



COALITION FOR FAIR LUMBER IMPORTS

May 29, 2009

PUBLIC DOCUMENT

BY HAND DELIVERY

The Honorable Gary Locke
Secretary of Commerce
Attn: James Terpstra
Import Administration
APO/Dockets Unit, Room 1870
U.S. Department of Commerce
14th Street and Constitution Avenue, NW
Washington, DC 20230

Subject: Softwood Lumber Subsidies Bi-Annual Report: Request for Comment

Dear Secretary Locke:

The Coalition for Fair Lumber Imports (“Coalition”) hereby submits an original and six copies of comments to the U.S. Department of Commerce (the “Department”) on subsidies provided by Canada, a country exporting softwood lumber and softwood lumber products to the United States. These comments are submitted in response to the Department’s request for comments published in the Federal Register on May 1, 2009. Subsidy Programs Provided by Countries Exporting Softwood Lumber and Softwood Lumber Products to the United States; Request for Comment, 74 Fed. Reg. 20289 (Dep’t Commerce May 1, 2009).

Canada is the dominant exporter of softwood lumber to the United States. The attached comments describe the Canadian subsidy programs, including the names for the programs if available, and identify whether the subsidy is provided by the Canadian federal government or one of the Canadian provincial governments. We have separated our comments into two sections: (1) newly-identified subsidy programs and new subsidy program information not included in our most recent prior subsidy comments to the Department dated November 26, 2008; and (2) subsidy programs previously identified and commented on. The attachment is not necessarily complete, and does not purport to comment on every Canadian softwood lumber subsidy program.

The Coalition urges the Department to include all subsidies identified in the attachment and any others of which the agency becomes aware in the Department’s report to Congress pursuant to the Softwood Lumber Act of 2008.

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Please contact me at (202) 567-6035 if you require clarification of any aspect of this submission. An electronic copy of this submission has been e-mailed to *webmaster-support@ita.doc.gov*.

Respectfully submitted,



David A. Bentley
General Counsel

Attachment

CANADIAN SUBSIDIES TO SOFTWOOD LUMBER

Major New Subsidies and Additional Information About Previously Reported Subsidies

The information set forth below is further to information on British Columbia ("BC") stumpage included in the next section of this submission and in the November 2008 comments of the Coalition for Fair Lumber Imports.

I. Expansion of British Columbia Sawtimber Harvest Graded as Salvage

This policy relates to grading of and prices that British Columbia ("BC") lumber companies pay for timber that is harvested from government land in the BC Interior. For the most part, "stumpage" paid for BC timber varies based on the way it is graded. BC Interior log grades range from 1 (highest quality) to 6 (lowest quality), with the bulk of the volume being graded as 2 or 4. BC has vastly expanded its existing stumpage subsidy (under-pricing of timber) by changing its grading practices to greatly enlarge the share of timber that is assigned a "salvage" grade – although it is used for lumber production – and for which the provincial government charges virtually nothing.

At issue is Lodgepole pine timber that is either normal quality or relatively low quality, but still adequate to be processed into lumber ("sawtimber").¹ Much of it is reportedly harmed by the mountain pine beetle. As of spring 2008, low quality Lodgepole pine sawtimber was commanding the equivalent of C\$20-25 per cubic meter in western Montana. If graded as 2, this timber was sold by the BC government for roughly C\$7.50 per cubic meter during the first eleven months of 2008. If graded 4, the timber has been and continues to be sold for only C25 cents.

Since late 2007, the BC government has authorized major lumber companies in the BC Interior region to grade logs after sample material is heated in a kiln. On April 17, 2009, the BC Forest Ministry distributed a memorandum which specified that the "pilot" program regarding "use of kilns to re-dry sample loads," previously scheduled to expire April 30, 2009, has been extended until October 31, 2009.

The log-heating practice and, perhaps, other practices have substantially increased the share of the BC Interior Lodgepole pine scaled harvest that is graded 4 and priced at only C25 cents per cubic meter. That is, there is a large and increasing share of the BC Interior sawtimber

¹ Lodgepole pine is the highest volume species of timber in the BC Interior. During the first eleven months of 2008, Lodgepole pine accounted for roughly 65 percent of all softwood timber scaled from non-BC Timber Sale ("BCTS") tenures in the BC Interior. Mountain pine beetle infestation is generally limited to Lodgepole pine.

harvest that would have been sold for C\$6.50 to C\$7.50/m³ as grade 2, but instead is sold for C\$0.25/m³ as grade 4.

Introduction of log heating in 2007 coincided with the outset of a dramatic expansion of the grade 4 harvest. Notwithstanding that the pine beetle infestation was fully realized by 2006, only 18 percent of the BC Interior Lodgepole pine harvest scaled during the second half of that year was assigned grade 4.² In the first half of 2007, prior to the advent of the log heating policy, the grade 4 share of the scaled harvest in the BC Interior stood at about 19 percent, with none of the top ten forest districts having a grade 4 share above 33 percent. In the first quarter of 2009 (the most recent period for which complete data are available), fully 54 percent of all Lodgepole pine timber scaled in the BC Interior was graded as 4, with two of the top four forest districts having a grade 4 share above 70 percent.

The impact of changed grading practices has been particularly pronounced in the central portion of the BC Interior. Six forest districts located in the central BC Interior – Prince George, Quesnel, Central Cariboo, Vanderhoof, Nadina and 100 Mile House – accounted for roughly 59 percent of the Lodgepole pine scaled harvest in the first half of 2007 and 66 percent of the scaled harvest of Lodgepole pine in the second half of 2008. The share of scaled Lodgepole pine graded as 4 in those forest districts rose from 24 percent in the first half of 2007 to 66 percent in the second half of 2008 and 67 percent in the first quarter of 2009. In the Prince George forest district, which has by far the largest volume of scaled Lodgepole pine timber in the BC Interior, the share of scaled Lodgepole pine graded as 4 rose from 33 percent in the first half of 2007 to **77 percent** in the second half of 2008 and 74 percent in the first quarter of 2009. Thus, as those central Interior forest districts became the predominant areas of harvesting in the BC Interior, grade 4 has come to dominate the Lodgepole pine harvest.

The share of increased grade 4 volumes that has been due to log heating must be substantial. In early 2008 (before the share of grade 4 logs truly exploded in the BC Interior), Canada's second largest lumber producer, Canfor, announced that the log heating policy reduced its stumpage by 5%. Opinion 250, Feb. 26, 2008. This is likely an understatement. Even if that statement were accurate, however, it would imply that as of early 2008 roughly a third of all logs graded 4 were so graded due to changed grading practices.³ (That share has likely increased markedly since that time.) In fact, by early 2008 the change in grading practices had already been revealed to be such a bonanza for Canfor and West Fraser (the largest Canadian lumber producer) that Tolko, the third leading BC producer, publicly complained about being shut out of

² Scaled BC Interior harvest figures relate to the portion of the BC Interior softwood harvest from government lands outside the BC Timber Sales auction program. This is the bulk of the BC Interior softwood harvest.

³ The share of scaled Lodgepole pine logs graded 4 in the BC Interior increased by roughly 15 percentage points between 1Q 2007 and 2Q 2007. If it is assumed that the grade distribution of scaled logs processed by Canfor matched that within the BC Interior as a whole, and if it is further assumed that Canfor experienced a stumpage cost savings of 5 percent due to the advent of the log heating policy, then it appears that the share of logs processed by Canfor and graded 4 rose from 19 percent to 34 percent and that roughly 5 percentage points (or a third) of that increase was due to the changed grading practices.

the program.⁴ This highly unusual public plea for application of the log-heating grading change is irreconcilable with the proposition that grading outcomes would have been the same without the heating policy. BC responded by extending the log heating policy to Tolko.

Even if one could conclude that the timber at issue is properly being graded as 4, the changed grading practices and explosion of grade 4 timber sold for C\$0.25/m³ in the BC Interior have massively enhanced the BC stumpage subsidy and dramatically reduced the cost of sawtimber for BC lumber producers. At the same time, it is evident that the bulk of the allegedly grade 4 volume that the lumber companies are using is not properly deemed salvage timber. This is clear since there is no evidence of the dramatic diminution in lumber yield that would necessarily attend mass reliance on salvage timber. To the contrary, there is every reason to believe that, on a per-unit-of-timber basis, the average volume and quality of lumber that the BC Interior industry is producing has remained stable as the share of supposed grade 4 has skyrocketed.

II. British Columbia Coast Stumpage Reduction

In January 2009, British Columbia announced a major stumpage reduction in the province's Coast region to aid its lumber industry there. The provincial government vigorously took credit for increasing the stumpage subsidy.

When it announced and took credit for the stumpage reduction, there was no suggestion that it was the natural result of the operation of BC's stumpage system. To the contrary, BC announced that it had "changed" BC coast stumpage. And Canadian reports have repeatedly confirmed this:

- BC Premier Gordon Campbell has "dropped stumpage rates on the B.C. Coast by 50 per cent to \$5 a cubic metre . . . as part of a plan to kick-start the moribund forest industry." *Vancouver Sun* (Jan. 14, 2009).
- "Campbell . . . slashed the stumpage rate on the coast by 70 per cent, to less than \$5 per cubic metre, in response to calls from industry." *The Province* (Jan. 15, 2009).
- "B.C. will cut coastal stumpage rates by more than 70 per cent to reflect tough economic times in the forest industry, Premier Gordon Campbell announced Wednesday." *Canwest News Service* (Jan. 15, 2009).
- BC government has "cut its fee for coastal timber by half." *Revelstoke Times Review* (Jan. 19, 2009).
- Premier Campbell "announced that the province was slashing its Crown stumpage fee for coastal timber to \$5 a cubic metre, capping a 70 per cent reduction in just one year." *Agassiz Observer* (Jan. 20, 2009).

⁴ "Tolko Wants Stumpage Equity," Opinion 250 (Feb. 26, 2008).

Furthermore, there is no basis to contend that the stumpage reduction comports with market levels and market changes. In fact, the BC benchmark log value series *employed by BC authorities to set stumpage* actually rose between December 2008 and January 2009.

BC engineered its January 2008 stumpage reduction by doing two things. First, BC changed the formula used to determine the "Final Estimated Winning Bid" – a key element in BC Coast stumpage calculations. Second BC changed the so-called "Tenure Obligation Adjustment" so that it rose in most cases. One of the major components of the Tenure Obligation Adjustment is the forest district-specific Basic Silviculture adjustment. (Silviculture is replanting of seedlings after harvesting of timber and related activity.) The weighted-average silviculture adjustment rose by 46% in January 2009. In addition, both the forest planning and administration cost estimate and the road management cost estimate employed by BC Coast authorities increased significantly in January 2009. The former rose from C\$9.43/m³ to C\$10.63/m³, while the latter rose from C\$1.34/m³ to C\$2.13/m³. Again, there is no apparent reason why these costs would have increased significantly in recent months. It is almost certainly not coincidental that the cost estimates employed by the BC Coast authorities are based on a survey of costs allegedly experienced by the very lumber companies that harvest the timber. Those companies are highly motivated to overstate their costs to achieve lower stumpage.

With respect to the model employed to determine the "Final Estimated Winning Bid": at least one critical component of the new model – the so-called constant term – is not statistically significant or robust. If that constant term is set equal to zero, then the stumpage rate would increase by roughly C\$4.50/m³.

In sum, all relevant data indicate that BC manipulated its Coast stumpage calculations to achieve an enormous stumpage reduction not called for by changes in timber values.

III. Quebec Loan Guarantee for AbitibiBowater

In May 2009, Quebec issued a financing guarantee of C\$100 million for AbitibiBowater expressly to preserve its processing operations. AbitibiBowater, Canada's fourth largest lumber producer, is in receivership. Without a government guarantee, private sector financing for the company would be unthinkable at any interest rate. Obviously, then, this is an enormous subsidy.

IV. Stumpage Reduction for Canfor's Mackenzie, BC Sawmill

In May 2009, BC agreed to lower stumpage for a major sawmill of Canada's second largest lumber producer, Canfor, in Mackenzie, BC to induce the company to reopen and operate the facility. This appears to be a straightforward stumpage reduction subsidy and SLA violation. A May 5, 2009 BC news report specified that "Canfor gained concessions on rates it pays the province for the spruce trees it cuts down." This follows BC steps in 2007 to manipulate stumpage in favor of this same Canfor mill.

V. Canadian Federal Government Subsidized Financing

The Government of Canada has stated publicly that it is providing financing to aid Canadian softwood lumber producers. It reinforced its role in financing softwood lumber operations in a May 15, 2009 announcement by the Canada-Quebec Forestry Task Team. That announcement highlights the roles of two Canadian federal government entities: the Business Development Bank of Canada ("BDC") and Export Development Canada ("EDC"). The announcement specified that BDC "assists 1,111 businesses in the forest sector across Canada" through loans and other benefits. It continued that EDC has provided assistance to the forest sector valued at over \$16 billion in 2008 and 2009 to date. Identified EDC assistance included: "a 50% guarantee on a \$1.2 million operating line of credit for a Quebec sawmill;" \$10 million in lending to a lumber company "to build a facility to reuse by-products (slash and chips);" and \$10 million in lending to a "softwood producer" to enable it to "modernize" its "infeed and sorting capabilities."

Subsidies Identified In Previous Submissions To The U.S. Department Of Commerce

The following subsidy programs are summarized here for the Department's convenience. These programs were addressed more fully in a prior submission to the Department dated November 26, 2008, and that prior submission is incorporated herein by reference. There is no publicly available information suggesting that any of the previously-identified Canadian subsidy programs have been eliminated or changed in any material way.

I. Stumpage Subsidies

British Columbia

The British Columbia ("BC") government owns roughly 95% of all harvestable timberlands within the province. BC has created a complex system of different "tenure" arrangements that permit private forest products firms to harvest logs on government land for government-set fees. This subsidization system has three essential elements: a) non-market allocation of tenure rights, b) complex administered pricing mechanisms that ensure that softwood lumber producers obtain this wood at below-market prices; and c) regulations and practices that funnel the harvest of discounted timber to production of softwood lumber within British Columbia.

The BC Ministry of Forests sets softwood sawtimber stumpage prices based on the results of a complex statistical modeling exercise deemed to produce the "estimated winning bid" for the timber being harvested. Those administratively set stumpage prices are consistently well below the market value of the softwood sawtimber being harvested in BC. Accordingly, under this program the BC Ministry of Forests provides softwood lumber producers in BC with their single largest factor input – softwood timber – at prices well below adequate remuneration.

Alberta Stumpage

The Alberta government owns the vast majority of useable timberland in the province, allocates this timber on a non-market basis, charges stumpage fees or "dues" that fall far below market prices, and ensures that the benefits of these fees go to the primary forest products processing industry and the softwood lumber industry in particular.

Quebec Stumpage

The Quebec government owns the vast majority of the province's forestland and allocates the rights to harvest public timber through 25-year, renewable tenure arrangements known as Timber Supply and Forest Management Agreements ("TSFMAs") and through Forest Management Contracts ("FMCs"). The Quebec Government sets stumpage rates for timber sold under TSFMAs and FMCs through a complex, administered calculation methodology which results in payments that are far less than "adequate remuneration." The system is designed to enhance artificially economic growth in the lumber industry and to maintain employment, not to maximize the return on the timber resource.

Ontario Stumpage

The Ontario government owns the vast majority of the province's forestland and allocates the rights to harvest provincial timber through 20-year, renewable tenure arrangements known as Sustainable Forest Licenses ("SFL") and through Forest Resource Licenses ("FRL"). Ontario government sets stumpage rates for timber sold under SFLs and FRLs through a complex, administered calculation methodology which results in payments that are far less than "adequate remuneration." The Ontario timber system is designed to enhance economic growth in the lumber industry, maintain employment, and promote exports.

Manitoba Stumpage

Manitoba's tenure system is administered by the Forestry Branch of Manitoba Conservation. It has three types of tenure arrangements: the Forest Management License ("FML"), the Timber Sales Agreement ("TSA"), and the Timber Permit. These are expressly designed to increase the province's logging and lumber production. By law, all these tenures "shall be granted in such manner, and by such means, as, in the opinion of the minister, secures the maximum benefit to the forest industry of the province."⁶ FMLs in particular are granted "[w]here the investment in a wood using industry established or to be established is sufficient to require the security of a continuous timber supply," and are primarily or completely held by three large forest companies.⁷

⁶ Manitoba Forest Act (C.C.S.M. ch. F150) § 11(1).

⁷ Manitoba Forest Act § 18(1); Manitoba's Crown Forests.

Saskatchewan Stumpage

The Saskatchewan government owns the vast majority of the timberland in the province, and the provincial government allocates the overwhelming majority of its commercially available Crown forests through a tenure arrangement called the Forest Management Agreement ("FMA"). Fewer than six major companies hold FMAs accounting for most of the commercial forest land in the province. Each FMA holder must secure government approval of a forest management plan describing how their objectives for "employment and business opportunities . . . will enhance the social and economic health of communities in and around the license area."⁸ Regulations impose a minimum cut requirement on FMA holders, requiring a licensee to harvest the full amount designated in the license or risk reallocation of the shortfall to any other person.⁹

The provincial government sets timber dues (stumpage) at a flat base rate of just C\$2/m³ for all species of softwood timber greater than 14cm in diameter.¹⁰ When a lumber price index based on Random Lengths lumber prices exceeds a threshold level, stumpage dues increase by C\$0.03525/m³ for each C\$1 increase in the lumber price index – a small and wholly arbitrary rate of increase.¹¹ Furthermore, the formula takes no account of quality or species differences, and for smaller logs does not even pretend to have any relation to market values at all. The province may also forgive dues entirely where it wishes to encourage development of sawmills that are otherwise uneconomical.

II. Wood Cost Subsidies Associated with Log Export Bans

British Columbia Log Export Ban

British Columbia ("BC") maintains a domestic processing requirement and other log export restrictions. These measures prevent non-BC producers from obtaining BC logs and thereby reduce the demand for such logs and further reduce the domestic price of softwood sawtimber throughout the province.

The BC log export restrictions have two central legislative components: 1) an in-province processing requirement (i.e., an affirmative obligation to provide logs only to BC processors); and 2) a log export tax, which is designed to remove any incentive to export sawlogs even if an exemption to the processing requirement is issued. These restrictions apply to all logs harvested from lands under provincial jurisdiction, which comprise approximately 90% of all timberland in British Columbia. Federal restrictions apply to logs not covered by provincial restrictions.

⁸ The Saskatchewan Forest Resources Management Regulations § 28(c)(ii).

⁹ Sask. For. Res. Mgt. Reg. §§ 15(4), 21(2). Each license must also include the requirement to use the full designated volume and the consequences of failure to do so. Id. at § 11(e).

¹⁰ Sask. Forest Resources Mgt. Regs. App. 1 Table 1.

¹¹ Id.

By largely eliminating the market impact of a strong international demand for BC logs, the domestic processing requirement causes domestic BC log prices to be far lower than they otherwise would be.

Alberta Log Export Ban

Section 31(1) of the Alberta Forests Act prohibits the export of logs outside of Alberta.¹² The provincial government may, in its discretion, authorize the shipment outside of Alberta of logs for limited purposes (*i.e.*, to be used for research or experimental purposes) or for a limited time (*i.e.*, one year). By largely eliminating the market impact of international (primarily U.S.) demand for Alberta logs, the domestic processing requirement causes Alberta log prices to be lower than they otherwise would be. This results in more Alberta lumber production and employment, at the expense of U.S. production and jobs, than otherwise would be the case because Alberta sawmilling is permitted to operate with the benefit of undervalued logs.

Quebec Log Export Ban

The Quebec Forest Act has long required that all "timber harvested in the public forest, whatever the nature or object of the management permit authorizing the harvesting, must be completely processed in Quebec."¹³ Although the Quebec government may, in its discretion, authorize the shipment outside of Quebec of incompletely processed timber from public forests,¹⁴ there is no evidence that any significant volume of logs is in fact authorized for export. By largely eliminating the market impact of international (primarily U.S.) demand for Quebec logs, the domestic processing requirement causes Quebec log prices to be lower than they otherwise would be. This results in more Quebec lumber production and employment, at the expense of U.S. production and jobs, than otherwise would be the case because Quebec sawmilling is permitted to operate with the benefit of undervalued logs.

Ontario Log Export Ban

Ontario legislation mandates that trees harvested from public lands be manufactured in Canada, thus precluding the export of logs from the province.¹⁵ Although the Ontario government may, in its discretion, authorize the manufacture outside of Ontario of logs originating from Crown lands,¹⁶ there is no evidence any significant volume of softwood logs are in fact authorized for export. By largely eliminating the market impact of international (primarily U.S.) demand for Ontario logs, the domestic processing requirement causes Ontario log prices to be lower than they otherwise would be.

¹² Alberta Forests Act, R.S.A. 1980 C. F-16, § 31(1).

¹³ The Quebec Forest Act, Que.Rev. Stat. C. F-4.1 § 159.

¹⁴ Id. § 161.

¹⁵ Crown Forest Sustainability Act, S.O. 1994, c.25, § 30(1).

¹⁶ See id. at § 30(3).

III. Ontario and Quebec Subsidies Subject to SLA Arbitration

The U.S. government has advanced the claim that these programs violate the 2006 U.S.-Canada Softwood Lumber Agreement ("SLA"), and these programs are currently the subject of an arbitration proceeding between the United States and Canada (LCIA No. 81010). The programs are summarized in the November 26, 2008 submission to the Department on Canadian subsidy programs and are explained in detail in United States submissions to the arbitral panel in LCIA No. 81010.

- Quebec Capital Tax Credit for Primary Wood Processing Facilities. This program was announced in 2006 to provide a 15 percent tax credit to Quebec's forest products industry.
- Quebec Forest Management Measures. This program was announced in 2006 and allowed Quebec to incur costs previously borne by the forest products industry, e.g., road and bridge repair and construction, silviculture expenses.
- Quebec Forest Sector Financing "Envelope." This program was announced in 2006 to make financing available to Quebec's forest products industry.
- Ontario Forest Sector Prosperity Fund ("FSPF"). This program was announced in 2006 to provide grants to the forest sector in support of new capital investment.
- Ontario Forest Sector Loan Guarantee Program ("FSLGP"). This program provides C\$350 million in loan guarantees over five years to stimulate investment in the forest industry.
- Ontario Forest Roadbuilding Program. This program was announced in 2006 to make available C\$75 million to reimburse forest companies for costs incurred for constructing and maintaining forest access roads.

IV. Other Subsidies

The following subsidy programs are identified and explained in the November 26, 2008 submission to the Department on Canadian subsidy programs:

- Nova Scotia "Transition Program." The provincial government announced in 2007 investments in woodlot silviculture and other forest-related initiatives.
- Provincial Tax Programs (New Brunswick, Nova Scotia and Quebec). These provinces have provided tax subsidies to forestry companies.
- Western Economic Diversification Program (Government of Canada). Under this program, the federal government provides grants to softwood lumber producers in the western provinces.

- Natural Resources Canada Softwood Marketing Subsidies (Government of Canada). This federal program provides grants to assist export markets and research and development in the forest products sector.
- Federal Economic Development Initiative in Northern Ontario ("FEDNOR"). This federal program benefits forest products companies in Northern Ontario.
- Forestry Innovation Investment Program ("FIIP") (British Columbia). This program supports the activities of universities, education organizations, government ministries and industry associations producing wood products.
- British Columbia Private Forest Property Tax Program. This program provides differential tax rates on two classes of private forest land.
- Compensation for Tenure Reclamation under Protected Areas Forest Compensation Act ("PAFCA") and Forest Revitalization Act ("FRA") (British Columbia). These programs provide benefits to tenure holders for tenure areas reclaimed for the purpose of creating parks, protected areas, and ecological reserves established by the BC government.
- Private Forest Development Program (Quebec). This program provides silviculture support to private woodlot owners.
- Investment Quebec Assistance under Article 28. The Department found this program countervailable during an administrative review of the most recent countervailing duty order on softwood lumber from Canada.
- Assistance From Societe de Recupertion d'Exploitation et de Development Forestiers du Québec ("Rexfor"). This program provides assistance to the Québec forest products industry.
- Northern Pulp and Paper Electricity Transition Program (Ontario). This program provides electricity rebates for paper production, but those rebates benefit lumber producers.
- Northern Ontario Grow Bonds Pilot Program. This program has provided a loan for the expansion of a lumber mill.