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United States - Final Countervailing Duty Determination with Respect to Certain Softwood Lumber from Canada

(AB-2003-6)

Oral Statement of the United States of America at the Meeting of the Appellate Body

November 20, 2003

Introduction

1. Good morning, Mr. Chairman and members of the Division. On behalf of the United States, we thank you for the opportunity to appear here today. Our written submissions set out the position of the United States in some detail. We will not repeat those points in this oral statement, but will instead highlight the core legal issues and correct some misimpressions arising from Canada's submissions.

Argument

2. *Interpretation of Article 14(d)*. The first issue appealed by the United States is whether the SCM Agreement required the United States to use private timber prices in Canada to determine the adequacy of remuneration, regardless of whether those prices are effectively determined by the very financial contribution at issue. The Panel found that it does; the United States maintains, to the contrary, that such prices may be disregarded if they do not reflect "market conditions". The United States further maintains that, if the government effectively determines all prices for the goods in question, "market conditions" do not exist for that product within the meaning of Article 14(d) of the SCM Agreement.

3. Based on a mischaracterization of the Panel's findings, Canada asserts that the "real issue" is whether determining the adequacy of remuneration based on prices from sources outside the country of provision is *per se* inconsistent with the SCM Agreement.[1] But the Panel made no such finding. What the Panel did find is that, in certain circumstances, it may not be possible to use "in country" prices and, in those instances, a benchmark would have to be based on some "proxy" or "estimate."[2] The Panel did not make any finding that such a proxy could not be based on so-called "out of country" prices. In fact, the Panel explicitly stated that it did not reach that issue.[3] Furthermore, the Panel suggested that, if the use of a proxy were appropriate in this case, the issue would not be whether out of country price data could be used, but rather whether appropriate adjustments were made to such data to reflect market conditions in Canada.[4]

4. The "real issue" therefore is whether the Panel's conclusion that the SCM Agreement required the United States to use the private timber prices in Canada is correct. The Panel recognized the logical flaw in requiring the use of "in country" prices, even if they are effectively determined by the financial contribution. Perhaps in an attempt to compensate for that flaw, Canada asserts that the administrative record demonstrates that Canadian private prices were not distorted and implies that the Panel made such a finding.[5]

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[1] Appellee Submission of Canada, November 5, 2003 ("Canada Appellee Submission), para. 3.

[2] *United States–Final Countervailing Duty Determination with Respect to Certain Softwood Lumber from Canada*, WT/DS257/R, circulated August 29, 2003 ("*Panel Report*"), para. 7.57.

[3] *Panel Report*, para. 7.64.

[4] *Id*.

[5] Canada Appellee Submission, para. 29, footnote 32.

5. The Panel, however, explicitly made no such finding. The Panel declined to do so because it apparently concluded that no amount of evidence of price distortion due to the government's provision of timber would permit the United States to reject private prices as a basis to determine the adequacy of remuneration. Consequently, the Panel limited its analysis to the mere fact that there were private timber prices in Canada. That is the issue that the United States is appealing in this case and we will limit our remarks to Canada's arguments on that issue.

6. The text of Article 14(d) of the SCM Agreement states that the adequacy of remuneration shall be determined "in relation to prevailing market conditions" in the country of provision. Canada argues that the United States attempts to "avoid the text" by suggesting that the word "market" must be interpreted in isolation from the word "prevailing."[6] To the contrary, the United States argues that whether the conditions that prevail are "market conditions" within the meaning of Article 14(d) is a question of fact that must be determined on a case-by-case basis.[7]

7. As the Panel correctly noted, the ordinary meaning of the term "prevailing" is "predominant in extent or amount," to be "prevalent" or to "exist."[8] The Panel also correctly found that not all conditions that prevail constitute "market conditions" within the meaning of Article 14(d). For example, the Panel acknowledged that, if the government is the sole supplier

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[6] *Id*., para. 23.

[7] Appellant's Submission of the United States, October 21, 2003 ("U.S. Appellant Submission"), para. 28.

[8] *Panel Report,* para. 7.50, citing *NSOD* at 2347.

of the goods in question, the conditions that prevail are not "market conditions." Nevertheless, the Panel gave no consideration to the fact that the government, which controls the overwhelming majority of the timber in Canada, is the "predominant" supplier.

8. The Panel also correctly acknowledged that "market conditions" may not exist because of certain government actions in the market for the good in question. The specific example provided by the Panel was where the government administratively controls all prices for the good. Accordingly, private prices subject to formal government price controls would not constitute "market conditions." Contrary to Canada's assertion,[9] therefore, the Panel did acknowledge that the mere existence of private prices does not necessarily mean that "market conditions" exist. Nevertheless, the Panel based its conclusion in this case on the mere existence of private timber prices in Canada. The Panel's conclusion is wrong.

9. Government market power could achieve the same result as formal price controls. Canada does not deny this. Rather, Canada argues that such an interpretation would allow investigating authorities to determine whether, in fact, market conditions exist.[10] It is the essential role of the investigating authority, however, to establish the facts and draw legal conclusions from them. There is nothing unique about investigating whether market conditions exist for a particular product in a particular case. Those findings, like the many others investigating authorities routinely make, would be subject to review if disputed.

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[9] Canada Appellee Submission, para. 28.

[10] *Id.*, para. 31.

10. The basis for the Panel's conclusion that evidence of government distortion of private prices is irrelevant is that Article 14(d) does not explicitly refer to a "market undistorted by government intervention."[11] By the same token, however, the text does not explicitly refer to a "private market" or to a "market without administrative price controls" and the Panel had no difficulty correctly concluding that such qualifications were implicit in the phrase "market conditions."

11. Government prices for the good in question, or private prices subject to government price controls, do not constitute "market conditions" because such conditions cannot measure the benefit conferred by the government financial contribution. Similarly, private prices that are effectively determined by the government's financial contribution cannot measure whether or to what extent a benefit is conferred by that contribution. The Panel acknowledged that fact.[12] There is simply no basis for the Panel's conclusion that, as a matter of law, prices subject to formal price controls are *not* "market conditions" but prices effectively determined by other government-imposed conditions *are* "market conditions."

12. Despite suggestions to the contrary by Canada, the United States has never argued that "market conditions" means a hypothetical "pure" market, free of any government influence, no

[11] *Panel Report*, para. 7.51.

[12] *Id.*, para. 7.58.

matter how minimal.[13] Instead, the issue of whether market conditions exist must be determined on a case-by-case basis, taking account of all relevant factors. In finding that the United States was not permitted to consider any factors other than the mere existence of private prices for timber in Canada, the Panel incorrectly interpreted Article 14(d) of the SCM Agreement.

13. In the Panel's view, "in relation to prevailing market conditions" apparently means comparison to existing prices. Article 14(d), however, defines "prevailing market conditions" with reference to a non-exhaustive list of factors, "including price, availability, marketability, transportation and other conditions of purchase or sale." In other words, conditions other than the mere existence of prices may be relevant to the benefit analysis.

14. The text supports this. The Members' choice of the phrase "in relation to" is consistent with the non-exhaustive list of "market conditions" in Article 14(d). For example, the government price is not compared with marketability or with transportation, but such conditions must be taken into account in determining the adequacy of remuneration. The text therefore requires an analysis that takes account of all relevant conditions. If the government controls the vast majority of the supply and effectively determines all prices for a particular good, those are relevant conditions that must be taken into account. There is no basis in the text of Article 14(d) to conclude otherwise.

[13] Canada Appellee Submission, para. 21.

15. Canada also argues that the Panel's interpretation of "market conditions" in Article 14(d) is consistent with its context. The guidelines in Article 14, however, are expressly linked to the term "benefit" in Article 1.1(b) of the SCM Agreement. As the Appellate Body has stated, the goal in comparing the government's financial contribution to the marketplace is to determine whether the recipient is better off than it otherwise would have been absent the government's financial contribution.[14] The Panel agreed with this underlying principle, but then improperly dismissed it as irrelevant to its analysis of Article 14(d).[15]

16. The Panel then interpreted Article 14(d) in a manner that, by its own admission, actually precludes a proper benefit analysis in cases where the government effectively determines all prices for the good in question.[16] Thus, under the Panel's interpretation, the *more* the government provision of goods distorts the market the *less* it is subject to discipline under the SCM Agreement. As we have demonstrated, Article 14(d) does not require such a perverse result. The United States therefore requests that the Appellate Body reverse the Panel's interpretation of Article 14(d).

17. *Pass-Through*. We will now turn to the Panel's finding that the United States was required to conduct a "pass-through" analysis with respect to sales of logs and lumber among softwood lumber producers. First, I would like to address what Canada refers to as a significant

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[14] *Appellate Body Report, Canada – Measures Affecting the Export of Civilian Aircraft*, WT/DS70/AB/R, adopted August 20, 1999 ("*Canada–Aircraft Appellate Body Report*"), para. 157.

[15] *Panel Report*, para. 7.54

[16] *Id.*, para. 7.58.

concession by the United States.[17] The United States has never argued that subsidies granted to independent harvesters operating at arm's-length can be presumed to benefit softwood lumber producers. Rather, the United States argued before the Panel that the administrative record indicates that there are few, if any, independent harvesters operating at arm's-length. The Panel found that our establishment and analysis of those facts was insufficient and we have decided not to appeal that finding. We have made no concession as to when a pass-though analysis is required.

18. With the exception of the independent harvesters, it is undisputed that the entire subsidy in the numerator of the country-wide rate calculation went directly to softwood lumber producers. The sole purpose of a pass-through analysis would be to determine what portion of that subsidy, if any, went to specific lumber producers. The Panel therefore read into the SCM Agreement a requirement to make a company-specific subsidy determination. As the European Communities ("EC") points out, in doing so, the Panel has failed to preserve the right of Members to do an aggregate calculation or to use sampling techniques in countervailing duty investigations.[18]

19. It is clear from Article 19.3 of the SCM Agreement that a company-specific analysis is not required. In fact, the SCM Agreement does not prescribe any particular methodology for a countervailing duty investigation. A Member's right to conduct an aggregate investigation is

[17] Canada Appellee Submission, paras. 8, 61.

[18] Third Participant's Submission by the European Communities, November 5, 2003 ("EC Submission"), para. 36.

uncontested. In an aggregate investigation, subsidies are not "presumed." Instead, a single country-wide average subsidy rate is calculated – based on actual, not presumed, subsidies – and applied to all subject imports.

20. Using an aggregate methodology, the United States determined the total amount of subsidies granted directly to producers of softwood lumber in Canada. The United States then divided those subsidies by the aggregate value of the output of softwood lumber producers, including products that were not the subject of the investigation. Nothing in the SCM Agreement required the United States to establish a different rate for specific producers or groups of producers, or to calculate a country-wide rate based on an allocation of less than the total direct subsidies to softwood lumber production in Canada. These are, however, precisely the requirements the Panel has improperly imposed.

21. Canada also states that the United States does not contest the existence of many arm's-length sales of logs among sawmills, and that remanufacturers may purchase lumber inputs at arm's-length.[19] Canada then implies that the administrative record establishes those facts. Canada's statements are misleading. The United States contested Canada's view of the record evidence.[20] Moreover, as Canada knows, the United States did not examine whether log sales among sawmills or lumber sales to remanufacturers were at arm's-length because such an analysis is irrelevant in an aggregate case.

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[19] Canada Appellee Submission, paras. 62 - 63.

[20] First Written Submission of the United States to the Panel, January 22, 2003, paras. 110-111.

22. Canada further argues that there is no difference between logs sold by independent harvesters and logs sold by sawmills. There is, however, a major difference. The independent harvesters only harvest trees. In contrast, sawmills do not simply harvest trees. In fact, their primary activity is the production of softwood lumber. Canada's failure to see this significant distinction is based on its theory that the provinces only *directly* subsidize the production of logs, not lumber.[21] That is simply wrong.

23. The calculation of the total subsidy to Canadian softwood lumber production is based on the volume of Crown timber that actually entered sawmills. Economically, selling timber to a sawmill at less than market value is equivalent to a cash grant in the amount of the subsidy. If the government had given the sawmills million dollar grants, that would, without question, be a *direct* subsidy to the sawmills' total production, not simply to its production of logs. Likewise, the sale of timber to a sawmill for less than adequate remuneration is a *direct* subsidy to the sawmill's production, including its production of softwood lumber.

24. This case does not give rise to the pass-through issue addressed in *Canadian Pork*.[22] Certainly, log sales among sawmills do not raise the question of whether a subsidy to one industry has been passed through to another because the subsidy went directly to a softwood lumber producer. Likewise, primary lumber mills and remanufacturers are not distinct industries.

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[21] Canada Appellee Submission, para. 73.

[22] *GATT Panel Report, United States – Countervailing Duties on Fresh, Chilled and Frozen Pork From Canada*, DS7/R, adopted July 11, 1991 ("*Canadian Pork").*

As Canada explained in the underlying investigation, the label "remanufacturer" is not limited to companies that only purchase inputs. It is used for any producer with more than 50% of its production in remanufactured products. If the percentage of remanufactured products is less than 50%, the lumber producer is called a "sawmill." It is undisputed that tenure-holding sawmills produce both primary and remanufactured lumber. Factually, therefore, this case does not involve subsidies to two distinct industries. The subsidies went directly to the production of softwood lumber, including remanufactured products.

25. Because the United States based its calculation solely on subsidies granted directly to the production of softwood lumber in Canada, there can be no basis for requiring a pass-through analysis. The United States is permitted, consistent with the SCM Agreement, to establish a country-wide rather than company-specific *ad valorem* subsidy rate based on the total subsidy to softwood lumber production. Such an analysis does not overstate the subsidy. The United States therefore asks the Appellate Body to reverse that aspect of the Panel's finding.

26. *Financial Contribution*. Finally, I would like to touch briefly on Canada's appeal of the Panel's conclusion that the United States properly determined that there is a financial contribution in the form of the government provision of a good. As the Panel stated, the ordinary meaning of the word "goods" is property or possessions, especially – but not exclusively – moveable property. Nevertheless, Canada argues that standing timber – a valuable possession – is not a good because it is not tradeable across borders and subject to tariff classification. Canada

attempts to support this theory through flawed logic and irrelevant and incorrect references to U.S. property law.

27. In addition to misconstruing the ordinary meaning of the term "goods," Canada does not even attempt to reconcile its special, limited interpretation of the term "goods" with the explicit exception in the text for general infrastructure. It is precisely because the ordinary meaning of "goods" encompasses property and possessions, including fixed or immoveable assets, that the explicit exclusion for general infrastructure is necessary.

28. This point is reaffirmed in the submissions of the third participants. For example, as the EC notes, the French and Spanish versions of the text also use words that, like "goods," encompass property or possessions, whether or not the property is moveable.[23] Based on the ordinary meaning of the text, therefore, the Panel correctly concluded that standing timber is a good.

29. Finally, the Panel thoroughly reviewed the factual record concerning the nature and operation of provincial tenures and licenses and concluded that Canada is "providing" timber to the lumber producers.[24] The Panel's reasoning was straightforward. Regardless of the precise legal nature of the provincial stumpage contracts, ownership over the trees passed from the government to the tenure holders. The Panel's conclusion that standing timber is thus

[23] EC Submission, para. 7.

[24] *Panel Report*, para. 7.15.

"provided" to the tenure holders is entirely consistent with the ordinary meaning of the text and should be upheld.

Conclusion

30. Mr. Chairman, members of the Division, this concludes the oral statement of the United States this morning. As we said at the outset, our submissions dealt with all of the issues raised on appeal in some detail, and we have not undertaken to repeat them here. But we look forward to discussing them during the course of the day today. Thank you for your attention.