## APPENDIX

## THE ILLEGALITY OF LOG EXPORT RESTRICTIONS UNDER INTERNATIONAL TRADE LAWS

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British Columbia's log export restrictions ("LERs") are both illegal quantitative restrictions under the General Agreement on Tariffs and Trade 1994 ("GATT"), and countervailable subsidies to Canadian lumber producers under the WTO Subsidies and Countervailing Measures Agreement ("SCM Agreement").

LERs are clear violations of Article XI:1 of the GATT. Put simply, restrictions on exportation are prohibited under Article XI:1. LERs cannot be justified under the available exemptions to the general prohibition.

LERs are also countervailable subsidies to Canadian softwood lumber producers, as the Department of Commerce has found in prior lumber CVD investigations as well as in other CVD determinations. Through the Surplus Test and Fee-in-Lieu requirements, the provincial and federal governments entrust or direct harvesting companies in BC to provide logs, to domestic producers, thus providing a financial contribution. Because the logs are provided to domestic processors at below-market prices, a benefit is conferred. And because this timber is provided only to domestic timber processing industries in BC, the log export restrictions are specific.

### (1) LERs: ILLEGAL QUANTITATIVE RESTRICTIONS

LERs enable the government to control nearly all aspects of the exportation of logs, including whether the logs can be exported at all, how much can be exported, who can export, how often exports can take place, the costs related to the exportation, the purpose of all which is to help to ensure that BC log processors have continuous uninterrupted supply at all times to BC logs at suppressed domestic prices.

#### (a) Article XI:1 Violation

Article XI:1 of the GATT states that no prohibitions or restrictions other than duties, taxes or other charges, whether made effective through quotas, import or export licenses or other measures, shall be instituted or maintained by any contracting party on the importation of any product of the territory of any other contracting party or on the exportation or sale for export of any product destined for the territory of any other contracting party.

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Canada bans the export of logs from the province of BC which do not meet the Surplus Test.[2] By refusing to grant export permits unless the Surplus Test is satisfied, Canada unlawfully restricts the export of logs. The effect of the LERs is to restrict the ability of landowners to sell into international markets at international prices, and to increase the supply of logs at depressed prices to the downstream lumber processing sector.

LERs are a clear violation of Article XI of the GATT:

(i) Canada and BC are not required to grant approval to applicant exporters and are authorized to impose various restrictive conditions on the export of logs. The most notable limiting condition is that log exporters are required to create a log surplus in the domestic market before they are able to obtain government approval to export logs. Both the federal and provincial governments impose the Surplus Test. BC logs are only available for export after they have first been offered for sale to local processors at discounted prices. Canada in conjunction with BC have created a government system which requires log harvesters to continuously create a surplus of logs at suppressed prices in the domestic market at all times.

(ii) The Surplus Test imposes a mandatory requirement on all exporters to submit their logs to an arbitrary government sanctioned price comparison mechanism, designed to suppress domestic log prices for the benefit of local processors. Exporters are only permitted to export logs if a domestic processor does not offer a "fair" price for the logs at issue. What constitutes a "fair" offer in relation to the prevailing market prices in BC is an arbitrary institutionally biased process administered by a government-appointed Committee of individuals, all or almost all of which have interests directly opposed to that of the applicant log exporter. There are no official, inscribed publicly-disclosed policies or requirements for determining the conditions under which an offer will be considered "fair" by the Committee or for determining the benchmark domestic market price of logs. Both such determinations are left to the arbitrary undisclosed judgement of the Committee which is subject to no effective recourse or review.

The benchmark domestic value of logs is set in an environment

[2] WTO panels have considered similar measures restricting exports or imports to be "prohibitions or restrictions" within the meaning of Article XI. *United States-Import Prohibition of Certain Shrimp and Shrimp Products*, Report of the Appellate Body, WT/DS58/AB/R, adopted 6 November 1998, para. 7.16.

where the usual forces of supply and demand do not exist due to a system imposed by the Canadian and BC governments which grants domestic log processors extreme leverage to maintain suppressed domestic market prices for the logs they purchase in the log market. This leverage is exerted by the domestic log processors through their official ability to threaten to interfere with log exporters' exporting activities if logs are not made available to them at suppressed domestic prices.

(iii) Log harvesters seeking export permits for logs are often forced to strike side deals with BC domestic log processors to induce them not to submit bids for the logs in question, but at the cost of the log exporter sharing some portion of the log export price with domestic processors that might otherwise have bid for the logs.

(iv) Restrictions prohibiting the advertising of standing timber restrict the ability to obtain an export permit until after the logs are harvested.

(v) The restrictions impede the ability of harvesters to enter into long term contracts with foreign buyers for the supply of logs.

(vi) Canada imposes severe additional mandatory costs, and procedures (such as sorting requirements) on the export of logs thereby restricting their unimpeded access to international markets.

(b) Exceptions Do Not Apply

Article XI:1 goes on to set out the various exceptions. In particular, Article XI:2(a) states that the general prohibition in Article XI:1 shall not extend to export prohibitions or restrictions "temporarily applied" to prevent or relieve "critical" shortages of foodstuffs or other products "essential" to the exporting contracting party.

In *China-Measures Related to the Exportation of Various Raw Materials*, the Panel considered the meaning of "temporarily applied". The Panel concluded that this term required that "a restriction or ban under applied under Article XI:2(a) must be of a limited duration and not indefinite.[3]

[3] *China-Measures Related to the Exportation of Various Raw Materials,* Panel Report, WT/DS394, 395, 398/R., July 5, 2011, paras. 7.256-260.

Canada cannot justify its log export restrictions under Article XI:2(a). LERs have not been "temporarily applied", but have been in place for several decades with no indication of when they will be withdrawn. There can also be no "critical" shortage of logs in British Columbia as the volume of logs harvested has been below the Annual Allowable Cut for several years.

(c) Not Saved by GATT, Article XX

LERs are not justified under the general exception found in Article XX of the GATT because they do not meet the requirements of the chapeau to that provision: that the measures are not applied in a manner that constitutes arbitrary or unjustified discrimination or a disguised restriction on international trade.[4]

LERs discriminate between domestic and foreign users of the raw materials in question. The reason for that discrimination – a desire to favour domestic users of those raw materials – is not a reason that constitutes a "justification" within the meaning of the chapeau. The effect of the export restrictions is to favour domestic users of logs. Indeed Canada argued this very point in its support of the US complaint against China in *China-Measures Related to the Exportation of Various Raw Materials* wherein Canada stated:

> *China has not met the requirements of the chapeau of Article XX, notably because the export restrictions discriminate between domestic and foreign users of the raw materials in question. Also, the facts show that the effect of the export restrictions is to favour domestic users of the raw materials in question and this is a "disguised restriction" within the meaning of the chapeau.*[5]

(d) Illegal Export Restrictions in Other Cases

Several major Canada-US FTA, NAFTA and WTO decisions exemplify important applications of these provisions.

In 1986, the US initiated a GATT complaint against Canada's ban on the exportation or sale for export of certain unprocessed herring. In 1988, a GATT Panel found that these restrictions violated the prohibition in Article XI:1 of the GATT as they were not primarily aimed at the conservation of an exhaustible natural resource under Article XX.[6] Canada subsequently eliminated these export prohibitions and instead instituted requirements that various species of herring and salmon be landed in Canada before export, so that they could be inspected. A Canada-US FTA Panel found that the landing requirements were inconsistent with the FTA, violating the provisions of Article XI and were not justified under Article XX, given the availability

[4] Supra, 2, *US-Shrimp*, Appellate Body Report, at para. 150.
[5] Supra, 3, Addendum, ANNEX E-3 - Executive Summary of Written Submissions and Oral Statement of Canada, at para. 10.
[6] *Canada – Measures Affecting Exports of Unprocessed Herring and Salmon*, L/6268 Panel Report, adopted 22 March 1988, BISD 35S.

of less trade-restrictive measures for monitoring and ensuring the sustainability of the fish stock.[7]
Over the past several years, the U.S. and other countries have challenged several export restraint measures imposed by China for violation of Article XI of the GATT. In each case, Canada has somewhat hypocritically intervened to support the complaints notwithstanding that its own export restraints on logs violate the same provision. Arguably, logs are far less critical to Canada's national and economic security than, say, rare earth elements. Any claim that LERs are somehow essential seems highly tenuous.

In 2009, various countries, including the US, filed a WTO complaint against export restraints imposed on various raw materials from China. These included export duties, export quotas, minimum export price requirements, and export licensing requirements. In 2012, the Appellate Body largely affirmed the decision of the WTO Panel, finding that these export requirements violated Article XI of the GATT, and in particular the Panel's conclusion that China had not demonstrated that its export restrictions were "temporarily applied" to either prevent or relieve a "critical shortage" within the meaning of Article XI:2(a).[8]

Canada participated as a third party to support the complainants in this dispute. Canada argued that measures may not be applied under Article XI:2(a) for an indefinite period, but may only be applied for a fixed time; something which is clearly not the case with its own LERs which themselves have been in existence for decades.[9]

In 2012, another WTO complaint was filed by the US against various restrictions that China had imposed on the export of certain rare earth materials. While China appeared to accept that these restrictions violated Article XI of the GATT, 1994 it sought to justify the measures under Article XX(g) (the General Exceptions Provision in the GATT) as measures relating to the conservation of scarce natural resources if implemented in conjunction with measures restricting domestic production or consumption of such resources. The WTO Panel held that the terms of Article XX(g) were not satisfied, because domestic producers of products for which these rare earth materials were an import were not restricted in their access to these materials, and hence the restrictions were designed to serve industrial policy objectives in promoting domestic manufacturers by securing their preferential use

[7] *West Coast Salmon and Herring from Canada*, CDA-USA-1989-1807-01. See also see Michael Trebilcock and Robert Howse, *The Regulation of International Trade* (Edward Elgar, 3rd ed., 2005), at 515-518.
[8] *China - Measures Relating to the Exportation of Various Raw Materials,* WT/DS394/AB/R, WT/DS395/AB/R, and WT/DS398/R (January 30, 2012).
[9] *Supra*, note 3 at 7.254 "Canada submits that measures may not be applied under Article XI:2(a) for an indefinite period, but may only be applied for a fixed time."

of these materials and did not serve a conservation objective.[10] The Appellate Body, with some qualifications, affirmed the Panel's decision.[11]

Canada once again participated as a third party in support of the complainants, making detailed written and oral statements in opposition to the Chinese measures. Indeed, Canada even asked the Panel for enhanced third party rights to voice its opposition, but was denied.[12]

On July 13, 2016 the US filed a request for consultations with China relating to China's policies on the export of certain raw or rare materials, where China apparently has adopted measures that rely largely on export duties rather than quantitative restrictions.[13] The European Union filed a similar request for consultations on July 19, 2016.[14] Canada has once again requested to join both requests for consultation.

### (2) LERs: COUNTERVAILABLE SUBSIDIES

Prohibited and actionable subsidies may give rise to a WTO complaint by a member government under the SCM Agreement that came into force in 1995 as a result of the Uruguay Round negotiations. In cases where subsidies of products by one WTO member result in increased volumes of exports or lower prices in the market of another WTO member, causing material injury to domestic producers of like products in the importing country, unilateral application of countervailing measures is permitted, following the filing of a petition by domestic producers of like products in the importing country before domestic trade tribunals (in the case of Canada, the US, and Mexico, subject to a binational appeal procedure set out in Chapter 19 of NAFTA).

The countervailability of LERs was a major issue in 1993 Chapter 19 binational panel proceedings under the *Canada-US Free Trade Agreement*. In 1992, the Department of Commerce (DOC) issued a preliminary determination that LERs in BC conferred a weighted average subsidy of 8.23%.[15] According to DOC, "log export restrictions in BC result in an increase in the domestic supply of logs and a decrease in the domestic log price." In its Final Determination, DOC determined that BC's LERs conferred a subsidy of 4.65% on softwood lumber producers in BC.[16]

In 1993, the FTA Binational Panel reviewing DOC's Final Determination found that log export restrictions gave rise to the existence of a subsidy to domestic timber

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[10] *China - Measures Relating to the Exportation of Rare Earths, Tungsten, and Molybdenum,* WT/DS431/R, WT/DS432/R, and WT/DS433/R (Mar. 26, 2014).
[11] *China - Measures Relating to the Exportation of Rare Earths, Tungsten, and Molybdenum,* WT/DS431/AB, WT/DS432/AB, and WT/DS433/AB (Aug. 14, 2014). A number of issues raised in this case pertain to the terms of China's accession to the WTO and hence are specific to China's terms of membership.
[12] Supra, note 3, Addendum, ANNEX C-4 Integrated Executive Summary of the Arguments of Canada.
[13] Dispute DS508: China – Export Duties on Certain Raw Materials.
[14] Dispute DS509: China - Duties and other Measures concerning the Exportation of Certain Raw Materials.
[15] *Certain Softwood Lumber Products from Canada*, 57 Fed. Reg. 8,800 (1992).
[16] *Certain Softwood Lumber Products from Canada*, 57 Fed. Reg. 22,570 (1992).

processors by virtue of providing them with preferential access to logs harvested in Canada (in effect a captive market for these logs).[17] The Panel accepted that applying general principles of economics, it was obvious that foreclosing international competition for the purchase of raw logs indeed depressed the price of these logs in the domestic Canadian market, hence conferring a subsidy on domestic timber processors.[18]

As noted above, the DOC recognized the countervailability of export restrictions in its 1992 determination that Canadian softwood lumber was subsidized. The subsequent *Uruguay Round* SCM Agreement set out the criteria that must be met for a government action to be considered a subsidy. There must be a "financial contribution" which can occur if the government transfer funds directly, forgoes revenue that otherwise is due, provides a good or service *or* "entrusts or directs" a private body to carry out any of these actions. Second, the "financial contribution" must confer a benefit. In the Statement of Administrative Action[19] accompanying the U.S. implementing legislation (*1994 Uruguay Round Agreements Act*), the executive branch made clear that US law and the SCM Agreement recognized that an indirect subsidy could be provided through an export restraint scheme.[20] The DOC also confirmed that were it again to investigate situations similar to those in the 1992 softwood case, US trade law would continue to permit it to reach the same conclusion.

Given that the DOC had found LERs to be a countervailable subsidy in 1993, in May 2000, Canada challenged this policy before the WTO[21], alleging that the U.S. interpretation, as set forth in the above-cited documents, was inconsistent with US obligations under the SCM Agreement.

The WTO rejected Canada's arguments that the U.S. legislation implementing Uruguay Round on its face violated the SCM Agreement by identifying export restraints as countervailable. The Panel ruled that the law gives the DOC full discretion to decide whether or not to countervail export restraints. In effect, this means that the DOC is free to countervail BC LERs in any new trade remedy case against softwood lumber from the Canada.

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[17] *Softwood Lumber Products from Canada (Countervailing Duty*): US-Canada FTA-Article 1904: Binational Panel Review U.S.A.-92-1904-01: Decisions of the Panel, May 6, 1993 and December 17, 1993**.**

[18] Article 2 of the SCM Agreement provides that a subsidy is "specific" if it is specific to an enterprise or industry or group of enterprises or industries within the jurisdiction of the granting authority. The WTO Panel in *United States – Final Countervailing Duty Determination with Respect to Certain Softwood Lumber from Canada*, WT/DS257/R found that provincial stumpage was a specific subsidy holding at paragraph 7.121 that

> "a determination of specificity does not require a detailed analysis of the end-products produced by the enterprises involved. In our view, it was reasonable of the USDOC to reach the conclusion that the use of the alleged subsidy was limited to an industry or a group of industries. We consider that the "wood products industries" constitutes at most only a limited group of industries - the pulp industry, the paper industry, the lumber industry and the lumber remanufacturing industry - under any definition of the term "limited". We do not consider determinative in this respect the fact that these industries may be producing many different end-products. As we discussed above, specificity under Article 2 SCM is to be determined at the enterprise or industry level, not at the product level."

[19] H.R. 5110, H.R. Doc. 316, Vol. 1, 103d Congress, 2nd Session, 656 at 925-926 (1994).

[20] H. Doc. 103-316, vol. 1, at 925-926; "Countervailing Duties," 63 *Fed. Reg.* 65348, 65351(Nov. 25, 1998).

[21] *United States- Measures Treating Export Restraints as Subsidies*, Report of the Panel, WT/DS194/R, 29 June 2001. The Panel Report was not appealed to the Appellate Body.

The Panel did not directly address the question of BC LERs since the US did not then have measures in place to countervail those restraints. The Panel found hypothetically that a "bare" export restraint with no other government involvement would not constitute a financial contribution. The Panel was careful to limit its conclusion to the hypothetical export restraint as Canada defined it: namely, "a border measure that takes the form of a government law or regulation which expressly limits the quantity of exports or places explicit conditions on the circumstances under which exports are permitted".[22] However, the BC LERs, needless to say, are far more intrusive and support a finding of "entrust or direct," unlike the "bare" export restraint presented by Canada in this case.

The Panel was also careful to place narrow limits on its ruling.[23] The Panel was clear that its decision would not apply to export restraints which also function as a direction to process the goods within the province, which is precisely what the BC Surplus Test and its concomitant web of regulatory and procedural impediments is meant to do. The restrictions governing the export of logs from BC arise from a compilation of laws and regulations that, taken together, result in a clear direction to process the logs in BC.

Since this case, the DOC has proceeded in three other countervailing duty determinations involving the export of paper products from Indonesia in 2015 (*Certain Uncoated Paper from Indonesia*[24]), 2010 (*Certain Coated Pape from Indonesia*[25]*)* and 2007 (*CFS from Indonesia*[26]) to find that log export restrictions imposed by the Indonesian government created a market distortion and confer a specific countervailable subsidy to downstream industries, including Indonesian pulp and paper processors that were given preferential or captive access to domestic log supplies. In these cases, DOC found that the Indonesian government, through the log export restriction, entrusted or directed harvesting companies to provide lower-price inputs (logs and chipwood) to companies in the pulp and paper producing industries. The DOC determined that the log export restriction provided a benefit in that the restriction allowed the purchase of inputs (logs and chipwood) at below-market prices. The subsidies have been found to be specific because they are restricted to only a limited group of industries, and because they cover only a small number of products within those industries.

These Indonesian paper cases clearly point to the existence of a countervailable subsidy induced by LERs for domestic log processors in Canada. DOC has found that the government entrusted and directed "forestry/harvesting companies to provide

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[22] At para. 8.76.
[23] At para. 8.76 the Panel was careful to limit its finding.
[24] *Certain Uncoated Paper from Indonesia: Final Affirmative Countervailing Duty Determination*, 81 Fed. Reg. 11187 (March 3, 2016).
[25] *Certain Coated Paper Suitable for High-Quality Print Graphics Using Sheet-Fed Presses from Indonesia: Final Affirmative Countervailing Duty Determination*, 75 Fed. Reg. 59209 (Sept. 27, 2010).
[26] *Coated Free Sheet Paper from Indonesia: Final Affirmative Countervailing Duty Determination*, 72 FR 60642 (October 25, 2007) (CFS Final), and accompanying Issues and Decision Memorandum (CFS IDM).

lower-price inputs (logs and chipwood) to companies in the pulp and paper industries.[27]

Most recently in *Countervailing Measures on Supercalendered Paper from Canada*[28], DOC initiated an investigation into the subsidies provided by BC LERs during its expedited reviews of Irving and Catalyst[29]. In doing so, DOC has accepted the allegation that through the LERs both the Government of British Columbia and Government of Canada "entrust or direct" log harvesters to provide logs to the wood processing and pulp and paper industries in British Columbia thereby providing a financial contribution; that LERs provide a benefit because logs and downstream products are provided at prices that are lower than they would be without the restrictions in place; and that LERs are *de facto* specific because the actual recipients of the subsidy (users of logs) are limited in number, or, in the alternative the predominant users of the subsidy.

Finally, as the US Lumber Coalition points out in its submission of May 30, 2014, if log export restrictions were abolished in all their various forms, many of the alleged subsidy programs maintained by federal and provincial governments in Canada would be negated. For example, assuming for the sake of argument, that stumpage rates for timber harvesting on Crown lands are artificially low, domestic and foreign log harvesters could simply harvest these logs at the assumed artificially low stumpage rates and export the unprocessed logs into the US and other international markets, presumably creating an incentive for provincial governments to raise stumpage rates, given that prevailing rates would no longer confer any benefit on domestic timber processors.

In summary, LERs violate established international trade law and cannot be sustained by Canada in the long term.

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[27] *Certain Uncoated Paper From Indonesia: Preliminary Affirmative Countervailing Duty Determination and Alignment of Final Determination With Final Antidumping Determination*, 80 Fed. Reg. 3 697 1 (June 29, 2 0 1 5) and Accompanying Issues and Decision Memorandum at 22.

[28] *Supercalendered Paper from Canada: Final Affirmative Countervailing Duty Determination*, 80 Fed. Reg. 63535 (October 20, 2015).

[29] *Supercalendered Paper from Canada: Initiation of Expedited Review of the Countervailing Duty Order*, 81 Fed. Reg. 6506 (February 8, 2016), including: New Subsidy Analysis Memorandum (April 18, 2016), in which the US initiated an investigation into the new subsidy allegations filed by the petitioner on 16 February 2016.