

**REPORT TO
THE MINISTER OF FINANCE**

**REQUEST FOR TARIFF RELIEF BY
DISTEX INC.
REGARDING
JACQUARD CIRCULAR WEFT-KNIT FABRIC**

FEBRUARY 8, 1999

DISTEX INC.

REQUEST NO.: TR-98-002

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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 with respect to those requests to the Minister.

Pursuant to the Minister's reference, the Tribunal received a request from Distex Inc. (Distex) on July 6, 1998, for the removal, for an indeterminate period of time, of the customs duty on imports of Jacquard circular weft-knit fabric for use in the manufacture of golf jerseys.

On August 27, 1998, the Department of National Revenue (Revenue Canada) reported the results of its testing of samples of the fabric for which tariff relief was being requested and incorporated those results in a draft product description, which read: "Jacquard circular weft knit, certified by the exporter that the fabric has been knit on a Jacquard loom, solely of cotton, mercerized, of yarns of different colours, for use in the manufacture of golf jerseys." The laboratory report noted that, although Revenue Canada was able to determine that the yarns had been mercerized, it was unable to determine whether the fabric had been "double mercerized," i.e. whether the yarns are mercerized, knit into a fabric and subjected to a second mercerization process.

On September 28, 1998, the Tribunal, being satisfied that the request was properly documented, issued a notice of commencement of investigation that was distributed and published in the October 10, 1998, edition of the *Canada Gazette*, Part I.³ The textile input was described in the notice of commencement of investigation as Jacquard circular weft-knit fabric, certified by the exporter that the fabric has been knit on a Jacquard loom, solely of cotton, mercerized, of yarns of different colours, of a weight of 100 g/m² or more but not exceeding 200 g/m², of subheading No. 6002.92, for use in the manufacture of golf jerseys (the subject fabric).

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 a number of potential importers of the subject fabric. In addition, the Department of Foreign Affairs and International Trade was asked to provide current information on any quantitative import restrictions on the subject fabric, and the Department of Industry and the Department of Finance were informed of the request and asked to provide any relevant comments. In addition, samples of five allegedly identical fabrics provided by Agmont Inc. (Agmont) were submitted for analysis to the Laboratory and Scientific Services Directorate of Revenue Canada.

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. Vol. 132, No. 41 at 2660.

PRODUCT INFORMATION

Revenue Canada advised the Tribunal that the subject fabric is classified under tariff classification No. 6002.92.90.10 and is currently dutiable at 16 percent *ad valorem* under the MFN tariff, at 10 percent *ad valorem* under the Mexico and Chile tariffs, but is duty free under the US tariff and the Canada-Israel Agreement tariff.⁴

REPRESENTATIONS

The Tribunal received representations from the Canadian Apparel Manufacturers Institute (CAMI) supporting the request and the Canadian Textiles Institute (CTI) opposing the request and a response submission from Distex. No representations were submitted directly by domestic producers. Any views attributed to domestic producers in the following sections of the report were obtained from responses to the Tribunal's producer's questionnaire,⁵ plant visit memoranda, Distex's request or the above noted representations and response submission.

Users of the Subject Fabric

Requester

Distex's request is for the removal of the customs duty, for an indeterminate period of time, on imports of the subject fabric. Distex, located in Saint-Laurent, Quebec, is a manufacturer of men's and women's sportswear sold under the trademark "Robert Barakett." The company has been in existence for over two years. It imports the subject fabric from Italy and hires subcontractors in Montréal, Quebec, to manufacture golf jerseys using the subject fabric. The majority of these golf jerseys are exported to the United States. According to Distex, the removal of the tariff would enhance the company's competitiveness and increase its sales. Distex argued that it is at a competitive disadvantage because its US competitors import the subject fabric at a lower duty rate.⁶ Distex also submitted that the removal of the duty would enable it to reduce the selling price of its jerseys in the US market, thereby allowing it to be more competitive with Italian-made jerseys. This, according to Distex, would lead to an increase in demand for its products and result in an expansion of production and increased employment.

Distex submitted that the subject fabric is a high-quality Jacquard knitted double mercerized fabric consisting of very intricate patterns, manufactured to customer specifications from an inventory of over 150 different coloured yarns. Distex also submitted that its Italian supplier accommodates its need for short production runs. In addition, Distex submitted that all of its customers demand double mercerized knit

4. The rates of duty under the MFN, US and Canada-Israel Agreement tariffs were in effect in 1998 and have not changed in 1999. The rates of duty under the Mexico and Chile tariffs declined from 12.5 percent *ad valorem* in 1998 to 10 percent *ad valorem* on January 1, 1999.

5. Agmont and Manoir Inc. provided complete responses to the Tribunal's questionnaire. Cannon Knitting Mills Limited sent a letter alleging that it produced substitutable fabrics, but provided no other information. Tricots Liesse (1983) Inc. did not respond to the questionnaire, but alleged during a plant visit made by Tribunal staff that it produced substitutable fabrics.

6. The Canadian MFN rate will remain at 16 percent *ad valorem* from January 1, 1999, to December 31, 2002, compared to the US MFN rate which will be reduced annually from 12.0 percent *ad valorem* to 10.8 percent *ad valorem* between January 1, 1999, and January 1, 2002, and then remain at 10.8 percent *ad valorem* until December 31, 2002.

fabrics and that its sales are dependent on the double mercerized quality of its fabrics. According to Distex, using other quality fabrics would result in lost sales. Distex claimed that it had canvassed Canadian knitters and that it had determined that there are no domestically produced fabrics which are identical to or substitutable for the subject fabric.

In its response submission, Distex argued that the five allegedly identical fabrics produced by Agmont are not identical because they are not Jacquard knit fabrics. Distex also pointed to Revenue Canada's analysis of these fabrics which showed that each of the five fabrics fell outside the specifications of the subject fabric. In particular, Distex noted that two of the fabrics were double-knit rather than single-knit fabrics and were made from one-ply rather than 2-ply yarns of substantially different decitex,⁷ compared to the yarns used to knit the subject fabric.

Distex also argued that the five Agmont fabrics were not substitutable for the subject fabric because they are not Jacquard fabrics, their designs are too simple, they are not made from 2-ply yarns which offer greater durability and suppleness, the decitex of the yarns is too high, and the fabrics are too heavy and thick and lack lustre. Distex submitted that, in order to protect the interests of Canadian knitters, it was prepared to amend its definition of the subject fabric by adding a reference to the use of 2-ply yarns and by limiting the decitex of the yarns to an amount not exceeding 180 per single yarn.

Distex argued that golf jerseys made from double mercerized fabrics constitute a separate segment of the golf jersey market. The jerseys that it produces from the subject fabric are higher priced at retail and distributed through the more expensive and exclusive golf clubs. Allegedly, its jerseys are purchased by affluent consumers who are members of the more expensive and exclusive golf clubs and who seek exclusivity in the golf jerseys that they purchase. Distex also submitted that its jerseys compete exclusively with high-quality Italian-made golf jerseys in the highest end of the price spectrum (i.e. US\$160 or more at retail).

Distex argued that, in order to be considered substitutable, a fabric must at least be mercerized once. Consequently, Distex argued that the non-mercerized allegedly substitutable fabrics produced by Agmont and Manoir Inc. (Manoir) are not substitutable for the subject fabric.

Distex argued that, in the absence of domestically produced identical or substitutable fabrics, the Tribunal should grant the request for tariff relief.

In the event that the Tribunal concluded that either identical or substitutable fabrics were produced in Canada, Distex argued that they were not available to Distex. For example, if the Tribunal concluded that Agmont's allegedly identical fabrics were either identical or substitutable, Distex argued that the evidence shows that Agmont has neither the capability nor the willingness to produce the quality, variety and small volumes required by Distex. Distex submitted that it approached Agmont in April 1998 with a clear intention to purchase the subject fabric. However, Agmont declined the request and informed Distex that it did not produce the subject fabric in Jacquards. Distex argued that, where identical or substitutable fabrics are not available, the request for tariff relief should be granted.

7. Decitex is one tenth of a tex unit. Tex is a unit for expressing linear density, equal to the weight in grams of one kilometre of yarn.

Finally, Distex argued that the benefits of duty relief exceed the alleged costs to domestic producers even if the Tribunal concludes that identical or substitutable fabrics are available. Distex submitted that the domestic producers' claimed potential lost sales and profits were overstated and based on the erroneous assumption that any lost sale to their customers (golf jersey producers) in the United States would go to Distex. Distex argued that no lost sales would occur because its customers in the United States are in a separate market segment and do not compete directly with the retailers that buy golf jerseys from Agmont's US customers.

CAMI

CAMI supports Distex's request for tariff relief. CAMI argued that a comparison of the technical features of the domestic fabric and the subject fabric shows that no identical or substitutable fabrics are produced in Canada. In addition, CAMI contended that the quality of the subject fabric differentiates it from allegedly identical or substitutable domestic fabrics. CAMI also argued that the fabric cost and selling price of the jerseys show that Distex occupies a unique market niche, separate from the market segment in which Agmont and other knitters operate as fabric suppliers. In CAMI's view, there would be no negative economic impact on Canadian textile manufacturers from granting the tariff relief.

According to CAMI, double mercerization is important to the quality of the fabric, as it gives the fabric sheen, shimmer and a silk-like feel. CAMI argued that dyeing and mercerizing at the yarn stage are performed because they add features to a fabric, which cannot be obtained by mercerizing only the knitted fabric. For example, CAMI submitted that mercerizing the yarns gives them more tensile strength, which allows the knitting of finer-gauge fabrics. CAMI argued that Agmont's investment in mercerizing equipment is only for mercerizing fabric. CAMI contended that, while Agmont claimed that it could import high-quality Pima cotton yarn from Peru to make double mercerized fabrics, Agmont provided no indication of who would mercerize the yarn and at what cost. CAMI argued that Agmont's claim suggests a potential for production that likely is uneconomical and untested in the marketplace. CAMI also submitted that Manoir, which claims to supply some high-end golf jersey producers, has not supplied mercerized fabric. CAMI argued that Distex's evidence establishes that unmercerized fabrics are not used to produce high-end golf jerseys.

CAMI argued that the type of Jacquard knitting machinery used to produce the subject fabric is a critical element in attaining the quality required by Distex. It was submitted that Agmont has provided no evidence that its knitting equipment is Jacquard or that it is of a comparable gauge or has the thread-changing capability of the machinery used to produce the subject fabric.

CAMI submitted that it is questionable that Agmont's allegedly identical fabrics are of a quality that would make them competitive with the subject fabric, in view of the difference between the average selling price of the Agmont product and that of the higher-cost subject fabric. CAMI also questions whether Agmont and Manoir are supplying high-end golf jersey producers that compete with Distex in the US market, in view of the price structure of the US golf jersey market. CAMI submitted that apparel producers create strategic product categories based on specific quality characteristics. The retail price structure reflects that categorization and tends to segregate the preferences of consumers. CAMI argued that consumers perceive a difference in quality at different price points. Furthermore, CAMI contended that consumers distinguish the difference in the quality of jerseys made with one-ply unmercerized yarns and those produced with fabric consisting of 2-ply, double twisted, mercerized yarns. CAMI argued that consumers know through experience that high-quality fabrics do not lose their sheen and shimmer over a reasonable period of

time, a feature which is achieved by mercerizing not only the fabric but also the yarn. Consumers are prepared to pay more for features such as double mercerization, multi-yarn colour, patterned jerseys, shimmer and soft hand. According to CAMI, Distex survives by targeting a retail price superior to US\$100, but below US\$160.⁸ In comparison, golf jerseys produced by Ardent Sportswear Inc. (Ardent), an importer of allegedly substitutable but unmercerized fabric, are at a lower price point. According to CAMI, Ardent cannot demand a price which translates to a retail price above US\$100 because its fabric is not double mercerized. CAMI argued that there is no significant competitive threat to Distex from Ardent, which proves the existence of insulated market segments defined by quality features.

CAMI argued that no substitutable fabrics are produced in Canada. Consequently, it alleges that there would be minimal, if any, negative repercussions on domestic manufacturers from granting the tariff relief requested and that such relief would yield economic benefits to Distex.

Importers of Allegedly Substitutable Fabrics

Ardent and Fountain Set Textiles (Ontario) Ltd. (Fountain Set) support the request for tariff relief on the grounds that they import allegedly identical or substitutable fabrics for use in the production of golf jerseys. Ardent noted that the subject fabric is produced with double twist yarn, as is the fabric imported by Ardent. According to Ardent, this feature reduces torque in the fabric. Accordingly, Ardent seeks tariff relief for Jacquard knit fabrics produced with 2-ply double twist dyed yarns of gauge 60. Neither the fabrics imported by Ardent and Fountain Set nor the yarns used to produce them are mercerized.

Domestic Textile Producers

CTI

The CTI opposes the request for tariff relief on the grounds that there is domestic production of identical or substitutable fabrics and that the costs of granting tariff relief would exceed any benefit.

The CTI submitted that the product description adopted by the Tribunal on the advice of Revenue Canada is broader in scope than the fabric described by Distex in its request. The CTI submitted that the absence of any reference to yarn size and the broader weight range of the fabric contained in the definition of the subject fabric increase the potential damage from granting the tariff relief beyond that threatened by the original request. The CTI also submitted that Revenue Canada found that the yarn sizes and fabric weight of the sample provided by Distex fell outside the values for these elements, as described in the request. Specifically, the yarns were of lower counts (coarser) and the fabric was heavier than the weight stated in the request.

The CTI argued that, while Distex contended that double mercerization is a unique feature of the subject fabric which distinguishes it from other fabrics, Distex failed to show how double mercerization can be detected and what consumer benefit is offered. The CTI submitted that retailers and consumers cannot perceive whether a mercerized cotton fabric has been mercerized at more than one stage. The CTI also argued that Revenue Canada was unable to determine whether the sample provided by Distex was double mercerized. In addition, the CTI contended that the questionnaire responses of Ardent and Fountain Set indicate that they consider the unmercerized fabrics that they import to be substitutable for the subject fabric.

8. This price (US\$160) is the approximate opening price point for golf jerseys imported from Italy.

The CTI pointed out that Agmont has invested in mercerizing equipment and argued that it is equipped to produce mercerized weft-knit fabrics in three ways: (1) from purchased mercerized yarns to single-mercerized fabric; (2) from purchased regular yarns to fabric that is mercerized in the finishing process; and (3) from purchased mercerized yarns to fabric that is mercerized in the finishing process (i.e. double mercerized). It was submitted that Agmont is producing circular weft-knit fabrics mercerized in each of these ways.

The CTI also argued that the term “Jacquard loom” found in the definition of the subject fabric adopted by the Tribunal is incorrect, as no such textile machinery exists. Producers interpreted the terminology to mean a Jacquard weft-knitting machine. The CTI argued that fabric knit on a Jacquard weft-knitting machine is not necessarily distinguishable either in the laboratory or in the marketplace from fabric produced on an ordinary weft-knitting machine. It noted that Revenue Canada could not determine whether the sample of the subject fabric was produced on a Jacquard machine. The CTI also objected to the definition of the subject fabric requiring certification that the fabric was produced on a Jacquard machine, on the grounds that the administration of the tariff should not be entrusted to offshore competitors. The CTI argued that, if Agmont is not producing Jacquard fabrics currently, it is only because its customers are not demanding such products.

The CTI also submitted that Taxitex Inc. is manufacturing Jacquard weft-knit, mercerized, cotton, yarn-dyed fabrics in Canada.⁹

With respect to Distex’s claim that identical or substitutable fabrics are not available from domestic producers, the CTI argued that there is no evidence that Distex made a serious effort to source the subject fabric in Canada.

The CTI argued that average costs and prices cannot be relied on to compare imports and domestic production because the input yarns differ in technical characteristics and, therefore, cost. In the CTI’s view, the only relevant comparison of import and domestic fabric costs would be where the domestic fabric is produced using yarns identical to those used by Distex’s Italian producer.

The CTI argued that the benefit and cost analysis shows that the only benefit is a small amount of duty savings against substantial costs to domestic producers. The CTI argued that the costs shown in the analysis are substantial because the broad definition of the subject fabric adopted by the Tribunal covers a large variety of fabrics that are produced in Canada and that would be negatively affected by the granting of tariff relief.

Other Information

The Department of Foreign Affairs and International Trade advised that Canada does not maintain quota restraints on the subject fabric classified in subheading No. 6002.92. This fabric, therefore, is not subject to any quantitative import restrictions.

9. It should be noted that Taxitex Inc. was included in the Tribunal staff’s survey of potential producers of identical or substitutable fabrics. Tribunal staff provided Taxitex with a producer’s questionnaire, but was informed by the company that it would not provide a response.

Revenue Canada stated that there would be no additional costs, over and above those already incurred by it, to administer the tariff relief requested for the subject fabric.

ANALYSIS

The terms of reference direct the Tribunal to evaluate the economic impact that reducing or removing a tariff would have on domestic textile producers and downstream producers and, in so doing, to consider all relevant factors, such as the substitutability of an imported fabric with a domestic fabric, the ability of domestic fabric producers to serve the Canadian downstream industries and the competitiveness of those downstream industries at home and abroad. Consequently, the Tribunal's decision to recommend tariff relief is based on the extent to which it considers that such tariff relief would provide net economic gains for Canada.

This request concerns an Italian-made fabric that is used to produce golf jerseys in Canada for export to the high-end golf jersey market in the United States. The finished jerseys are sold to pro shops of the more expensive and exclusive golf clubs. The purchasers of these jerseys are individuals who spend considerably more money on golfing activities than the bulk of the golfing public and who seek a degree of exclusivity in their apparel. The market is small, and retail prices exceed US\$100 and approach US\$200 per jersey. The Tribunal is convinced that the subject fabric's technical features, particularly that they are Jacquard knitted and double mercerized, are critical elements in Distex's ability to compete in this high-end market.

Based on the information available to the Tribunal, tariff relief would result in benefits to Distex of over \$20,000 in annual duty savings, increased sales and the creation of three new jobs.

Four domestic knitters informed the Tribunal that they produce allegedly identical or substitutable fabrics. These are Agmont, Manoir, Tricot Liesse (1983) Inc. and Cannon Knitting Mills Limited. Of these, only Agmont claimed to produce identical fabrics and provided samples for analysis by Revenue Canada. Agmont also submitted that it produces substitutable fabrics, as did the other three firms. Of the latter three firms, only Manoir responded to the Tribunal's producer's questionnaire. Consequently, the Tribunal considered only the potential substitutability of the fabrics identified by Agmont and Manoir.

The CTI opposes the request on the grounds that there is domestic production in Canada of identical or substitutable fabrics. The Tribunal does not agree.

The Tribunal first considered the allegedly identical fabrics submitted by Agmont. A comparison of Revenue Canada's analysis of the subject fabric and the allegedly identical fabrics submitted by Agmont shows that there are a number of technical features that distinguish the subject fabric from the fabrics produced by Agmont. The subject fabric is composed of 2-ply mercerized yarns compared to Agmont's one-ply unmercerized yarns. The subject fabric is made from yarns having a finer decitex than those produced by Agmont and is a single knit compared to Agmont's double-knit product. The Tribunal notes that Revenue Canada was unable to conclusively determine whether the subject fabric was double mercerized or Jacquard knit. Nevertheless, Distex has attested that these features are key elements of the fabric for which tariff relief is sought, and Agmont has reported that its fabrics are not double mercerized and are regular weft-knit products rather than Jacquards. In the Tribunal's view, these technical variances establish that Agmont's fabrics are not identical to the subject fabric.

The Tribunal then went on to examine whether Agmont's allegedly identical fabrics might be substitutable for the subject fabric. As indicated previously, Agmont's fabrics are not Jacquards nor are they double mercerized. Furthermore, the Tribunal is satisfied that the golf jerseys that are produced with the subject fabric occupy a niche in the high-end US golf jersey market. According to the information available, the US retail market for high-end golf jerseys is divided into the following price segments: over US\$160, US\$140 to US\$160, and US\$120 to US\$140. Distex is able to target a retail price of more than US\$120 because of the features of the subject fabric, but below US\$160, which is the beginning of the price range for high-end golf jerseys imported from Italy. Although Distex's jerseys are made with Italian fabric, they lack the important competitive attribute of being made in Italy. In order to be competitive, Distex must price its jerseys below the price point for the Italian-made products. Based on the information available, the Tribunal is convinced that jerseys produced from Agmont's allegedly identical fabrics would not compete at the same price point or in the same market segment as those produced by Distex using the subject fabric. The Tribunal notes that there is no evidence of direct competition between Distex's customers and the retailers that sell jerseys produced using Agmont's fabrics. The Tribunal, therefore, concludes that the allegedly identical fabrics produced by Agmont are not substitutable for the subject fabric.

The Tribunal next considered the allegedly substitutable fabrics produced by Agmont and Manoir. The record of information shows that these products are not Jacquard knits nor are they mercerized fabrics. The Tribunal is satisfied that these allegedly substitutable fabrics do not have the most critical technical features of the subject fabric and would not compete in the same segment of the golf jersey market as Distex. Consequently, the Tribunal does not consider them to be substitutable for the subject fabric.

Based on the information available, the Tribunal concludes that there is no domestic production of identical or substitutable fabrics. Consequently, there should be no economic cost to producers from granting the tariff relief requested. For these reasons and considering the benefits to Distex, the Tribunal concludes that granting the tariff relief requested would result in net economic benefits to Canada.

In administering a new tariff item to provide the tariff relief requested, a concern was raised respecting the ability to detect whether an imported fabric has been double mercerized and produced on a Jacquard weft-knitting machine. Revenue Canada reported that it could not ascertain whether the fabric samples that it analyzed had been double mercerized or whether the knitting machinery was a Jacquard machine. The Tribunal is of the view that this concern can be satisfied by requiring certification of these technical features by the producer of the fabric as part of the product definition.

The Tribunal notes the concerns expressed by the CTI regarding the broad scope of the definition of the subject fabric in the Tribunal's notice of commencement of investigation. Distex proposed, in its response submission, that the definition could be narrowed by adding a reference to 2-ply yarns and by defining the decitex of the yarns as "an amount not exceeding 180 per single yarn." The Tribunal is satisfied that the CTI's concerns are sufficiently addressed by these proposed amendments and has incorporated them in the definition of the subject fabric.

In the event that the Minister makes an order implementing the Tribunal's recommendation for tariff relief, and should the circumstances that led to the initial recommendation change at some point in the future, textile producers may request that the Tribunal review the recommendation that led to the Minister's order.

RECOMMENDATION

The Tribunal hereby recommends to the Minister that tariff relief be granted, for an indeterminate period of time, on importations from all countries of fabric, solely of 2-ply cotton yarns of different colours,

having a decitex not exceeding 180 per single yarn, of a weight of 100 g/m² or more but not exceeding 200 g/m², certified by the exporter to have been knit on a Jacquard circular weft-knitting machine and to have been “double mercerized” (i.e. the yarns have been mercerized, knit into a fabric and subjected to a second mercerization process), of subheading No. 6002.92, for use in the manufacture of golf jerseys.

Richard Lafontaine

Richard Lafontaine
Presiding Member

Peter F. Thalheimer

Peter F. Thalheimer
Member

Anita Szlazak

Anita Szlazak
Member