

December 6, 2004

## MEMORANDUM

TO: James J. Jochum  
Assistant Secretary  
for Import Administration

FROM: Barbara E. Tillman  
Acting Deputy Assistant Secretary  
for Import Administration

SUBJECT: Section 129 Determination: Final Countervailing Duty Determination, Certain Softwood Lumber from Canada

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### Summary

Consistent with the WTO Appellate Body's findings, we have analyzed whether there were "arm's-length" transactions involving Crown timber in which the stumpage subsidy benefit did not "pass-through" to the purchasing sawmills. As discussed in detail below, for some transactions involving Crown timber we found that certain factors controlled, limited, or otherwise affected the transactions in a manner that warranted the conclusion that the transactions were not at "arm's length." For other transactions, we found that these factors were not present and we were able to determine whether a benefit was received by (i.e., "passed-through" to) the purchasing sawmills. We removed from the numerator of the aggregate subsidy calculation any benefit that we found did not pass-through to the purchasing sawmills. As a result of this recalculation, the country-wide subsidy rate was reduced from 18.79 to 18.62 percent *ad valorem*.

### Background

On May 22, 2002, the Department issued a final affirmative countervailing duty (CVD) determination, covering the period of investigation, April 1, 2000 through March 31, 2001 (POI).<sup>1</sup> During the

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<sup>1</sup>See Notice of Final Affirmative Countervailing Duty Determination and Final Negative Critical Circumstances Determination: Certain Softwood Lumber Products from Canada, 67 Fed. Reg. 15545 (April 2, 2002), as

investigation, the Government of Canada and the Provinces of British Columbia, Alberta, Manitoba, Saskatchewan and Ontario (Canadian parties) claimed that a portion of the Crown logs processed into softwood lumber by sawmills were purchased in arm's-length transactions from independent harvesters. The Canadian parties further claimed that such logs must be excluded from the numerator of the subsidy calculation unless the Department makes an affirmative determination that any subsidy to the independent harvester "passed-through" to the downstream lumber producers. The Canadian parties failed to provide the information necessary to support their claim. Consequently, given the aggregate nature of the investigation and the lack of evidence supporting the claims, the Department did not address this question in the investigation and did not exclude any volume of such logs from the calculation of the total subsidy amount, which is the numerator in the *ad valorem* subsidy calculation.

The WTO Appellate Body in United States - Final Countervailing Duty Determination with Respect to Softwood Lumber from Canada, WT/DS257/AB/R, adopted February 17, 2004 ("Appellate Body Report"), found that the Department acted inconsistently with its obligations when it failed "to conduct a pass-through analysis with respect to arm's-length sales of logs by tenure harvesters/sawmills to unrelated sawmills."<sup>2</sup> On March 5, 2004, the United States notified the WTO Dispute Settlement Body of its intention to implement the Appellate Body's report. The parties subsequently agreed that ten months, *i.e.*, until December 17, 2004, was a reasonable period of time for implementation. Accordingly, the Department has conducted a "pass-through" analysis in conformity with the Appellate Body Report. This analysis and the results are described below.

On November 19, 2004, the Department issued a draft Section 129 Determination to the parties, soliciting comments by November 26, 2004. On November 24, 2004, the domestic industry filed comments. On November 26, 2004, the Canadian parties filed comments. The issues raised in the comments submitted by the parties concerning the Section 129 Determination are also addressed below.

## **Procedural Background**

This investigation was conducted on an aggregate basis; as such, we relied primarily on aggregate government data to analyze the alleged subsidy programs, including the provincially administered Crown stumpage programs. However, to determine whether transactions are at arm's-length requires information about the relationship between the parties to the transactions (*e.g.*, affiliations) and the circumstances surrounding the transactions. In addition, if a transaction is at arm's-length, other company-specific information is necessary to determine whether the purchaser received a benefit. Therefore, to conduct a complete "pass-through" analysis for this implementation proceeding, it was

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amended, 67 Fed. Reg. 36070 (May 22, 2002).

<sup>2</sup>Appellate Body Report at para. 159. For purposes of this determination, the referenced log sales by tenured independent harvesters/sawmills will be referred to as sales by independent harvesters.

necessary to request additional information from the provincial governments, as well as company-specific data regarding the log sale transactions. For example, as discussed below, we requested additional information from the provincial governments regarding government mandated restrictions that may affect whether the parties are, in fact, operating at arm's length. In addition, to analyze whether a competitive benefit was passed-through in an arm's-length transaction between an input supplier and a downstream producer involving subsidized Crown timber we requested additional, company-specific pricing data. This information is business proprietary. As discussed for each province below, where we determined that log sale transactions were conducted at arm's length, and where the private parties supplied the business proprietary transaction-related data that we requested, we were able to complete our competitive benefit analysis. In other instances, e.g., for British Columbia (B.C.), respondents failed to provide supporting information. Therefore, we denied their claim that an adjustment to the numerator was warranted.

On April 14, 2004, the Department issued the first "pass-through" questionnaire. The Canadian provincial governments provided questionnaire responses on May 21, 2004, in which they provided a breakdown of the volume of log sales between sawmills and independent harvesters claimed to be at arm's length. They also provided copies of sample tenure contracts governing the Crown timber harvested for these sales, as well as actual tenure contracts for some of the claimed log sale transactions. The Department issued a supplemental "pass-through" questionnaire on August 17, 2004. Recognizing the difficulties that the provincial governments would have in providing detailed company-specific data, the Department attached to this supplemental questionnaire a "Pass-through Appendix" that requested this information directly from the sawmills and independent harvesters concerning corporate relationships, log sales data, and purchase contracts. The Canadian parties submitted their responses to this supplemental questionnaire on September 15, 2004. Some responses to the "Pass-through Appendix" were also submitted by sawmills and harvesters. On October 5, 2004, the Department issued a second supplemental pass-through questionnaire, requesting clarifying and additional information from the provincial governments to their September 15, 2004 questionnaire responses and a supplemental "Pass-through Appendix" for tenure holders. The Canadian parties submitted a response to the second supplemental questionnaire on October 25, 2004.

## **Methodology and Analysis**

The Appellate Body concluded that the Department had to determine whether any alleged subsidy benefit received by independent harvesters of Crown timber had been "passed-through" to sawmills that purchased logs from these independent harvesters in arm's-length transactions. Consistent with the Appellate Body Report, we asked the Canadian parties to identify the volume of logs they claim were sold at arm's length. We also requested that they support those claims with detailed information concerning the parties to and the circumstances surrounding these log sales. For the reasons explained below, we have determined based on the information provided (or the lack thereof) that a significant portion of the reported log sales cannot be considered to have been conducted at arm's length. For sales not conducted at arm's length or for which respondents failed to provide sufficient data to

determine whether they were conducted at arm's length, we did not conduct any further pass-through analysis and the volume of these sales was not removed from the numerator of the subsidy calculations. However, where we determined that the log sales were conducted at arm's length, and where we received the relevant company-specific data, we compared the prices charged by the independent harvester that sold Crown logs with benchmark log prices to determine whether any benefit was passed-through to the purchaser. The results of our findings are described in the Province-specific sections below.

### Sales Between Affiliated Parties

We first examined whether any of the log sale transactions at issue were between affiliated parties, as defined by section 771(33) of the Tariff Act of 1930, as amended. If any of the log sales reported by the Canadian parties were determined to have been between affiliated parties, we concluded that these were not arm's-length transactions and no further pass-through analysis was conducted.

### Government-Mandated Restrictions and Other Factors Affecting Log Sales

Evidence on the record indicates that government-mandated restrictions affect many of the log transactions that Canada reported as arm's-length sales. Principally, these restrictions include (1) limitations on log sales that are contained in Crown tenure contracts such as appurtenancy and local processing requirements and (2) government-mandated wood supply agreements. Furthermore, many of the reported log transactions are also affected by other factors, such as (1) the payment of Crown stumpage fees by sawmills for logs purchased from independent harvesters, (2) the structure of certain log purchase agreements, and (3) fiber exchanges between Crown tenure holders. For the reasons discussed below, where we determined that any of the sales reported by the Canadian parties were affected by one or several of the five factors listed above, we concluded that the transactions were not conducted at arm's length.

The limitations placed on log sales by independent harvesters through their Crown tenure contracts such as appurtenancy and local processing requirements dictate to the harvester those entities to whom it may sell, severely restricting the ability of the harvesters to bargain freely with willing purchasers in the marketplace. The most egregious example of this is an appurtenancy clause that requires that all or a specified amount of a tenure holder's timber be processed in a specified mill. Logs sold under such government mandates were therefore found not to be arm's-length transactions.

Similarly, wood supply agreements also restrict harvesters' choices in disposing of Crown timber. Under these agreements, the provincial government requires that an applicant, as a condition of obtaining a Crown tenure, negotiate a contract with another party regarding the disposition of the timber harvested from the tenure. Unlike in an open market transaction where sellers can choose freely among

potential buyers, log sales made pursuant to mandated wood supply agreements cannot be considered arm's-length transactions because the sale is a function of the government's mandate.

Furthermore, many of the transactions reported by the Canadian provinces are based on log purchase agreements which, in many instances, more closely resemble contracts for harvesting and hauling of logs than arm's-length log sales thereof. These include transactions in which the purchasing sawmill takes an active role in managing all aspects of harvest and delivery of the Crown timber. For example, the sawmill may make separate payments to a harvesting company, the unaffiliated "tenure holder," and log hauler. In other instances, the sawmill finances or otherwise provides goods or services to the tenure holder as part of the transactions. In these transactions, the tenure holder is not merely selling the log for a negotiated arm's length price. Rather, the sawmill controls many elements of the transaction so that the transaction cannot be considered to have been conducted at arm's length.

We acknowledge that some of the log transactions subject to log purchase agreements reported by the Canadian provinces do represent arm's-length log sales. The difference between these two types of transactions is in the nature of the applicable contract terms. For example, some of the log agreements simply reflect one price paid by the sawmill to the independent harvester for delivered logs. Differentiating between these two types of transactions requires a review of each contract. This analysis, by necessity, involves business proprietary information which is normally solely within the control of private parties. Although the provinces generally did not have access to such contracts, they could (and some did) request this information directly from the parties to the transactions. Where private parties supplied such information in response to our "Pass-Through Appendix," we were able to differentiate between these two types of transactions.

In addition, to the structure of these contracts, we found that in a great many transactions the sawmills pays the Crown directly for the stumpage due for logs purchased from independent harvesters, rather than paying the harvesters the price of a log. Under this arrangement, it appears that the stumpage benefit goes directly to the sawmill paying the stumpage fee, just as if the sawmill were drawing from its own tenure and contracting out for harvesting and hauling services.

Finally, fiber exchange agreements are transactions in which tenure holders with processing facilities exchange Crown logs with other tenure holders. For example, a tenure holder with a mill that is set up to process only SPF timber species may end up with a harvest including some species other than SPF, e.g., Douglas fir. Fiber exchange agreements allow the SPF mill to exchange the Douglas fir for SPF with another tenure holder. Fiber exchange agreements can be entirely volume based, i.e., on a "equivalent volume" basis, although, in some instances, the parties attach a nominal price to the exchanged logs. Such agreements are often based on government-mandated appurtenancy or other processing requirements, which require that all Crown harvest, or an equivalent volume, be processed in a certain mill. The mills exchange wood precisely because they are not allowed to sell the logs on the open market. Moreover, the mills are required to harvest certain volumes from their own tenure, including logs they do not need for their own mills. These exchange agreements therefore are a

mechanism for these tenured sawmills to deal with the various government restrictions on the disposition of the timber they harvest, not arm's-length log sales.

## **Results**

We examined the universes of Crown log transactions which comprise Canada's various "no pass-through" claims. Based on a review of the tenure contracts and statements by company and government officials, we determine that the Canadian parties provided sufficient evidence that a portion of those transactions constitute arm's-length sales of logs by independent harvesters to unaffiliated sawmills during the POI. However, applying the methodology described above, we determine that the evidence on the record demonstrates that a significant portion of the transactions included in the claims by Alberta, British Columbia, Manitoba, Ontario, and Saskatchewan are not arm's-length log sales.

As noted above, where we have determined that the log sales reported by the provinces can be characterized as arm's-length transactions, we then examined whether the purchasing mill received a competitive benefit from the sale of the subsidized logs. This competitive benefit analysis is guided by the provisions of the Department's regulation on upstream subsidies. 19 CFR 351.523. Under this analysis, a competitive benefit exists when the price for the input is lower than the price for a benchmark input price. The Department's regulations provide for the use of actual or average prices for unsubsidized input products, including imports, as the benchmark input prices. Because the Department's preference is to use company-specific benchmark data whenever possible, in the "Pass-through Appendix," to collect such company-specific benchmark data we requested that each mill provide pricing data for purchases of logs harvested from private lands or logs imported from the United States. We received company-specific data in response to the "Pass-through Appendix" from some of the mills, as described in the Province-specific sections, below.

For each universe of Crown log transactions for which a "no pass-through" claim was made, if we found that the volume claimed (whether provided by the provincial government or a company) qualifies as an arm's-length transaction, we then compared the price per cubic meter for those transactions with the benchmark input price. As benchmarks, we used record information on company-specific log purchases or publicly available log prices in Canada. Where possible, we used as benchmark prices the actual company-specific prices that the mill paid for logs harvested from private lands in the respective province and logs it imported into that province. Where actual company-specific purchase data were not available, we used a weighted-average of publicly available prices for logs harvested from private lands and logs imported into the province.

If the price per cubic meter was equal to or higher than the benchmark input price, we determined that no competitive benefit passed through and the corresponding volume was excluded from the numerator of our calculations. If, based on the evidence on the record, we were unable to ascertain that the amount qualified as an arm's-length transaction or that the stumpage for the log was paid by the

harvester, we did not compare the price per cubic meter with the benchmark input price and the numerator was not reduced by that volume.

We determine that the evidence on the record sufficiently demonstrates that, during the POI, there were some arm's-length log sales between sawmills and tenured harvesters/sawmills in Alberta, Manitoba, Ontario, and Saskatchewan. However, we determine that the evidence also indicates that the majority of the arm's-length log sales at issue were made at prices below the benchmark prices, and therefore confer a competitive benefit to the purchasing sawmills. Where the difference between the benchmark and actual log prices was greater than that province-specific per-unit stumpage benefit (e.g., C\$11.99 for Ontario), we capped the amount of the subsidy considered to have "passed-through" by the province-specific per-unit stumpage benefit. To illustrate, if the benchmark price was \$20 and the actual transaction price was \$15, the per unit benefit found to have "passed-through" was \$5. If, however, the province-specific per unit stumpage benefit was only \$3, we capped the "pass-through" amount at that \$3. As such, the amount of the competitive benefit that passed through in the transaction was never greater than the subsidy granted by the Crown. The result of these calculations is that only a small portion of the Crown harvest volume originally included in the numerator is excluded from the numerator of our revised subsidy calculations.

## **Summary of Comments**

### Comment 1:

Canadian parties argue that under U.S. law, the WTO Agreement on Subsidies and Countervailing Measures (SCM Agreement), and the General Agreement on Tariffs and Trade 1994, the Department cannot conduct a pass-through analysis starting with a presumption that the independent harvester passes any benefit it received through to the sawmill. Instead, they argue, that the Department's determination that an upstream subsidy has been passed through to downstream producers must be based on substantial record evidence and that the ultimate burden of proof rests with the Department. However, they argue that because the Department presumed that transactions are not arm's length, it unlawfully shifted the burden of proof to the respondents.

Petitioners state that the NAFTA panel reviewing the original final determination concluded that record evidence sustains the Department's finding that the legal requirements imposed upon the sale of logs by entities that do not own sawmills operate to limit their ability to set the price. NAFTA Panel Dec. (2003) at 64. Petitioners contend that the WTO Appellate Body in United States - Final Countervailing Duty Determination with Respect to Softwood Lumber from Canada, WT/DS257/AB/R (January 19, 2004) ("Appellate Body Report"), required the Department to provide a more explicit analysis of its determination. Thus, consistent with U.S. law, the Department should simply have provided a more detailed explanation of its original determination that no pass-through analysis is called for because there is no basis to conclude that any Crown logs were sold in arm's-length transactions. Petitioners argue that as a matter of U.S. law, the Department's treatment of pass-through claims has

been sustained as supported by substantial evidence. Therefore, there is no legal basis for the Department to investigate the pass-through issue.

Department's Position: The Canadian parties incorrectly assert that the Department presumed that benefits received by independent harvesters passed through to sawmills in log sale transactions. The Appellate Body Report found that the Department acted inconsistently with its obligations when it failed “to conduct a pass-through analysis with respect to arm’s-length sales of logs by tenure harvesters/sawmills to unrelated sawmills. As a result, the Department has conducted a “pass-through” analysis in conformity with the Appellate Body Report.

Although the Canadian parties raised the pass-through issue during the original investigation, they failed to provide any supporting information on the record of the proceeding. This information, which is solely within the control of the Canadian parties, is necessary to properly conduct a pass-through analysis. Therefore, the Department sought detailed information concerning the nature of the log sale transactions at issue. As discussed in the Procedural Background section of this determination, the Department sent a series of questionnaires to the Canadian parties and the information and data submitted by the Canadian parties in response to these questionnaires informed the Department’s pass-through analysis and conclusions. This is described fully in the Methodology and Analysis and Results sections above. The Department did not presume pass-through. It properly conducted its analysis relying upon information provided by the Canadian parties. However, the burden of producing data supporting their claims was properly placed upon the Canadian parties.

Comment 2:

Canadian parties assert that the Department’s test to determine whether transactions were at arm’s length is inconsistent with U.S. law and the record evidence. They note that the Statement of Administrative Action accompanying the Uruguay Round Agreements Act (SAA) states that the term “arm’s-length transaction” means a transaction negotiated between unrelated parties, each acting in its own interest, or between related parties such that the terms of the transaction are those that would exist if the transaction had been negotiated between unrelated parties. See SAA 928. Thus, according to the Canadian parties, the concept of “arm’s-length” transactions in a pass-through analysis does not incorporate the absence of governmental regulation because such regulation does not affect whether, or the extent to which, any alleged benefit is passed through in sales of logs.

Department's Position: Consistent with the Appellate Body Report, we have examined the pass-through issue in the context of the specific circumstances of this case. As a consequence of the appurtenancy requirements, commitment letters, and other restrictions on the terms of sales that are described in the Methodology and Analysis section, above, buyers and sellers of many of the log sales at issue are not free to bargain with whomever they chose or to bargain on terms not encumbered by government mandates. The Canadian parties fail to distinguish between government actions that generally regulate the marketplace and those that impose particular outcomes on specific sales



transactions. The specific government-mandated restrictions taken into account by the Department directly affect the nature of the log transactions at issue. These mandates and limitations are conditions that are placed on the tenure licenses that have an impact on the disposition of the Crown logs sold by independent harvesters. When buyers and sellers are not free to bargain with whom they chose the transaction cannot be considered to be at arm's length. Such a determination fully accords with the arm's-length definition set forth in the SAA.

Comment 3:

Petitioners argue that Canadian parties have not demonstrated that alleged pass-through transactions were between unrelated parties. They contend that the Government of Alberta's (GOA) consultant, PriceWaterhouse Coopers (PwC) claims that it screened the affiliations of parties to allegedly arm's-length transactions, but that the GOA did not provide a list of the affiliated entities to support this claim. Further, petitioners argue that the GOA revised the total amount claimed in arm's-length transactions due to corrections in the number of related parties. Thus, petitioners contend that there is no basis for confidence that the GOA has eliminated all transactions between related parties from the data submitted to the Department.

Department's Position: The fact that the GOA revised its data does not, in and of itself, invalidate the number of transactions between unrelated parties. The Department's finding was not made solely on the GOA's revised data. Rather, the Department examined company-specific transaction data and the corresponding certifications. The GOA provided a copy of the PwC survey which specifically asked the companies whether the reported transactions were: a) from an affiliated person based on the definition specified in 19 U.S.C. § 1677 (33); b) a purchase; and c) if a purchase, whether the volume was purchased at arm's length. See GOA Questionnaire response concerning Pass-through of Alleged Benefits, dated May 21, 2004, Volume 1, Exhibit AB-S-75, Attachment A. See also GOA supplemental questionnaire response concerning Pass-through of Alleged Benefits, dated October 25, 2004, Volume 1 at page 3. In addition, the GOA provided company certifications associated with each reported transaction in the initial volume of the Government of Canada's September 15, 2004 supplemental questionnaire submission. Based on the certifications and information provided by the relevant companies and the GOA, the Department accepted the data reported to be from unaffiliated parties.

Comment 4:

Petitioners argue that although the Department correctly determined the five types of log transactions that do not result in arm's-length transactions, it did not consistently apply the first test with regard to log export restrictions. Petitioners contend that (1) all Canadian logs are export restricted under federal log restraints, and (2) domestic processing requirements govern all Crown log transactions in British Columbia (B.C.), Alberta, Manitoba, and Ontario. These legal restrictions prohibit tenure holding harvesters of Crown logs from obtaining the full value for their logs in export markets, which depress

the prices they receive from domestic mills. Therefore, the Department should not have conducted pass-through analyses for any Crown logs subject to in-province or other domestic processing requirements. Petitioners further argue that in the final determination, the Department should conclude and explain that the effects of the relevant government mandates on the log transactions reflect the provincial governments' intention to benefit sawmills.

Department's Position: The existence of log export restrictions does not necessarily preclude the existence of arm's-length transactions in Canada. These restrictions primarily limit commercial interchange between individual Canadian companies and companies outside of Canada. In contrast, the five factors we identified as imposing restrictions on the log sales transactions between unaffiliated Canadian parties did have a direct effect on those transactions and our consideration as to whether they were conducted at arm's length. Regarding domestic processing requirements, they work differently in the various provinces based on the tenure contract. For example, in B.C., domestic processing requirements result in non-market fiber exchange agreements being negotiated. Whereas, in Ontario, the only effect of the in-province processing requirement is that an independent harvester without a sawmill cannot sell unprocessed logs outside of the province.

Comment 5:

Canadian parties argue that the Department's determination that contractual provisions regarding stumpage fee payments by the log buyer affect the arm's-length nature of a transaction is deficient. They assert that the Department ignores the fact that a log supplier will seek to maximize its profit on logs sold to a sawmill, regardless of the requirements a particular contract may specify.

Canadian parties also argue that in an arm's-length transaction where the log purchaser pays the stumpage fee directly to the provincial government, the transaction is not transformed into a contract for harvesting and hauling services. They contend that the purchasing sawmills merely act as "agents of the Crown" for stumpage collection purposes, but the tenured harvester remains responsible for payment of the stumpage charge. Likewise, they argue that a tenure holding sawmill that harvests Crown stumpage and purchases harvesting and hauling services is obligated by its provincial tenure agreement to pay stumpage fees and other provincial tenure obligations in exchange for the right to harvest the log.

Petitioners contend that when the log purchase agreement requires the sawmill to assume the tenure holder's obligation to pay the Crown stumpage, it is no different than the sawmill harvesting from its own tenure and hiring loggers to perform harvesting services. They argue that even if it could be shown that some portion of the subsidy benefit is then "passed back" to the harvester, the Department should countervail the full benefit, because the CVD law is not concerned with how the subsidy recipient spends the benefit.

Department's Position: The stumpage fee is the vehicle by which the Crown bestows the subsidy through its administered stumpage programs. When this fee is paid directly to the Crown by the

sawmill purchasing the subsidized logs from the tenure holding independent harvester, that stumpage benefit also goes directly to the sawmill paying the fee, just as if the sawmill were drawing from its own tenure and contracting out for harvesting and hauling services. As such, there is no basis to perform a competitive benefit analysis for transactions in which the subsidy is, in effect, bestowed directly to the purchasing sawmill.

For those transactions where the sawmill did not pay the stumpage fee to the Crown on behalf of the independent harvester, we conducted the “pass-through” analysis based on company-specific transaction data provided in the responses to the Pass-through Appendix. Based on the evidence on the record, we determined whether a competitive benefit passed through and, where appropriate, the corresponding volume was excluded from the numerator of our calculations.

Comment 6:

Canadian parties assert that the Department has applied the results of its pass-through analysis to an invalidated countervailing duty rate that was based on cross-border benchmarks found illegal in the NAFTA appeal in the underlying investigation. Thus, the resulting calculation is internally inconsistent and legally infirm.

Department’s Position: The purpose of this determination is to implement, in accordance with section 129 of the Uruguay Round Agreements Act, the recommendations and findings in the Appellate Body Report. The Appellate Body’s sole recommendation and finding is that the Department conduct this pass-through analysis. Accordingly, implementation under section 129 does not warrant reconsideration of other issues. The NAFTA proceeding is an entirely separate proceeding.

Comment 7:

Petitioners contend that the Department’s choice of benchmark to measure the extent of the pass through does not account for the market value of logs. They point out that although this investigation does not involve an upstream subsidy, the Department used the analogy of a “competitive benefit” analysis to determine whether an indirect subsidy has been provided. However, they argue that because the “competitive benefit” benchmark is distorted by the subsidy program itself, the upstream subsidy statute requires the Department either to adjust the benchmark “to reflect the effects of the CVD subsidy” or to choose another benchmark. According to petitioners, to avoid the problem of using benchmarks that are affected by the subsidy programs, the Department should adopt one of the following three approaches to calculate the amount of any pass through subsidies: (1) actual market-based log price, which is a comparison of the prices paid by sawmills for Crown logs to actual market-determined prices for comparable logs; (2) timber benchmarks from the investigation plus provincial harvesting costs, which is a log price benchmark constructed by adding provincial harvesting and hauling costs to the province-specific timber benchmark price; or (3) a comparison of tenured stumpage prices to costs, which is a comparison of the price paid by sawmills for Crown logs

purchased in arm's-length transactions to the mills' cost for harvesting from their subsidized tenures. Petitioners argue that any of these three approaches would more accurately reflect the extent of any pass through of subsidy benefit than a comparison to log prices that are effectively determined by the subsidy program.

Department's Position: In the underlying investigation, the Department did not conduct a pass-through analysis, and therefore did not consider potential benchmarks to use in measuring whether a competitive benefit passed-through to the sawmills purchasing logs from tenured harvesters. Moreover, in determining the appropriate benchmark for measuring whether adequate remuneration was paid for Crown timber, we concluded that there were no useable private *stumpage* prices in Canada. We agree with petitioners that there is a potential for the distortion of private Canadian log prices by virtue of our investigation findings regarding stumpage prices. However, we do not have sufficient evidence that such distortion exists on the record of this proceeding to conclude that such private log prices are not useable for the competitive benefit calculation performed here.

Comment 8:

Canadian parties argue that in the context of an aggregate case, it is the Department's practice to accept the type of surveys and sample data provided by the respondents. They contend that for B.C., they provided the Department with detailed information regarding thousands of log purchase transactions involving 74 surveyed sawmills and unaffiliated parties. The detailed company-specific information provided permits the Department to employ its pass-through methodology by comparing company-specific prices paid for logs harvested from Crown land by independent harvesters with prices paid for logs from private land. Canadian parties also contend that the GOO provided the Department with the requested pass-through data for the total value and volume of Crown timber entering the 25 largest sawmills in Ontario from unaffiliated independent harvesters, and other Canadian parties provided similarly detailed and comprehensive data demonstrating that transactions between independent harvesters and sawmills were at arm's length. Therefore, Canadian parties argue that the information submitted, including data on individual log purchase transactions is sufficient for the Department to conduct the provincial pass-through analyses, and refutes the Department's presumption that alleged stumpage subsidies pass through harvesters of Crown logs to log purchasers. However, they argue that the Department failed to meet its statutory obligation to analyze this evidence and failed to conduct the required pass-through analysis.

Department's Position: To determine whether transactions are at arm's length requires information regarding the affiliations between the parties to the transactions and government mandates that affect such transactions. Once transactions are deemed to be at arm's length, to analyze whether a competitive benefit was passed-through between an input supplier and a downstream producer involving subsidized Crown timber we require company-specific pricing data. Although the surveys and sample data provided by the Canadian parties are sufficient for certain analyses undertaken in the context of the aggregate case, such data is not sufficient for the purposes of our pass-through analysis.

Regarding the Government of British Columbia's (GBC) submissions involving the 74 surveyed sawmills for B.C., the GBC did provide a substantial amount of data. However, as noted above, the GBC did not provide copies of all of the tenure agreements that contained domestic processing or other government-mandated requirements. The GBC also failed to identify transactions in which the sawmill paid the stumpage in the transactions it claimed were at arm's length. This information is essential for the Department to conduct its pass-through analysis.

Lacking this information, we were unable to adequately evaluate whether there were arm's-length transactions in which the benefit did not pass through.

Regarding the information provided by the GOO, in the September 15, 2004, questionnaire response, the GOO provided a breakdown of the log purchases by the largest 25 mills in Ontario from unaffiliated licensees which did not own a sawmill and were not subject to a commitment letter or a wood supply agreement. In addition, the GOO provided a breakdown of the log purchases by the largest 25 mills in Ontario from unaffiliated licensees which did not have a tenure during the POI. In response to the August 17, 2004, Pass-through Appendix, eight harvesters and mills provided company-specific log sales and purchase information and supporting documentation. In the Department's October 5, 2004, questionnaire, the Department requested that the GOO identify the transactions in which the stumpage was paid by the sawmills rather than the harvesting tenure holders. The GOO did not provide this requested data.

Because the GOO did not delineate the log sales in which the sawmill paid the stumpage, we were unable to conduct a pass-through analysis using those data sets. However, the companies provided information showing the transactions in which the mills paid the stumpage fees. Thus, we were able to conduct the pass-through analysis based on the company-specific transaction data and information provided in the company responses to the Pass-through Appendix. See Ontario's Pass-through Analysis Calculation Memorandum dated December 6, 2004.

#### Comment 9:

Petitioners argue that "there are numerous unexplained discrepancies between the company-specific data provided by Ontario sawmills and the GOO's own records" and that the Department should carefully examine all pass-through transactions claimed by the companies and exclude log transactions not included in Exhibits ON-PASS-6 and ON-PASS-7 of the GOO's September 15, 2004 response.

Department's Position: In the instructions to our Pass-through Appendix, we specifically requested that the companies provide data for transactions which were not made under a wood supply commitment. Although we recognize that there are discrepancies between data provided by the GOO and the data provided by the companies, there is no evidence on the record that would support a determination that these companies misreported their own data. Because the GOO's data sets do not delineate the transactions for which the stumpage fees were paid by the purchasing mills, we did not use the GOO's

data sets for our pass-through analysis. Rather, we relied on the data provided by the companies in response to our Pass-through Appendix.

Comment 10:

Petitioners contend that the Department incorrectly conducted its analysis on Ontario transactions which were conducted outside the POI. Petitioners also contend that, as with certain transactions that were reported as occurring outside the POI by Tembec, Manitoba, the Department should not conduct an analysis on such Ontario transactions.

Department's Position: Upon reviewing the calculations, we determine that we incorrectly conducted an analysis of some Ontario transactions which were outside of the POI. Therefore, we have removed those transactions from the Ontario calculations. This change results in a reduction of the amount of benefit previously subtracted from the numerator.

Comment 11:

Petitioners claim that the Department miscalculated the total amount of the competitive benefit which passed through to Weyerhaeuser Saskatchewan. They argue that the Department used in its calculations an incorrect figure from the investigation subsidy benefit. Petitioners explain that the Saskatchewan SPF subsidy benefit determined in the investigation is the correct figure to use.

Department's Position: Upon reviewing the calculations, we determine that we miscalculated the amount of benefit subtracted from the Saskatchewan numerator. We have recalculated the benefit using the per-unit Saskatchewan SPF subsidy benefit figure that was determined in the original investigation -- C\$25.13 per cubic meter. This change in the calculations results in a reduction of the amount of benefit that is subtracted from the Saskatchewan numerator.

Comment 12:

Canadian parties contend that the Department's conduct in this proceeding does not suggest an interest in either meaningfully assessing comments on the draft determination or issuing a reasoned decision based on substantial evidence. Canadian parties claim that the draft determination was issued more than two months after the scheduled issuance date, and with no advance notice. Yet, the Department is requiring that comments on the draft be submitted in less than three business days.

Department's Position: The Department has conducted a "pass-through" analysis "with respect to arm's-length sales of logs by tenure harvesters/sawmills to unrelated sawmills," in conformity with the Appellate Body Report. Throughout this proceeding, there has been an extensive process to collect detailed data and information concerning the log sales transactions at issue. As part of the process, the Department issued numerous questionnaires to the Canadian parties and reviewed voluminous

submissions. The results of the Department's analyses are set forth above. Furthermore, consistent with our obligations, the Department released a draft version of its pass-through determination allowing the parties time to comment, which they did.

## **Conclusion**

For the above reasons, we find that for the provinces of Alberta, Ontario, and Saskatchewan, there were partial benefits that did not pass through to the purchasing mills, and we have adjusted the numerator of the benefit calculation. For the provinces of B.C. and Manitoba, we find that all of the benefits passed through to the sawmills. Accordingly, for these two provinces, we did not reduce the numerator of the benefit calculation. Consistent with Section 129, we will await further direction from the Office of the United States Trade Representative following Congressional consultations.

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James J. Jochum  
Assistant Secretary  
for Import Administration

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Date