

ANNEX C

PARTIES' COMMENTS ON REPLIES TO QUESTIONS FROM THE SECOND MEETING

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ANNEX C-1

COMMENTS OF CANADA ON RESPONSES OF THE UNITED STATES TO QUESTIONS POSED IN THE CONTEXT OF THE SECOND SUBSTANTIVE MEETING OF THE PANEL

(5 September 2003)

86. The Panel refers to paras. 2 and 3 of the US Second Oral Statement. The Panel requests the US to note all the "misstatement" that it has identified in Canada's submissions, in addition to those mentioned in the Second Oral Statement. Further, in its replies to the questions posed by the Panel, Canada's Second Written Submission and Second Oral Statement, Canada made detailed factual presentations relevant to its claims. The US is requested to identify and substantiate all factual aspects with which it disagrees with Canada.

Canada's comments on the US response to Question 86 are the following:

1. In the Attachment to the Second US Responses to the Panel's Questions, the United States has raised two new arguments regarding initiation.
2. First, the US argument that information on the operations of the US surrogate mills is in the confidential version of the affidavits is not correct. As is obvious from the public version of the affidavits, there is no bracketed discussion of the operations of the companies.¹
3. Second, the United States argues, for the first time, that the US surrogate mills "... were used only with respect to factory overhead, planer shavings, and sawdust/bark".² Canada notes that this statement is in conflict with the statement in the prior paragraph of that attachment that information from the US mills was used to provide factor usage data on stumpage, harvesting costs, labour, electricity, fuel, and wood chips. A lumber mill's costs are determined by multiplying its factor usage by the per unit price for that factor. Factor usage costs are the part of the cost calculation that would vary most from mill to mill, making it critical that the data be derived from mills that are representative.

90. Please comment on Canada's Second Oral Statement, para. 20 which states that:

"[t]he United States, hiding behind the pretense of confidentiality, has not provided this Panel with any information that was before Commerce about the two US surrogate mills. These US mills were at the heart of Commerce's decision to initiate. Canada has not seen, and the Panel still does not have before it, basic information in the hands of the United States, such as the names of the US mills and what Commerce knew about those mills. The United States has responded to Canada's claims with nothing but assertions."

¹ See affidavits at Petition, Exhibit VI.C-1 (Exhibit CDA-135).

² See Attachment to the Answers of the United States to the Panel's 13 August 2003 Questions, 26 August 2003, at 2 [hereinafter "US Attachment"].

Canada's comments on the US response to Question 90 are the following:

4. At paragraph 15 of its Answer to Question 90 and page 7 of its Attachment responding to the Panel's Question 86, the United States cites a US Department of Agriculture Publication entitled *Profile 2001: Softwood Sawmills in the United States and Canada*.³ The United States cites that publication in support of its assertion that the US surrogate mills chosen to model the costs of Canadian producers for purposes of initiation were representative of Canadian producers.

5. The US citation of this report is deceptive for two reasons. First, the study cited by the United States was *not* before Commerce at the time of initiation. The Application only contained the first three pages of *Profile 1999: Softwood Sawmills in the United States and Canada*. It did not contain any listing of any companies, nor does it discuss "large, permanent operations", the phrase Commerce now relies upon to support its claim that at initiation it had evidence that the mills used were representative.⁴ The report now relied upon by the United States was not put on the record until respondents filed the document nearly three months *after* Commerce made the decision to initiate. It was put on the record as part of the respondents' submission requesting Commerce to terminate and rescind the investigation because of insufficient evidence.⁵

6. Second, and more important, the information before Commerce at the time of initiation indicates that the two US surrogate mills could *not* be characterized as "large, permanent operations." Counsel for the respondent companies have informed Canada that information designated as confidential confirms that: (1) any implication that the two US surrogate mills were "large, permanent operations" at the time of initiation is false; and (2) Commerce knew this at the time of initiation.

7. Finally, the US refusal to provide the Panel specific information on the US surrogate mills or on their operations on the basis that the information is confidential, claiming "Commerce's legitimate protection of the confidentiality of certain information as required by US statutory law"⁶ is inconsistent with the United States' treatment of Canadian respondents' data. Canada notes that the United States has released the confidential information of individual Canadian companies, in bracketed form, in this proceeding. For example, in defending itself against Canada's Article 2.4 claims, the United States has provided this Panel, and the Canadian Government, specific individual prices of Abitibi, Tembec, Slocan, West Fraser and Weyerhaeuser.⁷ These prices were given to Commerce by the individual companies pursuant to an administrative protective order. Commerce did not have their consent to reveal those prices to the Government of Canada and to the Panel.

96. At what stage were the respondents informed of DOC's finding that differences in dimension do not affect price comparability? What opportunities were provided to respondents to comment on that finding?

Canada's comments on the US response to Question 96 are the following:

8. Canada agrees with the US statement in response to this question that the evidence submitted and argument made "required Commerce to evaluate the pricing data on the record" for the purpose of

³ This is the publication cited at para. 25, footnote 38 of the US Second Written Submission.

⁴ See Petition, Vol. IB, Exhibit 1B-49, H. Spelter and T. McKeever, *Profile 1999: Softwood Sawmills in the United States and Canada* (Washington: USDA, 1999) at 1-3. (Exhibit CDA-185).

⁵ See *Certain Softwood Lumber from Canada: Request for Termination and Rescission of Investigation*, Letter from Weil Gotshal & Manges to Commerce (19 July 2001), at Enclosure 3 (Exhibit CDA-51). Commerce initiated the investigation on 23 April 2001, and published the notice of initiation in the Federal Register on 30 April 2001. See *Certain Softwood Lumber Products from Canada*, 66 Fed. Reg. 21,328 (Dep't Commerce 30 April 2001) (initiation) at 21,328 and 21,332 (Exhibit CDA-9).

⁶ Answers of the United States to the Panel's 13 August 2003 Questions, 26 August 2003, at para. 14 [hereinafter "US Second Responses to Questions"].

⁷ See, e.g., Exhibits US-42 and US-76.

“carefully reviewing the effect of dimension on price.”⁸ Yet, as the US response to Question 99 makes clear, Commerce did not do so. It applied no coherent methodology for selecting representative comparisons, in sufficient number to achieve representative results. Also, it performed no coherent analysis with respect to the handful of comparisons it appears to have examined. The best explanation the United States can offer is that Commerce determined not to allow for any adjustment (“difmer”) on any of the 2,382 non-identical comparisons it made,⁹ on the basis of charts showing individual transaction prices¹⁰ for one pair of West Fraser Products and one pair of Slocan products. These charts were not made part of Commerce’s record and thus appear to have been created after the fact. Indeed, Commerce appears to have performed no valid analysis at all. Even after the Final Determination, the United States has only offered a simple plotting of data points on compressed charts that do not provide sufficient information to confirm that the data are appropriate.

97. Please comment on Canada's response to Question 22, with reference to the respondents' demonstrating a need for a price adjustment:

"at the beginning, of the period, in April 2000, Abitibi's average net price for No. 2 grade 2x4x8 was around [[]] whereas the No. 2 2x6x16 price was [[]]. The comparable figures for economy grade were [[]] for the smaller size and [[]] for the larger."

Canada's comments on the US response to Question 97 are the following:

9. The graphical representation of data in Exhibit US-81, which was not before Commerce at the time of its Final Determination,¹¹ is misleading, difficult to follow, and analytically deficient.¹² Although not explained, the graph plots, in a compressed fashion, all of Abitibi's individual home market sales of four products. The Y-axis appears to show the net price in Canadian dollars (after subtracting freight costs and other adjustments),¹³ while the X-axis appears to plot the invoice date.¹⁴

10. Prices for individual sales are rarely set on the invoice date. For example, Abitibi has a wide range of sales arrangements, including spot sales, in which prices are negotiated at the time of order, as well as contract sales with longer-term prices, or with formula prices.

11. In view of the fluctuating nature of lumber prices, there is no reason to expect that sales of even the same product with the same invoice date will show the same price, much less that different products will show “consistent” price differences based on the invoice date. It is for this reason that Canadian respondents, and Canada in this proceeding, have always examined monthly average or annual average prices, as such averages smooth out data fluctuations caused by the different mechanisms and times at which prices are set in relation to invoice date. A scatter diagram of individual transaction prices based on invoice dates is essentially useless in determining whether dimension has an impact on price.

⁸ US Second Answers to Questions, at para. 32.

⁹ See Canada's Responses to Questions to the Parties from the Panel in Connection with the First Substantive Meeting, 30 June 2003, at para. 97, for a table showing the number of non-identical comparisons Commerce made for each respondent.

¹⁰ It is not clear whether these are gross or net prices.

¹¹ The same is true of Exhibits US-76, US-42, and US-43.

¹² Throughout this proceeding, the United States has argued that the Panel should not examine charts or tables not before Commerce, even if the underlying data were before Commerce. In submitting this exhibit, the United States recognizes that which Canada has asserted all along. As long as the underlying data were before the investigating authority, it is perfectly appropriate for parties to present these data to the Panel in a new form, using graphs, charts and tables.

¹³ The United States did not state what adjustments were made.

¹⁴ This is not explained either.

12. In this respect, it is instructive to review Abitibi's data for the No. 2 grade products Commerce examined. As Canada noted previously, the United States made a total of 2,382 non-identical product price comparisons, and made *no* adjustment for physical characteristics for *any* of those comparisons. This can only be justified if the record shows that dimension *never* affects price comparability. Canada need only establish that for particular comparisons, dimension does affect price to show that "due allowance" is required for differences in dimension, which allowance, as Canada has acknowledged, may be zero in particular cases.¹⁵

13. An analysis of the data relied upon by the United States is revealing. First, the weighted average annual net price for each dimension product across the entire period of investigation was computed. This shows, on average, whether different-dimension products sell for the same price or different prices. The use of annual average prices is comprehensive, in that it considers all sales, and also smooths out differences due to the manner and date on which the price for individual sales occurs, as well as other anomalies.¹⁶ The average net price charged by Abitibi for No. 2 2x6x16 was [[]] for No. 2 2x4x8. These data show that, for these products, dimension affects price, and significantly so. The average difference in value is some [[]], or almost [[]] per cent.

14. Next, adopting the US approach of using individual transactions, and of invoice date as relevant for comparison purposes,¹⁷ we tested the US assertion that prices converge, diverge, and overlap, show no "consistent" pattern, and thus cannot establish that dimension affects price. Instead of simply providing a raw scatter diagram, we looked at the number of days on which both products were sold, and calculated the number of times the 2x6x16 product sold for a higher price than the 2x4x8. The data before Commerce show that of the 56 occasions on which both products were invoiced on the same date, the larger product sold for a higher price on 55 of those dates, or over 98 per cent of the time.¹⁸ This would seem to be fairly "consistent."

15. Finally, the data were replotted, using less compressed, more appropriate Y-axis points that allow one better to view the data. Rather than simply testing for patterns using Commerce's "eyeball" test, a regression analysis was done to determine, for each product, the best fitting curve matching each product's prices.¹⁹ This analysis enables one to plot the overall price pattern. The results are presented in attached Exhibit CDA-185. Contrary to Commerce's unsupported assertions, the regression analysis shows pronounced pricing differences between the two products. Indeed, the two curves are almost parallel, demonstrating that the observed pricing differences were, in fact, fairly consistent over the period.

16. In short, once the data are analyzed, rather than simply printed, they establish that, for these products, the dimensional differences create price differences and thus affect price comparability. They also conclusively refute the US suggestion that sometimes one price is higher, sometimes the other is higher, such that on average there is no difference.

99. With respect to the consistency in price patterns, the Panel has the following questions:

¹⁵ See Canada's Responses to Questions to the Parties from the Panel in Connection with the Second Substantive Meeting, 26 August 2003, at para. 46 [hereinafter "Canada's Second Responses to Questions"].

¹⁶ It is for this reason that Canada's initial presentation to the Panel included graphs showing annual average prices for different dimension products. See POI Average Prices for Different Lengths and Widths: Abitibi, Canfor, Slocan, West Fraser and Weyerhaeuser (Contains Business Confidential Information) (Exhibit CDA-76).

¹⁷ Canada believes this approach to be erroneous for the reasons noted above.

¹⁸ Where there were multiple sales on the same date, we used the weighted average net price.

¹⁹ The regression performed was the ordinary least squares using a quadratic model.

- (a) **Could DOC explain in detail the methodology it used to carry out its consistency test? Illustrate your explanation with an example from the test that was carried out in this case, including any sampling, selection of dates, etc. Did the US consider using other methodologies?**
- (b) **Could the US explain in detail how the results of its test were evaluated? Please explain the evaluation leading up to that conclusion.**

Canada's comments on the US response to Question 99 are the following:

17. In response to this question, the United States claims that Commerce "examined random sales of commonly sold softwood lumber products, comparing products with relatively small dimensional differences"²⁰ and provided two examples. The United States further claims that Commerce did so for "each of the Canadian respondent companies, plotting sales over the entire period of investigation ... includ[ing] both above- and below-cost sales ...".²¹

18. The United States, however, has provided no citation to any record document supporting that this analysis was done. It strains credibility that Commerce was able to "eyeball" all sales of particular product comparisons for the entire Period of Investigation (POI) for each of the respondents, without needing to draft any document in support of this "analysis".²²

101. Please comment on Canada's Second Oral Statement, para. 56 which states that:

"[t]he US International Trade Commission, in the injury inquiry, determined that 'lumber prices generally differ substantially depending on grades and dimensions'."

Canada's comments on the US response to Question 101 are the following:

19. Contrary to the US contention that the US International Trade Commission's (ITC) finding of fact was not material to its injury determination, Canada notes that, as the investigating authority charged with making the injury determination, the ITC, under US law, must specifically examine "the effect of imports of that [investigated] merchandise on prices in the United States of domestic like products."²³ Indeed, price analysis is critical to the ITC analysis. US law expressly requires the ITC to compare prices of imported products with domestic like products for purposes of determining whether imports are underselling domestic like products or causing price depression.²⁴ The ITC thus examines pricing data of imported products and domestic like products. In selecting and evaluating such comparisons it is critical first to assess all factors affecting price comparability, so as to ensure that its price comparisons are meaningful. It is in this context that the ITC found that lumber prices differ substantially, depending on grade and dimension.

²⁰ US Second Answers to Questions, at para. 41.

²¹ *Ibid*, at para. 42.

²² In contrast, when Commerce wanted to confirm the appropriateness of the relationship of prices across grades, a Commerce official was tasked with the analysis and a memorandum was placed on the record supporting that analysis. See DOC Issues and Decision Memorandum for the Antidumping Duty Investigation of *Certain Softwood Lumber Products From Canada* (21 March 2002), Comment 33, at 24 and footnote 62 (Exhibit CDA-2) [hereinafter "IDM"].

²³ 19 U.S.C. § 1677(7)(B)(i)(II) (Exhibit CDA-7).

²⁴ 19 U.S.C. § 1677(7)(C)(ii) (Exhibit CDA-7).

102. In paras. 58-60 of Canada's Second Oral Statement, Canada alleged that the average dumping margin for the non-identical comparisons was 2 to 7 times higher than the average margins of dumping for identical comparisons as DOC made numerous comparisons of smaller, low-value lumber sold in the US to larger dimension, high-value lumber sold in Canada, without any adjustment for dimension. Could the US comment on this allegation that this establishes a prima facie breach of the requirement of Article 2.4?

Canada's comments on the US response to Question 102 are the following:

20. The United States argues for the first time that the reason the margins on non-identical comparisons were two to seven times higher than the margins on identical comparisons was because the non-identical comparisons were on US sales of low-value products, which generated high margins because they were the most dumped products. However, the reason Commerce found these products to be the most dumped was primarily because of Commerce's failure to adjust for differences in physical characteristics when it compared non-identical merchandise.²⁵ The US argument is an exercise in circular reasoning (*i.e.*, the result is used to justify the failure to comply with the requirements of Article 2.4 that led to those results) that cannot support a conclusion that Commerce's establishment of the facts was proper and its evaluation of those facts was unbiased and objective.

G. ABITIBI:

To the US:

113. Please comment on Exhibit CDA-176.

Canada's comments on the US response to Question 113 are the following:

21. The United States has made several new arguments based on mischaracterizations of Canada's position. Contrary to the arguments now made by the United States, Canada has never asserted that the costs of producing goods are fully reflected in accounts receivable, or that financial costs are only incurred on inventory. Rather, it has been Canada's consistent position that financial costs relate directly to the total debt of a company (only debt generates interest expenses), and that both debt and equity together relate to the total amount of cash invested in the company, or, as the United States has sometimes termed it, the company's total "cash needs." Such total cash needs are reflected in total company assets. The facts establish this to be correct. The basic formula for every balance sheet is that liabilities (cash provided by debt) plus equity (cash provided by investors) equal assets. As money is fungible, and thus specific assets are not associated with specific debt or specific equity, debt relates equally to all assets, and financial expenses relate to total assets. To be precise, in this case, Abitibi's C\$11 billion in assets are financed by C\$3 billion in shareholder equity and C\$5.6 billion in long-term debt, and C\$2.4 billion in other liabilities, including accounts payable, etc. Debt is on the balance sheet, and thus interest expense resulting from debt also relates to items on the balance sheet, not the cash flow statement (as the United States erroneously asserts in its Response to Question 115, at para. 62). The US position that Abitibi's debt and interest expense relates exclusively to its cost of sales of C\$4 billion, cannot be reconciled with the evidence. Abitibi cannot

²⁵ Commerce's finding on non-identical comparisons was also due to its cost analysis, an issue not before this Panel. Commerce allocated the exact same costs to dimensions that had a low market value as it allocated to dimensions that had a high market value. Had Commerce used the same value-based cost allocation method for dimensions that it used for grades, then it would have allocated less cost to the low-value products, more of them would have survived the costs test, and there would have been identical matches with much lower dumping margins for more of these low-value products. Commerce then compounded the problem by comparing lower-value products in the US market to higher-value products in the Canadian market without any adjustment for the differences in physical characteristics.

have borrowed C\$5.6 billion in long-term debt to finance C\$4 billion in short-term expenses. The evidence establishes that it is the US premise that is incorrect.

22. Next, the United States contends that it is a “false premise” that Abitibi finances the full value of its assets in each year of production.²⁶ But while the United States characterizes this claim as “extraordinary” and “contrary to normal business practices”, without explanation, it is, in fact, true, and demonstrably so. Indeed, it is what every balance sheet establishes. As noted above, debt plus equity equals assets, every year. Contrary to the US argument, it is precisely the case that a company must, each year, finance the full value of every asset it requires for its business. Indeed, this is the necessary consequence of the United States’ own argument that money is fungible, and thus debt relates to all assets rather than specific assets. A company deploys cash to buy an asset, and the amount of cash required is reflected in its full value, not in its depreciation expense.

23. The United States overlooks the simple fact that the cash spent on an asset remains invested in the asset. The value of the asset *always* reflects the cash deployed in that asset and thus the amount that must be financed, as long as that asset is carried as an asset. Until an asset is sold, or fully depreciated to zero, the amount that must be financed is the remaining value of the asset. It is never the depreciation expense, because depreciation expense never reflects the amount of cash resources the company has “tied up” in the asset.

To both parties:

115. The Panel understands Canada to argue in para. 80 of its Second Oral Statement that an asset-based methodology can capture the flow elements through inventory. Please comment.

Canada’s comments on the US response to Question 115 are the following:

24. The US arguments concerning inventory and cash flow again mischaracterize Canada’s position. As Canada has repeatedly demonstrated, the amount of money needed over a year to finance production is not the same as the total annual costs of production. Unlike fixed and other assets necessary for producing and selling Abitibi’s products (which assets are not sold, and thus must be fully financed each year), once lumber is produced, it is sold and paid for. Abitibi thus only has to finance lumber production from the time it begins to harvest logs until the time it receives payment from its customer. It is only during this period that the company has had to deploy its cash.

25. The annual cash needed to finance the production and sale of lumber for a year thus is not reflected in the production costs incurred in that year, much less in cost of goods sold (COGS), which, as noted, reflects production costs incurred over a different period. Rather, the cash needed to finance the production and sale of lumber in a year is equal to the average costs of the current assets that must be kept on hand to produce and sell lumber – the raw materials inventory, the work-in-process inventory, the finished goods inventory, and the accounts receivable. These costs alone reflect the amount of cash invested in current lumber operations.

26. To illustrate, suppose Abitibi had a line of credit that it used to finance its ongoing lumber operations. As expenses are incurred to harvest logs, process lumber, pay salaries, etc., the negative balance in the account would increase. As payment is received from customers, the balance declines. The key point is that the interest expense incurred over the course of a year will be a function of the average negative balance in the account. The average negative balance, in turn, equals the total value of all the inventory and accounts receivable asset accounts – the costs outstanding for raw materials and goods produced but not yet paid for. Contrary to the US position, the annual interest charge will bear no relationship to the total amount of expenses charged to the account in the year, much less the “flow” through the account for goods produced at other times but sold during the period.

²⁶ US Second Answers to Questions, at para. 58.

27. The fact that annual financing expenses relate directly to assets and not to current expenses also has nothing to do with how proceeds from sales are spent, as the United States erroneously asserts. As the example above demonstrates, Canada's argument in no way depends on how the proceeds from the sales of lumber are used. The point the United States ignores is that lumber is sold and paid for, and thus does not have to be financed for the entire cost period examined. Fixed and other long-term assets, on the other hand, are not sold, but rather are kept in use for the entire cost period. Thus, they must be financed, at their value, for the entire cost period.

28. Finally, the United States is wrong that the COGS methodology considers both the costs of goods in inventory as well as those sold, while Canada's methodology considers only the costs of goods in inventory. The issue before the Panel is not how to determine production costs, but rather how to allocate interest expenses. Interest expenses are a function of (1) cash needs, and (2) the amount of time for which such cash must be invested. Total COGS for a year reflects neither of these for that year. Canada's methodology is based on both of these functions. The COGS during the year are fully considered, but only for the time the cash invested in producing those goods remains invested, *i.e.*, until they are paid for, and thus only for so long as they remain an asset – either in raw materials inventory, work-in-process-inventory, finished goods inventory, or accounts receivable. Once a good is sold and paid for, no cash remains invested in that good, and it is no longer being financed by the company. The United States has nowhere explained the basis for its position that goods sold and paid for still are being financed by the producer.

119. In its reply to question 56, the US refers to the "reliability of cost data". Based on the record, did DOC find in the context of the investigation that data submitted by Tembec for the Forest Products Group was not reliable? If so, please point to relevant documents submitted to the Panel – including cost verification reports – or provide them.

Canada's comments on the US response to Question 119 are the following:

29. In its answers to Questions 119 and 120, the United States states four times, in paragraphs 65-69 and at pages 16-17 of the Attachment, that no evidence was presented that Tembec's divisional data were kept in accordance with generally accepted accounting principles (GAAP). Those statements are inaccurate. Note 20 to Tembec's Consolidated Financial Statements contained in Tembec Inc.'s 2000 Annual Report explicitly states that "[t]he accounting policies used in these business segments are the same as those described in the summary of significant accounting policies" to the Consolidated Financial Statements.²⁷

30. As noted in the Auditors' Report to the Consolidated Financial Statements, an audit includes assessing the accounting policies used in preparing the statements. The auditors found those statements, including the policies used in preparing them, to be in accordance with GAAP in Canada.²⁸ The United States assertion that Tembec's Forest Products Group records are not maintained in accordance with GAAP is an assertion unsupported by any evidence and contrary to the evidence that is on the record.

120. Please comment on paras. 84-88 of Canada's Second Oral Statement, specially on the last sentence of para. 85.

Canada's comments on the US response to Question 120 are the following:

²⁷ See Tembec Section A Questionnaire Response (22 June 2001), Exhibit A-15 (Tembec Inc. 2000 Annual Report) at 44 (Exhibit CDA-94).

²⁸ *Ibid.*, at 29 (Exhibit CDA-173).

31. The United States makes two new arguments in paragraph 66 and on page 17 of its Attachment in response to the Panel's question about the evidence that Tembec's pulp and paper operations incurred significantly higher G&A than its lumber operations. The first new argument is that "the productivity of assets does not determine the amount of G&A used ...".²⁹ That argument is not relevant. Canada never made arguments concerning assets with respect to Tembec's G&A. The United States is confusing Abitibi and its financing expenses with Tembec's G&A.

32. The second argument is that "no reliable evidence was presented showing that Tembec's lumber division incurred less G&A than its other divisions."³⁰ This argument is an inaccurate *ex post facto* rationalization. The Hyperion statements included as exhibits to the verification reports show that the pulp and paper groups incurred higher G&A than the Forest Products Group.³¹

33. The United States further claims in paragraphs 65 and 67 that "Commerce rejected the [Forest Products Group G&A] data because they were less reliable and could have led to distortions." This new argument is also an *ex post facto* rationalization that was not part of the agency's explanation for rejecting the Forest Products Group G&A data. Commerce, in its Issues and Decision Memorandum, defended its normal practice of using company-wide data by noting that "[this] methodology also avoids any distortions that may result if, for business reasons, greater amounts of company-wide general expenses are allocated disproportionately between divisions."³² Commerce made no findings that this hypothetical concern was applicable to Tembec. Commerce never made any written findings that Tembec's Forest Products Group G&A data were less reliable or would lead to distortions. The record evidence actually shows that Commerce's use of the company-wide data led to distortions that would have been avoided had Commerce used the Forest Products Group data.

34. Finally, the United States, in paragraph 69 of its answer to Question 102 and at page 17 of its Attachment, claims that Commerce used Tembec's divisional data only for the very narrow purpose of removing certain packaging costs from the denominator in the calculation of the G&A ratio. Commerce, the United States claims, did not use Tembec's divisional data for any other purpose. Actually, Commerce used the Forest Products Group divisional data for every element of the sales databases and its price-to-price comparisons, including not only the sales prices themselves, but also every adjustment.³³ Moreover, Forest Products Group divisional data were used for every element of Commerce's cost calculations except G&A and financing expenses. They were used to determine the costs of all raw materials, labour, energy, depreciation and factory overhead.³⁴

123. It is stated in para. 84 of the US Second Written Submission that:

"[g]eneral expenses are, by definition, expenses incurred for the benefit of a corporate group as a whole. They are not specific to one or another product line. A requirement that general expense be directly related to the good produced would make it impossible to allocate general expense within a company that produces many goods because a direct relationship would never be identifiable. This would render meaningless the requirement of Article 2.2

²⁹ US Attachment, at 17.

³⁰ *Ibid.*

³¹ See Tembec Cost Verification Exhibit 10, at 2 (Contains Business Confidential Information) (Exhibit CDA-149).

³² IDM, Comment 33, at 105 (Exhibit CDA-2).

³³ See DOC Analysis Memorandum For Tembec Inc., at 1 ("This margin is based on sales information supplied by Tembec.") (Tembec Sales Exhibit, at 6 (Contains Business Confidential Information) (Exhibit CDA-187)); see also Verification Report and Accompanying Exhibits providing verified data derived from Tembec's Forest Products Group (*ibid.*, at 7-24).

³⁴ See Cost Verification Report, at 5 (*ibid.*, at 8).

that “a reasonable amount for administrative, selling and general costs” be included in a company’s cost calculation.”

In its practice, how does DOC treat G&A costs which have been demonstrated to it not to "pertain[] to production and sales () of the like product" in accordance to the chapeau of Article 2.2.2? Please provide a recent example of that practice.

Canada’s comments on the US response to Question 123 are the following:

35. In its response to Question 123, the United States acknowledges that its policy is to allocate only a portion of parent company G&A to the producer of the like product. The United States misstates its practice. In *Brass Sheet and Strip*, Commerce found that, in calculating G&A:

[it] includes an amount of G&A from related companies which pertains to the product under investigation. G&A and other non-operating income and expense items are not considered fungible in nature. Thus, non-operating income and expenses realized by a related company does not necessarily affect the general activity of [the respondent].³⁵

36. This practice clearly anticipates that non-operating expenses are not fungible and that some such expenses incurred by a parent company may not “affect the general activity of the respondent.” Weyerhaeuser’s hardboard siding expense is a non-operating expense. The United States concedes that it relates to non-like product. If, as Commerce states, such expenses are not fungible, then there is no basis for attributing the hardboard siding expense to the production and sale of Weyerhaeuser Canada Limited’s softwood lumber.

125. Please comment on the following portion of para. 229 of Canada's Second Written Statement:

"Commerce agreed that it was proper to exclude the expense from parent company G&A in its preliminary determination".

Canada’s comments on the US response to Question 125 are the following:

37. The United States suggests that it did not know that Weyerhaeuser excluded the hardboard siding expense until verification, after the Preliminary Determination. Canada submits as Exhibit CDA-188 pages from Exhibit D-11 of Weyerhaeuser’s Section D response. This response was submitted on 23 July 2001, months before Commerce’s Preliminary Determination. The attached pages include Weyerhaeuser’s worksheet for calculating parent company G&A and clearly omits the hardboard siding expense, which is a line item that appears in Weyerhaeuser’s financial statement (also included in Exhibit D-11). Commerce reviewed Weyerhaeuser’s submission and accepted the data. It never objected to Weyerhaeuser’s calculation. It reviewed the data at verification and, again,

³⁵ *Brass Sheet and Strip from Canada*, 61 Fed. Reg. 46,618, at 46,619 (Dep’t Commerce 4 September 1996) (Exhibit CDA-104), citing *Certain Hot-Rolled Carbon Steel Flat Products from Japan*, 58 Fed. Reg. 37,154, at 37,166 (Dep’t Commerce July 9, 1993).

never mentioned that the exclusion of the hardboard siding expense was an issue to be reviewed. Commerce only addressed this issue in vague terms after the record closed.³⁶

³⁶ See the discussion on pages 85-87 of Canada's Second Written Submission.

ANNEX C-2

COMMENTS OF THE UNITED STATES ON RESPONSES OF CANADA TO QUESTIONS POSED IN THE CONTEXT OF THE SECOND SUBSTANTIVE MEETING OF THE PANEL

(5 September 2003)

1. In this submission, the United States comments on certain statements Canada made in its 26 August 2003 responses to questions from the Panel. The United States is mindful of the narrow scope of the Panel's invitation to comment and, therefore, responds only to new factual data and new arguments raised by Canada. There are many other statements in Canada's 26 August 2003 responses with which the United States disagrees. However, in general, the United States has already addressed the substance of those statements in its prior submissions.

A. Physical Characteristics

2. In its response to Panel Question 92, Canada has significantly oversimplified the softwood lumber production process and the methodologies used by the respondent companies for recording their many production costs. The United States refers the Panel to Comment 4 in the *Final Determination* for a detailed discussion of the issues involved in measuring the cost of producing softwood lumber in this case.¹

3. In paragraph 33 of its response, Canada states that Commerce "*created*" variable cost differences among product grades.² Commerce did not "create" any costs or any cost differences. The costs and cost differences associated with grade are a direct result of the data on the record. At the Canadian companies' urging (and, in fact, contrary to the wishes of the domestic parties), Commerce reallocated certain costs that were recorded and reported by the companies on a volume basis. These costs were reallocated to the various grades produced using pricing data, because grade was determined to result from qualities inherent in the wood.³ As a result, the variable costs of varying grades of softwood lumber may differ.

4. In paragraph 35 of its response, Canada states that the United States has raised the question of variable costs and is thereby confusing the issue. At no point in this dispute has the United States raised any question with respect to Commerce's calculation of variable costs or any related issue. The United States has simply explained the basis for Commerce's long-standing approach for granting adjustments for differences in physical characteristics, which normally depends on differences in variable costs.⁴ Nor has the United States ever attempted to "change the focus" in this case to address "*how* the allocation would be calculated."⁵ The United States has consistently directed its arguments

¹ *Final Determination*, Comment 4 (Exhibit CDA-2).

² Canada Responses to Second Panel Questions, para. 33.

³ See *Final Determination*, Comment 4 (Exhibit CDA-2).

⁴ See US First Written Submission, paras. 126, 133 notes 163, 164; US First Answers to Panel Questions, para. 43; US Second Submission, para. 53, note 89; US Second Answers to Panel Questions, paras. 21-30.

⁵ Canada Responses to Second Panel Questions, para. 35.

to the requirements of Article 2.4, unless a specific question from the Panel or argument from Canada has dictated otherwise.

5. In response to Question 93, at paragraph 39, Canada makes yet another attempt to plead surprise with Commerce's Final Determination. This time, however, Canada argues for the first time that respondents did not and could not know what Commerce's model match methodology would be. This contradicts much of Canada's argument, which rests on the parties' comments regarding model matching and the implication of Commerce's alleged acquiescence to those model matching suggestions in the *Preliminary Determination*. Canada argues that respondents could not anticipate what pricing arguments to make unless they could have anticipated (apparently with absolute precision) what non-identical matches Commerce would actually make.

6. Canada's latest claim of surprise makes no sense. Respondents were well aware of Commerce's model match hierarchy, which did not change significantly from the Preliminary Determination to the Final Determination.⁶ Thus, they could easily anticipate, generally, what softwood lumber items were likely to be compared as identical and similar. They were familiar with their own databases and their own product mixes. This is the kind of examination that Commerce performed. The softwood lumber databases are enormous (thousands of transactions). As a result, even Commerce could not determine *precisely* what items are similar and what items are matched as identical until the final computer programme generated the final matches, taking into account all variables and adjustments. If Commerce had been required to perform the analysis Canada suggests, and release it to the parties for comment and possible revision, Commerce could not have completed the investigation in a timely manner.

B. Calculation of the Dumping Margin

7. In response to Panel Question 104, Canada argues for the first time that, when using the transaction-to-transaction comparison methodology in Article 2.4.2 of the AD Agreement, an investigating authority must offset dumping margins with the amount by which distinct transactions have not been dumped. Canada's sole basis for this assertion appears to be the "fair comparison" language of Article 2.4.⁷ According to Canada, not providing an offset "gives these transactions less weight in the calculation of the overall dumping margin."⁸ Canada is simply incorrect. As the United States explained in response to the Panel's Question 109, in calculating the overall dumping margin, Commerce divides the aggregate amount of dumping by the aggregate value of all export transactions that were examined. The aggregate value of all export transactions includes all non-dumped export transactions and no adjustment is made to their value as a result of the fact that they were not dumped. Thus, non-dumped transactions are weighted in the exact same manner as dumped transactions – by their value – and there is no basis for Canada's suggestion that they are given less weight. At the same time, such transactions properly do not affect the numerator in this calculation because, as Canada agrees, "the price comparison revealed no dumping."⁹

C. Abitibi Financial Expenses

8. In response to Panel Question 115, Canada has submitted new factual information in the form of Exhibit CDA-181. Exhibit CDA 181 is misleading and inaccurate for at least two reasons. First, Canada uses this exhibit to imply that all of Abitibi's asset categories are more or less equal. However, as the United States has explained, the vast majority of Abitibi's assets are capital assets for

⁶ *Final Determination*, Comment 7 (Exhibit CDA-2) (The basic methodology did not change between the Preliminary and the Final Determination. Commerce did fine-tune the matches, *i.e.*, subdivided length into length bands and added grade groups).

⁷ Canada Responses to Second Panel Questions, paras. 48-49.

⁸ *Id.*, para. 58.

⁹ *Id.*, para. 49.

which depreciation expenses were realized.¹⁰ (The chart labels these assets as “Building” and “Machinery and Equipment.”) The chart is misleading, because it suggests that the asset category “Land,” which was so insignificant that Abitibi did not list it separately on its financial statement, is roughly equal to these other asset categories.

9. The relative size of “Building” and “Machinery and Equipment” as compared to “Land” is important and illustrates the shifting nature of Canada’s argument before this Panel. Initially, Canada argued that the COGS-based methodology was inappropriate as applied to Abitibi because it ignored the fact that Abitibi’s non-lumber producing divisions required more capital assets than the lumber division.¹¹ The United States explained that because the COGS methodology included depreciation expenses, which are realized on the vast majority of Abitibi’s capital assets, the COGS methodology adequately considered the varying capital asset requirements in allocating financial expenses.¹²

10. In response, Canada’s argument changed, and started to focus on the only example of capital assets for which depreciation expenses are not realized, *to wit*, land. Canada argued that because depreciation expenses were not realized on land, the COGS methodology must be unreasonable.¹³ By creating a chart that suggests that Abitibi owned significant amounts of land during the POI, Canada seeks to strengthen its argument. However, this Panel should look beyond the misleading nature of Exhibit CDA-181. Abitibi did not own significant amounts of land during the POI, as evidenced by the fact that it did not include it as a separate line item on its financial statement.¹⁴

11. Exhibit CDA-181 is also misleading because it explicitly states that all production (or “sawmill”) costs are captured in inventory.¹⁵ Normally, a company produces a large amount of inventory that is sold throughout the year. None of the production costs for these sold goods is included in inventory at the end of the year. Thus, inventory in no manner includes all the production costs incurred throughout the year.

12. In allocating financial expenses, it is important to consider all production costs, because a company may incur financial expenses on any of its costs, including any of its production costs throughout the year. In response to Panel Question 115, Canada argues that a company would not incur financial costs on sold goods, because the proceeds from sales are used to pay for the production of those sold goods.¹⁶ However, this argument disregards the fungible nature of money, a concept with which Canada ostensibly agrees.¹⁷ Because of the fungible nature of money, proceeds from sales, just like proceeds from a loan, may be used to pay for assets as easily as production costs. Thus, all production costs, and not just those in inventory, are properly considered when allocating financial costs.

D. Tembec By-Product Revenue

13. In response to Panel Question 130, Canada incorrectly characterizes a point made by the United States at the Second Substantive Meeting. The United States did not assert that Exhibit CDA-175 demonstrates that there is an actual “cost of production for a by-product.” As the United States has explained throughout this proceeding, by-products do not have an actual cost of production. Nonetheless, just as transfer costs are generally less in value than unaffiliated party transactions, because of the existence of profit, so too are offsets to the cost calculation, in this case

¹⁰ See, e.g. US Second Written Submission, para. 74.

¹¹ See, e.g. Canada First Written Submission, paras. 191-194.

¹² See, e.g. US Second Written Submission, para. 74.

¹³ See, e.g. Canada Responses to First Panel Questions, para. 136.

¹⁴ See, Abitibi Financial Statement, p. 35 and p. 49 note 9 (exhibit CDA-82).

¹⁵ See also, Canada Responses to Second Panel Questions, paras. 83-86.

¹⁶ See, e.g. Canada Responses to Second Panel Questions, para. 85.

¹⁷ See, e.g. Canada Second Written Submission, para. 189.

by-products, generally less in value than the sale price of by-products to unaffiliated purchasers. As Commerce explained in paragraph 88 of its Answer's to the Panel's 13 August 2003 Questions, Exhibit CDA-175 supports this proposition. The exhibit provides, as a general proposition, that at some point, a company will assign a value to a by-product. Once this value has been assigned, future sales of that by-product to unaffiliated parties may result in a "gain," for accounting purposes, to the company. Nothing Canada has offered in drawing distinctions between accounting methods for valuing by-products refutes this proposition, and in fact, Canada's new explanations ignore the United States' central argument: Commerce used Tembec's own books and records to value wood chips in this investigation, as required by Article 2.2.1.1. of the AD Agreement. In doing so, it determined that the difference between Tembec's interdivisional transfer prices and its sales to unaffiliated purchasers could be explained by this reasonable, anticipated "gain". Canada's Exhibit CDA-175 supports Commerce's accounting methodology, which recognizes the existence of such a "gain", and Canada's new arguments have failed to show otherwise.

E. Slokan

6. In response to Panel Question 135, Canada makes a new assertion that the United States "conceded" during the Second Substantive Meeting that Commerce concluded that Slokan's futures profits constituted an offset to indirect selling expenses.¹⁸ Commerce certainly made no such conclusion, and the only point the United States made during the Second Substantive Meeting was that these expenses might properly be indirect expenses, despite Slokan's own claim during the investigation that it had no indirect selling expenses in the United States. Thus, the United States notes that (1) this supposed "concession" is nowhere on the record of the investigation, (2) is a post hoc argument raised by Canada (but never raised by Slokan), and (3) indirect selling expenses still would not affect price comparability in the context of Slokan's requested adjustment, because they are not terms and conditions of sale to a US customer.¹⁹

¹⁸ Canada Responses to Second Panel Questions, para. 126.

¹⁹ See US First Written Submission, para. 249-250.

ANNEX C-3

LETTER OF THE UNITED STATES EXPRESSING OBJECTIONS TO THE COMMENTS OF CANADA ON RESPONSES OF THE UNITED STATES TO QUESTIONS POSED IN THE CONTEXT OF THE SECOND SUBSTANTIVE MEETING OF THE PANEL

(9 September 2003)

Dear Mr. Chairman,

My authorities have instructed me to express objections regarding Canada's 5 September 2003, Comments on US Responses to Questions from the Panel in Connection with the Second Panel Meeting ("Canada's Comments"). On 28 August 2003, the Panel permitted a limited opportunity for the Parties to comment on each other's replies to questions posed by the Panel following the second substantive meeting. The Panel instructed the Parties "not to comment on any factual issues or arguments which have already been subject to discussion during the procedure, but to restrict their comments to any **new** factual data or any **new** arguments raised by the other Party."

Material in Canada's Comments exceeds the scope of the Panel's instructions. In particular, Canada has submitted yet another "regression" analysis (Exhibit CDA-186), this time for certain Abitibi transactions. This exhibit is not addressed to "new factual data" or "new arguments." Instead, it is addressed to factual issues and arguments that had been introduced prior to the 26 August 2003 submission of responses to questions. Canada's assertions regarding Abitibi's sales were included in Canada's 30 June 2003, Responses to Panel Question from the First Substantive Meeting, para. 87. At the Second Substantive Meeting, the Panel asked the United States to comment on Canada's assertions, which the United States did in its Response to Panel Question 97, at paras. 34-36 and Exhibit US-81. Canada improperly has submitted new evidence to the Panel under the guise of responding to "new" data and arguments. Therefore, not only is the submission of this exhibit contrary to the Panel's explicit instructions of 28 August 2003, it is contrary to para. 14 of the Panel's working procedures.

Contrary to Canada's suggestion, (*see* Canada's Comments at note 12), the United States has not objected to the submission of charts, such as CDA-Exhibit 76, that simply reflect the data that were before the investigating authority. The United States did not object to the submission of the presentation of that data, notwithstanding that such charts and analysis had not been presented to Commerce during the underlying investigation. The United States continues to object, however, to eleventh-hour *manipulations* of the underlying data. This is the case for Exhibit CDA-77 and, now, Exhibit CDA-186. Under Article 17.5(ii), such submissions cannot serve as a basis for establishing a violation of obligations under the AD Agreement.

The United States is providing a copy of this letter directly to Canada.

ANNEX C-4

LETTER OF CANADA REPLYING TO THE OBJECTIONS OF THE UNITED STATES REGARDING THE COMMENTS OF CANADA ON RESPONSES OF THE UNITED STATES TO QUESTIONS POSED IN THE CONTEXT OF THE SECOND SUBSTANTIVE MEETING OF THE PANEL

(15 September 2003)

Dear Mr. Chairman,

In its letter of 9 September 2003, the United States objects to the submission of Exhibit CDA-186 as part of Canada's comments on the US responses to the Panel's questions from the second substantive meeting.

As stated in Canada's comment on the response of the United States to Question 97 of the Panel, Exhibit CDA-186 was part of Canada's comments on Exhibit US-81. In Exhibit US-81, the United States for the first time presented an analysis of the daily net prices for certain Abitibi products. This analysis was not before Commerce during the underlying investigation. Moreover, these net prices were not on the record before Commerce, but rather had to be calculated for the Panel by subtracting certain adjustments from gross prices. At the Panel's invitation, Canada commented on Exhibit US-81 because it contained new factual data. Canada also commented on new arguments made by the United States based on Exhibit US-81 that are misleading, difficult to follow, and analytically deficient.

As to the more general objection by the United States that the acceptance by the Panel of regression analyses would contravene paragraph 14 of the Panel's Working Procedures, Canada refers to its reply of June 10, 2003, to the preliminary objections filed by the United States to Canada's First Written Submission. As stated there, it is Canada's view that regression analyses are admissible, provided that the underlying data were before the investigating authority; otherwise, the Parties would be barred from assisting the Panel by explaining the relevance of such data in relation to the obligations of the investigating authority pursuant to the *Anti-Dumping Agreement*.

Indeed, Canada sees no distinction between the use of record data in Exhibit US-81 and Exhibit CDA-186. Both require calculations using record data, and both plot the same data points. These exhibits both equally reflect the record data that were before Commerce.

Thank you for considering these comments.