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**MEMORANDUM**

**TO:** James J. Jochum
Assistant Secretary
for Import Administration

**FROM:** Jeffrey May
Deputy Assistant Secretary
Import Administration, Group I

**SUBJECT:** Issues and Decision Memorandum for the Final Countervailing Duty Determinations of the Investigations of Certain Durum Wheat and Hard Red Spring Wheat from Canada

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**SUMMARY**

On March 10, 2003, the Department of Commerce ("the Department") published the preliminary determinations in these investigations. See Preliminary Affirmative Countervailing Duty Determinations and Alignment of Final Countervailing Duty Determinations with Final Antidumping Duty Determinations: Certain Durum Wheat and Hard Red Spring Wheat from Canada, (68 FR 11374) ("Preliminary Determinations"). The "Analysis of Programs" and "Subsidies Valuation Information" sections below describe the subsidy programs and the methodologies used to calculate the benefits from these programs. We have analyzed the comments submitted by the interested parties in their case and rebuttal briefs in the "Analysis of Comments" section below, which also contains the Department's responses to the issues raised in the briefs. As a result of our analysis, we have made changes to the margin calculations from the Preliminary Determinations. We recommend that you approve the positions we have developed in this memorandum. Below is a complete list of the issues in these investigations for which we received comments and rebuttal comments from parties:

Comment 1: The Department Should Treat the Government-Leased Railcars Differently from the Government-Owned Railcars.
Comment 2: The Provision of Government-Owned and Leased Railcars is Tied to Non-U.S. Markets.

Comment 3: The Provision of Rail Cars Does Not Result in an Indirect Subsidy to the CWB.
Comment 4: Countervailablility of Subsidies Given to Third Party Service Providers.
Comment 5: The Governments' Entrustment or Direction of the Railways to Provide Rail Service.
Comment 6: The Provision of Government-Owned and Leased Railcar Confers No Benefit.
Comment 7: Measurement of Benefit from the Government-Provided Railcars.
Comment 8: The Revenue Cap Does Confer a Benefit.
Comment 9: The Rail Freight Revenue Cap Does Not Provide a Financial Contribution.
Comment 10: The Department Should Determine That the Revenue Cap Does Not Provide a Financial Contribution Because It is Consistent With Market Principles.
Comment 11: The Benefit of the Revenue Cap Extends to All CWB Shipments, Including Shipments to the United States.
Comment 12: The Closure Fee for Grain Dependent Branch Lines Confers a Financial Contribution.
Comment 13: Impact of the Lending and Initial Payment Guarantees on the CWB's Cost of Borrowing.
Comment 14: The Benchmark.
Comment 15: The Borrowing Guarantee is Tied to Non-U.S. Markets.
Comment 16: The Department's Analysis of the Initial Payment Guarantee is Based on Incomplete and Inaccurate Data.

## SUBSIDIES VALUATION INFORMATION

*Allocation Period*

Pursuant to 19 CFR 351.524(b), non-recurring subsidies are allocated over a period corresponding to the average useful life ("AUL") of the renewable physical assets used to produce the subject merchandise. Section 351.524(d)(2) of the Department's regulations creates a rebuttable presumption that the AUL will be taken from the U.S. Internal Revenue Service's 1977 Class Life Asset Depreciation Range System (the "IRS Tables"). For the wheat products industry, the IRS Tables prescribe an AUL of 10 years. Neither the petitioners, the Canadian Wheat Board ("CWB"), the Government of Canada ("GOC"), the Government of Alberta ("GOA"), nor the Government of Saskatchewan ("GOS") have contested using the AUL reported for the wheat products industry in the IRS tables. Therefore, we have used a 10-year allocation period for allocating non-recurring benefits.

## ANALYSIS OF PROGRAMS

Unless otherwise specified, these programs encompass both durum and hard red spring wheat. Accordingly, the countervailable subsidy rate applies to both products.

Based upon our analysis of the petition and the responses to our questionnaires, we determine the following:

*I. Programs Determined to Be Countervailable*

A. Provision of Government-Owned and Leased Railcars

In the Preliminary Determinations we determined that the CWB received countervailable subsidies during the period of investigation ("POI") from the provision of rail service. See Preliminary Determinations, 68 FR at 11377. Specifically, we determined that through the operating and alternate use agreements, the federal and provincial governments (including the CWB) are entrusting or directing the railway companies to provide rail services for Western grain. The provision of this rail service is a financial contribution within the meaning of section 771(5)(D)(iii) of the Tariff Act of 1930, as amended ("the Act"). We also found that the rail services are being provided to a specific group, within the meaning of section 771(5A)(D)(iii)(I) of the Act, the CWB and other users of hopper car services. Finally, we determined that the Canadian National ("CN") and Canadian Pacific ("CP") are providing these rail services for less than adequate remuneration within the meaning of section 771(5)(E)(iv) of the Act.

For the final determinations, we continue to find that the CP and CN have been entrusted or directed to provide rail service for the movement of Western grain, including grain shipped by the CWB, for less than adequate remuneration.

*Benefit*

To determine the benefit received by the CWB under this program, we multiplied the total volume of grain the CWB shipped in government-owned and leased railcars during the POI by the added ownership costs (modified as described in Comment 7, below) to arrive at the total benefit the CWB received during the POI. We determine the countervailable subsidy to be 0.35 percent *ad valorem*.

The GOC challenged the Department's preliminary finding by arguing that the provision of government-owned and leased railcars is not a countervailable subsidy because any benefit is tied to shipments for export to countries other than the United States. Based on our analysis of this issue in Comment 2, below, we find that the provision of hopper car service to the CWB is not tied to particular sales.

The GOC, GOA, GOS and CWB (collectively, the "respondents") also challenged the Department's determination that the federal and provincial governments have entrusted or directed the railway companies to provide railcar service for Western grain. According to the respondents, the operating and alternate use agreements between the governments and the railway companies do not require the railway companies to: (i) use the railcars, (ii) transport Western grain, or (iii) transport Western grain to the United States. However, as discussed in Comment 5, below, we have continued to find that the federal and provincial governments, through the operating and alternate use agreements, entrusted or directed the railway companies to provide railcar service for the movement of Western grain, including grain shipped by the CWB.

Finally, the respondents argued that even if the Department finds that the federal and provincial governments entrusted or directed the railway companies to provide railcar service, there is no evidence that the railway companies passed through the benefits they received to the shippers. As explained in our analysis of this issue in Comment 6, below, we find that the CWB received a benefit because the railways provided hopper car service for less than adequate remuneration.

B. Comprehensive Financial Risk Coverage: The Borrowing, Lending, and Initial Payment Guarantees

The CWB represents Western Canadian wheat producers who want to sell their wheat in the global wheat market. Until 1998, the CWB was an agent Crown Corporation of Canada, and it enjoyed the powers and rights of a government agency. At the end of 1998, the CWB lost its agency status, and became a shared-governance corporation. As a shared-governance corporation, the CWB is governed by a 15-member board of directors. Ten of these directors are elected by Western Canadian grain producers, and five, including the president/chief executive officer, are appointed by the Governor in Council. Despite the loss of status as a Crown Corporation, the CWB still enjoys certain powers and rights similar to those of government agencies.

Under the Canadian Wheat Board Act, the CWB is a single-desk seller of all Western grain. Specifically, under section 32 of the Canadian Wheat Board Act, the CWB "shall undertake the

marketing of wheat produced in the designated area in interprovincial and export trade and for that purpose shall: (a) buy all wheat produced in the designated area and offered by a producer for sale and delivery to {the CWB} . . . ." Further, section 45 of the Canadian Wheat Board Act states that :

> "Except as permitted under the regulations, no person other than {the CWB} shall:
>
> > (a) export from Canada wheat or wheat products owned by a person other than {the CWB};
> >
> > (b) transport or cause to be transported from one province to another province, wheat or wheat products owned by a person other than {the CWB};
> >
> > (c) sell or agree to sell wheat or wheat products situated in one province for delivery in another province or outside Canada; or
> >
> > (d) buy or agree to buy wheat or wheat products situated in one province for delivery in another province or outside Canada."

As stated in its 2001-2002 annual report, the CWB uses the powers and privileges it enjoys, namely, the single-desk, the pool accounts, and government guarantees on credit sales and farmer payments as a "core of strength" to ensure that Western Canadian grain producers' "returns from the marketplace are maximized." See CWB's May 2, 2003 submission, "CWB 2001-02 Annual Report" at 1. Thus, the CWB, with the strong backing of the government, is a major international grain marketing entity. The CWB achieves this status, in significant part, through the backing of the GOC by means of a comprehensive and multifaceted scheme of protection against financial risks, i.e., the GOC's guarantees.

This protection is comprehensive in that it explicitly shields the CWB from a variety of financial risks that the CWB would otherwise incur as a result of how its operations are structured in order to carry out its mandate. One contingency in which the CWB's risks are covered involves the CWB's initial payments to Western grain farmers. In July of each year, the CWB sets an initial payment level for the wheat it will receive from the farmers over the coming crop year (August - July). The farmers receive this initial payment when they deliver their wheat for sale by the CWB. Over the course of the crop year, the initial payment can be revised upward. Since the 1990-91 crop year, the CWB has set the initial payment at approximately 75 percent of the expected price for the crop year.

To the extent that the CWB earns more revenue from its sales than it has spent for the initial payments and other operating expenses, the residual is distributed to the farmers. However, pursuant to section 7(3) of the Canadian Wheat Board Act, in the event of a shortfall (i.e., revenues are less than the initial payments plus operating expenses) the Canadian Wheat Board Act obligates the GOC to cover the deficit. The GOC has made payments under this guarantee seven times during the history of the CWB, the last time for the 1990-91 marketing year.

A second element of the CWB's operations in which the attendant risks are covered under this program involves the CWB's sales on credit. The CWB has two types of credit grain sales programs which are guaranteed by GOC, the Credit Grain Sales Program ("CGSP") and the Agri-Food Credit Facility ("ACF"). Section 19(6)(b) of the Canadian Wheat Board Act provides that the GOC "guarantee{s} payment with interest of amounts owing to the {CWB} in respect to the sale of grain on credit."

The CGSP was established in 1952, and allows the CWB to sell grain on credit to customers who can provide a sovereign guarantee of repayment. Repayment terms under the CGSP cannot exceed 36 months. As of the beginning of the POI, the CWB had approximately C$7.2 billion in outstanding credit under the CGSP. Approximately 83 percent of this total consisted of debt that had been rescheduled or subject to rescheduling pursuant to Paris Club agreements,[1] and an additional 12 percent represents overdue debt from the Government of Iraq.

The ACF was established in 1995 to support sales of grain on credit to private sector customers. CWB lendings under the ACF are short-term, with repayment periods of one year or less. At the start of the POI, the CWB had approximately C$85 million in outstanding credit under the ACF. All of the debts under this program are current.

A third element to the financial risk coverage involves the CWB's borrowings. The CWB borrows to finance its advance payments to farmers, operating expenses, and credit sales to sovereign and private buyers. Under section 19(5) of the Canadian Wheat Board Act, the GOC insures the repayment of money borrowed by the CWB, provided the Ministry of Finance has approved the CWB's borrowing plan for the crop year and authorized the time, terms, and conditions of the borrowing programs. As of the beginning of the POI, the CWB had approximately C$7.6 billion in outstanding debt reflecting its short-term borrowing in money markets in Canada, the United States, and the global money market.

A key point to note about these various risk contingencies is that they all potentially arise as a result of actions of the CWB that are fundamentally interrelated. Specifically, the CWB pays farmers up front for deliveries of wheat in the amount of 75 percent of the expected price for the crop year. However, because some of those sales are made on credit, the CWB must finance its initial cash outlay for those credit sales. The CWB finances these credit sales through its borrowings from commercial sources.

Under section 771(5)(B) of the Act, a subsidy is bestowed where a government provides a financial contribution to a person and a benefit is thereby conferred. Further, that subsidy is countervailable if it is limited to a specific firm or industry or group of firms/industries.

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[1] The Paris Club is a forum where the GOC and other sovereign creditors have periodically agreed to extend repayment terms beyond original maturity dates and/or reduce the principal owed by a debtor country.

In the Preliminary Determinations, we analyzed each of the elements of risk coverage as though they were three separate financial contributions (i.e., an initial payment guarantee, a lending guarantee, and a borrowing guarantee) with distinct benefits.[2] However, we noted the interrelatedness of the borrowing and lending guarantees in the Preliminary Determinations and the interrelatedness of the borrowing guarantee and the initial payment guarantee in the "Initial Payment Memo." See Preliminary Determinations, 68 FR at 11379-80; see also Initial Payment Memo at 4-5. Subsequent to our preliminary determinations, the petitioners alleged that it is incorrect to analyze these elements of risk coverage as separate, isolated subsidies only. See Petitioners' April 28, 2003 submission at 7 through 9. Moreover, in the Initial Payment Memo, we indicated that we intended to seek additional information regarding the issues raised by the petitioners.

Since the preliminary determinations, we have collected additional, pertinent information that has prompted a reconsideration of the approach we took in our preliminary findings. Specifically, we have determined that the many elements of risk coverage comprise an integrated program that is most appropriately analyzed as a single financial contribution that bestows a single benefit specific to the CWB.

*Financial Contribution*

We believe that the facts and circumstances of operations of the CWB as they involve the GOC's coverage of financial risks are unique. Though in our countervailing duty analysis we are often faced with situations where a government provides a variety of subsidy programs that all contribute to supporting a company's financial health, the various elements of the GOC's risk guarantee in this case are clearly exceptional in the degree of their inter-relatedness. Neither the statute nor the Department's regulations provide explicit direction for how such multifaceted and uniquely inter-related support should be categorized or defined for purposes of a financial contribution determination. The Statement of Administrative Action ("SAA"), however, provides some helpful guidance.

> Section 771(5)(D) lists the four broad generic categories of government practices that constitute a "financial contribution." The examples of particular types of practices falling under each of the categories *are not intended to be exhaustive*. The Administration believes that these generic categories are sufficiently broad so as to encompass the types of subsidy programs generally countervailed by Commerce in the past, *although determinations with respect to particular programs will have to be made on a case-by-case basis*. (Emphasis added.)

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[2]Our preliminary findings with regard to the "initial payment guarantee" are contained in the May 5, 2003 memorandum to Acting Assistant Secretary Joseph A. Spetrini, "Preliminary Determination for the Initial Payment Guarantee Program" ("Initial Payment Memo") on file in the CRU.

See SAA accompanying the Uruguay Round Agreements Act, H. Doc. 103-316, Vol. 1. (1994) (SAA) at 927. In other words, while the Act sets forth various examples of typical types of subsidy programs and measurement of benefits (such as equity infusions and loan guarantees), the list is illustrative only. As such, Congress has recognized the fact that a particular government program may not fit neatly into a "box" or otherwise be compartmentalized.

Though not directly speaking to this issue, we believe the Department's regulation regarding "integral linkage" also provides some useful guidance in this regard. Under the integral linkage regulation, which directly applies to an analysis of specificity, the Department would consider two or more programs as a single program if: (1) the subsidy programs have the same purpose; (2) the subsidy programs bestow the same type of benefit; (3) the subsidy programs confer similar levels of benefits on similarly situated firms; and (4) the subsidy programs were linked at inception. Not all of these factors are necessarily relevant to the instant issue, nor do these factors exhaust the issue that might be relevant to finding a singular financial contribution. We determine, however, based on the following analysis, that certain of the integral linkage factors, as well as our understanding of the benefit mechanism at play in the financial risk coverage program, necessitate that we find a single financial contribution from that program.

First, all aspects of this risk coverage contribute to the same fundamental purpose, i.e., to ensure the CWB is able to pay out as high and timely a return as possible to the farmers without incurring the risk of longer term financial loss. As explained above, if the CWB is unable to repay any of its loans, the GOC will ensure that the CWB remains financially whole by repaying the money the CWB borrowed. Further, if and when a CWB customer under the credit grain sales programs is unable to make its payments, the GOC will ensure that the CWB is paid by making payments with interest. During the POI, the GOC has made principal and interests on behalf of CWB debtors in the credit grain sales programs. While the actual amount paid by the GOC is proprietary information, the CWB 2001-2002 annual report shows a year-end balance of C$31 million in CGSP accounts receivable due to the CWB from the GOC. Under the initial payment guarantee, the CWB is also relieved of the risk of a financial loss during the crop year due to its initial and adjustment payments made to grain farmers for the grain it purchased from them because the GOC will make payments to the CWB to cover its losses. In effect, all aspects of this coverage work in tandem in providing the CWB a comprehensive financial risk coverage to ensure that the CWB remains financially "whole" at the end of the crop year.

We note that this finding is strongly echoed in the CWB's own arguments. According to the CWB, virtually all of its borrowing during the POI is used to finance its accounts receivable from its credit grain sales programs. See CWB's June 23, 2003 Case Brief at 13. In addition, the CWB borrows money to finance grain inventories, administrative and operating expenses, and to administer the GOC's advance payment programs. See CWB's May 2, 2003 submission, "CWB 2001-02 Annual Report" at 36. Furthermore, because of the low borrowing rates the CWB pays on the money it borrows due to the GOC's guarantee and the higher lending rates it receives under the credit grain sales programs, the CWB earns interests revenue to offset its operating costs. Thus, under the borrowing guarantee, the lending guarantee, and the initial payment guarantee, the GOC is conferring comprehensive financial risk coverage that provides a single

financial contribution to the CWB.

Second, we find that the three guarantees bestow the same type of benefit. Specifically, all three guarantees sheltered the CWB from risk.

Third, we find that the elements of the program are linked at inception. The Canadian Wheat Board Act was enacted in 1935. As amended, this act is the statutory authority for CWB operations. As mentioned above, until 1998, the CWB was an agent Crown Corporation of Canada, and it enjoyed the powers and rights of a government agency. In June 1998, through a number of amendments to the Canadian Wheat Board Act, the corporate identity of the CWB was changed from a Crown Corporation to a shared-governance corporation. See GOC's January 14, 2003 submission at 22. Under sections 19(5), 19(6)(b), and 7(3) of the Canadian Wheat Board Act, the borrowing guarantee, the lending guarantee, and the initial payment guarantee are conferred to cover the operations of the CWB as a shared-governance corporation. Thus, at the inception of the CWB as a shared-governance corporation, the guarantees are already in place. Further, the guarantees are promulgated in the same legislative action, i.e., the Canadian Wheat Board Act.

Finally, we find, in this instance, that the financial risk coverage provides a benefit by means of a mechanism that does not generate a distinct benefit for each instance in which the risk guarantee can be invoked. The benefit derives from the joint impact of the guarantees on the recipient's borrowing costs, analogous to the benefit from loan guarantees under section 771(5)(E)(iii) of the Act.

Accordingly, we find that all elements of the GOC's guarantee comprise a single program, i.e., comprehensive financial risk coverage, which constitutes a single financial contribution in the form of a potential direct transfer of funds within the meaning of section 771(5)(D)(i) of the Act. This financial contribution is in the form of a potential direct transfer of funds since the GOC is required to pay the CWB or pay others on its behalf when the guarantee is invoked under any of the risk contingencies enumerated in the Canadian Wheat Board Act.

Also, because this comprehensive financial risk coverage is explicitly provided for the CWB in the Canadian Wheat Board Act, the subsidy is specific within the meaning of section 771(5A)(D)(I).

*Benefit*

Sections 771(5)(B)(i) and (iii) of the Act state in relevant part that a subsidy is conferred when an authority provides a financial contribution "...to a person and a benefit is thereby conferred." While the Act does not define the term "benefit", section 771(5)(E) of the Act sets forth various examples of types of government programs and the appropriate measure of "benefits" thereunder.

Our regulations direct that where the Act identifies a particular type of government program and sets forth a corresponding rule for the measurement of the "benefit" thereunder, we must follow

the specified methodology. See 19 C.F.R. § 351.503(a). Otherwise, the Department will normally consider a benefit to exist where a firm pays less for its inputs (e.g., money, a good, or a service) than it otherwise would pay in the absence of the government program, or receives more revenues than it otherwise would earn. See 19 C.F.R. § 351.503(b)(1).

We have determined that, during the POI, the CWB benefitted from a comprehensive financial risk coverage scheme. While one element of this government program may have characteristics similar to a loan guarantee, simplistically applying the measurement calculation set forth in section 771(5)(E)(iii) of the Act to this subsidy program would fail to accurately identify the benefit conferred by the comprehensive financial risk coverage program. As a direct result of the comprehensive financial risk coverage program, the CWB enjoyed an elevated credit rating, which, in turn, significantly lowered its borrowing costs. Accordingly, this comprehensive program falls under the provisions of 19 C.F.R. § 351.503(b)(1). Specifically, the CWB paid less for its money "input" than it otherwise would pay in the absence of the government program. The full benefit of this scheme is the difference between the CWB's actual cost of debt financing[3] and its cost of debt financing absent the comprehensive financial risk coverage.

The Department sought information from the parties for the purpose of determining the appropriate credit rating for CWB. In response, the CWB submitted a study examining the impact of the "borrowing guarantee" on its credit rating, and a second report on the interest rates that would be available to a company with that rating. The credit rating report does not directly address the effect of the other guarantees on the CWB's credit rating.

At verification, the agency that drafted the credit rating report stated that, absent the three guarantees, the CWB would probably not have received the same credit rating as indicated in its report. These same experts also acknowledged that, absent the GOC's lending guarantee, they would examine the quality of the CWB's pool of accounts receivables to ascertain the appropriate credit rating for the CWB. See CWB Verification Report, June 9, 2003 at 19. Also at verification, the Department asked CWB officials for any information and/or studies in their possession concerning the issue of the CWB's credit rating absent the combined guarantees. While CWB officials suggested that they might have such information, they declined to provide it. See CWB Verification Report at 17.

Based on the credit reports submitted by the CWB and information developed at verification, the petitioners have made their own assessment of what the CWB's credit rating would be in the absence of the three guarantees. The petitioners argue that the most critical component in determining the credit rating would be the credit ratings of the countries with receivables outstanding under the CWB's Credit Sales Program. Because many of the CWB's sovereign debtors have poor long-term foreign currency credit ratings, if they could borrow at all, it would be at interest rates corresponding to the 'Baa' rated long-term bonds, according to the petitioners.

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[3] The record indicates that the CWB generally finances it operations through debt financing and not through equity financing.

Therefore, they argue that this rate should be used to measure the benefit of the three guarantees to the CWB.

Based on our review of the record evidence, we have determined that in the absence of the comprehensive financial risk coverage provided by the GOC, the CWB would look very different to its lenders. It would no longer be certain that the CWB's acquisition and operating costs would be covered, or that the government would step in to pay its debts. Also, the accounts receivable would likely become non-performing assets. According to the financial experts we met with at verification, the CWB would lose access to certain credit markets and might not be able to borrow in the commercial paper market.

However, none of the information tells us exactly what the CWB's credit rating would be in the absence of the comprehensive financial risk coverage provided by the GOC. As noted above, the petitioners have suggested what they view as a conservative measure, based on the quality of the CWB's receivables. While we agree that the quality of the CWB's accounts receivable would be a significant factor in determining the CWB's credit rating, as suggested by the credit rating officials at verification, we believe that it would be weighed against the strengths of the CWB's operations. For example, during the POI, the CWB had approximately $ 4.3 billion Canadian dollars in revenue from grain sales, of which only 9.4% was in credit sales. Thus, the CWB sold a great deal of wheat and over 90% of its sales were for cash. Also, we believe that lenders would see the CWB's status as a single desk seller as a strength.

These considerations have led us to conclude that without the comprehensive financial risk coverage provided by the GOC, the CWB would not be able to raise funds in the commercial paper market. Instead, we have determined that the prime rate offers the best measure of what the CWB would pay to raise funds. As we stated in the Preliminary Determinations, the prime rate, is "an alternative to the commercial paper markets, albeit a higher cost alternative, and one that would be used by firms with lower credit ratings." According to the U.S. Federal Reserve, the prime rate is "one of several base rates used by banks to price short-term business loans." Because we have concluded that the CWB's credit rating would be lower in the absence of the comprehensive financial risk management provided by the GOC, bank loans at the prime rate reasonably reflect what the CWB would pay for funds. Moreover, as a short-term rate, the prime reflects the type of borrowing undertaken by the CWB.

We calculated the benefit of this subsidy program by comparing the interest actually paid during the POI on the CWB's borrowing to what the CWB should have paid during the POI absent the comprehensive financial risk coverage provided by the GOC. We used the prime rate as a measure of what the CWB should have paid to raise funds. We then divided the total benefit from this subsidy program by the total sales of the CWB in the POI to calculate the total countervailable subsidy. On this basis, we determine that the CWB received countervailable benefits of 4.94 percent *ad valorem*.

*II. Programs Determined to Be Not Countervailable*

A. Rail Freight Revenue Cap ("Revenue Cap")

In the Preliminary Determinations, we found that the GOC is entrusting or directing the railways to provide a financial contribution, specifically rail transportation services, to the CWB. See sections 771(5)(B)(iii) and 771(5)(D)(iii) of the Act. Further, we found that the revenue cap is limited to the transportation of Western grain and, therefore, specific within the meaning of section 771(5A)(D)(i) of the Act. We preliminarily determined, however, that the CWB did not receive any benefits from the revenue cap within the meaning of section 771(5)(E)(iv) of the Act.

For the final determinations, we continue to find that the CWB did not receive a benefit during the POI under this program.

Respondents argue that the revenue cap does not entrust or direct the railways to provide rail service. As explained in Comment 9, because we are finding no benefit, we do not need to reach the issue of entrustment or direction.

Petitioners argue that the revenue cap does provide a benefit and give three reasons for their position. We address their arguments in Comment 8 and the Department continues to find, as we did in the Preliminary Determinations, that the CWB did not receive any benefits from the revenue cap within the meaning of section 771(5)(E)(iv) of the Act, because there is no evidence that, as a result of the revenue cap, the railways are providing rail services to the CWB for less than adequate remuneration.

B. Maintenance of Uneconomic Branch Lines

In the Preliminary Determinations, we found that closure fees for discontinuance of grain-dependent branch lines ("GDBLs") does not constitute a countervailable subsidy. We preliminarily concluded that the government had not entrusted or directed the railways to provide rail service under this program.

For these final determinations, we continue to find no subsidy. However, the focus of our anlaysis has shifted and we find that there is no subsidy because the record does not provide evidence that would allow us to quantify a benefit (see Comment 12).

C. Short Line Financial Assistance Program

Under the Short Line Financial Assistance Program, short line operators are eligible to receive a percentage of the capital required to purchase rail lines slated for abandonment within Saskatchewan. Funding for the program was provided by the GOC, through the Canadian Agri-Infrastructure Program (CAIP), and the GOS. The program was in effect from July 2, 1996, to December 31, 2001, during which time only one application was presented and approved, all within 1999. For the one project, a 15-year loan from the GOS was disbursed on May 1, 1999 and a one-time non-repayable cash grant from the GOC was disbursed on July 20, 1999.

In the Preliminary Determinations, we found that no subsidy was conferred under this program during the POI because the grant and loan did not provide a benefit to Red Coat Road and Rail, the one railway that used the program.

For the final determinations, we continue to find no subsidy. However, the focus of our analysis has shifted. Specifically, we question whether a finding of entrustment or direction should depend on whether the private party allegedly being entrusted or directed to provide a financial contribution received measurable subsidies during the POI.

However, even if we were to find that Red Coat Road and Rail had been entrusted or directed to provide railway service to the CWB and that the service was provided for less than adequate remuneration, we do not believe there would be any measurable benefit to the CWB because of the minuscule amount of grain (0.11 pecrcent of the CWB's shipments) that were carried on this line.

## DISCUSSION OF ISSUES

### Comment 1: The Department Should Treat the Government-Leased Railcars Differently from the Government-Owned Railcars.

*Petitioners' Argument:* The petitioners argue that there are significant differences between the government-owned railcars provided directly by the governments to the railways and those leased by the CWB with funds provided by the GOC. According to the petitioners, the Department should treat the reimbursement of railcar lease payments by the GOC to the CWB as a grant. The petitioners disagree with the Department that the CWB acts as an agent of the GOC in leasing the railcars. The petitioners claim that according to a report by Transport Canada, Transport Canada considers the lease reimbursements as "a transfer payment or grant to the CWB that enables the CWB to acquire and lease railcars to promote the efficient transportation of grain in Western Canada." Further, the petitioners claim that alternate use payments from the leased railcars are paid to the CWB while alternate use payments for railcars owned by the governments are paid to the respective governments. The petitioners contend that under the Department's regulations, the benefit for the provision of the government-leased railcars is equal to the amount of the lease reimbursements during the POI.

*GOC's and CWB's Argument:* The GOC and CWB disagree that the reimbursement payments by the GOC to the CWB for leasing railcars are grants to the CWB. They argue that the CWB merely acts on behalf of the GOC as its agent in leasing the railcars and receives reimbursement for the lease costs. The GOC and CWB state that the March 1981 agreement between the GOC and the CWB establishes an agency relationship, specifically stating that the CWB will "contract on behalf of the Majesty in right of Canada for the lease, purchase or manufacture of 2,000 railway hopper cars." Further, the GOC and CWB contend that the leasing of the railcars and the reimbursement of the leasing costs, including the difference in the manner in which alternate use payments are paid for the government-owned railcars and the government-leased railcars and the

interest earned by the CWB on alternate use payments, do not negate the agency arrangement between the GOC and the CWB. They acknowledge that the manner in which alternate use payments are paid differs between the government-owned and leased railcars, as suggested by the petitioners. However, according to the GOC and CWB, the alternate use payments paid to the CWB are offset against the GOC's reimbursements on the leases.

*Department's Position:* The Department has continued to treat the government-leased railcars like the government-owned railcars and, therefore, we do not view the GOC's reimbursement of the lease costs as a grant. The CWB is acting as an agent of the GOC, leasing the railcars on GOC's behalf and receiving full reimbursement of the lease fees. As noted in our Preliminary Determinations, in March 1981, the GOC entered into a contribution agreement with the CWB directing the CWB to lease, on behalf of the GOC, railcars designed for the transportation of grain, including subject merchandise. The agreement also directs the CWB to provide the leased railcars to the railways for the transportation of Western grain. Under the terms of the contribution agreement, the CWB is obliged to make lease payments for the leased railcars and to invoice the GOC for the lease costs. The GOC, in turn, fully reimburses the CWB for the lease costs. See Preliminary Determinations, 68 FR at 11378. Thus, because of this arrangement between the CWB and the GOC, we view the CWB as an agent of the GOC for these transactions. Therefore, the payments made by the GOC are not grants, but merely reimbursements for the lease costs. With respect to the alternate use payments, we agree with the GOC and CWB that the GOC reimburses the CWB net of the alternate use payments received by the CWB.

**Comment 2: The Provision of Government-Owned and Leased Railcars is Tied to Non-U.S. Markets**.

*GOC's Argument*: The GOC argues that the Department's "tying" rules apply to the government-provided railcars. Specifically, the GOC contends that under the operating agreement between the GOC and the railways, use of the railcars at no cost to the railways is limited to the transportation of Western grain within Western Canada (i.e., to port for export overseas or to Thunder Bay or Armstrong), and does not apply to shipments to the United States. The GOC argues that the operating agreement and alternate use agreements between the GOC and the railways require the railways to pay negotiated alternate use fees that are above the market-set commercial lease rates during the POI for any southbound shipments to the United States. Consequently, according to the GOC, the alleged subsidy is tied to markets other than the United States.

The GOC notes that where the alleged subsidy is tied to shipments to non-U.S. destinations, the Department will not countervail that benefit. The GOC cites to Pipe from Turkey where the Department concluded that the benefits from a freight rebate provided by the government to shippers on a shipment-by-shipment basis were "shipment-specific," and "tied to a particular destination." See Certain Welded Carbon Steel Pipes and Tubes and Welded Carbon Steel Line Pipe from Turkey; Preliminary Results of Countervailing Duty Administrative Reviews, 62 FR

16782, 16785 (April 8, 1997) ("Pipe from Turkey") (no change in Final Determination, 62 FR 43984). The GOC states that in that case, the Department countervailed only the freight benefit attributable to shipments to the United States. Therefore, because the alleged railcar subsidy is shipment-specific and is expressly precluded for certain routes, including shipments to the United States, the Department may not include railcar benefits in its calculation of a subsidy.

The GOC contends that the Department has indicated that an examination of tying focuses strictly on terms by which an alleged subsidy is bestowed on the recipient. (Emphasis in original). The GOC further cites to the preamble to the Department's regulations: "tying rules are an attempt at a simple, rational set of guidelines for reasonably attributing the benefit from a subsidy based on the stated purpose of the subsidy or the purpose we evince from record evidence at the time of bestowal." See Final Rule: Countervailing Duties, 63 FR 65348, 65403 (November 25, 1998) ("Preamble"). The GOC cites to Final Affirmative Countervailing Duty Determination: Certain Steel Products From Austria, 58 FR 37217, 37232 (July 9, 1993) indicating that "the Department's traditional position on the tying of benefits to a particular product is that a subsidy is 'tied' when the intended use is known to the subsidy giver and so acknowledged prior to or concurrent with the bestowal of the subsidy." The GOC also cites to Certain Welded Carbon Steel Pipes and Tubes and Welded Carbon Steel Line Pipe from Turkey; Final Results of Countervailing Duty Administrative Reviews, 62 FR 43984 (August 18, 1997) and its accompanying Decision Memorandum at Comment 1, showing that the Department's practice of attributing benefits to specific merchandise or particular destinations based on the circumstances at the time of bestowal.

The GOC argues that the alleged subsidy - government provision of railcars for use by the railways without ownership costs in transporting Western grain in Western Canada - was tied to non-U.S. markets at the time of bestowal. This is because the operating and alternate use agreements (the agreements under which the railcars are provided) also establish where the railcars can be used at no cost to the railways.

The GOC also challenges the Department's statement in the Preliminary Determinations that "{n}o information has been provided to show that the rates charged by the railways for service to particular destinations varies because they pay (or don't pay) an alternate use fee for the government-provided hopper cars." See Preliminary Determinations, 68 FR at 11379. The GOC argues that the commercial nature of setting railway freight rates makes it impossible to correlate any given railway cost to rates and cannot be taken as a sign of whether the alternate use fees are tied to particular markets.

Finally, the GOC asserts that the Department cannot determine whether tying exists based on the price of the output - in the instant investigations, rail freight rates. According to the GOC, such an approach would require the Department to find that the selling price of a subsidized product is cheaper by the amount of subsidy in the U.S. market than in other markets before the Department can conclude that the subsidy is tied to the U.S. market. However, this would be inconsistent with the Department's stated practice of looking to whether the use of the railcars provided by

the governments was tied to non-U.S. markets at the time the governments bestowed the railcars on the railways.

*Petitioners' Argument:* The petitioners argue that the benefit received by the CWB is not tied to non-U.S. markets. The petitioners claim that the respondents have failed to show whether the rates charged by the railways for railway service to particular destinations vary because the railways pay or do not pay an alternate use fee, information that the petitioners argue will help determine if tying exists in the instant investigations. The petitioners also contend that past Department determinations indicate that the Department's review is not limited to exploring only the United States market and that there is not a *per se* rule against analyzing subsidies tied to third countries. Rather, the petitioners argue that the Department must determine whether those subsidies benefit subject merchandise. In support, the petitioners cite to Colombian Roses, where the Department concluded that "it may allocate benefits tied to a product not under investigation over a product under investigation when it has 'a clear reason to believe that such a benefit encourages production or export to the United States of the product under investigation.... The issue is whether export subsidies explicitly tied to non-subject merchandise (*i.e.,* exports to third countries) provide a countervailable benefit to subject merchandise{,}'" citing Roses and Other Cut Flowers from Colombia; Miniature Carnations from Colombia; Final Results of Countervailing Duty Administrative Reviews of Suspended Investigations, 61 FR 45941, 45943 (August 30, 1996) ("Colombian Roses"), which in turn cited to Certain Fresh Cut Flowers from Israel; Final Affirmative Countervailing Duty Determination, 52 FR 3316 (February 3, 1987) and Industrial Nitrocellulose from France; Final Results of Countervailing Duty Administrative Review, 52 FR 833, 835 and 838 (January 9, 1987).

The petitioners also argue that the alternate use fees do not eliminate the subsidy from the government-provided railcars. First, the petitioners note that for the railcars the GOC leased through the CWB, the flat monthly alternate use fee agreed upon between the CWB and the CP negates the tying issue. This is because destination has no effect on the amount of alternate use fee paid. Second, the petitioners assert that U.S. shipments benefit from the government-owned and leased railcars because U.S. shipments do not incur alternate use fees for the portion of the movement in Canada prior to export to the United States. The petitioners contend that the respondents have not shown that rates charged by the railways for service to particular destinations vary because they railways pay or do not pay an alternate use fee. The petitioners claim that the fact that freight rates do not vary according to whether the railcars are government-owned or are subject to alternate use fees indicates that the lower ownership costs resulting from the government-provided railcars are allocated across prices on all shipments, including shipments to the United States.

*Department's Position:* We disagree with the respondents that the subsidy provided under this program is tied to non-U.S. markets. In its tying argument, the GOC focuses on the provision of railcars to the railways as the subsidy and the fact that the railways pay the governments different fees depending on how the railcars are used. However, our analysis focuses on the subsidy which the railways have been entrusted or directed to provide: hopper car service for less than

adequate remuneration (see Comment 5 regarding "entrustment or direction"). As explained below, there is no evidence that the provision of this subsidy is tied to export markets other than the United States.

We have concluded that the rates charged by the railways for hopper car service do not reflect the ownership costs of the government-provided railcars and, thus, the rates are not consistent with market principles. See Comment 6 regarding "adequate remuneration." There is no evidence indicating that the rail rates for shipments to particular destinations vary because the railways pay or do not pay alternate use fees. Indeed, the GOC's statements in its brief (summarized above) indicate that the railways would not set rates on particular routes in a manner that reflects the relative costs of hopper cars for those routes. Thus, there is no evidence of tying at the time the freight rate subsidy is bestowed. Moreover, if particular costs are not assigned to particular routes, this indicates that any cost savings to the railways by virtue of not having to pay ownership costs for the hopper cars would affect all shipments. Therefore, the benefit under this program is not tied to shipments of Western grain to export markets other than the United States.

**Comment 3: The Provision of Railcars Does Not Result in an Indirect Subsidy to the CWB**

*CWB's Argument*: The CWB contends that the Department's fundamental task in a CVD investigation is to determine whether the financial contribution it has identified confers a current benefit on the producers being investigated. Consistent with this, the Department must find that the government provided the CWB with a financial contribution and a benefit.

The CWB claims that the Department cannot circumvent this requirement by finding that the CWB indirectly benefitted from a subsidy given to the railways. According to the CWB, this is not an indirect subsidy case because in order to find an indirect subsidy, the Department must determine that a benefit is conferred by the government's act of entrusting or directing the private party to make a financial contribution. By way of explanation, the CWB provides the example of a telecommunications company that is required to provide service to all who request it. If the telecommunications company provides service to one customer at a low rate (relative to some benchmark), the CWB contends that there is no benefit (and, hence, no subsidy) because the telecommunications company was not directed to charge the low rate to that customer.

In support of its position, the CWB cites to the preamble to the Department's Regulations (See Preamble, 63 FR at 65350): "Although the indirect subsidies that we have countervailed in the past have normally taken the form of a foreign government requiring an intermediate party to provide a benefit to the industry producing the subject merchandise, often to the detriment of the intermediate party, indirect subsidies could also take the form of a foreign government causing an intermediate party to provide a benefit to the industry producing the subject merchandise in a way that is also in the interest of the intermediate party. We believe that the phrase 'entrusts or directs' could encompass government actions that provide inducements, other than upstream subsidies, to a private party to provide a benefit to another party." The CWB also cites AK Steel v. United States, 192 F.3d 1367 (Fed. Cir 1999) ("AK Steel"), where the Federal Circuit stated that: "Moreover, in the case of an indirect subsidy, evidence of a causal nexus between the

program and the benefit is also required." The CWB acknowledges that AK Steel applied pre-Uruguay Round Agreements Act ("URAA") law, but claims that the Department has taken the position that "directs or entrusts" situations involve "indirect subsidies." Moreover, according to the CWB, the SAA stated that pre-URAA practice with respect to indirect subsidies would be maintained by the URAA. See SAA at 926.

The CWB contends that the Department's preliminary determinations regarding the governments' provision of railcars to the railways differ from other cases where the Department has found indirect subsidies. The CWB divides the past cases into two categories depending on the nature of the financial contribution the private party has been directed to provide. In the first category are financial contributions that "inherently" confer a benefit, such as grants, debt forgiveness and equity infusions. In the second category are situations where the government's action affects the terms on which the financial contribution is provided. Among these are the provision of loans and of goods and services, actions that do not "inherently" confer a benefit. As examples of the latter category, the CWB points to the Government of Korea's direction of the price at which POSCO sold steel inputs and to the loans provided to Hynix under terms set by government-controlled and owned banks. See Final Results and Partial Rescission of Countervailing Duty Administrative Review: Stainless Steel Sheet and Strip in Coils from the Republic of Korea, 67 FR 1964 ( January 15, 2002) and Final Affirmative Countervailing Duty Determination: Dynamic Random Access Memory Semiconductors from the Republic of Korea, 68 FR 37122 (June 23, 2003) ("DRAMs from Korea") and its accompanying Issues and Decision Memorandum at 47.

In the instant cases, however, the governments did not influence the terms on which the railways provided freight service to the CWB, according to the CWB. Instead, the CWB claims, the railways dealt with the CWB at arm's length and on a commercial basis. Consequently, the CWB argues, the provision of railcars to the railways does not confer an indirect subsidy on the CWB.

*GOA's Argument:* Like the CWB, the GOA argues that a benefit would only exist if the government action directing the railways to provide rail service also resulted in a price for rail service that was less than adequate remuneration. Because the government action did not determine what the railways can charge, the GOA contends that there is no subsidy.

*GOS's Argument:* Citing the Federal Circuit's decision in Delverde, SrL v. United States, 202 F.3d 1360, 1366 (Fed. Cir. 2000) ("Delverde"), the GOS contends that the Department must find a causal link between the government action (allegedly directing the railways to provide service) and the alleged benefit (lower rail rates). Specificially, the GOS refers to the following language in Delverde: "The statute does not contemplate any exception to the requirement that Commerce determine that a government provided *both a financial contribution and a benefit* to a person, either directly or indirectly, by one of the acts enumerated ... A subsidy can only be determined by finding that a person received a *'financial contribution' and a 'benefit'* by one of the acts enumerated in §§ 1677(5)(D) and (E)." (Emphasis added by GOS).

*Petitioners' Argument:* The petitioners claim that CWB's authority to allocate railcars evidences a causal link between the railways and the CWB, and the GOC's direction to the railways to provide transport services. The petitioners note that the August 2001 settlement between the CWB and the Western Grain Elevator Association on the allocation of railcars and tendering on delivery contracts to transport grain, clearly establish the CWB's control over railcar allocation.

*Department's Position*: We are continuing to find that the governments have indirectly provided a subsidy to the CWB by entrusting or directing the railways to provide hopper car service for less than adequate remuneration. We disagree with the CWB that this line of analysis "circumvents" any statutory requirements.

Under section 771(5)(B) of the Act, a subsidy exists where a government "makes a payment to a funding mechanism to provide a financial contribution, or entrusts or directs a private entity to make a financial contribution ... to a person and a benefit is thereby conferred." As this language makes clear the government need only entrust or direct the private entity to make a financial contribution. The statute does not impose the further requirement that the government entrust or direct the private entity to provide a benefit.

We acknowledge the language cited by the CWB from the preamble to the Department's regulations. The cited language was not written to address comments about whether the government must entrust or direct a private party to provide both a financial contribution and a benefit. Thus, we disagree with the CWB that this language precludes us from analyzing the provision of hopper car service as an indirect subsidy.

Regarding AK Steel , the Court in that case was applying pre-URAA law. Prior to the URAA, the statute provided much less guidance on indirect subsidies. Because the URAA is explicit in stating that the government's action need only entrust or direct the private entity to make a financial contribution, we disagree that the AK Steel reference to a "causal nexus" between the government action and the benefit has any relevance; moreover, that reference is ambiguous in that it may or may not be limited to specificity issues. We acknowledge that the SAA approved prior Department practice with respect to indirect subsidies. However, we do not see the SAA as limiting the reach of the indirect subsidy provision as suggested by the CWB. In fact, the SAA indicates that the term "entrusts or directs" should be interpreted broadly. See SAA at 926.

Turning to the Delverde language cited by the GOS, the Court is reminding the Department that it needs to find both a financial contribution and a benefit before it can find a subsidy. We have done so here. The financial contribution is the provision of hopper car service and the benefit is the provision of that service for less than adequate remuneration. We disagree that the Delverde Court, which was ruling on the Department's application of a different section of the countervailing duty law, precludes us from making this determination.

We further disagree with the CWB's characterization of the Department's past practice, in particular, the alleged differential treatment of financial contributions that "inherently" give rise to a benefit and those that do not. First, the Department has examined many indirect subsidies.

Consequently, a general theory of Department practice in this regard should be based on more than a few decisions. Second, the CWB lists equity infusions as financial contributions that inherently give rise to a subsidy. However, equity investments only give rise to a benefit when they are inconsistent with the usual investment practice of investors in the investigated country. (See, e.g., the Department's determination that Hynix was unequityworthy in DRAMs from Korea and its accompanying Issues and Decision Memorandum, section on subsidies valuation information.) Regarding the specific cases cited by the CWB, we do not dispute that there are instances where the government's act of entrusting or directing a private party to provide a financial contribution also directs the private party to provide a benefit (e.g., a government directs a private bank to provide loans at low interest rates). However, as explained above, the government does not need to direct both the financial contribution and the benefit in order for an indirect subsidy to exist.

Finally, regarding the CWB's claims that the rail rates were negotiated at arm's length and are on commercial terms, see the Department's position in response to Comment 6, below.

**Comment 4: Countervailability of Subsidies Given to Third Party Service Providers**

*CWB's Argument*: According to the CWB, the provision of railcars to the railways and the railways' use of those cars to transport grain is similar to situations governed by the provisions addressing upstream subsidies, sections 771A and 771B of the Act.

The CWB contends that the Department's authority to countervail upstream subsidies derives exclusively from sections 771A and 771B. Moreover, the CWB argues, the Congress provided the Department with the authority to countervail upstream subsidies only in specific and limited circumstances. (The CWB points to Railway Labor Executives' Ass'n. v. National Mediation Board, 29 F.3d 655, 666-67, amended by, 38 F.3d 1224 (D.C. Cir. 1994) and FAG Italia S.p.A. v. United States, 291 F.3d 806, 817 (Fed. Cir. 2002) regarding "limiting conditions.") The circumstances of the instant investigations, where the railways are providing a service, do not fit within sections 771A and 771B, according to the CWB, because services are not an "input product used in the manufacture of a downstream good."

The CWB further contends that the Department's regulations support the CWB's position. Citing to the preamble to the Department's regulations, the CWB claims that the Department will only investigate subsidies to input producers in the context of the upstream provisions (unless there is "cross ownership" between the input provider and the producer, which is not relevant here). See Preamble, 63 FR at 65348, 65401.

*GOA's Argument:* The GOA argues that while there is an explicit provision addressing "upstream" subsidies to input suppliers, there is no provision addressing "upstream" subsides to service suppliers. The fact that the upstream subsidy provisions in sections 771A and 771B of the Act are so explicit and detailed is, in the GOA's view, strong evidence that an upstream analysis cannot be applied to services.

*Petitioners' Argument*: According to the petitioners, the CWB acknowledges that the upstream subsidy provisions, by their very terms, do not cover this situation. Therefore, these provisions should not be applied.

*Department's Position*: Contrary to the CWB's position, the analogy to the upstream subsidy provisions is not appropriate in this instance. In an upstream situation, the Department must analyze, inter alia, whether the input supplier receives subsidies. We have made no finding in these investigations that the railways received subsidies from the federal or provincial governments. Nor have we analyzed whether such subsidies are passed through (see, Department's position in response to Comment 6, below).

More importantly, we do not agree that Congress has narrowly limited to the Department's ability to investigate and countervail subsidies. Under the position taken by the CWB, the Department could never look at whether private service providers can bestow subsidies on producers of the merchandise under investigation. While the CWB may be correct that such situations cannot be reached under the upstream provisions, we believe that these subsidies can be investigated as indirect subsidies for the reasons explained in the Department's response to Comment 3 above.

**Comment 5: The Governments' Entrustment or Direction of the Railways to Provide Rail Service**.

*GOC's Argument:* The GOC argues that, if the Department concludes that potential subsidies under this program can be attributed to U.S. sales, the Department should find that the provision of the railcars is not a financial contribution to wheat shippers since the railcars are provided to the railways. The GOC disputes the Department's finding that the GOC provided a financial contribution to the CWB by entrusting or directing the railways to transport Western grain. The GOC contends that the operating and alternate use agreements do not command the railways to use the railcars, or to transport Western grain, or to do anything else. In addition, the GOC argues that it does not entrust or direct the railways to transport Western grain to the United States.

The GOC contends that the railways would not breach any provision of the operating or alternate use agreements if they parked the hopper cars and refused to use them at all. The GOC also asserts that the GOC has not commanded the railways to be (or stay) in the business of transporting Western grain or in any business. The GOC contends that the railways decide whether to use the railcars for grain service, alternate use, or not use them at all.

Even if the Department finds that there is a command in the operating agreement to use the railcars for grain service, the GOC argues that the operating agreement does not command the railways to transport Western grain to the United States. The GOC states that under the operating and alternate use agreements, these railcars are not available to the railways for southbound shipments and eastbound shipments beyond the Western Division, routes on which the U.S. shipments occurred, unless alternate rates are paid.

*GOA's Argument:* Like the GOC, the GOA argues that there is no financial contribution to the CWB by virtue of the government-owned railcars because the railcars are provided to the railways. Similarly, the GOA contends that the Department erred in concluding that the GOA entrusted or directed the railways to provide rail services for Western grain through the operating and alternate use agreements. The GOA claims that the agreements contain no provisions requiring the railways to use the railcars or requiring them to transport any specific product. Thus, the Department cannot conclude that entrustment or direction existed.

*GOS's Argument:* Like the GOC, the GOS argues that neither the grain producers nor the CWB receive any financial contribution from the provision of government-owned railcars because the railcars are provided to the railways, not to grain producers or to the CWB. The GOS further contends that the operating and alternate use agreements between the GOS and the railways do not require the railways to use the government-owned railcars to "carry anything for anyone."

*Petitioners' Argument:* The petitioners argue that the evidence on record shows that the railways have been directed or entrusted to provide rail service to the CWB. The petitioners note that sections 32 and 45 of the Canadian Wheat Board Act require that wheat must be sold through and transported by the CWB. The petitioners also claim that Schedule II of the Canada Transportation Act effectively binds CP and CN to transport grain on behalf of the CWB. The petitioners state that in the Preliminary Determinations, the Department was correct in its assessment of the operating and alternate use agreements entered into by the GOC, GOA and GOS and the railways.

*Department's Position:* The Department interprets "entrusts or directs" to mean that, if a government entity affirmatively causes or gives responsibility to a private entity or group of private entities to carry out what might otherwise be a governmental subsidy function of the type listed in subparagraphs (i) through (iv) of section 771(5)(D) of the Act, there would be a financial contribution. In the instant investigations, we find that the operating and alternate use agreements entered into between the governments and the railways assign responsibility to the railways to transport Western grain, including grain shipped by the CWB. (See March 3, 2003 memorandum to Susan H. Kuhbach, "Analysis of Provision of Government-owned and leased Railcars as Indirect Subsidies.") Consequently, we determine that the railways have been entrusted or directed to provide hopper car service to the CWB.

The respondents have argued that nothing in these agreements compels the railways to use the hopper cars provided by the governments or even to transport grain. We believe that this claim oversimplifies the situation. First, under the Canadian Wheat Board Act, designated wheat sold for export or for domestic human consumption must be sold through and transported or caused to be transported by the CWB. Second, the railways historically and currently are the primary means for movement of grain within the Western Division. Third, the railways are heavily dependent on the movement of grain as a source of income and rely upon the governments' provision of hopper cars to transport wheat. As a practical matter, therefore, the railways will transport wheat. Consequently, the governments need only place restrictions on the use of the hopper cars to ensure the transport of wheat by the railways. That is what the operating and

alternate use agreements do for the 14,414 hopper cars provided during the POI.

We also disagree with the respondents' argument that even if the Department finds that there is direction in the agreements to use the railcars for grain service, there is no direction to transport Western grain to the United States. The respondents are effectively repeating their arguments that the provision of railcars is tied to non-U.S. shipments. As explained in response to Comment 6, below, we find that the rates charged by the railways do not reflect the ownership costs of the government-provided hopper cars. Therefore, the subsidy under this program is not tied to shipments to particular markets.

**Comment 6: The Provision of Government-Owned and Leased Railcar Confers No Benefit**.

*GOC's Argument:* The GOC argues that even if the Department finds that the railways received the railcars for less than adequate remuneration the Department cannot determine that there is a countervailable subsidy unless the Department finds that the railways passed through their cost savings to the CWB and other wheat shippers. The GOC contends that in relying on the Sparks Study commissioned by Transport Canada (the government agency that administers the GOC-owned railcars), the Department's conclusion that the government's provision of railcars benefitted the CWB rests on a presumption. Specifically, the GOC states that the Sparks Study merely estimated the ownership costs that would be added to "the railway and/or shipper costs" upon the disposal of the government-provided railcars. The GOC argues that the Sparks Study does not show that the CWB or other shippers received a benefit from the rail services provided by the railways.

The GOC argues that the statute and court precedent require the Department to examine the evidence in the case and determine whether a pass through of benefits exists, citing to the Act and Delverde, SrL v. United States, 202 F.3d 1360, 1366-67 (Fed. Cir. 2000) ("Delverde") (where the court found that the Department had acted improperly when it presumed that a respondent had received a government subsidy after purchasing assets from the actual recipient of the subsidy). The GOC contends that the Department failed to do this and simply assumed that the railways under-charge the CWB because the railways received the railcars free of ownership costs.

Further, the GOC argues that no actual pass through of the hopper car cost savings exists because the railways provided rail services to the CWB at commercial rates based on market principles. The GOC notes that under Department practice, when a transaction is between two parties negotiating at arm's length, subsidy pass through exists only when the transaction is not at fair market value. According to the GOC, the Department has recognized that the railways determine the prices they charge and that the government do not mandate that the railways set rates in a particular way. In these circumstances, the GOC claims, there is no basis for finding that the railways passed any benefit they received from railcar ownership cost savings to the CWB. In support of its position, the GOC cites Potassium Chloride from Israel; Final Affirmative Countervailing Duty Determination, 49 FR 36122, 36125 (September 14, 1984) ("Potassium

Chloride from Israel") and Final Negative Countervailing Duty Determinations: Certain Softwood Products from Canada, 48 FR 24159, 24169-70 (May 31, 1983) ("1983 Softwood Lumber"), to show that the Department has concluded that transportation rates negotiated between the transporter and shipper at arm's length do not constitute countervailable subsidies.

*CWB's Argument:* The CWB disputes the Department's preliminary conclusion that hopper car service was provided for less than adequate remuneration because, the CWB contends, there is no evidence that the railways acted inconsistently with market principles in setting their rates. Citing Carbon and Certain Alloy Steel Wire Rod from Trinidad and Tobago, 67 FR 55810, ("Wire Rod from T&T") Final Issues and Decision Memorandum, Comment 3, the CWB argues that there is a presumption that in an arm's length transaction a purchaser does not benefit from subsidies given to a seller.

Further, according to the CWB, in past cases the Department has found the following factors indicative of whether prices are set in accordance with market principles: whether a consistent rate making policy was used in setting those prices; whether the supplier covered its costs in providing the input; whether the supplier has earned a reasonable rate of return in setting rates; and/or whether the supplier applied market principles in determining its rates. However, the CWB contends, the Department failed to apply these principles in determining whether the railways received adequate remuneration, and simply presumed that the cost savings to the railways that were reported in the Sparks Study were passed through to the CWB.

The CWB argues that the Department cannot rely on such a presumption. According to the CWB, Congress permitted a presumption of pass through only in very narrowly drawn circumstances relating to processed agricultural products, circumstances which are not present in this case. Additionally, adopting such a presumption would, in the CWB's view, raise important policy considerations as subsidy recipients would seek to lower their countervailing duty rates by arguing that their subsidies had been passed through to their customers.

*GOA's Argument:* The GOA contends that the Department's preliminary finding that the railways independently set their rates and that those rates were market rates can only support the conclusion that rail service is not being provided for less than adequate remuneration. Further, the GOA argues, there is no evidence that the railways set their rates to subsidize anyone. The Sparks Study, in the GOA's view, only estimated the ownership costs of the cars and does not indicate that there would be any impact on the rates charged by the railways.

*GOS's Argument:* Like the other respondents, the GOS argues that there is no evidence to support the Department's preliminary conclusion that the railways received less than adequate remuneration for hopper car service. The GOS further contends that there is no evidence that the railways paid anything other than a market price for the railcars used to ship grain to the United States.

Finally, the GOS contends that if the Department were to continue to find that the GOS required the railways to provide rail service, it should also find that the provision of rail services

constitutes "general infrastructure," which is specifically excluded as a financial contribution under section 771(5)(D)(iii) of the Act. According to the GOS, it originally purchased the railcars to address general infrastructure concerns and, because of the province's location and its economic reliance on agricultural exports, the province as a whole benefits from the development of transportation infrastructure to move its agricultural production to market. Hence, the GOS claims that the provision of the government-owned railcars contributes to the "broader societal welfare" of the province.

*Petitioners' Argument*: The petitioners refute the respondents' argument that no benefit has been conferred on the CWB arguing that there is ample evidence on the record to show the governments' actions caused the benefit that accrues to the CWB. Specifically, the petitioners claim that the provision of the government-owned and leased railcars gives the CWB, through its power to allocate railcars, control over railcars for which the CWB incurred no capital charges. This, in petitioners' view, is a benefit to the CWB. The petitioners also argue that despite the arm's-length commercial relationship between the railways and the CWB, the negotiated rail prices do reflect the lower ownership costs of the government-provided railcars. The petitioners contend that the government-imposed revenue cap does not allow the railways to negotiate rates freely with the CWB at the levels the markets will bear. The petitioners note that the respondents have not provided either actual rate information or data on comparable rail rates for wheat or for other commodities to allow the Department to determine if the negotiated rail rates are indeed market rates.

In response to the GOS's argument that the provision of rail services constitute general infrastructure, the petitioners counter that the railcars are not general infrastructure since unlike an interstate highway system, they are not generally available to everyone and they are provided free for grain shipments, subject to alternate use fees for other commodities.

*Department's Position:* We disagree with the respondents that the provision of rail service confers no benefit on the CWB. First, we do not agree that the Department has presumed that the benefits of the government-provided railcars were passed through to the CWB. Instead, our determination was based on a full review of the record information. The Sparks Study was an important piece of record evidence. That study concluded that disposal of the government-owned railcars and termination of the provision of these railcars by the federal and provincial governments would have the effect of adding ownership costs for these cars to the railways' and/or shippers' costs. We read this to indicate that the railways' costs would increase and that increase might cause shippers' (e.g., the CWB) costs to increase.

The Sparks Study also stated that upon the disposal of the government-owned railcars and termination of the provision of these railcars by the federal and provincial governments, the federal government would need to adjust the revenue cap to reflect the increased costs incurred by the railways for acquiring railcars. This same conclusion is reflected in the Canada Transportation Act, which provides that "{the government} shall make adjustments to the {revenue cap} to reflect the incremental costs incurred by the prescribed railways for purposes of obtaining cars as a result of the sale, lease or other disposal or withdrawal from service of

government hopper cars." See Division VI of the Canada Transportation Act. Similarly, a paper on the disposal of the government hopper cars prepared in September 1999, states, "{a}s the regulated grain freight rate does not compensate government for its ownership cost of the hopper cars, commercialization of the government's cars will require an increase in the maximum rate or proposed revenue cap." See the GOC's January 13, 2003 submission, Exhibit B-10. These references indicate that if the governments ceased to provide these railcars, then rail rates would have to be increased, necessitating a change in the revenue cap. Thus, based on the conclusions of the Sparks Study, the Canada Transportation Act, and the above-cited paper, we conclude that the rates charged by the railways for railway services do not reflect the ownership costs of the government-provided railcars.

Second, we disagree with the respondents' argument that any benefit received by the railways could not have passed through to the CWB because the rates were determined in arm's length negotiations that resulted in fair market value being charged. While we agree that the parties negotiated at arm's length, it is also true that the parties came to the negotiations with full knowledge that the railways pay no ownership costs for hopper cars used on designated shipments. Clearly, as one of the providers of these hopper cars, the CWB knows the cost savings that are being enjoyed by the railways. Also, as noted in Comment 5, above, the CWB is a very large customer of the railways and, therefore, comes to the negotiations with certain amount of power. In light of these circumstances, we do not share the respondents' view that the cost savings to the railways by virtue of the government-provided cars would be captured by the railways.

In citing Potassium from Israel and 1983 Softwood Lumber, the respondents are relying on precedents that predate changes to our statute and regulations regarding provision of services. Also, the respondents' references to Delverde and Wire Rod from T&T are misplaced as those cases relate to the sale of a company or its assets, and not the provision of a service. The statute (at section 771(5)(E)(iv)) of the Act, and our regulations (at 19 C.F.R. § 351.511) clearly articulate the standard for finding a benefit in this situation.

Finally, with respect to the GOS's argument that the provision of rail services is one of general infrastructure which is specifically excluded as a financial contribution under section 771(5)(D)(iii) of the Act, we agree with the petitioners. Under the operating and alternate use agreements between the GOS and the railways, the railcars are specifically provided to the railways for transportation of Western grain subject to the terms and conditions of the agreements. The railcars are hopper cars designed for the transportation of grain, and not for general uses. Therefore, the provision of these rail services could not be considered as general infrastructure.

**Comment 7: Measurement of Benefit from the Government-Provided Railcars**.

*Petitioners' Argument:* The petitioners dispute the Department's preliminary conclusion that there is no information on the record about the prices charged by other railways in Canada for hopper car service. The petitioners contend that the Department should rely on actual

transactions, i.e., how much the CWB paid for railcars during the POI. Citing Notice of Final Affirmative Countervailing Duty Determination: Certain Cold-Rolled Carbon Steel Flat Products from the Republic of Korea, 67 FR 62102 (October 3, 2002), Notice of Final Affirmative Countervailing Duty Determination and Final Negative Critical Circumstances Determination: Certain Softwood Lumber Products from Canada, 67 FR 15545 (April 2, 2002), Preliminary Results, Intent to Partially Rescind and Postponement of Final Results of Countervailing Duty Administrative Review: Stainless Steel Sheet and Strip in Coils from the Republic of Korea, 67 FR 57395 (September 10, 2002), and Notice of Preliminary Affirmative Countervailing Duty Determination and Alignment of Final Countervailing Duty Determination with Final Antidumping Duty Determination: Certain Cold-Rolled Carbon Steel Flat Products from the Republic of Korea, 67 FR 9685 (March 4, 2002), the petitioners claim that in countervailing duty decisions involving the provision of goods or services, the Department has routinely determined the adequacy of remuneration by comparing the government price to a market-determined price based on actual transactions in the country in question.

The petitioners contend that the record establishes the actual prices CWB has paid for railcars under two leasing arrangements during the POI. The petitioners argue that the Department should calculate the benefit for the government-owned railcars based on a weighted average of the two leases. The petitioners further argue that if the Department does not treat the lease reimbursements to the CWB and the provision of government-owned railcars separately, the Department should value the subsidies arising from both based on these actual transactions.

If the Department does not rely on actual transactions to value the benefit for the government-provided railcars, the petitioners urge the Department not to adjust the Sparks data using the lease rates provided by the GOC. The petitioners claim that these rates were calculated in a self-serving manner and that the data obtained from one of the leasing companies is aberrational. Moreover, according to the petitioners, the record is not clear whether the lease rates apply to the POI. Instead, the petitioners urge the Department to use the actual lease rates the CWB paid for the railcars it leased during the POI to adjust the Sparks Study data.

In addition, in a March 17, 2003 submission, the petitioners claim that the Department made an error in its preliminary calculation by using the wrong Sparks Study ownership cost. The petitioners contend that the Sparks Study clearly states that the ownership costs for the government-provided railcars range from C$2.22/tonne to C$3.50/tonne. The petitioners further claim that the Sparks Study did not state how the higher ownership cost range was converted to a savings of only C$2.00/tonne to C$3.00/tonne. See Petitioners' March 17, 2003 submission at 3.

Finally, the petitioners assert that the Department should also reject the respondents' suggestion to adjust the subsidy for alternate use payments. The petitioners claim that in addition to the respondents not having demonstrated that the rates charged by the railways vary because they pay or do not pay alternate use fees, the alternate use figures provided by the GOC have not been verified and are maximum estimates of the alternate use payments the GOC could have earned.

*GOC's Argument:* The GOC contends that the actual rates recommended by the petitioners are

not a benchmark for measuring the benefit for the government-provided railcars because they reflect the cost to the government for the leased railcars, not what the railways would have paid in the absence of the government-provided railcars. The GOC claims that had the government-leased railcars not been available during the POI, the railways would have replaced the railcars with the least expensive alternative, which is leasing railcars under short-term, triple net-leases. The GOC contends that the GOC's lease costs for the leased railcars do not represent "prevailing market conditions" as specified in section 771(5)(E) of the Act because the railcars were leased under conditions existing in the early 1980s, in a tight and expensive railcar market. In addition, the GOC argues that the lease costs on railcars leased by the CWB on its own are not a benchmark to value the alleged benefit from the government-provided railcars. The GOC contends that the lease costs paid by the CWB for the railcars the CWB leased on its own (through a lease option it acquired in 1995) reflect rates set many years ago, not "prevailing market conditions."

The GOC asserts that in the event the Department decides to rely on the Sparks Study to calculate a benefit for the provision of the government railcars, the Department should make three corrections to its preliminary benefit calculation. First, the GOC contends that the Department should deduct alternate use payments since in estimating the ownership costs of the railcars, the Sparks methodology did not account for the time in which the railcars were on alternate use routes. Second, the GOC argues that the Department should average the lease rates it used in the preliminary calculation with the March 2002 average monthly lease rates for a one-year lease submitted at verification. Finally, the GOC states that to determine the total benefit of the alleged subsidy, the Department should multiply the estimated ownership cost to the CWB by only the total tonnes of CWB wheat shipped in government-provided railcars during the POI, and not by CWB wheat shipped in both government and non-government railcars, as was done in the preliminary determinations.

In responding the petitioners' arguments, the GOC claims that the lease rates it submitted to the Department provide a basis for adjusting the calculation in the Sparks Study. Specifically, the GOC asserts that the lease rates it provided are amply documented on the record, obtained from private leasing companies, and were verified by the Department. Further, the GOC contends that the lease rates reflect prevailing market prices resulting from actual transactions during the POI.

The GOC also urges the Department to reject the petitioners' suggestion to use a higher cost savings reported in the Sparks Study. The GOC claims that there is no basis for the Department to use a higher adjustment since the Sparks Study specifically stated that the efficiencies gained in the rail system stemming from railway deregulation would further reduce ownership costs.

*CWB's Argument:* The CWB also challenges the petitioners' suggestion that the Department value the subsidy from the government-owned railcars based on the price at which the CWB leased the railcars from private lessors. The CWB argues that use of this measure is inconsistent with the petitioners' position that the government-provided railcars are an indirect subsidy where the benefit is whether the railways provide rail service to the CWB at less than adequate remuneration.

The CWB also argues that the first benchmark proposed by the petitioners, based on lease costs established twenty years earlier for the 1,675 railcars the CWB leases, is contrary to section 771(5)(E) of the Act because benchmarks that are so far removed in time cannot be considered as representing the prevailing market conditions. According to the CWB, the second benchmark proposed by the petitioners, based on lease costs for other railcars the CWB leases, is not an appropriate benchmark because the lease is for a five-year period. However, the GOC-owned railcars were provided to the railways under the equivalent of a short-term lease because the operating agreement between the GOC and the railways can be terminated with 90-day written notice by either party. Further, the agreements were established well before the POI and in different market conditions.

*Department's Position:* We agree with the respondents that using the actual lease costs of the railcars during the POI to determine the benefit of the government-provided railcars would be inconsistent with our analysis of the government-provided railcars as an indirect subsidy. In our analysis, we have examined whether the railways have been entrusted or directed to provide hopper car service to the CWB for less than adequate remuneration. As such, our benchmark must reflect what the CWB would otherwise pay for such a service. Therefore, we have not used the CWB's lease rates as the basis of the benefit calculation.

Regarding the proposed adjustments to the preliminary calculation, we have adopted certain of these suggestions. First, we disagree with the petitioners' claim that the Department made an error in its preliminary calculation by using the lower range of ownership costs in the Sparks Study. We used this lower range because the Sparks Study clearly indicated that the ownership costs it estimated will be reduced. According to the Sparks Study, the reduction in ownership costs is due to better railcar utilization and lower lease rates resulting from incremental efficiencies created by a more commercial transportation environment.

Second, one component of the Sparks Study calculation is the lease rate that the railways would pay if they did not have access to the government-provided railcars. In the Preliminary Determinations, we made an adjustment to reflect lease rates in effect during the POI (as opposed to the lease rates used by the Sparks Study which dates from 1999). We calculated this adjustment using data submitted by the GOC. This data reflects the average lease rate of one-year triple net leases.

For the final determinations, the petitioners have asked us to make this adjustment using actual lease rates paid by the CWB during the POI. The respondents have asked us to use the data from the preliminary determinations and to average that with the one-year lease rates from March 2002.

We have determined that it is appropriate to average the verified lease rates paid by the CWB with the data from our Preliminary Determinations, which was also verified. We are not using the March 2002 data provided at verification because it was presented on the last day of verification and we were not able to examine it and ask follow-up questions. Thus, because we have verified data, we prefer to use that data.

Although the CWB lease rates were set years ago, these are clearly lease rates paid during the POI. Respondents would have us speculate what type of lease the railways would sign in the absence of the government-provided hopper cars pointing, in particular, to the 90 day opt out periods in the operating agreement. However, this operating agreement is between the railways and the government, and not between the CWB and commercial railcar lease companies. Moreover, while these opt out provisions may exist, the agreement has an open-ended duration. Thus, we do not agree that the opt out provision in the operating agreement should lead us to reject the lease rates negotiated in long-term contracts. Furthermore, in the absence of the government-provided railcars, the CWB might have negotiated contracts years ago, identical to those entered into by the CWB. Therefore, because the lease rates paid by the CWB reflect hopper car lease rates paid during the POI, we believe it is correct to include them in making the adjustment to the Sparks Study calculation.

We disagree with the petitioners that the lease rates provided by one of the leasing companies are aberrational. We verified the data and examined the written confirmation from the leasing company. We have no reason to believe that the rates are aberrational. Further, the GOC stated that it obtained lease rates quoted by the leasing companies for the POI. See GOC's February 11, 2003 submission at Exhibit B-15. We verified the data provided by the GOC. See the June 9, 2003 GOC Verification Report at 5.

Beyond the lease rate adjustment, we agree with the GOC's argument that the Department should account for the alternate use payments made by the railways that are attributable to the transport of CWB grain. Without such a deduction, our calculation would overstate the ownership costs of the railcars. In estimating the ownership cost of the railcars, the Sparks Study did not account for the alternate use payments, which the railways would not incur if they owned the railcars. We disagree with the petitioners that we should not adjust for the alternate use payments as suggested by the GOC because they are not verified. We verified the alternate use payments which the GOC received from the railways during the POI, which indicated that the GOC also received alternate use payments from the railways for transporting non-CWB grain. See the June 9, 2003 GOC Verification Report at 3. Thus, it is appropriate to adjust the ownership costs estimated in the Sparks Study by only the alternate use payments attributable to CWB grain. We believe that the data submitted by the GOC on the alternate use payments attributable to CWB grain is reliable and we used it in our final calculation.

Finally, the GOC claims that the Department should multiply the freight rate savings by the number of tonnes shipped on government provided railcars, rather than the total tonnes shipped. We agree. Because of the way in which the amount is calculated in the Sparks Study, i.e., savings per metric tonne.

**Comment 8: The Revenue Cap Does Confer a Benefit.**

*Petitioners' Argument:* The petitioners argue that the Department should find that the revenue cap does confer a benefit, and set out three arguments based on the Department's findings in the Preliminary Determinations. First, they claim that the Department's finding that the railways'

earnings were below the revenue cap is both factually incorrect and, in any case, irrelevant to the analysis. On a percentage basis, the railways were not "significantly below" their respective revenue caps, according to petitioners, and by staying just below their revenue caps the railways maximized their capped revenues and avoided paying a severe penalty for being over the revenue cap. Further, petitioners claim, since the railways cannot forecast anticipated freight revenues or track their revenue subject to the revenue cap at all times, they will always seek to ensure that they fall just below the revenue cap. This, however, does not mean that the revenue cap has no effect on revenues or rates charged, according to petitioners.

Second, the petitioners disagree with the Department's position that the railways' ability to increase or create fees for services that are not subject to the revenue cap allows the railways to increase revenue from Western grain movements, irrespective of the revenue cap. They argue that the fact that the railways are allowed to increase fees on these services has no bearing on whether the fees for basic grain service have been held down and are lower than they would have been because of the government-set revenue cap. Also, increases in revenues from other optional services have no bearing on whether the CWB benefitted from lower rates on basic transportation services it purchases from the railways, the petitioners argue. Since these outside fees are mostly penalties, which can be avoided, the fact that they have been increased sheds no light on whether basic transport costs are lower as a result of the revenue cap.

Third, the petitioners argue that the Canadian Transportation Agency study ("Transportation study"), relied upon by the Department as evidence that the rates on revenue-capped movements were not for less than adequate remuneration, is flawed. The petitioners state that the study compares rates instead of net revenues, thereby ignoring incentives such as multi-car rebates and seasonal variations. The petitioners also argue that the study is statistically unreliable because it is not comparing a significant portion of movements, due to the limited number of non-revenue-capped movements to compare to capped movements of the same length of haul. Finally, they argue that the GOC requirement that rates on single car movements originating on branch lines cannot exceed mainline rates by more than three percent distorts Western rates. Western Canada has all of the GDBLs and the cost to maintain these GDBLs on a per tonne basis is higher since they carry less traffic. Since the rates on branch lines are limited by mainline rates, the railways must recoup these costs on their mainline routes throughout the West. Thus, in comparing non-revenue capped routes to revenue-capped routes, there is an upward bias in the revenue-capped routes in Western Canada.

The petitioners cite the Quorum Report in support of their argument that the revenue cap caused a decrease in rates from the previous railway rate policy. The Quorum Report states, "...the freight rates now in place are likely still lower than those that would have otherwise come about without the policy change..." See Quorum's *Second Quarter Report 2001-2002 Crop Year* at GOC January 13, 2003 Questionnaire Response at Exhibit C-7.

The petitioners conclude by arguing that the revenue cap is nothing more than a system-wide rate cap modified by an inflation factor times the number of tonnes shipped, and that the railways are still limited in what they can charge for services. They argue that since the GOC has stated that

the railways' grain revenue for the crop year 2000-2001 would be 18 percent lower for a movement of 967 miles, which includes a 4.5 percent savings from the elimination of the scheduled rate increase, the 18 percent decrease in rates that the revenue cap caused upon implementation should be used to measure the benefit. The petitioners also compare CP's revenue-capped freight rates in Canada to CP's U.S. freight rates for a similar length of haul to show that rates are lower in Canada, and that the 18 percent figure is a reasonable approximation of the benefit.

*GOC's Argument:* The GOC agrees with the Department's finding that the revenue cap does not confer a benefit, and it replies to the three arguments put forth by the petitioners. First, the GOC claims that the petitioners have miscalculated the spread between the revenue cap and the revenue earned by the railways. According to the GOC, properly calculated, the spread is larger. The GOC further states that the railways, as large sophisticated business entities, have elaborate tracking systems to keep them appraised of their position at all times concerning the revenue cap. Knowing their position with respect to the revenue cap, the fact that they do not adjust their rates higher when they see that they will fall far under the revenue cap simply shows that they are charging rates that the market can bear.

Second, the GOC argues that the other fees charged outside of the revenue cap are relevant to the benefit analysis because the railways are able to increase their overall income from their shippers from these assessments. Also, the shippers are not receiving a discount because of the revenue cap since their total freight fee is the revenue-capped amount plus the outside charges, according to the GOC.

Third, the GOC states that the Transportation study does not compare nominal, single-car rates as the petitioners suggest. Instead, the Transportation study calculates the average revenue actually earned for each tonne mile of subject merchandise transported during the POI on comparable lengths of revenue-capped and non-revenue-capped routes in Canada, with rebates and incentives accounted for to the extent possible. The GOC argues that it is immaterial that the average length of haul on revenue-capped routes may be longer than the average length of haul for non-revenue-capped routes, and that what is material is that the study actually compared movements on similar lengths of haul. Therefore, the study does correctly measure differences between capped and non-capped movements. The GOC also refutes the peitioners' concern about the treatment of branch lines by stating that the study uses actual net revenues, not rates, as suggested by petitioners, pointing out that the Transportation study included a branch line adjustment on Eastern movements to account for the fact that Eastern Canada does not have grain dependent branch lines.

The GOC argues that the Department should continue to reject the petitioners' argument that rates would have been 18 percent higher "but for" the implementation of the revenue cap. This percentage was derived from rates under the previous rate-capping system, which was a government-mandated scheme. The GOC argues that the proper test for benefit in these circumstances is whether the these rail services are being provided for less than adequate remuneration, to "be determined in relation prevailing market condition...in the country which is

subject to the investigation or review." See section 771(5)(E)(iv) of the Act. Rates set under the old government rate setting regime cannot be considered representative of market conditions, especially since the data derived by the petitioners predated the POI.

The GOC dismisses the petitioners' comparison of U.S. and Canadian rail rates, claiming that rail rates in the United States are not a lawful benchmark. The GOC again cites section 771(5)(E)(iv) of the Act and 19 C.F.R. § 351.511(a)(2) to argue that benchmarks should be chosen from "the country in question." The GOC also argues that the U.S. rail rates the petitioners use are not factually valid because there is no evidence on the record to support the conclusion that rail rates in the United States are set in the same way as rail rates in Canada.

The GOC concludes its arguments regarding the revenue cap by noting that by Canadian law, the vast majority of U.S. movements are not subject to the revenue cap and that any calculation of benefit would need to exclude those shipments from the calculation. Citing to section 351.525(b)(4) of the Department's regulations, the GOC argues that when a subsidy is tied in part to markets other than the United States, the portion tied to non-U.S. markets may not be attributed to U.S. sales.

*CWB's Argument*: The CWB concurs with the arguments put forth by the GOC. The CWB further argues that the fees charged outside of the revenue cap are relevant to the benefit analysis because the fees are not optional and are associated with the basic transportation service the railways provide to the CWB. The CWB states that it cannot avoid these charges as they are imposed on grain companies and are passed on to the CWB and grain producers.

The CWB concurs with the GOC that the 18 percent figure relied upon by the petitioners is not an accurate benchmark for the revenue cap because it was based upon a comparison to the prior (rate cap) system of regulated rates, which does not constitute a "prevailing market condition" contemplated by section 771(5)(E) of the Act for determining whether a good or service has been provided for adequate remuneration. The previously regulated rates do not constitute "actual transactions in the market," or a "world market price," nor are they "consistent with market principles." See 19 C.F.R. § 351.511(a)(2). If the Department does consider use of a benchmark rate based upon "administered" rates, the rate cap upon which the benchmark was based was abnormally high and should not be used because the rates had not been adjusted in the 1999-2000 crop year to account for the significant efficiency gains achieved by the railways since the 1992 costing study. Therefore, as the 1999-2000 rail rates do not reasonably reflect the "prevailing market conditions" during the POI, they cannot be used for purposes of calculating a benchmark.

Regarding the petitioners' comparison of U.S. and Canadian freight rates, the CWB argues additionally that differences in government regulatory regimes, tax regimes, investment regimes, capital and labor costs, exchange rates, banking and financial systems, and the business climate all have important effects on prices. Therefore, according to the CWB, the Department cannot assume that the terms of service in one country are comparable to the terms of service in another. See section 771(5)(E) of the Act concerning comparability of rail service with respect to "overall price, quality, availability, marketability, transportation, and other conditions of sale."

*Department's Position:* The Department continues to find, as it did in the Preliminary Determinations, that the revenue cap does not confer a benefit on the CWB. Our conclusion is based on the Transportation study's comparison of the revenue per ton mile figures for revenue-capped routes with non-revenue capped routes. This study demonstrated no advantage for shippers from the revenue cap.

Contrary to the petitioners' position, we find that the Transportation study was a reasonably formulated analysis for comparing the revenue generated by the railways on capped and non-capped routes of equal distance. First, the study was based on the revenue generated on the comparable routes, and not, as petitioners suggest, on the nominal rates. For example, to the extent practicable, in determining the revenue generated, the study took into account rebates and incentives between the parties. Second, while the GOC does not contest that there are fewer non-capped routes of the same length of haul as the average length of haul for capped routes, there is no information on the record that the limited number of non-capped routes somehow skewed the purpose of the study, which was to compare the revenues on routes of the same or similar length of haul. On this point, we are satisfied that the Transportation study compared capped and non-capped routes of similar length of haul and that all the non-capped routes of comparable length of haul were included. Similarly, the petitioners provided no evidence to support their argument that study is flawed because the railways increased their main line rates in Western Canada to compensate for the cost they incur in maintaining GDBL routes in Western Canada. We confirmed that the Transportation study did include an adjustment on the non-capped routes to compensate for the additional costs associated with maintaining GDBLs in Western Canada..

We first note that there is no evidence on the record to indicate that the revenue cap resulted in lower revenues on capped routes. Assuming *arguendo*, however, that it did result in lower revenues on capped routes, we do not agree with the petitioners that we should look at capped charges only. The Department agrees with the GOC and CWB that many of the fees and charges, which were not incorporated into the revenue cap formula and, thus, are outside of the revenue cap, cannot be controlled or avoided by the CWB. Therefore, these fees are not optional shipping costs to the CWB. For example, demurrage at a port if a ship is not ready, excess loading time for grain from the grain elevator to the railcar, or excess unloading time from the railcar to the terminal are typical of the services covered by these outside fees and are part of the total transportation fee that the CWB must pay to move grain to the final destination. Irrespective of whether the charge falls under the revenue cap or not, the CWB must pay the total amount.

The Department also continues to find that the 18 percent figure is not an appropriate benchmark to calculate a benefit. The figure is derived from the previous rate cap scheme that was abolished in the year 2000, and only relates to the supposed savings immediately after the implementation of the revenue cap, which is before our POI. Therefore, as argued by the GOC and CWB, it does not reflect rates prevailing during the POI. In fact, the Quorum Report states that for the time period covered by the POI, the published single car rates had returned to pre-revenue cap levels. See January 13, 2003, Questionnaire Response of the GOC at 58, and Exhibit C-7 at 23.

The petitioners have compared revenue capped freight rates in Canada to U.S. freight rates to demonstrate that the U.S. freight rates for a similar length of haul are higher than comparable hauls on capped routes in Canada by an average of 19 to 51 percent. The petitioners use this finding to support their conclusion that the 18 percent differential cited above is a reasonable approximation of the benefit. As noted above, we have determined that the 18 percent figure cited by petitioners is not an appropriate benchmark to calculate a benefit.

**Comment 9: The Rail Freight Revenue Cap ("Revenue Cap") Does Not Provide a Financial Contribution.**

*GOC's Argument:* The GOC argues that the revenue cap does not provide a financial contribution. The GOC claims that the revenue cap is based upon a separate governmental policy distinct from the government-provided railcars and that any decision of whether the revenue cap confers a financial contribution should be made independent of the Department's analysis of government-provided railcar benefits. Since the GOC does not provide rail service and the railways are private companies, there is no direct provision of a financial contribution from the government, nor are the railways entrusted or directed by the revenue cap itself to provide rail service.

*Petitioners' Argument:* The petitioners state that the Department correctly determined that the GOC is entrusting or directing the railways to provide a financial contribution, specifically rail transportation services, to the CWB and that this is a subsidy. They further agree with the Department's determination that the revenue cap is limited to the transportation of Western grain and is, therefore, specific within the meaning of the statute.

*Department's Position:* As the Department has found that no benefit is conferred by the revenue cap, we have not addressed the issues raised in this comment.

**Comment 10: The Department Should Determine That the Revenue Cap Does Not Provide a Financial Contribution Because it is Consistent With Market Principles.**

*CWB's Argument:* The CWB argues that because the revenue cap was a market-oriented response by the GOC to the lack of competition in the transport of Western grain, the Department should determine that the revenue cap is "consistent with market principles" and does not entrust or direct the railways to provide rail service at less than adequate remuneration. The CWB argues that the revenue cap is consistent with market principles because it is a market-oriented response to the railways' oligopoly powers, and that the government was attempting to correct for market distortions which allowed the railways to charge prices for more than adequate remuneration.

The CWB argues that the countervailing duty laws seek to address government actions that "distort or subvert the market process," not actions that correct for market distortions and seek to achieve a result that is consistent with the competitive outcome. See, e.g., Creswell Trading Co.

v. Allegheny Foundry Co. 141 F.3d 1471,1475 (Fed. Cir. 1998) and Georgetown Steel Corporation v. United States, 801 F.2d 1308,1310 (Fed. Cir. 1986).

The CWB also cites to the Department's preliminary determination in the administrative review of Certain Cut to Length Carbon Steel Plate from Mexico 64 FR 48,796, 48,803 (Sept. 8, 1999), where the Department found that a monopolistic government supplier of inputs was supplying the input for more than adequate remuneration and, therefore, found that it was not providing a countervailable benefit. The CWB argues that the revenue cap was a response to a "more than adequate remuneration" situation and, therefore, even if the revenue cap lowered rail rates, this result would most reasonably be considered to involve the restoration of market pricing.

Finally, the CWB argues that the Department may take into consideration the GOC's price "philosophy" as discussed in the preamble to the Department's regulations. See Preamble, 63 FR at 65378. The CWB argues that the GOC's philosophy in adopting the revenue cap was that unregulated rail service involved an unacceptably high likelihood of anti-competitive pricing. Therefore, the CWB argues that the conceptual foundation of the revenue cap was completely consistent with market principles.

*Department's Position:* Since the Department has determined that the revenue cap did not confer a benefit on other grounds, we have not addressed this issue.

**Comment 11: The Benefit of the Revenue Cap Extends to All CWB Shipments, Including Shipments to the United States.**

*Petitioners' Argument:* The petitioners claim that it is undisputed by respondents that some U.S. shipments are subject to the revenue cap and, thus, directly benefit from the revenue cap. The petitioners also argue that as a result of multi-car discounts on all Western grain movements, the revenue cap has the indirect effect of lowering rates on multi-car shipments to the United States, thereby benefitting the CWB's shipments to the United States.

*GOC's Argument:* The GOC argues that, if the Department insists on calculating a benefit, it would have to remove 99.99% of hard red spring wheat and 90.33% of durum wheat shipments to the United States from the calculation since those shipments were moved on routes not subject to the revenue cap. The Department's tying regulations state that the portion of subsidies tied to non-U.S. markets may not be attributed to U.S. sales and only the portion tied to U.S. markets may be countervailed. See 19 C.F.R. § 351.525(b)(4).

*Department's Position:* Since the Department has determined that the revenue cap did not confer a benefit and, thus, does not constitute a countervailable subsidy, we have not addressed this issue.

**Comment 12: The Closure Fee for Grain Dependent Branch Lines Confers a Financial Contribution.**

*Petitioners' Argument:* The petitioners argue that, through the CTA, the GOC is directing or entrusting the railways to maintain uneconomical GDBLs instead of abandoning them by requiring the railways to compensate communities for the closure of such lines. The petitioners argue that the focus should be on whether the railways would have closed more uneconomical lines if the GDBL closure fee had not been instituted and not, as the Department stated in the Preliminary Determinations, whether the railways closed any lines after the implementation of the fee.

The petitioners argue that the railways had many more lines slated for closure before the closure fee came into effect than were actually closed subsequent to the implementation of the fee, and that the CN railway moratorium on line closings is evidence of the effect of the closure fees on the railways' decisions regarding closings.

The petitioners also argue that the revenue cap affects the decision to close of GDBLs because closures lower the average length of haul amount used in calculating the revenue cap. This, in turn, lowers the revenue cap. The petitioners argue that this reduction in the revenue cap is large and, therefore, plays a part in keeping GDBLs from being abandoned. By forcing the railways to keep the GDBLs open, the CWB benefits from not having to pay higher priced truck rates to haul part of grain from farms.

*GOC's Argument:* The GOC concurs with the Preliminary Determinations that the GOC is not directing and/or entrusting the railways to provide continued rail transportation services over GDBLs. The GOC argues that there was no financial contribution because the closure fee does not compel the railways to keep open the GDBLs. The GOC claims that it has demonstrated and the Department has verified that the closure fee is minimal compared to the cost savings of closing the line. The GOC points to evidence on the record indicating that the petitioners have simply misconstrued the record regarding the number of miles of GDBLs closed or transferred by the railways, and note that the record demonstrates that the railways actually closed more lines in the first year of the fee than in the year prior to the fee.

The GOC argues that the revenue cap does not force the railways to maintain GDBLs. Contrary to petitioners' assertions, the GOC contends that the closure of GDBLs affects the revenue cap by a very small amount because the railways' average length of haul is calculated by dividing revenue tonne miles by revenue tonnes for the revenue cap formula and a closure of GDBLs affects this number only slightly. The GOC demonstrates the minimal effect of the closures on the revenue cap by calculating the effect on the revenue cap from the closure, during the POI, of two GDBLs lines. The results of this analysis show that, taking into account both the closure fee and the minimal impact on the revenue cap, the railways still achieve considerable savings in closing GDBLs.

*Department's Position:* In the Preliminary Determinations, we found that the GOC was not entrusting or directing the railways to maintain uneconomic branch lines because the closure fees did not appear to deter the railways from closing these lines. For these final determinations, we have reviewed the record information on this point and have concluded that the evidence is

mixed. For example, the petitioners claim that the railways planned to close nearly 700 miles of GDBLs, but as a result of the closure fees, the railways closed or transferred less than half of that amount. The GOC argues that the petitioners have misread the data and that, in fact, nearly 600 miles of GDBLs were closed or transferred. Even accepting the GOC's argument, this means that over 100 miles of planned closures or transfers did not occur. Additionally, the petitioners have pointed to CN's moratorium on line closings. On the other hand, as we verified, the closure fees are small relative to the cost savings experiences by the railways in closing GDBLs.

In addition to finding that the record information paints a mixed picture, we have also considered whether the line of analysis in our Preliminary Determinations was correct. Specifically, we question whether a determination of entrustment or direction should depend on whether the government' direction had its intended result. In this case, the government has clearly made it more costly for the railways to close GDBLs than it would have been in the absence of the fees, and this would normally lead us to conclude that the government had entrusted or directed the railways to keep these lines open and to provide rail service to user of these lines.

However, even if we were to make a finding of entrustment or direction, we are unable to quantify any benefit because to do so we would need to know how many miles of GDBLs would be closed in the absence of the fees. The records of these investigations simply don't tell us the answer to that question. In part, this is because the closure fees replaced an earlier policy that also restricted the ability of railways to close GDBLs. Therefore, there is no benchmark period to show how the railways behaved in the absence of restriction or penalties on closing GDBLs.

Therefore, in these final determinations, we are unable to make a determination that the closure fees for GDBLs confer a countervailable subsidy on the CWB. If these investigations result in countervailing duty order, we will consider this issue further in the context of any administrative reviews of these orders.

**Comment 13: Impact of the Lending and Initial Payment Guarantees on the CWB's Cost of Borrowing.**

*Petitioners' Argument*: Petitioners agree with the Department's finding in the Preliminary Determinations that the borrowing guarantee enabled the CWB to pay a lower interest rate on its borrowing than it would pay on a comparable commercial loan without the guarantee. Petitioners further allege that absent the guarantees of initial payment and lending, the CWB would receive a lower credit rating and therefore, its cost of borrowing would increase.

Specifically, petitioners contend that there is a direct link between the initial payment guarantee and the CWB's credit rating because absent the initial payment guarantee the CWB would have to establish a contingency fund to maintain its credit rating. Petitioners further state that the benefit accruing to the CWB from the initial payment guarantee in the form of reducing the CWB's cost of borrowing, is in addition to the benefit that was originally alleged (i.e., the amount that the CWB would have had to pay to purchase a put option). With respect to the lending guarantee, petitioners conclude it supports the CWB's credit rating and thereby reduces

borrowing costs since the guarantee insures investors of CWB debt that they will be paid.

Petitioners reject the respondents' position that the statute and the Department's regulations preclude the Department from calculating a benchmark borrowing rate for the CWB in the absence of all government guarantees. Rather, petitioners argue that when there are multiple government programs (e.g., guarantees) that each contribute to the same benefit, the Department is required to take each program into account in calculating the amount of the benefit.

Such an analysis, petitioners stipulate, is consistent with Congressional intent that the Department interpret the countervailing duty law in a broad and flexible manner. Moreover, petitioners argue that the Department is permitted to find that a subsidy may have additional benefits.

With respect to the respondent's argument that the Department cannot consider the effect of the lending guarantee on borrowing costs on the basis that the Department preliminarily determined the lending guarantee is tied to non-U.S. markets, the petitioners respond that it is Department practice to consider all subsidies, even subsidies nominally tied to non-U.S. markets. Further, if there is clear indication that the benefit directly or indirectly affects merchandise subject to review, the Department will find that benefit countervailable. See Industrial Nitrocellulose from France: Final Results of Administrative Review, 52 FR 833, 835 (January 9, 1987); see also Colombian Roses.

Finally, petitioners reject the respondents' claim that petitioners are requesting the Department to find "secondary consequences." Rather, petitioners argue that the guarantee of lending is an indirect guarantee of borrowing, and that this analysis is consistent with the statute. See section 771(5)(E) of the Act.

Petitioners state that if the Department determines that it cannot consider the benefit provided by the GOC's lending and initial payment guarantees when calculating the benefit of the borrowing guarantee, then the Department should separately countervail the income stream and savings generated as a result of those guarantees.

*CWB's Argument*: The CWB attempts to respond to petitioners' assertion that the Department must consider the effects of the lending and initial payment guarantee on the CWB's cost of borrowing, by claiming that such an analysis is precluded by the statute, the Department's regulations, and practice.

Specifically, the CWB contends that the statute limits the benefit from a loan guarantee to the effect of the loan guarantee itself. See section 771(5)(iii) of the Act. According to the CWB, the Department made the policy clear in the preamble to the Department's regulations, when it stated that "the impact of the benefit under one subsidy program should not be considered in calculating the benefit under a separate program." See Preamble, 63 FR at 65362.

To consider the impact of the lending and initial payment guarantees on the CWB's credit rating

and cost of borrowing, the CWB argues, is analogous to taking into account current and prior subsidies in determining the creditworthiness or equityworthiness of a loan recipient, which is explicitly prohibited by the Department's regulations. See section 351.505(a)(4)(iii) and section 351.507(a)(4)(iii) of the Department's regulations, respectively.

Further, the CWB argues that considering the removal of the lending guarantee on the CWB's cost of borrowing would require the Department to consider a range of "secondary consequences" that, in the end, results in a highly speculative exercise. For example, the CWB asserts that the Department would have to consider the fact that the CWB would likely restructure its asset portfolio because it "is very unlikely that the CWB would retain those sales on its books."

Moreover, since any type of government subsidy has at least a theoretical effect on a company's benchmark cost of funds, then under the petitioners' approach, the Department would have to adjust for all of these factors in determining the benchmark cost of funds. The CWB asserts that such an analysis is not feasible.

The CWB further refutes the petitioners' proposal because the Department found in its Preliminary Determinations that the lending guarantee is tied to markets other than the United States. See Id at 11380. Therefore, the CWB argues that "whatever benefit the guarantee of credit receivables has on the CWB's borrowing costs is a benefit that results from a program tied to markets other than the United States."

Finally, the CWB notes that the petitioners have argued that the Department could analyze the effect of the lending and initial payment guarantee on the CWB's borrowing costs as a "secondary consequence" measured under the borrowing guarantee, or as a "separate benefit" under each program. In either case, the CWB contends that petitioners are simply recasting the same argument using different words, and that both approaches are equally inconsistent with the statute and the Department's regulations.

The CWB rejects the petitioners' position, generally, that the Department should consider the impact of the lending and initial payment guarantee on the CWB's cost of borrowing. Specifically, the CWB notes that the petitioners' approach (i.e., one financial contribution can have multiple "benefits") is clearly inconsistent with the statute. Thus, for example, the benefit conferred by the initial payment guarantee in reducing the CWB's borrowing costs cannot be "in addition" to the "direct" benefit that the petitioners allege to exist with respect to the initial payment guarantee.

Next, the CWB argues that the Department has consistently rejected consideration of the effect of one program on another program (i.e., "secondary consequences"), because such adjustments would be entirely speculative. Specifically, the Department's regulations have rejected considering "secondary consequences" with respect to tax consequences (19 C.F.R.§ 351.503(e)), equityworthiness (19 C.F.R. § 351.507(a)(4)(iii)), and creditworthiness (19 C.F.R. § 351.505(a)(4)(iii)). Therefore, the CWB concludes that the Department should apply the same

reasoning to the issue at hand.

Further, the CWB responds to the petitioners' assertion that the CWB's credit rating would hinge on the individual credit ratings of the sovereign countries that owe money to the CWB under the CGSP. As an initial matter, the CWB contends that this is impermissible because it would assume that the Department should calculate the benefit of the borrowing guarantee absent all government guarantees, an issue that the CWB disputes for the reasons described above. Second, the CWB argues that it is illogical to assume that, in the absence of all three guarantees, the CWB would maintain its full portfolio of credit receivables and the approximately C$ 7 billion in debt associated with those credit receivables.

*GOC's Argument*: The GOC rejects the petitioners' argument that the borrowing guarantee should be adjusted to reflect the lending and initial payment guarantees. The GOC notes that the lending guarantee was found in the Preliminary Determinations to be not countervailable because it is tied to non-U.S. markets. Therefore, according to the GOC, any portion of the CWB's credit rating due to the lending guarantee is also tied to non-U.S. markets and, therefore, cannot be used to measure the benefit of the borrowing guarantee.

*Department's Position:* We agree with the petitioners that the three GOC guarantees are fundamentally interrelated. As described in the Analysis of Programs section, above, we find that the GOC guarantees provide the CWB a comprehensive and multifaceted scheme of protection against financial risks because they explicitly shield the CWB from a variety of financial risks that the CWB would otherwise incur as a result of its operations. Thus, we agree with the petitioners that absent the guarantees, the CWB would receive a lower credit rating, and therefore, its cost of borrowing would increase. We find that in selecting the prime rate as the cost of borrowing that the CWB would face without the government's support, we have captured the entire benefit of that support. Therefore, we disagree with the petitioners that the benefit to the CWB from the comprehensive financial risk coverage provided by the GOC is in addition to the individual benefits of each of the guarantees. Indeed, countervailing these benefits separately and then jointly would amount to double-counting.

We disagree with the CWB that the approach we have adopted looks at the effects of subsidies. Instead, as explained in the Analysis of Programs section, above, the interrelatedness of the guarantees led us to conclude that they served jointly to protect the CWB from financial risk. Put simply, the comprehensive financial risk coverage provided by the GOC is the subsidy, not the effect of other subsidies.

Regarding the CWB's reference to the preambular language regarding the impact of the benefits of one subsidy on another, this principle is not codified in the regulations, except with respect to the tax consequences of subsidies. See 19 C.F.R. § 351.503(e). Consequently, there is no general requirement that the Department ignore for purposes of identifying the benefit what have come to be known as secondary consequences. In any event, as explained above, the Department has found that the comprehensive financial risk coverage provided to the CWB represents a single subsidy program with various interrelated elements. The Department's preference for not

considering the interrelation of benefits under *different* subsidy programs is therefore of no import to the benefit issue here.

We note that in explaining the Department's practice of ignoring past and current subsidies in determining the creditworthiness of a loan recipient, the preamble to the 1989 proposed regulations treated the issue as an application of the policy against attempting to evaluate secondary effects. See Countervailing Duties; Notice of Proposed Rulemaking, 54 FR 23366, 23370 (May 31, 1989) ("this approach takes into account the secondary effects of subsidies, a highly speculative exercise which the Department has avoided in other contexts"). When the creditworthiness practice was codified in the regulations at 19 C.F.R. § 351.505(a)(4)(iii), however, the Department was more specific, indicating that, "trying to adjust a company's financial ratios for previously received subsidies would be an extremely difficult and speculative exercise." See Preamble, 63 FR at 65368.

We find for two reasons that the regulatory guidance regarding creditworthiness is of no bearing on the proper determination of the benefit from the comprehensive financial risk coverage program. First, the Department is simply not making a creditworthiness determination here. Second, the Department is not "trying to adjust a company's financial ratios for previously received subsidies." On the contrary, the Department is determining the impact of a single risk coverage program, during the POI, on the CWB's credit costs. There is nothing more speculative about this exercise than about the Department's normal benefit calculations for loans and loan guarantees under section 771(5)(E) of the Act. We acknowledge that we may not be able to establish a perfect measure to calculate the benefit in the instant investigations. However, as described in Comment 14, below, the evidence on record supports our finding for the final determinations.

We also disagree with the CWB's claim that analyzing the joint impact of the program elements on the CWB's cost of funds is not feasible since any type of government subsidy has at least a theoretical effect on a company's benchmark cost of funds. The CWB is in effect claiming that an implication of the adoption of a "holistic" benefit methodology in this case is that, in the future, all subsidy programs will have to be treated as risk coverage programs. As explained in the Analysis of Programs section, above, the facts and circumstances surrounding the subsidy program at issue here are exceptional, particularly to the degree to which its various elements are interrelated. Despite the absence of explicit direction in the statute or the Department's regulations on how to analyze such a program, it is clear that we are not required to break it up into its constituent parts for purposes of identifying and calculating the benefit; nor are we required to find that it falls into one of the illustrative benefit categories set forth in section 771(5)(E) of the Act. The benefit methodologies for subsidy programs that do fall into one of the statutory categories – and for other subsidy programs that do not provide comprehensive risk coverage – are unaffected by our treatment of the comprehensive risk coverage program in this case.

We disagree with the CWB's and GOC's argument that the Department could not analyze the programs jointly because in the Preliminary Determinations, the Department found that the

lending guarantee is tied to markets other than the United States. A final determination takes into account information obtained after the preliminary determination. Here, we have collected additional pertinent information that has prompted us to reconsider the approach we took in our preliminary findings, including our finding on the lending guarantee. As explained above and in more detail in the Analysis of Programs section, we have determined that the many elements of the comprehensive financial risk coverage provided by the GOC comprise an integrated program that benefits the company as a whole; the benefit is thus not tied to particular markets.

**Comment 14: The Benchmark**

*CWB's Argument*: The CWB claims that the Department should calculate the benefit from the borrowing guarantee using the reports submitted by the CWB on April 14, 2003. Specifically, the CWB claims that it was directly responsive to the Department's request in the preliminary determinations for further information that would allow the Department "to more accurately estimate the credit rating of the CWB in the absence of the GOC guarantee, and the benchmark rates that would be applicable to the CWB with such a credit rating." See Preliminary Determinations, 68 FR at 11377. First, the CWB solicited a credit rating report from a rating agency which included the assumption that the CWB no longer had the borrowing guarantee. Subsequently, based on the credit rating, the CWB asked another firm to prepare an estimate of commercial paper rates that the CWB would have paid during the POI, absent the GOC guarantee of the CWB's borrowing.

The CWB argues that the interest rates contained therein are consistent with the Department's requirement for benchmark rates applicable to comparable commercial loans. Moreover, the CWB asserts that, as evidenced by the submitted reports, its interest rates would differ only slightly in the absence of the borrowing guarantee.

*Petitioners' Argument:* The petitioners refute the respondents' claim that the Department should base the benchmark on the reports submitted by the CWB, since in the petitioners' view, the reports contain major omissions and the CWB's counsel tightly controlled the assumptions, wording, and conclusions of the report. Therefore, the Department cannot use these reports to estimate the CWB's credit rating and cost of borrowing, absent the guarantee.

*GOC's Argument:* The GOC asserts that the only information on the record that shows what the CWB's cost of borrowing would be absent the borrowing guarantee are the reports submitted by the CWB. Therefore, according to the GOC, these interest rates should be used by the Department to calculate the benchmark. Moreover, the reports demonstrate that the CWB would still have access to the commercial paper market, even absent the borrowing guarantee.

*Department's Position*: As explained in our response to Comment 13, we are not calculating a separate benefit for the borrowing guarantee provided to the CWB. Therefore, the reports submitted by the CWB, which address what the CWB's credit rating would be in the absence of the borrowing guarantee only, are not germane.

**Comment 15: The Borrowing Guarantee Is Tied to Non-U.S. Markets**.

*CWB's Argument*: The CWB argues that the borrowing guarantee that it provided to the CWB is "tied" almost exclusively to the amount of the CWB's outstanding credit receivables, which result from export credit sales made under the CGSP and the ACF. The CWB states that the GOC has neither approved, nor has a single sale been made by the CWB to the U.S. market pursuant to either program.

According to the CWB, the benefit, if any, of the borrowing guarantee is, thus, tied to markets other than the United States, and not countervailable pursuant to section 351.525(b)(4) of the Department's regulations. The CWB argues that this practice is consistent with previous Department determinations[4] and the U.S. Court of Appeals for the Federal Circuit's ("CAFC") holding in Kajaria Iron Castings Pvt. Ltd. v. United States, 156 F.3d 1163, 1176 (CAFC 1998)("Kajaria"). Moreover, after removing any borrowing tied to these receivables, the remaining, non-tied portion yields a *de minimis* margin and, therefore, is too small to be considered.

The CWB asserts that in determining whether tying exists, the Department considers the government's intent at the time it approved the subsidy. See Industrial Phosphoric Acid from Israel: Final Results of Countervailing Duty Administrative Review, 63 FR 13626, 13630 (March 20, 1998; see also Preamble, 63 FR at 65348, 65403). In the instant proceedings, the CWB argues that the GOC intended for the CWB to borrow in order to finance its credit receivables. As evidence of the GOC's intentions, the CWB points to the formula approved by the GOC to project the CWB's borrowing limit for the forthcoming quarter, as well as the borrowing approval letter from the GOC to the CWB, which explicitly states that the funds be used for "accounts receivable relating to credit grain sales."

Finally, the CWB argues that, as a matter of fact, its borrowing was "tied" to non-U.S. credit grain sales because during the POI almost all of the money it borrowed was used to finance credit receivables, and only a small amount went to its financing requirements in another area.

The CWB also notes that the Department preliminarily found that any subsidies conferred by the lending guarantee are "tied" to markets that received the guarantees (i.e., non-U.S. markets), and thus, not countervailable. Therefore, the GOC asserts that the Department should find the borrowing guarantee, specifically approved to support the same credit sales, also not countervailable.

*GOC's Argument*: The GOC reiterates the CWB's argument that the borrowing guarantee is tied

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[4] See, e.g., Notice of Suspension of Countervailing Duty Investigation: Unprocessed Float Glass from Mexico, 49 FR 7264 (February 28, 1984); see also Certain Softwood Lumber Products from Canada, 67 FR 15545 (April 2, 2002) (Final Determination Decision Memorandum, Forest Renewal B.C. section at Comment 4)

to non-U.S. sales.

*Petitioners' Argument*: Petitioners challenge the "tying" argument by asserting that the GOC's guarantees provide profits that support all of the CWB's operations by reducing administrative and general expenses across-the-board. Specifically, the CWB is able to borrow against accrued, but unpaid, interest earnings on these credit receivables at favorable rates, and thereby generate profits based on the spread between its guaranteed borrowing rate and the guaranteed rate of interest theoretically being earned on the credit receivables.

Petitioners cites the preamble to the Department's regulations which discusses the possible scenarios in which the Department may deviate from its "tying" rules. "If subsidies allegedly tied to a particular product are in fact provided to the overall operations of a company, the Secretary will attribute the subsidy to sales of all products by the company." See Preamble, 63 FR at 65348, 65400. Thus, the benefit accruing from the guarantees is not tied to markets other than the United States.

Further, as a factual matter, petitioners dispute respondents' claim that there are no credit receivables on U.S. sales. Rather, petitioners argue that the CWB makes credit sales to the United States, albeit apart from sales made under the CGSP or ACF. Nonetheless, petitioners argue that the credit sales to the U.S. market would still be included in the credit receivables for which the CWB obtains borrowing authority.

Also, the CWB argues that because money is fungible, it is not reasonable to conclude that the CWB would use its borrowed funds to finance its credit receivables, and that its other funding requirements (e.g., farmer payments, financing ongoing operations) are financed through other means. Petitioners argue that it would be impossible to trace the use of borrowed funds or attribute their expenditure first to its credit receivables.

Finally, petitioners refutes the respondents' assertion that the borrowing guarantee is tied to non-U.S. markets because it is used to finance credit receivables, on the basis that such an analysis requires the Department to examine the effects of the subsidy (i.e., how the CWB used the funds). Such an analysis, petitioners argue, is contrary to the statute (see section 771(5)(C) of the Act).

*Department's Position*: As explained in the Analysis of Programs section and in our response to Comment 13, we are not analyzing the borrowing guarantee separately. Therefore, we do not reach the issue of whether any subsidy bestowed by the borrowing guarantee is tied to sales to a particular market. Moreover, there is no evidence that the comprehensive financial risk coverage provided by the GOC is tied to sales to particular markets.

**Comment 16: The Department's Analysis of the Initial Payment Guarantee is Based on Incomplete and Inaccurate Data**.

*Petitioners' Argument:* According to the petitioners, the Department's preliminary analysis of

the initial payment guarantee reflects the inaccurate assessment of Professor Furtan that an option does not have value if it is not traded at a particular strike price. The petitioners argue that this reasoning is faulty because there are situations in which there are no observable prices in the market. Further, the petitioners contend that the options data provided by Professor Furtan contain only settlement values and not values based on actual trades. The petitioners also claim that Professor Furtan's analysis and options data are for all Canada Western Red Spring ("CWRS") with a protein content of 13.5 percent. The petitioners contend that the proper comparison is with 2 CWRS 13.5.

The petitioners note that the GOC guarantees not only the initial payments but also the CWB's operating expenses. Therefore, the petitioners argue that any calculation of the cost of insuring against a deficit to the pools would have to include coverage for the operating expenses of the pools.

In addition to the guarantee on initial payments, the petitioners contend that the GOC also guarantees adjustments to the initial payment. According to the petitioners, the adjustments made to the initial payment by the CWB during the crop year effectively raise the GOC guaranteed amount upwards. Thus, the petitioners argue that the expected guarantee is not of the initial payment, but an amount higher than the initial payment. The petitioners claim that each adjustment payment results in a repricing of the original put option, with a new asset price, new strike price, and new duration.

For valuing the initial payment guarantee for durum using the Asian option model, the petitioners argue that the Department should only use durations of at least twelve months because the CWB's crop year is twelve months long. The petitioners also contend that the Department should use a volatility of 0.32 for hard red spring and 0.489 for durum, which is the annualized standard deviation of the daily high-low elevator prices for Northeast Montana maintained by the Montana Wheat & Barley Committee.

The petitioners claim that the Department can use put option values from the Minneapolis Grain Exchange ("MGE") or the Asian options model to value the initial payment guarantee. For hard red spring wheat, the petitioners argue that the Department should "average put options values using the most valuable option on each day that the strike price equivalent to the GOC guarantee is 'at the money'." The petitioners claim that this methodology yields a subsidy rate.

Alternatively, the petitioners argue that if the Department decides to use the Asian options methodology to value the guarantee, the Department should include the adjustments to the initial payment into its valuation and use a volatility of 0.32 and 0.489 for hard red spring wheat and durum, respectively. The petitioners claim that this methodology also yields a subsidy rate for both hard red spring wheat and durum.

*GOC's Argument:* The GOC rejects the petitioners' argument regarding the initial payment guarantee claiming that the Department correctly determined that the initial payment guarantee confers no benefit. The GOC argues that the petitioners' analysis of the initial payment

guarantee fails to consider that the risk to the pool declines over the course of the crop year as actual sales are made and revenue is received by the CWB during the pool period. According to the GOC, as the quantity of unsold product decreases, the risk that the pool will go into deficit will necessarily be reduced.

The GOC also argues that the petitioners misused the Asian option methodology by creating distorted volatility figures taken from unrepresentative data. The GOC claims that an objective application of the Asian option methodology would apply a volatility figure even lower than the conservative numbers relied upon by Professor Furtan. Further, the GOC objects to the petitioners' claim that a duration of at least twelve months should be used in conducting the Asian option methodology. According to the GOC, if the Department uses the twelve-month duration in the Asian option methodology, the Department would be assuming that the CWB sells none of its wheat until the end of the pool year, i.e., on July 31.

*CWB's Argument:* The CWB contends that the petitioners' criticisms of Professor Furtan's analysis of the MGE option prices are inaccurate. Specifically, the CWB challenges the petitioners' assertion that an option might have value even though it was not traded, or it might have had value on days other than days on which actual trades occurred. The CWB states that the option never traded because it did not have any value. Concerning the petitioners' claim that Professor Furtan's MGE data contained "only settlement values and not the last traded value," the CWB asserts that settlement values are based on current market prices for the option regardless whether there were buyers and sellers for the option. The CWB agrees that Professor Furtan mistated the value of the initial payment because the correct initial payment for comparing with MGE strike prices should have been the initial payment for No. 2 CWRS 13.5.

The CWB maintains that the petitioners' calculation of the benefit from the initial payment guarantee is fundamentally flawed. The CWB claims that the petitioners' failed to recognize that the risks associated with the initial payment guarantee steadily decline throughout the crop year. The CWB explains that the risk of a deficit occurring in a particular pool is a function of the expected price of the remaining unsold portion of the pool grain at any point during the crop year. According to the CWB, "because initial payments and adjustment payments are progressive approximations of the expected final average price per bushel for the entire pool, the risk that the average price will not be met declines as more grain is sold throughout the year." The CWB asserts that "the point of maximum risk" for the initial payment guarantee is at the beginning of the crop year on August 1 and as grain from the pool is sold in the course of the year, the risk of a deficit occurring becomes smaller and smaller as the year progresses.

The CWB contends that the petitioners made an error in comparing the initial payment, as increased by adjustment payments, to the prevailing strike prices on the MGE for a July 2002 put option equal to the adjusted initial payment. The CWB maintains that the initial payment guarantee insures against the final realized price in the pool will not be less than the total amount the CWB already paid to the farmers in the pool, plus operating costs of the pool. Thus, according to the CWB, the proper comparison to determine if there is value for the guarantee should be between the strike price on any given date and the breakeven price on that same date.

Further, the CWB claims that the petitioners made the same errors in their Asian option calculations. Additionally, the CWB disputes the volatility figures that the petitioners suggested for an Asian option calculation. Specifically, the CWB argues that the petitioners's use of cash prices for spring and durum wheat at isolated elevators in Northeast Montana to calculate volatility does not reflect the global movements in prices. The CWB asserts that volatilities based on the International Grain Council price data more appropriately reflect the global price risk that the CWB encounters. The CWB also claims that the petitioners' volatility calculations which are based on prior year's price data are in error. The CWB asserts that most volatility calculations for agricultural options rely not on historical volatility, but on the volatility in futures contracts for that crop year. Further, according to the CWB, the petitioners made an error in calculating volatilities based on the price movements within a range of protein and quality characteristics. The CWB claims that because the relative value of protein and quality shifts more dramatically in response to current market conditions, the measurement of price movements with a range of protein and quality characteristics is inherently more volatile than the volatility of prices for wheat with the same protein and quality characteristics.

The CWB challenges the petitioners' proposed twelve-month duration in any calculations using the Asian option method. The CWB claims that since the CWB sells wheat throughout the crop year, the risk of a deficit decreases and examining the range of values between a 6-month duration and a twelve-month duration is a reasonable indication of the period of time for which the average price risk captured by the initial payment guarantee is outstanding.

Finally, the CWB contends that petitioners' suggestion that the Department add operating costs to its initial payment calculations would result in double-counting the same expenses. The CWB claims that the initial payment levels and adjustment payments it recommends to the GOC for approval already include the projected operating costs for the pool. The CWB further claims that "at the time a payment is made, the strike price of the implicit option includes the projected operating expenses for the relevant pool." Therefore, the CWB asserts that adding the projected operating expenses to the initial and adjustment payments would amount to double-counting of the same expense.

*Department's Position*: As set forth in the Analysis of Programs section, above, we have valued the benefit of the initial payment guarantee in the context of the comprehensive financial risk coverage provided by the GOC. Therefore, we have not addressed these comments because they relate to the valuation of the initial payment guarantee in isolation.

## RECOMMENDATION

Based on our analysis of the comments received, we recommend adopting all of the above positions and adjusting all related countervailing duty calculations accordingly. If these recommendations are accepted, we will publish the final determinations of these investigations and the final countervailing duties calculation for the respondents in the Federal Register.

AGREE _________ DISAGREE _________

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James J. Jochum
Assistant Secretary
for Import Administration

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Date