Exporter Briefing – UPM China

I. Introduction

UPM (China) Co., Ltd ("UPM") is a Chinese supplier of copy paper to the Australian market. UPM manufactures copy paper at its factory located in the Changshu Economic and Technology Development Zone, Jiangsu Province, China. The exporter is a related-party entity, UPM Asia Pacific Pte Ltd ("UPM AP") that operates in Singapore. UPM AP sells via a sales company in Australia and New Zealand that operates as a "commission agent". UPM is owned by UPM Kymmene Corporation of Finland.

It [*transactions*] for the goods exported to Australia between the related entities UPM and UPM AP, prior to the export sale to Australia.

II. Raw material supply

UPM [*arrangements for pulp supply*] from associated parties. In the EQR for the current investigation, UPM has stated that "No pulp is purchased from associated entities in 2015"[1]. [*UPM pulp producer in Uruguay*] , UPM Fray Bentos (annual capacity of 1.3 million tonnes) – although Section G-6 of the Exporter Questionnaire Response ("EQR") indicates that UPM does not purchase any raw materials from associated parties.

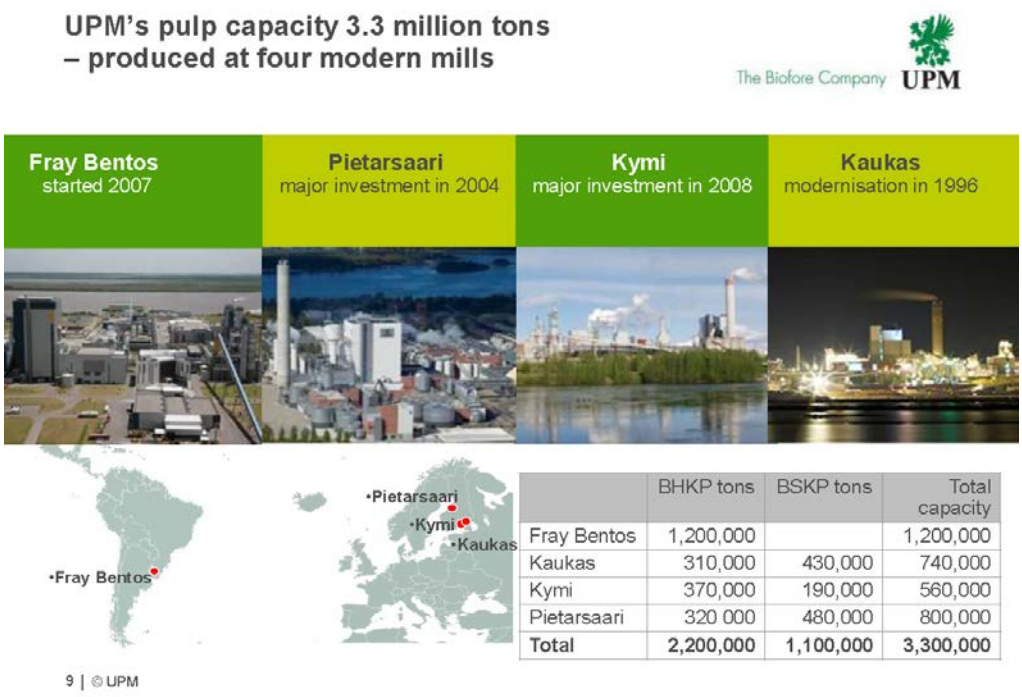
In its 2015 Annual Report, UPM Kymmene Corp Oyj comments on the "economic impact of UPM on the Uruguayan economy[2]" that it can attribute to its pulp plant and the sourcing of local eucalyptus varieties of timber. It claims that the "direct impact of UPM Fray Bentos pulp mill represents more than 3% of the country's manufacturing industry". Further, "Pulp is one of the four main export products and UPM is Uruguay's largest exporting company. In 2014, UPM Fray Bentos exports represented approximately 7.2% of total goods exports."

According to the Uruguay Investment and Export Promotion Agency, Uruguay's 1.6 million export tonnes of pulp were primarily to Europe (45%) and China (43%). As indicated, in the 2013 inquiry UPM confirmed that it imported its pulp from Uruguay. The second pulp mill in Uruguay – the Montes del Plata mill is a JV between the Chilean producer Arauco and Europe's Stora Enso (hence accounting for a significant proportion of pulp exports to Europe).

UPM's pulp supply [*commentary re pulp supply and pulp trading*]

AP encourages the Commission to fully investigate UPM's pulp purchasing arrangements through its related party company in Singapore. Where it is evident that the relationship between the parties impacts the purchase price for the pulp, the Commission must disregard UPM's pulp purchase prices during the investigation period.

[1] UPM (China) Co. Ltd, Exporter Questionnaire Response, Section G-6, P.32.
[2] UPM Kymmene Corporation Oyj Annual Report 2015, P. 48.



	BHKP tons	BSKP tons	Total capacity
Fray Bentos	1,200,000		1,200,000
Kaukas	310,000	430,000	740,000
Kymi	370,000	190,000	560,000
Pietarsaari	320 000	480,000	800,000
Total	**2,200,000**	**1,100,000**	**3,300,000**

III. UPM's production facility in Jiangsu

The UPM paper facility in the Changshu Economic and Technology Development Zone manufactures 1.4 million tonnes of paper products (including copy paper). The company opened an M3 paper machine in April 2016. Following the opening of the M2 mill in 2005, UPM's production capacity at Changshu was 800,000 tonnes.

UPM first commenced production at Changshu in 1999.

In UPM's media release of 24 May 2005, the company confirmed its pulp was to be supplied from Uruguay.

The 200 hectare mill site includes a harbour, a power plant, and an effluent treatment plant.

[*precipitated calcium carbonate (PCC) supply*]. '

The construction of the third paper-making machine meant a number of facilities on the Changshu site required upgrades/enhancements. Capital outlays were required for the upgrades.

IV. Financial reports

UPM does not produce an annual report. UPM's financial data is consolidated into its (ultimate) parent company UPM Kymmene Corp's annual report. The Commission is therefore verifying UPM's statements that are included in UPM's

UPM Kymmene Corp Oyj 2015 Annual Report

The UPM Kymmene 2015 Annual Report includes segment reporting. UPM (China) Co. Ltd (i.e. Changshu Mill) is included in the 'UPM Paper Asia' segment.

It is noted in the "UPM Asia" and "Business Area Reviews" sections of the UPM Kymmene Corp 2015 Annual Report for UPM Paper Asia that "*Overcapacity prevailed in all paper grades, and the preliminary Unites States anti-dumping duties added regional supply*"[3]. The anti-dumping measures imposed on Chinese exports of copy paper to the USA have increased regional supply, impacting pricing also.

UPM Paper Asia

Markets and drivers

- In Asia overcapacity prevails in all paper grades and US anti-dumping and countervailing duties on some Asian producers are adding regional fine paper supply. New investments and paper machine conversions to uncoated wood-free and labelling materials in Asia Pacific, as well as conversions to labelling materials in Europe have intensified the competition.

V. UPM Exporter Questionnaire Response

(a) Changshu manufacturing facility

It is alleged by UPM that it manufactures and sells domestically various paper, paper board and other paper products, on a toll manufacturing basis

- from the outset, the Commission will need to be satisfied as to the correct allocation of costs for the production of copy paper;
- what is basis for cost allocation?

UPM states that it operates under a "contract manufacturing agreement" with its related party UPM AP to process raw materials (i.e. pulp) with finished paper products (including copy paper)

- raw materials supplied to UPM at a price that is influenced by the relationship between buyer and seller;
- claimed that UPM charges its parent company (i.e. UPM AP) a 'processing fee'. How is this fee determined? What are the factors taken into account in determining this fee? Does the fee take account of all costs incurred by UPM at Changshu for the conversion of pulp to copy paper?
- the sell price to UPM AP reflects a toll-manufacturing fee and is not a price that reflects the 'full cost recovery' of manufacturing costs incurred by UPM;
- important for the Commission to request details on UPM AP's purchase prices from Uruguay (i.e. related party purchase prices) and other import sources;
- the processing fee charged by UPM to its parent UPM AP is not a market-based price but a "fee" determined between two related parties;
- the Commission cannot accept the "processing fee" as a cost for use in normal value determination;
- UPM's normal value to be based upon UPM's actual fully-absorbed manufacturing costs (excluding pulp cost), plus profit;
- UPM's pulp cost to be determined upon an appropriate, relevant domestic benchmark price unaffected by Government of China influence;

[3] UPM Kymmene Corporation Annual Report 2015, Pages 28 and 82.

- Level of profit to be determined by reference to UPM Kymmene Corps' global target rates as detailed in 2015 annual report.

The arrangements that UPM AP and UPM have in place for the supply of pulp and the contract processing of pulp into paper, and the subsequent sales by UPM AP to an affiliated agent in Australia, [*audit trail*] by the UPM related entities in the production and sale of copy paper exported from China.

AP holds serious concerns that the claimed arrangements will result in non-disclosure of actual costs incurred for the production of copy paper by UPM at its Changshu facility.

(b) Export sales to Australia

UPM sells to a number of customers in Australia (Private label brands – *names*). An agency commission that "compensates for both pre and post exportation expenses", is paid to UPM's Australian agent on a per tonne basis

- what specifically is the commission compensating?
- Is the commission a flat fee of, for example, 2 or 3 per cent?
- Does UPM Australia incur losses on the export sales to Australia?
- How are rebates accounted for under this arrangement?
- Are global rebates paid from related parties?

(c) Domestic sales

UPM states that it distributes copy paper through its regional sales offices located in Shanghai, Beijing, Gangzhou, Wuhan to independent customers. It also sells to distributors. Distributors purchase product from UPM and use their own distribution network to sell the product.

- UPM states that the domestic selling prices do not vary between the distribution channels - that is, whether direct to customer or via distributor;
- Rebates (information redacted from UPM EQR) are paid by UPM;
- UPM has warehouse and delivery service contracts – how do the service contracts impact UPM's selling prices?

(d) Rebates & Discounts

The 2013 dumping inquiry verified that rebates and other financial support (not appearing in the declared FOB prices) are paid to major importers of copy paper.

Rebate programs and funding supports might be found in various forms including but not limited to:

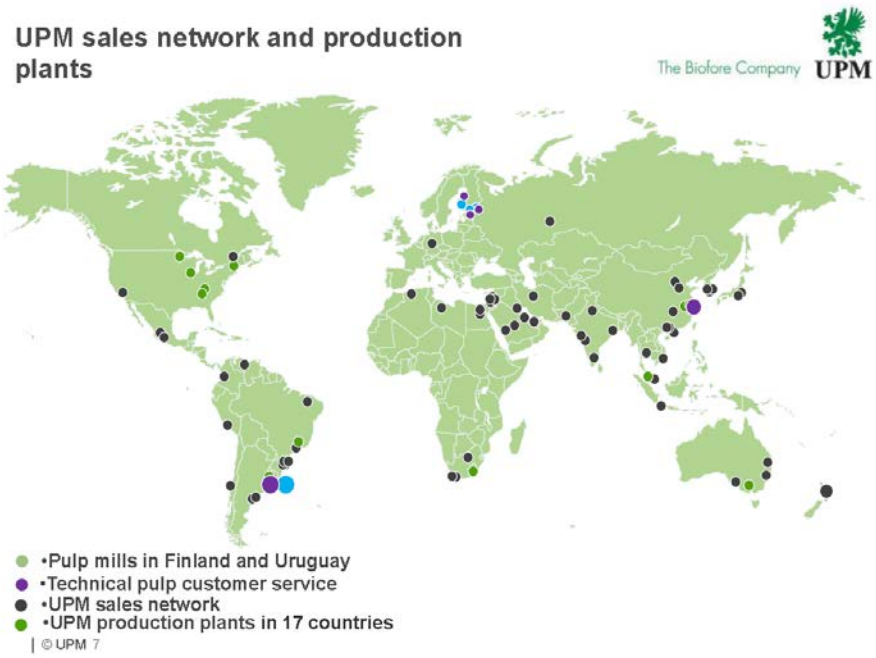
[*rebate categories*]

Reconciliation of rebates and [*rebate type*] can be managed numerous ways depending on the type of rebate, including;

[*rebate arrangements*]

Given the fact that UPM is a global entity operating its UPM AP business through Singapore [*consideration in form of rebates*]

AP believes that whilst both the official Australian import statistics and Chinese official export statistics may accurately report the declared FOB value of the goods, [*comment on financial assistance*].



(e) Fair comparison

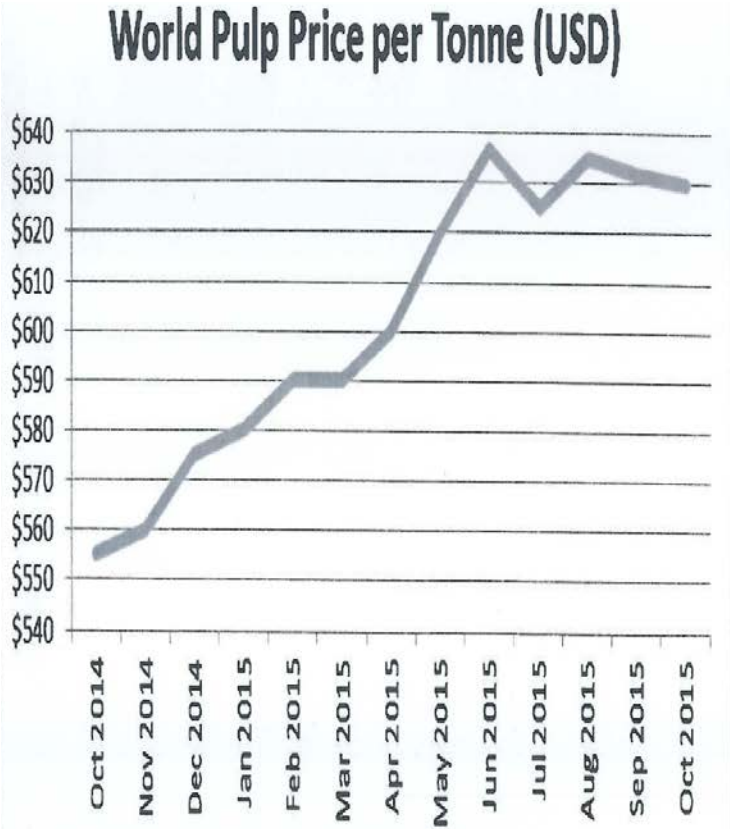
UPM is seeking an "adjustment" for the agency commission fee it pays to its Australian agent. AP does not consider that an adjustment for this fee can be justified as it is between related parties and bears no reflection of a market-based commission between unrelated parties.

UPM has identified that for goods sold domestically, a 17 per cent VAT is applicable, and any customs duty paid on imported raw materials. Exported copy paper does not attract these input costs. The Commission will need to obtain full documentation [*full information to be disclosed*].

It is noted that no level of trade adjustment has been sought by UPM, nor any claim for duty drawback. It is likely that there is a cost difference between packing of goods for domestic versus export.

(f) Costing information and constructed value

UPM uses actual costs. No variances apparent – likely due to the transfer price associated with purchased pulp from related party. Need to refer to increasing global pulp prices during period of investigation (graph).



VI. Particular Market Situation

UPM is subject to GOC policies on investing in China as detailed in "Catalogue for the Guidance of Foreign Investment Industries" specifying industries as encouraged, restricted and prohibited. UPM is also subject to The Paper Industry 12th and 13th Five-Year Plans implemented by GOC.

Paper production in China is an "encouraged" industry. Prior to 2000, no Chinese paper manufacturer was listed in the world Top 100 paper producers. By 2009, China has nine companies ranked in the Top 100 as China's output of paper and cardboard products dramatically increased. China has now captured the No. 1 position as the world's largest producer of paper and cardboard products – surpassing the US. Between 2009 and 2013, China's paper and cardboard production increased from xxx million tonnes to xxx million tonnes (US at xxM and xxM respectively).

UPM is the subject of the policies of the GOC as enacted in the 12th and 13th Five Year plans for the paper industry.

VII. Countervailing

The Changgshu Economic and Technological Development Zone ("CEDZ") website confirms that companies considering investing in the zone will be offered an "incentive package" to do so. Reference is also made to the exemption of municipal fees.

The Commission is well appraised on the benefits available to companies that invest in China's Special Economic Zones ("SEZs"). Included in the benefits are exemptions/reduction in the corporate tax rate of 25 per cent. UPM's EQR indicates that it is in receipt of reduced income tax rates during the period of investigation.

The construction of the M3 paper machine by UPM (opened in 2016) would also have attracted a range of benefits to the company, including:

- exemptions from VAT and customs duties on imported and locally sourced equipment; and
- exemptions from local provincial and municipal charges.

UPM has also indicated that it is the beneficiary of certain (redacted) grants from the Government of China ("GOC"). The grants included those listed as programs 12 to 16, along with additional grants not identified.

Australian Paper requests the Commission to be thorough in its examination of all benefits received by UPM under the identified subsidy programs (listed and not listed), as well as investigating benefits received in respected of upgraded facilities linked to the new M3 machine that will benefit the supply of raw materials and utilities to UPM's paper making machines M1 and M2 (and hence are directly related to the production of the exported goods during 2015).