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August 22, 2003

**PUBLIC DOCUMENT**

The Honorable Grant D. Aldonas  
Under Secretary for International Trade  
U.S. Department of Commerce  
Central Records Unit, Room 1870  
Pennsylvania Avenue and 14th Street, N.W.  
Washington, D.C. 20230

Attn: Mr. James Terpstra

Re: Proposed Policies Regarding the Conduct of Changed Circumstances Reviews of the Countervailing Duty Order on Softwood Lumber from Canada - Request for Comments (C-122-839)

Dear Under Secretary Aldonas:

On August 8, 2003, the Gouvernement du Québec submitted initial comments on the Department of Commerce's *Proposed Policy Bulletin*.<sup>1</sup> On the same day, other interested parties also filed comments, including the *Coalition for Fair Lumber Imports*.<sup>2</sup> Five days later, on August 13, 2003, the *North American Free Trade Agreement Chapter 19 Binational Panel* issued its decision in the appeals taken from the Department's final affirmative countervailing duty in *Certain Softwood Lumber Products from Canada*.<sup>3</sup>

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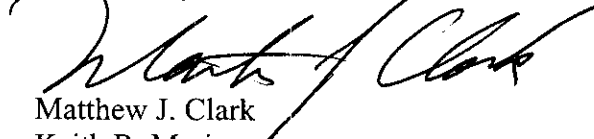
<sup>1</sup> *Proposed Policies Regarding the Conduct of Changed Circumstances Reviews of the Countervailing Duty Order on Softwood Lumber from Canada*, 68 Fed. Reg. 37, 456 (Dep't. Comm. June 24, 2003) ("*Proposed Policy Bulletin*").

<sup>2</sup> *Letter from Dewey Ballantine LLP to Hon. Grant D. Aldonas* (August 8, 2003) ("*Coalition Comments*").

<sup>3</sup> Article 1904 Binational Panel Review under the North American Free Trade Agreement, In the Matter of Certain Softwood Lumber Products from Canada Final Affirmative Countervailing Duty Determination File USA-CDA-2002-1904-03, Decision of Panel (August 13, 2003) ("*NAFTA Panel Decision*").

In response to the initial comments to the *Proposed Policy Bulletin*, and the intervening *NAFTA Panel Decision*, the Gouvernement du Québec files the following rebuttal comments as permitted by the Department and pursuant to the extended deadline.<sup>4</sup> Because Québec believes there are certain aspects of the *Proposed Policy Bulletin* that will have to be revisited by the Department in light of the *NAFTA Panel Decision* (e.g., defining the statutory term “adequate remuneration” as synonymous with “fair market value”) and the earlier WTO decision,<sup>5</sup> Québec’s rebuttal comments are, by design, quite limited.<sup>6</sup> As with Québec’s initial comments, the absence of specific comment should in no measure be viewed as agreement or assent to the comments of any party, particularly those of the Coalition. In addition to these comments, Québec specifically endorses and incorporates the separately filed comments of the Government of Canada.

Respectfully submitted,



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<sup>4</sup> *Memorandum to All Reviewers from James Terpstra, Program Manager Import Administration re Extension of Comment Period* (July 24, 2003).

<sup>5</sup> *United States – Preliminary Determination with Respect to Certain Softwood Lumber Products from Canada, Report of the Panel*, WT/DS236/R (Sept. 27, 2002, adopted Nov. 1, 2002).

<sup>6</sup> Québec refrains from commenting on the many factually and legally inaccurate assertions made by the Coalition regarding, among other things, appurtenancy requirements, tenure security issues, and adjustments. Many of these assertions have already been rebutted by Québec’s initial comments on the *Proposed Policy Bulletin*. Other assertions made by the Coalition have been rejected and rendered moot by the intervening *NAFTA Panel Decision*, and the remaining assertions are inappropriate for this forum, belying the Coalition’s alleged desire to contribute constructively to the process of developing a final *Policy Bulletin*.

## **Rebuttal Comment 1 (Definition of Market)**

### **Summary of the Comment**

The Coalition's demand that the Department adopt a 50% *per se* rule to evaluate whether a "reference market" is a "viable market" must be rejected because the recent *NAFTA Panel Decision* found such an approach to be illegal under U.S. law. In addition, the demand of the Coalition fails at an analytical level because the Coalition itself fails to define what should constitute the boundaries of a reference market. In the final *Policy Bulletin*, the Department must provide the operational definition it will employ when determining the boundaries of a reference market because such boundaries must be set *before* the Department can evaluate whether a reference market is "viable."

### **Discussion**

In its comments on the *Proposed Policy Bulletin*, the Coalition urges the Department to adopt into any final *Policy Bulletin* a *per se* rule requiring at least 50% of the sales in a reference market be made in "open and competitive markets" to ensure that the reference market is "not dependent upon current or previous government pricing systems." This argument was rejected in the recent *NAFTA Panel Decision*:

The Panel rejects the notion that significant involvement by the government in the market, by itself, serves as a basis for rejecting the first regulatory tier, without sufficient analysis of whether and how such involvement has distorted actual transaction prices. It is unreasonable to conclude, without further support, that where the government is a majority provider, private prices may not be used as a benchmark.<sup>7</sup>

Clearly, a *per se* rule rejecting private prices may not be adopted by the Department, and a final *Policy Bulletin* must provide for benchmarks for changed circumstances reviews that measure competitive conditions *in* Canada, with corresponding reference markets that are *in* Canada.

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<sup>7</sup> *NAFTA Panel Decision* at 26

The inappropriateness of the *per se* approach notwithstanding, Québec notes that even if such an approach were permissible under U.S. law, the Coalition provides no definition of what should constitute the boundaries of a “reference market,” other than recursive references to the definition of a “viable market.”<sup>8</sup>

The Coalition’s misunderstanding of the analytical process involved in defining and evaluating a reference market is evident in its rush to eliminate the first step of the analysis (*i.e.*, defining the boundaries of a reference market), in order to leap to the second step (*i.e.*, determining a reference market’s viability). The Department must provide the operational definition of what constitutes a *market*, as opposed to what makes a market *viable*. A reference market must have boundaries, meaning it must be limited. For example, does the Department intend to limit the size of a reference market by political boundaries, geographic boundaries, or economic boundaries? What are the principles the Department intends to employ when establishing those limits?<sup>9</sup>

Defining the boundaries of a reference market is a separate and distinct exercise from determining whether a reference market, once defined, is viable. The two steps of the analysis are conceptually separate and must remain separate for a valid determination of a reference market’s viability. Most importantly, the characteristics that determine whether a market is viable *cannot* be the same characteristics that are used to determine its boundaries. It is critical for the Department

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<sup>8</sup> *Coalition Comments*, at 17 n. 27.

<sup>9</sup> For example, the *NAFTA Panel Decision* cites as evidence of competitive conditions in the private market in Québec that “mills in Québec import significant quantities of logs from the U.S., and if prices in Québec were artificially low, it would not make economic sense to import.” *Id.*, at 27.

to establish that reference markets will be defined rationally and coherently, and then subsequently evaluated based on their viability. Finally, the Department must explain the reasoning providing the basis for its positions both as to market definition and viability.

## **Rebuttal Comment 2 (Private Transactions Benchmark with Delivered Log Cost Validation)**

### **Summary of the Comment**

The NAFTA Panel not only ruled that there is no “world market price” the Department may use as a benchmark to determine if provincial governments receive adequate remuneration on the sale of standing timber, but that there *cannot be* a world market price for standing timber. The Department must now provide an in-country, private transaction benchmark in the final *Policy Bulletin*, as required by U.S. law. Alleged government distortion of private prices can be tested based on delivered log costs, thus allowing Commerce to assure itself that claims of distortion have been properly addressed and accounted for by making, where necessary, an appropriate adjustment to provincial timber prices.

### **Discussion**

In determining whether the Canadian provinces receive adequate remuneration on sales of standing timber, the NAFTA Panel held that comparisons to external benchmarks are impermissible under U.S. law. As stated in the *NAFTA Panel Decision*, and as is consistent with earlier World Trade Organization Dispute Settlement Panel precedent on this issue, the analysis *must* be based on market conditions *in* the relevant jurisdiction:

The Panel is of the opinion that the statute requires an analysis based on market conditions in Canada. By basing its price comparison on prices in the U.S., adjusted inadequately to account for differences in Canadian market conditions, Commerce has construed the statute in a manner that is contrary to law.<sup>10</sup>

Accordingly, the sections of the *Proposed Policy Bulletin* that imply cross-border comparisons to U.S. prices are no longer valid. This includes cross-border comparisons to U.S.

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<sup>10</sup> *NAFTA Panel Decision* at 34.

prices envisioned under the *Proposed Policy Bulletin's* section entitled *Comparison With Prices Established in Markets in Other Jurisdictions*.<sup>11</sup>

As a result of the *NAFTA Panel Decision*, any final *Policy Bulletin* must provide benchmarks for changed circumstances reviews that measure competitive conditions in the country under investigation. Québec, therefore, renews its request that the Department provide in its final *Policy Bulletin* an example of a permissible benchmark based on in-country, private transactions. As both the NAFTA Panel and the Department have stated, such a benchmark provides the greatest level of accuracy, and moreover is the *preferred* benchmark under U.S. law:

Clearly, the law prefers market-based, actual transactions that occur in the country of export. Commerce itself has stated that “[t]he most direct means of determining whether a government required [sic] adequate remuneration is by comparison with private transactions for a comparable good or service in the country. The preferred benchmark in the hierarchy is an observed market price for the good, in the country under investigation, from a private supplier (or, in some cases, from competitive government auction) located either within the country, or outside the country. . . .”<sup>12</sup>

In the text accompanying its initial comments, Québec detailed just such an approach, both satisfying the legal imperative that benchmarks be internal, while at the same time addressing potential concerns regarding alleged distortion to private prices caused by government timber sales. The text, as originally submitted with the initial comments of the Gouvernement du Québec, is attached as Appendix A.

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<sup>11</sup> *Proposed Policy Bulletin* at 37,461-62.

<sup>12</sup> *NAFTA Panel Decision* at 25-26 (citing *Commerce Issues and Decision Memorandum* at 36), accord, 19 C.F.R. § 351.511(a)(2)(i)(placing no limitation on the use of private party transactions but limiting government run auctions to “certain circumstances.”

The validation and correction process envisioned in the attached appendix identifies any potential distortion and corrects it by making an adjustment to the provincial timber price. Delivered log cost validation was not used in the underlying investigation, but has been considered and approved by some of the largest members of the Coalition. Delivered log cost validation resolves all legitimate concerns regarding a changed circumstances review and that rely on in-country private transaction prices as a benchmark.<sup>13</sup>

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<sup>13</sup> The initial comments submitted by the Natural Resource Defense Council, Defenders of Wildlife, Northwest Ecosystems Alliance, West Coast Environmental Law Association, and the Alberta Wilderness Association raised a generalized concern about the reliability of surveys. NRDC et al, at 34 (August 8, 2003). Québec's proposed text, like the *Proposed Policy Bulletin*, notes the central role of transparency and verifiability. In combination with the Department's experience of multiple, non-discrepant verifications of the regular and systematic price and cost surveys conducted by Québec under the Forest Act, the *Proposed Policy Bulletin* fully addresses these concerns.



### **Rebuttal Comment 3 (“Consistency with Market Principles” Benchmark)**

#### **Summary of the Comment:**

In addition to an in-country private transactions benchmark, the final *Policy Bulletin* should include an option based on the third regulatory benchmark, specifically “consistency with market principles.” This benchmark could be provided as a new example in a final *Policy Bulletin*.

#### **Discussion**

As stated in the previous comment, the *NAFTA Panel Decision* held that cross-border comparisons to U.S. prices, as well as comparisons to the second regulatory benchmark (*i.e.*, world market prices), are not permissible. At the same time, the *Proposed Policy Bulletin* does not provide obvious options under the first or the third benchmarks of the Department’s regulatory hierarchy. In its initial comments and in the second rebuttal comment above, Québec requested that an example arising under the first regulatory benchmark, in-country private transactions, be included in any final *Policy Bulletin*. In that request Québec proposed the added safety measure of a delivered log cost validation to identify and correct any distortion of prices. Québec also believes that any final *Policy Bulletin* should provide for an option for determining the validity of provincial timber prices through the third regulatory benchmark, *i.e.* an analysis of whether the provincial stumpage systems are operated in a manner “consistent with market principles.”<sup>14</sup>

It is not clear whether the *Proposed Policy Bulletin* already provides for an analysis under the third regulatory benchmark in the section entitled *Other Timber Sales Methods Designed To Achieve Adequate Remuneration*.<sup>15</sup> In the final *Policy Bulletin*, the Department should clarify that

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<sup>14</sup> 19 C.F.R. § 351.511(a)(2)(iii).

<sup>15</sup> *Proposed Policy Bulletin* at 37,462.

an analysis of “consistency with market principles” is grounds for revocation during a changed circumstances review. This alternative could be clearly stated in its own example in a final *Policy Bulletin*.

By adopting an alternative based on the third regulatory benchmark, the Department will be operating within the parameters of U.S. law. Because the Department did not address the third benchmark in its final determination, the NAFTA Panel did not address this approach. Nevertheless, since distortion under the first benchmark is a “perceived” concern, and the second benchmark has been determined to be invalid, an option under the third regulatory benchmark would be fair, objective, verifiable, and most importantly lawful. As the Department is aware, the third benchmark of “consistency with market principles” has been used in prior proceedings by the Department to determine adequate remuneration.<sup>16</sup> Furthermore, this approach has been found to be reasonable when domestic prices are purportedly distorted and world market prices are an inappropriate benchmark.<sup>17</sup> Consequently, Québec believes there is no justifiable reason to omit this additional option in the final *Policy Bulletin* on future changed circumstances reviews.

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<sup>16</sup> *Carbon and Certain Alloy Steel Wire Rod from Trinidad and Tobago*, 67 Fed. Reg. 55, 810 (Dep’t Comm. 2002); *Certain Hot-Rolled Carbon Steel Flat Products from South Africa*, 66 Fed. Reg. 50,412 (Dep’t Comm. 2001); and *Certain Hot-Rolled Carbon Steel Flat Products from Thailand*, 66 Fed. Reg. 50,410 (Dep’t Comm. 2001).

<sup>17</sup> *Canada- Measures Affecting the Importation of Milk and the Exportation of Dairy Products*, AB-2001-6 at para. 93 (December 3, 2001).

#### **Rebuttal Comment 4 (Incorrect Factual Assumption Concerning Buyers of Private Timber)**

##### **Summary of the Comment**

In their comments on the *Proposed Policy Bulletin*, the Ontario Forest Industries Association, the Ontario Lumber Manufacturers Association (“Ontario Industry”), and the Free Trade Lumber Council (“FTLC”) incorrectly describe the economic motivation of private timber sellers in Québec and, therefore, the operation of the private and public timber markets in the province. The error is based on an incorrect factual assumption that makes their assertions overly broad as they apply to Québec.

##### **Discussion**

In two sections of their comments<sup>18</sup> on the *Proposed Policy Bulletin*, the Ontario Industry and the FTLC describe the operation of the Québec public and private timber markets as follows:

Québec’s stumpage system requires tenure holders to shop for stumpage first in the private market, and to use crown stumpage only after the availability of private resources is exhausted. This relationship is, by definition, not functioning independently. To the contrary, the private market is positioned by law to hold tenure holders hostage for inflated prices, but for prices not inflated so much as to put the entire supply required by a mill out of reach. Thus, the private seller of stumpage is acutely aware of what a tenure holder might have to pay, and can afford, for crown stumpage, and prices his private stumpage accordingly. The public price is then designed, with adjustments, to match the private price.<sup>19</sup>

\* \* \*

In Québec, tenure holders must first exhaust private supplies before they can harvest crown stumpage. The prices that emerge from these transactions then set the adjusted public prices. *However, no private seller is ignorant of the public, published price from the prior year, nor is he ignorant of the overall market demand. Therefore, even as he may to a limited degree hold a buyer hostage to a*

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<sup>18</sup> Letter from Baker & Hostetler LLP to the Honorable Grant D. Aldonas (August 8, 2003)(“Ontario Industry and FTLC Comments”).

<sup>19</sup> Ontario Industry and FTLC Comments at 21.

*price, he is bounded by reasonable expectations of what the buyer is willing and able to pay the crown.* There can be no complete independence of the markets.<sup>20</sup>

These descriptions are overly broad, conclusory, and based on an inaccurate factual assumption. The assertions and conclusions drawn are predicated on a buyer who is free to purchase timber from both the public and private markets. However, as verified by Commerce in the investigation (as well as in *Lumber III*), there are hundreds of mills in Québec (indeed the majority of sawmills in the province) that have no other option but to buy from private timber owners.<sup>21</sup> These mills have no public tenures. Nor do they have the potential to gain public timber because Québec's provincial lands are fully allocated. Therefore, the underlying presumption of this assertion – that buyers can shop between public and private sources – is not true for hundreds of mills in Québec who have no other source of supply but private sources.

The distinction between tenure holders that are free to compete for private supply and non-tenure holders who have no option other than to compete for private supply is important. Non-tenure holders, by definition, obtain all of their furnish from the contested or reference private market. In the case of Québec, that private market consists not only of private lands within Québec, but also private log sellers in other provinces and in the U.S. From the perspective of non-tenure holding mills, the private market is independent of the public stumpage market because those non-tenured mills have no access to public stumpage or logs and must operate solely within the confines of the private market.

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<sup>20</sup> *Id.* at 30 (emphasis added).

<sup>21</sup> Although there are more than 1,100 sawmills in Québec, practically the entire harvest from public lands during the period of investigation was accounted for by only 253 public tenure holders. During the same period, 661 sawmills were required to obtain their timber supply exclusively from private sources and had no access to standing timber on public land. See *Québec Questionnaire Response*, Vol. 1 (Stumpage) at 8, 27, and 42-45.

Because the comments of the Ontario Industry and the FTLC proceed solely from the perspective of the seller they misapprehend the independence of the private market from the perspective of the hundreds of buyers who have no recourse to the so-called public tenure market. The characterization of the private market as not being independent of the public stumpage market is therefore overbroad. At the same time the Ontario Industry and the FTLC are correct in their observation that as to tenure holders, the Québec Forest Act imposes obligations as to the primacy of private supply and the residuality of public supply that acts to intensify competition for private supply.

# Appendix A

Province C annually assesses the weighted-average stumpage charge applied to the administered portion of the harvest by comparing delivered log costs for timber harvested from private lands (including private lands in other jurisdictions) and from public lands. To enable this comparison, Province C conducts a statistically valid survey of log consumption by randomly selected sawmills producing lumber in the province to obtain information on delivered log costs, omitting only logs from private timberlands owned by integrated mills. The survey collects information on both delivered log costs and the quality aspects (i.e., species and size) of the mills' log furnish by origin (i.e., from provincial land, on the one hand, or alternate sources of supply on the other). The delivered log costs by source (public and competitive) are then compared using common standard board foot scaling rules. The comparison is made by first translating the delivered log costs per cubic meter into thousand board foot equivalents using the International ¼ in. log scaling rule and the solid cubic meter log scaling rule applicable to public land in Province C. To ensure accuracy in the determination and application of the conversion factors, dual scalings will be performed.

Using a composite profile of the surveyed log supply from public and competitive sources, log stacks are assembled representing the actual public and competitive log supply to Province C's saw mills. The stacks are then scaled using the International ¼ in. rule and the solid cubic meter scaling rule applied on Province C's public lands. The existing International ¼ in. rule will be applied to logs having a top end diameter of 6 inches or more for purposes of the province's dual scaling exercise. But because that rule is recognized to be less accurate with respect to logs of 4 inch and 5 inch diameters, the existing International ¼ in. scaling rule for those logs will be restated so as to make them consistent with the International ¼ in. rule for logs with top end diameters of 6 inches or more. This calibration will be accomplished using a series of actual sawmill production runs to permit actual yield ratios to be obtained by comparing the 4 and 5 inch log production results to the 6 inch log production results. Those ratios will then be applied to the International ¼ in. rule for logs with a top end diameter of 6 inches to arrive at the new scaling rule for logs with top end diameters of 4 and 5 inches. The province will apply the new scaling rule to logs with top end diameters of 4 and 5 inches in its dual scaling exercise.

The dual scaling exercises are performed by teams of professional scalers skilled in the application of the relevant scaling rules and the scaling exercises are open to observation and verification. In the second step the conversion factors obtained from the dual scaling exercises are weight averaged by source (if there is more than one source). The resulting weighted average conversion factor is then multiplied by the per cubic meter log cost to express the delivered log cost on a thousand board foot basis for public source logs and for competitive source logs. In the final step the difference in the board foot costs of logs from the two sources is restated on a cubic meter basis by application of the actual scaled conversion factor for logs from public land in order to adjust the public stumpage rate using this difference in delivered log cost. The operation of the annual log cost adjustment is fully transparent and verifiable.