

Ottawa, Tuesday, May 18, 1999

Appeal No. AP-95-128

IN THE MATTER OF an appeal heard on December 1, 1998,
under section 67 of the *Customs Act*, R.S.C. 1985, c. 1
(2nd Supp.);

AND IN THE MATTER OF decisions of the Deputy Minister of
National Revenue dated May 31 and July 24, 1995, with respect to
requests for re-determination under section 63 of the *Customs Act*.

BETWEEN

NOWSCO WELL SERVICE LTD.

Appellant

AND

THE DEPUTY MINISTER OF NATIONAL REVENUE

Respondent

DECISION OF THE TRIBUNAL

The appeal is dismissed.

Pierre Gosselin
Pierre Gosselin
Presiding Member

Peter F. Thalheimer
Peter F. Thalheimer
Member

Richard Lafontaine
Richard Lafontaine
Member

Michel P. Granger
Michel P. Granger
Secretary

UNOFFICIAL SUMMARY

Appeal No. AP-95-128

NOWSCO WELL SERVICE LTD.

Appellant

and

THE DEPUTY MINISTER OF NATIONAL REVENUE

Respondent

This is an appeal under section 67 of the *Customs Act* from decisions of the Deputy Minister of National Revenue made under section 63 of the *Customs Act*. The goods in issue are coiled tubing. There is no issue in this appeal as to the proper tariff classification of the goods in issue. The issue in this appeal is whether the goods in issue qualify for duty relief under Code 1485 or 1553 of Schedule II to the *Customs Tariff*.

HELD: The appeal is dismissed. With respect to Code 1485, the Tribunal is not persuaded that the goods in issue are “materials” or that the processing of the ends of the goods in issue is sufficient in scope or alters the goods to such an extent as to constitute manufacture. With respect to Code 1553, the Tribunal is not persuaded that the goods in issue are machinery, apparatus or parts thereof.

Places of Video Conference

Hearing: Hull, Quebec, and Calgary, Alberta
Date of Hearing: December 1, 1998
Date of Decision: May 18, 1999

Tribunal Members: Pierre Gosselin, Presiding Member
Peter F. Thalheimer, Member
Richard Lafontaine, Member

Counsel for the Tribunal: John L. Syme

Clerks of the Tribunal: Margaret Fisher and Anne Turcotte

Appearances: Barry P. Korchmar, for the appellant
Jocelyn Sigouin, for the respondent

Appeal No. AP-95-128

NOWSCO WELL SERVICE LTD.

Appellant

and

THE DEPUTY MINISTER OF NATIONAL REVENUE

Respondent

TRIBUNAL: PIERRE GOSSELIN, Presiding Member
 PETER F. THALHEIMER, Member
 RICHARD LAFONTAINE, Member

REASONS FOR DECISION

INTRODUCTION

This is an appeal under section 67 of the *Customs Act*¹ (the Act) from decisions of the Deputy Minister of National Revenue made under section 63 of the Act. The goods in issue are coiled tubing. Coiled tubing is manufactured from strips of low-alloy mild steel which are precision cut, rolled and seam welded in a range of diameters up to 3 ½ inches. For transport, the finished product is rolled onto wooden spools in lengths of up to 12,000 feet. The appellant imported a quantity of such tubing into Canada during 1993 and 1994, and certain of those imports form the basis of this appeal.²

There is no issue in this appeal as to the proper tariff classification of the goods in issue, both parties agreeing that the goods are properly classified under tariff item No. 7306.50.00 of Schedule I to the *Customs Tariff*.³ The issue in this appeal is whether the goods in issue qualify for duty relief under Code 1458 or 1553 of Schedule II to the *Customs Tariff*.

At all times relevant to this appeal, subsection 68(2) of the *Customs Tariff* provided that the customs duties imposed under Part I of the *Customs Tariff* were to be reduced or removed as provided for in, *inter alia*, Schedule II to the *Customs Tariff*. Among the goods in Schedule II in respect of which duties were to be removed were as follows:

1. R.S.C. 1985, c. 1 (2nd Supp.).
- 2.

| B3 Entry No. | B3 date | Section 63(3) Decision |
|---------------------|--------------------|-------------------------------|
| 13086-011285973 | October 15, 1993 | May 31, 1995 |
| 13086-012204261 | April 7, 1994 | July 24, 1995 |
| 13086-012228884 | June 9, 1994 | July 24, 1995 |
| 13086-013153068 | August 10, 1994 | July 24, 1995 |
| 13086-013152591 | August 10, 1994 | July 24, 1995 |
| 13086-013163286 | September 13, 1994 | July 24, 1995 |

3. R.S.C. 1985, c. 41 (3rd Supp.).

1485 **Materials** for use in the manufacture of drill pipe, casing or tubing, or fittings, couplings, thread protectors or nipples therefor, of a kind used with natural gas or oil wells

The following to be employed in the exploration, discovery, development, maintenance, testing, depletion or production of oil or natural gas wells . . . excluding the motor vehicle chassis portion and parts thereof of special purpose motor vehicles of heading No. 87.05, all other motor vehicles of Chapter 87 and geophysical instruments of heading No. 90.15.

1553 **Well fracturing machinery, apparatus and parts** thereof.

EVIDENCE

Mr. Alexander R. Crabtree, an expert on coiled tubing in the oil and gas industry, and Mr. William G. Gavin, Team Leader for Coiled Tubing Services at Nowsco Well Service Ltd., gave evidence on the appellant's behalf. Mr. Crabtree was accepted as an expert on the use of coiled tubing in the oil and gas industry. He testified that coiled tubing is used in a variety of applications in the industry, including drilling operations, well fracturing, well perforating, well logging and production.

Mr. Crabtree described, in detail, the use of coiled tubing in drilling operations as follows. As noted, the appellant receives tubing on wooden drums. The free end of the tubing is prepared by, among other things, reaming, polishing and, when necessary, restoring its circularity. A fitting is then welded onto the free end. The free end is inserted into the centre of a working reel, and the tubing is spooled onto the reel. Once all the tubing is on the working reel, the other end of the tubing is prepared to accept a fitting. With the use of water, an electrical cable is fed through the tubing. The coil is then transported to the well site. At the well site, the tubing is partially fed through a coiled tubing drilling structure. The tubing protruding below the structure from the injector head is then cut and refinished (i.e. reamed, polished, etc.). By means of a mechanical connection, a device called a "grapple module" is then attached to the end of the tubing. A series of other pieces, including an instrument module/steering tool, orientor module, PD motor, bent housing and bit, are attached. The electrical cable referred to above provides power to certain of these devices and conveys data from the instruments. This entire string (i.e. tubing, grapple module, etc.) is used in horizontal drilling. Fluids are pumped down through the tubing to the PD motor. That motor converts the hydraulic power to mechanical power, which is used to drive the bit. Mr. Crabtree testified that, on import, coiled tubing is not suitable for use in directional drilling or, indeed, in any oil or gas operation. The ends must be properly prepared and pressure fittings attached so as to allow for the controlled transmission of fluids.

Mr. Crabtree described well fracturing as a "stimulation treatment" by which a given formation is fractured to increase the flow rate. Coiled tubing is used to pump a mixture of fluids and sand into the formation to effect the fracture. The tubing is lowered into the well by means of an injector head. Once the tubing reaches the required depth, it is connected to a high-pressure pump, which is used to pump liquids through the tubing. Mr. Crabtree opined that, in the well fracturing context, coiled tubing operates as an "apparatus," in that it contains the fluids and allows them to be conveyed to the formation. He stated that the tubing also provides mechanical integrity by containing the fluids and delivering them to the formation.

Mr. Crabtree explained that the goods in issue could also be used as production tubing. In that application, the tubing would act as a conduit through which production from an existing well would be conveyed to the surface.

In cross-examination, Mr. Crabtree agreed that the fittings that would be put on the end of the tubing that would “go into the well” would vary with the function being carried out, but indicated that the fitting “at the centre of the reel” is generic across all applications.

In questioning by the Tribunal, Mr. Crabtree stated that, in well fracturing, coiled tubing serves as an “apparatus” which works in concert with other equipment in the overall pursuit of fracturing the formation. He indicated that he considered the tubing an apparatus because it is a tool which allows for the conveyance of fluids to the formation to be fractured. Mr. Crabtree stated that the only piece of equipment which is unique to fracturing is the pump or “blender” which pumps fluids and sand into the well.

Mr. Crabtree indicated that the equipment which is attached to the downhole end of the tubing (the “bottomhole assembly”) is detached from the tubing at the completion of each operation on a given well. For example, after drilling is completed, the bottomhole assembly and the downhole fitting are removed. The coil may then be transported to another site where the fitting and bottomhole assembly required for the operation to be performed, whether drilling, fracturing, etc., are attached. He testified that he considered the preparation of the ends of the tubing, the attachment of the fittings and the inspection of the fittings to be “manufacture,” in that, as a result of those operations, the tubing is changed into something that can be used in specific oil and gas well operations.

Mr. Crabtree testified that, in certain applications, such as drilling and well fracturing, coiled tubing must be bent and unbent. This action fatigues the tubing. As a result, a given section of tubing could, for example, be used in drilling operations on approximately three occasions. After the tubing has become fatigued, it is normally used as production tubing.

Mr. Gavin gave testimony regarding certain confidential documents which the appellant had placed on the record. He testified that the documents indicated that, between February 1995 and October 1998, the appellant had “raised” 746 invoices for “hanging strings,” a procedure which involves running coiled tubing into wells and using it as production strings. Mr. Gavin indicated that virtually all of the persons who purchase coiled tubing from the appellant are involved in oil and gas production. Some of the tubing sold by the appellant as production tubing was new, and some had been previously used by the appellant in other oil and gas operations (i.e. well fracturing and perforating). Mr. Gavin stated that virtually all of the coiled tubing imported by the appellant is ultimately used as production tubing. He stated that the confidential documents put into evidence reflect basically all of the coiled tubing imported and ultimately resold by the appellant.

Dr. David R. Budney gave evidence on behalf of the respondent. He was accepted as an expert in mechanical engineering with a special focus on tubing, machine design and manufacture. Counsel for the respondent referred Dr. Budney to the following definition of “machine”:

a machine is comprised of a more or less complex combination of moving and stationary parts and does work through the production, modification or transmission of force and motion.⁴

Dr. Budney testified that he would not consider coiled tubing to be machinery because it serves a simple function as a conduit to transmit materials from one location to another. By way of contrast, Dr. Budney testified that the device that deploys tubing down a well and the pump used in directional drilling

4. *Ingersoll-Rand Door Hardware Canada Inc. v. Minister of National Revenue (Customs and Excise)*, 80 N.R. 397 at 400, Federal Court of Appeal, Court File No. A-503-86, October 21, 1987.

to pump mud down the tubing would satisfy that definition. He explained that the pump would be considered a machine because it has a number of moving and stationary parts which work together to develop the necessary pressure to inject drilling liquid into the well. He also testified that, based on certain definitions of the term “apparatus,”⁵ he would not consider coiled tubing to be apparatus, as it lacks the necessary degree of complexity. Dr. Budney indicated that, in order for an object to be considered a “part” of a machine or an apparatus, that object would have to be made specifically for the machine or apparatus in question. Finally, the following definition of “manufacturing” was put to Dr. Budney:

the process of converting raw materials into products.⁶

Dr. Budney testified that he would not consider the steps taken by the appellant to prepare the coiled tubing for use in the field (i.e. cutting, reaming, polishing and attaching fittings) to be manufacture. He stated that pipe or tubing is used in several industries and that it is common in the industry to modify the pipe end, to clean it, to make sure that the dimensions are right, to polish it, to attach fittings and then to inspect and do the required tests to see if it has the necessary integrity. He also indicated that he would not consider the tubing to be a raw material. He stated that it would be necessary to go further upstream to the iron ore or steel from which the tubing was made to find a raw material.

ARGUMENT

The appellant’s representative submitted that the evidence before the Tribunal indicated that, at the time of import, the goods in issue were not in a form in which they could be used as drill pipe, casing or tubing. Before they could be used, the ends had to be “processed” (i.e. cleaned, reamed, etc.). The representative submitted that, after these steps had been taken, a product, different from the one imported by the appellant, was created. He submitted that the goods in issue have mechanical features, in that they must maintain the integrity of both internal and external pressures, the internal pressures being the fluids pumped down through it hydraulically and the external pressures being the outside pressures exerted by the well itself.

The appellant’s representative submitted that the appellant uses the goods primarily in well fracturing operations with its machinery and that the goods in issue are well fracturing machinery, in particular, apparatus and/or parts for use therewith.

In the alternative, the appellant’s representative submitted that the evidence indicated that virtually all of the coiled tubing imported by the appellant is ultimately used as production tubing. He noted that, prior to being used in this manner, the coiled tubing must be processed. In particular, he noted that it must be cut to the correct length, as dictated by the location or depth of the formation into which it is to be inserted, and, as with other applications, that both ends of the tubing must be prepared.

Counsel for the respondent submitted that the goods in issue do not fit within either of the codes advanced by the appellant. With respect to Code 1553 (i.e. well fracturing), counsel submitted that the goods in issue are not machinery. She submitted that the goods in issue are not comprised of a combination of

5. The *McGraw-Hill Dictionary of Scientific and Technical Terms*, 5th ed. (McGraw-Hill, 1994) at 116, defines “apparatus” as follows: “A compound instrument designed to carry out a specific function”; and the Tribunal’s decision in *Pillar Construction Ltd. v. The Minister of National Revenue*, Appeal No. AP-89-122, October 25, 1990, at 7 states: “To be an apparatus, they would have to consist of a number of interrelated parts, each having a definite function.”

6. *Manufacturing Processes for Engineering Materials* at 1, Tribunal Exhibit AP-95-128-21.

moving and stationary parts and that they do not do work. Counsel also submitted that the goods in issue are not apparatus. Referring to several definitions of the term “apparatus,” counsel noted that the goods in issue are not a “compound instrument” and do not contain a number of interrelated parts. Counsel submitted that, at the time of import, the goods were simply a large reel of tubing. Finally, counsel submitted that the goods in issue were not “parts” as contemplated by Code 1553. She submitted that, in order for an article to be a part of a product, that article must be manufactured to a degree that commits it for use with the product. Counsel submitted that the evidence indicated that there are a variety of uses to which the goods in issue could be put. In addition, relying on the Tribunal’s decision in *Computalog Ltd. v. The Deputy Minister of National Revenue for Customs and Excise*,⁷ counsel submitted that, in order for the goods in issue to be parts under a code in Schedule II of the *Customs Tariff*, they would have to have been classified as parts in Schedule I. The goods in issue were not so classified.

With respect to Code 1485, counsel for the respondent submitted that the preparation of the ends of the goods in issue does not constitute manufacture.

DECISION

The Tribunal is not persuaded that the goods in issue qualify for duty relief under Code 1553 or 1485 of Schedule II to the *Customs Tariff*.

In the Tribunal’s view, with regard to Code 1553, the goods in issue are not well fracturing machinery, apparatus or parts thereof.

First, several definitions for “machinery” were put into evidence. In the Tribunal’s view, a machine is normally comprised of a combination of moving and stationary parts and does work through the production, modification or transmission of force and motion. On import, the goods in issue were simply 10,000 feet of coiled tubing. They had no components and no moving or stationary parts. The goods in issue are, in many ways, analogous to a length of solid pipe. In the Tribunal’s view, the goods in issue are in no sense machinery.

Second, the goods in issue are also not, in the Tribunal’s view, apparatus. The *McGraw-Hill Dictionary of Scientific and Technical Terms* defines “apparatus” as “[a] compound instrument designed to carry out a specific function.” *Merriam Webster’s Collegiate Dictionary*⁸ defines “apparatus,” in part, as “a set of materials or equipment designed for a particular use . . . a group of anatomical or cytological parts functioning together . . . an instrument or appliance designed for a specific operation.”⁹ *The Random House Dictionary of the English Language*¹⁰ defines “apparatus,” in part, as “a group or combination of instruments, machinery, tools, materials, etc., having a particular function . . . any complex instrument or mechanism for a particular purpose.”¹¹ In the Tribunal’s view, there are two common elements which run through these definitions. The first is that, to be considered an apparatus, an object must possess at least some degree of complexity. The second is that the object must be designed for a particular purpose or function. In the Tribunal’s view, the goods in issue do not satisfy either of these criteria. First, the Tribunal is of the view that the goods in issue, which are simply a coiled length of tubing, lack the necessary complexity

7. Appeal No. AP-92-265, May 12, 1994.

8. Tenth ed. (Merriam-Webster, 1993).

9. *Ibid.* at 56.

10. Second ed. (New York: Random House, 1987).

11. *Ibid.* at 100.

to be considered apparatus. Second, the goods in issue can be used in a number of oil and gas operations; therefore, it cannot be said that the tubing is designed for or has a particular purpose.

Third, the Tribunal is of the view that the goods in issue are not “parts” of any machinery or apparatus. To be a part of machinery or of an apparatus, an article must, at a minimum, have an attribute or attributes which link it to that machinery or apparatus. Normally, an article which is a part of another thing may be, without modification, simply inserted, attached or incorporated into that thing. In the present case, the evidence indicates that, on import, the goods in issue are simply a length of coiled tubing. They are not ready to be inserted, attached or incorporated into anything, without being modified. Therefore, the Tribunal is of the view that, on import, the goods in issue could in no sense be a part of well fracturing machinery or apparatus.

With regard to Code 1485, the Tribunal is of the view that the goods in issue do not qualify for relief under that code on several bases. First, the Tribunal is of the view that the goods in issue are not “materials” within the contemplation of Code 1485. In the Tribunal’s view, the word “materials” must be construed with reference to the word “manufacture.” The use of the word “manufacture” suggests that what is contemplated by Code 1485 is materials such as steel, rubber, plastic and the like, which could be used in the manufacture of the articles enumerated in that code. The goods in issue are a finished product. That, following import, they are modified to perform various tasks does not alter that fact. Returning to the pipe example, the fact that a length of pipe might be modified following import for use in a particular application would not convert that pipe into a “material” from a finished product.

Counsel for the respondent introduced a definition of “manufacturing” as “the process of converting raw materials into products.” *Merriam Webster’s Collegiate Dictionary* does not contain a definition of “manufacturing.” However, it defines “manufacture,” in part, as “something made from raw materials by hand or by machinery . . . the process of making wares by hand or by machinery esp. when carried on systematically with division of labor . . . the act or process of producing something.¹²” Leaving aside the question of raw materials, the Tribunal is not persuaded that the processing of the ends of the goods in issue is sufficient in scope or alters the goods to such an extent as to constitute manufacture.

Accordingly, the appeal is dismissed.

Pierre Gosselin
Pierre Gosselin
Presiding Member

Peter F. Thalheimer
Peter F. Thalheimer
Member

Richard Lafontaine
Richard Lafontaine
Member

12. *Supra* note 8 at 709.