In the World Trade Organization

Panel Proceedings

United States - Countervailing Measures on Softwood Lumber from Canada

(DS533)

Third Party Written Submission
by the European Union

Geneva, 14 December 2018
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I. INTRODUCTION

1. The European Union (“EU”) exercises its right to participate as a third party in this case because of its systemic interest in the correct and consistent interpretation and application of the covered agreements and other relevant documents, and the multilateral nature of the rights and obligations contained therein, in particular the Agreement on Subsidies and Countervailing Measures ("SCM").

2. Whilst not taking a position on the specific facts of this case, the EU will provide its views on certain legal issues raised by the Parties to the dispute: the use of benchmarks under Article 14(d); entrustment or direction; purchases of services and direct transfers of funds; and the determination of benefit with respect to provincial electricity programmes. This submission should not be seen as exhaustive. The EU reserves its right to submit arguments on other questions (or to further develop the arguments set out here) at the Third Party Session of the First Substantive Meeting with the Parties, or in response to questions from the Panel.

II. CANADA’S CLAIMS UNDER ARTICLE 14(D) OF THE SCM AGREEMENT

A. The use of benchmarks from Nova Scotia for four Canadian provinces as “in-country” benchmark

(a) Canada’s arguments

3. Canada argues that the USDOC should have used the prices for standing timber in the four provincial markets of Alberta, New Brunswick, Ontario and Québec as benchmarks under Article 14(d) SCMA, rather than using prices for private timber in the small and geographically isolated province of Nova Scotia. According to Canada, each of these provinces constituted separate regional markets with specific characteristics (e.g. regarding forest species, harvesting and transportation
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costs etc.)\(^1\) and had appropriate, undistorted in-market benchmarks. The Nova Scotia benchmark was also unreliable.\(^2\)

4. Canada considers that the USDOC was incorrect to find that provincial governments in Alberta, Ontario, Québec and New Brunswick supplied Crown-origin timber in a manner that distorted in-country benchmarks. In three out of four of these provinces, a sizeable private standing timber industry exists, the prices of which should have been used as benchmarks by the USDOC. In addition, Canada argues that standing timber prices for Crown-timber in Québec are set by competitive auctions and hence there is no price distortion in that province. Regarding Ontario, the USDOC ignored evidence about the private stumpage market and the private log markets. Regarding Alberta, the USDOC ignored evidence about Alberta’s private log market. Regarding New Brunswick, the provincial government supplied less than 50% of standing timber and there was no price distortion.

(b) US’s arguments

5. The US argues that it chose an in-country benchmark (private prices from Nova Scotia) for four provinces and hence necessarily acted consistently with the guidelines in Article 14(d) SCMA. According to the US, the primary benchmark under this provision are the prices at which the same or similar goods are sold by private suppliers in arm’s-length transactions in the country of provision.\(^3\) The US also refers to Appellate Body case law which found that “[t]o the extent that…in-country prices are market determined, they would necessarily have the requisite connection with the prevailing market conditions in the country of provision that is prescribed by the second sentence of Article 14(d).”\(^4\) The US considers that Article 14(d) is not concerned, from a geographic perspective, with the local jurisdiction of the authority providing the subsidy but the relevant location is the country of

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\(^1\) Canada’s first written submission, paras. 741 et seq.
\(^2\) Canada’s first written submission, paras. 825 et seq.
\(^3\) United States’ first written submission, para. 72 citing Appellate Body Report, US – Carbon Steel (India), para. 4.154.
\(^4\) US first written submission, paras. 10 and 74 with reference to Appellate Body Report, US – Countervailing Measures (China), para. 4.46.
provision. The United States argues that there is no support in the case law for Canada’s contention that the region of provision of timber should dictate where the benchmark can be found. The term “market” in Article 14(d) is not identical to the term “market” in Article 6.3 and the focus in Article 14(d) is on the nature and qualities of the market in question, rather than geographical limitations. In addition, the only geographical limitation in Article 14(d) is that the location must be the “country of provision.” The province of Nova Scotia, whose stumpage prices were used as benchmark for four provinces, is located in the country of provision. The US disagrees with Canada that the market conditions in Nova Scotia (e.g. in terms of forest species, size of trees etc.) differ significantly from the other provinces.

6. The US considers that the strict requirements for the use of out-of-country benchmarks do not apply in the present case since the USDOC used an in-country benchmark; in any event, the conditions of using out-of-country benchmarks in case of market distortion are fulfilled. In particular, the artificial market conditions created by provincial government involvement “pervade the entire lumber sector in each of the five provinces”. Private prices were artificially suppressed and hence distorted because of the prices charged for the same goods by the government.

(c) EU’s observations

7. The EU recalls that Article 14(d) SCMA stipulates that the determination of benefit in case of the provision of goods by a government depends on whether the remuneration is less than adequate which shall be determined "in relation to prevailing market conditions for the good in the country of provision."
8. The EU does not opine as to whether, factually, there are different regional markets for Crown-timber and whether “prevailing market conditions” in the respective provinces justify the USDOC’s use of Nova Scotia prices as the only in-country benchmark.

9. However, the EU takes the legal position that the use of any “in-country” price is not a benchmark that is automatically consistent under Article 14(d) for other regions in the same country. The government of the subsidising country may submit positive and verifiable evidence that a particular region has such different market conditions (e.g. is very isolated from the rest of the country) that it constitutes a separate market altogether within the meaning of Article 14(d). In other words, there may be regional geographic markets and hence more than one single “prevailing market condition” in a given country. This also reflects the position of the Appellate Body which stated the following in Canada – FIT for electricity markets:

“We observe that, while Ontario and Quebec are in the same "country", that is, Canada, they have separate regional markets for electricity. Thus, the "prevailing market conditions" in the country of purchase within the meaning of Article 14(d) of the SCM Agreement is to be read in this case as referring to the Ontario regional market as opposed to other out-of-province markets, within Canada or in another country.”

10. As the US correctly states, one accepted definition of “market” is “the area of economic activity in which buyers and sellers come together and the forces of supply and demand affect prices”. The use of the term “area” indicates that a “market” also includes a geographical element. This is how the term market is normally understood, i.e. as including both the relevant product market and the relevant geographic market. The EU does not consider that this established way of interpreting the term “market” should be different under Article 14(d). Article 14 has the purpose of calculating the appropriate amount of

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14 Appellate Body Report, US – Carbon Steel (India), para. 4.150.
benefit.\textsuperscript{15} However, if separate regional markets exist, the price of a good in one region may not necessarily be a suitable benchmark for a different region, even if the prices relate to the same country. Ignoring the differences between regions would therefore risk miscalculating the benefit amount and hence run counter the objective of Article 14. This interpretation of Article 14(d) is also in line with the interpretation of the term market in Article 6.3 where the Appellate Body explicitly found that markets in Article 6.3(c) can also be regional markets within a country.\textsuperscript{16} The EU does not conclude as to whether the use by the USDOC of separate regional benchmarks for each of the four provinces concerned was consistent with Article 14(d) in the present circumstances. The point that the EU wants to make is that it does not consider that the use by the USDOC of a benchmark in one province (Nova Scotia) was \textit{automatically} consistent with Article 14(d), based on the mere fact that this province is located in Canada and hence constitutes an “in-country” benchmark.

\textbf{B. The use of in-country benchmarks from Nova Scotia for four Canadian provinces due to the predominant or significant role of the Canadian government as supplier}

11. As explained above, the EU considers that Nova Scotia prices may, but do not necessarily, represent prevailing market conditions under Article 14(d) for the four provinces in question. However, the Panel may still come to the conclusion that the use of Nova Scotia prices by the USDOC was consistent with Article 14(d), notably if the standing timber prices in the other four provinces were distorted by the government’s role as supplier of that good so that these prices could not serve as benchmarks.

12. In circumstances where the subsidising Member provides positive evidence that the relevant market for the benchmark determination is regional, the EU considers that similar principles that would allow an investigative authority to use “out-of-country” benchmarks would also permit an authority to use a regional price within the same country that is not distorted, instead of a regional price that is distorted.


\textsuperscript{16} Appellate Body Report, \textit{US – Large Civil Aircraft (2nd complaint)}, para. 1076 (referring to Appellate Body Report, \textit{EC and certain member States – Large Civil Aircraft}, para. 1117).
This is a logical consequence of the EU’s position that there can be separate geographic markets and hence different benchmarks within the same country.

13. Depending on the circumstances, an investigation authority may use as benchmark \textit{inter alia} the regional benchmark of the region (geographic market) in question, the regional benchmark of a different region within the same country, or an out-of-country benchmark. The EU does not consider that the use of an “in-country” regional price is a requirement in all cases in which different regional markets exist within one country. It is not excluded that, depending on the circumstances, an out-of-country benchmark may be more appropriate in such a scenario. The EU will not opine whether this was the case in the present dispute (regarding British Columbia). The EU also notes that in many instances there may be no need to identify regional markets at all, e.g. where no such regional markets exist or where the subsidizing Member provides no evidence in this regard.

14. The EU will not opine as to whether the USDOC acted consistently with Article 14(d) when using Nova Scotia prices for the four provinces in question but it will offer some observations concerning the question whether prices in the four provinces in question were distorted because of the role of the provincial governments in Canada concerning the supply of standing timber.

15. Prior Appellate Body and Panel Reports have accepted that the market of the subsidizing Member may be so distorted by the government's role in it, that no "market" conditions and no benchmark prices in the country of provision exist and that out-of-country benchmarks (or, in this case, other regional benchmarks) can be used instead. However, the Appellate Body made clear that this is rather the exception and that “the possibility under Article 14(d) for investigating authorities to consider a benchmark other than private prices in the country of provision is very limited.”17 But the Appellate Body has found, for example, that prices of private suppliers in a country could not be used as benchmarks because the government's predominant role in the market would make the use of those prices

\footnote{Appellate Body Report, \textit{US – Softwood Lumber IV}, para. 102.}
The case law on out-of-country benchmarks may nevertheless provide some guidance also for the use of in-country (regional) benchmarks as regards the question when regional prices are distorted. Concerning possible distortions by the government as supplier of the good in question, at least three sub-categories may be distinguished which all concern differing degrees of market power of the government.

16. The first sub-category, which has been discussed by the Panel as a hypothetical scenario, covers situations in which the government is the sole supplier of the good in question in which case there is no private price available that can be used as a benchmark.

17. The second sub-category, which has been the subject of previous disputes, concerns situations in which the government has a predominant role as a supplier of the good in question. Very high market shares (e.g. 96.1% in US – Anti-Dumping and Countervailing Duties (China)) are a strong indicator of predominance but not necessarily the only relevant factor. The EU recalls that the Appellate Body cautioned against an approach that equates the concept of government predominance with the concept of price distortion. The link between the two is an evidentiary one. The Appellate Body found that predominance does not allow a per se conclusion that price distortion exists; other evidence – if available – must still be considered by the investigating authority. However, the higher the government's market share and hence the more pronounced its predominance (and market power), the less relevant such other evidence becomes.

18. The third sub-category, which has been discussed by the Appellate Body as a hypothetical scenario, concerns situations where the government is a significant supplier of the goods in question (e.g., the government has high but not very high market shares). In this case, evidence other than market share is always required.

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for a finding of price distortion since "significance" is not in itself sufficient to prove price distortion.22

19. The EU understands that in the four provinces concerned, the government owns 98% of timber in Alberta, 90% in Ontario, 85% in Québec and 50.79% in New Brunswick.23 The EU will provide some observations on possible price distortion for each of these provinces.

Alberta

20. Regarding Alberta, prior case law would indicate that the provincial government is a predominant supplier since it owns 98% of standing timber, i.e. it holds a very high market share. According to the above-referenced case law, such high market levels would be a strong indication of predominance (and hence of price distortion) and other evidence, while it must be considered by the investigation authority, would be less relevant. A market share of 98% is almost akin to the government being the sole supplier, in which case there is no private price that can be used as a benchmark. This may be the reason why Canada proposed prices of logs, rather than prices of standing timber, as benchmark under Article 14(d). Canada argues that logs are products that are very similar to standing timber and that log prices were used by the USDOC as benchmark for standing timber in a previous investigation.24

21. The EU recalls that Article 14 SCMA contains guidelines and that investigation authorities have some discretion regarding the calculation of benefit.25 The EU therefore considers that an investigation authority has some margin of discretion as to whether to accept a similar good as a benchmark, depending inter alia on the degree of similarity of the products in question. The US argues that log prices are not the prices for the relevant good - standing timber - and are, in addition, distorted.26 The EU does not opine on the factual questions as to whether logs are

23 United States’ first written submission, para. 57.
24 Canada’s first written submission, para. 228.
26 United States’ first written submission, paras. 332 et seq.
products that are sufficiently similar to standing timber or whether the log market in Alberta is distorted. The EU would like to note, however, that the acceptance of a similar product as benchmark in a previous investigation does not bind the investigation authority in a subsequent investigation since all investigations are necessarily case-specific.

**Ontario**

22. Canada contends that the province of Ontario is not a predominant supplier of standing timber and that, even if it was, this would not allow a *per se* finding of price distortion. 27 Canada argues that the USDOC should have used private standing timber prices as well as arm’s length private log transactions in Ontario as benchmark, rather than using Nova Scotia’s prices.

23. A market share of 90% 28 may be indicative of predominance. Previous cases have established predominance at market share levels of 96.1% 29 and 93%. 30 The EU considers that there is no definitive market share level that would mark the border between a predominant and a significant market share. In addition, market shares are not the only criterion to establish predominance. Other factors such as the competitive structure of the market and barriers to entry may also be taken into account. However, the EU takes the position that where the government holds market shares of around 90% or more, it approaches the situation of a sole supplier and this is indicative of predominance.

24. The private standing timber market in Ontario is necessarily relatively small in view of the high market shares of the provincial government. As a result, private prices for standing timber may be distorted although the USDOC (and the Panel) must take into account all available evidence in this regard. The EU will not opine on this factual matter. However, the EU would like to comment on a legal argument by the US according to which private prices in Ontario were distorted

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27 Canada’s first written submission, para. 327.
28 According to Canada, Crown-origin timber in Ontario accounted for 91.9% of the harvest volume (Canada’s first written submission, para. 328). While the US indicates a market share of 90% at para. 57 of its first written submission, it refers to a market share of 96.5% at para. 287.
because of the small number of private companies, i.e. the high level of market concentration. The EU would, as a general matter, caution against using market concentration as an argument for price distortion. Markets may be more fragmented or more concentrated, depending e.g. on the characteristics of the market concerned. If a market is concentrated, this does not per se call into question the suitability of private prices as benchmarks in that market. For example, certain markets may require large amounts of up-front investments, other markets may depend on raw materials that are only available in certain regions and other markets may be characterised by network effects which in each case may result in that market being accessible only for a small number of market players. This should not, however, automatically render private prices in those markets unsuitable as benchmarks under Article 14(d). Article 14(d) does not call for perfectly competitive markets and perfectly competitive markets rarely exist in real life. The level of concentration of a market forms part of the prevailing competitive conditions and if prices reflect the higher concentration of a market, this does not automatically render those prices distorted. It is not high market concentration as such that causes price distortion. However, if the high market concentration results in anti-competitive collusion among the few players, such collusion would no longer form part of competitive market conditions and could lead to price distortion. There are no allegations of collusion in the present case. The EU therefore considers that the US’s argument on the level of market concentration should be assessed with the above considerations in mind.

Québec

25. Canada argues that Québec has a competitive public auction system for selling timber. Canada contends that, rather than using Nova Scotia prices, the USDOC should have used Québec’s auction prices which are market prices. Canada considers that the design of the auction system ensures its open and competitive

31 Canada’s first written submission, para. 341.
33 The situation may be different, for example, if the high level of market concentration is the result of government intervention, for example, if the government only provides licenses to a small number of companies or only to one (monopoly) company.
34 Canada’s first written submission, paras. 361-362.
nature. These auction prices also determine the price of non-auction timber in Crown forests.

26. The USDOC found that the market for standing timber in Québec is distorted by the presence of the government and that the auction system cannot serve as a benchmark. It also considered that certain circumstances serve to decrease firms’ incentive to pay or bid above the administratively-set price for private timber (e.g. the high market concentration with ten large corporations and the fact that the 15% of auction volumes that did not sell was significant).

27. The EU considers that a government market share of 85% for standing timber is indicative of predominance. On top of the 15% of standing timber owned by private companies, Canada argues that one must add the 22% of standing timber that are sold through competitive auctions and 11% of imports which means that almost 50% of the Québec market is competitive. If either of these two contentions by Canada concerning auctions or imports were factually correct, the EU considers that the provincial government of Québec would be at most a significant supplier of the good in question but not a predominant supplier, depending on the market conditions.

28. The EU does not opine on the factual question whether the auction system in Québec is designed in a manner that would ensure competitive prices. However, provided that the auction system does ensure competitive prices, the EU considers that the 22% of auction volume may be attributed to the competitive and hence “non-distorted” part of the Québec market. The EU recalls that the Appellate Body found that where the government is the predominant provider of certain goods, ”it is likely that it can affect through its own pricing strategy the prices of private providers for those goods.” However, the government cannot pursue its own

35 Canada’s first written submission, para. 391.
36 Canada’s first written submission, para. 377.
37 Exhibit CAN-010, Commerce, FD I&D Memo, p. 98.
38 United States’ first written submission, paras. 249 et seq.; Exhibit CAN-010, Commerce, FD I&D Memo, pp. 98, 99 and 101.
39 Canada’s first written submission, para. 425.
pricing strategy or set prices if prices are set through competitive auctions and, to that extent, the government also cannot affect private prices.

29. The EU does not consider that the fact that ten corporations received 75% of Crown-timber would necessarily call into question the existence of competitive market conditions in Québec. First, as mentioned previously, the EU considers that the level of market concentration is not particularly relevant, if at all, to assess price distortion under Article 14(d). The level of market concentration simply forms part of the prevailing market conditions. Second, the existence of 10 larger companies does not indicate a particularly high level of market concentration. The EU understands that there are also 120 smaller companies bidding in auctions which would rather indicate a fragmented market.\(^{41}\)

**New Brunswick**

30. Canada argues that New Brunswick has a strong private market for standing timber and that the USDOC even relied on private prices in New Brunswick in previous investigations relating to softwood lumber.\(^ {42}\) New Brunswick sets Crown stumpage prices by periodically surveying stumpage prices in the private market.\(^ {43}\) Canada contends that the USDOC did not show that the province of New Brunswick exercised market power or distorted private market prices. The USDOC rejected private prices in New Brunswick because the Crown supplied slightly more than 50%\(^ {44}\) of the market and because the limited number of (private) consumers of standing timber made them responsive to the price setting behaviour of the government.\(^ {45}\)

31. The EU considers that, given the market share of around 50%, the province of New Brunswick is a significant supplier of standing timber. The other half of the market remained in private hands. New Brunswick therefore would therefore not appear to be a predominant supplier.\(^ {46}\) The EU considers that it was therefore for

\(^{41}\) Canada’s first written submission, para. 431.
\(^{42}\) Canada’s first written submission, para. 488.
\(^{43}\) Canada’s first written submission, para. 489.
\(^{44}\) According to Canada, New Brunswick owns only 47.6% (Canada’s first written submission, para. 497).
\(^{45}\) Canada’s first written submission, para. 491 and paras. 565 et seq.
\(^{46}\) United States’ first written submission, para. 200.
the USDOC to demonstrate, on the basis of evidence and not merely on the basis of the significant market share of the government, that the government prices distorted the private prices.

32. The fact that 50% of standing timber is held by the province of New Brunswick is in itself insufficient to demonstrate price distortion. The Appellate Body found that “[t]he fact that the government is a significant supplier of goods does not, in itself, establish that all prices for the goods are distorted.” The EU also does not agree with the USDOC’s argument that the small number of consumers (i.e. a concentrated private market) would be evidence that these consumers align more easily with government prices or that prices are necessarily suppressed. The EU fails to see the logic behind that argument. If the private market share is large enough to be “independent” of the government market, the fact that the private market is made up of a smaller or larger number of companies should in principle not be of particular relevance. Even if prices in a market with only a few private buyers of standing timber are suppressed, this does not necessarily mean that those prices are not market determined. The lower prices simply reflect the higher market power of the purchasers and hence are a function of supply and demand in that market. In addition, the number of private companies in a market is not a relevant indicator of price distortion, as discussed earlier. Article 14(d) does not require a “pure” market with perfect competitive conditions. Finally, it would be for the USDOC to prove, on the basis of positive evidence, that such price alignment by private companies did happen. Mere allegations would not be sufficient in this respect.

C. The use of the US State of Washington as out-of-country benchmark for British Columbia

(a) Canada’s arguments

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48 United States’ first written submission, para. 209.
49 As stated earlier, the situation may be different if the high concentration is caused by government intervention.
33. Canada takes objection with the fact that the USDOC compared the provision of Crown-timber in British Columbia to log prices in the US State of Washington, a forestry area with very different market conditions (e.g. different types of forests, different transport costs etc.).\(^{50}\) Canada argues that stumpage prices in British Columbia are set by competitive auctions and hence there is no distortion by the provision of Crown-timber in those provinces.\(^{51}\) The USDOC acted inconsistently with Article 14(d) by finding price distortion per se on the basis that the majority of the market is controlled by the government.\(^{52}\) Contrary to the assertions by the USDOC, the LEP (Log Export Permitting) process had no impact on log prices or auction prices.\(^{53}\)

(b) US’s arguments

34. With respect to the out-of-country benchmark used for the province of British Columbia (prices in the US State of Washington) the US contends that its approach was in line with Appellate Body requirements. The US did not apply a simple per se test as Canada contends but took into account various elements for its finding of price distortion.\(^{54}\) According to the US, prices in British Columbia are distorted because the majority of the market is controlled by the government and hence is not market-determined.\(^{55}\) The US considers that the auctions were not sufficiently competitive because of the small number of bidders and certain features of the auction system.\(^{56}\) Finally, the US also argues that the LEP process, under which exported logs require an export permit, suppresses prices in auctions and renders them not market-determined.\(^{57}\)

(c) EU’s observations

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\(^{50}\) Canada’s first written submission, paras. 601 and 608.
\(^{51}\) Canada’s first written submission, para. 61.
\(^{52}\) Canada’s first written submission, paras. 144 et seq.
\(^{53}\) Canada’s first written submission, paras. 192 et seq.
\(^{54}\) United States’ first written submission, para. 375.
\(^{55}\) United States’ first written submission, paras. 91-92.
\(^{56}\) United States’ first written submission, paras. 377 et seq.
\(^{57}\) United States’ first written submission, paras. 391 et seq.
35. The government of British Columbia owns around 90% of all standing timber.\(^{58}\) A market share of 90% may be indicative of predominance as explained earlier. However, the EU understands that around 20% of Crown-timber are sold in competitive auctions and the auction prices are also used, subject to certain adjustments, to set the prices for non-auctioned British Columbia Crown timber.\(^{59}\) If the auctions in British Columbia are designed in a way to ensure competitive market prices, the EU does not opine in this respect, the EU considers that this may result in prices for government timber being market-determined in which case it would seem that – at least to that extent - private prices would not be distorted by government ownership of standing timber.

36. In any event, whether the government of British Columbia was a predominant of significant supplier of standing timber, the rejection of British Columbia prices solely (\textit{per se}) on the basis of government ownership would not be consistent with Article 14(d) in the present case (the EU does not opine whether the USDOC did in fact adopt such a \textit{per se} approach). The EU does not exclude that there may be situations in which a benchmark may be rejected \textit{per se} on the sole basis that the government is the predominant supplier of the good in question. The Appellate Body found that an investigation authority must take into account available evidence also in cases of predominance.[emphasis added] However, if there is no other evidence available, the EU considers that predominance may be the only (and hence sufficient) reason for rejecting a benchmark. This does not appear, however, to be the situation in the present case where Canada alleged it made available additional evidence to the USDOC which the USDOC was obliged to take into account. A \textit{per se} approach in such circumstances would be inconsistent with Article 14(d).

37. While the EU does not opine on the specific design of the auction system in British Columbia, notably as to whether it results in competitive prices, the EU does not share some of the concerns that the US raises against the auction system. The US considers that the fact that a “small number of large lumber companies” dominate

\(^{58}\) United States’ first written submission, para. 57.

\(^{59}\) Canada’s first written submission, paras. 92, 101 and 147.
the auctions renders the auctions insufficiently competitive. However, as explained above, the fact that a market is concentrated is not a sufficient reason for finding distortion. Similarly, an auction system cannot be faulted for the mere fact that the auctions are carried out in a concentrated market environment. Perfectly competitive markets are rare and absent actual distortion (e.g. anti-competitive collusion), the level of market concentration simply forms part of the prevailing market conditions in Article 14(d). The EU also notes that the market shares of the top three companies in auctions were 17%, 10% and 7%, respectively, with many other companies being active in the market. These market shares would not seem to be indicative of a particularly high market concentration.

38. The EU also considers that it was for the USDOC to demonstrate and adequately explain why the three-sale auction rule, a rule intended and acknowledged to promote competition, limited the effectiveness of the auction system to the point of generating distorted prices. While the EU does not opine in this respect, it finds that the operation of this rule would prima facie seem to open up auctions also for smaller companies (i.e. the larger companies cannot buy up all timber by participating in all auctions in parallel) and hence to further competition and hence market-determined prices.

39. Regarding the US’s argument that the LEP process led to distorted prices, the EU will not opine on the facts of the case. As a general matter, the EU considers that export restraints may in principle lead to price distortions in a given market. This is because, depending on the level of export restriction, the goods in question may have to be sold domestically instead of being exported which may lead to oversupply and hence a significant lowering of the price on the domestic market. At the same time, the existence and level of distortion in case of export restrictions will have to be analysed for each specific case. For example, domestic producers may adapt their production of the good in question and produce less or may switch to producing other products instead in which case the distortive effect of the export restriction may be mitigated. In addition, the effect of the export restriction will

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60 Canada’s first written submission, para. 161.
61 Canada’s first written submission, para. 180.
62 Canada’s first written submission, para. 183.
depend to a considerable extent on the type of export restriction. E.g. an export ban will have a different impact on the domestic price than a mere restriction that makes exports subject to certain conditions. The Panel may take into account in this respect the fact that 99% of log export applications appear to be approved by the government\textsuperscript{63} and that the fees in this respect seem to be very low.\textsuperscript{64}

40. The EU does not opine as to whether the use of an out-of-country benchmark for British Columbia by the USDOC met the conditions (“very limited circumstances”) imposed by the Appellate Body in this respect.

III. ENTRUSTMENT OR DIRECTION UNDER ARTICLE 1.1(a)(1)(iv) OF THE SCM AGREEMENT

41. \textbf{Canada} argues, \textit{inter alia}, that the USDOC’s finding that the measures of Canada and British Columbia imposing restrictions on the export of logs amount to a financial contribution is contrary to Article 1.1(a)(1)(iv) of the SCM Agreement, because there is no evidence of entrustment or direction.\textsuperscript{65}

42. \textbf{The United States} considers that the USDOC was correct in finding that the export restrictions at issue amount to the entrustment or direction of private log suppliers to provide logs to consumers in British Columbia. This finding, according to the United States, was not based simply on marketplace effects, but also on the explicit legal requirement to use or provide logs locally. The United States considers that “entrustment or direction” can encompass a range of actions including an export restriction, and that an explicit command to sell a particular product at a particular price is not required.\textsuperscript{66}

43. \textbf{The EU} recalls that a “financial contribution” attributable to a government or public body is an essential component of a “subsidy”. A financial contribution may be provided not just \textit{directly} by the government, but also \textit{indirectly}, where a government entrusts or directs a private body to carry out one or more of the type of functions illustrated in Article 1.1(a)(1) (i) to (iii) which would normally be

\textsuperscript{63} Canada’s first written submission, para. 201.
\textsuperscript{64} Canada’s first written submission, para. 204.
\textsuperscript{65} Canada’s first written submission, section IV.
\textsuperscript{66} United States’ first written submission, section IV.
vested in the government and the practice, in no real sense, differs from practices normally followed by governments. Entrustment or direction, therefore, entails attributing private conduct to the government, in cases where a private body is “being used as a proxy by the government to carry out one of the types of functions listed in paragraphs (i) through (iii).”67 In that sense, Article 1.1(a)(1)(iv) is an anti-circumvention provision.68

44. Whether a particular action constitutes a financial contribution within the meaning of Article 1.1(a)1(i) to (iii) is therefore a distinct question from whether that action, when performed by private actors, can be attributed to the government under Article 1.1(a)(1)(iv). In this submission, the EU will restrict its comments to the latter question.

45. The EU considers that mere acts of encouragement by the government, or an effect on prices that is merely co-incidental or a by-product of legitimate governmental regulation, do not suffice for entrustment or direction under Article 1.1(a)(1)(iv). While regulatory measures may or may not be consistent with other provisions of WTO law, such as those in the GATT 1994, in the EU’s view they should not be seen as “entrusting or directing” producers to provide financial contributions purely on the basis of a co-incidental effect on prices.

46. As pointed out by the United States,69 the Appellate Body disagreed with the US – Export Restraints panel that “entrustment or direction” is limited to express delegations or commands.70 However, the Appellate Body agreed that entrustment and direction do not cover "the situation in which the government intervenes in the market in some way, which may or may not have a particular result simply based on the given factual circumstances and the exercise of free choice by the actors in that market." The Appellate Body also held that “not all government acts necessarily amount to entrustment or direction”, that “entrustment and direction—through the giving of responsibility to or exercise of authority over a private body—imply a more active role than mere acts of encouragement”, and that

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69  United States’ first written submission, para. 554.
entrustment or direction “cannot be inadvertent or a mere by-product of governmental regulation.” As the EU sees it, the panel in *US – Countervailing Measures (China)* essentially confirmed this view.

47. The United States is correct to point out that a range of measures, not just express delegation of responsibility or an express command to undertake an individual transaction of a particular kind, could amount to entrustment or direction. However, the fact that there may be different methods of entrusting or directing does not mean that Members should be allowed to apply countervailing measures “whenever a government is merely exercising its general regulatory powers.” A link must be shown between the government and the conduct of the private body as a “proxy” for the government; private conduct cannot be presumptively attributed to the State. Whatever the effects of a measure may be in the marketplace, entrustment or direction requires either that the government gives responsibility to a private body, or exercises its authority over a private body, in order to effectuate a financial contribution.

48. As the Appellate Body pointed out, it is difficult to specify in the abstract what needs to be shown to satisfy that requirement. This depends on the facts. “Guidance” by the government may suffice, even though “some form of threat or inducement” will normally be expected. The measure, its design and architecture should be considered as a whole. In doing so, it should be kept in mind that entrustment or direction frequently takes place in ways that are informal or even covert. While this may pose evidentiary challenges, it would be wrong to insist that entrustment or direction can only occur through formal legal rules. The government may, instead, guide or induce private actors to provide financial contributions through a measure or set of measures designed to achieve that result, without any explicit command or delegation.

49. The panel could draw useful guidance from the *US – Countervailing Measures (China)* panel, which drew a distinction between the exercise of governmental authority over a private body (i.e. direction) “in respect of the function of providing goods to domestic users” and the exercise of governmental authority which “relates only to the conditions of export”. 78 Similarly, with respect to entrustment, that panel wondered whether there is an indication that a government “gave responsibility” to private actors to provide the financial contribution. 79 This seems to suggest that a measure involving an export restraint could constitute entrustment or direction depending on the relevant facts and evidence, taking the measure as a whole and possibly in combination with other relevant measures or pronouncements by the government.

50. The EU does not take a position on whether such elements were shown to exist in this case. However, we note that the United States does not consider USDOC’s findings to be based purely on the effects of the export restraint. For example, the United States refers to explicit requirements imposed by Canadian legislation that logs must be “used or provided to timber processing facilities in British Columbia unless an exception applies”, 80 which are coupled with a mechanism of supervision and enforcement. 81 It should be assessed whether these provisions suggest that Canada gave responsibility to private bodies, or directed them, to provide the financial contribution at issue. The panel should take careful note of the relevant findings of USDOC when determining whether “entrustment or direction” can be found, in accordance with the Appellate Body’s guidance.

IV. DIRECT TRANSFERS OF FUNDS AND PURCHASES OF SERVICES

51. **Canada** claims that USDOC erred when concluding that certain reimbursements to harvesters in Québec and New Brunswick constituted grants, and therefore financial contributions within the meaning of Article 1.1(a)(1)(a). Instead, those reimbursements should properly have been considered as payments for license management and silviculture services provided by those harvesters to Québec and

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80 United States’ first written submission, paras. 534 and 535.
81 United States’ first written submission, paras. 536 - 539.
New Brunswick. Therefore, what is at issue are purchases of services, which are excluded from Article 1.1(a)(1) and cannot constitute financial contributions.  

52. **The United States** counters that the USDOC was correct in finding that the reimbursements are a direct transfer of funds in the form of grants, *inter alia* because harvesters were legally required to undertake silviculture and forest management activities, and the subsequent reimbursement of the costs of those activities constituted a grant that did not involve a reciprocal obligation.

53. The parties seem to agree that whether a particular transaction constitutes only a transfer of funds or a purchase by the government depends, in essence, on whether the government receives consideration in return.

54. As a starting point, the EU agrees with the United States that there may be circumstances in which a transaction could be described as a grant even though it reimburses the costs of an activity performed by the alleged recipient of the subsidy. It could be relevant, in that context, if the activity was performed on the basis of a distinct legal requirement.

55. In many cases, this may be largely a matter of perspective. If a transfer of funds occurred, and an action was performed by the recipient of funds, it could be argued either that the action was a service and the transfer a payment, or that the action and the transfer occurred separately. The European Union struggles to see why that should be the threshold question for the existence of a financial contribution, and therefore for the applicability of the disciplines of the SCM Agreement.

56. Therefore, the European Union agrees with what seems to be implied by the United States’ position: governmental transfers of funds should not be automatically excluded from Article 1.1(a)(1)(a) just because they are said to have occurred as reimbursement for the provision of a service.

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82 Canada’s first written submission, section V.
83 United States’ first written submission, section V.
84 Canada’s first written submission, para. 978; United States’ first written submission, para. 619.
85 United States’ first written submission, paras. 634. (“The governments each reimbursed the relevant companies for performing tasks that they had legally required the companies to perform.”) 636 (“New Brunswick held JDIL legally responsible for performing certain silviculture and forest management, then separately reimbursed JDIL for the costs associated with its performance of those activities.”); emphasis added.
57. The European Union notes that there is no Appellate Body finding, and no upheld panel finding, that purchases of services are excluded from the coverage of Article 1.1(a)(1)(a). In US – Large Civil Aircraft, the Appellate Body declared the panel findings on that issue referred to by Canada to be moot and of no legal effect.\(^{86}\) The compliance panel in the same dispute did not even consider whether purchases of services amount to a financial contribution.\(^{87}\) Indeed, it proceeded to assess whether there is a benefit, \textit{arguendo}, on the assumption that they do.\(^{88}\) Had the Appellate Body truly endorsed the original panel’s view that purchases of services can never be financial contributions, whether explicitly or implicitly, one would have expected the compliance panel in the very same dispute to proceed on that basis. It chose not to do so.

58. On a proper reading of Article 1.1(a)(1)(a), an alleged purchase of services could give rise to a financial contribution, such as a direct transfer of funds. This is supported by the ordinary meaning of the phrase “a government practice involves a direct transfer of funds”. There is nothing in Article 1.1(a)(1)(a)(iii), as context, that necessitates the conclusion that purchases of services can never be financial contributions. Moreover, completely excluding purchases of services would frustrate the object and purpose of the SCM Agreement by creating a massive loophole in the Agreement’s coverage, allowing the unchecked granting of actionable or even prohibited subsidies when connected to the provision of a \textit{service}, potentially leading to distortions in the international trade in \textit{goods}.

59. Properly interpreting Article 1.1(a)(1)(a) in this way would allow purchases of services to be disciplined by the SCM Agreement if they give rise to a financial contribution, for example as a direct transfer of funds. This would enable panels to directly tackle the issue of the existence of a subsidy in cases of governmental transfers of funds.

V. \textbf{THE DETERMINATION OF BENEFIT WITH RESPECT TO PROVINCIAL ELECTRICITY PROGRAMMES}

\(^{87}\) Panel Report, \textit{US – Large Civil Aircraft (Article 21.5)} para. 8.436.
60. **Canada** argues that USDOC erred in finding that electricity purchasing programmes in three Canadian provinces constituted a purchase of goods for more than adequate compensation within the meaning of Articles 1.1(b) and 14(d) of the SCM Agreement, and therefore conferred a benefit. In particular, Canada argues that, according to the Appellate Body’s guidance in *Canada – FIT*, USDOC should have defined the relevant market as the market for the specific type of electricity being purchased (electricity from biomass), and not the market for all types of electricity. Consequently, USDOC should have used a benchmark that takes as a given Canada’s desired energy supply mix. In addition, USDOC failed to take into account that certain electricity purchases were based on market principles due to a price discovery mechanism.

61. **The United States** responds that USDOC was correct to find that the prices arising from the electricity programmes themselves were not an appropriate benchmark. Those prices were not market-based, because they reflected only one type of electricity, and electricity is a fungible good; moreover, it would be incongruent to use the price determined under the very programme being challenged as the benchmark. USDOC’s market definition does not conflict with *Canada-FIT*, notably because USDOC compared the public utilities’ purchase price for electricity from biomass with the same utilities’ selling price for electricity, reflecting both sides of the market.

62. In *Canada-FIT*, the Appellate Body clarified that the definition of the relevant market should precede an analysis of benefit. When defining the relevant market, both demand-side considerations (including the substitutability of electricity generated from different sources) and supply-side considerations (including the government intervention in the marketplace, based on the government’s desired energy supply mix) should be considered. On the basis of this, the Appellate Body concluded as follows:

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90 Canada’s first written submission, section VI.
91 United States’ first written submission, section VI.A.
“[E]ven if demand-side factors weigh in favour of defining the relevant market as a single market for electricity generated from all sources of energy, supply-side factors suggest that important differences in cost structures and operating costs and characteristics among generating technologies prevent the very existence of windpower and solar PV generation, absent government definition of the energy supply-mix of electricity generation technologies. This, in turn, would have lead the Panel to conclude that the benefit comparison under Article 1.1(b) should not be conducted within the competitive wholesale electricity market as a whole, but within competitive markets for wind- and solar PV-generated electricity, which are created by the government definition of the energy supply-mix.”

63. This guidance is clearly relevant in this context. The issue in dispute between the parties is precisely whether or not the relevant market is only that for the type of electricity from renewable sources (biomass) purchased by Canada, or for all types of electricity. In the European Union’s view, the panel should consider whether there are pertinent reasons to distinguish this case from the circumstances in Canada-FIT such that the Appellate Body’s reasoning would not apply.

64. As the European Union understands, the United States argues that the circumstances are different because the Canadian public utilities both purchase (biomass-generated) electricity from and sell (all types of) electricity to the same respondent companies. Using the price at which the utilities sell as the benchmark is appropriate, according to the United States, because the same companies are present, respectively as sellers or buyers, both in the transaction said to be a subsidy and in the benchmark transaction. USDOC considered the demand-side of the relevant market (the utilities) and the supply-side (the companies), and found that both the utilities and the companies consider all types of electricity as substitutable.

65. Generally speaking, the EU agrees that the fact that the benchmark is tailored to the circumstances of the same companies said to be receiving a subsidy may be relevant in deciding whether that benchmark is appropriate. However, what is absent in the United States’ arguments is the key aspect of the guidance in Canada

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95 See, for example, United States’ first written submission, paras. 682 - 683.
–– FIT: the importance of the government’s definition of the energy supply-mix, leading essentially to the creation of the market for particular types of electricity from renewable sources. When the Appellate Body referred to the need to consider the supply side of the electricity market, it was concerned with these issues, and not for example with the subjective views of industry actors on whether electricity from different sources is substitutable.

66. Of course, even if the panel were to agree with Canada on the issue of the relevant market, this would not be the end of the enquiry. A benefit would still exist if the electricity purchase prices did not reflect a hypothetical market outcome. An appropriate benchmark for biomass electricity generation would thus normally need to be found. This benchmark could be found, for example, in “administered prices for the same product (in the country of purchase or in other countries, subject to adjustments), provided that it is determined based on a price-setting mechanism that ensures a market outcome”, or in “price-discovery mechanisms such as competitive bidding or negotiated prices, which ensure that the price paid by the government is the lowest possible price offered by a willing supply contractor.” ⁹⁶ Whether the benchmarks proposed by Canada fulfil those requirements is a factual matter on which the European Union takes no position.

67. Just because a price discovery mechanism exists, it does not follow that there is no benefit. The relevance of price discovery mechanisms for the existence of benefit will depend on the circumstances. For example, if the aspect of a contract said to confer a benefit was not factored into competitive bidding, then the presence of competitive bidding could not lead to the conclusion that there is no benefit.⁹⁷ Moreover, price discovery mechanisms may carry different weight depending on the market circumstances: for example, whether a product is fungible or heterogeneous, whether the number of suppliers is big or small, and whether there are asymmetries of information.⁹⁸

VI. CONCLUSIONS

68. The EU considers that this case raises important questions on the interpretation of the SCM Agreement. While not taking a final position on the merits of the case, the EU requests this Panel to take into account the observations made in this submission.