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Softwood Lumber Imports from Canada: Issues and Events

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SUMMARY

U.S. lumber producers have raised concerns about softwood imports from Canada many years. Alleged Canadian subsidies (a prerequisite for establishing countervailing duties — CVDs) were investigated in 1982, 1986, and 1992. No subsidies were found in 1983. Subsidy findings led to a 15% Canadian tax on lumber exports in 1986, and to a 6.51% CVD in 1992. The CVD was challenged and ended in 1994. A 1996 Softwood Lumber Agreement restricted Canadian exports until March 31, 2001.

U.S. Industry Arguments. The U.S. producers argue that they have been injured by Canadian subsidies, especially for provincial *stumpage fees* (for the right to harvest trees). In Canada, the provinces own 90% of the timberlands; this contrasts with the United States, where 42% of timberlands are publicly owned and where government timber is often sold competitively. These differences in land tenure make comparisons difficult.

In addition, U.S. lumber producers argue that Canadian log export restrictions subsidize producers by preventing others from getting access to Canadian timber. U.S. log exports from federal and state lands are also restricted, but logs are exported from U.S. private lands. Canada argues that U.S. treatment of export restrictions violates the WTO Agreement on Subsidies and Countervailing Measures.

Finally, U.S. producers argue that they have been injured by imports of Canadian lumber. They point to the growth in Canadian exports and market share, from less than 3 billion board feet (BBF) and 7% of the U.S. market in 1952 to more than 18 BBF per year and a market share of more than 33%. Canadians counter that the U.S. industry has been unable to satisfy U.S. demand. Homebuilders and other lumber users assert that Canadian lumber is needed to satisfy U.S. demands.

Current Issues. In March 2002, the Department of Commerce (DOC) determined that Canadian lumber was subsidized and was being dumped. The ITC determined that imports threatened to injure U.S. industry, and final duties were set at 27%. Canada requested three NAFTA binational panel reviews; each faulted the determinations. After two remands to DOC in the dumping case and three in the CVD case, DOC lowered dumping margins for most individually investigated producers (one to a *de minimis* level), slightly increased the "all others" rate, and reduced the subsidy rate to 1.88%. The CVD determination was remanded to DOC May 23, 2005; the panel has not yet ruled on the dumping determination. In the injury case, the ITC issued a "no threat" determination, as the panel directed, in September 2004; the United States appealed, with panelists named January 31, 2005. DOC has also conducted administrative reviews of the original orders, which set the official duty rates for imports in the 2002-2003 and 2003-2004 periods. Lower subsidy and dumping margins have resulted. Canada sought NAFTA binational review of the CVD review for 2002-2003, which only minimally reduced the subsidy margin.

Canada also filed WTO cases challenging the final ITC and DOC determinations, each resulting in adverse rulings at least in part. In response, DOC minimally lowered the original subsidy rate and, using a mode of price comparison different from that ruled upon, raised dumping margins; the ITC issued a new determination that continued to find threat. Canada is currently challenging each of the new determinations in the WTO

MOST RECENT DEVELOPMENTS

An administrative review of the original duties, issued on December 14, 2004, lowered the subsidy rate and reduced most dumping margins. On September 10, 2004, at the direction of a NAFTA binational panel, but under protest and with the chairman dissenting, the ITC issued a finding of "no threat of injury." The United States has appealed, with a ruling due March 9, 2005. On July 30, 2004, the Department of Commerce (DOC) lowered the subsidy rate; the NAFTA binational panel directed another recalculation.

In several cases, Canada is challenging the U.S. investigations before the WTO. The final panel report on dumping, issued in April 2004, largely upheld DOC actions, but on August 11, 2004, the Appellate Body upheld the panel finding against the U.S. practice of *zeroing* as violating WTO rules, and the United States has agreed to comply by May 2, 2005. The ITC injury determinations were faulted in a final panel ruling in April 2004, but a new determination continues to find threat of injury.

BACKGROUND AND ANALYSIS

Concerns among U.S. lumber producers about softwood lumber imports from Canada have been raised for decades; the current dispute has persisted for at least 20 years. U.S. producers argue they have been harmed by unfair competition, which they assert results from subsidies to Canadian producers, primarily in the form of low provincial stumpage fees (fees for the right to harvest trees from Province-owned timberlands) and Canadian restrictions on log exports. Canadians defend their system, and U.S. homebuilders and other lumber users advocate unrestricted lumber imports. This issue brief provides a concise historical account of the dispute, summarizes the subsidy and injury evidence, and discusses current issues and events. (For more historical background and analysis, see CRS Report RL30826.)

Historical Background

The current dispute began in 1981, when letters from Members of Congress and a petition from the U.S. lumber industry asked the U.S. Department of Commerce (DOC) and the U.S. International Trade Commission (ITC) to investigate lumber imports from Canada for a possible countervailing duty (CVD).[1] The ITC found preliminary evidence of injury to the U.S. industry, but in 1983, the DOC's International Trade Administration (ITA) determined that subsidies were *de minimis* (less than 0.5%), ending the CVD investigation.

In 1986, the U.S. lumber industry filed a petition for another CVD investigation with the DOC and the ITC. A 1985 court ruling on an ITA determination of countervailable benefits on certain imports from Mexico was seen as a favorable precedent for reversing the ITA finding on Canadian lumber subsidies. The ITC again found preliminary evidence of

[1] U.S. trade law (19 U.S.C. §§1671-1671h) authorizes countervailing duties on imported goods, if the DOC determines that the imports are being subsidized (directly or indirectly) by a foreign country and if the ITC determines that the imports have materially injured a U.S. industry. The duty is set at the calculated level of the subsidies.

injury to the U.S. industry, and the ITA reversed its 1983 determination, with a preliminary finding that Canadian producers received a subsidy of 15% *ad valorem* (i.e., 15% of lumber market prices). On December 30, 1986, the day before the final ITA subsidy determination, the United States and Canada signed a Memorandum of Understanding (MOU), with Canada imposing a 15% tax on lumber exported to the United States, to be replaced by higher stumpage fees within five years. The U.S. industry then withdraw its petition.

In September 1991, the Canadian government announced that it would withdraw from the MOU, because most of the provinces had increased their stumpage fees. The U.S. Trade Representative (USTR) responded by beginning a §301 investigation,[2] pending completion of a new CVD investigation by the ITA and the ITC. In March 1992, the ITA issued a preliminary finding of 14.48% *ad valorem* subsidies, with a final determination in May establishing a 6.51% *ad valorem* subsidies, leading to a 6.51% *ad valorem* duty. This was confirmed in July with a final ITC finding that the U.S. industry had been injured by Canadian lumber imports.

The Canadian federal government appealed both the ITA and the ITC final findings to binational review panels under the U.S.-Canada Free Trade Agreement (FTA), which was signed on January 2, 1988. In May 1993, the binational subsidy panel remanded the ITA finding for further analysis, and in September, the ITA revised its finding to 11.54% *ad valorem* subsidies. In December, the binational subsidy panel again remanded the ITA finding and ordered the ITA to find no subsidies. In January, the ITA complied with the order. Using a provision of the FTA, the USTR requested an Extraordinary Challenge Committee (ECC) to review the binational panel decisions, but the ECC was dismissed in August 1994 for failing to meet FTA standards. In August, the DOC revoked the CVD, and in October, the USTR announced that it would terminate the Section 301 action.

Two events in September 1994 induced Canada to negotiate restrictions on its lumber exports to the United States. First, the U.S. lumber industry filed a lawsuit challenging the constitutionality of the FTA review process. Second, the Uruguay Round Agreements Act (URAA; P.L. 103-465) explicitly approved the President's "statement of administrative action" (SAA) that had accompanied his proposed legislation; the SAA stated that, because of Canadian practices, lumber imports from Canada could be subject to a CVD. In February 1996, the two nations announced an agreement-in-principle — a fee on Canadian lumber exports to the United States in excess of a specified quota for five years — with the final U.S.-Canada Softwood Lumber Agreement (SLA) signed in May and retroactive to April 1, 1996. The SLA was effective through March 31, 2001.

Analysis: Subsidies and Injury

Annual Canadian lumber imports have risen from less than 3 billion board feet (BBF), about 7% of the U.S. market, in the early 1950s to more than 18 BBF, more than a third of the U.S. market, since the late 1990s. U.S. lumber producers argue that subsidies to Canadian producers give them an unfair advantage in supplying the U.S. market and that this

[2] Under §301 of the Trade Act of 1974 (19 U.S.C. §§2411-2420), the USTR can investigate and can respond, with a broad range of feasible actions, to foreign trade practices which are found to be illegal, unreasonable, or discriminatory, and are burdensome to U.S. interests.

has injured U.S. producers. These two issues — subsidies and injury — are the basis in U.S. trade law for determining if a CVD is warranted. In addition, *critical circumstances* — which allow for retroactive duties — are deemed to exist, if imports rise significantly after ending import restrictions. Finally, dumping — selling imports at less than the cost of their production — can lead to additional duties.

Subsidies: Canadian Stumpage Fees. The U.S. lumber industry has argued that the stumpage fees charged by the Canadian provinces are less than the market price of the timber would be and are therefore a subsidy to Canadian producers. About 90% of the timberlands in the 10 provinces are owned by the provinces. The provinces require management plans for forested areas and allocate the timber harvests through a variety of agreements or leases, often for 5 or more years with renewal options. Stumpage fees for the timber are determined administratively, often with adjustments to reflect changes in market prices for lumber. This contrasts with the U.S. situation, where 42% of the forests are publicly owned and where public timber is typically sold in competitive auctions; thus, much of the timber in the United States is sold by public and private landowners at market prices.[3] The use of administered fees in Canada opens the possibility that the Canadian system results in transfers to the private sector at less than their fair market value, as the U.S. lumber industry has charged. However, comparisons of U.S. and Canadian stumpage fees are often disputed, because of: differences in measurement systems and the imprecision of converting Canadian cubic meters of logs to U.S. board feet of lumber; differences in the diameter, height, quality, and species mix of U.S. and Canadian forests; differences in management responsibilities imposed on timber buyers (e.g., road construction, reforestation); differences in environmental conditions and policies; and other factors.

Subsidies: Export Restrictions. Export restrictions by British Columbia (BC) were identified as a subsidy to BC lumber producers by the ITA in its 1992 CVD investigation. BC generally prohibits the export of logs from Crown (provincial) lands, to assure domestic production, provide jobs, and encourage economic development. Export restrictions on public timber in the United States indicate substantially higher prices for export logs than for comparable logs sold domestically. Most economists would consider restrictions that reduce domestic prices below the world market price to be subsidies, and the General Agreement on Tariffs and Trade (GATT) generally prohibits export restrictions. In addition, current U.S. trade law allows the DOC to consider an export restraint on a product to be a subsidy if the private parties who would be exporting the product provide the restrained good to domestic purchasers for less than adequate remuneration. Nonetheless, Canada challenged the ITA treatment of export restrictions as a subsidy, arguing that this treatment is inconsistent with the World Trade Organization (WTO) Agreement on Subsidies and Countervailing Measures. This challenge is discussed more below.

Injury to the U.S. Lumber Industry. Proving injury or threat of injury to U.S. lumber producers is also essential to establishing a CVD. The share of the U.S. softwood lumber market provided by Canadian lumber has grown substantially over the past 50 years.

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[3] Some argue that U.S. federal agencies are not comparable to traditional, market-oriented private "willing sellers," because they do not make investments or sales based on profitability, as a private landowner presumably would. However, the U.S. federal government owns only 33% of U.S. timberlands, and thus probably has less impact on timber markets than do the Canadian provinces.

In 1952, lumber imports from Canada were less than 3 BBF, and Canada's market share was less than 7%. In 1998 and 1999, Canadian lumber imports were more than 18 BBF, and Canada's market share has fluctuated between 33% and 35% since 1995. These facts are cited by U.S. producers as evidence that Canadian imports have come at the expense of normal domestic growth in industrial lumber production. U.S. homebuilders and other lumber users counter that Canadian lumber is essential to meeting domestic demand, and argue for unrestricted imports. Despite consistent ITC findings of injury, indisputable proof of injury to U.S. producers is difficult to establish.

Current Issues and Events

Two aspects of this situation are currently the focus of attention in the long-running dispute over the exports of softwood lumber from Canada to the United States. One is the 2001-2002 countervailing and antidumping investigations. The other is the several NAFTA and WTO challenges by the Canadians questioning the countervailing and antidumping investigative processes.

The 2001-2002 Countervailing and Antidumping Investigations. The 1996 U.S.-Canada Softwood Lumber Agreement expired on March 31, 2001. On April 2, the U.S. Coalition for Fair Lumber Imports filed antidumping and CVD petitions. On April 24, the DOC announced that it was initiating the antidumping and CVD investigations, because the petitioners had standing and had shown adequate industry support. On May 16, the ITC issued its preliminary determination that there was "a reasonable indication that a U.S. industry is threatened with material injury by reason of imports of softwood lumber from Canada that are allegedly subsidized and sold in the United States at less than fair value" (Investigations Nos. 701-TA-414 and 731-TA-928 (Preliminary)). On August 17, the DOC published its preliminary determination of Canadian subsidies of 19.31% *ad valorem*, and established a preliminary duty at that level. DOC also found that critical circumstances existed, allowing retroactive application of the duty. On November 6, DOC published its preliminary determination that Canadian firms were dumping lumber, with margins ranging from 5.94% to 19.24% (12.58% for most firms). The DOC also announced it would align, and postpone until March 25, 2002, final determinations in the CVD and antidumping cases.

Negotiations were undertaken to forestall final determinations of injury, subsidy, and dumping. The negotiations collapsed on March 21, 2002, and on March 22, the DOC issued final determinations, which, as later amended, found Canadian subsidies to be 18.79% *ad valorem*, and dumping margins to range from 2.18% to 12.44% for individually investigated companies and 8.43% for all other firms. On May 2, by a 4-0 vote of the commissioners, the ITC issued a final finding of injury. Duties averaging 27% went into effect May 22, 2002, when DOC published the final duty notice in the *Federal Register*.

On December 13, 2004, the DOC announced the final results of the first administrative review of the AD and CVD orders, covering entries from May 22, 2002, through March 31, 2003 for the CVD review, and from May 22, 2002, through April 30, 2003, for the AD review. This action established a new official rate for imports entered during the covered period. DOC announced a country-wide *ad valorem* subsidy rate of 17.18% (1.6% less than the original rate), corrected and lowered in mid-February 2005 to 16.37%. The administrative review, as corrected in January 2005, resulted in an average dumping rate of 4.40% for individually investigated companies and a "review-specific average"of 3.78% for

all other producers participating in the administrative review. Dumping and subsidy rates were further lowered in the preliminary results of the department's administrative review for the 2003-2004 period announced June 1, 2005. The review-specific average for dumped imports was preliminarily reduced to 2.44%; the subsidy rate was lowered to 8.18%. In January 2005, Canada requested NAFTA review of the first CVD administrative review. Canadian industry has also reportedly sought judicial review of the first AD administrative review.

NAFTA Panel Review of Antidumping and Countervailing Duty Determinations. Canada and Canadian lumber producers have sought binational panel reviews of DOC and ITC final determinations in both the antidumping and countervailing duty cases, an option available under Chapter 19 of the North American Free Trade Agreement (NAFTA) in lieu of judicial review. The panels have been established to examine whether the DOC and ITC determinations are in accordance with U.S. antidumping and countervailing duty law.

As a result of these challenges, Canada has obtained lower AD rates for individually investigated companies, a significantly reduced subsidy rate, and a "no threat of injury" determination from the U.S. International Trade Commission. Canada seeks eventual removal of the orders and return of more than $3 billion in duty deposits, thus avoiding potential distribution of duties to U.S. producers under the Byrd Amendment. (See "Other Developments," below.) At the same time, the U.S. position has been that even were the orders to be rescinded, duties would not be refunded absent a negotiated settlement. The United States has further indicated that the relevant duty rates are now those announced in the administrative review described above.

In January 2005, Canada requested binational panel review of the first CVD administrative review, as well as of DOC and ITC determinations issued in response to adverse WTO rulings. (See WTO case summaries, below.) While the request for NAFTA review of the new DOC subsidy determination was withdrawn, a request has since been made for NAFTA review of the DOC's new dumping determination. The panel process involving the ITC action has been stayed pending the outcome of the U.S. appeal of the NAFTA panel ruling on the original ITC injury determination. As discussed noted below, Canada is also challenging each of these three determinations in WTO compliance proceedings. Summaries of the NAFTA cases are provided below.

DOC Final Dumping Determination (USA-CDA-2002-1904-02). The binational panel report on the DOC's final determination in the antidumping case was issued July 17, 2003. It unanimously affirmed the determination in part and remanded it in part; DOC was directed to publish revised dumping margins in light of the panel's remand instructions, which focus in part on DOC's product comparisons. On October 15, 2003, DOC submitted its new determination to the panel, which resulted in lower antidumping duty rates for all but one individually investigated producer (Slocan), as well as a slightly reduced "all others" rate. The panel's decision on the remand, issued March 5, 2004, found the DOC determinations to be inconsistent with U.S. law and ordered new determinations for three Canadian exporters (Tembec, Slocan, and West Fraser). In its April 21, 2004 redetermination, DOC lowered the dumping margin slightly for Tembec and Slocan, though still retaining for Slocan a rate that was higher than that in the original AD order. Slocan is now merged with another Canadian lumber producer, Canfor, and is no longer a separate

corporate entity. DOC also found a *de minimis* (negligible) margin for West Fraser and recalculated the "all others" rate to 8.85%, which slightly exceeds the rate in the original AD order. The panel has not yet specified a due date for its decision on the DOC action.

DOC Final Subsidy Determination (USA-CDA-2002-1904-03). In its report on the DOC's final (August 13, 2003) determination in the CVD case, the binational panel upheld the DOC treatment of provincial stumpage programs as subsidies and the DOC finding that the programs are "specific" to an industry (a necessary element of a domestic subsidy finding). At the same time, it found as contrary to U.S. law DOC's use of cross-border market comparisons to calculate the subsidy, the blanket refusal of DOC to exclude from the scope of the CVD order reprocessed Maritime-origin softwood lumber, and other aspects of DOC determination related to the exclusion of products.

On January 12, 2004, the Department submitted its new determination, lowering the duty rate from 18.79% to 13.23%. According to a DOC press release, the recalculated rate was based on a revised methodology using a benchmark "constructed on the basis of Canadian log prices and import value of logs, adjusting for harvesting costs." DOC also excluded certain Maritime-origin lumber and old lumber, including used railroad ties, from the scope of the CVD order. In a June 7, 2004 decision, the binational panel granted DOC's request for a remand "to reconsider certain limited implementation issues" and additionally remanded to DOC with instructions to recalculate various provincial benchmark prices, to reconsider the adjustment for profit with respect to the benchmarks for all Canadian provinces, and to make two other recalculations.

On July 30, 2004, DOC issued its second remand determination, lowering the CVD rate to 7.82% *ad valorem* and determining that five companies and a mill of a sixth company were eligible for exclusion from the order. After a third remand, DOC issued a new determination January 24, 2005, with a subsidy rate of 1.88% *ad valorem.* The panel remanded the DOC decision for the fourth time on May 23, 2005; a new DOC determination is due July 7, 2005.

ITC Final Injury Determination (USA-CDA-2002-1904-07). The binational panel examining the ITC's final injury determination issued its report September 5, 2003, remanding in part and affirming in part. The panel directed the ITC to reconsider its threat of injury determination, its like product determination relating to bed frame components and flangestock, and its decision to cross-cumulate dumped and subsidized imports in its threat of injury determination. The panel upheld the ITC on a number of points, including its like product determination regarding Western Red Cedar and Eastern White Pine and its finding that it did not have statutory authority to treat the Maritime Provinces as a "country" entitled to a separate injury determination. The panel also affirmed that the ITC was not required as a matter of law to determine that the threat of material injury was caused through the effects of subsidies or dumping, and that the ITC adequately considered the nature of the subsidy and its likely trade effects so as to have met its statutory burden regarding the evaluation of relevant economic factors in assessing threat.

The ITC issued its redetermination December 15, 2003, in which it reaffirmed its earlier affirmative injury rulings. In an April 19, 2004 decision, the panel (with one concurrence) remanded this determination, having found that the ITC's finding of threat of injury to the domestic industry was not in accordance with law and not supported by substantial evidence.

In particular, the panel faulted ITC findings involving Canadian producer capacity, volume and price of imports, and domestic overproduction, with a deadline of May 10, 2004. ITC asked for an extension to July 22, 2004, in part because of a cited delay in receiving the decision and further to "reevaluate all of the record evidence and collect further information as necessary in order to make a remand determination consistent with the Panel's findings." The panel, finding no basis that would preclude it from restricting the ITC's second redetermination "to the existing administrative record where no reason has been given to justify reopening the record," gave the ITC until May 27, 2004, to file its remand redetermination "based solely on the existing administrative record and the conclusions of the Panel's review."

In its second remand redetermination, filed June 10, 2004, the ITC found once again that the U.S. industry was threatened with material injury and, in addition, requested the panel to reconsider its April 19, 2004 decision on the ground that the panel "manifestly and repeatedly overstepped its authority as established by the North American Free Trade Agreement ... by failing to apply the correct standard of review and by substituting its own judgment for that of the Commission." On August 31, 2004, the panel, instead of remanding for a third time, directed the ITC to issue a "no threat of injury" determination in the case in 10 days. With the commission chairman dissenting, the ITC did so, under protest, on September 10, 2004. The panel affirmed the new determination October 12, 2004.

On November 24, 2004, the United States requested that an Extraordinary Challenge Committee (ECC) review the panel's decisions (EC-2004-1904091USA). Under the ECC procedure (in NAFTA Article 1904(13) and Annex 1904.13), an involved party may allege that one or more of three specified situations "has materially affected the panel's decision and threatens the integrity of the binational panel review process." The three predicates are as follows: (1) a member of the panel was guilty of gross misconduct, bias, or a serious conflict of interest; (2) the panel seriously departed from a fundamental rule of procedure; or (3) the panel manifestly exceeded its powers, authority or jurisdiction (e.g., by failing to apply the appropriate standard of review). If the ECC finds that one of the grounds has been established, it must vacate the original panel decision (thus requiring that a new panel be established) or remand it to the original panel for action not inconsistent with the ECC decision. If the grounds are not established, the ECC must deny the challenge, thus affirming the original binational panel decision. Since ECC panelists were not appointed until January 31, 2005, the original decision date of March 9, 2005, has been extended; the new date has not yet been determined.

DOC Final Results of CVD Administrative Review and Rescission of Certain Company-Specific Reviews (USA-CDA-2005-1904-01). This request, filed by Canada and Canadian producers in January 2005, challenges the DOC determination in the administrative review of the May 2002 countervailing duty order for softwood lumber imports entered in the period beginning May 22, 2002, and ending March 31, 2003. DOC determined that countervailable subsidies were being provided and, as noted earlier, announced a new official country-wide *ad valorem* subsidy rate (as corrected in February 2005) of 16.37%, about 2.5% lower than the original rate. A decision date is to be determined.

USITC Implementation of New Determination under Section 129(a)(4) of the Uruguay Round Agreements Act (USA-CDA-2005-1904-03). This request, filed January 21, 2005, by Canadian producer Tembec, Inc., involves the ITC determination issued in response to the WTO decision discussed below (DS277) in which the ITC continued to find material injury to U.S. industry from dumped and subsidized Canadian softwood lumber imports. The panel proceeding was stayed as of March 22, 2005, pending the outcome of the Extraordinary Challenge Committee proceeding described above.

Department of Commerce Antidumping Duty Determination under Section 129 of the Uruguay Round Agreements Act (USA-CDA-2005-1904-04). This request, filed May 31, 2005, by a Canadian producer, challenges the DOC determination issued in response to the WTO decision discussed below (DS264). In its new determination, DOC increased dumping margins as a result of using a price comparison methodology that was not at issue in the WTO case and which the DOC maintained was not subject to the adverse WTO ruling. A panel decision is due April 11, 2006.

Other Developments. On January 6, 2003, the DOC offered a discussion draft entitled *Proposed Analytical Framework, Softwood Lumber from Canada*. The draft identifies market-based timber sales as the conceptual starting point, discusses how provincial timber practices could be modified to conform with this concept, and identifies bases for revoking the countervailing duty and antidumping margins. Negotiations continue.

Canadians have expressed concerns that in cases where Canadian firms are subsequently excluded from an AD or CVD order, and were the orders to be eventually revoked, duty deposits would not be returned and would be thus available for distribution to U.S. lumber firms under the Continued Dumping and Subsidy Offset Act of 2000 (CDSOA), also known as the Byrd Amendment. The statute, codified at 19 U.S.C. §1765c, mandates the annual disbursement of antidumping and countervailing duties to petitioners and interested parties in the underlying trade remedy proceedings for a variety of qualifying expenditures. As reported in December 2003 press accounts, a proposal to settle the softwood lumber dispute negotiated by U.S. and Canadian officials included an approximate 50/50 split of the CDSOA softwood duties; the proposed settlement was opposed by many Canadian producers and provinces and was not acted upon.

As reported by Customs, approximately $5.3 million in softwood lumber duties were distributed under the CDSOA in FY2004. At the same time, Customs has reported that some $2.875 billion in softwood lumber duty deposits was contained in so-called "clearing accounts" as of October 1, 2004, an amount that increases as additional Canadian softwood lumber enters the United States. Each clearing account contains estimated duties received pursuant to a specific AD or CVD order; once duties are finally assessed, they are received by Customs into a special account for the order and are available for disbursement to U.S. firms.

The CDSOA was successfully challenged in a WTO dispute proceeding brought by Canada and ten other WTO Members. Absent action by the United States to repeal or modify the law by the compliance deadline of December 27, 2003, eight of the complainants, including Canada, requested authorization from the WTO to impose retaliatory measures. The United States objected to the request, sending it to arbitration. On August 31, 2004, the arbitral panel ruled that each of the eight countries seeking to retaliate may do so in an

amount equal to 72% of the annual CDSOA disbursements relating to duties paid on imports from that country. The WTO authorized the retaliation requests November 26, 2004. Having identified a current annual retaliation level of $14 million, Canada began to impose a 15% surcharge on imports of U.S. live swine, cigarettes, oysters, and certain specialty fish as of May 1, 2005. In addition, Canada and Canadian industry groups filed suit in the U.S. Court of International Trade on April 29, 2005, arguing that the CDSOA violates a provision of the NAFTA Implementation by not expressly stating that it applies to Canada.

Canadian WTO Challenges to U.S. Countervailing Duty and Antidumping Laws and Proceedings. Canada has initiated eight cases in the WTO in connection with softwood lumber issues. These cases, identified below with their WTO case number, involve challenges both to U.S. trade statutes and to the softwood lumber antidumping and CVD proceedings themselves. As noted earlier, Canada has requested NAFTA binational panel review of the determinations issued by DOC and ITC in response to adverse WTO rulings in DS264 and DS277, respectively.

Export Restraints as Subsidies (DS194). The DOC recognized the countervailability of export restrictions in its 1992 determination of subsidies involving Canadian softwood lumber and in a 1990 determination of subsidies involving leather from Argentina. In the SAA accompanying the Uruguay Round Agreements Act (URAA; H.Doc. 103-316, vol.1, pp. 925-926), and in the DOC's *Federal Register* explanation of its implementing rule (63 *Fed. Reg.* 65349-51, November 25, 1998), the Executive Branch confirmed that if it were again to investigate situations and facts similar to those in the two cases just described, U.S. trade law would continue to permit it to reach the same conclusion. Canada challenged this policy in the WTO, alleging that the U.S. interpretation, as set forth in those documents, is inconsistent with U.S. obligations under the WTO Agreement on Subsidies and Countervailing Measures (SCM). The WTO panel agreed with Canada that export restraints do not constitute a financial contribution from the government, and thus do not confer a countervailable subsidy under the SCM Agreement; however, the panel recommended no remedial action, since U.S. law does not require the DOC to treat an export restraint as a subsidy and since there was no current U.S. measure based on such a finding. The panel report was adopted August 23, 2001.

Section 129(c)(1) (DS221). In apparent anticipation of possible U.S. antidumping and CVD cases against Canadian softwood lumber imports, Canada filed another WTO complaint against the United States on January 17, 2001, challenging § 129(c)(1) of the URAA, which sets forth procedures for administrative compliance with adverse WTO panel reports involving U.S. antidumping or CVD measures. Canada alleged that § 129(c)(1) prohibits the United States from refunding estimated duties in trade remedy proceedings that are found to be inconsistent with WTO obligations and thus violates portions of the WTO Dispute Settlement Understanding and various WTO antidumping and countervailing duty obligations. The panel's report, circulated to WTO Members July 15, 2002, concluded that the United States was not in violation of its WTO obligations since the law did not mandate a WTO-inconsistent result. The panel report was adopted August 30, 2002.

Preliminary Softwood CVD Determinations (DS236). On August 21, 2001, Canada requested consultations with the United States, claiming that DOC's preliminary subsidy and critical circumstances determinations in the softwood lumber CVD proceeding violated the SCM Agreement and the GATT 1994 (WT/DS236). Regarding the subsidy

determination, Canada cited, among other things, DOC's treatment of stumpage as a financial contribution, inflation of the subsidy by calculating a country-wide rate based upon only a portion of Canadian exports to the United States, and measuring the adequacy of remuneration for timber that provincial governments sold to lumber producers by comparing stumpage prices in U.S. and Canadian markets, rather than by referring to prevailing market conditions in Canada alone. (See 66 *Fed. Reg.* 45724-45725, Aug. 29, 2001).

The final panel report, circulated to WTO Members September 27, 2002, upheld the U.S. determination that provincial stumpage programs constitute a financial contribution to the industry, but faulted the methodology used by DOC in determining whether a benefit was conferred on Canadian lumber producers, citing the above-mentioned use of cross-border price comparisons as well as the Department's failure to examine whether a subsidy had passed through an unrelated upstream supplier to a downstream user of lumber inputs. While the panel also found that DOC's preliminary critical circumstances determination (allowing provisional duties) was improper, DOC had revoked the finding in its final CVD determination. Finally, the panel upheld U.S. laws and regulations regarding expedited and administrative reviews in CVD cases, finding that they did not require the Executive Branch to act inconsistently with WTO obligations. Neither party pursued an appeal and the panel report was adopted November 1, 2002.

USTR stated in a press release issued at the time that even though the United States had not appealed the report, it did not agree with the adverse panel conclusion regarding DOC methodology and would argue in the WTO proceeding challenging DOC's final subsidy determination (DS257, below) that the later panel should disregard these earlier findings. The United States reported to the WTO November 29, 2002, that it did not need to take any action to comply with the panel report on the ground that the preliminary duties were no longer in effect and the provisional cash deposits at issue had been refunded to Canada before the panel report was circulated.

Provisional Softwood Antidumping Measure (DS247). On March 6, 2002, Canada requested consultations with the United States regarding the provisional antidumping measure imposed on Canadian lumber after DOC's affirmative preliminary dumping determination October 31, 2001. Canada is arguing that neither the initiation of the antidumping investigation nor the preliminary determination is in accord with the WTO Antidumping Agreement. The case remains in consultations.

Final DOC Softwood Subsidy Determination (DS257). On May 3, 2002, Canada requested consultations with the United States on DOC's final subsidy determination in the softwood lumber CVD proceeding. The United States blocked Canada's first panel request, made at a July 29, 2002, meeting of the WTO Dispute Settlement Body (DSB). Canada later withdrew the request, refiled it, and made a new panel request at the DSB's August 30, 2002 meeting. A panel was established October 1, 2002, the United States having blocked Canada's August 30 request. Panelists were named by the WTO Director-General November 8, 2002.

A final report in the case was reportedly issued to the parties July 2, 2003, and publicly circulated August 29, 2003. The panel made findings similar to those in DS236 above, upholding the DOC finding that provincial stumpage programs were financial contributions by the government for purposes of the WTO subsidy definition, and that the subsidies were

specific to an industry. However, the panel faulted DOC use of cross-border comparisons and determination that the subsidy passed through to downstream users.

The United States appealed the panel report and, in a January 19, 2004 decision, the WTO Appellate Body upheld the panel's stumpage determination, but reversed the panel on its finding that cross-border comparisons could not be used and on its consequential finding that the U.S. determination of the existence and amount of the benefit violated WTO rules. Because of insufficient information, however, the Appellate Body could not complete the analysis as to whether the benchmark that the United States use was proper and consequently whether the U.S. benefit finding and ultimately its imposition of countervailing duties based on that determination comported with WTO obligations. Regarding downstream users, the Appellate Body upheld the panel's finding that DOC had violated WTO obligations when it failed to conduct a pass-through analysis regarding arm's-length sales of logs by tenured harvesters/sawmills to unrelated sawmills, but reversed the panel on its finding that DOC acted inconsistently with WTO obligations when it failed to conduct a pass-through analysis regarding arm's-length sales of lumber by such sellers to unrelated remanufacturers.

The appellate and modified panel reports were adopted by the WTO on February 17, 2004, and the parties later agreed on a 10-month compliance period ending December 17, 2004. On November 9, 2004, the USTR invoked the procedure set out in §129 of the Uruguay Round Agreements Act, 19 U.S.C. §3538, for agency compliance with adverse WTO decisions involving antidumping and countervailing duty proceedings. As provided in the statute, the USTR requested DOC to issue a revised determination not inconsistent with the Appellate Body decision. The new determination, effective December 10, 2004, lowered the subsidy rate from 18.79% to 18.62 % *ad valorem* on all shipments entered, or withdrawn from warehouse, for consumption on or after this date.

At Canada's request, a WTO compliance panel was established in early 2005 to review the new CVD determination. Canada also requested authorization to impose sanctions against the United States covering trade in the amount of approximately $160 million (U.S.). The United States objected to the retaliation request, sending it to arbitration. Under an agreement between the United States and Canada, the arbitration is currently suspended until the rulings in the compliance procedure are adopted. If the rulings are adverse to the United States, either party may request that the arbitration be resumed. The compliance panel reportedly submitted its final ruling to the panelists on June 3, 2005, the panel finding that Commerce had not carried out the necessary pass-through analysis to determine whether the benefit of the subsidy was conferred on downstream purchasers. Once the panel report is publicly circulated, either party will have 60 days to appeal; an appeal takes up to 90 days.

Final DOC Softwood Dumping Determination (DS264). On September 13, 2002, Canada requested consultations with the United States regarding the final affirmative determination of sales at less than fair value with regard to Canadian softwood lumber announced by the DOC March 21, 2002. Canada claims various violations of the GATT and the WTO Antidumping Agreement, arguing that the DOC improperly initiated the case because of the lack of sufficient evidence in the petition and the same failure to gauge industry support alleged in DS257 (discussed above); that it improperly applied a number of methodologies, resulting in artificial or inflated dumping margins; that it did not establish a correct product scope for its investigation; and that it failed to adhere to various WTO requirements involving procedural matters in the investigation.

The panel circulated its final report April 13, 2004, generally rejecting Canada's claims, though (with one dissent) faulting the United States on its use of "zeroing." The practice, used in calculating weighted average dumping margins, involves assigning a "zero" value to transactions in which the export price or constructed export price exceeds normal value (i.e., where there is no dumping), and as a result not using the higher prices in these transactions to offset the lower prices in other sales. The United States appealed on this issue, and in August 2004, the Appellate Body upheld the panel's conclusions regarding the practice. In addition, on an issue appealed by Canada, the appellate decision reversed the panel's finding that the United States had not infringed various Antidumping Agreement provisions in calculating financial expenses for softwood lumber for one company under investigation (Abitibi). Since the reversal focused only on the panel's interpretation of the legal standard that the panel used to evaluate the DOC's approach, the Appellate Body did not make any findings as to whether the United States in fact acted consistently or inconsistently with the provisions involved. The rulings were adopted August 31, 2004, and the parties agreed on a compliance deadline of May 2, 2005.

On January 31, 2005, the Department of Commerce issued a preliminary § 129 determination in which it continued to find dumping and moreover increased dumping margins. DOC applied a mode of comparing foreign and U.S. prices that was not used in the original dumping determination, maintaining that the WTO ruling applied only to the use of "zeroing" in the methodology addressed in the case and did not apply to other methodologies of price comparison that Commerce has discretion to use in dumping investigations. Commerce used this methodology in its final determination, which again resulted in higher margins, ranging from 3.93% to 16.35% for individually investigated producers and including an "all others" rate of 11.54%, approximately three percentage points higher than the original rate. Notice of the determination was published in the May 2, 2005 *Federal Register* (70 *Fed. Reg.* 22636). At Canada's request, the new determination was referred to a WTO compliance panel on June 1, 2005. Canada is also seeking to suspend approximately $350 million (U.S.) in concessions owed the United States, but on the U.S. objection, the request has been sent to arbitration. In an agreement between the two countries, the arbitration has been suspended pending completion of the compliance proceedings.

The practice of *zeroing* had earlier been ruled to violate the Antidumping Agreement in a case brought by India against the European Union and is currently the subject of separate WTO challenges against the United States by the EU and Japan. Federal courts have held the practice to be allowed, but not required, under U.S. law. (See, e.g., *The Timken Co. v. United States*, 354 F.3d 1334 (Fed. Cir. 2004).)

ITC Injury Investigation in Softwood Antidumping and Countervailing Duty Cases (DS277). On December 20, 2002, Canada requested consultations with the United States regarding the International Trade Commission's injury investigation in the softwood antidumping and countervailing duty cases, including its May 2, 2002, final affirmative injury determinations that resulted in the imposition of duties in each. Canada has claimed violations of the GATT, the Antidumping Agreement, and the Agreement on Subsidies and Countervailing Measures, alleging, among other things, that the ITC based its threat of injury determination "on allegation, conjecture and remote possibility" and that it failed to consider properly a number of relevant factors in its determinations of injury or threat.

A final panel report faulting the ITC's threat determination and its causal analysis was issued to the parties February 10, 2004, and publicly circulated March 22. While the panel recommended that the United States bring its measures into conformity with the WTO Antidumping and SCM Agreements, it declined to recommend any ways for it to do so. The United States took issue with the panel's negative findings, but chose not to appeal and the report was adopted April 26, 2004. On May 19, the United States told the WTO Dispute Settlement Body that it intended to comply and the parties agreed on a deadline of January 26, 2005.

The ITC issued a § 129 determination on November 25, 2004, which, with one dissent, found as before that U.S. industry is threatened with material injury by reason of dumped and subsidized Canadian imports. While the United States, at a January 25, 2005, meeting of the WTO Dispute Settlement Body, stated that it had complied in the case, Canada in February 2005 requested the establishment of a compliance panel as well as authorization to impose approximately $3.5 billion (U.S.) in sanctions, an amount it stated represents the total amount of CVD and antidumping duty cash deposits collected and not refunded as a result of the United States' failure to revoke the May 22, 2002, CVD and antidumping orders, which Canada views as proper implementation of the WTO rulings in the case. As is it did in the other softwood disputes, the United States objected to the retaliation request and thus sent it to arbitration. Again, the arbitration has been suspended until the rulings in the compliance procedure are adopted, with either party able to request that arbitration be resumed if the rulings are ultimately adverse to the United States. The panel is expected to rule in September 2005, at which time its report may be appealed.

DOC Reviews of Countervailing Duty on Softwood Lumber (DS311). On April 14, 2004, Canada requested consultations with the United States regarding the ongoing CVD case, arguing that the United States had violated the SCM Agreement and the GATT by failing to provide expedited and administrative reviews to establish individual CVD rates for specific exporters who had requested them. While the consultation period has expired, to date no panel request has been made.

FOR ADDITIONAL READING

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John A. Ragosta, Harry L. Clark, Carloandrea Meacci, and Gregory I. Hume, *Canadian Governments Should End Lumber Subsidies and Adopt Competitive Timber Systems: Comments Submitted to the Office of the United States Trade Representative on Behalf of the Coalition for Fair Lumber Imports* (Washington, DC: Dewey Ballantine LLP, April 14, 2000).

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