



**REPORT TO
THE MINISTER OF FINANCE**

**REQUEST FOR TARIFF RELIEF BY
PEERLESS CLOTHING INC.
REGARDING
CERTAIN WOVEN FABRICS OF VIRGIN WOOL
AND FINE ANIMAL HAIR**

FEBRUARY 20, 1998

PEERLESS CLOTHING INC.

REQUEST NO.: TR-96-005

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INTRODUCTION

On July 14, 1994, the Canadian International Trade Tribunal (the Tribunal) received terms of reference¹ from the Minister of Finance (the Minister) pursuant to section 19 of the *Canadian International Trade Tribunal Act*.² 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, the Tribunal received, on June 18, 1997, a revised request³ from Peerless Clothing Inc. (Peerless) of Montréal, Quebec, for the removal, for an indeterminate period of time, of the customs duty on importations from all countries of woven fabrics of combed or carded yarns, wholly of virgin wool and fine animal hair, containing not less than 10 percent by weight of fine animal hair, as certified by the exporter, of a weight exceeding 140 g/m² but not exceeding 300 g/m², of tariff item No. 5111.11.90, 5112.11.90 or 5112.19.91 of the schedule to the *Customs Tariff*,⁴ for use in the production of men's suits, jackets, blazers and trousers (the subject fabrics).

On July 16, 1997, 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 July 26, 1997, edition of the *Canada Gazette*, Part I.⁵

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

A staff investigation report, summarizing the information received from these departments, Peerless and other interested parties, was provided to those interested parties that had filed notices of appearance in the investigation, thereby becoming "parties" to the proceedings.

A public hearing was not held for this investigation.

PRODUCT INFORMATION

Currently, Peerless imports the subject fabrics from offshore. The fabrics are then used in the manufacture of men's suits, jackets, blazers and trousers. All cutting, sewing, finishing and quality control of end products are performed in Peerless's Montréal factory.

As of January 1, 1998, subject to the exception set out below, the subject fabrics are dutiable at 16 percent *ad valorem* but not to exceed \$4.65/kg under the MFN tariff; at 4 percent *ad valorem* but not to

1. On March 20 and July 24, 1996, and on November 26, 1997, the Minister of Finance revised the terms of reference.

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

3. Further amendments were filed with the Tribunal on November 3, 1997.

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

5. Vol. 131, No. 30 at 2111.

exceed \$0.74/kg under the Mexico tariff; and at 4 percent *ad valorem* but not to exceed \$0.71/kg under the Chile tariff. The subject fabrics imported from the United States or Israel enter Canada duty-free. On the other hand, the MFN tariff is still subject to yearly reductions and will be 14 percent by 2004.

Under tariff item No. 5111.11.20,⁶ woven fabrics of **carded** wool, of a weight not exceeding 300 g/m², containing 85 percent or more by weight of wool or of fine animal hair, and valued at \$5.98/m² or more, for the use in the manufacture of certain men's apparel, are dutiable at 5.5 percent *ad valorem* under the MFN tariff. These fabrics, if imported from the United States, Mexico, Israel or Chile, enter Canada duty-free.

REPRESENTATIONS

Peerless

Peerless has been manufacturing men's apparel in Canada since 1919. The company is privately owned and employs in excess of 2,000 people. Following the FTA, Peerless established itself as an international manufacturing and marketing company, supplying a wide range of tailored suits to major outlets in the United States.

In its submissions to the Tribunal, Peerless claimed that there are no acceptable substitutes for the subject fabrics and that wool/cashmere, wool/alpaca, wool/mohair and wool/camel blends have a greater consumer appeal than wool/synthetic blends. Peerless submitted that the subject fabrics are required to satisfy a market niche which features apparel made of high-quality European fabrics. Peerless pointed out that this market niche is growing rapidly and, therefore, that it needs duty-free access to wool/fine animal hair fabrics; otherwise, retailers and consumers will turn to imported apparel.

Peerless submitted that, over the past two years, it has not been able to find identical or substitutable fabrics in Canada to satisfy its requirements. With respect to woven fabrics of **carded** yarns, Peerless stated that two of the samples provided by Victor Woolen Products Ltd. (Victor) fall outside the weight range of the subject fabrics and that none of the samples contain fine animal hair, but that they are wool/nylon blends. Peerless pointed out that, although CookshireTex intends to produce higher-priced fabrics containing fine animal hair in the future, these fabrics are also outside the weight range of the subject fabrics. Moreover, Peerless submitted that Victor and CookshireTex are active in the outerwear markets (varsity/awards jackets and women's overcoats) and that they have not provided any evidence to indicate that they serve Canadian manufacturers of men's suits, jackets, blazers and trousers. As for woven fabrics of **combed** yarns, Peerless indicated that only a few of the samples provided by Cleyn & Tinker Inc. (Cleyn & Tinker) meet the criteria of the subject fabrics and that these fabrics represent a small portion of the company's plant sales. It also argued that Cleyn & Tinker has not provided enough information to clearly demonstrate that it sells products mainly to manufacturers of men's apparel.

Peerless indicated that all domestic production of allegedly identical or substitutable fabrics is priced lower than the subject fabrics. In addition, Peerless argued that, if identical or substitutable fabrics were available from Canadian textile manufacturers, these companies could sell these fabrics at a significant premium above world prices because Canadian manufacturers of men's wool suits, when using fabrics produced in North America, can export their finished goods to the United States duty-free. Peerless pointed

6. Formerly Code 4210 of Schedule II to the *Customs Tariff*, 1997.

out that, because the wool apparel tariff preference levels⁷ (TPLs) are at present filled, all NAFTA-based wool fabric producers have at least 40 percent effective duty protection from offshore suppliers. Peerless argued that, with the elimination of the Duty Drawback Program, it will be at a price disadvantage if tariff relief is not provided and that the company's sales in the United States may be eliminated.

Peerless submitted that the removal of the customs duty on imports of the subject fabrics would reduce its costs, increase employment, allow it to compete more effectively with imports of the finished products and enable it to increase sales. Peerless indicated that benefits would be passed on to the consumer. Should tariff relief be granted, Peerless proposed that the minimum fibre content be certified by the exporter. This, according to Peerless, is an established procedure that has been utilized for years. Peerless also noted that the textile industry has obtained tariff relief through tariff codes that do not mention the terms "virgin," "prime" or "price points." In addition, Peerless pointed out that Code 4210 of Schedule II to the *Customs Tariff, 1997*, included a reference to "virgin" wool. Peerless stated that it would not object to the elimination of the term "virgin" in any description.

Finally, Peerless argued that it should not be limited or penalized in any way for taking the lead in filing several requests for tariff relief that can be of benefit to all manufacturers of men's clothing.

Users of the Subject Fabrics

Parker Brothers Textile Mills Limited (Parker Brothers)

Parker Brothers, of Trenton, Ontario, is a weaver, dyer and finisher of fabrics. The company stated that it produces substitutable goods and that, because it has limited production capacity, it imports the subject fabrics to supplement its product line. Most of the company's customer base is made up of producers of women's apparel.

Parker Brothers supported Peerless's request for tariff relief and stated that the customs duty should also be removed for like fabrics used in the production of women's apparel.

Weston Apparel Manufacturing Company (Weston)

Weston, of Toronto, Ontario, a manufacturer of suits, jackets and trousers, stated that it supports the request since the removal of the customs duty on imports of the subject fabrics would make the company more competitive and increase sales. Weston stated that there are no domestic producers of substitutable fabrics. It submitted that the subject fabrics are superior in quality, that samples are easily obtainable and that minimum order requirements are low.

Domestic Producers of Allegedly Identical or Substitutable Fabrics

Cleyn & Tinker

Cleyn & Tinker, of Huntingdon, Quebec, was formed in 1930 and is a vertically integrated weaver and finisher of fabrics made of: (1) 100 percent worsted wool (e.g. using combed yarns); (2) worsted wool

7. Under the Canadian apparel TPLs, items receive preferential NAFTA tariff treatment despite their incorporation of non-North-American (i.e. non-originating) fabric.

combined with either other natural fibres (e.g. mohair, cashmere and silk) or man-made-fibres; and (3) blends of polyester, viscose, silk and linen. The company has an overall capacity of 7 million linear metres and employs 650 people. It sells mainly to manufacturers of men's suits, jackets, blazers, vests and trousers, and approximately 45 percent of its production is exported, mostly to the United States.

Cleyn & Tinker also has a wholly owned US subsidiary company which maintains limited production facilities in the state of New York. The fabrics produced at these facilities are destined for sale to US manufacturers of men's, women's and uniform apparel.

Cleyn & Tinker submitted that it produces a wide range of worsted fabrics which compete directly with those outlined in Peerless's request. Cleyn & Tinker's fabrics vary in fibre content, construction and finish, and weigh between 160 and 275 g/m². The company stated that over one third of its product line changes every year in response to fashion trends.

Cleyn & Tinker opposed Peerless's request because, should tariff relief be granted, it would have a major impact on the company's production and sales of competing fabrics. Cleyn & Tinker claimed that it produces identical or substitutable fabrics. It submitted that the market for these types of fabrics is very competitive and that customer accounts can be lost or gained on the basis of a few cents per metre. Cleyn & Tinker further submitted that, should tariff relief be granted, customers would either pressure the company to match price reductions or switch their purchases to the subject fabrics. This, according to Cleyn & Tinker, would place the company in an untenable position with respect to margins and profits and would undermine its ability to maintain production of the competing fabrics.

Cleyn & Tinker also argued that Peerless has an edge in the US market vis-à-vis US manufacturers of apparel because Canadian tariffs on wool fabrics imported from non-NAFTA countries are significantly lower than US MFN tariffs and that NAFTA rates of duty (under TPLs) for imports of men's apparel into the United States are much lower than US MFN rates of duty for men's apparel. Also, it stated that Peerless continues to be entitled to full duty drawback on non-NAFTA inputs used in apparel exported to the United States at MFN rates of duty.

CookshireTex⁸

CookshireTex, of Cookshire, Quebec, was founded in 1943 and is a vertically integrated fabric producer. It produces yarn from raw materials such as wool, synthetic fibres or fine animal hair. It then weaves, dyes and finishes the fabrics. With continuous and regular investment, CookshireTex has increased its production capacity, as well as its capability. Initially, CookshireTex produced just melton and flannel fabrics. Now, it produces a wide range of woollen fabrics (e.g. using carded yarns) made of 100 percent wool and wool combined with either other natural fibres or man-made fibres. The woollen fabrics that it sells are used in the manufacture of men's and women's overcoats and blazers.

CookshireTex opposed the request for tariff relief on woven fabrics of carded yarns, on the basis that it has the capability and capacity to produce identical or substitutable fabrics of equal quality. CookshireTex stated that the sample fabrics that it submitted demonstrate that identical or substitutable fabrics are available from Canadian production. It noted that such fabrics are also available from US suppliers at low tariffs.

8. On October 3, 1997, Victor announced that it had signed an agreement to purchase CookshireTex.

Victor

Victor, of Saint-Victor, Quebec, was founded in 1947. Over the years, it has evolved from manufacturing yarns using the woollen system to weaving, dyeing and finishing. Victor is an integrated operation which begins with the purchase of wool and synthetic fibres. It manufactures the yarns and then weaves fabrics from its own yarns. Victor also dyes and finishes the fabrics.

Victor submitted that it produces a wide range of fabrics, from 30 percent wool to 100 percent wool. The yarns used are carded yarns spun on the woollen system and range from a fine count to a coarse count. The fabric weights vary from 220 to over 1,000 g/m², with more than 90 percent of its production falling between 300 and 500 g/m². Fabrics normally range in width from 150 to 154 cm.

Victor also opposed Peerless's request for tariff relief on woven fabrics of carded yarns because: (1) it produces substitutable fabrics that fall within the scope of tariff item No. 5111.11.90 and that are used in the production of men's and women's apparel; (2) Revenue Canada is unable to determine the percentage of fine animal hair contained in the subject fabrics, to determine whether the fine animal hair is a prime quality fibre (costing over \$50/kg) or a waste fibre (costing less than \$10/kg) and to distinguish between virgin and reprocessed wool; (3) it is aggressively developing sales and looking for new opportunities in the Canadian and US markets; (4) it must maintain its market share in order to develop and keep operations in Canada; (5) a healthy woollen garment market can be developed in North America by having apparel manufacturers work closely with the woollen fabric manufacturers, not working against one another; (6) apparel manufacturers have benefited from trade liberalization; and (7) jobs will be lost in the Beauce region if tariff relief is granted.

Victor submitted that it is unclear whether the term "virgin," contained in the Tribunal's notice of commencement of investigation, applies to fine animal hair as well as to wool. Should this not be the case, non-virgin forms of fine animal hair, selling at much lower prices, would threaten an important part of Victor's business. In addition, Victor argued that the financial incentives for misrepresentation are unusually high in cases involving fine animal hair and that certification by the exporter, as contemplated in the notice of commencement of investigation, is not an effective means of enforcement.

Other Submissions

The **Canadian Textiles Institute (CTI)** submitted that certification of a minimum fine animal hair content by the exporter is not a reliable means of preventing non-qualifying imports from duty-free access to the Canadian market and consequent damage to Canadian textile producers. It stated that that mislabeling is endemic, as evidenced by recent cases in the United States, and that there are no effective means of auditing or verifying the certification given by exporters. Since Revenue Canada has technical limitations in respect of administering the "virgin wool" provision, the CTI alleged that it also lacks the technical ability to determine whether the animal hair present in a fabric is of prime quality. Should tariff relief be extended to all wool/fine animal hair fabrics regardless of the quality of the hair component, the CTI alleged that the domestic industry will be threatened by duty-free imports of substandard fabrics. In this connection, it mentioned that carded yarn fabrics are frequently made from reprocessed wool.

The CTI argued that, in real life, there is not an individual market for the subject fabrics, i.e. blends of wool and fine animal hair. It submitted that the subject fabrics are individual items in a large set or population of worsted and woollen fabrics which compete with each other. According to the CTI, the

consumer, retailer or user of fabrics containing 10 percent or more of animal hair cannot detect the presence or absence of such fibres.

The CTI pointed out that all the woven fabrics of carded yarns imported by Peerless are subject to the Code 4210⁹ rate of 5.5 percent. Because the tariff rates for woven fabrics of combed yarns are capped, the CTI argued that there is no additional cost paid by the importer when it moves from all wool fabrics to the subject fabrics. Should tariff relief be granted, however, the importer would have a new and significant economic incentive to switch from domestic wool fabrics to imported duty-free wool/fine animal hair blends.

The CTI submitted that, contrary to Peerless's claim, Canadian mills produce fabrics containing fine animal hair. It indicated that imported fabrics containing small amounts of fine animal hair can be substituted for most of the Canadian mills' production and that the smaller the fraction of fine animal hair content in imported fabrics, the more direct the competition between these fabrics and 100 percent Canadian-made wool fabrics.

The CTI also argued that Peerless is already the beneficiary of many special measures under NAFTA and the textile reference and that the numerous requests for tariff relief made by Peerless entail new risks for domestic textile producers and costs for everyone concerned.

The **Department of Foreign Affairs and International Trade (Foreign Affairs and International Trade Canada)** informed the Tribunal that Canada maintains quantitative import restrictions on combed wool fabrics, including any fabrics mixed mainly or solely with combed wool or fine animal hair, imported from Bulgaria, the Republic of China, the Czech Republic, India, Poland, Romania, the Slovak Republic, the Republic of Korea, Taiwan and Uruguay. Should the Tribunal recommend tariff relief, Foreign Affairs and International Trade Canada could consider a request for ex-quota entry of the textile inputs.

Revenue Canada indicated that it is unable to identify the different fine animal hair fibres, especially when they are blended with other fine animal hair or with wool. Hence, it pointed out that it is unable to accurately determine the percentage by weight of the fine animal hair and the wool. Moreover, Revenue Canada stated that it does not have the expertise to distinguish between "wool" and "virgin wool." It indicated that there would be no additional costs, over and above those already incurred by it, to administer the tariff relief requested, should it be granted on the basis of the wording in the notice of commencement of investigation. However, it stated that the addition of certain conditions, for example, determining the presence of virgin wool, could result in it requiring an independent laboratory analysis at an additional cost to it.

ANALYSIS

The Minister's terms of reference direct the Tribunal to assess the economic impact on domestic textile and downstream producers of reducing or removing a tariff and, in doing so, to take into account all relevant factors, including the substitutability of imported textile inputs for domestic textile inputs and the ability of domestic producers to serve the Canadian downstream industries.

The request for tariff relief filed by Peerless covers two groups of fabrics, namely, woven fabrics of carded wool and fine animal hair classified under tariff item No. 5111.11.90 and woven fabrics of combed wool and fine animal hair classified under tariff item No. 5112.11.90 or 5112.19.91. Peerless submitted that

9. Now tariff item No. 5111.11.20.

there is no acceptable domestic production of fabrics identical to or substitutable for the subject fabrics. In essence, Peerless argued that, in order to satisfy an emerging market trend towards men's apparel made of wool and fine animal hair blends, it requires superior European-style fabrics. However, two Canadian producers, CookshireTex and Victor, claimed that they have the capability and capacity to produce identical or substitutable woven fabrics of carded wool and fine animal hair, while Cleyn & Tinker indicated that it produces a wide range of identical or substitutable woven fabrics of combed wool and fine animal hair.

In the past, the Tribunal has recognized that the yarn type, size, fabric construction and various finishing techniques add different characteristics to fabrics which make them look, feel and drape differently. This is usually evidenced by the fact that there are broad price ranges within which different woven fabrics are placed. For example, prices for fabrics of wool combined with man-made fibres are generally lower than prices for 100 percent virgin wool fabrics, and prices for wool fabrics combined with fine animal hair are usually higher than prices for 100 percent virgin wool fabrics. The evidence on the record¹⁰ confirms, in general, the existence of these different price points. Notwithstanding this evidence, it is clear to the Tribunal, from a review of the samples provided in respect of this investigation, that domestic producers have the ability to produce very high-quality wool and wool blend fabrics and, hence, it becomes increasingly difficult to determine the exact composition of the fabrics and to distinguish, by touch and appearance, 100 percent virgin wool fabrics from fabrics of virgin wool combined with low percentages of fine animal hair.

With respect to woven fabrics of carded yarns, the Tribunal notes that CookshireTex and Victor generally serve the outerwear market and that most of the samples submitted to the Tribunal fall outside the weight range of the subject fabrics. However, CookshireTex provided two samples¹¹ containing wool and cashmere, one weighing 325 g/m², the other 366 g/m². Evidence of projected sales for the first sample is, in the Tribunal's view, an indication of CookshireTex's ability to produce finer woollen fabrics acceptable to the market. In addition, it provided a fabric¹² of wool blended with nylon, weighing 244 g/m². Victor also indicated that it produces a wide range of wool and wool/nylon fabrics, some of which weigh less than 300 g/m². This shows that domestic producers have the capability and expertise to produce quality fabrics in lower weight ranges. Moreover, Victor indicated that, over the past two years, it has increased its production capacity over 40 percent in order to keep up with market demand and that the addition of the CookshireTex facility is part of a plan not only to ensure future production needs but to expand its women's business as well.¹³

Thus, the Tribunal believes that Victor, with the acquisition of CookshireTex, is in a position to produce and supply very fine quality fabrics to manufacturers of both women's and men's apparel and, more specifically, to respond to the needs of Peerless for carded fabrics of wool and fine animal hair in lower weight ranges.

As noted earlier, when meeting the end-use requirements, woven fabrics of carded wool, of a weight not exceeding 300 g/m², containing 85 percent or more by weight of wool or of fine animal hair, and valued at \$5.98/m² or more, attract a rate of duty of 5.5 percent under tariff item No. 5111.11.20. Therefore, the

10. *Protected Staff Investigation Report*, November 7, 1997, Tribunal Exhibit TR-96-005-50 (protected) at 9, Administrative Record, Vol. 2.

11. Exhibits 17.5B and 17.5F.

12. Exhibit 17.5H.

13. Tribunal Exhibit TR-96-005-48, Administrative Record, Vol. 1.

current situation provides some tariff relief to importers of carded fabrics, while offering tariff protection to domestic producers of similar fabrics.

Turning to woven fabrics of combed yarns, the Tribunal is persuaded by the information on the record that Cleyn & Tinker presently produces worsted fabrics that are similar to or substitutable for the subject fabrics. In this connection, the Tribunal finds it difficult to detect substantial differences between the subject fabrics and the allegedly identical or substitutable fabrics¹⁴ provided by Cleyn & Tinker. In addition, the Tribunal notes that major manufacturers of men's clothing, which compete directly with Peerless, presently purchase fabric from Cleyn & Tinker. Although the production volume of worsted wool combined with fine animal hair represents only a small portion of Cleyn & Tinker's total production, it is clear that the company has the technical capabilities to produce and supply high-quality fabrics containing wool and fine animal hair that would meet the specific requirement of Peerless. Moreover, the fact that over one third of its product line changes each year in response to fashion trends indicates to the Tribunal that the company is both dynamic and responsive to the marketplace.

The Tribunal also notes that, under the present tariff classification, the duty payable on the subject fabrics cannot exceed \$4.65/kg under the MFN tariff. Consequently, importers of combed fabrics that fall within the scope of this investigation benefit from some measure of tariff relief.

Peerless argued that, with the elimination of the Duty Drawback Program, it will be at a price disadvantage if tariff relief is not provided and that the company's sales in the United States may be eliminated. The Tribunal notes, however, that full duty drawback continues to apply to apparel exports to the United States that are traded at full MFN rates of duty (after the TPLs have been fully utilized).¹⁵ Duty drawback also continues to apply to apparel exported outside the NAFTA area. Since Peerless is a significant exporter of men's apparel to the United States, it would appear that its exports to the United States, which are subject to the MFN rate of duty, qualify for duty drawback.

Overall, the Tribunal concludes that the domestic textile industry currently produces similar or substitutable fabrics or has the technical capabilities to produce identical or substitutable fabrics. The Tribunal is of the view that the costs which would be incurred by the domestic textile industry, if tariff relief were granted, would outweigh the benefits to the producers of men's suits, jackets, blazers and trousers. The complete removal of the tariff, in this particular case, would hamper Canadian textile producers' opportunity to participate in this emerging market.

In its representation, Parker Brothers stated that, should the Tribunal recommend tariff relief on the subject fabrics, the removal of duties should also apply to fabrics used in the production of women's apparel. The Tribunal notes that the notice of commencement of investigation did not cover precisely these fabrics. Should a Canadian producer wish to obtain tariff relief on fabrics not covered by this investigation, it should file a properly documented request concerning these inputs with the Tribunal.

14. For example, Exhibits 17.4A, 17.4B and 17.4C.

15. See Annex 303.6 of the *North American Free Trade Agreement*, done at Ottawa, Ontario, on December 11 and 17, 1992, at Mexico, D.F., on December 14 and 17, 1992, and at Washington, D.C., on December 8 and 17, 1992 (in force for Canada on January 1, 1994).

RECOMMENDATION

In light of the foregoing, the Tribunal hereby recommends to the Minister that tariff relief not be granted on importations of woven fabrics of combed or carded yarns, wholly of virgin wool and fine animal hair, containing not less than 10 percent by weight of fine animal hair, as certified by the exporter, of a weight exceeding 140 g/m² but not exceeding 300 g/m², of tariff item No. 5111.11.90, 5112.11.90 or 5112.19.91, for use in the production of men's suits, jackets, blazers and trousers.

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