



**REPORT TO
THE MINISTER OF FINANCE**

**REQUEST FOR TARIFF RELIEF BY
LINGERIE BRIGHT SLEEPWEAR (1991) INC.
REGARDING
PRINTED COTTON FLANNELETTE**

MARCH 6, 1996

REQUEST NO.: TR-95-004 LINGERIE BRIGHT SLEEPWEAR (1991) INC.

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INTRODUCTION

On July 14, 1994, the Canadian International Trade Tribunal (the Tribunal) received terms of reference from the Minister of Finance (the Minister) pursuant to section 19 of the *Canadian International Trade Tribunal Act*.¹ The Minister directed the Tribunal to investigate requests from domestic producers for tariff relief on imported textile inputs for use in their manufacturing operations and to make recommendations in respect of those requests to the Minister.

Pursuant to the Minister's reference, on May 11, 1995, the Tribunal received a request from Lingerie Bright Sleepwear (1991) Inc. (Bright) of Montréal, Quebec, for the immediate and permanent removal of the customs duty on importations of printed, flannelette, woven fabric of 100 percent cotton, of plain weave construction 42 x 44/sq. in., yarn count of 20 x 10, width of 44 in. and weighing more than 100 g/m², for use in the production of children's and women's sleepwear (the subject fabric). Bright seeks tariff relief retroactive to September 30, 1994, citing the non-availability of the subject fabric from domestic production.

On July 28, 1995, the Tribunal, being satisfied that the request was properly documented, issued a notice of commencement of investigation, which was widely distributed and published in the August 5, 1995, edition of the Canada Gazette, Part I.²

As part of the investigation, the Tribunal's research staff sent questionnaires to potential producers of identical or substitutable fabrics. Questionnaires were also sent to known users and several potential importers of fabrics identical to or substitutable for the subject fabric. A letter was sent to the Department of National Revenue (Revenue Canada) requesting information on the tariff classification of the subject fabric, and a sample was provided for laboratory analysis. Letters were also sent to a number of other government departments requesting information and advice.

On October 3, 1995, a staff investigation report, summarizing the information received from these departments, Bright and other firms that responded to the questionnaires, was provided to the parties that had filed notices of appearance for this investigation. These parties are Bright, Adorable Lingerie Inc., Lutfy Ltd., Claudel Lingerie, Lingerie Hago Inc. and the Canadian Textiles Institute (CTI).

Bright filed a response to the staff investigation report. Subsequently, the CTI filed a submission to which Bright provided a response. A public hearing was not held for this investigation.

PRODUCT INFORMATION

The subject fabric is printed, flannelette, woven fabric of 100 percent cotton, of plain weave construction 42 x 44/sq. in., yarn count of 20 x 10, width of 44 in. and weighing more than 100 g/m², for use in the production of children's and women's sleepwear. Cotton flannelette is a heavy, soft material that is given a napped or brushed finish. Napping is a finishing process that raises the fibres of a fabric to the surface by means of revolving cylinders covered with metal points or teasel burrs. Flannelette is normally

1. R.S.C. 1985, c. 47 (4th Supp.).

2. Vol. 129, No. 31 at 2476.

brushed on both sides of the fabric. Bright stipulates the exact number of brushings per side to the fabric producer. The fabric is printed prior to napping. The printing method used in the People's Republic of China is roller printing. The number of colours in the design determines the number of times the fabric is passed through the printing rolls. The majority of the printing in Canada is heat transfer printing. Heat transfer printing cannot be used for cotton flannelette fabric because the fabric cannot be napped after it is printed.

Printed cotton flannelette designs are referred to as either generic (no licence fee) or licensed. In the latter case, sleepwear producers pay licence fees for the right to incorporate trademark figures in the patterns printed on their fabrics. In the case of generic designs, sleepwear manufacturers either choose a design from a selection offered by fabric producers or provide fabric producers with a design. Bright imports only generic flannelette fabrics.

Revenue Canada informed the Tribunal that the subject fabric is classified under tariff item No. 5208.52.90 of Schedule I to the *Customs Tariff*.³ It was dutiable, in 1995, at 16.0 percent *ad valorem* under the MFN tariff; at 15.7 percent *ad valorem* under the BPT; at 5.2 percent *ad valorem* under the U.S. tariff; and at 14.0 percent *ad valorem* under the Mexico tariff. Revenue Canada also advised that, presently, the goods of subheading No. 5208.52 qualify for the benefits of Code 4215⁴ of Schedule II to the *Customs Tariff* and are dutiable at 10.0 percent *ad valorem* under the MFN tariff. The tariff treatment under Code 4215 is applicable to woven fabrics of cotton of certain subheadings, including subheading No. 5208.52, for use in the manufacture of apparel or apparel accessories.

Revenue Canada confirmed that the subject fabric is a plain weave fabric, woven from single yarns of cotton fibres and that it has been napped/brushed on both sides. However, Revenue Canada found that the yarn count in the warp, the weave construction and the width of the samples provided were inconsistent with the definition provided by Bright. Specifically, the warp yarn had a cotton count of 24, compared to 20 reported by Bright. The weave construction was 49 x 40/sq. in., compared to 42 x 44/sq. in. as stated in the definition, and the sample was 39 in. wide, compared to 44 in. as stated in the definition. Revenue Canada indicated that the discrepancy in the yarn (cotton) count could be attributed to the napping/brushing operation performed on the fabric.

Revenue Canada also stated that the description of the subject fabric provided by Bright is inconsistent with the terminology found in the Harmonized Commodity Description and Coding System⁵ and suggested that, in the Tribunal's recommendations to the Minister, the subject fabric be described as follows:

printed plain weave cotton fabric that has been napped/brushed on both sides, weighing 163 g/m² for use in the manufacture of nightshirts, nightdresses, pajamas, bathrobes, dressing gowns, négligés and similar articles.

Bright uses the subject fabric to produce women's and children's sleepwear. The principal goods produced are nightshirts, pajamas, jumpsuits, robes, dorm sets and peignoirs. The subject fabric is received at Bright's premises where it is cut and sewn into finished garments, which are then tagged, placed on

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

4. Code 4215 was revised December 14, 1994, and issued January 1, 1995.

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

hangers, packaged and shipped to Bright's customers across Canada. All production is performed in-house by Bright, including the design work for the subject fabric. Two metres of the subject fabric are required to produce one unit of each product.

Imports of the subject fabric originate in the People's Republic of China. Total Canadian imports of the subject fabric, in 1994, were about 140,000 linear metres, having a value for duty of approximately \$115,000. The volume of imports anticipated for 1995 is just under 230,000 linear meters, having a value for duty of about \$340,000. In 1994, other producers of flannelette sleepwear imported allegedly substitutable fabrics from the People's Republic of China, Pakistan and other low-cost countries, amounting to approximately 1.5 million linear metres and having a value just in excess of \$1.9 million. For 1995, these user-importers anticipated imports of just under 1.9 million linear metres, having a value of approximately \$3.0 million.⁶

The apparent Canadian market for the subject fabric and allegedly substitutable fabrics for use in the production of children's and women's sleepwear, in 1994, is estimated to be just under 1.8 million linear metres. This estimate is based on the combined purchases of imports reported by Bright and other user-importers which produce children's and women's flannelette sleepwear and the volume of total sales of the allegedly substitutable fabrics produced by Dominion Industrial Fabrics Company (DIFCO) to domestic sleepwear producers. Imports accounted for 90 percent of the market in 1994. The market, in 1995, is estimated to be over 2.5 million linear metres, based on projected imports provided by the known importers and assuming that DIFCO maintains its 1994 market share.

REPRESENTATIONS

Bright's request is for the immediate and permanent removal of the customs duty on importations of the subject fabric. The estimated duty savings for Bright would exceed \$12,000 annually.

Bright's position is that tariff relief should be granted on the grounds that there is no domestic production of fabrics identical to or substitutable for the subject fabric. Bright contends that there is no acceptable substitute for the subject fabric because there is a clear consumer preference for 100 percent cotton in the production of flannelette sleepwear.

Bright submitted that, of the six fabrics alleged by DIFCO to be identical or substitutable, only TC583 (50/50 polyester/cotton) has been sold to Canadian sleepwear manufacturers. Bright submitted that, although DIFCO identified five 100 percent cotton fabrics that it produces, it reported no sales of these fabrics to the sleepwear industry. Bright contends that, as no sales history was provided by DIFCO for these fabrics, there is no performance criterion that would enable the Tribunal to conclude that these other fabrics are substitutable. Respecting the alleged substitute, TC583 (50/50 polyester/cotton), Bright submits that consumer demand and preference dictate a separate market niche for sleepwear composed of 100 percent cotton.

6. The volume of imports of the subject fabric represents approximately 6 percent of the total imports classified under tariff item No. 5208.52.90.

Bright asked that the Tribunal be mindful of its decision in Request No. TR-94-004⁷ respecting printed cotton flannelette, wherein the Tribunal held that DIFCO had not provided sales of the allegedly identical or substitutable fabrics to the end product market. Consequently, the Tribunal found that DIFCO did not establish market acceptance of its allegedly substitutable fabrics nor sales revenue that would be lost if tariff relief were granted. Bright submitted that, in the present case, DIFCO has failed to establish market acceptance in the market niche that Bright supplies, that being the 100 percent cotton flannelette segment of the sleepwear market. Bright contends that, as in its decision in Request No. TR-94-004, the Tribunal should conclude that no revenue loss would occur if tariff relief were granted.

Bright submitted that retailers have become significant importers of cotton flannelette sleepwear that competes directly with the sleepwear that it produces using the subject fabric. Bright submitted that tariff relief would help to create a more level playing field, thereby allowing it to better compete with imported sleepwear and to sustain and expand its business.

Bright submitted that the suggestion by DIFCO that import competition is declining, based on Statistics Canada import data for cotton flannelette garments and knitted sleepwear, may be incorrect, as the Statistics Canada data may contain misclassified import entries.

Five other sleepwear producers⁸ made submissions in response to the Tribunal's questionnaire to domestic users. These firms use cotton flannelette fabrics that vary somewhat in description from the subject fabric. They support Bright's request provided the tariff relief does not create a competitive advantage for Bright. Consequently, they requested that the flannelette fabrics that they use to produce sleepwear be covered by any tariff relief granted.

DIFCO opposes the request on the grounds that it produces six fabrics that are allegedly identical to or substitutable for the subject fabric. Of these, five are 100 percent cotton and one is a 50/50 polyester/cotton fabric. DIFCO submitted that it produces these fabrics from raw fibres spun into yarns which are woven into greige fabrics at its mill in Magog, Quebec. The greige fabrics are finished (dyed, printed and napped) at the C.S. Brooks plant, also located in Magog. DIFCO noted that the greige fabrics produced at Magog can be dyed in solid colours or printed in a variety of patterns and finished to the customers' needs (single napped, double napped and other special treatments). DIFCO submitted that these fabrics are used in the production of a number of end products, including pajamas, shirts, linings, wrappings, packaging and hospital garments. DIFCO submitted that, in 1994, it produced just under 400,000 linear metres of the six allegedly identical or substitutable fabrics. According to DIFCO, any of the allegedly substitutable fabrics are suitable for the production of sleepwear, and fabric MF088 is a 100 percent cotton equivalent to TC583 that can be bleached, napped and printed.

DIFCO acknowledged that, of the six allegedly substitutable fabrics, only TC583 (the 50/50 polyester/cotton fabric mentioned above) is sold to sleepwear/lingerie manufacturers. According

7 Report to the Minister of Finance: Request for Tariff Relief by Woods Canada Limited Regarding Certain Printed Cotton Fabrics, June 8, 1995.

8. Adorable Lingerie Inc., Lutfy Ltd., Claudel Lingerie, Lingerie Hago Inc. and Universal Manufacturing Inc.

to DIFCO, in 1994, these sales accounted for revenues of over \$350,000 and amounted to less than 5 percent of the company's total sales of all fabrics on a volume basis.

DIFCO submitted that, if tariff relief were granted, it would lose its annual sales revenue from the sleepwear market or be forced to reduce selling prices to below break-even levels. DIFCO contends that such action can lead to discontinuing the export of similar products to the United States due to a reduced total sales volume. DIFCO submitted that the economic impact of removing the tariff could affect its total North American sales of the allegedly identical or substitutable fabrics, resulting in potential losses of approximately \$4 million.

DIFCO contends that the direct import competition claimed by Bright appears to be diminishing and questions Bright's claim that it will benefit from tariff relief by being more competitive with imports of sleepwear. DIFCO submitted that Statistics Canada published import data show that imports of cotton flannelette nightshirts, nightdresses and pajamas declined in 1994 by about 20 percent and by 42 percent in the first half of 1995, compared to the first half of 1994. In addition, DIFCO submitted that Statistics Canada import data show that imports of woven sleepwear are declining compared to those of knitted sleepwear, which are increasing. According to DIFCO, there appears to have been a shift away from woven sleepwear, which Bright produces, towards knitted sleepwear.

Doubletex Inc. (Doubletex) is Canada's largest fabric converting mill. Doubletex imports greige fabrics from around the world for conversion in its three plants located in Montréal, Toronto, Ontario, and Winnipeg, Manitoba. Among other types of conversion, Doubletex dyes and finishes imported 100 percent cotton greige fabric. Doubletex submitted that it produces a 100 percent brushed cotton fabric that can compete with the subject fabric in some instances. Doubletex's view is that it is discriminatory to grant duty-free status to a finished fabric while leaving the duty on an identical greige fabric.

The CTI submitted that domestic production exists and cites DIFCO's claim that it produces five styles of cotton flannelette fabrics and certain polyester/cotton fabrics. The CTI contends that one of DIFCO's domestic fabrics is virtually identical to the subject fabric. The CTI submitted that Bright's competitors in the end product market have identified a number of fabrics that they use to produce competing sleepwear. In the CTI's view, these other fabrics are substitutable for the subject fabric, and this shows that fabrics of different constructions compete with each other in this end product market.

The CTI contends that Statistics Canada trade data show that imports of flannelette sleepwear have been declining for some time, while imports of tricots and other constructions have increased. According to the CTI, this reflects declining demand for flannelette sleepwear and is the reason for sales losses by Bright.

The CTI submitted that the savings from tariff relief are too small to make Bright more competitive against imported sleepwear. The CTI also contends that the benefits of tariff relief will not be retained by Bright and other users. In support of this view, the CTI cited the comments of one competitor which stated that retailers demanded and received retroactive price reductions, in 1995, to reflect the decline in duty under the MFN tariff from 16 to 10 percent on January 1, 1995, under Code 4215.

The CTI submitted that, should tariff relief be granted, no more money would be gained by the users than would be lost in tariff revenue by the Government of Canada.

The Department of Foreign Affairs and International Trade informed the Tribunal that Canada maintains quota restraints on fabrics classified under classification No. 5208.52.90.90. Restraints apply to finished woven cotton fabrics from the People's Republic of China and greige and finished cotton fabrics imported from Hong Kong and Taiwan. In 1994, imports of finished cotton fabric from the People's Republic of China amounted to a 90.0 percent utilization of the restraint level (adjusted for an annual growth rate of 3.5 percent). The Canada/Hong Kong restraint agreement includes cotton (excluding denim) and polyester/cotton woven fabrics. In 1994, imports of this aggregate group amounted to a total utilization rate of 14.0 percent. Of these imports, 97.8 percent were greige and finished woven cotton fabrics. The Canada/Taiwan restraint agreement includes combed wool, cotton (including denim), nylon, polyester filament and polyester/cotton woven fabrics. In 1994, imports of these fabrics amounted to a total utilization rate of 33.0 percent. Of these imports, 32.0 percent were greige and finished cotton fabrics. The Tribunal was also advised that ex-quota entry on the subject fabric will be considered where a recommendation has been made by the Tribunal to remove the tariff on the basis of non-availability.

Revenue Canada has indicated that there would be no additional costs, over and above those already incurred by it, to administer the tariff relief should it be granted.

ANALYSIS

In assessing the economic impact of reducing or removing the tariff, the Tribunal took into account all relevant economic factors, paying particular attention to the substitutability of domestically produced fabrics and the impact of granting the tariff relief on the interested domestic producers. In this case, the interested domestic producers are DIFCO and Doubletex.

Substitutability

There is no domestic production of fabrics identical to the subject fabric. On the question of substitutability, the Tribunal considered the technical descriptions and market acceptance of the allegedly substitutable fabrics.

DIFCO indicated that it is a domestic producer of six identical or substitutable fabrics. It reported sales of an allegedly substitutable fabric to producers of children's and women's sleepwear. The fibre content of that fabric is 50 percent polyester and 50 percent cotton, while the subject fabric is made of 100 percent cotton. The different fibre contents indicate that this allegedly substitutable fabric is not of the same general classification as the subject fabric and does not fall under the same classification number as the subject fabric. The Tribunal agrees with Bright's view that 100 percent cotton flannelette sleepwear is a separate market segment from sleepwear produced from fabrics made of other fibres or blends of fibres. As such, the different fibre content of the domestically produced fabric indicates that the sales reported by DIFCO are not to the particular market segment to which the subject fabric is supplied, that being the 100 percent cotton flannelette segment of the sleepwear production market. Consequently, the sales reported by DIFCO are not evidence of market acceptance of its allegedly substitutable fabric. In sum, the Tribunal concludes that the 50/50 polyester/cotton fabric submitted by DIFCO is not substitutable, in view of its different technical characteristics and lack of evidence of acceptance in the relevant market segment.

The remaining five allegedly substitutable fabrics submitted by DIFCO are all 100 percent cotton fabrics. DIFCO alleges that they all may be finished (i.e. napped and printed) in a manner that makes them suitable for use in the production of flannelette sleepwear. No sales to the cotton flannelette sleepwear industry were reported by DIFCO. Consequently, the Tribunal concludes that there is no evidence that these allegedly substitutable fabrics have gained acceptance in the relevant market segment and, as such, the Tribunal must conclude that these domestically produced cotton fabrics are not substitutable for the subject fabric.

Potential Impact on Domestic Producers

DIFCO submitted that the economic impact of removing the tariff would force DIFCO either to reduce its selling prices to below break-even levels or to suffer a loss of sales volume in the domestic market of the six allegedly substitutable fabrics, which would cause DIFCO to reduce its exports to the United States, thereby affecting its total North American sales of these fabrics. The Tribunal does not accept the proposition that DIFCO will lose sales volume if the tariff is removed, given that it has not sold its allegedly substitutable fabrics to the market segment supplied by Bright. Also, DIFCO has not provided information to support its claim that its wholesale selling prices would be reduced below its break-even levels. In any case, the information before the Tribunal shows that DIFCO is not competing with Bright, but is supplying a different market segment of the sleepwear production industry. The Tribunal, therefore, cannot accept DIFCO's claim that prices will have to be reduced in response to a reduction in the price of the subject fabric.

Doubletex alleges that it is discriminatory to grant tariff relief on the subject fabric while maintaining the tariff on an identical greige fabric. However, Doubletex did not provide a technical description or sales information for its allegedly substitutable fabrics. Consequently, the Tribunal was not able to conclude that Doubletex produces substitutable fabrics or to determine the economic impact of granting the tariff relief as requested. In these circumstances, while the Tribunal recognizes the potential danger of creating a tariff anomaly on imported greige fabrics that are otherwise identical to the subject fabric, it finds that it is not appropriate to make a recommendation that is wider than the scope of the original investigation.

Bright's Competitiveness

Bright submitted that tariff relief would improve its ability to compete with imports of sleepwear. The submissions of Bright, Adorable Lingerie Inc. and Lutfy Ltd. attest to the substantial participation of the major retailers in the direct importation of sleepwear from low-cost countries. These imports set the wholesale price levels that must be met by domestic sleepwear producers. The Tribunal has noted the decline in the volume of imports of flannelette garments, generally, found in Statistics Canada import data, but also notes that these data cover imports of much more than the end products defined in this request. As well, Statistics Canada import data supplied by DIFCO do show growth in the volume of imports of knitted sleepwear in recent years. The Tribunal agrees with DIFCO's view that the relevance of this type of data depends on the extent to which they are reflective of market trends within the segment of the sleepwear market that is supplied by Bright. However, the information before the Tribunal does not address that issue. Consequently, to attempt to determine the impact on Bright's sales volume of these trends in imports of the broad range of garments included in the Statistics Canada import data would be speculative.

On the basis of the foregoing, the Tribunal concludes that granting the tariff relief as requested will result in net economic gains for Canada.

RECOMMENDATION

In light of the foregoing, the Tribunal hereby recommends to the Minister that the customs duty on importations from all countries of

printed, plain weave 100 percent cotton fabric that has been brushed/napped on both sides, weighing more than 100 g/m², for use in the production of children's and women's nightshirts, nightdresses, pajamas, bathrobes, dressing gowns, négligés and similar articles

be removed for an indeterminate period of time.

Should the Minister grant tariff relief pursuant to the Tribunal's recommendation and a Canadian producer commence production of the subject fabric, that producer may request the commencement of an investigation for the purpose of recommending an amendment of the order of the Governor in Council which provides tariff relief.

Although its recommendation for tariff relief is restricted to finished fabrics, the Tribunal recognizes the concerns expressed by Doubletex relating to the potential creation of a tariff anomaly for imports of otherwise identical greige fabrics. While it has refrained from making any recommendation about tariff relief for those greige fabrics, the Minister, in considering whether to implement the Tribunal's recommendation on the subject fabric, may wish to consult with potential domestic producers of greige fabrics to determine whether there is any valid objection to similar tariff relief on greige fabric imports. In any event, any domestic producer that wishes to seek tariff relief on greige fabric imports may file a request with the Tribunal.

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