

## INTERNATIONAL TRADE

### CANADA-U.S. SOFTWOOD LUMBER DISPUTE: WHAT'S CHANGED? B.C. LOG EXPORT RESTRICTIONS (LERS) AND NAFTA IMPLICATIONS

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#### Introduction

The softwood lumber industry is a vital component of the Canadian and American economies. Both countries have been trading lumber since the 1800s. The softwood lumber dispute is one of the longest and most important trade disputes between the United States ("U.S.") and Canada, affecting the lumber industry to the present day.

Though the central issue in this decades old dispute continues to focus on the alleged subsidization of Canadian lumber producers through what is known as "stumpage" (i.e. the provision of provincially owned government timber to producers for less than the market value of the timber), new threats and opportunities have emerged in this latest round. On one hand, the U.S. Department of Commerce ("DOC") recently found that log export restrictions ("LERS") in British Columbia ("B.C."), including those applicable to timber harvested off private land, confer a considerable countervailable subsidy, thereby adding to the list of issues in contention. On the other hand, it is well known that although the dispute has progressed through four separate rounds of litigation since 1982 (*Lumber 1 through Lumber IV*), the parties have tended to find more lasting resolution through negotiated settlements. Therefore, the recent launch of renewed NAFTA negotiations may become the forum in which to settle this long standing dispute once and for all.

#### Lumber V Will Hurt

##### *Historic Context*

Many things have changed since *Lumber I* in 1982 when the American industry filed their first of many countervailing duty petitions against Canadian exports of softwood lumber. Amongst the variability, there has been at least one constant: Canada and the U.S. are still at odds about softwood lumber. Indeed, the political backdrop in 2017 bears a striking resemblance to 1982, when a well-known Republican President (Ronald Reagan) sent cautionary rhetoric throughout the media to his Canadian counterpart, Prime Minister Trudeau, regarding Canada's policies governing its lumber industry. Then, like today, the Canada-U.S. trade relationship was ripe for change, including the potential for major adjustments to the Canadian softwood lumber industry and the federal and provincial laws which govern it.

Following *Lumber IV*, Canada and the US agreed to a *Softwood Lumber Agreement*, which came into force in 2006 and expired on October 12, 2015. *Lumber V* results from the expiration of that Agreement on October 12, 2015, which began a one-year truce during which the coun-

tries tried to reach a new deal. The expired Agreement ended a lengthy trade dispute between the two countries during which the U.S. collected approximately \$5 billion in anti-dumping duties ("ADDs") and countervailing duties ("CVDs") from Canadian producers. As officials between Canada and U.S. failed to reach a new deal before October 12, 2016, the U.S. Lumber Coalition was free to initiate another round of litigation against Canadian producers.

##### *The Petition*

Last November, after the expiration of the litigation standstill, an association of U.S. lumber producers and associations — the "Committee Overseeing Action for Lumber International Trade Investigations or Negotiations" — filed a softwood lumber petition. The petition alleged that Canadian lumber exports are subsidized, injure the U.S. industry and that Canadian exporters are guilty of dumping.

In the petition, U.S. lumber producers maintain that Canadian softwood lumber is subsidized for several reasons, two of which bear mention. First, the provincial governments set stumpage fees that are below competitive market conditions. Second, as more particularly described below, the B.C. and Federal Government together impose LERS on both public and private lands in that province which in turn forces B.C. log harvesters to offer logs to domestic processors at below market prices, prior to any export to international markets. It is alleged that the latter measure constitutes a clear case of the government provision of a good, through a private party, at below market cost. In fact, nowhere else in North America do such restrictions exist on private lands.

##### *The Investigation*

On April 24, 2017, the [DOC announced preliminary CVDs on Canadian lumber imports](#). Among the investigation respondents, West Fraser received the highest rate of 24.12 percent, followed by Canfor at 20.26, Tolko at 19.5, Resolute at 12.82 and J.D. Irving at only 3.02. All other producers in Canada will be subject to the "all others" rate of 19.88 percent, which is a weighted average of the CVDs levied on the respondents. The DOC will release its final CVD determination on September 7, 2017. The DOC noted in its Decision Memorandum Release that imports of softwood lumber from Canada were valued at an estimated US\$5.66 billion in 2016.

##### *Retroactive Duties for Almost All!*

In addition, the DOC preliminarily found that "critical circumstances" exist with respect to J.D. Irving and all companies subject to the "all others" rate, which means the duties will apply retroactively for 90 days for all Canadian producers other than Canfor, West Fraser, Resolute Forest Products and Tolko. These lumber producers will be forced to pay the CVD rate on all sales dating back to early February 2017. DOC Secretary Wilbur Ross has stated that he expects this retroactive charge to total approximately US\$250 million.

### *And More: Anti-Dumping Duties*

On or about June 23, 2017, the DOC is also expected to announce the preliminary imposition of ADDs. If the DOC finds that Canadian softwood lumber exports are being sold in the U.S. for less than fair market value, it will impose ADDs, which when combined with the CVDs, could raise the overall duty rate on Canadian exports above 30 percent.

### **What's Changed In Lumber V?**

While preliminary CVD rates for *Lumber V* are similar to the preliminary CVD rates levied in *Lumber IV*, there is one particular aspect of the determination that is different this time around.

### *The Adverse Effect of B.C. LERs*

Perhaps the most striking portion of the DOC's Decision Memorandum on CVDs was the extent to which B.C. LERs factored into the DOC's final subsidy rates. While [industry experts](#) have previously warned the Canadian government and public of the potential countervailable status of CVDs, they have never featured prominently in past lumber disputes. More than in any prior case, in *Lumber V*, lumber producers across Canada are being punished for the forest policies in B.C., and more specifically, the Federal LER regime on **federally regulated private lands**.

Under federal legislation, the export of logs is prohibited unless an export permit is issued by the Minister of Foreign Affairs and International Trade (the "Minister"). This permit requirement is set out in the *Export and Import Permits Act*, R.S.C. 1985, c. E-19. As a result, logs are listed as Item 5101 on Canada's *Export Control List*, S.O.R./89-202.

In B.C., the vast majority of the harvestable land base (by area and volume) is provincial Crown land, with a small percentage being federally regulated private land. Federal Notice No. 102 ("Notice 102") is a policy adopted by the Federal Government with regard to the regulation of federally regulated private land in B.C. (and the small portion of federally regulated Crown land in B.C.).

Notice 102 applies a "Surplus Test" to proposed log exports harvested from private lands in B.C. This means that logs cannot be exported from B.C. private lands unless they are "surplus" to the needs of domestic processors. The Surplus Test requires the log harvester to first offer logs to a local processor before an export permit can be issued.

The DOC determined that the B.C. LER regime, and particularly the Surplus Test, allows domestic processors to "block" exports by objecting to the granting of export licenses for B.C. logs. A domestic processor need merely make an offer on an export application to halt the export process of a log. As a result, timber harvesters in B.C. are often forced to negotiate informal supply arrangements at discounted prices with certain domestic processors in exchange for the processor's agreement not to block the harvester's exports. Therefore, LERs lower the price of logs below the levels that timber harvesters could obtain on the international market by exporting the logs.

The B.C. LER regime is a contentious point for American industry, who alleged in their petition that LERs suppress domestic logs prices by up to 66 percent. The DOC agreed with the Petitioner and determined that LERs on private lands in B.C. are a significant countervailable subsidy. In reaching its conclusion, the DOC made a number of significant findings, including:

1. the laws and regulations pertaining to exporting logs from B.C. (whether under federal or provincial jurisdiction) are applied throughout the entire province, and thus impact all of B.C. (i.e. a "rippling effect");
2. this, in turn, impacts the prices interior log suppliers offer to their customers (including, the B.C. mandatory respondents); and
3. B.C.'s LERs result in a financial contribution by means of entrustment or direction of private entities in that official governmental action compels suppliers of B.C. logs to supply to B.C. consumers, including mill operators.

### *The Impact is Broader And Hurts Some Much More Than Others*

The LER subsidy represents a substantial 24 to 36 percent of the overall subsidy rates applied to each of the three mandatory B.C. respondents, West Fraser, Canfor and Tolko. Given that B.C. exports approximately 60 percent of all Canadian lumber shipped to the U.S., the LER subsidy rates also contribute significantly to the volume weighted "all others" rate of 19.88 percent applied to all Canadian producers.

In fact, [industry writers](#) have noted that as much as one third of the nationwide CVD duty reflects the effect of B.C. LERs. In other words, but for LERs, Canada's lumber industry would be facing a significantly reduced CVD on its exports. For example, in Atlantic Canada, where log exports from private land are free from restraints imposed by government, the CVD rate applied to J.D. Irving was only 3.02 percent. Yet, all other Atlantic producers will be adversely affected by the "all others" rate of 19.88 percent largely as a result of B.C. LERs. In many ways, Maritime producers are being penalized by processes which they claim no benefit from, including both B.C. LERs and Crown stumpage policies, because Atlantic Canada lumber is harvested exclusively from private lands.

In a similar thread, the "all others" rate will be particularly felt by certain Canadian producers located along the Quebec/U.S. border, which import primarily U.S. timber for processing, before exporting the end product back to the U.S. These producers received an exemption under *Lumber IV*. Like the Atlantic producers, they will be subject to the punitive "all others" rate of 19.88 percent despite having no real connection to the government policies that were the subject of the petition. In failing to provide an exemption for the border mills, which do not obtain their product from Quebec lands, it is arguable that the U.S. have abused trade law in order simply to increase leverage towards a settlement.

### *Broad Impact Demonstrated Further by Bailouts*

The impact of *Lumber V* extends beyond its impact on industry and will be felt by all Canadians. As a direct result of *Lumber IV*, it is believed that over 15,000 jobs were lost. This time around, the Federal Government is putting together an aid package, which is believed to include almost \$1 billion dollars in funding to help the Canadian lumber industry cope with the duties imposed by the DOC. It is not yet known whether the Federal Government will offer loan support to help producers fund the duties. This funding further demonstrates the real impact of Canada's lumber policies, as losses to Canadian producers resulting from *Lumber V* will be partially offset by the tax dollars of Canadian citizens.

### *NAFTA Negotiations*

The U.S., and particularly DOC Secretary Wilbur Ross, has used softwood lumber as an example to demonstrate "the problems" with NAFTA and the Canada-U.S. free trade relationship. The U.S. position on softwood lumber is designed to eliminate all unfair trade practices that American officials believe exist. Softwood and supply management are amongst the top of the U.S.'s list of issues with Canada.

On May 18, 2017, the Trump Administration announced its intention to initiate negotiations with Canada and Mexico regarding modernization of [NAFTA](#). Although the U.S. has stated its intentions to continue softwood lumber negotiations on their own in the hopes of finding an agreement in the 90 days before NAFTA negotiations begin, if an agreement is not reached by that time, it would not be surprising to see softwood lumber fall in line as part of NAFTA renegotiations. In that case, it is conceivable that softwood lumber is dealt with in a distinct NAFTA chapter, similar to NAFTA's chapters on energy and financial services. The debate surrounding softwood lumber has never come at a time of such rhetoric and uncertainty surrounding the Canada-U.S. trade relationship. This broader context has the potential to shape the softwood lumber dispute and its negotiations in ways that previous disputes were not exposed to.

It is worth noting that LERs are also a major trade irritant for Canada not only with the U.S., but with Canada's other international trade partners, including Japan and China, who are engaged in free trade discussions with Canada.

**As Notice 102 is a policy, not a regulation or statute, it can easily be rescinded administratively by the Federal Government without legislative approval.** This will be a point to watch in Canada's upcoming trade negotiations.

### **Conclusion**

Painful CVDs will continue to be in effect pending the most likely outcome of the dispute: the eventual negotiation of another bilateral agreement – whether within or outside the context of NAFTA. The ultimate agreement could very well include far-reaching changes to

provincial forest regimes, including the elimination of LERs on private lands in B.C. by the Canadian federal government.

A prudent course of action for all affected companies on both sides of the border is to monitor and advocate where necessary to ensure that their interests are protected and promoted in any new agreement or subsequent litigation. Those efforts include closely monitoring developments over the next several months and interjecting where necessary; undertaking the necessary efforts to make sure that the products that are subject to any new agreement are not adverse to their interest; advocating for particular export measures in any negotiated settlement; advocating for product and company exclusions or inclusions according to their interests; and understanding how any new ADD or CVD duties or export measures in any future agreement, whether in the form of quotas, taxes or both, will be applied, paid and collected throughout the supply chain.

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