



Ottawa, Friday, March 15, 2002

Appeal No. AP-2000-040

IN THE MATTER OF an appeal heard on February 15, 2001,
under section 67 of the *Customs Act*, R.S.C. 1985 (2d Supp.), c. 1;

AND IN THE MATTER OF decisions of the Commissioner of
the Canada Customs and Revenue Agency dated June 22, 2000,
with respect to a request for redetermination under
subsection 60(4) of the *Customs Act*.

BETWEEN

SABLE OFFSHORE ENERGY INCORPORATED

Appellant

AND

**THE COMMISSIONER OF THE CANADA CUSTOMS AND
REVENUE AGENCY**

Respondent

DECISION OF THE TRIBUNAL

The appeal is dismissed.

Richard Lafontaine
Richard Lafontaine
Presiding Member

Pierre Gosselin
Pierre Gosselin
Member

James A. Ogilvy
James A. Ogilvy
Member

Michel P. Granger
Michel P. Granger
Secretary



UNOFFICIAL SUMMARY

Appeal No. AP-2000-040

SABLE OFFSHORE ENERGY INCORPORATED

Appellant

AND

**THE COMMISSIONER OF THE CANADA CUSTOMS AND
REVENUE AGENCY**

Respondent

The issue in this appeal is whether the goods in issue are properly classified in heading Nos. 73.04, 73.05 and 73.06 as line pipe of a kind used for oil or gas pipelines, as determined by the respondent, or should be classified under tariff item No. 8479.89.99 as components of a functional unit, namely, a gas-processing machine, or, alternatively, under tariff item No. 8430.49.00 as components of fixed platforms, as claimed by the appellant.

The appellant argued that the offshore platforms at Thebaud, Venture and North Triumph gas fields and the onshore facilities at Goldboro and Point Tupper, Nova Scotia, constitute a functional unit, a gas-processing machine, whose objective is to take raw natural gas from the gas wells and transform it into saleable natural gas and byproducts. The appellant claims that the gas-processing machine should be classified as a functional unit in heading No. 84.79. The appellant argued that the line pipe in issue should also be classified with the functional unit, as the pipe is critical to the gas-processing function. Finally, while acknowledging that it can no longer appeal the classification of the other components of the functional unit because the time limits have passed, the appellant nevertheless argued that the fact that the goods entered under certain tariff items did not mean that they were properly classified and could not have been classified elsewhere.

The respondent argued that each facility carried out a specific function or, alternatively, a primary function that may have subsidiary functions, which would make the facility fall under a specific heading covered by Chapter 84. The respondent argued that the pipe is auxiliary to each of the functional units and is not a component of any of them. The line pipe is only a container and a means of transportation and does not contribute to the processing of the gas. Finally, the respondent argued that to accept that the facilities are a functional unit that should be classified as machines in heading No. 84.79 would lead to an absurd result, since a substantial number of the components were imported under different headings, subheadings and chapters. The Tribunal does not have the jurisdiction to make a ruling on any of these importations, as they are not before it.

HELD: The appeal is dismissed. The Tribunal is satisfied that the offshore platforms and the onshore facilities at Goldboro and Point Tupper, taken together, constitute a machine or a combination of machines that encompasses plants, equipment and apparatus. Their components are interconnected by the line pipe in issue. The Tribunal is satisfied that the machinery was purchased as a turnkey project and was intended, from the outset, to accomplish a clearly defined function, that of processing natural gas from its raw state into a saleable product. Therefore, the Tribunal agrees that, on a technical basis, the entire system could be regarded as a functional unit. However, in order to classify the pipes in issue as components of a functional unit, there must either be a properly classified functional unit to whose function they are essential or one that is still eligible to be classified and designated as such. The goods were imported under numerous chapters, headings and subheadings. There is no evidence that the machine or combination of machines was

classified under tariff item No. 8479.89.99, nor is there any evidence that any of the components were so classified. The Tribunal is of the view that components may not be classified in a heading appropriate to a functional unit that exists only in a technical sense. In the Tribunal's view, this would, for all practical purposes, permit the reclassification of goods that have already been classified and, as in this case, time-barred from reclassification. The Tribunal is not convinced that this was Parliament's intention.

In light of the above, the Tribunal concludes that it is not open to it to classify the pipe in issue under tariff item No. 8479.89.99. Therefore, the Tribunal finds that the line pipe is properly classified in heading Nos. 70.04, 70.05 and 70.06.

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| Place of Hearing: | Ottawa, Ontario |
| Date of Hearing: | February 15, 2001 |
| Date of Decision: | March 15, 2002 |
| Tribunal Members: | Richard Lafontaine, Presiding Member Pierre Gosselin, Member James A. Ogilvy, Member |
| Counsel for the Tribunal: | Michèle Hurteau |
| Clerk of the Tribunal: | Anne Turcotte |
| Appearances: | Richard A. Wagner and Larry N. James, for the appellant Susanne Pereira, for the respondent |

Appeal No. AP-2000-040

SABLE OFFSHORE ENERGY INCORPORATED

Appellant

AND

**THE COMMISSIONER OF THE CANADA CUSTOMS AND
REVENUE AGENCY**

Respondent

TRIBUNAL: RICHARD LAFONTAINE, Presiding Member
PIERRE GOSSELIN, Member
JAMES A. OGILVY, Member

REASONS FOR DECISION

INTRODUCTION

This is an appeal under section 67 of the *Customs Act*¹ from decisions of the Commissioner of the Canada Customs and Revenue Agency dated June 22, 2000, regarding line pipe made of steel of various grades, finishes and diameters (8 in. to 26 in.) imported into Canada in 1998 and 1999. The issue in this appeal is whether the goods in issue are properly classified in heading Nos. 73.04, 73.05 and 73.06 of the schedule to the *Customs Tariff*² as line pipe of a kind used for oil or gas pipelines, as determined by the respondent, or should be classified under tariff item No. 8479.89.99 as components of a functional unit, namely, a gas-processing machine, or, alternatively, under tariff item No. 8430.49.00 as components of fixed platforms, as claimed by the appellant.

The relevant tariff nomenclature is as follows:

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| 73.04 | Tubes, pipes and hollow profiles, seamless, of iron (other than cast iron) or steel. |
| 73.05 | Other tubes and pipes (for example, welded, riveted or similarly closed), having circular cross-sections, the external diameter of which exceeds 406.4 mm, of iron or steel. |
| 73.06 | Other tubes, pipes and hollow profiles (for example, open seam or welded, riveted or similarly closed), of iron or steel. |
| 84.19 | Machinery, plant or laboratory equipment, whether or not electrically heated, for the treatment of materials by a process involving a change of temperature such as heating, cooking, roasting, distilling, rectifying, sterilizing, pasteurizing, steaming, drying, evaporating, vaporizing, condensing or cooling, other than machinery or plant of a kind used for domestic purposes; instantaneous or storage water heaters, non-electric. |
| 84.21 | Centrifuges, including centrifugal dryers; filtering or purifying machinery and apparatus, for liquids or gases. |

1. R.S.C. 1985 (2d Supp.), c. 1 [hereinafter Act].
2. S.C. 1997, c. 36.

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|---------------|--|
| 84.30 | Other moving, grading, levelling, scraping, excavating, tamping, compacting, extracting or boring machinery, for earth, minerals or ores; pile-drivers and pile-extractors; snow-ploughs and snow blowers. |
| 8430.49.00 | --Other |
| 8430.49.00.60 | ---- Fixed platforms for the discovery or exploitation of off-shore deposits of oil or natural gas |
| 84.79 | Machines and mechanical appliances having individual functions, not specified or included elsewhere in this Chapter. |
| 8479.89 | --Other |
| 8479.89.99 | ---Other |
| 8479.89.99.94 | -----For the production of petroleum or gas |

EVIDENCE

Mr. David L. North, Operations Manager of Sable Offshore Energy Incorporated, and Mr. Herbert Jacklin, Deputy Project Manager of the Sable Offshore Energy Project, testified on behalf of the appellant.

Mr. North testified that the appellant is a joint venture whose prime purpose is to operate the facilities and to produce saleable products, such as natural gas, propane, butane and condensate. He described the various facilities comprising the Venture, North Triumph and Thebaud offshore platforms and the onshore gas and fractionation plants. Each facility is located at a distance from the others, and all are linked by pipes. The Venture platform's 18-in. pipeline and the North Triumph platform's 12-in. pipeline link those satellite platforms to the Thebaud wellhead/processing platform. The Thebaud platform has a 26-in. pipeline which connects it with the Goldboro facility. An 8-in. pipeline connects the Goldboro facility to the fractionation facility at Point Tupper. Mr. North testified that those pipes were the goods in issue.

Mr. North described the natural gas found in the ground at Sable Island, Nova Scotia, as being under very high pressure and at high temperatures. In this state, its primary constituent is probably water, and it also contains other problematic constituents such as wax, emulsions, H₂S and CO₂. Mr. North testified that natural gas, in its original state, is not a saleable product because of the water content and the heavier hydrocarbon components, such as propane, butane and condensate. To achieve saleable natural gas, the water and hydrocarbon components must be controlled.

Mr. North testified that pipe is used throughout the natural gas processing system. Because the material being handled is under pressure, it must be confined. Pipe is the means used to transport the material from one part of the process to another. Mr. North testified that processing also takes place as the gas moves through the pipe. He distinguished between gas extraction, which takes place up to the wellhead, and gas processing, which begins at the wellhead. Mr. North indicated that there could be no gas processing without the pipe.

Mr. North testified that the Goldboro facility is situated at a remote location because the appellant had identified a subsea pipeline route that would come ashore there. The location of the fractionation plant at Point Tupper was chosen, as it already had a crude oil storage facility of 7 million barrels and the infrastructure to move the condensate either by rail, by truck or by sea. Mr. North stated that the natural gas is shipped by truck or by rail, as those forms of transportation are less expensive. The biggest share of propane and butane transportation is done by rail.

Mr. North testified in detail as to the gas processing that takes place at the various facilities. He explained that the gas-processing operation begins at the wellheads at all three offshore locations. It is there that the pressure of the mixture is initially changed, allowing for the separation of constituents from natural gas to begin, as the liquids, which are in solution with the gas, start condensing as temperature and pressure are reduced. He explained that there were three phases to separation: two liquid phases – hydrocarbon liquid and water; and the gas separation phase. At the Thebaud platform, Mr. North testified, triethylene glycol is used to remove water by absorbing water vapour from the gas streams coming from the Venture, North Triumph and Thebaud facilities. The remaining mix of natural gas and hydrocarbon liquid then goes through a 26-in. pipeline to the Goldboro facility. There, the slug catcher, a series of long, 48-in. pipes with a slope that causes the liquids to run to one end, allows the liquids to be collected and separated from the gas. The natural gas comes off the top of the slug catcher and goes through an inlet separation process, where the pressure is dropped so that more liquid is taken off and joins the liquid stream coming out of the slug catcher. Final processing to produce saleable gas then takes place within the Goldboro facility. For their part, the liquids are shipped to the natural gas liquid processing plant at the Point Tupper facility. Mr. North testified that the gas processing ends when there is a saleable product. The saleable products are the gas, which flows through the transmission pipeline from the Goldboro facility to market, and the propane, butane and condensate, which are the products processed at Point Tupper. Mr. North testified that, during the processing, the gas is always in a pipe.

Mr. North indicated that the transmission pipeline does not process gas. The distinction between the transmission pipeline and the pipe previously discussed is that the gas that enters the transmission pipeline is exactly the same as the gas that exits it, while the gas that comes out of the facilities differs markedly from the gas that exits the wellhead because it is being processed along the system.

In Mr. North's view, the gas-processing equipment and the onshore facilities and offshore platforms are a functional unit, and it is essential that they function together in order to keep the operation going. There may be interruptions, but within a period of 24 hours following an interruption, the system would shut down. The only exception is the offshore platforms, as the operations could continue if the Venture and/or North Triumph platforms were to shut down. However, if the Thebaud facility were to shut down, the whole system could not operate, and both the Point Tupper and the Goldboro facilities would also be shut down, as they could not make saleable quality natural gas. In concluding his testimony, Mr. North agreed that the onshore facilities and offshore platforms met the definition of a gas-processing plant.

In cross-examination, Mr. North explained that the purpose of a drilling rig is to drill down into or below the seabed, to reach the hydrocarbon reservoir. The rig is part of the extraction process, but is not part of gas processing. Once the gas gets through the choke in the wellhead, the extraction is complete and the processing begins. He stated that the extraction is a continuous process.

In response to the question as to whether there could be a fractionation plant without a gas-processing plant, Mr. North testified that there needs to be a gas-processing plant with the fractionation plant to provide some way of separating the hydrocarbon liquids. Mr. North indicated that the offshore pipe is, in some respects, involved in the processing, in that, by slowing up the speed of the gas travelling in the line, the liquids separate in the line. The speed is controlled at the Goldboro and Thebaud facilities. Mr. North admitted that the pipe itself does nothing to change the speed of the gas in the pipe and likened this to the process in distillation columns, in that they themselves do nothing, but the change of heat in the columns will boil off some of the liquids. Mr. North agreed that the pipe is a space to house the materials and that it is the materials themselves that are changing. The physical conditions of the materials change because of the rate of flow, the temperature and the pressure.

In answer to the Tribunal's question as to whether the system described could have more than one function, Mr. North described the function as taking a natural resource and converting it into a saleable product. He stated that the Point Tupper facility does not have a describable function on its own. He also testified that the pipes that connect the satellites to the Thebaud platform are the same as those that connect the Goldboro and Point Tupper facilities. The diameters of the pipe differ.

Mr. Jacklin provided an overview of the companies that formed the alliance established to design, construct, install, start up and test the gas-processing facilities on a turnkey basis. He testified that the alliance was not involved in the exploration for gas or in drilling the wells for the project. The alliance was contracted to deliver the entire gas-processing facilities that were described by Mr. North. Mr. Jacklin referred to the "Design Intent"³ where a description of the facilities can be found.

Mr. Jacklin testified that the pipeline that connects the North Triumph and Venture platforms to the Thebaud platform and the pipeline that connects the Thebaud platform to the onshore facilities at Goldboro constitutes the interfield gathering systems. With respect to the transmission pipeline, Mr. Jacklin indicated that the alliance was contracted to build it, but that it was separate from the contract for the facilities. Mr. Jacklin explained that the processing of the gas, including the time during which the gas is in the pipe, was a critical element of the process design. There were also functional specifications for each component of the facilities. Mr. Jacklin explained that specific criteria for the actual project were applied to the pipe; in this case, the criterion was the pressure of the fluid within the pipe. The project team also had to take into account the installation of the pipe, as the mechanical requirements for laying offshore pipe in 300 metres of water vary from those for laying pipe in a trench. Therefore, within the standard, one could more precisely define the metallurgy and the thickness of the product.

Mr. Jacklin testified that approximately 83 percent of all materials and equipment for the gas-processing plant, including the pipeline, were imported. In his view, the line pipe that was purchased is used as an integral component of the gas-processing plant that the alliance was contracted to design, build and deliver. Mr. Jacklin testified that the plant cannot function without the line pipe in issue because, if it does not function to design, then the plant cannot deliver on the contractual requirements.

In cross-examination, Mr. Jacklin said that the alliance received goods, such as machinery or component parts that were used in the construction of the facilities, from Canadian suppliers. This amounted to 17 percent Canadian-sourced materials. He also stated that the facilities were built piece by piece and that the Canadian components were integrated into the facilities at the time of construction. He acknowledged that no one supplier could provide the alliance with an entire gas-processing facility.

In response to the Tribunal's questions, Mr. Jacklin indicated that there is no difference in the purpose of the overall activity of a line pipe and a process pipe. The difference lies in how the pipe is specified and the codes to which it is specified. He also stated that the platforms and the Goldboro and Point Tupper facilities could have been awarded to three different construction groups at different times. In essence, it came down to the contracting strategy and to risk aversion of the contractors. With respect to the location of the gas plants and fractionation plants, Mr. Jacklin responded that it is quite usual for a gas plant and a fractionation plant to be situated together.

Mr. Denis Blondin, Senior Appeals Officer with the Canada Customs and Revenue Agency, testified as to how the transactions of imported goods for the appellant were gathered and retrieved and as to

3. Appellant's Exhibit A-6, Exhibit 10.

how the information contained in the respondent's Book of Documents⁴ was structured. In cross-examination, Mr. Blondin admitted that the lists of imports show only those goods imported by the appellant and would not include imports by any other person, even though that person may have purchased for the appellant.

ARGUMENT

The appellant argued that the line pipe is an integral component of a machine, which is a functional unit, being a gas-processing machine, and should be classified under tariff item No. 8479.89.99 as "[o]ther [m]achines and mechanical appliances having individual functions, not specified or included elsewhere in this Chapter [f]or the production of petroleum or gas". The appellant submitted that it contracted with the alliance to purchase a gas-processing machine, which was imported, and that its function was to process raw gas obtained at the wellheads into saleable gas through the platforms and the Goldboro and Point Tupper facilities. In the alternative, the appellant argued that the line pipe should be classified under tariff item No. 8430.49.00 as components of fixed platforms, extracting machinery.

The appellant submitted that the facts and the evidence establish that the objective of the gas project is to take raw natural gas from the gas wells off the Scotia Shelf near Sable Island and to transform it into saleable natural gas products, such as gas, butane, propane or condensate. The evidence also shows that the appellant contracted with the alliance for the design, building and construction of a gas-processing plant. A gas-processing plant contemplates transforming gas into a saleable product. The testimony also shows that, in order to transform the raw material into saleable products, the process has to be continuous and that it cannot be completely or partially stopped. The appellant's witnesses testified that, if one part of the facilities were shut down, the entire process would need to be stopped. Therefore, the appellant submitted that the gas-processing plant is one machine.

The appellant submitted that, where a machine is not covered by any other particular heading of Chapter 84, it is covered by heading No. 84.79. Note 4 to Section XVI and the related *Explanatory Notes to the Harmonized Commodity Description and Coding System*,⁵ which describe a functional unit, provide that, if a machine, including a combination of machines, is intended to contribute to a clearly defined function, then the whole machine and all its components are to be classified in the appropriate heading of Chapter 84. In this case, the appropriate classification of the gas-processing machine is in heading No. 84.79 as a functional unit, as the gas-processing facility is a machine having an individual function not elsewhere specified in Chapter 84. Moreover, the components, such as the pipe in issue, should be classified with the functional unit, as they also contribute to the gas-processing machine.

The appellant also submitted that the components of a functional unit need not be imported all at the same time. There may be a series of customs entries. One must look at the true nature of the transaction, what was contracted and whether the contract was for a functional unit. In this case, the appellant stated that the essence of the transaction was a contract by it to purchase a gas-processing machine. The appellant relied on a number of cases to support its position that complex machines consisting of various components can qualify as functional units, even where the various components are imported over a period of time.⁶

4. See respondent's confidential Exhibit AP-2000-040 B-1.

5. Customs Co-operation Council, 2d ed. Brussels, 1996 [hereinafter Explanatory Notes].

6. *Windsor Wafers, Division of Beatrice Foods v. DMNRCE* (21 November 1991), AP-89-281 (CITT) [hereinafter *Windsor Wafers*]; *Grinnell Corp. of Canada v. DMNR* (14 February 1997), AP-95-254 (CITT) [hereinafter *Grinnell*]; *Asea Brown Boveri v. DMNR* (5 November 1996), AP-95-189 [hereinafter *Asea Brown Boveri*].

Dealing with the issue of the gas-processing facility being a machine, the appellant pointed to the witnesses' testimony and the exhibits that establish that gas processing is a continuous process that is an individual identifiable function for a machine. The process takes raw natural gas and changes it into saleable products, such as gas, propane, butane and condensate. The appellant submitted that the machine is for gas processing and that it is made of a series of machines and components. The gas-processing machine meets the test for machines, in that it is a complex combination of parts and, since it is not identified in any heading and is an identifiable machine, it must be classified in heading No. 84.79, which is for machines not otherwise specified or provided for in Chapter 84.

With respect to whether the gas-processing plant is a functional unit, the appellant indicated that the evidence was clear that the alliance bought the machine on a turnkey basis. Further, it was designed and built as a gas-processing plant. The gas-processing plant meets the three elements of Note 4 to Section XVI, in that it is a machine or a combination of machines consisting of individual components, including the line pipe in issue, which contribute together to a clearly defined function, in this case, to process gas.

Turning to the issue of the classification of the line pipe in issue, the appellant argued that, where there is a continuous process, case law has recognized that all the equipment used in that process is included as part of that process.⁷ Case law has also recognized that pipes and pipelines are used directly in the production and manufacture of natural gas.⁸ Moreover, Note 4 to Section XVI recognizes that pipes and pipelines are part of a functional unit, such as in *Grinnell*, where the sprinkler system, including the pipe that ran the water throughout the system, was included in heading No. 84.79. On that basis, the appellant submitted that the pipe is critical to the gas-processing function of the gas-processing machine, which should be classified as a functional unit under tariff item No. 8479.89.99.

The appellant also argued that, where the line pipe is an integral part of a machine, as in this case, it cannot be classified in Chapter 73. Note 1(f) to Section XV, relating to base metals and articles of base metal, does not cover articles of Section XVI (machinery, mechanical appliances and electrical goods). Therefore, in the appellant's view, where the line pipe can fall under Chapter 73, but is part of articles that are machinery, mechanical appliances or electrical goods, that pipe cannot be classified in Chapter 73.

Finally, turning to the issue of the substance of the import transaction, the appellant argued that a machine, even if it is incomplete at the time of importation, can be classified as a machine if it has the essential character of the finished article. The appellant contended that, on the evidence, the substance of the import transaction for the line pipe was one of a series of transactions by which the pipe was imported. The purpose of the series of transactions was to import the processing plant. As 83 percent of the physical components of the entire plant were imported, it is the appellant's submission that the entire plant was imported. Pursuant to Rule 2 (a) of the *General Rules for the Interpretation of the Harmonized System*,⁹ as most of the machine was imported, its essential character is that of a gas-processing machine. The fact that there were multiple purchase orders over a two-year period does not detract from the fact that the gas-processing machine is a functional unit that was imported.¹⁰

In the alternative, the appellant argued that the Thebaud, Venture and North Triumph platforms were imported as complete units under classification No. 8430.49.00.60 as other extracting machinery for minerals. The appellant submitted that, given that the platforms were imported as functional units and given

7. See *DMNRCE v. Hydro-Québec*, [1994] 172 N.R. 247.

8. See *Amoco Canada Petroleum v. DMNRCE*, [1983] 5 C.E.R. 442 at 445-46.

9. *Supra* note 2, Schedule [hereinafter General Rules].

10. *Supra* note 6, *Windsor Wafers* and *Asea Brown Boveri*.

the evidence that there is gas processing from the platforms to the gas plant, the line pipe connecting the platforms is integral to their operation. Without the line pipe taking the gas elsewhere, there would be no reason for the platforms to be there. In the appellant's view, if the platforms are not part of a functional unit for gas processing, then the platforms exist to exploit natural gas. The appellant submitted that the line pipe is a very integral aspect of the exploitation, because without the pipe there is no gas exploitation. Therefore, the line pipe on the platforms and the pipeline connecting them to each other and to the Goldboro facility are integral parts of the platforms, and the line pipe and platforms form a functional unit. Therefore, the pipes are connected to either the processing, exploitation or extraction function that falls within the general rubric of classification No. 8430.49.00.60.

According to the appellant, the evidence indicated that there was processing of the gas in the pipe in issue and that the gas that exited the pipe was different from that going through the pipe. The pipe in issue differed from the transmission pipeline, in that the evidence clearly showed that the gas entering the transmission pipeline is the same as that exiting the pipeline. The evidence showed that the line pipe in issue was designed to include the processing of the gas.

In rebuttal, the appellant addressed the issue of whether the other goods had been properly classified or could have been classified elsewhere, an issue which, it admitted, had arisen in putting the case together. The appellant argued that the fact that the goods entered under certain tariff items did not necessarily mean that they were properly classified and could not have been classified elsewhere. The appellant admitted that it can no longer appeal these classifications because the expiry limits have passed and that it is, therefore, statute-barred from asking for reclassification of the other goods. However, in the appellant's view, it is open to the Tribunal to find that the goods, including the line pipe in issue, should have been classified as a functional unit.

The respondent argued that each facility carried out a specific function or, alternatively, a primary function that may have a number of other subsidiary functions, making each of the facilities fall in a specific heading of Chapter 84. Because each of the facilities is unto itself a functional unit and is covered by a heading of Chapter 84, the collective facilities cannot be a functional unit in heading No. 84.79. Moreover, in the respondent's submission, the evidence clearly establishes that each of the facilities has a specific or, alternatively, a primary function specific enough for each of the facilities to fall in a specific heading rather than in a general catch-all heading, in this case, heading No. 84.79.

The respondent argued that, while the appellant attempted to characterize the various individual platforms collectively as a single plant with one function, the information and the testimony of the appellant's witnesses clearly indicate that each facility has its own function. The primary function of the Thebaud facility is the extraction of natural gas. While the testimony indicates that there is some gas processing done at the offshore facilities, the evidence is that the processing is not significant when compared with the processing done at the Goldboro facility and the fractionation done at the Point Tupper facility. The respondent submitted that Mr. North's testimony indicated that the primary function of the Goldboro facility is to separate the different components of the natural gas that comes from the offshore facilities and to process it into saleable gas, which is then sent to market via the transmission pipeline. It was also clear from the evidence that the Point Tupper facility has only one primary function, that of fractionation. For that reason, the respondent argued, it could not be said that the collective facilities together are a functional unit in heading No. 84.79. Therefore, each facility should be classified in its own heading. The fractionation plant at Point Tupper should be classified in heading No. 84.19 because the evidence was that the process at the plant involves a temperature change that heats up the material and then cools it. In the case of the Goldboro facility, the respondent argued, the evidence indicated that there is a purification

process that occurs and, therefore, this facility should be classified in heading No. 84.21. In the case of the offshore extraction facilities, the respondent submitted that they should be classified in heading No. 84.30.

The respondent submitted that the Explanatory Notes to heading No. 84.79 excluded the onshore and offshore facilities because that heading is restricted to machinery that is covered by no other heading, as pertains to its function, description or type. According to the respondent, if each of the facilities has more than one function, reference should be had to Note 7 to Chapter 84. The respondent submitted that the pipelines are auxiliary to each of the functional units and are not components of any of them. The pipelines are purely for the purpose of transporting the crude material from one facility to another. According to the evidence, some processing did occur in the pipeline, although, in the respondent's submission, the processing is minimal and is not done as a result of the line pipe itself. The line pipe is simply a container, a method of transportation. And while pipe is used, it is not the only transportation available. The gas could be transported by ship, although this may not be economical.

Moreover, the respondent submitted that the evidence was that the processing was controlled from the Goldboro facility, which changes the speed at which the raw material travels through the line pipes and, therefore, causes the separation of the liquids from the raw gas. The line pipes themselves do not contribute to the actual processing. The materials inside the pipes are separated by a combination of the slope of the line pipe and the speed at which the raw materials are travelling. The processing is not inherent to the pipes themselves. In conclusion on this point, the respondent contended that, even if each facility was found to be a functional unit, the line pipe is simply auxiliary because it is economically more feasible to use line pipe than ships. The line pipe does not contribute directly to the overall function.

The respondent argued that, if the appellant's argument were to be accepted, in that the facilities are a functional unit which should be classified in heading No. 84.79, it would lead to an absurd result, as a substantial number of the components were imported in different chapters, headings and subheadings. Further, if the appellant now claims that all these goods are a functional unit, it would be absurd to say that only the line pipes should be classified in heading No. 84.79. Moreover, line pipes, which are not machines in and of themselves, are passive. Therefore, to have them classified as part of a functional unit or part of machinery, when the actual machinery or the actual facility is not classified in heading No. 84.79 and was imported in other headings, would lead to an absurd result. According to the respondent, the Tribunal does not have the jurisdiction to make a ruling on any of these importations because they are not before it.

The respondent does not take issue with the fact that some goods were imported in 1998 and others in 1999, acknowledging that components that are parts of a functional unit may be imported at different times. However, if the intention of the importer is to use all the small individual component parts and incorporate them into a functional unit, then it makes sense to import all the components in the heading of the functional unit or under the tariff item of a functional unit. According to the respondent, that is not the case here.

The respondent referred to the CCRA's administrative policy,¹¹ which sets out a three-part test:

- (a) the various components make up a commercial unit which is advertised and sold at a single price;
- (b) the various components were purchased as a unit on one contract or a single purchase order; and

11. CCRA, "Administrative Policy – Tariff Interpretation of 'Functional Units'", Memorandum D10-13-2 (3 April 1992) [hereinafter administrative policy].

(c) the sole function of the various components that comprise the integral unit cannot be accomplished if any single component is removed.

The respondent submitted that the appellant did not meet the first part of the test because the purchase involved the individual components which, in turn, helped construct the unit. Nor, the respondent submitted, has the appellant met the second test. While *Windsor Wafers* may suggest that there could be more than one purchase order, the facts of that case suggest that there was only one purchase order, which is distinguishable from this case in which there were numerous purchase orders. As two parts of the test were not met, the respondent contended that the facilities are not a functional unit collectively and cannot be classified in heading No. 84.79.

The respondent also pointed out that the administrative policy refers to the Canadian content of the components that constitute the facilities. The evidence was that there was Canadian content in every one of the facilities, which included not only physical components but labour and services. According to the testimony, the physical components are integral to the functioning of each facility. The respondent submitted that the actual percentage of Canadian content was irrelevant, given that the goods in issue were integrated or combined with other domestically sourced or supplied components to form a functional unit and that the case is about whether the facilities form one functional unit or whether each facility is its own functional unit. The respondent argued that, if essential character, pursuant to Rule 2 of the General Rules, was being relied on to establish foreign content, then the essential character of the Thebaud and Venture facilities is that of an extraction facility; the essential character of the Goldboro facility is that of a filtering or purification plant; and the essential character of the Point Tupper facility is that of a fractionation plant.

In conclusion, the respondent stated that the evidence was clear that the goods in issue are auxiliary to each of the different facilities and that each facility falls in its own heading. Consequently, the goods in issue should not be classified in heading No. 84.79.

DECISION

Section 10 of the *Customs Tariff* provides that the classification of imported goods under a tariff item shall be determined in accordance with the General Rules and the *Canadian Rules*.¹² Section 11 of the *Customs Tariff* provides that, in interpreting the headings and subheadings of the schedule, regard shall be had to the *Compendium of Classification Opinions to the Harmonized Commodity Description and Coding System*¹³ and the Explanatory Notes.

The General Rules are structured in a cascading form. If the classification of an article cannot be determined in accordance with Rule 1, then regard must be had to Rule 2, etc. Rule 1 provides the following:

The titles of Sections, Chapters and sub-Chapters are provided for ease of reference only; for legal purposes, classification shall be determined according to the terms of the headings and any relative Section or Chapter Notes and, provided such headings or Notes do not otherwise require, according to the following provisions.

Moreover, Rule 1 of the *Canadian Rules* reiterates that the classification of goods under the tariff items of a subheading or of a heading shall be determined according to the General Rules.

12. *Supra* note 2, schedule.

13. Customs Co-operation Council, 1st ed., Brussels, 1987.

The Tribunal must now decide whether the pipes are part of one functional unit, part of several functional units or simply line pipes.

The Tribunal first reviewed the evidence and testimony to determine whether the pipe in issue should be classified as a component of a single functional unit, that being a gas-processing machine, under tariff item No. 8479.89.99.

Note 4 to Section XVI reads as follows:

Where a machine (including a combination of machines) consists of individual components (whether separate or interconnected by piping, by transmission devices, by electric cables or by other devices) intended to contribute together to a clearly defined function covered by one of the headings in Chapter 84 or Chapter 85, then the whole falls to be classified in the heading appropriate to that function.

The appellant gave testimony and argument to the effect that the conversion of the raw natural gas that emerges from the ground into saleable natural gas products is a single, continuous process that begins at the wellhead and progresses through both the offshore platforms and onshore facilities, to the point at which saleable gas and associated products are ready for market. The appellant further noted, under cross-examination, that pipe is required throughout the process, since the substance being refined would dissipate if it were not contained. The appellant also made it clear that the products are not saleable until they have completed the processing cycle, to emerge as saleable natural gas at the outlet flange of the Goldboro facility, or as other saleable products, such as propane, butane and condensate, after processing at the Point Tupper facility. The appellant also testified to a number of actions, such as the control of the speed of flow of the gas through the pipes, which require mechanisms that together contribute to the process of refining the raw material.

Note 5 to Section XVI reads as follows:

For the purpose of these Notes, the expression “machine” means any machine, machinery, plant, equipment, apparatus or appliance cited in the headings of Chapter 84 or 85.

The Tribunal is satisfied that the offshore platforms and the Goldboro and Point Tupper facilities, taken together, constitute a machine or a combination of machines, a term that encompasses, *inter alia*, plants, equipment and apparatus. Further, it is clear that their individual components are interconnected by the line pipe in issue. The Tribunal views this arrangement as analogous to the interconnections between parts of a milking machine, an example of a functional unit provided in the Explanatory Notes to Section XVI.¹⁴ In addition, the appellant made it clear that the processing function would be identical if all components were collocated on a gas field. The Tribunal also sees the complete system as analogous to an asphalt plant, another example of a functional unit provided in the Explanatory Notes to Section XVI. The mere fact of geographic separation of the components in this case does not, in the Tribunal’s view, prevent the whole from being regarded as a functional unit.

In his brief, the respondent argued that the functions of the offshore platforms and the Goldboro and Point Tupper facilities should be seen as separate and distinguishable and pursued this approach in oral argument. However, in the Tribunal’s view, these functions should not be separated. The evidence and testimony demonstrate to the Tribunal’s satisfaction that the machinery was purchased as a turnkey project and was intended, from the outset, to accomplish a clearly defined function, that being the processing of

14. “Milking machines with separate component parts (vacuum pump, pulsator, teat-cups and pails) interconnected by hoses or piping (heading 84.34).”

natural gas from its raw state at the wellhead into saleable products. The Tribunal is also of the view that, in principle, the classification of the goods in issue, namely, the line pipe, in a heading of Chapter 84 would be appropriate. Therefore, the Tribunal is in agreement with the appellant that, on a technical basis, the entire system of facilities taken together, beginning at the wellhead and progressing through all the steps to the production of saleable products, could be regarded as a single functional unit under tariff item No. 8479.89.99.

In view of the foregoing conclusion, the Tribunal need not consider whether the goods in issue are components of several functional units.

That having been said, Note 4 to Section XVI stipulates that, where a machine or a combination of machines consists of individual components intended to contribute together to a clearly defined function covered by one of the headings in Chapter 84 or Chapter 85, then the whole falls to be classified in the heading appropriate to that function.

The Tribunal is of the view that, in order to classify the pipes in issue as components of a functional unit, there must be either a properly classified functional unit to whose function they are essential or one that is still eligible to be classified and designated as such. The goods that were imported in this case were imported in numerous chapters, headings and subheadings. The appellant argued that the onshore and offshore facilities are a functional unit that is classifiable under tariff item No. 8479.89.99. There is no evidence that the machine or combination of machines was classified under tariff item No. 8479.89.99, nor is there any evidence that any of the components have been so classified. Also, no machine or combination of machines is actually before the Tribunal for classification under that tariff item, nor are any other components, except for the goods in issue. Indeed, save in the case of the goods in issue, the appellant admitted that it was statute-barred from bringing those items forward for purposes of classification.

The Tribunal is of the view that components may not be classified in a heading appropriate to a functional unit that exists only in a technical sense. In this connection, the appellant argued that, for purposes of classifying its components, the Tribunal is entitled to rely only on what “should be” the proper classification of the machine or combination of machines that makes up a functional unit. In the Tribunal’s view, this would, for all practical purposes, permit the reclassification of goods that have already been classified and, as in this case, are time-barred from reclassification. The Tribunal is not convinced that this was Parliament’s intention. This, in its view, would lead to absurd results and create uncertainty in the marketplace, while the whole purpose of the *Harmonized Commodity Description and Coding System* is the opposite. For example, components or parts not yet classified would benefit from a classification from which other parts or components of the same machine that were already classified and time-barred would not benefit. The Tribunal is not persuaded that Parliament contemplated such a regime of dual classification. The Tribunal cannot find support for the appellant’s proposition in either the *Customs Tariff* or the Act. Nor can it find support for the proposition in the relevant Section or Chapter Notes to the *Harmonized Commodity Description and Coding System*. The Explanatory Notes are also of no assistance in this regard.

In light of the above, the Tribunal is of the view that it is not open to it to classify the pipe in issue under tariff item No. 8479.89.99, as claimed by the appellant. Therefore, the Tribunal finds that the line pipe is properly classified in heading Nos. 73.04, 73.05 and 73.06.

Consequently, the appeal is dismissed.

Richard Lafontaine
Richard Lafontaine
Presiding Member

Pierre Gosselin
Pierre Gosselin
Member

James A. Ogilvy
James A. Ogilvy
Member



Ottawa, Wednesday, March 20, 2002

Appeal No. AP-2000-040

IN THE MATTER OF an appeal heard on February 15, 2001,
under section 67 of the *Customs Act*, R.S.C. 1985 (2d Supp.), c. 1;

AND IN THE MATTER OF decisions of the Commissioner of
the Canada Customs and Revenue Agency dated June 22, 2000,
with respect to a request for redetermination under
subsection 60(4) of the *Customs Act*.

BETWEEN

SABLE OFFSHORE ENERGY INCORPORATED

Appellant

AND

**THE COMMISSIONER OF THE CANADA CUSTOMS AND
REVENUE AGENCY**

Respondent

CORRIGENDUM

In the English version of the Unofficial Summary, the heading numbers listed in the last sentence should have been “73.04, 73.05 and 73.06”.

By order of the Tribunal,

Michel P. Granger
Secretary