making government-driven rather than market-driven prices the standard by which the benefit is measured.

Q17. Assuming, arguendo, that the total amount of subsidy benefit has been determined in conformity with the Agreement, could both parties clarify what, in their view, was or should have been the product scope of the numerator and the denominator in the USDOC subsidization calculation?

Reply

36. Tenure holders pay for the volume of trees they harvest. The subsidy benefit is the extent to which they pay less than adequate remuneration for the trees they harvest. Thus, the proper basis for calculating the total benefit is to multiply the total volume of harvested Crown timber entering the sawmills[47] by the difference between the market benchmark stumpage price and the government stumpage price. For example, if the sawmill paid $2/cubic meter for 500,000 cubic meters of harvested timber, and the market benchmark is $4/cubic meter, the total benefit to the sawmill is $1 million ($4 - $2 = $2 x 500,000).

37. The denominator of the subsidy calculation should be the sales value of all products resulting from the processing of the timber.[48] This includes milled and remanufactured softwood lumber products and by-products that result from the processing of the timber.

38. At the first substantive meeting of the Panel, Canada asserted that certain other products, such as posts and ties, should also have been included in the denominator. The United States would have included such products in the denominator had Canada provided data from which the value of these sales could have been derived. Canada, however, failed to do so. Rather, Canada argued that a category of products labelled "residual products" should have been included in the denominator. The StatsCan information provided by Canada consisted of a single number representing the total

[45] *See* EC Third Party Submission, at para. 32.

[46] *See* US First Written Submission, at para. 72; US First Opening Statement, at para. 14.

[47] Crown timber harvested by remanufacturers from their own tenures should also be included in the numerator. However, as the United States explained in its first written submission and at the first panel meeting, the United States did not have this data, which would have increased the total benefit calculation. US First Written Submission, at para. 104, fn. 134.

[48] The lumber production process includes remanufactured softwood lumber. Remanufacturers perform minor operations, such as cutting to odd lengths or finger jointing. By contrast, products such as particle board involve substantial additional manufacturing processes. For example, particle board requires not only the pressing of pieces of wood, but also a chemical treatment to act as an adhesive. Products resulting from such additional manufacturing processes do not belong in the denominator.

shipments that fell within the residual products category and a list of products contained in the residual products category.[49] The list included products, such as particle board and spruce logs, that did not result from the processing of timber.[50] Canada did not, however, provide any information concerning the break out of the residual products category.[51] The United States therefore could not determine which specific products from the list provided made up what percentage of the total number provided for in the residual products category. Accordingly, because Canada did not provide enough information concerning the make-up of the residual products category, the United States could not include that category in the denominator.[52]

Q19. According to Canada, the USDOC used "manifestly incorrect data" (para. 132 Canada's oral statement) in its selection of a conversion factor which led to the inflation of the subsidy and amounts to a legal error. In Canada's view, was it manifestly incorrect of the USDOC not to accept the conversion factor suggested by Minnesota in its Public Stumpage Price Review and Price Index (CDA-113), when it is clearly noted in this Minnesota document that "the reader should use caution when comparing the prices shown in this report with actual prices received or expected on any specific timber sale. Individual sale prices will vary significantly from the averages shown in this report because of variability in both economic and physical conditions"? (CDA-113, p. IV.A)

Reply

39. While Canada asserted in paragraph 132 of its oral statement that the United States used "manifestly incorrect data" in its selection of conversion factors, Canada failed to point to any record evidence demonstrating that the conversion factors used by the United States were inaccurate. Rather, in response to the Panel's enquiry, Canada merely referred to alternative sources of conversion factors: (1) the Minnesota 2000 Corrected Public Stumpage Price Review ("Minnesota Stumpage Price Review")[53], and (2) an Analysis of Comparative Factors Between the Public Forests of Quebec and the Private Forests of Maine.[54]

40. Moreover, while Canada alleges that the United States ignored the conversion factor used in the Minnesota Stumpage Price Review, its argument is based on a misreading of this document. Canada contends that the Minnesota Stumpage Price Review applied a conversion factor of 6.25. However, the first page of the document indicates that the 6.25 conversion factor only applied to the data contained in Table 2, which contained calculated volume and average prices received for pulp and bolts. The United States used the data from Table 1 to calculate certain benchmark prices because that table contained data on sawtimber. Unlike the pulp and bolts data in Table 2, the sawtimber data in Table 1 did not include any conversion factor.

Q20. Could each party clarify how it sees the role of the Panel in respect of the calculation-related claims, in light of the Panel's standard of review?

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[49] *See* Memorandum from Eric Greynolds to Melissa Skinner, Countervailing Duty Investigation of Softwood Lumber Products from Canada: Verification of the Questionnaire Responses Submitted by the Government of Quebec (15 February 2002) at 8, 10, Exhibit 13 (Exhibit US-71).

[50] *Id.* at Exhibit 13 (Exhibit US-71).

[51] *See Issues and Decision Memorandum*, at 22 (Exhibit CDA-1).

[52] *Id.* at 22-23 (Exhibit CDA-1).

[53] *Minnesota 2000 Corrected Public Stumpage Price Review and Price Index*, State of Minnesota, Department of Natural Resources, Division of Forestry (Exhibit CDA-113).

[54] Del Degan, Masse et Associates Inc., *Quebec/Maine Analysis of Comparative Factors Between the Publis Forests of Quebec and the Private Forests of Maine* (December 2001), at 8-10 (Exhibit CDA-114).

Reply

> The Panel's standard of review is set forth in Article 11 of the DSU:
>
> [A] panel should make an objective assessment of the matter before it, including an objective assessment of the facts of the case and applicability of and conformity with the relevant covered agreements, and make such other findings as will assist the DSB in making the recommendations or in giving the rulings provided for in the covered agreements.

42. In making an objective assessment of the matter before it, this Panel is to address only those provisions of the covered agreements cited by Canada in its request for the formation of a panel.[55] Canada has claimed that Articles 10, 19.1, 19.4, and 32.1 of the SCM Agreement and Article VI:3 of GATT 1994 essentially imposes on Members obligations with respect to the calculation of the subsidy rate. In light of the Panel's standard of review, therefore, the role of the Panel is *inter alia* to determine the "applicability" of these cited provisions in assessing the calculation methodologies used by the United States.

43. As the United States noted in its closing statement, however, Canada has failed to cite to any language in Articles 10, 19.1, 19.4 or 32.1 of the Subsidies Agreement, or Article VI:3 of the GATT 1994 establishing any obligations applicable to Canada's calculation-related claims.[56]

44. As such, because none of these provisions cited by Canada contains any obligations concerning the methodology of calculating the *ad valorem* subsidy rate, the Panel should find that Canada has failed to make a *prima facie* case that the United States has acted inconsistently with the SCM Agreement or GATT 1994, and that there is no inconsistency between the *ad valorem* subsidy calculation and the United States' obligations under the SCM Agreement.

Q21. Could the US explain how it considers the USDOC complied with its obligations under Article 12.8 of the SCM Agreement with regard to the change in the US benchmark state from Montana to Minnesota? What, in the US view, is the difference between the obligations/requirements of Articles 12.1 and 12.3 on the one hand and Article 12.8 on the other?

Reply

45. Article 12.1 of the SCM Agreement provides:

> Interested Members and all interested parties in a countervailing duty investigation shall be given notice of the information which the authorities require and ample opportunity to present in writing all evidence which they consider relevant in respect of the investigation in question.

The nature of the obligation contained in Article 12.1 is further elaborated upon in Articles 12.1.1, 12.1.2, and 12.1.3 which discuss questionnaires, availability of non-confidential submissions, and provision of the application for an investigation. Canada does not dispute that it was notified of the

[55] *See* Article 7.2, WTO *Understanding on Rules and Procedures Governing the Settlement of Disputes* ("DSU"); Appellate Body Report, *Brazil – Measures Affecting Desiccated Coconut*, WT/DS/22/AB/R, adopted 20 March 1997, p. 22; Panel Report, *Egypt – Definitive Anti-Dumping Measures on Rebar from Turkey*, WT/DS211/R, adopted 1 October 2002, para. 7.141.

[56] Closing Statement of the United States at the First Meeting of the Panel, paras. 7-8.

information the Commerce Department required and that it had ample opportunity to present information to the Department.

46. Article 12.3 of the SCM Agreement provides:

> The authorities shall whenever practicable provide timely opportunities for all interested Members and interested parties to see all information that is relevant to the presentation of their cases, that is not confidential as defined in paragraph 4 and that is used by the authorities in a countervailing duty investigation, and to prepare presentations on the basis of this information.

The Commerce Department's regulations provide that all information submitted by interested parties must be served on all other interested parties. All non-proprietary information is also placed on the public record.[57] While confidential business information is protected from disclosure, any party submitting business confidential information must also supply a public summary of the submission consistent with Article 12.4.1 of the SCM Agreement. In addition, information obtained by Commerce Department officials on their own was placed in the public record and made available to all interested parties during regular business hours. Parties regularly made use of their ability to prepare presentations based on information made available to them and the record of the investigation contained more than 1500 documents.

47. Article 12.8 of the SCM Agreement states:

> The authorities shall, before a final determination is made, inform all interested Members and interested parties of the essential facts *under consideration* which form the basis for the decision whether to apply definitive measures. Such disclosure should take place in sufficient time for the parties to defend their interests. (Emphasis added.)

The reference to facts "under consideration" cannot be equated with the facts "finally determined" to be the proper basis for the determination. Such an interpretation would render the obligations in Article 22.5 of the SCM Agreement redundant.

48. In other words, Canada's suggestion, in paragraph 143 of its first oral statement, that the United States was obligated to inform Alberta and Saskatchewan of its final choice of benchmark prior to making its final determination, cannot be reconciled with Article 22.5 of the SCM Agreement. Article 22.5 provides that the final determination in an investigation must provide "all relevant information on the matters of fact and law and reasons which have led to the imposition of final measures". If Members are to be prohibited from selecting among different facts on the record when making their final determinations unless their reliance on such facts has been previously announced, there would be no point in providing for such detailed notices of final determinations. All of the "essential facts" actually relied upon would have been identified to the parties prior to the final determination, according to Canada's interpretation, thus obviating the need for the obligations in Article 22.5 of the SCM Agreement.

49. The "essential facts *under consideration*" include competing sources of information that may serve as the basis of the final determination, and not necessarily a single set of facts upon which the final determination will rely. Indeed, the interests of the parties may differ, resulting in the parties viewing different facts as essential to the investigating authority's determination. In order to defend their interests, therefore, interested parties need to have access to the competing sources of information under consideration, not just what one party may believe is essential.

[57] *See* 19 C.F.R. § 351.303(f)(1) (Exhibit US-45).

50. Moreover, it is the view of the United States that when the investigating authority provides a detailed preliminary determination, access to the administrative record, detailed verification reports identifying the items examined during verification and any discrepancies found, exchange of case briefs and rebuttal briefs in which parties identify both legal and factual issues and advocate approaches to those issues, these processes reasonably inform the parties of all essential facts under consideration, consistent with Article 12.8 of the SCM Agreement.[658]

Q22. Is it the US view that the rate of subsidization found to exist varies depending on which US state is chosen as a basis for the comparison? If yes, would this not imply that the actual state used as the basis for the comparison is essential to the determination of the rate of subsidization? Is it the US view that the interested parties were informed of the choice of Minnesota as the benchmark state before the final determination was issued?

Reply

51. With respect to the first part of the Panel's question, it is axiomatic that the amount of benefit found may vary with the selection of the benchmark price against which the government price will be measured. To that end, when multiple possible benchmarks are available, the United States does not dispute that selection of the benchmark is highly significant to the subsidy calculation. As discussed in response to question 21, however, this does not mean that the United States was obligated to announce its final choice of benchmark prior to issuing its final determination.

52. In this case, the United States announced in the *Preliminary Determination* its preliminary decision to use northern US border states as the basis for calculating the benchmarks for each province.[659] The United States also announced which criteria it considered in selecting the benchmark sources, including species-mix, climate, and topography. Moreover, the record contained information from a limited number of potential benchmarks for all Canadian provinces being examined: Washington, Idaho, Montana, North Dakota, Minnesota, Michigan, New York, Vermont, New Hampshire, Maine, and Alaska. Therefore, based on the evidence contained in the record, and on the criteria announced in the *Preliminary Determination*, all parties were informed that a limited pool of potential benchmark sources was under consideration as the basis for the benefit calculations.

53. Minnesota is a US northern border state, and the record contained all of the information necessary to use Minnesota as the basis for a benchmark prior to the parties' submission of briefs.[660] Canada, Alberta, and Saskatchewan all were active parties to the investigation and received copies of all information concerning Minnesota. These facts, combined with the recognition that the United States had indicated that it was considering a limited pool of potential market benchmarks which included Minnesota, leave no doubt that the United States complied with Article 12.8 by giving

[58 4] *See* Panel Report, *Argentina – Anti-Dumping Measures on Imports of Certain Floor Tiles from Italy*, WT/DS189/R, adopted 5 November 2001, para. 6.125 (clarifying the obligation under Article 6.9 of the *Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994*, the analogous provision to Article 12.8 of the SCM Agreement).

[59 5] *See Notice of Preliminary Affirmative Countervailing Duty Determination, Preliminary Affirmative Critical Circumstances Determination, and Alignment of Final Countervailing Duty Determination with Final Antidumping Duty Determination: Certain Softwood Lumber Products from Canada*, 66 Fed. Reg. 43186, 43197 (17 August 2001) (Exhibit CDA-20) ("*Preliminary Determination*").

[60 6] *See* Memorandum from the Team to File, Calculations for the Preliminary Affirmative Countervailing Duty Determinations: Stumpage Programmes in the Investigation of Certain Softwood Lumber Products from Canada (9 August 2001) ("*Preliminary Determination Calculations Memorandum*") (Exhibit US-50).

Canada notice that the use of Minnesota stumpage prices was among the "essential facts under consideration."[661]

Q25. Could both parties comment on the views of the EC concerning Article 12.8 as presented in paragraphs 23 and 24 of the EC's oral statement ?

Reply

54. The United States does not agree that the use of the plural, "presentations", necessarily means that the interested parties must have the opportunity to make a formal counter-rebuttal. Rather, the EC has taken the word "presentations" out of its context in Article 12.3 of the SCM Agreement. In its entirety, Article 12.3 states:

> The authorities shall whenever practicable provide timely opportunities for *all interested Members and interested parties* to see all information that is relevant to the presentation of *their cases*, that is not confidential as defined in paragraph 4, and that is used by the authorities in a countervailing duty investigation, and to prepare *presentations* on the basis of this information.[662]

In its context, Article 12.3 refers to multiple parties presenting "their cases". The use of the plural, "presentations," parallels the plural terms "interested Members and interested parties," and "their cases" and merely refers to the fact that each party participating in the investigation has the ability to make its own presentation. The language does not require Members to provide opportunities for each party to make more than one presentation, as the EC argues.

55. Moreover, with respect to paragraph 24 of the EC oral statement, as the United States noted in response to Question 21, it makes the administrative record accessible to all interested parties throughout the investigation. Indeed, the US regulations require that all submissions to the record are provided by the submitting party to all other interested parties at the time of submission, subject to protections for proprietary information.

Q26. Could the parties please provide an overview of the dates of the communications concerning the MFPC report, and explain the nature of such communications in each case ? Could the US explain why this MFPC letter was not put on the record when it was received by the administration, and indicate where in the record these reasons are reflected? Please provide a copy of the USDOC regulations concerning submission and service of documents in countervailing duty investigations.

Reply

56. Canada argues that it was denied the opportunity to rebut information contained in two reports submitted by the petitioners on 4 March 2002 in response to the Maine Forest Products Council ("MFPC") letter. The 4 March 2002 letter[663] contained commentary on the MFPC letter, and

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[61 7] During the first substantive Panel meeting, Canada asserted that nothing would stop the United States from changing the starting point of the benchmark calculations from Montana or Minnesota to the United Kingdom or Russia. In contrast to the necessary Minnesota data, the Commerce Department's record did not contain any information concerning the United Kingdom or Russia. Thus, it is clear that the United Kingdom and Russia were not under consideration as potential bases for the benchmark calculations. Canada's example is therefore inapposite.

[62 8] Emphasis added.

[63 9] Letter from John J. Ragosta to Secretary of Commerce (March 4, 2002) (Exhibit CDA-112) ("4 March 2002 letter").

tables containing information that Quebec itself submitted on 4 January 2002. Specifically, a report authored by the James W. Sewall Company ("Sewall Report") attached to the 4 March 2002 letter contains tables with information derived from the Maine Forest Service 2000 Stumpage Price Report and 2000 Wood Processor Report.[764] Quebec submitted those reports as an attachment to its 4 January 2002 submission.[765] Therefore, much of what Canada complains about is commentary on factual information Quebec had placed on the record.[766]

57. The chronology of events concerning the March 4, 2002 letter is provided below.

58. On 30 October 2001, Deputy Assistant Secretary Bernard Carreau ("DAS Carreau") and other Commerce Department officials met with representatives of the MFPC. During this meeting, the MFPC gave the officials a survey of US private landowners and Quebec border mill owners. On 31 October 2002, the Commerce Department placed a memorandum in the administrative record stating that this meeting took place, which contained a copy of the survey that the MFPC had presented to the Commerce Department.[767]

59. During this meeting, the MFPC asserted that the Commerce Department should not have used only sawlogs when it calculated the weighted-average stumpage price for Maine. According to the MFPC, DAS Carreau "invited" the MFPC to provide the Commerce Department with more information concerning standing timber prices in Maine.[768]

60. On 20 December 2001, the MFPC sent a letter addressed to DAS Carreau[769], in which the MFPC stated that studwood was used in the production of lumber in Maine. This letter included tables based on information from a survey conducted by the Maine Forestry Service containing prices for studwood in Maine.[770] The MFPC did not submit this letter in accordance with the Commerce Department's regulations.

61. Section 351.303(b) of the regulations[771] require the submission of all documents to "the Secretary of Commerce, Attention: Import Administration, Central Records Unit." Properly addressed submissions are processed through the Administrative Protective Order Office ("APO

[64 0] *See* James W. Sewall Company, Review of Letter from Jonathan Ford to Department of Commerce, attached to 4 March 2002 letter (Exhibit CDA-112).

[65 1] *See* Letter from Arent Fox to Secretary of Commerce (4 January 2002), Attachment 1 – Quebec/Maine Analysis of Comparative Factors Between the Public Forests of Quebec and the Private Forests of Main ("Quebec/Maine Analysis"), Appendix 7 to the Quebec/Maine Analysis – Maine Forest Service, 2000 Stumpage Reports, and Appendix 8 to the Quebec/Maine Analysis – Maine Forest Service, 2000 Wood Processor Report (Exhibit US-73).

[66 2] Exhibit 1 to the Sewall Report does contain species-specific studwood stumpage prices that was not placed on the record previously. James W. Sewall Company, Review of Letter from Jonathan Ford to Department of Commerce, attached to March 4, 2002 letter (Exhibit CDA-112). Quebec had placed on the record aggregate studwood stumpage prices by counties in Maine through Appendix 7 of its 4 January 2002 submission. *See* Quebec/Maine Analysis (Exhibit US-73).

[67 3] Memorandum from Melissa G. Skinner, Re: *Ex Parte* Meeting with the Maine Forest Products Council Concerning the Countervailing Duty Investigation on Softwood Lumber from Canada (31 October 2001) (Exhibit US-72).

[68 4] Letter from MFPC to Bernard Carreau (20 December 2001) (Exhibit CDA-100). Often in such informal *ex parte* meetings, parties may attempt to present to Commerce Department officials oral information concerning the case. When that occurs, Commerce Department officials routinely request that the party formally file any relevant information in written form.

[69 5] Pursuant to Commerce Department regulations, parties filing documents with the Commerce Department must address those documents to the Secretary of Commerce. *See* 19 C.F.R. § 351.303(b) (Exhibit US-45).

[70 6] Letter from MFPC to Bernard Carreau (20 December 2001) (Exhibit CDA-100).

[71 7] The United States provided a copy of these regulations to the Panel as Exhibit US-45.

office"). The APO office controls access to business proprietary information, ensures that all documents have a certificate of service, and distributes the documents to appropriate Commerce Department officials. Commerce Department officials, such as DAS Carreau, normally receive submissions through this process.

62. Section 351.303(f)(1)(i) of the Commerce Department's regulations also requires that "a person filing a document with the Department simultaneously must serve a copy of the document on all other persons on the service list by personal service or first class mail." Section 351.303(f)(2) requires that all documents be accompanied by a certificate attesting to such service.[772]

63. Because the Commerce Department relies on these regulations to ensure that information is placed on the record and provided to interested parties, it was not immediately apparent that the MFPC letter had not been formally placed on the record. On 8 February 2002, Quebec filed a letter with the Commerce Department informing it that the MFPC letter had not been placed on the record.[773] The Commerce Department then took immediate steps to rectify this situation.

64. On 20 February 2002, the Commerce Department provided a copy of the MFPC letter to all interested parties, and requested comments, including information intended to rebut, clarify or correct information. Interested parties had the option of commenting on the MFPC letter in their rebuttal briefs, which were due to the Commerce Department on March 1, 2002. The Commerce Department indicated that it would accept rebuttal comments and information on the MFPC letter up to 4 March 2002.

65. On 1 March 2002, Quebec submitted its rebuttal brief, which commented on the information contained in the MFPC letter.[874] On March 4, 2002, the petitioners submitted comments on the MFPC letter, and rebuttal information, including the Sewall Report.[875]

66. This chronology establishes that all parties had an opportunity to comment on, clarify or rebut the information in the MFPC letter. The fact that the parties were not afforded an opportunity for sur-rebuttal is not consistent with the SCM Agreement.

[72 8] Commerce Department regulations also require that each document submitted must include on the first page in the upper right hand corner: (1) the case number; (2) whether the document concerns an investigation or some other administrative proceeding; (3) the office within the Commerce Department conducting that proceeding; and (4) whether the document contains business proprietary information. 19 C.F.R. § 351.303(d)(2) (Exhibit US-45). This information had to be hand-written on the document by a Commerce Department official when it was formally placed on the record.

[73 9] Letter from Arent Fox to US Department of Commerce Regarding Request that Department Place Information Received from Maine Landowners on the Record (Feb. 8, 2002) (Exhibit CDA-101).

[74 0] Rebuttal Brief of the Gouvernement du Quebec (Exhibit US-51). This was not Quebec's only opportunity to discuss the issue of whether to include studwood in the stumpage prices from Maine. Rather, on 4 January 2002, Quebec submitted a report authored by Del Degen, Masse Associates Inc., dated December 2001, which argued that the studwood, pulpwood and sawlogs in Maine must be considered. *See* Quebec/Maine Analysis (Exhibit US-73).

[75 1] *See* James W. Sewall Company, Review of Letter from Jonathan Ford to Department of Commerce, attached to 4 March 2002 letter (Exhibit CDA-112).

ANNEX B

PARTIES' RESPONSES TO QUESTIONS FROM THE SECOND MEETING

ANNEX B-1

CANADA RESPONSE TO QUESTIONS FROM THE PANEL AT THE SECOND MEETING

(4 April 2003)

To both parties

Q1. Could the parties please comment on the relevance, if any, of footnote 36 to Article 10 in the context of Canada's pass-through claim, in particular Canada's assertion that the Agreement requires that the calculation of the subsidization rate of the investigated product must be accurate.

Reply

1. Footnote 36 defines the term "countervailing duty" as a special duty levied for the purpose of "offsetting any subsidy bestowed directly or indirectly". The ordinary meaning of "offset" is "[s]et off as an equivalent *against*; cancel out by, balance by something on the other side or of contrary nature; counterbalance, compensate".[1] The concept is further illustrated by the French text of Article 10, which provides that countervailing duties are designed to "*neutraliser toute subvention accordée*". The United States violated Article 10 of the SCM Agreement because it failed to determine the existence of a subsidy before imposing countervailing duties. Where a Member imposes countervailing measures in the absence of a subsidy, there is nothing to "offset" and the duty imposed has no legal justification. Where no subsidy exists, the subsidy amount is zero – not some presumed amount.

2. Other panels and the Appellate Body have examined Article 10 of the SCM Agreement and the relevance of footnote 36. In *United States – Lead and Bismuth II*, a case involving another instance of an impermissible presumption of subsidization by the United States, the panel confirmed that the determination of the existence of a subsidy was a fundamental condition to the lawful imposition of countervailing duties.[2] The United States agreed.[3] The panel stated in particular:

> In our view, [the provisions of the SCM Agreement governing the imposition of countervailing measures] are all based on the premise that no countervailing duty may be imposed absent (countervailable) subsidization. Furthermore, we consider that this premise underlies the very purpose of the countervailing measures envisaged by Part V of the SCM Agreement. Footnote 36 to Article 10 of the SCM Agreement provides that "[t]he term 'countervailing duty' shall be understood to mean a special duty levied for the purpose of offsetting any subsidy bestowed directly or indirectly […]". Thus, the imposition of a countervailing duty is only envisaged in

[1] *New Shorter Oxford English Dictionary* (Oxford: Clarendon Press, 1993) at p. 1985. (Exhibit CDA-171)

[2] *United States – Imposition of Countervailing Duties on Certain Hot-Rolled Lead and Bismuth Carbon Steel Products Originating in the United Kingdom*, Report of the Panel, WT/DS138/R, adopted 7 June 2000, at paras. 6.45-6.57 ["*United States – Lead and Bismuth II*"].

[3] *Ibid.*, at para. 6.43, footnote 62 ("[T]he investigating authority must first identify the existence of a subsidy before measuring and allocating the amount of the subsidy found to exist or imposing a countervailing duty").

> circumstances where it is necessary to "offset" a (countervailable) subsidy. In our view, footnote 36 to Article 10 does not envisage the imposition of countervailing duties when no (countervailable) subsidy is found to exist, for in such cases there would be no (countervailable) subsidy to "offset".[4]

3. The Appellate Body confirmed the panel's findings in that case.[5] In *United States – Countervailing Measures Concerning Certain Products from the European Communities*, a case concerning yet more instances of presumed subsidization by the United States, the panel, relying on the text of footnote 36, found that a determination of subsidization in an investigation or review "must be made before countervailing duties can be imposed, and permits a calculation of the extent of subsidization".[6] The Appellate Body upheld this finding, and recalled that a subsidy under Article 1.1 is composed of both a "financial contribution" and "benefit".[7] It then confirmed that Article VI of GATT 1994 requires an investigating authority to "ascertain the precise amount of a subsidy attributed to the imported product," and noted Article 10 in furtherance of this obligation.[8]

4. In this case, because the United States has failed to conduct any pass-through analysis and therefore failed to establish the existence of a subsidy, the volume of Crown timber harvested by entities that did not produce subject lumber and the amount of subsidy derived from that volume, for example, must be excluded from the numerator in the subsidy rate calculation. Likewise, no duty can lawfully be imposed on the products of lumber remanufacturers purchasing at arm's-length.

5. Footnote 36 confirms that pursuant to Article 19.4, in all instances, the subsidy amount must accurately reflect the subsidization found.

Q2. Is it relevant to the interpretation of Article 14(d), in particular its reference to "… in the country of provision", that Articles 14(b) and 14(c) contain no similar reference?

Reply

6. The absence of any reference to "prevailing market conditions … in the country of provision" in Articles 14(b) and 14(c) is relevant to the interpretation of Article 14(d), as the entirety of Article 14 provides context for this provision.

7. Contrary to what the United States claims, the guidelines contained in Article 14 are not "general principles" that provide no limitation on how Members must measure benefit. Rather, Article 14 prescribes clear rules for measuring benefit with which Members must comply when the financial contribution at issue involves the government provision of equity capital, loans, loan guarantees or goods or services.

8. Articles 14(b) and (c) deal with loans and loan guarantees. Unlike Article 14(d), they do not contain the phrase "in the country of provision". They therefore do not restrict the benchmark that must be used to measure benefit to in-country benchmarks, in the way Article 14(d) does. That this phrase was included in Article 14(d) and not in Articles 14 (b) or (c) is evidence of the intent of the Members at the time the SCM Agreement was negotiated to distinguish between situations where an

[4] *Ibid.*, at para. 6.56.

[5] *United States – Imposition of Countervailing Duties on Certain Hot-Rolled Lead and Bismuth Carbon Steel Products Originating in the United Kingdom*, Report of the Appellate Body, WT/DS138/AB/R, adopted 7 June 2000, at paras. 63 and 75(b).

[6] *United States – Countervailing Measures Concerning Certain Products from the European Communities*, Report of the Panel, WT/DS212/R, adopted 8 January 2003, at paras. 7.41-7.44.

[7] *United States – Countervailing Measures Concerning Certain Products from the European Communities*, Report of the Appellate Body, WT/DS212/AB/R, adopted 8 January 2003, at para. 139.

[8] *Ibid.*

investigating authority should not be restricted to in-country benchmarks (e.g. due to the international nature of financing) and situations where an investigating authority should be so restricted.

Q3. Why, in the US view, are US stumpage prices broadly representative of market conditions in Canada? What is the motivation or incentive for Canadian harvesters to cut timber in the US, at much higher cost than in Canada, especially in the light of the abundant (in the US view, unlimited) supply of Crown timber? Would such purchases be typical, or instead essentially exceptional?

Reply

9. US stumpage prices are not broadly representative of market conditions in Canada for the myriad of reasons that Canada has set out in its Submissions. In particular borders affect prices profoundly and these effects are difficult if not impossible to quantify (political boundaries drive differences in government regulatory regimes, tax regimes, investment regimes, etc.). In addition, US standing timber is not of the same species mix, size, quality, or harvested under similar operating or sales conditions as Canadian standing timber. Moreover, there is a limited distance over which logs can be hauled economically. This is why standing timber is processed into logs, and then into lumber, close to the resource.

10. The only motivation for a Canadian harvester to cut timber in the United States and export the logs back to Canada would be that doing so was economically attractive in comparison with harvesting in Canada, as in the case of, for example, the high quality logs exported from Maine. Such transactions are almost entirely unique to Québec and are the exception for the rest of the country. The United States itself recognized the unique nature of the log trade between Québec and Maine in *United States – PD Softwood Lumber*. As the Panel's question suggests, if private prices in Québec were suppressed, this trade in logs would not exist, as these mills would source their logs from the domestic private market.

11. The import of logs into the rest of Canada represents less than 1 per cent of the total annual harvest.

Q4. In paragraph 40 of its second oral statement, Canada argues that "the fundamental basis for Commerce's rejection of in-country evidence was its reliance on the Preamble to its Regulations to presume price suppression". According to the parties, does the Preamble provide for such a presumption in case of dominant position by the government? According to the parties, did the USDOC interpret the Preamble to imply a presumption against the use of market data where the government holds a dominant position in the market? (See for example p. 37 CDA-1 or p. 58: "The preamble to section 351.511 of the Regulations provides that, where a government has a dominant position in a market, the Department will avoid the use of private prices in determining the adequacy of remuneration. Where the market for a particular good is so dominated by the presence of the government, the remaining private prices in the country in question cannot be considered to be independent of the government price").

Reply

12. The Preamble does not provide for a *per se* rule in the case of a dominant position by a government.[9] The Preamble merely invites an inquiry into whether a large government presence in the market creates actual distortion. Commerce did not conduct such an inquiry. Rather, it treated the Preamble as imposing a *per se* rule and assumed price suppression based on government involvement in the marketplace.

[9] Canada also notes that the Preamble does not override the US statute.

13. In paragraph 37 of the Final Determination Commerce described the Preamble as stating that "*if* the government provider constitutes a majority or a substantial portion of the market, *then* such prices in the country will no longer be considered market based and will not be an appropriate basis of comparison for determining whether there is a benefit."[emphasis added]. Therefore, in the circumstances of this case, where the government is a "majority provider", Commerce was not concerned with whether there were private prices in Canada because it had already dismissed these prices as "unusable". Commerce therefore treated the Preamble as prescribing a *per se* rule that requires the rejection of in-country market transactions as benchmarks in any situation where the government is the "majority provider" of the good.

14. That this was in fact what Commerce did is reinforced by its statement in paragraph 58 of the Final Determination where, with reference to the Preamble alone, Commerce stated that it will avoid using private prices in circumstances where the government has a dominant position and that in such circumstances "the remaining private prices in the country of question *cannot* be considered to be independent of the government price" [emphasis added]. Thus the fact that Commerce found that the provincial governments were "majority providers" was sufficient for it to exclude consideration of private prices in Canada.

To the US

Q5. The US argues that any overstatement of the subsidy amount due to arms' length transactions for logs between timber harvesters and lumber producers is now being addressed through individual expedited reviews being conducted by the USDOC. Could the US please explain how, if at all, such individual reviews affect the overall aggregate subsidization calculation. That is, does the aggregate subsidization rate remain the same, or is it recalculated to exclude the relevant amounts from the numerator, the denominator, or both, of subsidy amounts attributed to, and sales by, the individual firms subject to expedited review?

Reply

15. A recalculation of the country-wide subsidy rate by the United States at the conclusion of the expedited review process would not address the overstatement of the subsidy amount due to the illegal presumption of subsidy pass-through in arm's-length transactions. This is because the presumption made was applied to all producers, not just those who have requested expedited reviews. A subsequent review of only a few producers, even if conducted properly, will not change the fact that the country-wide rate applicable to all other producers was established illegally.

16. It is also not certain that pass-through analysis in the expedited review proceedings will be undertaken at all. Almost a year has passed since issuance of the countervailing duty order and Commerce has not even issued a questionnaire eliciting information for a pass-through analysis, and has given no indication whether, or when, the requested pass-through analyses will be conducted.

Q6. Could the US respond to the statistics referred to in paragraph 57 of Canada's oral statement, i.e., that the US recognizes that in British Colombia, 24 per cent of Crown timber was harvested by entities that do not own sawmills, and that scores of producers purchased their log and lumber inputs in arms'-length transactions from independent harvesters and other entities.

Reply

17. Nothing in the SCM Agreement permits the presumption of a subsidy pass-through. At a minimum, an investigating authority must address any record evidence establishing arm's-length

transactions.[10] The panel in *United States – PD Softwood Lumber* confirmed this obligation.[11] The United States has admitted that such transactions exist in this case.[12] The US obligation to establish subsidization in the investigation and calculating the correct subsidy rate is not met by mischaracterizing record evidence after-the-fact in WTO proceedings, nor is it met by any subsequent company-specific review.[13] By presuming a pass-through, the United States has both impermissibly overstated the subsidy amount and illegally imposed countervailing measures in the absence of a subsidy determination.

Q8. At para. 32 of the US second submission, the US states that the data on private stumpage prices in Ontario and Quebec highlight that "prices that are distorted by the government's financial contribution do not reflect 'market' conditions". Could the US please explain in what way this price information demonstrates this.

Reply

18. In its preliminary response to the Panel's question at the Second Substantive Meeting the US conceded that data on private stumpage prices do not prove price distortion in these provinces. Rather, it pointed to "other factors" that affect the price data so that this data cannot be used as a benchmark.

19. If the "other factors" the United States was referring to were the provincial forest management practices discussed in paragraphs 33-39 of its Second Written Submission, Canada has already observed that these practices were not the subject of the investigation. Moreover, the Final Determination did not analyse whether these forest management practices had any effect on private timber prices and certainly contained nothing demonstrating that these practices had "distorted" the market. Instead, Commerce relied heavily on the Preamble to reject in-country private prices supported by a few pieces of anecdotal evidence and a single fundamentally flawed economic analysis, as discussed in Canada's submissions.

Q9. Could the US respond to the argument at paragraph 40 of Canada's statement that the US took a selective approach to the record evidence in reaching its determination that Canadian private stumpage prices were distorted by the provincial stumpage programmes.

Reply

20. As explained in the comments Canada made at the Second Substantive Meeting, Canada's statement regarding "selective references" in paragraph 40 of its Oral Statement was intended to point out that the provincial forest management practices the United States referred to in its Second Written Submission were not the subject of this investigation. Furthermore, these practices did not form the basis for Commerce's conclusion in the Final Determination that private market prices for stumpage in Canada were distorted by government involvement in the marketplace. That determination was based solely on the Preamble, a flawed economic analysis and a few pieces of anecdotal evidence.

Q11. Could the US comment on Canada's argument at para. 28 of its second submission concerning the third benchmark in Section 351.511 of the USDOC Regulations. In particular, could the US comment, first, on Canada's argument that there are no world market prices for

[10] Canada's Second Written Submission, at para. 48.

[11] *United States – Preliminary Determinations With Respect to Certain Softwood Lumber From* Canada, Report of the Panel, WT/DS236/R, adopted 1 November 2002, at para. 7.79 ["*United States – PD Softwood Lumber*"].

[12] Canada's Second Written Submission, at para. 48 and references to US submissions therein.

[13] Canada's First Written Submission, at para. 146; Canada's Second Written Submission, at para. 48, fn 46.

stumpage, and second, on Canada's position that the evidence shows that provincial stumpage programmes are operated in a manner consistent with market principles, as foreseen by the USDOC Regulations.

Reply

21. The United States in this proceeding, unlike in *United States – PD Softwood Lumber,* has avoided arguing that US prices for short-term timber harvesting rights are "world market prices". This is undoubtedly because no "world market prices" for stumpage exist.

22. Canada has addressed Commerce's assertion that US prices for short-term cutting rights are "world market prices" in its previous submissions. However, even Commerce itself essentially accepted that there is no "world market price" for stumpage in the Final Determination when it selected benchmarks from multiple states. If there were in fact a "world market price" Commerce would have used a single benchmark for all of the Canadian provinces.

23. Canada further notes that the US admitted in its preliminary response to the Panel's question that it would have used its third benchmark – consistency with market principles - if US stumpage prices had not satisfied the second benchmark.[14]

Q14. Could the US respond to the argument at paragraph 82 of Canada's oral statement, that new evidence from the petitioners' 4 March 2002 submission was in fact used by the USDOC in its subsidy calculations for Quebec.

Reply

24. At the Second Substantive Meeting of the Panel with the Parties, the United States admitted that the March 4, 2002, evidence submitted by the petitioners (Exhibit CDA-112) was, in fact, relied upon by Commerce in its subsidy calculations for Québec. The US admission confirms what Exhibit CDA-170 establishes, that Commerce used the March 4, 2002, evidence to calculate a Maine benchmark price to compare with Québec prices.

25. The United States has previously admitted that the March 4, 2002, submission by the petitioners contained new evidence that was not on the investigation record.[15]

26. Interested parties from Québec were denied any opportunity to prepare presentations on the basis of information the United States admits was new and was relied upon to calculate the Maine benchmark price. By its own admission, the United States has violated Article 12.3 of the SCM Agreement.

Q16. Could the US please respond to the argument in para. 81 of Canada's second submission that the US excluded from the denominator "other softwood products that were also produced in the sawmill establishments from logs entering those sawmills"?

[14] The evidence on the record related to consistency with market principles is set out in Canada's submissions. See: First Written Submission of Canada, at paras. 106 - 111; and Oral Statement of Canada at the First Substantive Meeting, at para. 54.

[15] Answers of the United States of America to the Panel's February 24, 2003 Questions, at footnote 72 ["US Answers"].

Reply

27. The United States included the total volume of logs that entered sawmill establishments in its calculation of the amount of the alleged subsidy (the numerator of its subsidy per unit calculation). However, it did not include the value of all products produced from those logs by those establishments in the denominator of its subsidy per unit calculation. Specifically, it did not include the value of residual non-lumber products produced by sawmill establishments in the denominator. This resulted in an inflated subsidy per unit rate. A countervailing duty imposed on the basis of such a rate violates Article 19.4.

28. In response to question 17 of the Panel's First Questions to the Parties, the United States conceded that it "would have included such products [residual products such as posts and ties] in the denominator had Canada provided data from which the value of these sales could have been derived."[16] Likewise, in its Second Written Submission, the United States provided as follows:

> To the extent that particular products in the residual products category resulted from the lumber production process, the United States *would have included the sale of such products in the denominator* if Canada had provided information from which the United States could have derived their value.
>
> Canada failed to submit any evidence from which the United States could separate the value of additional products resulting from the lumber production process from the broader residual products category. Accordingly, the United States did not include the residual products category in the denominator.[17] [emphasis added]

29. In the foregoing the United States admitted that the per unit subsidy rate was inflated. Therefore, the countervailing duty rate was correspondingly inflated and the United States has violated Article 19.4.

30. The US reasoning in defence of its violation has no basis in Article 19.4. The United States did not ask for a disaggregated breakdown of product values in the residual category at any point in the investigation.[18]

31. More important, the United States did not require disaggregated residual product data to accurately calculate the amount of the alleged subsidy. The United States had data on the record that allowed it to limit its subsidy per unit calculation to subject merchandise – softwood lumber products. By limiting the numerator to the volume of logs entering sawmills that results in softwood lumber only, the denominator could then have properly been limited to the sales value of softwood lumber products. There was no need to deal with the volume or value of residual products to accurately calculate the amount of the alleged subsidy. (This, however, would not have corrected for Commerce's errors in converting from MBF to m^3 and in the use of understated final mill sales value data in the denominator.)

32. Even if it were appropriate to calculate the countervailing duty rate by dividing the subsidy to all logs that entered sawmill establishments by sales of all softwood products, the United States still had all the data it needed. The numerator was not limited to logs used in the softwood lumber production process, but included all logs that entered sawmill establishments. All products in the residual products category are softwood products produced by sawmills. Therefore, in such a calculation, all sales in the residual products category would have to have been included in the denominator.

[16] *Ibid.*, at para. 38.
[17] US Second Written Submission, at paras. 63-64.
[18] Canada's Second Written Submission, at para. 83.

To Canada

Q17. With regard to the impermissibility of using US stumpage prices as the benchmark, the US argues in para. 48 of its second submission that: "Canada's assertions … are based on its view that the provinces provide intangible harvesting 'rights' that cannot be imported". Could Canada please comment.

Reply

33. Canada's position with respect to the impermissibility of using US stumpage prices as the benchmark is based on the plain meaning of the text of Article 14(d). An investigating authority is required by the unambiguous language of Article 14(d) to use in-country benchmarks. As the panel in *United States – PD Softwood Lumber* concluded "the ordinary meaning of this provision excludes an analysis based on market conditions other than those in the country or provision of the goods, i.e. Canada".[19] The United States' reliance on cross-border comparisons therefore violates Article 14(d). Further, the alleged good Commerce claimed was subsidized was "standing timber". Standing timber in the United States can only be purchased in the United States and trees growing in the United States cannot be harvested in Canada.

34. Finally, with respect to the right to harvest US standing timber, Canada notes that this right can only be exercised in the United States.

Q18. Given the existence of some US timber sales to Canadian harvesters, in what sense does Canada argue that US stumpage is not "available" to Canadian harvesters. Is it not possible for a Canadian harvester, located in Canada, to bid on and win bids for US timber?

Reply

36. While it is true that Canadian harvesters may bid on stumpage in the United States (in actual fact very few do) that does not make US stumpage available in Canada. US stumpage is not "available" to softwood lumber producers in Canada because timber can be harvested only in the country where it stands, even if the logs produced from its timber can be exported. Harvesting rights related to land cannot be exported across the border because the land cannot be. Just as it make no sense to say that land purchased in one country is also purchased in another country; it makes no sense to say that stumpage purchased in the United States is somehow purchased in Canada.

37. For a price to be available in the country of provision, the good or service must be available for purchase in the country of provision. The question therefore is whether the good is available for purchase in the country of provision. The alleged good that Commerce claimed was subsidized in this case is standing timber.

38. The United States deliberately blurs the distinction between logs and standing timber in order to make its argument that US stumpage is available in Canada. Even if the good at issue were logs, Commerce clearly did not consider the availability of logs a necessary element in its selection of benchmarks. For example, Commerce used the Minnesota benchmark for Alberta and Saskatchewan even though there was no record evidence that logs from Minnesota were available in either province. In addition log export restrictions in place on public lands in Washington, Idaho and Montana – which were the exclusive source of benchmarks for British Columbia - made the import of logs into Canada from these comparison areas impossible.

[19] *United States – PD Softwood Lumber*, at para 7.44.

Q19. Could Canada please respond to the US example in paragraph 19 of the US oral statement, i.e., that based on Canada's argument, prices of products purchased FOB factory gate in the US, by purchasers located in Canada, are not "available" to those purchasers.

Reply

39. In the context of this case the only "products" that could be purchased FOB factory gate in the US are logs, not standing trees and it is standing trees that the United States has alleged is subsidized. The significance of this distinction is that while it may be argued that the logs in this example could be "available" in Canada if they are imported, it cannot be said that the standing timber used to process these logs in the United States is available in Canada. The reason for this is that there must be manufacturing activity involving those standing trees that takes place in the United States before the logs are exported. In this situation it cannot be said that the price of the standing trees that were used in the United States to produce those logs is available in Canada. It is not. It is a price wholly and only available in the United States.

Q20. Canada argues, at para. 74 of its second submission, that the numerator in a subsidization calculation must reflect the proportional amount of the subsidy that can be attributed to the subject merchandise. In other words, Canada's argument seems to be that there must be a volume-based allocation of subsidy amounts among a firm's different products, before the rate of subsidization of the subject merchandise can be calculated.

(a) Is this a correct characterization of Canada's argument on this point? If not, please clarify.

Reply

40. This is a correct characterization of Canada's position concerning the calculation of the amount of the subsidy to be included in the numerator of the subsidy per unit calculation in this case.

41. Canada's position is based on the fact that the alleged subsidy arises from the provision of an alleged good that is, in different proportions, a physical input to particular products, only one of which is subject merchandise. A volume-based allocation normally would not be necessary, for example, where the financial contribution is a grant or loan or other fungible resource, or where a good is equally an input to all products produced by a firm. In this case, however, where only a portion of a log (the input product produced from standing timber – the alleged good) produces softwood lumber, a volume allocation at the outset is the only means of properly determining the amount of the subsidy that goes to the allegedly subsidized products.

42. Canada does not suggest a rule for all subsidy calculations. Rather, an investigating authority is required, on the specific facts of each case, to ensure that it does not inflate the subsidy per unit rate. The United States failed to comply with that obligation in this case.

43. It is perhaps useful in order to fully understand Canada's argument on this point to recall how Commerce calculated the subsidy per unit rate in this case.

- *The Subsidy Amount (numerator)* – Commerce calculated the amount of the alleged subsidy (numerator) by determining a benchmark price for harvested timber in each US state that it considered to be relevant for comparison purposes. The US benchmark prices were expressed in US log scale measurement units. In order to compare with Canadian provincial prices, Commerce converted the US benchmark prices into cubic metres. Commerce deducted its determined cost per cubic metre for harvested timber in each relevant province from the US state benchmark price Commerce considered relevant. Commerce then multiplied this per cubic metre price differential

by the total volume of softwood logs produced from Crown timber in each province that entered sawmills to determine a provincial subsidy amount.

- *The Subsidy Per Unit Rate* – In order to arrive at a subsidy per unit rate, the alleged subsidy was divided by a denominator that consisted of the sales value of some of the products produced from the volume of logs included in the numerator.[20]

44. Based on the record evidence and the products at issue in this case, the most accurate method of calculating the subsidy amount in the numerator was to add the following step to Commerce's methodology: multiply the alleged subsidy amount by the volume of those softwood logs that actually went into the subject merchandise – softwood lumber products. The denominator could then properly be limited to the sales value of the subject merchandise rather than the value of all products produced from softwood logs that entered sawmill establishments.

(b) If this is a correct characterization of Canada's argument, how does Canada reconcile this with the fact that the de minimis rule for countervailing duties is expressed on an ad valorem basis in the SCM Agreement (e.g., Article 11.9)?

Reply

45. There is no inconsistency between Canada's position and Article 11.9. Canada's proposed approach still results in the calculation of an *ad valorem* rate because the total subsidy in the numerator is still allocated over the total sales value of the subject merchandise.

(c) Similarly, how does Canada reconcile this position with the fact that the Annex IV guidelines for calculation of ad valorem subsidization of a product, in the context of (now expired) Article 6.1(a) specifically require that this rate of subsidization be calculated using the total value of the firm's sales as the denominator of the subsidization equation, except in the case of a tied subsidy, in which case the denominator is the value of the firm's sales to which that subsidy is tied? (In other words, the general approach was that the total subsidy amount would be divided by the firm's total sales to arrive at the ad valorem subsidization of the product.) In what way, analytically, is this different from what the USDOC did in the Lumber investigation?

Reply

46. Subsidization per unit, mentioned in Article 19.4, is the amount of the subsidy attributable to a product subject to countervailing duties. A subsidy per unit rate is the *ad valorem* rate of subsidization, determined by dividing the subsidy attributable to a product by the value of that product.

47. In the case of a tied subsidy, as paragraph 3 of Annex IV sets out, the amount of a subsidy specifically earmarked for the production or sale of a product should be the amount divided by the value of that product, to yield a per unit rate.

48. In the case of an untied cash subsidy, because money is fungible, the assumption is that a producer receiving the subsidy would spread the total amount of the subsidy across the total volume

[20] As Canada noted in response to question 16, Commerce did not include the value of residual products in the denominator that were included in its calculation of the subsidy amount. In addition, Commerce used an inaccurate final mill sales value in the denominator that was too low to reflect the actual sales value of remanufactured products within the scope of the investigation.

of production. Accordingly, a rational and relatively easy way of determining the subsidy per unit rate would be to divide the total amount of the subsidy by the total volume of the recipient's sales.

49. In this case, the subsidy attributable to the production of softwood lumber is the volume of the allegedly subsidized log that is used in the production of softwood lumber. In this sense, the most rational way of determining the subsidy per unit rate for the subject merchandise is to determine the amount of the subsidy in the volume of log attributable to the subject merchandise, and to divide that by the value of the subject merchandise.

50. Commerce's approach differed from the one set out in paragraph 2 of Annex IV in two ways. First, as Canada has noted in response to question 16, the United States has admitted that Commerce left out some products from the denominator. When the total amount of the subsidy is divided by less than the total sales of the products to which the subsidy is attributable, by definition, the subsidy per unit rate is inflated.

51. Second, in the specific facts of this case – and this is where the question of "volume" is important – dividing the total amount of the subsidy by the total softwood product sales results in an inflation of the subsidy rate of the subject merchandise.[21] This is because products other than lumber use very large volumes of wood, but are not valued as highly as the lumber products. Chips and sawdust (co-products), for example, are intermediate products, not finished goods like lumber, when they leave the sawmill. In the period of investigation, softwood lumber sales were 73 per cent of softwood product sales, while other softwood products were only 27 per cent of sales by sawmills.[22] However, other softwood products accounted for more than 60 per cent of the volume of softwood products. The large amount these other products add to the numerator from the major wood volumes they use is not balanced out by the value contribution they make to the denominator – creating a sharp increase in the subsidy rate compared to a calculation using only lumber-related numbers.

52. Softwood products other than lumber (that is, co-products and residual products) account for about 60 per cent of the volume of logs that entered sawmills, or in other words, 60 per cent of the alleged subsidy. And yet, they account for about 23 per cent of the value of the production. Using the whole amount of the alleged subsidy, therefore, results in the impermissible attribution of subsidy to certain products and an inflation of the subsidy per unit rate for those products. In the case of Alberta, this aspect of Commerce's methodology had the effect of inflating the subsidy per unit rate from 12 per cent to more than 32 per cent.[23]

Q21. Could Canada elaborate in more detail on its argument in paragraph 61 of its oral statement – that is, where exactly does Canada see an internal contradiction between the US pass-through and specificity arguments?

Reply

53. The United States found that that the alleged stumpage subsidy goes to primary sawmills holding harvesting rights, and presumed that the subsidy was passed-through to certain downstream remanufacturers that do not hold stumpage but that purchase Crown logs or lumber at arm's length. This presumption was based on the remanufacturers' use of an allegedly subsidized *input*, not on the nature of their *output*. And if the alleged stumpage subsidy automatically goes to downstream remanufacturers of subject lumber, then it also automatically goes to any other downstream producer.

[21] See also Canada's Second Written Submission, at paras. 73-78.

[22] Verification of the Government of Canada (January 23, 2002) at Exhibit 7 – "Worksheets for Calculating Total POI Lumber Shipments by Sawmills". (Exhibit CDA-133)

[23] Canada's Second Written Submission, at para. 78.

54. In its specificity finding, however, the United States determined that the alleged stumpage subsidy was made *only* to "pulp and paper mills and the saw mills and remanufacturers *which are producing the subject merchandise*". This finding is based on the nature of the output product. The two findings are not reconcilable: to the extent that a subsidy is "passed-through" to the users of lumber made from allegedly subsidized logs whether or not they harvested those logs, then the alleged subsidy is passed through to all users of products made from those logs. This universe of recipients is far larger than *only* the remanufacturers that produce the subject merchandise. It includes not only remanufacturers that produce non-subject merchandise, but also, the myriad other downstream industries using softwood-origin inputs.

55. This is but one example of the internal contradictions in the US logic. Another is in the US positions on financial contribution and specificity. If, as the US posits, the provision of an extraction/harvesting right (as in the case at hand) can be considered to be a "good" under Article 1, then Article 2 cannot be reduced to an analysis of whether the users of the harvesting right are fewer than everyone in the jurisdiction in question. To do so, as we have explained, reduces the specificity provision to automaticity and superfluousness. This, neither logic nor the principles of treaty interpretation will permit.

Q22. While Canada has indicated that during the investigation, Saskatchewan made clear that it rejected the use of any US state as a benchmark, the US argument at paragraph 40 seems to go to a different point, as the US indicated in its comments before the Panel at the second meeting. In particular, the US argument seems to be that Canada cannot now claim before the Panel that the USDOC's choice of a non-contiguous state as a benchmark for Alberta and Saskatchewan came as a complete surprise. The US cites as support for this assertion Saskatchewan's own arguments to the USDOC that if any cross-border comparison were to be used, Alaska, a non-contiguous state, was preferable to Montana, a contiguous state. Could Canada please address this specific point.

Reply

56. The United States has submitted a portion of a Saskatchewan reply brief to Commerce to this Panel and suggested that it demonstrates that interested parties should have been aware of the potential choice of a non-contiguous benchmark state to compare with Alberta and Saskatchewan.[24] This argument has no merit for at least two reasons.

57. First, even after Saskatchewan's reply brief was submitted on 22 February 2002, and in fact, even after the Final Determination was issued on 25 March 2002, the United States continued to justify Commerce's choice of benchmark states in the Preliminary Determination on the basis that the chosen states bordered the relevant provinces. On 13 June 2002, the United States filed the following in response to a panel's question in *United States – PD Softwood Lumber*:

> Even within the United States, not all timber prices are appropriate. The Department of Commerce did not use prices from the large timber-growing areas in the southeast, *or from any non-contigous state*, because as a matter of commercial reality, Canadian lumber producers do not consider it commercially viable to transport logs over that long a distance.[25] [emphasis added]

58. It is not credible to suggest that all interested parties, including those from Alberta, should have been aware of the potential choice of a non-contiguous benchmark state – let alone a "particular" non-contiguous benchmark state – on the basis of an alternative argument in a reply brief of one of the

[24] Case Brief of the Government of Saskatchewan, at pps. 25-27 (22 February 2002) (Exhibit US-95).

[25] *Answers of the United States of America to the Panel's 6 June 2002 Questions*, WT/DS236, 13 June 2002, at para. 95. (Exhibit CDA-162). See paras. 88-89 in Canada's Second Written Submission.

interested parties. This is especially true where the United States itself continued to justify the validity of the benchmarks in the Preliminary Determination even after the Final Determination on the basis that the relevant states bordered the provinces.

59. Second, the United States argues in its Second Oral Statement that interested parties "knew that factors such as climate, terrain, and species mix – not proximity – were the key considerations, and that a non-contiguous state might be selected for the benchmark."[26] Rather than justifying Commerce's unannounced switch of benchmark state, this substantiates the procedural violations claimed by Canada.

60. The portion of the Saskatchewan reply brief immediately preceding the excerpt submitted by the United States as Exhibit US-95, is dedicated to demonstrating the irrationality of using Montana as a basis of comparison with Saskatchewan for a variety of reasons including differences in commercial timber species mix, geography, topography and timber size.[27] In its reply brief, Saskatchewan noted that Montana and Saskatchewan have no commercial softwood species in common. While Saskatchewan's commercial harvest is made up primarily of white spruce, jack pine and black spruce, Montana's harvest is made up of Douglas fir, ponderosa pine and lodgepole pine.[28] Even though Saskatchewan did not advocate any cross-border comparison, it suggested Alaska as a potential benchmark because sales of the same commercial species were reported in both Saskatchewan and the interior of Alaska.

61. Saskatchewan and Alberta were able to make detailed and focussed presentations concerning Montana that highlighted differences in factors such as species mix, timber size, and geography, to name a few, precisely because they were aware that Montana was the potential benchmark state. They were able to demonstrate that Montana was an inappropriate benchmark because they were aware that it was under consideration and were able to tailor their submissions accordingly. As the United States has admitted, these submissions were instrumental in demonstrating that Commerce had erred in choosing Montana as the benchmark state in the Preliminary Determination.[29] Yet, interested parties were denied the same opportunity with respect to Minnesota. Commerce deprived itself of valuable information about the appropriateness of Minnesota as a benchmark state because it failed to inform interested parties of the state it might use as a benchmark.

62. Article 12.8 is an obligation on investigating authorities to inform interested parties prior to a final determination "of the essential facts under consideration which form the basis for the decision whether to apply definitive measures." An oblique reference by petitioners in a countervailing duty petition that any of the 50 states could serve as a benchmark does not satisfy an investigating authority's obligation under Article 12.8.[30] In the same vein, an alternative argument in a reply brief

[26] Second Oral Statement of the United States, at para. 40.

[27] Case Brief of the Government of Saskatchewan, at pps. 14-25 (22 February 2002) (Exhibit CDA-172).

[28] *Ibid.*, at p. 19.

[29] See *Issues and Decision Memorandum: Final Results of the Countervailing Duty Investigation of Certain Softwood Lumber Products from Canada*, 21 March 2001, at pps. 113 and 138-139. See also US First Written Submission, 22 January 2003, at paras. 164 and 168.

[30] Canada's Second Written Submission, at para. 87.

made by one interested party in respect of a state that was not used as a benchmark does not serve as notice of the essential fact of the benchmark under consideration for the purpose of Article 12.8.

ANNEX B-2

UNITED STATES RESPONSE TO QUESTIONS FROM THE PANEL AT THE SECOND MEETING

(4 April 2003)

Q1. Could the parties please comment on the relevance, if any, of footnote 36 to Article 10 in the context of Canada's pass-through claim, in particular Canada's assertion that the Agreement requires that the calculation of the subsidization rate of the investigated product must be accurate.

Reply

1. As the United States has previously noted[1], Article 10 of the WTO *Agreement on Subsidies and Countervailing Measures* ("SCM Agreement") provides a general obligation to impose countervailing duties in conformity with the obligations in the SCM Agreement. The general definition of a countervailing duty in footnote 36 to Article 10 does not alter that general obligation. By defining the term "countervailing duty" as "a special duty levied for the purpose of offsetting any subsidy", footnote 36 to Article 10 complements Article 19.4 of the SCM Agreement, which, as the United States has previously noted[2], establishes the subsidy found to exist as an upper limit on the amount of the countervailing duty that may be levied.

2. The definition of a countervailing duty in footnote 36 does not, however, impose any obligations regarding how the existence of a subsidy is to be determined. Furthermore, the general definition of "countervailing duty" cannot override the more specific provision of Article 19.3 of the SCM Agreement, which permits the imposition of countervailing duties on non-investigated exporters of the subject merchandise. As the United States has explained throughout this proceeding[3], subjecting uninvestigated companies to countervailing duties does not constitute an impermissible presumption that those companies received a subsidy benefit. Article 19.3 permits Members to apply countervailing duties to exports from companies that were not individually investigated, and Members routinely do so. Moreover, Article 19.3 clearly contemplates that Members may apply countervailing duties to such companies even though they may not have received any subsidy benefit or may have received a subsidy benefit significantly lower than the rate applied.[4]

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[1] *See* First Written Submission of the United States, fn. 213 (22 January 2003) ("US First Written Submission").

[2] *Id.* at para. 96, fn. 213; Answers of the United States to the Panel's Questions, para. 30 (24 February 2003) ("US First Response to Panel Questions"); Second Written Submission of the United States, para. 56 (6 March 2003) ("US Second Written Submission"); Oral Statement of the United States at the Second Meeting of the Panel, para. 34 (25 March 2003).

[3] *See* US First Written Submission, at para. 109; Oral Statement of the United States at the First Meeting of the Panel, para. 33 (11 February 2003) ("US First Oral Statement").

[4] As discussed in our previous submissions, Article 19.3 simply obligates Members to provide expedited reviews for such companies to calculate individual subsidy rates, and these reviews are currently underway in this case. *See, e.g.*, US First Oral Statement, at para. 34.

3. In its preliminary response to this question at the second substantive meeting of the Panel, Canada referenced the panel and Appellate Body reports in *United States – Lead and Bismuth*.[5] The underlying measures at issue in those reports, however, were the final results of administrative reviews conducted with respect to particular companies, and the issue under consideration was whether those particular companies had received subsidies. The focus on whether the particular companies involved received subsidies is inapposite here because the measure at issue in this case is the final determination in an investigation and, as discussed above, Article 19.3 of the SCM Agreement clearly contemplates the imposition of countervailing duties on non-investigated exporters. Thus, the reports that Canada cited are not relevant to this dispute.

Q2. Is it relevant to the interpretation of Article 14(d), in particular its reference to "in the country of provision", that Articles 14(b) and 14(c) contain no similar reference?

Reply

4. All of the guidelines in Article 14 of the SCM Agreement address the determination of whether a benefit has been conferred, i.e., whether the recipient is better off with the government's financial contribution than it would otherwise have been absent the financial contribution. The guidance in each subparagraph is tailored to the type of financial contribution at issue.

5. Articles 14(b) and (c) provide that the benefit from a government loan or loan guaranty must be determined by comparison to a "comparable commercial" loan that "the firm could actually obtain on the market" or the amount that the firm would pay on a "comparable commercial" loan absent the government guarantee. In conducting the analysis, neither Article 14(b) or (c) requires any examination of financial markets in the country under investigation, or any adjustments, before using lending rates from sources outside the country under investigation.

6.. Article 14(d), like the other provisions of Article 14, must answer the basic inquiry of whether the recipient is better off than it would otherwise have been absent the government's financial contribution. In accordance with the findings of the Appellate Body[6], the point of comparison under Article 14(d) is, as always, the "market". Thus, the point of comparison must be a market-determined price undistorted by the government's financial contribution. Article 14(d) requires that adequate remuneration be determined "in relation to prevailing market conditions . . . in the country of provision". In light of that language, the most probative evidence of adequate remuneration is actual market-determined prices in the country of provision. That language is not, however, a directive to use price data solely from sources in the country of provision in all cases. Where there are no reliable "market" prices in the country of provision, price data from sources outside the country of provision may form the basis for the adequate remuneration analysis. In such cases, however, adjustments must be made, as necessary, to relate the analysis to conditions of sale "in the country of provision."

Q3. Why, in the US view, are US stumpage prices broadly representative of market conditions in Canada? What is the motivation or incentive for Canadian harvesters to cut timber in the US, at much higher cost than in Canada, especially in the light of the abundant (in the US view, unlimited) supply of Crown timber? Would such purchases be typical, or instead essentially exceptional?

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[5] *See* Appellate Body Report, *United States – Imposition of Countervailing Duties on Certain Hot-Rolled Lead and Bismuth Carbon Steel Products Originating in the United Kingdom*, WT/DS138/AB/R, adopted 7 June 2000; Report of the Panel, *United States – Imposition of Countervailing Duties on Certain Hot-Rolled Lead and Bismuth Carbon Steel Products Originating in the United Kingdom*, WT/DS138/R, adopted 7 June 2000.

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

7. As the United States has noted previously[7], when the market, rather than the government, sets timber prices, it does so based on the value of the downstream product, lumber. The North American lumber market is highly integrated. Thus, timber values in both Canada and the United States are driven by the same demand for lumber, and, in fact, 60 per cent of all Canadian lumber is exported to the United States. Canada does not enjoy a comparative advantage. As discussed in our prior submissions,[8] the timber supply in the United States is comparable to Canadian timber, and the United States used species-specific benchmarks to account for any differences in species mix. The US timber prices are therefore broadly representative of the fair market value of timber in Canada. While there are some differences in conditions of sale, those differences were accounted for in the benchmark calculation.[9]

8. Furthermore, it is undisputed that Canadian mills can and do purchase US timber.[10] Given the wide availability in Canada of Crown timber at below-market rates, these purchases are relatively infrequent, especially outside of Quebec, but they do occur for a number of reasons, such as local availability or related-party transactions.[11] While the supply of Crown timber in Canada is not "unlimited," the availability of additional supply in each province affects the marginal price that Canadian mills will pay for timber from other sources, and thus the volume of Canadian purchases of US timber is doubtless much less than it would be, but for the Canadian subsidies. At the same time, the fact that some transactions occur demonstrates that US timber prices are in fact commercially available to Canadian mills.

Q4.. In paragraph 40 of its second oral statement, Canada argues that "the fundamental basis for Commerce's rejection of in-country evidence was its reliance on the Preamble to its Regulations to presume price suppression". According to the parties, does the Preamble provide for such a presumption in case of dominant position by the government? According to the parties, did the USDOC interpret the Preamble to imply a presumption against the use of market data where the government holds a dominant position in the market? (See for example p. 37 CDA-1 or p. 58: "The preamble to section 351.511 of the Regulations provides that, where a government has a dominant position in a market, the Department will avoid the use of private prices in determining the adequacy of remuneration. Where the market for a particular good is so dominated by the presence of the government, the remaining private prices in the country in question cannot be considered to be independent of the government price").

Reply

9. Under the US regulations, the preferred benchmark for determining adequate remuneration is actual market-determined prices in the country under investigation. The Preamble states that, where such prices exist, the US Department of Commerce normally will not account for government distortion of the market. Thus, the presumption is that government involvement in the market does *not* affect the use of in-country prices. The Preamble does recognize, however, that government distortion of the market may be significant where the government has a majority share of the market.

[7] *See* US First Written Submission, at para. 79.

[8] *Id.* at paras. 77-84 and fn. 106.

[9] *Id.* at paras. 77-84 and fn. 59; US Second Written Submission, at paras. 46-50; US First Response to Panel Questions, at paras. 11-13.

[10] *See* US First Written Submission, at para. 80, fn. 104.

[11] Quebec's forestry consultants report that much of the Maine timber harvested by Quebec lumber producers is taken from Maine timberlands owned directly by Canadian companies. *See* Del Degan, Massé et Associés Inc., *The Private Forest Standing Timber Market in Québec*, 91 (July 2001), appended to Response of the Government of Quebec to the Department's 25 June 2001 Questionnaire, volume 3, Exhibit QC-S-100 (3 August 2001) (Exhibit CDA-29).

Rejection of actual in-country prices is limited, however, to cases "where it is reasonable to conclude that actual transaction prices are significantly distorted as a result of the government's involvement in the market . . .".[12] Thus, the Preamble does not "presume" price suppression on the basis of the government's market share. The United States' application of its regulations in this case was consistent with that policy.

10. The specific statements from the *Final Determination* referenced in the Panel's question should not be viewed out of context. First, the statements were intended to paraphrase the Preamble itself, which, as noted above, does not establish a presumption that in-country prices are distorted whenever the government has a majority share of the market. Second, it is evident from the *Final Determination* that the United States did not, in fact, simply presume that private prices in Canada were distorted as a result of the provincial governments' 90 percent market share. The provinces' dominant market share was sufficient to raise the potential for significant distortion of private prices. Consistent with the Preamble, however, the United States relied on record evidence that established that the private prices in Canada were distorted by the government's dominant role in the market. That evidence was discussed in the *Final Determination*, in the general benefit section and in the province-specific sections.[13] Had the United States employed a presumption of distortion, such evidence would have been irrelevant.

Q5. The US argues that any overstatement of the subsidy amount due to arms' length transactions for logs between timber harvesters and lumber producers is now being addressed through individual expedited reviews being conducted by the USDOC. Could the US please explain how, if at all, such individual reviews affect the overall aggregate subsidization calculation. That is, does the aggregate subsidization rate remain the same, or is it recalculated to exclude the relevant amounts from the numerator, the denominator, or both, of subsidy amounts attributed to, and sales by, the individual firms subject to expedited review?

Reply

11. This is an issue actively under consideration by the United States in the ongoing expedited reviews. The reviews are being conducted, and this issue will be addressed, consistent with the United States' obligations under the SCM Agreement.

Q6. Could the US respond to the statistics referred to in paragraph 57 of Canada's oral statement, i.e., that the US recognizes that in British Colombia, 24 per cent of Crown timber was harvested by entities that do not own sawmills, and that scores of producers purchased their log and lumber inputs in arms'-length transactions from independent harvesters and other entities.

[12] *Issues and Decision Memorandum: Final Results of the Countervailing Duty Investigation of Certain Softwood Lumber Products from Canada*, 59 (21 March 2002) ("*Issues and Decision Memorandum*") (Exhibit CDA-1), quoting *Countervailing Duties, Final Rule*, 63 Fed. Reg. 65348, 65377 (25 November 1998) ("Preamble").

[13] *Id.* at 36-38, 58-59, 95-98. *See also* US First Written Submission, at paras. 68-72; US Second Written Submission, at paras. 33-45.

Reply

12. First, Canada's statistical reference to the percentage of British Columbia ("B.C.") Crown timber "harvested by entities that do not own sawmills" is misleading. Obviously, entities in B.C. that do not own sawmills (e.g., pulp mills) harvest Crown timber. The subsidy was calculated, however, based solely on the volume of softwood timber that actually entered sawmills. Thus, the portion of the harvest that did *not* enter sawmills is irrelevant. The vast majority of the timber entering sawmills came from the mill's own tenure.

13. Moreover, the statistics referred to in paragraph 57 of Canada's oral statement at the second substantive meeting of the Panel are inconsistent with the record evidence provided by B.C. itself. As the United States explained in its second written submission, more than 83 per cent of the B.C. Crown softwood timber harvest is provided to holders of four types of B.C. tenures. Each of these tenures requires the tenure holder to own a processing facility (for these purposes, a sawmill) and process the harvested timber (or an equivalent volume) in its own mill.[14] In addition, another 4.6 per cent of the harvest is allocated under section 21 of the Small Business Forest Enterprise Programme ("SBFEP"), which imposes requirements that have effects similar to explicit mill ownership requirements.

14. The remaining B.C. Crown timber is provided under licenses that are normally reserved (with some case-by-case exceptions) to entities not owning timber processing facilities. These include SBFEP Section 20 licences (7 per cent of the softwood timber harvest) and woodlot licenses (2 per cent of the softwood timber harvest). However, there are a number of legal restrictions (e.g., local processing requirements) that call into question whether any transactions for the timber covered by these tenures could be considered to be at "arm's-length". Moreover, as B.C. stated: "For the most part, loggers operate as employees or contractors for holders of private lands or Crown tenures".[15]

15. Finally, as noted above, tenure holders are required to process the timber they harvest, or an equivalent volume, in their own mills. Thus, many of the alleged arm's-length sales are, in fact, simply log trades or swaps among tenure holders. Thus, Canada's claims referenced in the Panel's question are not supported by the record.

Q7. Could the US respond to the argument in paragraph 61 of Canada's statement that the US positions in respect of pass-through and specificity are internally inconsistent.

Reply

16. Canada prefaces its erroneous assertion of an inconsistency on the flawed premise that what is at issue is a "subsidy on standing timber".[16] The subsidy at issue, however, is a subsidy to lumber producers, including remanufacturers. Specifically, the subsidy is the provision of provincial timber for less than adequate remuneration.

[14] *See* US Second Written Submission, at fn 48, citing Response of the Government of British Columbia to the Department of Commerce's 1 May 2001 Questionnaire, vol. 9, Exhibits BC-S-59 at section 1.02, BC-S-62 at section 15.01, BC-S-63 at section 14.01 (28 June 2001) ("B.C. 28 June Questionnaire Response") (Exhibit US-76). *See also* US First Written Submission, at fn. 137, citing *United States – Lumber Preliminary Determination with Respect to Certain Softwood Lumber from Canada*, Answers of the United States of America to the Panel's 26 April 2002 Questions, paras. 2-3 (8 May 2002) ("US Response to *US – Lumber Preliminary Determination* Panel's Questions") (Exhibit US-37).

[15] *See* US Response to *US – Lumber Preliminary Determination* Panel's Questions, at para. 3 (Exhibit US-37), quoting B.C. 28 June Questionnaire Response, at vol. 15, BC-LER-45.

[16] Oral Statement of Canada at the Second Substantive Meeting of the Panel, para. 60 (25 March 2003).

17. Remanufacturers use provincial tenures and were included in the United States' specificity determination. As stated in the *Final Determination*:

> Benefits under these Provincial stumpage [programmes] are limited to those companies and individuals specifically authorized to cut timber on Crown lands. These companies are pulp and paper mills and the saw mills and *remanufacturers* which are producing the subject merchandise. This limited group of wood product industries is specific under section 771(5A)(D)(iii)(I) of the Act.[17]

Article 2.1(c) of the SCM Agreement provides that a subsidy is specific if it is used by a limited number of enterprises, industries, or group of industries. The subsidy at issue is the provision of Crown timber for less than adequate remuneration. Thus, the analysis of whether the subsidy is specific properly focused on the holders of provincial tenures.

18. The benefit calculation was not in any way inconsistent with the specificity determination. As the United States has explained previously, it conducted this investigation on an aggregate basis. The aggregate methodology is consistent with the SCM Agreement and Canada has not argued to the contrary. In an aggregate investigation, the United States determines the total amount of the subsidy provided during the period of investigation to producers of the subject merchandise (the numerator), then allocates the total subsidy across all of those producers (the denominator).

19. The subject merchandise, lumber, is produced both by primary mills ("sawmills") and secondary mills ("remanufacturers"). The numerator was therefore based on the total volume of Crown logs entering sawmills.[18] Likewise, both remanufacturers and sawmills were included in the denominator of the ad valorem subsidy rate calculation, i.e., a portion of the subsidy benefit was allocated to remanufacturers. Allocation of the total subsidy to producers of the subject merchandise (sawmills and remanufacturers) does not constitute an impermissible presumption that any individual producer received a portion of the subsidy. In fact, Article 19.3 of the SCM Agreement specifically provides for the imposition of duties without determining company-specific rates in an investigation.

20. There is, therefore, no inconsistency in the United States' positions with respect to specificity and the allocation of the subsidy.

Q8. At para. 32 of the US second submission, the US states that the data on private stumpage prices in Ontario and Quebec highlight that "prices that are distorted by the government's financial contribution do not reflect 'market' conditions". Could the US please explain in what way this price information demonstrates this.

Reply

21. In paragraph 32 of its second written submission, the United States was not suggesting that the price data from Ontario and Quebec proves the distortion. Rather, the United States was noting that, in light of other evidence demonstrating that those prices are distorted by the government's financial contribution, they cannot serve to measure the subsidy benefit. The evidence that the

[17] *Issues and Decision Memorandum*, at 52 (emphasis added) (Exhibit CDA-1).

[18] As noted previously, the United States did not include the volume of Crown logs from tenures held by remanufacturers in the numerator due to a lack of available data. *See* US First Written Submission, at para. 104, fn. 134; US First Response to Panel Questions, at para. 36, fn. 47.

provincial tenure systems distort the small private sector timber sales is discussed in the *Final Determination* and in the United States' prior submissions to the Panel.[19]

Q9. Could the US respond to the argument at paragraph 40 of Canada's statement that the US took a selective approach to the record evidence in reaching its determination that Canadian private stumpage prices were distorted by the provincial stumpage programmes.

Reply

22. The United States considered all of the evidence presented. As we have noted previously, evidence that Canada claims the United States ignored was, in fact, considered, but found unpersuasive.[20] Where the parties submit evidence in support of opposing views, it is the role of the investigating authority to weigh that evidence and draw a conclusion. In that respect, an investigating authority must, in the end, select the evidence it finds persuasive and on which it will rely. Article 22.5 of the SCM Agreement requires that a final determination include "all relevant information on the matters of fact and law and reasons which have led to the imposition of final measures," including the reasons for the acceptance or rejection of relevant arguments or claims made. The United States did so in the 164 page *Final Determination*, and Canada has not claimed that the United States' determination is inconsistent with Article 22.5 of the SCM Agreement.

Q10. Could the US please elaborate on its reference to Article 14 as containing "guidelines", and not "detailed rules". Is the US suggesting that the reference to "guidelines" in the chapeau of Article 14 means that where the word "shall" appears in subparagraphs (a) through (d) of Article 14, it is less than fully binding?

Reply

23. Article 14 of the SCM Agreement expressly states that it contains "guidelines" that Members must follow in calculating a subsidy benefit. While the guidelines are binding, they are, nonetheless, guidelines rather than detailed rules. A "guideline" is a general principle to guide the development of policies and procedures.[21] The guidelines in Article 14 are quite distinct from the types of detailed rules found elsewhere, such as in Article 2 of the *Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994* ("Antidumping Agreement"). Article 2 of the Antidumping Agreement specifies how to perform dumping calculations and the particular data that must be used for specific purposes. As discussed in our prior submissions,[22] Article 14(d) of the SCM Agreement provides that the adequate remuneration analysis must relate to prevailing market conditions in the country of provision, but does not specify the methods for doing so or the types of data that may be used. Thus, where there are no market-determined benchmark prices in the country of provision, a Member may, consistent with the guideline set out in Article 14(d), rely on prices from sources outside the country of provision, provided that adjustments are made, as necessary, to relate the adequate remuneration determination to conditions of sale in the country of provision.

[19] *See, e.g.*, US First Written Submission, at paras. 68-76; US Second Written Submission, at paras. 33-44. *See also Issues and Decision Memorandum*, at 36-38, 57-59, 75-77, 95-98, 109-111, 128-129, 137 (Exhibit CDA-1).

[20] *See* Closing Statement of the United States at the First Meeting of the Panel, para. 6 (12 February 2003); US Second Written Submission, at paras. 40-43.

[21] *See The New Shorter Oxford English Dictionary*, 1159 (1993) (defining "guideline" as "a directing or standardizing principle laid down as a guide to procedure, policy, etc.") (Exhibit US-12).

[22] *See, e.g.*, US First Written Submission, at para. 46.

24. Moreover, Canada concedes that a price that is available to purchasers in the country of provision is part of the prevailing market conditions in the country of provision.[23] As discussed below in response to question 11, US timber prices are available to lumber producers in Canada.

Q11. Could the US comment on Canada's argument at para. 28 of its second submission concerning the third benchmark in Section 351.511 of the USDOC Regulations. In particular, could the US comment, first, on Canada's argument that there are no world market prices for stumpage, and second, on Canada's position that the evidence shows that provincial stumpage programmes are operated in a manner consistent with market principles, as foreseen by the USDOC Regulations.

Reply

25. Under the US regulations, the second tier in the benchmark hierarchy states:

> If there is no useable market-determined price with which to make the comparison under paragraph (a)(2)(i) . . . the Secretary will seek to measure the adequacy of remuneration by comparing the government price to a world market price where it is reasonable to conclude that such price *would be available to purchasers in the country in question*. Where there is more than one *commercially available* world market price, the Secretary will average such prices to the extent practicable, making due allowance for factors affecting comparability.[24]

As used in the US regulation and in prior determinations, the term "world market price" simply means a price for the good or service from a source outside the country under investigation.[25] However, only world market prices that are commercially available to purchasers in the country under investigation fall within the ambit of the second tier of the regulation.[26]

26. Availability is a case-by-case factual determination. As the United States has discussed in its prior submissions[27], the record demonstrates that prices for US timber are commercially available to lumber producers in Canada. Canada argues that US timber prices are not available to purchasers in Canada because the trees must be harvested in the United States. Under Canada's reasoning, FOB US factory prices are not available to purchasers in Canada because the purchaser must take delivery in the United States. The reality is, however, that when Canadian lumber producers need wood fibre, they can (and occasionally do) purchase US trees. They take delivery in the United States, but they transport the harvested timber to Canada and process it in Canadian mills. The prices for US timber are therefore available to purchasers in Canada.

27. Canada also argued that the US prices are not available to purchasers in Canada because of log export restrictions. However, the vast majority of timber in the United States is privately held, and none of the privately held timber is subject to export restrictions. These private timber sales are the primary driver of US stumpage fees in the timber market overall. The export restrictions that Canada refers to are limited to public timber in Western states. As the United States explained in the

[23] S*ee* Second Written Submission of Canada, para. 41 (6 March 2003).

[24] 19 C.F.R. § 351.511(a)(2)(ii) (emphasis added) (Exhibit US-14).

[25] The provision for averaging multiple world market prices reflects the fact that the term "world market price" is not being used narrowly, i.e., it is not restricted to commodities with a single worldwide price.

[26] The Preamble to the US regulations illustrates the importance of commercial availability by noting that prices for electricity in Europe are not likely to be an appropriate basis for determining the value of electricity in Latin America because the electricity "in all likelihood would not be available to consumers in Latin America." *Issues and Decision Memorandum*, at 35 (Exhibit CDA-1), citing Preamble, 63 Fed. Reg. at 65377.

[27] *See, e.g.*, US First Written Submission, at para. 80.

Final Determination, however, that public timber is sold through open and competitive public auctions in which most purchasers have the choice of buying public or private stumpage. The auction prices for public timber therefore reflect market prices generally, including private timber prices commercially available to purchasers in Canada.[28]

28. The US regulations provide that "[i]f there is no world market price available to purchasers in the country in question", the adequacy of remuneration will normally be determined by assessing whether the government price is consistent with market principles.[29] Where commercially available world market prices exist, as in this case, analysis under the third tier of the US regulations is unnecessary. If the government price is less than the market benchmark price, it is, by definition, less than adequate remuneration.

29. The fact that the provincial stumpage prices are below the market benchmark price contradicts Canada's claim that the provincial stumpage programmes are operated in a manner consistent with market principles. That benchmark comparison is all that is necessary to establish the existence of a benefit, consistent with Article 14(d). Nevertheless, as discussed in our prior submissions,[30] other evidence demonstrates that the provincial tenure systems are based on public policy objectives, not market principles. Moreover, the United States disagrees with Canada's argument that evidence that British Columbia makes a profit on its timber sales is sufficient to find that government prices are based on market principles. A government price below fair market value – even a profitable one – is not based on market principles.[31]

Q12. What is the basis for the US statement in footnote 40 that the reports on the profits earned by provinces on their timber sales implicitly account for the cost to the government of trees as $0?

Reply

30. Footnote 14 of the United States' oral statement provides the relevant citation to B.C.'s questionnaire response, which can be found at Exhibit CDA-48. With respect to Alberta, Ontario, and Quebec, the United States directs the Panel's attention to pages 10, 11, and 12 of Exhibit CDA-47. The "profit" calculation in Exhibit CDA-48 is the basis for Canada's claim that B.C. prices timber in accordance with market principles. The only costs incurred by B.C. included in this calculation, however, are current administrative expenses.[32] Nowhere in the calculation is there a figure for the value of the trees themselves. Thus, the calculation effectively values the trees at zero. The information set forth in Exhibit CDA-47 suffers from the same infirmity.

Q13. The US, at paras. 83-85 of its second submission, in the context of Canada's Article 12.8 claim, emphasizes the words "essential facts under consideration". The complete phrase from Article 12.8, however, is "essential facts under consideration *which form the basis for the*

[28] *See Issues and Decision Memorandum*, at 44 (Exhibit CDA-1).

[29] The Preamble to the regulations states that "[i]n our experience, these types of analyses may be necessary for such goods or services as electricity, land leases or water." *Id.* at 35 (Exhibit CDA-1), citing Preamble, 63 Fed. Reg. at 65377-78. All of the cases that Canada cited with respect to US practice concerning the third tier in the regulatory hierarchy involved the provision of electricity or other types of goods or services (port facilities; railway "hopper car" services) for which there was no evidence of world market prices commercially available to purchasers in the country under investigation.

[30] *See* US First Written Submission, at paras. 69-70; US Second Written Submission, at paras. 35-38.

[31] *See also* US response to Question 12, below.

[32] The calculation includes current expenses for "silviculture," "roads and bridges," "protection," "timber sales costs," and "sustainable forest management." *See* B.C. 28 June Questionnaire Response, at Exhibit BC-S-111 (Exhibit CDA-48). *See also* PricewaterhouseCoopers, *Report on Revenues and Expenditures of Certain Canadian Provinces Relating to Stumpage Operations*, 10-12 (25 June 2001) (Exhibit CDA-47).

***decision* whether to apply definitive measures". The US implies in its arguments that Canada's interpretation of Article 12.8 would require, essentially, disclosure of the entire final results before the final determination was actually made. Under the facts of this case, could the USDOC simply have informed the parties, before issuing its final determination, that it was considering changing the comparison state to Minnesota, and allowing the parties a brief period to comment? Does the US consider that such a disclosure would be equivalent to issuing the entire final determination in advance? Please comment, and explain any reasons why such an approach would not have been possible, if this is the US view.**

Reply

31. The parties challenged the decision to use Montana in their case briefs, which were submitted one month before the *Final Determination* was issued. We have no basis on which to determine when, in response to those comments, the United States first considered changing to Minnesota. Thus, we cannot speculate on whether there would have been sufficient time to request, receive, and analyze additional comments.[33]

32. Moreover, it is the view of the United States that Article 12.8 did not require additional opportunity for comment. The very purpose of notice and comment is to afford parties the opportunity, as they had in this case, to persuade the investigating authority to take specific positions. There may be many issues on which an investigating authority considers changing its mind in response to comments from the parties, but ultimately does not do so; in other instances the investigating authority may change its mind. Nothing in Article 12.8 of the SCM Agreement requires an ongoing notification of that deliberative process. Furthermore, Article 12.8 does not preclude an investigating authority from altering a final decision in response to parties' comments without affording further opportunity to comment. Reading such an obligation into Article 12.8 would undermine the very purpose of notice and comment. The investigating authority could effectively be precluded from altering a decision in response to comments in many instances because of the obligation to complete what is often a very complex investigation within a specified period.

33. Article 12.8 simply requires that a certain result be achieved, i.e., that interested parties be informed of the essential facts under consideration which form the basis of the decision whether to apply definitive measures in time to defend their interests. Article 12.8 does not require any specific procedure for achieving the required result. To determine whether that result has been achieved in a particular case, it is necessary to view the process as a whole.

34. Because Article 12.8 addresses events "before a final determination is made," it cannot be read as requiring pre-notification of the final determination. In this case, where the parties had ample opportunity to defend their interests, Canada's position is equivalent to a requirement to issue a pre-notification of the final decision with respect to the benchmark state (and, by logical extension, pre-notification of the final decision with respect to all issues for which the final decision differed in any respect from the preliminary determination).

35. It is evident from the record of the investigation that the parties had ample notice and opportunity to defend their interests. First, the record establishes that the parties knew that the United States was considering a US state as the basis for the market benchmark and knew the United States' preliminary choice of benchmark state. The parties also knew that the benchmark state would be

[33] This was a very complex investigation and the *Final Determination* required the United States to weigh the evidence and make decisions on a substantial range of issues. Thus, if the United States initially focused on other issues or other provinces, it is possible that specifically identifying Minnesota as being under consideration, in time for parties to submit additional comments on the benchmark determination, would have been precluded as a practical matter.

selected from evidence on the record and that the record only contained evidence on Washington, Idaho, Montana, North Dakota, Minnesota, Michigan, New York, Vermont, New Hampshire, Maine, and Alaska.[34]

36. Second, the parties knew the criteria that the United States would use to select the benchmark state, which included species mix, climate, and topography.[35] Saskatchewan obviously did not believe that the potential pool of states was limited by contiguousness, given that Saskatchewan itself proposed Alaska, a non-contiguous state, as an alternative.

37. Third, the parties were aware of all of the data on each state under consideration, including those not selected in the preliminary determination. And finally, the parties were aware of the arguments presented by all other parties concerning the appropriate comparison state.

38. The parties received all of this information in sufficient time to defend their interests, as evidenced by their case and rebuttal briefs. It is therefore evident that the only thing the interested parties did not know in this case was the United States' final decision *after* considering the essential facts and the comments of the parties.

Q14. Could the US respond to the argument at paragraph 82 of Canada's oral statement, that new evidence from the petitioners' 4 March 2002 submission was in fact used by the USDOC in its subsidy calculations for Quebec.

Reply

39. Canada's argument at paragraph 82 of its oral statement relates to footnote 151 of the United States' second written submission. That footnote states, in its entirety:

> Moreover, the 4 March 2002 letter primarily commented on the MFPC Letter and provided an analysis of information that Quebec had placed on the record on January 4, 2002. Although the United States *considered petitioners' March 4 rebuttal comments, it did not rely on the information provided.* The United States instead relied on a publication by the US Department of Agriculture, which was already on the record. *See Issues and Decision Memorandum*, at 62 (Exhibit CDA-1).[36]

As demonstrated below, this statement is accurate with respect to the issue of the use of studwood in Maine for lumber production.

40. In its December 20, 2001 letter, the Maine Forest Products Council ("MFPC") contended that it was inappropriate for the United States to use only sawlog prices to calculate stumpage prices from Maine.[37] The MFPC proposed a weighted average stumpage price, including prices for pulpwood and studwood in the calculation.[38] The MFPC proposed that studwood account for approximately 74 per cent of the weighted-average stumpage price.[39] The petitioners responded to this proposal on

[34] *See* US First Response to Panel Questions, at para. 52; US Second Written Submission, at para. 88.
[35] *See* US First Response to Panel Questions, at para. 52; US Second Written Submission, at para. 88.
[36] US Second Written Submission, at para. 91, fn. 151 (emphasis added).
[37] *See* Letter from MFPC to Deputy Assistant Secretary Bernard Carreau, 1 (20 December 2001) ("MFPC Letter") (Exhibit CDA-100).
[38] *Id*. at 2.
[39] *Id*. at 5.

4 March 2002, submitting a report by Lloyd C. Irland, which contended that the proportion of studwood in the Maine harvest is substantially lower than that alleged by the MFPC.[40]

41. Thus, the main issue addressed by the MPFC Letter and the petitioners' 4 March 2002 submission was the percentage of the timber used in lumber production in Maine that was studwood. As explained in its *Issues and Decision Memorandum*, the United States made independent enquiries of the Maine Forest Service ("MFS") to identify the names of the four softwood studmills operating in Maine and analyzed their production from a US Department of Agriculture report previously placed on the record to arrive at studwood ratio of 25.36 per cent.[41]

42. As the United States acknowledged in its responses to the Panel's first set of questions[42], the petitioners' 4 March 2002 submission also included species-specific studwood stumpage prices that had not been placed on the record previously. The petitioners obtained these prices, however, from a public source, the MFS Stumpage Reports, which is the same source that the United States used in its preliminary determination in this case. Indeed, Quebec had access to this source and submitted aggregate studwood stumpage prices from the MFS in its January 4, 2002 submission.[43] The 4 March 2002 submission represented the only record source for species-specific studwood stumpage prices for Maine, and, in order to make the calculation as accurate as possible, the United States used these prices from the 4 March 2002 submission in its calculations of the market-based benchmarks for Quebec. The United States also used species-specific information from the March 4, 2002 submission pertaining to the total volume of sawlogs harvested in each county of Maine.

Q15. Could the US please respond to the argument in para. 67 of Canada's second submission, in which Canada seems to imply that the US argues that the SCM Agreement contains no obligation to *correctly* calculate the rate of subsidization. Is this the US argument? Alternatively, is the US arguing that there is such an obligation, but that it simply is not found in SCM Article 19.4? If the latter is the US position, in which specific provision(s) of the SCM Agreement does the US consider that this obligation is found?

Reply

43. It is the position of the United States that, although there are obligations in the SCM Agreement concerning the calculation of the subsidy, there are no such obligations in Article 19.4 of the SCM Agreement. Article 19.4 simply provides that the duty may not exceed the subsidy found to exist. This was confirmed by the Appellate Body, which recently stated that Article 19.4 "set[s] out the obligation of Members to limit countervailing duties to the amount . . . of the subsidy found to exist by the investigating authority."[44]

44. Article 19.4 does not establish the methodological obligations that Canada alleges. For example, there is no obligation in Article 19.4 to allocate the subsidy on a volume, as opposed to value, basis, and there is no basis in Article 19.4 to read into the SCM Agreement a host of undefined obligations with respect to the calculation of the rate of subsidization. What constitutes a "correct" calculation can only be determined by reference to the explicit obligations in the Agreement.

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[40] *See* Lloyd C. Irland, *Estimates of Maine Spruce-Fir Log Production by Grade, 2000* (March 2002), Attachment 2 to Letter from Dewey Ballantine to Secretary of Commerce Donald Evans (4 March 2002) (Exhibit CDA-112).

[41] *See Issues and Decision Memorandum*, at 61 (Exhibit CDA-1).

[42] *See* US First Response to Panel Questions, at para. 56, fn. 72.

[43] *Id.* at para. 56, fn. 71.

[44] Appellate Body Report, *United States – Countervailing Measures Concerning Certain Products from the European Communities*, WT/DS212/AB/R, para. 139, adopted 8 January 2003.

45. Various provisions of the SCM Agreement are relevant to Members' obligations to calculate the ad valorem subsidy rate. Article 14, for example, establishes obligations concerning the calculation of the amount of the benefit. Annexes II and III provide guidelines on when indirect tax rebate, duty deferral, and duty drawback programmes can provide a benefit and thereby constitute an export subsidy. Annex IV provided specific rules for the calculation of the ad valorem subsidy rate with respect to the determination of whether serious prejudice existed as defined by the now lapsed Article 6.1(a) of the SCM Agreement.

46. In addition to these obligations, the calculation of the ad valorem subsidy rate must have evidentiary support and a reasoned basis. Article 22.5 obligates Members to provide public notice of all relevant information of matters of fact and law and the reasons that led to the imposition of final measures.

47. Moreover, many of the alleged "obligations" that Canada contends are established by Article 19.4 are in reality questions of fact. For example, Canada's claims regarding the conversion factor and the exclusion of residual products from the denominator are in fact challenges to the United States' findings of fact. The Panel, however, is not charged with *de novo* review. As demonstrated in the *Final Determination*, the United States considered all of the relevant facts and provided a reasoned explanation for its conclusions.

Q16. Could the US please respond to the argument in para. 81 of Canada's second submission that the US excluded from the denominator "other softwood products that were also produced in the sawmill establishments from logs entering those sawmills"?

48. The United States has acknowledged that some of the products in the "residual products" category would have been included in the denominator had Canada provided the information necessary to determine the value of those products.[45] Canada, however, failed to do so. Canada merely provided a single number representing all shipments of products in the residual products category and a list of those products.[46] Canada did not provide any break-out of the residual product category that would have allowed the United States to include those products that resulted from the lumber manufacturing process. The residual products category clearly included products not produced by sawmills, such as spruce logs and other wood in the rough.

Q20. Canada argues, at para. 74 of its second submission, that the numerator in a subsidization calculation must reflect the proportional amount of the subsidy that can be attributed to the subject merchandise. In other words, Canada's argument seems to be that there must be a volume-based allocation of subsidy amounts among a firm's different products, before the rate of subsidization of the subject merchandise can be calculated.

(a) Is this a correct characterization of Canada's argument on this point? If not, please clarify.

(b) If this is a correct characterization of Canada's argument, how does Canada reconcile this with the fact that the *de minimis* rule for countervailing duties is expressed on an *ad valorem* basis in the SCM Agreement (e.g., Article 11.9)?

(c) Similarly, how does Canada reconcile this position with the fact that the Annex IV guidelines for calculation of *ad valorem* subsidization of a product, in the context of (now expired) Article 6.1(a) specifically require that this rate of subsidization be calculated using the total value of the firm's sales as the denominator of the subsidization equation, except in the case of a tied subsidy, in which case the denominator is the value of the firm's sales to which that subsidy is tied? (In other words, the general approach was

[45] *See* US Second Written Submission, at para. 63.
[46] *See* US First Response to Panel Questions, at para. 38.

that the total subsidy amount would be divided by the firm's total sales to arrive at the *ad valorem* subsidization of the product.) In what way, analytically, is this different from what the USDOC did in the Lumber investigation?

Reply

49. At the Panel's second substantive meeting, Canada preliminarily agreed that the chapeau to these questions was a correct characterization of its argument. Thus, Canada's claim is that to calculate the subsidy to lumber, the United States was required to allocate the total subsidy benefit based on volume rather than value. Article 19.4 of the SCM Agreement, however, does not contain an obligation to allocate a subsidy on the basis of volume rather than value. "The most logical conclusion to be drawn from this silence is that the choice . . . is up to the investigating authority".[47]

50. Whatever additional calculation steps Canada may propose to convert the subsidy amount to an ad valorem rate are irrelevant. Canada's methodology still presumes an obligation in the first instance to allocate the subsidy benefit based on volume, and no such obligation exists in the SCM Agreement.

[47] Panel Report, *European Communities – Anti-Dumping Duties on Imports of Cotton-Type Bed Linen from India*, WT/DS141/RW, circulated 29 November 2002, para. 6.87 (finding that because nothing in the text of Article 2.2.2(ii) of the Antidumping Agreement specified whether averages should be weighted by volume or value, the choice is up to the investigating authority); *see also id*. at para. 6.82, quoting Appellate Body Report, *India – Patent Protection for Pharmaceutical and Agricultural Chemical Products*, WT/DS50/AB/R, adopted 16 January 1998, para. 45.

ANNEX C

THIRD PARTY RESPONSES TO QUESTIONS FROM THE PANEL

ANNEX C

EUROPEAN COMMUNITIES RESPONSE TO QUESTIONS FROM THE PANEL AT THE THIRD PARTY SESSION

(24 February 2003)

Q1: Paragraph(2) of the preamble of the EC regulation 1973/2002 (Exhibit US-15) provides that that when "prices or costs do not exist or are unreliable, then the appropriate benchmark should be determined by resorting to terms and conditions in other markets" (emphasis added). What in the EC's view would be a situation:

(a) where prices or costs are unreliable and recourse could be had to market conditions in other markets?

(b) Where prices or costs do not exist and recourse could be had to market conditions in other markets?

Reply

1. The European Communities would first observe that the second preambular paragraph of Regulation 1973/2002 ("the amending Regulation") is referring to the issue addressed in the addition to Article 6(d) of Council Regulation (EC) 2026/97 ("the amended Regulation"). This addition provides as follows:

> If there are no such prevailing market terms and conditions for the product or service in question in the country of provision or purchase which can be used as appropriate benchmarks, the following rules shall apply:
>
> (i) the terms and conditions prevailing in the country concerned shall be adjusted, on the basis of actual costs, prices and other factors available in that country, by an appropriate amount which reflects normal market terms and conditions; or
>
> (ii) when appropriate, the terms and conditions prevailing in the market of another country or on the world market which are available to the recipient shall be used.

2. This language addresses the problem that arises where there are no "prevailing market terms and conditions" for a product or service. The second preambular paragraph of the amending Regulation states:

> It is prudent to provide for clarification as to what rules should be followed in cases where a market benchmark does not exist in the country concerned. In such situation the benchmark should be determined by adjusting the terms and conditions prevailing in the country concerned on the basis of actual factors available in that country. If this is not practicable because, *inter alia*, such prices or costs do not exist or are unreliable, then the appropriate benchmark should be determined by resorting to terms and conditions in other markets.

3. Sub-questions a) and b), as the European Communities understands them, are based on a distinction between situations where prices are unreliable and situations where prices do not exist. The European Communities would like to note that the preambular phrase "prices or costs do not exist or are unreliable" is merely an illustration of circumstances in which terms and conditions in the market of another country or on the world market would need to be used in accordance with the dispositive part of Article 6(d)(ii) of Council Regulation (EC) 2026/97.

4. As to the question in which situations recourse to terms and conditions outside the market of the country of export will be required, the European Communities regrets that it is not possible to indicate more precisely circumstances in which the criteria contained in Article 6(d) of Council Regulation (EC) 2026/97 as amended would be found to be met, because they have only entered into force in November 2002 and have not yet been tested in actual investigations.

Q2. Is it the view of the EC that market conditions exist where the government is the price leader, due to its market power, and the private players on the remaining market are mere price takers? Are the prices of the private players in such circumstances reliable in the view of the EC for purposes of establishing in-country market conditions?

Reply

5. Article 14(d) of the *SCM Agreement* envisages the use of "prevailing market conditions" as benchmark for "adequate remuneration". The European Communities notes that the term "price leader" is not provided for under the *SCM Agreement*. The expression "price leader" is broad and ambiguous. When used in the context of antitrust law, that notion might even refer to a provider who holds a significantly bigger market share in relation to all other suppliers, e.g., 20 per cent market as opposed to others with 1-5 per cent each. However, the mere existence of such "price leader" - be it the government or a private player - does not mean that there are no "prevailing *market* conditions" where prices are otherwise driven by demand and supply.

6. The European Communities considers that an assessment of whether there are exceptionally no prevailing *market* conditions must be made on a case-to-case-basis taking account of all the factors set forth in Article 14(d) of the *SCM Agreement*. Such assessment is complex and will differ considerably between the myriad types of products (industrial commodities, e.g., computers, renewable and non-renewable natural resources, e.g., lumber or oil) and different types of services. Therefore, it is difficult to elaborate general criteria.

7. However, as the European Communities pointed out already, where there is evidence for imports of a product in combination with a significant market share of private operators, a finding based on the mere generalisation that this market is distorted solely because the government is a price leader would not be sufficient.[1]

Q3. In its oral statement (para. 28), the EC states that the disclosure in a written document sent to the parties is "the usual practice" in the EC pursuant to Article 12.8 SCM Agreement. For the panel's information, what does the EC do in this respect when it does not follow that "usual practice"?

Reply

8. The European Communities confirms that disclosure of the essential facts and considerations on the basis of which definitive action will be taken is consistently made in writing.

[1] See, Third Party Submission by the European Communities, para. 32.

Q4. In noting, at paragraph 12 of its oral statement, that "the USDOC did not make a de jure specificity determination although certain stumpage programmes were restricted to certain enterprises owning saw mills", is the EC implying that the USDOC erred in not doing so?

Reply

9. The European Communities considers that the USDOC's specificity determination before the Panel is based on a flawed assessment of benefit and therefore did not consider it possible on the basis of the evidence available to it to comment on whether there is an additional violation of Article 2.1 of the *SCM Agreement*.

10. The European Communities simply wished to note that on the basis of the factual aspects of the case available to the European Communities, it would have seemed logical to explore first *de jure* specificity before resorting to the *de facto* test. However, the difference between a *de jure* or *de facto* determination is essentially one of evidence. A *de jure* case is based on the legislation pursuant to which the granting authority operates, whereas a *de facto* case requires the compilation of factual evidence concerning the use of the subsidy. It is essentially the choice of the investigating authority which avenue it pursues.

ANNEX D

REQUEST FOR THE ESTABLISHMENT OF A PANEL

ANNEX D

REQUEST FOR THE ESTABLISHMENT
OF A PANEL

WORLD TRADE ORGANIZATION

WT/DS257/3
19 August 2002

(02-4513)

Original: English

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

Request for the Establishment of a Panel by Canada

The following communication, dated 19 August 2002, from the Permanent Mission of Canada to the Chairman of the Dispute Settlement Body, is circulated pursuant to Article 6.2 of the DSU.

On 3 May 2002 the Government of Canada requested consultations with the Government of the United States concerning the initiation on 23 April 2001 of a countervailing duty investigation with respect to certain softwood lumber from Canada (*Lumber IV*) by the U.S. Department of Commerce (Commerce), and the affirmative final countervailing duty determination announced on March 21, 2002 and issued on March 25, 2002. This request (WT/DS257) was made pursuant to Article 4 of the Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU), Article XXII of the General Agreement on Tariffs and Trade 1994 (GATT 1994), and Article 30 of the Agreement on Subsidies and Countervailing Measures (SCM Agreement).

Canada and the United States held consultations on 18 June 2002 covering the initiation, the final determination, and the application of U.S. law concerning expedited reviews and company-specific administrative reviews in *Lumber IV*. These consultations failed to settle the dispute.

Canada therefore requests, pursuant to Articles 4 and 6 of the DSU, Article XXIII of GATT 1994 and Article 30 of the SCM Agreement, that a panel be established at the next meeting of the Dispute Settlement Body (DSB), to be held on 30 August 2002. Canada further requests that the panel have the standard terms of reference as set out in Article 7 of the DSU.

Finally, Canada requests that the panel consider the claims and find that the U.S. measures are inconsistent with U.S. obligations under the WTO Agreement, as set out below.

1. Initiation of the Investigation

In initiating the *Lumber IV* investigation, the United States violated Articles 10, 11.4 and 32.1 of the SCM Agreement. Specifically, contrary to Article 11.4, the initiation of the *Lumber IV* investigation was not based on an objective and meaningful examination and determination of the degree of support for the application by the domestic industry, because the "Continued Dumping and Subsidy Offset Act of 2000" (CDSOA), by requiring that a member of the U.S. industry support the application as a condition of receiving payments under the CDSOA, made impossible an objective and meaningful examination of industry support for the application.

2. Commerce's Final Countervailing Duty Determination

In making the final determination, the United States acted inconsistently with Articles 1, 2, 10, 12, 14, 19, 22 and 32 of the SCM Agreement and Article VI of GATT 1994. Specifically:

(a) Commerce violated Articles 10, 19.1, 19.4 and 32.1 of the SCM Agreement and Article VI:3 of GATT 1994 by imposing countervailing duties in respect of practices that are not subsidies because there is no “financial contribution” by government.

Commerce found that Canadian provincial stumpage programs provide goods or services and are, therefore, financial contributions by government under Article 1.1(a) of the SCM Agreement. Commerce erred in this finding. Canadian provincial stumpage programs do not constitute the provision of goods or services within the meaning of Article 1.1(a) of the SCM Agreement and are not “financial contributions” by a government;

(b) Commerce violated Articles 10, 14, 14(d), 19.1, 19.4 and 32.1 of the SCM Agreement and Article VI:3 of GATT 1994 by imposing countervailing duties in respect of practices that are not subsidies because there is no “benefit conferred”.

Commerce erred by:

(i) determining and measuring the adequacy of remuneration for the alleged provision of goods or services in relation to purported prevailing market conditions in a country other than the country of provision,

(ii) incorrectly assessing and comparing evidence related to those purported market conditions, and

(iii) rejecting evidence of prevailing market conditions for the alleged good or service in question in the country of provision within the meaning of Article 14(d) of the SCM Agreement;

(c) Commerce violated Articles 10, 19.1, 19.4 and 32.1 of the SCM Agreement and Article VI:3 of GATT 1994 by imposing countervailing duties in instances where no subsidy exists. Commerce erroneously and impermissibly *presumed* that an alleged subsidy passes through an arm=s-length transaction to a downstream user of an input;

(d) Commerce violated Articles 1.2, 2.1, 2.4, 10, 19.1, 19.4 and 32.1 of the SCM Agreement by imposing countervailing duties where the alleged subsidies are not “specific” within the meaning of Article 2 of the SCM Agreement.

Commerce erroneously and impermissibly made a finding of "specificity",

(i) based solely on the unsupported and incorrect assertion that only three industries use provincial stumpage, and

(ii) without taking into account the extent of diversification of economic activity within the jurisdiction of the alleged granting authority;

(e) Commerce violated Article 19.4 of the SCM Agreement and Article VI:3 of GATT 1994 by inflating the alleged subsidy rate through the use of impermissible methodologies, including by:

(i) calculating the alleged stumpage benefit on the basis of the whole softwood log, and then attributing that benefit to only a portion of the products produced from that log,

(ii) excluding relevant shipments from the denominator such that the numerator and the denominator of the alleged benefit calculation were not congruent,

(iii) allocating the total alleged stumpage benefit over a sales value that had been demonstrated on the record to be inaccurate, and

(iv) excluding from the denominator shipments of companies demonstrated to be unsubsidized; and

(f) Commerce violated Articles 10, 12, 22 and 32.1 of the SCM Agreement and Article X:3(a) of GATT 1994 because the investigation was not conducted in accordance with fundamental substantive and procedural requirements. In particular:

(i) Commerce refused to accept or consider relevant evidence offered on a timely basis, contrary to Article 12.1 of the SCM Agreement,

(ii) Commerce gathered and relied upon information not made available to the parties and not verified, contrary to Articles 12.2, 12.3, 12.5 and 12.8 of the SCM Agreement,

(iii) Commerce failed to address significant evidence and arguments in its determination, contrary to Article 22.5 (and Article 22.4 as it relates to Article 22.5) of the SCM Agreement,

(iv) Commerce failed to issue timely decisions and to provide reasonable schedules for questionnaire responses, briefings, and hearings, contrary to Articles 12.1, 12.2, 12.3 and 22.5 (and Article 22.4 as it relates to Article 22.5) of the SCM Agreement, and

(v) Commerce improperly applied adverse facts available to cooperative parties, contrary to Article 12.7 of the SCM Agreement.

3. Expedited and Administrative Reviews

(a) In initiating "expedited reviews" with respect to the *Lumber IV* investigation, the United States has violated Articles 10, 19.3, 19.4 and 32.1 of the SCM Agreement and Article VI:3 of GATT 1994 because:

(i) Commerce has failed to ensure that each exporter requesting an expedited review is granted a review and given an individual countervailing duty rate, and

(ii) Commerce's proposed methodology for calculating company-specific countervailing duty rates fails to properly establish an individual countervailing duty rate for each exporter granted a review.

(b) U.S. law specifically prohibits company-specific administrative reviews in aggregate cases. In conducting the *Lumber IV* investigation on an aggregate basis, the United States has therefore violated Articles 10, 19.3, 19.4, 21.1, 21.2 and 32.1 of the SCM Agreement and Article VI:3 of GATT 1994 because:

(i) Commerce is prohibited under U.S. law from conducting company-specific administrative reviews in this case except for companies with zero or *de minimis* rates, and

(ii) a rate obtained following an aggregate administrative review will replace any company-specific rates arrived at through the expedited review process.

WORLD TRADE ORGANIZATION

WT/DS257/R/Corr.1[1]
29 August 2003

(03-4443)

Original: English

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

Report of the Panel

Corrigendum

The following text should be added to the end of footnote 75 in document WT/DS257/R:

"In addition, prior to the first substantive meeting we ruled, in respect of three unsolicited *amicus curiae* briefs that were sent to us, that we would consider any arguments raised by *amici curiae* only to the extent that those arguments were taken up in the written submissions and/or oral statements of any party or third party."

[1] In English only

WORLD TRADE ORGANIZATION

WT/DS257/R/Corr.1[1]
29 August 2003

(03-4443)

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