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."**

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[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.

"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 prices[10] 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:

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[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 cost sales

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102. In paras. 58-

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 requi

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.

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 TD 0 Tc 0.2N.ties used by

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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 Abitbi'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 included 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

ANNEX C-3