

August 22, 2003

**Proposed Policies Regarding the Conduct of Changed Circumstance Reviews of the
Countervailing Duty Order on Softwood Lumber from Canada (C-122-839)**

Rebuttal Comments of the Coalition for Fair Lumber Imports

Comments of National Resources Defence Council, Defenders of Wildlife, Northwest Ecosystem Alliance, West Coast Environmental Law Association and Alberta Wilderness Association (collectively "ENGOS")

As the ENGO Comments highlight, recent legislative changes in British Columbia ("BC") permit substantial exemptions from maximum cut restrictions because of "wind, fire, insect or disease" and introduce other potential areas of flexibility with respect to Annual Allowable Cut ("AAC") requirements. ENGO Comments I.A.2. As discussed at Part I.A.6 of the draft Policy Bulletin, the Department of Commerce (the "Department") would have to analyze provincial policies that could undermine other reforms, such as the management of AAC, very carefully in a changed circumstances review.

The ENGO Comments also highlight certain unintended consequences that could result from tenure reform and the importance of fully understanding the real world impact of proposed changes. The Coalition for Fair Lumber Imports (the "Coalition") agrees with the ENGOS that "actual take-back and redistribution of tenures is essential." ENGO Comments I.A.5. The Coalition concurs that this will require a substantial take-back of tenure holders' cutting rights. As the ENGOS stress, there is no basis to conclude that British Columbia's proposed 20 percent tenure take-back will be sufficient to ensure that competitive mechanisms set the administered price and not the reverse. Id. at I.B.1.c.

Rules that foster redistribution, such as BC's rule that required 5 percent of volume to be returned upon transfer, should not be eliminated. Under existing conditions in BC, "commodifying long-term tenure would be a huge windfall benefit to the small group of companies" that "currently controls tenures." Id. at I.A.5.

While the draft Policy Bulletin focuses primarily on timber auctions, we agree with the ENGOs that properly structured competitive log markets could be part of the solution. ENGO Comment I.B.1. Particularly if provinces are unwilling to reallocate sufficient quantities of timber to competitive mechanisms, rules that require some portion of the administered harvest to flow through open and competitive log markets could help to ensure that tenureholders respond to market signals. To ensure that log markets are competitive, they must incorporate sufficient volume and structures that foster competition and participation by diverse parties. To this end, the Department should examine closely the ENGOs' detailed list of conditions that should be applied to newly created competitive log markets. Further, we agree with the ENGOs that provinces should take steps to curtail log bartering, which has dominated prior mechanisms for log exchange, such as the Vancouver log market. Log trading has inhibited competition by blocking smaller operators from bidding on logs, hindered transparency and rendered log data almost unusable since most trades do not incorporate a real cash price.

While there have been numerous problems with existing BC log markets, we disagree with the ENGOs that one has been marginal pricing problems. In a competitive market the most efficient producer would bid as high as the total marginal value that it could obtain from the log, which would be based on an assessment of its marginal costs. A marginal price is not an "artificially high" price.

Finally, the ENGO Comments highlight the importance of measuring the net balance between pricing and regulation. ENGO Comments I.A.6. If provinces nominally increase stumpage prices, but undercut regulations and environmental standards, thereby reducing operating costs, the subsidy practice would not be eliminated. Rollbacks in environmental and operating standards would be inconsistent with the goals of the Policy Bulletin.

Comments of the Indigenous Network on Economies and Trade ("INET")

We concur with INET's suggestion that the following text be added to the draft Policy Bulletin:

Alternatively, if a province were to expand significantly the percentage of harvest . . . in the hands of indigenous peoples, sales . . . by indigenous peoples could also suffice as an adequate basis for assessing the province's timber sales programs.

The Coalition agrees that competitive sales by indigenous peoples of timber that they hold could form part of the reference market for determining whether provincial timber systems generate adequate remuneration within the meaning of the statute. These sales would, of course, need to satisfy the other standards for reference markets set out in the Policy Bulletin, *inter alia*: sufficient number of participants, transparent operations, published prices, no barriers to entry or exit, safeguards against collusive behavior.¹ Volumes reallocated to indigenous tribes for ecosystem-based planning and management would also contribute to the solution. Such reallocation would remove administered volume from the long-term tenures of integrated processors, forcing these operators to source from competitive markets for a larger share of their furnish.

As INET's comments reflect, the issue of tenure takeback is complex and highly contentious among the provinces. As the INET indicates, tenure takeback would yield important benefits for the provinces. If provinces engage in significant takeback of allocated tenure volumes, they will not only be able to create viable and undistorted reference markets, but also satisfy obligations to other stakeholders. This will help to ensure the stability of policy reform.

¹ Proposed Policies Regarding the Conduct of Changed Circumstance Reviews of the Countervailing Duty Order on Softwood Lumber Products from Canada (C-122-839), 68 Fed. Reg. 37,456, 37,459 (June 24, 2003) ("Policy Bulletin").

Comments of Robert E. Vance

The Coalition also supports the comments of Mr. Vance, which note that current restrictions on private log exports from BC give local mills a chance to block export trade and suppress domestic log prices. Private log restrictions in BC, jointly administered by the Canadian federal and BC governments, should be removed as a condition of revocation. The Canadian federal government should also remove all licensing and other requirements that currently regulate the export of logs from private lands in other provinces.

Comments of Ontario Forest Industries Association ("OFIA), Ontario Lumber Manufacturers' Association ("OLMA") and the Free Trade Lumber Council ("FTLC")

The OFIA/OLMA/FTLC Comments indicate that there are segments of the Canadian industry that will seek to block provinces' movement toward anything approaching market-based stumpage systems. This, in turn, reinforces the need for the Department: 1) vigorously to scrutinize administered systems advanced in the context of changed circumstances proceedings; and 2) to retain the proposed evidentiary standard for the Policy Bulletin (Policy Bulletin, 68 Fed. Reg. at 37,462 (Section III.C)) and requirements as regards the contents of changed circumstances review requests (id. at Section III.B). The Department's review must, as the draft Policy Bulletin contemplates, entail examination not simply of whether legal requirements have been changed but also evidence of actual timber price movement and comparisons to the range of observed prices in open and competitive timber markets. Policy Bulletin, 68 Fed. Reg. at 37,462.

The Coalition and other parties have offered thoughtful, limited suggestions about how the draft Policy Bulletin might, in the commentors' views, be improved. The OFIA/OLMA/FTLC Comments are very different. They are a frontal assault on the whole idea behind the bulletin, *i.e.*, providing suggestions as to how the province might achieve market-based stumpage systems which the Department can reasonably find to be non-subsidizing under statutory mandates. (Happily, it appears that neither Ontario nor any other province has expressed support for the OFIA/OLMA/FTLC Comments.)

The OFIA, OLMA and FTLC contend, for example, that a non-subsidizing system should not be based on open competition for timber, but rather on prices for downstream products. OFIA/OLMA/FTLC Comment I.A.2. The proposition that actual market competition for an item does not produce the best estimation of economic value

is quite remarkable and indicative of these parties' interests. During the investigation, the Coalition detailed why, even in theory, "residual value" timber-pricing systems will never generate timber prices that comport with full market value. E.g., Coalition for Fair Lumber Imports Executive Committee, Petition for Imposition of Countervailing Duties, No. C-122-839, vol. II, at 176-179 (Apr. 2, 2001).

Apart from the structural limitations of any residual value system, the OFIA's and OLMA's home province demonstrates how a residual value system can be manipulated to ensure that it systematically produces prices that are a fraction of market value. As the Department found, stumpage prices in Ontario are based on four component charges, one of which is derived from a residual value calculation based on end-product prices.² This charge is grounded in a basket of end-product prices, minus inflated costs collected in a survey of Ontario mills (guaranteeing a 20-percent profit). The province then assesses only 29 percent of the indicated charge and only when lumber prices exceed certain levels. Dec. Mem. at 98; 1 ONQR 90-101.

One wonders, by the way, why the commentators stopped at lumber prices as being most indicative of timber values. Why not the price of wooden barns which are, after all, made of lumber? While timber values are driven largely by prices for processed forest products, the true test of market value for timber or any other merchandise is what the item commands in open and competitive sales.³

² "Issues and Decision Memorandum" at 98, regarding Certain Softwood Lumber Products from Canada, 67 Fed. Reg. 15,545 (Apr. 2, 2002) ("Dec. Mem."); Response of the Government of Ontario to the Department's May 1, 2001 Questionnaire, vol. 1 at 90-101 (June 28, 2001) app. to Letter from Weil, Gotschal & Manges LLP to Department of Commerce, No. C-122-839 (June 28, 2001) ("ONQR").

³ The commentators' confusion reaches its apogee when they argue that data from U.S. timber auctions are not indicative of market value because "no downstream market signals are involved." OFIA/OLMA/FTLC Comment I.B.1.b. Setting

The theme of resisting competitive timber pricing flows throughout the OFIA/OLMA/FTLC Comments. Another example is the parties' amazing opposition to any limits on collusion among bidders for timber. OFIA/OLMA/FTLC Comment I.B.1.e. This insistence on a right to collude should clarify in the mind of any doubter that there are portions of the Canadian industry that, given the value of the subsidies, will not accept even the barest conditions for actual competition in provincial timber markets. It is also notable that the commentators essentially admit that the provinces maintain and enforce anti-market timber policies, such as minimum processing requirements. OFIA/OLMA/FTLC Comment I.A.4.

The commentators' criticisms of U.S. competitive timber sales are confused and lacking in any point. The commentators do not and cannot deny that prices from U.S. public timber auction sales represent the results of open and competitive bidding.

aside that bidders have prices for downstream products foremost in mind, the commentators appear to argue that the Department should reject open competition for timber as a non-subsidizing system in favor of administered pricing based on residual value.

Comments of the OLMA & OFIA

These Ontario associations insist that the Province B example should include an option to benchmark against mill delivered wood costs. OLMA/OFIA Comments at 2 (unnumbered). While there could, if all else failed, be a role for log prices in setting provincial timber prices, the Coalition supports the current draft Policy Bulletin's reliance on sales of the actual product at issue, *i.e.*, timber. Contrary to the suggestion of the Ontario industry associations, this is simplest and most direct valuation methodology.

The suggestion that U.S. prices could be used only until Ontario private timber pricing data can be obtained on Ontario private market transactions should be rejected out of hand. The Department found in the investigation that the Ontario private market is grossly distorted by the overwhelming dominance of administered sales. Dec. Mem. at 96-97. If Ontario implements necessary reforms, private markets would be expected to recover, but this process would take time. OLMA/OFIA Comments at 2-3. Any methodology based on current Ontario private markets would not satisfy the legal standard, and the Department could not revoke the countervailing duty order with respect to Ontario on this suggested basis.

The draft Policy Bulletin contemplates that Ontario might use private market prices as a reference point for administered timber sales at a later date. Policy Bulletin, 68 Fed. Reg. at 37,462. This transition could only occur when private markets recovered from the dominance of existing provincial mechanisms. It would be inconsistent with the general approach of the draft Policy Bulletin (for example, id. at Section III.C) to set an artificial deadline as to when this process might be complete.

Comments of the Gouvernement du Québec ("GOQ")

Quebec objects to the absence of a special Quebec-related example in the draft Policy Bulletin. While the Coalition could support another, reasonable example of a non-subsidizing system, Quebec has numerous reform options that could satisfy the statutory standard. Quebec could move to: 1) of course, open and competitive sales for all of its public timber; 2) open and competitive sales for adequate volumes of public timber with accurate benchmarking for remaining administered volumes; or 3) accurate benchmarking to prices for comparable timber in Maine.

Any timber-pricing methodology that relies on Quebec's private market must provide for sufficient reform of those markets. The Department found in the investigation that Quebec's private markets are distorted by the overwhelming dominance of administered timber sales and that private prices were not market-driven. Dec. Mem. at 59. Internal private markets will not produce non-subsidizing benchmarks until they are no longer distorted by under-priced public timber. Adequate testing and safeguards must be applied. Any Quebec-related example should be congruent with these facts.

The GOQ argues that appurtenancy "enhances market competition." GOQ Comments at 7-9. Since mills cannot sell public logs, the comments submit that appurtenancy requirements tend to enhance competition for private timber. This view misapprehends the Policy Bulletin's goal of intensifying competition broadly for fiber used for lumber production. Appurtenancy requirements and other restraints on log sales diminish the overall level of competition. In short, these types of artificial timber policy

"mandates" cannot be reconciled with timber pricing that comports with the results of open and competitive markets, the idea behind the Policy Bulletin.

Moreover, any Quebec example should also rely solely on prices for Maine fiber. At a minimum, the timber price benchmark should include stumpage transactions from outside of Quebec in the same proportion that those jurisdictions supply Quebec mill furnish. In addition, adjustments to individual tariffing zones should be based on demonstrated differences in market conditions between public and benchmark timber. Consistent with the requirements applied to other provinces, Quebec should also adequately address mandates including processing requirements, implicit minimum cut policies ("use-it-or-lose-it" timber allocations), and reform or eliminate restrictions on tenure transferability and appurtenancy. Finally, the GOQ should eliminate mandatory participation in syndicates for sellers of timber that is used for softwood lumber production.

Quebec proposes Policy Bulletin text that would describe a mechanism to adjust public timber prices as needed to make them reflect market prices. The mechanism that Quebec suggests would involve log-price comparisons. GOQ Comments at 28-29. The Coalition would support an effective such mechanism. The Coalition offers the following suggestions for designing a mechanism that would be expected to be effective:

- Ensure that log value data, as in a market, reflect the value of the entire log (including the demand for chips) and are accurate as to all relevant log size categories.
- Require that benchmark prices be solely for comparable Maine logs, which would preclude bias caused by artificial price depression in Quebec and any "feedback" dynamic. Maine logs are appropriate as they represent a substantial portion of Quebec mills' fiber diets.

- Establish clearly and categorically that *all* Quebec stumpage rates will automatically be adjusted to the full extent that the log mechanism shows them to be understated.
- Provide for regular -- at least annual -- application of the log mechanism and adjustment of Quebec stumpage rates based on the results.

The Department should bear in mind as it evaluates proposed provincial reforms that any administered timber pricing system is necessarily a flawed substitute for open and competitive timber markets. Consequently, the agency should rigorously scrutinize proposals for modified administered systems to ensure that they would be expected at least to approximate the results of full competition.

Comments of the International Mass Retail Association, National Association of Home Builders ("NAHB"), American Consumers for Affordable Homes, Consumers for World Trade, Fremont Forest Group Corporation -- Marubeni, National Lumber & Building Materials Dealers Association

Construction and related interests also request that the Department provide a specific example structured for Quebec. Again, the Coalition agrees that it may be appropriate to develop an example for Quebec, but the example must apply the same basic requirements facing other provinces for the Department to be able to reach a finding as to changed circumstances.

These groups also request that the Department undertake careful analysis of the impact of the current duties on U.S. consumers. There is no provision in the statute or the Department's regulations that contemplates this type of analysis. Moreover, the suggestion that financial analysis of the impact of the current duties in comments addressing proposed future reforms seems tangentially related at best.

In any event, the suggestion that U.S. consumers have been significantly harmed by the current duties is insupportable. Housing markets continue to boom,¹ current homeownership rates maintain historically high levels,² and major U.S. homebuilders report healthy profits,³ while lumber prices plummeted after the duties were put in place and even with very recent improvements, prices remain at historically modest levels. An effective unfair trade offset would simply stem the tide of subsidy/dumping-induced layoffs, mill closures and family timber

¹ E.g., "Home Building Hit 17-Year High in July," (Aug. 19, 2003) (available at <http://www.nahb.org>) (last visited Aug. 20, 2003)).

² See Table 5 "Homeownership Rates for the United States: 1965 to 2003" (available at <http://www.census.gov/hhes/www/housing/hvs/q203tab5.html>) (last visited Aug. 20, 2003)).

³ E.g., "Pulte Homes: 2nd quarter earnings are best ever," Oakland Press (July 25, 2003); "Centex quarter profit up 63 pct, to spin off," Reuters (July 21, 2003) (available at <http://www.forbes.com>) (last visited Aug. 20, 2003)); "Ryland posts 21% increase in quarterly earnings," The Business Journal of the Greater Triad Area (July 23, 2003).

value depreciation. There is every reason to believe that current, historically strong construction markets will continue unabated by a modest reversal of artificial lumber price depression.

Finally, the Coalition opposes the suggestion of the NAHB under I-B that using lumber markets could "provide a better basis than log or timber markets for determining { whether there is } adequate remuneration." NAHB at 3. While timber comparisons can be complex, and the Department will have to examine closely how a province applies competitive auctioned prices to the remaining administered volumes, this process is far more likely to result in timber prices that incorporate market value, than a residual value approach. Residual value demonstrably undervalues timber and has been rejected by several forest agencies worldwide as an appraisal tool for this reason.⁴ It requires numerous complicated adjustments demanding extremely detailed data. It understates market value because it deducts average costs, rather than the marginal costs on which producers would base bidding decisions in a competitive market.⁵ The Department should, therefore, not adopt the suggestion that a residual value calculation be used to estimate market value of timber

⁴ Including the United States Forest Service (Timber Program Issues: A Technical Examination of Policy Options (USFS: Jan. 1995) and the BC Ministry of Forests.

⁵ E.g., Peter H. Pearse, Introduction to Forestry Economics 45-46 (1990).