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August 22, 2003

PUBLIC DOCUMENT

VIA HAND DELIVERY

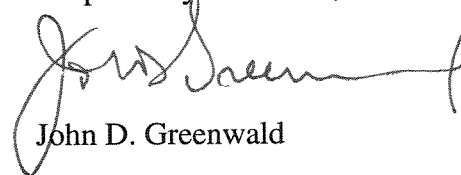
The Honorable Grant D. Aldonas
Under Secretary for International Trade
U.S. Department of Commerce
Central Records Unit, Room 1870
Pennsylvania Avenue and 14th Street, N.W.
Washington, D.C. 20230
Attn: Mr. James Terpstra

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

Dear Mr. Secretary:

We submit these rebuttal comments on behalf of the Québec Lumber Manufacturers Association and the Québec Forest Industry Council (collectively "QFIC"). They respond to the initial comments filed on behalf of the Coalition for Fair Lumber Imports (the "Coalition") and also expand upon points made by the Gouvernement du Québec ("Québec") in its initial comments. QFIC represents the great majority of Québec's softwood lumber producers accounting for the great majority of Québec's softwood lumber production.

Respectfully submitted,



John D. Greenwald

QFIC Rebuttal Comments on Proposed Policies Regarding the Conduct of Changed Circumstances Reviews of the Countervailing Duty Order on Softwood Lumber from Canada

A. Introduction

In its August 8 comments, Québec highlighted the need to accommodate within the Policy Bulletin framework stumpage systems that, like Québec's, set Crown stumpage prices by reference to stumpage pricing in prices in private markets.^{1/} The proposed Policy Bulletin contemplates provincial stumpage systems that derive Crown stumpage prices from actual transaction prices observed in a robust private market for stumpage within a province, but provides no specific example of the sorts of policies and practices that would qualify a province like Québec for a changed circumstances review.^{2/} Québec's submission proposed language that could be added to the policy bulletin to remedy the problem.^{3/} In these rebuttal comments, QFIC builds upon the suggestions in the Québec submission, proposing a new "Province C" section for the Policy Bulletin that, we believe, reflects areas of broad agreement between the Canadian and U.S. governments and industries.

QFIC believes that its proposal for the new "Province C" section addresses a number of concerns raised by the Coalition. Other Coalition comments, however, have nothing to do with a

^{1/} August 8 Letter from Arent Fox to the Honorable Grant D. Aldonas ("Québec Comments") at 5-6 (Comment 2) and 19 (Comment 8).

^{2/} 68 Fed. Reg. 37, 458, (June 24, 2003) ("Policy Bulletin"). Section I.B.1 of the proposed Policy Bulletin reads as follows: "For any portion of a provincial harvest that continues to be sold under prices set administratively, the Department will, in general, focus on whether those prices are set by reference to a sufficient range of representative transaction prices in one or more independently functioning markets for sales of standing timber or logs. Examples of independently functioning markets would include ... robust and competitive markets for the sale of standing timber or logs harvested from private lands within the province... ."

^{3/} Québec Comments at 6, 19, 20-21 and 25-26.

legitimate interest in market driven stumpage systems. Rather, many of the points made by the Coalition have a single purpose -- i.e., to force an increase in the price of Canadian stumpage without regard to market dynamics (or, for that matter, anything else). The emphasis that the Coalition places on “results” of reform is indicative of its objectives. The Coalition (and the Department) must recognize and accept the fact that the sorts of market driven reforms contemplated by the Policy Bulletin could just as easily result in lower as in higher stumpage prices; as we understand it, the point of the exercise is not to set prices, but to allow markets to work.

A last introductory point: The final Policy Bulletin must respect the decision of the NAFTA panel remanding the Department’s countervailing duty determination for its unlawful use of cross-border benchmarks and its decision to equate “adequate remuneration” with “fair market value.” The revisions to the Policy Bulletin required to conform it to the NAFTA panel decision are important but should not be difficult to make; at the same time, the NAFTA panel decision exposes the extent to which the Coalition’s comments are predicated on two invalid assumptions -- first, that “adequate remuneration” means “fair market value” and, second, that the subsidy margins that Commerce found by using cross-border comparisons are legitimate.

B. Addition of a “Province C” Example for Pricing Public Timber by Reference to Private Market Prices

Summary: Like Québec, QFIC believes that the Department’s Policy Bulletin is a significant initiative that, if finalized and implemented in a fair and even-handed manner, should provide the basis for the long-term resolution of a trade dispute that has frayed U.S.-Canada trade relations for over twenty years. However, if the final Policy Bulletin does not include a “Province C” section (or its equivalent) that accommodates stumpage systems like Québec’s, it will not adequately address the issues that it is designed to resolve (and if it does not guarantee a revocation of the outstanding countervailing duty order and does not prevent filing of new cases, it will not have served its basic purpose). QFIC joins Québec in proposing a new “Province C” section to be included in any final Policy Bulletin that, to the best of our knowledge, reflects the present state of discussions between the U.S. and Canadian governments and their respective industries.

Comment: We have attached at Annex 1 to these comments a proposal of a “Province C” section for provinces that price their Crown stumpage by reference to private market transaction prices for stumpage within the province. Given the discussions that have been held between the United States and Canada on this issue, QFIC believes that the final version of the Policy Bulletin should include a “Province C” section very much like that attached at Annex 1.

We want to draw particular attention to the inclusion of a delivered log cost “validation mechanism” in the proposed “Province C” section. A validation mechanism of this sort, which has been already explored by the U.S. and Canadian governments and their industries, addresses a number of concerns about the Policy Bulletin raised by the Coalition. The Coalition has, for example, expressed reservations about undue influence of Crown stumpage on provincial private

markets for stumpage.^{4/} The log validation mechanism in the proposed Province C section ensures against this by testing the scaled cost at the mill gate of logs harvested from Crown lands against the scaled mill gate price of logs harvested from private lands, including U.S. logs shipped in volume to Québec mills. If the scaled cost of logs from Crown lands is lower or higher than the scaled price of logs from private lands, Crown stumpage would be adjusted by the difference. Because the cost of logs from Crown lands includes all adjustments to Crown stumpage prices, the log scaling validation mechanism tests the economic justification for the adjustments that are part of Québec's parity system.

^{4/} August 8 Letter from Dewey Ballantine to the Honorable Grant D. Aldonas ("Coalition Comments") at 17-19.

C. Rebuttal Comments on the Coalition’s August 8 Submission

1. Rebuttal Comments on the Coalition’s “Introduction”

Summary: The introduction to the Coalition’s comments is, in some ways, the most troubling part of its August 8 submission. It reveals a determination to drive Canadian stumpage prices as high as possible and, until then, put in place “interim” trade measures to limit Canadian producer participation in the U.S. market. To the extent that the Coalition expresses any interest in the sort of market-based stumpage policies contemplated by the Policy Bulletin, it appears to be strictly a function of the effects they hope to see.

Comments: QFIC takes issue with the Coalition’s assertion that “the Department must ensure that a final Policy Bulletin and any future CCR produce economically ... adequate results.”^{5/} As we read this part of the Coalition’s submission, it is a thinly disguised insistence that the reforms contemplated by the Policy Bulletin have the effects that the Coalition wants (i.e., significantly increased stumpage prices). This sort of effects test has no place in the Policy Bulletin. Depending on market conditions, stumpage reforms that give free reign to market forces could result in higher stumpage prices, lower stumpage prices or prices that are essentially unchanged. For the Coalition to suggest that market forces drive prices in only one direction -- i.e., up -- is economic nonsense.

A second point in the Coalition’s introductory remarks that bears commentary is the claim that “unless and until [a] comprehensive solution [that includes an interim agreement] is attained, the Department should not promulgate a Final Policy Bulletin.”^{6/} The Policy Bulletin

^{5/} Coalition Comments at 4.

^{6/} Id.

should stand or fall on its own merits. As long as the policies in it make good economic and legal sense, the Policy Bulletin should be promulgated in final form as quickly as possible without regard to extraneous issues. In QFIC's view, a good policy initiative should never be held prisoner to extraneous developments.

2. **Rebuttal Comments on the Coalition's Views on Appurtenancy**

Summary: The Coalition's call for the "elimination" of "formal appurtenancy requirements" reveals a profound misunderstanding of appurtenancy and its impact on softwood lumber production in Québec.^{7/}

Comments: Québec's comments correctly point out that appurtenancy has nothing to do with stumpage pricing and, therefore, is unrelated to the adequacy of remuneration (i.e., the degree of subsidization) associated with Québec's stumpage system.^{8/} The Coalition ignores this basic point and mischaracterizes the effect of appurtenancy requirements on softwood lumber production in Québec. In fact, appurtenancy actually strengthens the market-determined character of Québec's substantial private stumpage market by preventing the supply of public timber from shaping demand for timber from Québec's private forest. Because Crown stumpage is tied to a specific mill, it cannot be used to supplant private supply to mills that do not have, or have limited access to, Crown timber. If, because of market conditions, it is uneconomic to harvest public timber that must be processed at a particular mill, a tenure holder may reduce production (or close the mill) but may not reallocate the timber to other mills. The Coalition is wrong when it claims that (1) appurtenancy "reinforces minimum cut requirements, mill closure restrictions and minimum processing requirements," (2) "appurtenancy encourages harvesting when the market would not," and (3) "failure to end (or substantially reform) appurtenancy would undermine commitments to reform other mandates."^{9/} The truth is:

^{7/} Id. at 6-7.

^{8/} Québec Comments at 1-6 (Comments 1 and 2).

^{9/} Coalition Comments at 6.

- Appurtenancy has nothing to do with minimum cut requirements, mill closure requirements, minimum processing requirements or any other measure related to the volume, as opposed to the location, of production.
- For a province that prices its stumpage by reference to private market transactions, appurtenancy, by preventing public and private supply from competing for the same business, guarantees the integrity of the private market.

3. Rebuttal Comments on the Coalition's Views on Reference Prices

Summary: There is no sound economic basis for the Coalition's claims that a reference market does not "function" as a truly competitive market unless it accounts for a "substantial majority," or at least 50 percent, of the volume of stumpage sold within a jurisdiction.^{10/} As long as a private market operates independently of the market for Crown stumpage and includes a significant number of buyers and a significant number of sellers that do a significant amount of business on a regular basis over a substantial period because both the buyers and the sellers profit from it, the Department must conclude that a reference market is robust. The Québec private forest meets this test.

Comment: Québec's private market for stumpage consists of a large number of buyers of stumpage, many of which do not have access to Crown stumpage, and a large number of private timberland owners. These buyers and sellers engage in thousands of stumpage transactions (for stumpage or logs) every year. The buyers of private stumpage buy, and the sellers of private stumpage sell, for one simple reason -- it is in their economic interest to do so. If Québec's private market were so distorted that sellers could not get a satisfactory price for their timber, it would not, and could not, have operated so successfully for so long.

^{10/} Id. at 18-19.

4. Rebuttal Comments on the Coalition's Views on "Direction of the Causal Link"

Summary: It is reasonable to ask a province to test or validate its Crown stumpage pricing by reference to prices in a robust private market or auction market. It is not reasonable to ask a Province to prove a negative -- i.e., that prices in the reference market are not influenced by prices in the administered segment.

Comment: The proposed Policy Bulletin requires a reference market to be sufficiently robust to give the Department confidence that reference market transaction prices used to derive Crown stumpage prices are shaped by market forces. However, the Coalition asks the Department to go a step further by requiring a province to "demonstrate that prices in the reference market are not effectively dictated by the administered segment." In other words, the Coalition wants to place on Québec and other Canadian provinces the impossible burden of proving a negative.

The Province C section that QFIC proposes goes to considerable lengths to remove any means by which Crown stumpage prices or policies might influence the price of timber in Québec's private market. The proposed section for Province C also tests stumpage prices by comparing the cost/price of scaled logs from Crown and private lands and, if there is a difference, adjusting for the difference. In short, QFIC believes that a province can and should be asked to show that the reference market is sufficiently insulated from the administered segment of the forest, but cannot be asked fairly to prove a negative.

5. Rebuttal Comments on the Coalition's Views on Transparency

Summary: QFIC supports the Policy Bulletin section on transparency and agrees that all adjustments used to drive the price of Crown stumpage from the reference have to be economically justified. By the same token, however, the Department cannot limit adjustments that are economically justified because the Coalition does not like the result.

Comment: The Coalition argues that: "A complicated system of adjustments, such as is applied in Québec's parity system ... would be unacceptable."^{11/} Why? The test cannot be complexity because the task of assessing differences in the values of different tracts of standing timber for differences in forest location, ease of harvest, size, type and quality of trees, burden of infrastructure and many other factors is necessarily complicated. The proposed Public Bulletin rightly focuses on economic justification, not complexity. Moreover, the log scaling validation mechanism in QFIC's proposed Province C section should answer the Coalition's concern on the issue of adjustments. The proposed mechanism specifically focuses on and captures the critical variable of quality and then tests the validity of Québec's stumpage pricing by comparing the cost of logs from Crown lands (with all the adjustments made under Québec's parity system) with the price of logs harvested from private timber. If there is a difference attributable to, inter alia, adjustments that are not economically justified, the validation mechanism will capture it.

^{11/} Id. at 28.

Annex I

C. Private Transactions

As an alternative to establishing the price of stumpage by reference to prices observed in the auction of the province's own standing timber, a province may wish to rely, instead, on prices established in open and competitive private transactions within the province or open and competitive private and public sales in other jurisdictions as a point of reference.

With respect to conditions on tenure that prevent firms in the province from freely adjusting to changes in market conditions, Province C eliminates the implicit minimum cut requirement in its 5-year tenure review process, all mill closure limitations, and any minimum processing requirements applicable to its current tenure holders or timber harvested from private lands.

With respect to appurtenancy and the transferability of tenure, Province C reinforces those aspects of appurtenancy that reduce access to public timber for failure to acquire, where available, a sufficient portion of a mill's furnish from private sources of supply. To promote competition for public timber, Province C authorizes the free transfer of tenure consistent with Province C's appurtenancy requirements (i.e., Province C will permit the transfer of tenure and the mills to which they apply, rather than requiring that tenure revert to Province C in the event of the sale of a mill). In addition, Province C authorizes the transfer of a portion of a tenure holder's annual allocation on public land to other mills.

Province C implements a series of governmental decisions to withdraw a portion of public forest land from the market to create new provincial parks and environmental set asides. In addition, Province C withdraws some existing long-term tenure areas and creates from them new, shorter-term tenures for aboriginal communities that are free of any appurtenancy, minimum processing requirements (including export restrictions), or minimum cut requirements.

With regard to pricing, Province C establishes the market price of standing timber through surveys of standing timber transactions in the province, including any transactions by mills in Province C for standing timber in other jurisdictions. Entities that hold public land tenures in Province C will continue to be specifically excluded from the pool of respondents in all standing timber transaction surveys. Province C then applies those prices to sales of standing timber on public land, taking into account only those adjustments that are economically justified. Province C ensures that there are no barriers to entry or exit in the market for privately-owned standing timber within its jurisdiction.

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 $\frac{1}{4}$ 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 $\frac{1}{4}$ in. rule and the solid cubic meter scaling rule applied on Province C's public lands. The existing International $\frac{1}{4}$ 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 $\frac{1}{4}$ in. scaling rule for those logs will be restated so as to make them consistent with the International $\frac{1}{4}$ 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 $\frac{1}{4}$ 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. Province C could also make the final stumpage adjustment by utilizing information about private stumpage in other jurisdictions.

To ensure that the prices for timber on provincial lands reflect changes in market conditions on an ongoing basis, Province C adjusts the prices quarterly based on observed changes in published log prices in the province, which includes logs harvested on private lands within the province and those harvested on private and public lands in adjacent jurisdictions.

Additionally, Province C adopts a number of mechanisms to reinforce the operation of the private sales market so as to make it more transparent and reliable as a reference point for setting stumpage rates. Those mechanisms may include creating an electronic market in the form of internet-based sites on which private-sector marketing boards, individual woodlot owners, and mills can publish prices at which they are willing to sell or buy logs of certain species and quality.