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DEPARTMENT OF COMMERCE

INTERNATIONAL TRADE ADMINISTRATION

Antidumping Proceedings: Affiliated Party Sales in the Ordinary Course of Trade

AGENCY: Import Administration, International Trade Administration, Department of Commerce.

ACTION: Modification concerning affiliated party sales in the comparison market

SUMMARY: The Department of Commerce is modifying its methodology in antidumping proceedings concerning the determination of whether sales to affiliated parties in the comparison market are made in the ordinary course of trade and thus may be considered for use in calculating normal value. The schedule for implementing this change is set forth in the "Timetable" section, below.

FOR FURTHER INFORMATION CONTACT: Kris Campbell (202) 482-1032, Office of Policy, Import Administration, International Trade Administration.

SUPPLEMENTARY INFORMATION:

Background:

This change in methodology concerns the test used in antidumping proceedings to determine whether comparison market sales between affiliated parties are made at arm's length and thus may be considered to be within the "ordinary course of trade."

Article 2.1 of the Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994 (the "AD Agreement") requires that investigating authorities exclude sales not made in the "ordinary course of trade" from calculations of normal value.[1] Section 773(a)(1) of the Tariff Act of 1930, as amended ("the Act"), implements this provision by restricting comparison market sales used to determine normal value to those made in the ordinary course of trade. Under current Department practice, comparison market sales by an exporter or producer to an affiliated customer are treated as having been made at arm's length, and may be considered to be within the ordinary course of trade,[2] if prices to that affiliated customer are, on average, at least 99.5 percent of the prices charged by that exporter or producer to unaffiliated comparison market customers.

Under this 99.5 percent test, the Department determines the weighted-average comparison market selling price for each product for sales by the exporter or producer to each affiliated party. The Department also determines the weighted-average selling price for each product to the group of unaffiliated comparison market customers. For each affiliated customer, the Department compares the weighted-average price to that affiliate for each product to the weighted-average price of the same product to all unaffiliated customers. The Department then weight averages the ratios found for all products sold to the affiliated customer. If the result

[1] Article 2.1 states: "For the purpose of this Agreement, a product is to be considered as being dumped, *i.e.*, introduced into the commerce of another country at less than its normal value, if the export price of the product exported from one country to another is less than the comparable price, in the ordinary course of trade, for the like product when destined for consumption in the exporting country."

[2] Such sales may be outside the ordinary course of trade for other reasons, *e.g.*, if they are below cost.

shows sales prices to an individual affiliated party are, on average, at least 99.5 percent of the sales prices to all unaffiliated comparison market customers (*i.e.*, the overall ratio is at least 99.5 percent), all of the sales to that affiliated party may be treated as being made in the ordinary course of trade and may be used in calculating normal value. Otherwise, if the prices to the affiliate are, on average, less than 99.5 percent of prices to non-affiliates, it is the Department's practice to disregard them. Additionally, for affiliates that pass this test (*i.e.*, those whose weighted-average prices are above 99.5 percent), the exporter or producer may request the exclusion of individual sales to such an affiliate upon a showing that such sales are for other reasons outside the ordinary course of trade, *e.g.*, the prices are "aberrationally" or "artificially" high.

In July 2001, the WTO Appellate Body issued a report in a dispute involving U.S. antidumping measures on certain hot-rolled steel products from Japan ("Japan Hot-Rolled"),[3] concerning, among other things, the Department's determination of whether sales made to affiliated parties in the comparison market were made in the ordinary course of trade and thus may be considered for use in calculating normal value. In its report in Japan Hot-Rolled, the Appellate Body found that the Department's application of its 99.5 percent arm's-length test in the underlying proceeding was inconsistent with the obligations of the United States under Article 2.1 of the AD Agreement. In the view of the Appellate Body, "[i]f a Member elects to adopt general rules to prevent distortion of normal value through sales between affiliates, those rules must reflect,

[3] *Dispute Settlement Panel Report on Japan Complaint Concerning U.S. Anti-dumping Measures on Certain Hot-Rolled Steel Products from Japan, WT/DS184/R (Feb. 28, 2001) ("Panel Report." Appellate Body Report on Japan Complaint Concerning U.S. Anti-dumping Measures on Certain Hot-Rolled Steel Products from Japan, WT/DS184/AB/R (July 24, 2001) ("AB Report").*

even-handedly, the fact that both high and low-priced sales between affiliates might not be 'in the ordinary course of trade'."[4] Furthermore, "the duties of investigating authorities, under Article 2.1 of the Anti-Dumping Agreement, are precisely the same, whether the sales price is higher or lower than the 'ordinary course' price, and irrespective of the reason why the transaction is not in the ordinary course of trade. Investigating authorities must exclude, from the calculation of normal value, all sales which are not made in the ordinary course of trade."[5] However, investigating authorities do not need to utilize identical rules to scrutinize each category of sales that is potentially not in the ordinary course of trade.[6] WTO Members are afforded discretion in this determination, but such discretion must be exercised in an "even-handed" manner.[7]

The United States and Japan entered into arbitration over the period of time in which to implement the Appellate Body's findings in the Japan Hot-Rolled dispute. The arbitrator found that the United States has until November 23, 2002, for implementation.

On August 15, 2002, we solicited public comment on our proposed modification to practice with respect to treatment of affiliated party sales in the comparison market.[8] We received numerous comments and rebuttal comments submitted pursuant to this notice, as discussed below.

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[4] *AB Report*, paragraph 148.
[5] *Id.*, paragraph 145.
[6] *Id.*, paragraph 146.
[7] *Id.*, paragraph 148.
[8] *"Request for public comment pursuant to section 129(g)(1)(C) of the Uruguay Round Agreements Act,"* 67 FR 53339 (August 15, 2002) ("Proposed Modification").

Final Modification to Arm's-Length Methodology:

The final modification to the Department's arm's-length test is the same as the proposed modification, with the exception of comparing prices of "similar" products where an identical comparison product was not sold to unaffiliated parties, as described below. The new test will provide that, for sales by the exporter or producer to an affiliate to be included in the normal value calculation, those sales prices must fall, on average, within a defined range, or band, around sales prices of the same or comparable merchandise sold by that exporter or producer to all unaffiliated customers. The band applied for this purpose will provide that the overall ratio calculated for an affiliate be between 98 percent and 102 percent, inclusive, of prices to unaffiliated customers in order for sales to that affiliate to be considered "in the ordinary course of trade" and used in the normal value calculation. This new test is consistent with the view, expressed by the WTO Appellate Body, that rules aimed at preventing the distortion of normal value through sales between affiliates should reflect, "even-handedly," that "both high and low-priced sales between affiliates might not be 'in the ordinary course of trade'."

The single change from the proposed arm's-length methodology involves comparing prices of products sold to affiliates with prices of non-identical products sold to unaffiliated customers, with an adjustment for physical differences in the products, where there is no identical product sold to non-affiliates. This methodology corresponds to that used in comparing prices of products sold in the U.S. and comparison markets in the dumping analysis. In comparing prices across markets, the Department first seeks to match U.S. sales with comparison market sales of identical merchandise. If there are no appropriate sales of identical merchandise in the comparison market, the Department seeks the most comparable merchandise based on the

relevant product matching characteristics. When comparing non-identical merchandise, the Department makes an adjustment, where appropriate, to normal value for differences in physical characteristics.[9] This adjustment normally is based on differences in the variable costs of manufacturing attributable to the physical differences between the products.[10] While product characteristics differ from case to case, the Department generally does not compare a comparison market product to a given product sold in the United States if the difference in variable manufacturing costs of the two products is greater than 20 percent.

We plan to employ a corresponding methodology, including adjustments for differences in variable costs and application of the 20 percent "difmer cap," in analyzing non-identical product matches between sales to affiliated and unaffiliated customers for purposes of the arm's-length test. In many cases the information needed, including matching criteria and variable and total cost information, will be on the record pursuant to our standard information requests.[11] Where we lack the necessary information we will limit our analysis to identical merchandise, consistent with our current methodology. That is, we will determine the overall ratio for a given affiliate only on the basis of sales of those products that were also sold to non-affiliates.

[9] *See* section 773(a)(6)(C)(ii) of the Act.
[10] *See* 19 CFR 351.411.
[11] In determining product matches across markets, the 20 percent difmer cap is calculated by dividing the difference in variable manufacturing costs between the two products by the total manufacturing costs of the U.S. product. For the arm's-length test, we will divide the difference in variable manufacturing costs between the two products by the total manufacturing costs of the product sold to the affiliated party. Variable manufacturing costs for home market sales normally are requested in all cases, while total manufacturing costs for home market sales currently are requested in cases involving below-cost inquiries.

The inclusion of comparisons of non-identical matches will enhance the reliability of the arm's-length test by increasing the pool of sales used to calculate the affiliate-specific ratios that are assessed against the 98-102 percent band. While some of the public comments submitted expressed concern that comparing non-identical merchandise will add unnecessarily to the complexity of the arm's-length test, or will otherwise increase the chance of error resulting from data not fully analyzed at the time the arm's-length test is conducted, we believe the benefits of bringing these matches within the ambit of the test outweigh these concerns.[12]

Finally, as noted in the Proposed Modification and as further discussed in the "Comments" section below, we will continue our present practices with regard to the use of so-called "downstream" sales (sales made by an affiliated buyer to that buyer's subsequent customer). Specifically:

1. If sales to all affiliates account for less than five percent of all comparison market sales, we normally will disregard downstream sales.

2. If sales to an affiliate fail the arm's-length test, and (1) does not apply, we normally will request the affiliate's downstream sales and use those instead of the sales which failed that test.

3. If a respondent has cooperated to the best of its ability and is unable to obtain downstream sales, we will not use adverse facts available for those sales.

Analysis of Public Comments

Numerous comments and rebuttal comments were submitted in response to the Proposed Modification. We have carefully considered each of the comments submitted. While we have

[12] *See also* "Analysis of Public Comments," Comment 5, below.

not adopted suggested alternatives to the proposed 98-102 percent band test, the comments were useful in helping to clarify the concepts underlying the "ordinary course of trade" analysis and in refining the test by allowing for comparisons of non-identical products. As such, we are grateful to those who took the time to comment on this aspect of the Department's antidumping methodology. Specific proposals are summarized below, along with our response to each. For more detail on the comments submitted, see the Department's web site at http://ia.ita.doc.gov, where all comments received have been posted in their entirety.

1. Proposals for automatically disregarding comparison market sales between affiliates and requesting downstream sales.

A number of commenters proposed that the Department should presume that comparison market sales between affiliates are always made outside the ordinary course of trade, and should automatically request downstream sales (sales from the affiliated purchaser to unaffiliated customers). These commenters maintain that such a methodology would be consistent with the Appellate Body report in Japan Hot-Rolled, which explicitly allowed for the use of downstream sales in determining normal value, and would also bring the normal value analysis into alignment with the analysis for U.S. sales, in which sales between affiliates are automatically disregarded. In the view of these commenters, such a methodology would reflect the fact that affiliated party sales are inherently suspect and subject to manipulation. They also suggest that the Act explicitly allows for use of comparison market downstream sales while it does not require the use of prices between affiliates. However, one commenter who recommends this approach acknowledges that it would require a change in the Department's regulations, in particular 19 CFR 351.403(c)-(d). This commenter recommends that the change in practice be

accompanied by an announcement that the Department intends to change the regulations to conform to the new practice.

Several commenters objected to this proposal. Some asserted that it is contrary to U.S. law, claiming that the Department must examine *all* sales in the ordinary course of trade, and citing section 773(f)(2) of the Act in support of the general proposition that the Department must make an affirmative finding that transactions between affiliates do not fairly reflect market value before disregarding them. Others claimed that it is contrary to U.S. regulations, and also is likely to give rise to problems of WTO consistency with respect to the obligation to make fair comparisons.

Department's Position: While we disagree with the comment that U.S. law prohibits requesting downstream sales in lieu of upstream sales to affiliated parties[13], we are not adopting the proposal to automatically disregard sales to affiliates. As we stated in the Proposed Modification and as acknowledged by at least one proponent of automatically excluding sales to affiliates, this proposal conflicts with the assumptions underlying the Department's regulations on affiliated party sales (19 CFR 351.403(c)-(d)) that such sales normally will be used in the dumping analysis if shown to be in the ordinary course of trade.

[13] Discretion to request downstream sales is explicit in section 773(a)(5) of the Act ("If the foreign like product is sold, or, in the absence of sales, offered for sale through an affiliated party, the prices at which the foreign like product is sold (or offered for sale) by such affiliated party may be used in determining normal value.").

We do not believe it necessary or appropriate to change these provisions, as suggested by one commenter. The current regulations were developed after extensive comment, including comment on the issue of whether to require in all cases that respondents report downstream sales. In our view, the regulatory scheme for reporting and analyzing affiliated party sales established by 19 CFR 351.403(c) and (d) strikes the appropriate balance between seeking to use first-level sales from the respondent where such sales can be demonstrated to be within the ordinary course of trade, and requiring downstream sales where sales to affiliates do not meet this standard. While this approach does not look to downstream sales automatically, it places an affirmative obligation on respondents to report such sales where sales to an affiliate cannot be shown to be at arm's length. As noted in the preamble to the regulations, the Department "will require a respondent to demonstrate in each segment of an AD proceeding that the reporting of downstream sales is not necessary."[14] This is accomplished in practice by maintaining a requirement that respondents report downstream sales for all affiliated party sales that do not pass the arm's-length test.

2. Proposals for using statistical testing methods instead of a percentage band approach.

Several commenters suggested that the Department incorrectly rejected statistically valid testing (*e.g.*, standard deviation, difference in means, non-parametric tests) in the Proposed Modification in favor of the 98-102 percentage band approach. One commenter took issue with the reasons given in the Proposed Modification for not relying on statistical testing in

[14] *Preamble to Dep't of Commerce Regulations*, 62 FR 27296, 27356 (May 19, 1997) ("Preamble").

determining whether sales are made in the ordinary course of trade, in particular the statement that "[s]uch tests, properly applied, would allow certain affiliated party sales to be deemed in the ordinary course of trade, including sales with prices below unaffiliated sales prices, that we believe would distort dumping calculations."[15] This statement, according to the commenter, is results-oriented reasoning because the Department is focusing on low-priced sales to affiliates and expressly rejecting statistical tests on the basis that, *when properly applied*, these tests would not exclude affiliated party transactions that the Department believes would result in the calculation of "distorted" margins. This commenter suggests that the concern over distorted margins is inappropriate in this context, since statistical approaches, if properly structured, by definition are intended to operate in a mathematically neutral manner.

Another commenter proposed standard deviation testing as an example of a statistically valid methodology more suitable to identifying outlier transactions than the percentage band approach. Citing a proposal for such testing by one of the Japanese respondents in the investigation underlying the Japan Hot-Rolled report, this commenter suggests that, in general, respondents should be allowed on a case-by-case basis to propose alternative testing methods that are reasonable and easy to administer.

Department's Position: While we appreciate the desire for a statistical-testing approach to the arm's-length test, as we indicated in the Proposed Modification, we have been unable to identify an alternative test that adequately serves the purposes of a dumping analysis and can be readily applied in the context of the variety of situations we encounter, including situations that involve

[15] Proposed Methodology at 53340 - 53341.

multiple products sold to an affiliate. The comment that the Department's reasoning is "results oriented" implies that the Department should be unconcerned that parties might manipulate pricing to affiliates for purposes of a dumping case. We disagree. We do not believe that the purpose of the types of statistical tests considered is applicable in this context. Moreover, the only specific proposal offered for a statistical test would apply the test on a CONNUM-specific basis, which is inconsistent with the purpose of evaluating the overall pricing relationship between the affiliates. (See Comment 6 below.) Therefore, we are not persuaded that a statistical test is appropriate in this context.

3. Proposals regarding appropriate size of the band.

A number of commenters proposed that, if the Department decides to use a "band" approach in determining whether comparison market sales to affiliates were made at arm's-length, it should alter the band size from the 98-102 percent range set forth in the Proposed Modification. Three types of proposals were made in this regard: (1) a wider band (*e.g.*, 90 - 110); (2) a narrower band (*e.g.*, 99.5-100.5); and an "asymmetrical" band (*e.g.*, 99.5-125).

Those favoring a wider band argue that a 98-102 percent range does not sufficiently recognize natural variability within a respondent's pricing data, both between customers and over time. This range, therefore, will produce results that fail to reflect commercial reality, leading to the inappropriate rejection of bona fide arm's-length sales.

These commenters suggest that pricing differences of up to ten percent can occur in the normal course of business for reasons unconnected with affiliation, such as differences in quantities and relative differences in bargaining power. One commenter suggested in addition that some variability in POI-average prices to affiliates and non-affiliates can result from selling in different quantities over time to the two groups, *e.g.,* a higher quantity to affiliated customers early in the POI and a higher quantity to unaffiliated customers later in the POI. Under this scenario, even where there is *no* variation in pricing to affiliates and non-affiliates at any single point in time, the affiliate-specific ratios calculated by the Department will show variance from average prices to non-affiliates.

These commenters also contend that a restrictive band for determining whether sales to affiliates are within the ordinary course of trade is counter to the general preference in both the AD Agreement and U.S. law for establishing normal value based on comparison market sales. Further, in the event that the Department seeks to replace sales that fail the new arm's-length test with downstream sales (as indicated in the Proposed Modification), a narrow test may impose overly burdensome reporting requirements, in which case it may not be considered sufficiently "even-handed" as the term is used in the Japan Hot-Rolled report.

Finally, certain commenters favoring a broader band suggest that, to the extent there is concern over manipulation of pricing (*via* clustering of sales to affiliates at the low end of the band), the Department could test for such pricing patterns upon receipt of a respondent's sales databases,

and could address such problems on a case-by-case basis, through the fictitious markets provision[16] as well as the ordinary course of trade provision.

Commenters arguing for a narrower band (99.5-100.5) stress that the change in practice under the proposed 98-102 percent band would go beyond the requirements of the Appellate Body report in Japan Hot-Rolled and would enhance respondents' ability to manipulate home market sales to mask dumping. One commenter provides a hypothetical example of this potential for manipulation, highlighting perceived weaknesses both in the range of acceptable prices in the new standard and the fact that, as with the old standard, it would be applied on an affiliate-specific, and not product-specific, basis.[17] This combination, according to the commenter, would allow respondents to make sales to an affiliate of products matching to U.S. products at prices significantly below the 98 percent threshold (*e.g.*, at 80 percent of prices to non-affiliates) while still passing the test by selling non-matched products to the same affiliate at prices above the threshold (*e.g.*, 120 percent). This commenter maintains that, while such manipulation is possible under the current test, it would be "dramatically easier" under the proposed 98-102 standard.

Another commenter suggests that, if the Department retains the 98-102 standard for investigations, it should at a minimum use a 99.5-100.5 standard for administrative reviews. This approach would place the arm's-length test on a consistent footing with the two percent and 0.5 percent *de minimis* dumping standards used in investigations and reviews, respectively.

[16] Section 773(a)(2) of the Act.
[17] *See also* Comment 6, below, regarding the affiliate-specific nature of the test.

Linking the standards used in the arm's-length test with those used in determining *de minimis* dumping would, according to this commenter, reduce any perceived arbitrariness over the range selected, thereby lowering its susceptibility to further WTO challenges. It would also reflect the greater potential for manipulation of pricing that can occur after imposition of an order than during the initial period of investigation.

Commenters in favor of an "asymmetrical" test base their arguments on language from a footnote in the Japan Hot-Rolled report providing that, "in finding that the application of the 99.5 percent test was not sufficiently *even-handed,* we do not suggest that the methods for verifying whether high and low-priced sales to affiliates are 'in the ordinary course of trade' must necessarily be *identical.*"[18] Accordingly, these commenters suggest, the Department retains the discretion to tailor an arm's-length test for comparison market sales between affiliates geared toward the primary concern in a dumping context: namely, low-priced sales designed to reduce normal value. These commenters maintain that an asymmetrical test is consistent with the WTO report since it imposes a "bright line" standard for high-priced sales, and is otherwise appropriate because it would retain a broader base of profitable sales made in the normal course of business than the proposed 98-102 percent test. It would also reflect the fact that a different set of circumstances exists for high-priced sales between affiliates, which are priced as such for internal company-specific reasons unrelated to the dumping analysis.

Department's Position: We have carefully considered each of the ranges proposed as alternatives to the 98-102 percent test. While some of these ranges (*e.g.*, 99.5-100.5) were

[18] *AB Report,* footnote 113.

previously examined in the course of arriving at the Proposed Modification,[19] we have reconsidered all options regarding upper and lower limits of the band in light of the arguments and hypothetical situations provided in the comments received.

As indicated in the Proposed Modification, the range adopted must account for concerns that the band be neither overly narrow, which would reduce the utility of the test as few affiliates would pass, nor overly broad, which could increase the potential for manipulating normal value through clustering of sales prices to affiliates at the lower end of the band.[20] Having considered the alternative suggestions regarding the appropriate band size, we continue to believe that the 98-102 range strikes the best balance in providing a reasonable and predictable means of assessing whether affiliated party sales were made at arm's-length prices. First, contrary to the argument of advocates for the 99.5-100.5 band, we do not believe that extending the lower end of the acceptable range from 99.5 percent to 98 percent provides a significant opportunity for manipulation of normal value, either in investigations or administrative reviews. The range established retains a standard that reasonably ensures that we only use sales between affiliates that are appropriate for use in the dumping analysis, in light of the fact that such sales are inherently suspect unless demonstrated to be in accord with prices negotiated by independent parties. While a particular concern arises regarding low-priced sales between affiliates in an antidumping context, the requirement that such sales, on average, fall within two percent of average prices to non-affiliates will provide a reasonable means of continuing to ensure against such manipulation.

[19] *Proposed Modification* at 53340. *See also Preamble* at 27356.
[20] *Proposed Modification* at 53340.

As noted, several commenters suggest that the proposed 98-102 standard will have largely the same effect as a 99.5-100.5 band, arguing that sales prices routinely diverge by more than this range in the normal course of business, and that the ratio can be affected by other factors such as the timing of sales to affiliates and non-affiliates within the period of investigation. In response, we note first that the test recognizes that pricing of individual transactions may vary by more than two percent in the normal course of business. Such sales may still be found to be at arm's length and included in the dumping analysis as long as sales to the affiliate are, on average, within the band. The test in this respect is appropriately geared toward a recognition that, while individual sales transactions may be expected to vary in the normal course of business, systematic underpricing or overpricing between affiliates over the period examined in the dumping analysis is indicative of sales not made at arm's length.

Second, as discussed in more detail in Comment 4, below, in comparing prices under the arm's-length test we routinely adjust for many of the factors that give rise to differences in pricing, and allow for additional adjustments, *e.g.*, for differences in quantities, where warranted.

Third, we disagree with suggestions for a broader band (*e.g.*, 90 - 110) coupled with the proviso that, if the Department finds upon further analysis that sales to affiliates are clustered at the low end of the band, it may then consider, on a case-by-case basis, whether to disregard them under either the fictitious market provision or the ordinary course of trade provision. The fictitious market provision is inappropriate for this analysis; whether or not a fictitious market exists, prices between affiliates may not reflect arm's-length transactions. Applying the fictitious market standard would not adequately serve the purpose of identifying systematic underpricing

or overpricing between affiliates. Furthermore, as we have stated in past cases, it is to be used in exceptional circumstances and not employed as a routine part of the Department's analysis.[21] Such inquiries typically require an allegation from an interested party and call for analyses based on information that is quantitatively and/or qualitatively different from the information normally gathered by the Department as part of its standard antidumping analysis.[22] In addition, the suggested approach is not sufficiently in accord with the concept that sales between affiliates are inherently suspect until demonstrated to be in the ordinary course of trade. In effect, it would reverse this concept for certain sales that in our view are suspect, requiring an additional finding, on a case-by-case basis, that other factors render such sales not at arm's length. Finally, there are serious concerns that any such approach would not be reasonably administrable within the time limits of an antidumping proceeding, particularly given the requirement in most instances for downstream sales once a determination is made that sales between affiliates are not at arm's length.

In light of these concerns, we believe the more appropriate finding is that sales below the 98 percent threshold, but within the proposed broader band, are outside the ordinary course of trade. However, as discussed in Comment 4, below, we will consider arguments on a case-by-case basis that such pricing patterns were determined entirely by market factors not captured by the arm's-length test, such as the timing of sales made to affiliated and unaffiliated parties during the period of investigation.

[21] *Certain Corrosion-Resistant Carbon Steel Flat Products from Japan*, 64 FR 12951, 12956 (March 16, 1999).
[22] *Preamble* at 27357.

Finally, we disagree with suggestions that an "asymmetrical" test would be consistent with the WTO report in Japan Hot-Rolled or is otherwise appropriate as a test for sales not made at arm's length. While the Appellate Body provided in a footnote that the tests for whether low-priced and high-priced sales to affiliates are in the ordinary course of trade did not necessarily have to be "identical," this was made in the context of statements that the current test was not sufficiently "evenhanded" to the extent that it "operated systematically to raise normal value, through the automatic exclusion of marginally low-priced sales, coupled with the automatic inclusion of high-priced sales, except those proved, upon request, to be aberrationally high priced." The Appellate Body's finding that the application of the 99.5 percent test in the Japan Hot-Rolled case violates Article 2.1 of the AD Agreement was based on its assessment that the test "focuses predominantly" on the distortion that results from low-priced sales and does not "take equal account of the possibility that prices 'above the [99.5 percent] threshold' can also 'distort' normal value."[23] We believe that automatically disregarding sales to affiliates at prices below the 99.5 percent threshold while automatically including sales at prices up to a 125 percent threshold would be inconsistent with this reasoning.

4. Proposals to take into account relevant commercial circumstances.

Numerous commenters proposed that, in assessing whether affiliated party sales were made in the ordinary course of trade, the arm's-length test should not focus exclusively on price, but should take into account all relevant commercial circumstances. Referencing a statement in the

[23] *AB Report,* paragraph 157.

Appellate Body report that "price is merely one of the terms and conditions of a transaction,"[24] these commenters suggest that, to the extent the arm's-length test ignores the commercial circumstances pertaining to affiliated and unaffiliated party sales, the new methodology will produce distorted results. Suggestions for factors to examine include level of trade, customer categories, quantities sold, product mix, and any other terms of sale relevant to the transactions under examination.

The suggestions vary with respect to the relationship between these factors and the arm's-length test as described in the Proposed Modification. One proposal is that affiliated party sales should be found within the ordinary course of trade wherever their terms of sale are the *same* as sales made at the same time to unaffiliated parties. Other commenters suggest that, if a price analysis is conducted, it needs to ensure that any *differences* in commercial terms and conditions between affiliated and unaffiliated party sales that could impact price are taken into account. A third proposal is that the price analysis should merely establish a *rebuttable presumption* that sales to an affiliated party are outside the ordinary course of trade, which could be countered by other information demonstrating that such sales were in fact made under the conditions and practices that are normal in the comparison market and, thus, are in the ordinary course of trade.

Department's Position: As with the current test, the new methodology takes account of many of the factors suggested by commenters as relevant to the ordinary course of trade analysis. We take this opportunity to clarify those aspects of the methodology used to establish the affiliate-specific price ratios that relate to this issue.

[24] *AB Report,* paragraph 142.

First, price comparisons between affiliated and unaffiliated party sales that are factored into the affiliate-specific price ratios (which are then applied against the 98-102 percent range) are made at the same level of trade, where appropriate. That is, the arm's-length test generally does not compare prices of sales made at different levels of trade. Any sales to affiliates for which there are no comparable sales to unaffiliated parties at the same level of trade are not used in determining the affiliate-specific price ratios. This does not mean that such sales are automatically disregarded from use in determining normal value, but simply that such sales are not used in determining whether, overall, sales to a given affiliate are made at arm's length. If, based on the sales that are used in the analysis, it is determined that sales to an affiliate were made at arm's length, all sales to the affiliate, including sales without comparable unaffiliated sales at the same level of trade, are included in the comparison market database used to establish normal value.[25]

In addition to comparing sales at the same level of trade, the test adjusts affiliated and unaffiliated party prices for numerous differences relating to the sales. The adjustments account for, among other things, differences in packing expenses, movement expenses from the original place of shipment, discounts and rebates, and selling expenses that relate directly to the sale at issue. While the Department's questionnaire specifically requests information pertaining to a number of adjustments, it also allows for responding companies to claim additional adjustments for other expenses relating to the sales at issue. Thus, provided that a respondent has accurately

[25] Under the current test, the same holds true regarding affiliated party sales that have no *identical* matching unaffiliated party sales. See Comment 5 regarding the change in methodology allowing for non-identical comparisons. In both situations, where there are *no* sales to an affiliate that can be compared with unaffiliated party sales, sales to this affiliate would not be used in the dumping analysis.

reported its claimed differences in circumstances of sale, along with other expenses and price adjustments relating to the reported sales, the arm's-length test will account for such differences between sales to affiliates and non-affiliates.

With respect to the request by numerous commenters that the test also take into account the price effect of any difference between sales to affiliates and non-affiliates in quantities sold, we note that adjustments for differences in quantity are addressed at section 351.409 of the Department's regulations. We do not automatically adjust for differences in quantities, but will do so under the conditions specified in this regulation. Moreover, the fact that the arm's-length test makes comparisons only at the same level of trade should reduce the number of instances in which sales of significantly different quantities are compared. As stated in the preamble to the Department's regulations, based on our experience we believe that differences in quantity are more likely to occur at different levels of trade.[26]

Considering these aspects of the arm's-length test in light of the proposals made, we believe the test adequately accounts for the factors alleged by the commenters to affect price comparisons between sales to affiliated and unaffiliated parties. Beyond this, we are not in a position to speculate on any case-specific circumstances that might warrant additional consideration. Accordingly, we have not changed the test in response to these comments. However, as with other aspects of the Department's dumping analysis, parties have a right to submit comments on the record of a proceeding regarding the adjustments that must be made under the statute in order to ensure a fair comparison. We will consider any comments submitted regarding case-specific

[26] *Preamble* at 27368.

adjustments made in the arm's-length analysis in that light. While this does not constitute what one commenter referred to as a rebuttable presumption with respect to the results of the 98-102 percent test, and is not a change in our practice of generally limiting the analysis to pricing as adjusted, as upheld by the Court of International Trade,[27] it does provide a fair opportunity to ensure that all appropriate adjustments are made in deriving the affiliate-specific ratios to which the band applies.

Finally, we have not adopted the proposal that equivalent terms of sale for affiliates and non-affiliates should conclusively establish that affiliated party sales are in the ordinary course of trade. This proposal, like others offered, appears to be based on a sale-by-sale analysis.[28] As we discuss further below, we do not believe this approach appropriately addresses the question of the nature of the relationship between the affiliates.

5. Treatment of sales to affiliated parties of products not sold to unaffiliated parties.

Certain commenters suggested that the Department alter the manner in which it treats sales to affiliated parties of products not sold to unaffiliated parties. Currently, as with affiliated party sales that cannot be compared to unaffiliated party sales at the same level of trade (see Comment 4, above), sales to affiliates with no identical match to an unaffiliated party sale are not used in determining the affiliate-specific ratios that are compared against the 99.5 percent threshold.

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[27] *NTN Bearing Corp. v. United States*, 905 F. Supp1083, 1099-1100 (October 2, 1995).

[28] Comment 6, below, addresses a similar proposal to retain all individual affiliated party sales that are priced at the level of any unaffiliated party sale considered to be in the ordinary course of trade.

However, such sales are not automatically disregarded for determining normal value; they are retained in the comparison market database if the affiliate passes the arm's-length test based on sales that could be compared with unaffiliated party sales.[29]

One commenter suggested that the new test should seek to compare affiliated party sales with sales of non-identical merchandise sold to unaffiliated parties, where there are no comparable sales of identical merchandise. This revision would, according to this commenter, expand the pool of sales used to determine whether pricing to an affiliate was made at arm's-length, and would also be in accord with the Department's regulations on affiliated party sales. These regulations provide that "the Secretary may calculate normal value based on [affiliated party sales] only if satisfied the price is comparable to the price at which the exporter or producer sold *the foreign like product* to a person who is not affiliated with the seller."[30] The use of the term "foreign like product" in this context, according to this commenter, indicates that the determination of whether affiliated party sales are made at arm's length is to be established with reference to the price of identical and similar merchandise sold to unaffiliated parties.

Another commenter suggests an alternative means of including sales to affiliates of products lacking an identical match in the arm's-length analysis; namely, that the Department should

[29] A number of comments received on this issue assume that such sales are automatically considered to have "failed" the arm's-length test and, as such, are disregarded in determining normal value. One commenter suggests that, in a variant of the test, the Department makes an adverse assumption and assigns all affiliated party sales of products with no match to unaffiliated party sales a CONNUM-specific ratio of 0 percent. While the commenter does not cite specific cases employing different methodologies, we will ensure that future cases are consistent in their treatment of affiliated party sales with no match to unaffiliated sales.

[30] 19 CFR 351.403(c) (emphasis added).

assume that such sales were made at 100 percent of the price to non-affiliates, and factor this into the affiliate-specific ratio.

Department's Position: As noted in the "Final Modification to Arm's-Length Methodology" section, above, we intend to match non-identical merchandise where there are no comparable sales of identical merchandise. The reference in the governing regulation to comparing prices of affiliated party sales with sales to non-affiliates of the "foreign like product" makes clear that the price of non-identical merchandise is appropriate for use in determining whether sales were made at arm's length. We expect to be able to make such comparisons where the respondent has provided both total and variable home market costs, typically in cases involving sales-below-cost inquiries. While we will not require total home market costs in non-cost cases solely for purposes of making comparisons in the arm's-length test, we will accept the reporting of such costs on a voluntary basis in such cases. While some commenters maintain that expanding the arm's-length test in this manner will add unnecessarily to the complexity of the analysis, we believe that comparisons to non-identical merchandise can be accommodated within the existing framework for the conduct of antidumping proceedings.

We can see no reason to adopt the alternative proposal for assuming sales with no identical match were made at 100 percent of the price to unaffiliated parties. There is no claim that such an assumption is grounded in fact, and could lead, in effect, to an assumption that affiliated party sales were made at arm's length.

6. Comments regarding appropriate level for determining whether sales are at arm's length: by individual sale; by product; by affiliate

As described in the Background section, above, the Department currently assesses whether sales were made at arm's length at the level of the individual affiliate. Both the methodology used in the 99.5 percent test and the Proposed Modification weight average the product-specific price ratios for all products sold to an affiliated customer to arrive at an affiliate-specific price ratio. If the result shows sales prices to an individual affiliated party are, on average, at least 99.5 percent of the sales prices to all unaffiliated comparison market customers (under the 99.5 percent test) or between 98-102 percent, inclusive, of unaffiliated prices (under the 98-102 percent test), then all sales to that affiliated party may be treated as being made in the ordinary course of trade and may be used in calculating normal value, including any sales made at prices below the threshold. Otherwise, if the affiliate-specific price ratios do not meet these criteria, all sales to the affiliate are generally considered outside the ordinary course of trade, including sales at prices above the 98-102 band.

A variety of proposals were submitted that would allow the arm's-length determination to be made on the basis of individual sale prices or weighted-average prices by product, as opposed to the affiliate-wide determination described above. One commenter suggests that the determination should be done on a sale-by-sale basis. Under this proposal, any individual sale to an affiliated party would be considered as made at arm's-length as long as it is priced at a level equivalent to any comparable sale to an unaffiliated party. According to this commenter, there is no basis to disregard such sales to affiliates where the comparable sale to the unaffiliated party is determined to be in the ordinary course of trade. Another commenter takes the opposite

approach, recommending that *all* individual sales to an affiliate must be found to be priced at levels establishing the arm's-length nature of the transaction in order for any sales to the affiliate to be used.

Another commenter proposes a product-specific approach for each customer, whereby the product-specific average price, as sold to an individual affiliate, must be within the band established for arm's-length sales in order for such sales to be used in determining normal value. According to this commenter, a product-specific approach to determining sales in the ordinary course of trade is more in line with the rest of the statutory framework for determining normal value, which is centered on the price of the foreign like product, *i.e.*, a model-specific hierarchy of merchandise for comparison. Yet another commenter views "foreign like product" broadly (akin to class or kind) and contends that the arm's-length analysis should focus on this broad basis, since a corporation's pricing decisions are rarely, if ever, made on a CONNUM-specific basis.

Department's Position: While we have carefully considered each of these alternative proposals for the appropriate level at which to determine whether affiliated party sales are made within the ordinary course of trade, we have decided to retain our normal practice of making this determination on an affiliate-wide basis. While certain individual sales and products that would pass the test on their own may be excluded under this approach, and vice-versa, an affiliate-wide analysis does not systematically bias the arm's-length determination in one direction or another. Our reasons for preferring that the determination of whether sales are made at arm's-length be

conducted at the level of the individual affiliate were set forth in the investigation underlying the AB Report in Japan Hot-Rolled:

> With respect to NKK's concern of applying the arm's-length test on a customer basis, we note that the question underlying the arm's-length test is whether affiliation between the seller and the customer has (in general) affected pricing. Because affiliation is the result of relationships between firms, the focus of the arm's-length test is the customer, not a particular product. For this reason, the Department makes one up-or-down call on pricing to an affiliated customer: either there is arm's-length pricing or there is not. However, under NKK's [product-specific] approach, affiliation could be found to matter for some connums, but not for others, even though the customer in both cases is the same.[31]

This aspect of the Department's methodology was not at issue before either the WTO Panel or the Appellate Body in Japan Hot-Rolled, and we do not find sufficient reason to depart from the current approach in adopting the new methodology. Moreover, abandoning the focus on the pricing relationship with the affiliate would fundamentally alter the nature of the test and introduce many complicated questions about other aspects of the test as well as use of downstream sales.

While the explanation cited above pertains to requests for a product-specific approach, its rationale applies as well to requests for a sale-specific approach. In particular, the proposal to retain an individual affiliated party sale if priced at a level equivalent to a comparable sale to an unaffiliated party would require that we ignore the potential for manipulation that results from the affiliation. Under this approach, affiliated party sales could be priced on average far below market price and still be retained for determining normal value as long as they are made at the

[31] *Final Determination of Sales at Less Than Fair Value: Hot-Rolled Flat-Rolled Carbon-Quality Steel Products from Japan*, 64 FR 24329, 24342 (May 6, 1999).

price of the *lowest* individual sale price to an unaffiliated customer. The adoption of this method for determining arm's-length sales would, therefore, not establish that affiliated party sales are appropriate for use in the dumping analysis.

7. Proposals for treatment of merchandise "consumed" by affiliates, as distinguished from merchandise resold.

Certain commenters submitted proposals for differentiating between sales of the foreign like product "consumed" (not resold as subject merchandise) by an affiliate and sales to an affiliate that are resold as subject merchandise.[32]

One commenter suggested that, when sales to affiliated parties are not resold but are instead "consumed," the standard used in the arm's-length test should be different. In particular, this commenter suggests dropping the requirement that sales, on average, be within the band and allowing any individual sales within the band to pass the arm's-length test. This commenter suggests that the broader requirement that pricing overall to the affiliate be within the band is less relevant where an affiliate consumes the merchandise by producing and selling a product that is outside the scope of the order.

Another commenter, while proposing that the Department automatically request downstream sales in the case of resales (see Comment 1, above), suggested applying an arm's-length test in

[32] Sales *by* an affiliate of subject merchandise are referred to in the Preamble to the Department's regulations, and in this notice, as "downstream sales." *Preamble* at 27356. Sales from the respondent company *to* the affiliated reseller are described in this notice as "upstream sales."

the limited instance of sales of merchandise "consumed" by an affiliate. Alternatively, a third commenter, while agreeing that the Department should automatically request downstream resales, suggested eliminating sales of merchandise consumed by an affiliate from the analysis. This commenter suggests that the Department's concern over a methodology that leads to fewer comparisons based on the preferred methodology (home market sales) is overstated, given the U.S. Court of Appeals ruling in *Cemex S.A. v. United States* with respect to matching to similar merchandise[33]. Further, according to this commenter, disregarding all sales to affiliated consumers would not be contrary to the Department's regulations or Congressional intent, since the former must be read in light of the general suspicion of affiliated party sales encompassed in the Statement of Administrative Action accompanying the Uruguay Round Agreements Act (SAA), and the latter anticipates that Commerce, "in general," will not rely on sales to affiliates in determining normal value.[34]

Department's Position: Consistent with our current practice and with section 351.403(c) of the Department's regulations, we intend to continue using sales to affiliates, whether of merchandise consumed or resold, to determine normal value where such sales are shown to be at arm's length. The comments submitted proposing different treatment of sales of merchandise consumed by affiliates do not provide sufficient reasons to depart from this practice.

[33] 133 F.3d 897 (Fed. Cir. 1998) (citing also DOC Policy Bulletin 98.1, which specifies that, henceforth, when all sales of a particular home market model are below cost, instead of automatically resorting to constructed value to determine normal value, the Department will first attempt to use prices of a non-identical model that remains above cost.)
[34] Citing H.R. Rep. No. 103-826, at 82 (1994).

With respect to the proposal that individual sales of merchandise consumed by affiliates should be found to have passed the arm's-length test whenever such sales prices are within the established price band, no underlying rationale was provided for this difference in treatment other than to claim that the affiliate-wide pricing requirement "makes no sense" as applied to affiliated consumers. We do not believe that there is sufficient reason to apply a different standard with respect to such sales. Whether the affiliate consumes or resells the subject merchandise, the question posed is the same and the test applied should be the same.

With respect to the suggestions that we should automatically disregard sales to affiliated consumers, or that we should apply an arm's-length test *only* to such sales while automatically disregarding sales to affiliated resellers, our response to Comment 1, above, which provides our reasons for applying an arm's-length test to upstream sales to resellers (as opposed to automatically disregarding such sales), applies as well to applying an arm's-length test to sales to affiliated consumers and using such sales to establish normal value when they are demonstrated to be at arm's length. There is insufficient reason to apply different methodologies to these two groups of sales to affiliated parties. We also note that, to the extent there is ambiguity regarding reporting requirements for these two types of affiliated party sales, we intend in the future to make clear that sales to affiliates, whether consumers or resellers, will be used in the dumping analysis where shown to be at arm's length based on the 98-102 price band methodology.

8. Other methodological proposals for determining sales at arm's length.

Other proposals made regarding the arm's-length test include:

- A proposal by the commenter who recommended a sale-by-sale approach to use, as an alternative in the event the sale-by-sale approach is not adopted, the quantity-based test described as an alternate option in the Proposed Methodology. Under this option, affiliated party sales would be found within the ordinary course of trade as long as a sufficient quantity of comparable sales to non-affiliates were priced above and below the affiliated price. This commenter believes the Department's concerns over this option, centering on complexity, implementation, and uncertainty over the appropriate level of quantities needed to pass the test, are overstated, and provides examples of how it could be implemented without undue difficulty.

- A suggestion to apply the arm's-length test only when common ownership between affiliates reaches a level of 50 percent or more. This approach, the commenter suggests, will more accurately reflect those situations where actual control exists sufficient to give rise to concerns over manipulation of pricing.

- A request for clarification of the methodology with respect to a single affiliate with multiple customer codes in the reported home market database, due to, for instance multiple billing addresses. This commenter requests that Commerce adopt in all cases the methodology used in *Certain Cold-Rolled Carbon Steel Flat Products from France,*[35] where it "collapsed" multiple customer codes and performed the arm's-length test on an aggregate basis.

[35] 67 FR 31204 (May 9, 2002)

C A request that the Department explain how a band approach, containing an upper-level ceiling on affiliated party prices, is consistent with the test applied for valuing inputs sold between affiliates, as prescribed at sections 773(f)(2) and (3) of the Act. The commenter believes any differences could be interpreted as reflecting inconsistent definitions of the term "foreign like product," one relating to price-based normal value (arm's-length test) and one relating to constructed value (the provisions of the Act cited above). This commenter requests that this explanation be made with reference to a recent remand by the Court of International Trade (as directed by the Court of Appeals for the Federal Circuit), in which the Department was asked to clarify why it uses different definitions of the term "foreign like product" for price-based and cost-based calculations.[36] The commenter also references the recent determination in *Certain Cold-Rolled Carbon Steel Flat Products from France*,[37] where, the commenter maintains, the arm's-length and cost valuation issues were joined, since a transaction that failed the current arm's-length test could be evaluated under the major input rule for use in determining input costs.

C A request for clarification that, when the Department finds an insufficient volume of sales to unaffiliated purchasers, it will continue its practice, as noted in the preamble to the Department's regulations,[38] of disregarding affiliated party sales.

[36] *FAG Italia v. United States*, 291 F.3d 806 (CIT 2002)
[37] 67 FR 31204 (May 9, 2002)
[38] *Preamble* at 27355.

- A request that the Department explicitly place on respondents the burden of proof for establishing that affiliated party sales are in the ordinary course of trade, and clarify that all such sales will be disregarded until this burden of proof is met.

- A request for clarification regarding whether all affiliated party sales that fail the arm's-length test will continue to be excluded from the CEP profit calculation. This commenter notes that the current practice is centered on *low-priced* sales falling below the 99.5 percent threshold,[39] and asks whether *high-priced* sales above the 98-102 band would also be excluded. This commenter suggests that "capping" the CEP profit calculation by excluding high-priced sales that fail the arm's-length test would conflict with the preamble to the Department's regulations and with its statutory obligations.[40]

Department's Position: We respond to each item, in turn. With respect to the suggestion favoring the use of a quantity-based test, our concerns with this test, as set forth in the Proposed Modification, remain despite the suggestions by the commenter. These include, in addition to the general complexity and implementation concerns cited by the commenter, concerns over whether to apply the test by affiliate or for all affiliates combined by product, and questions as whether this might not be an overly narrow definition of the "normal" price range of sales to affiliated parties. We continue to believe the 98-102 percent band provides a more reasonable, predictable, and administrable test.

[39] Citing *Import Administration Policy Bulletin 97.1: Calculation of Profit for Constructed Export Price Transactions*, at pages 3 - 5 (September 4, 1997).
[40] Citing *Preamble* at 27354 ("the statute does not authorize a cap on the amount of profit deducted from CEP.")

With respect to the suggestion that we only apply the arm's-length test in situations involving 50 percent or greater cross-ownership between affiliates, as we stated in the preamble to the Department's regulations, we believe an arm's-length analysis is appropriate "whenever there are transactions between parties within the meaning of section 771(33) of the Act. Therefore, if two parties are affiliated, any transactions between them are subject to paragraphs (c) and (d) of 19 CFR 351.403, allowing use of transactions between affiliated party sales only if found to be made at arm's length]."[41] We have not changed our view in this regard.

With respect to the issue of multiple customer codes for a single affiliate, we confirm that we intend to aggregate sales to a single affiliate for purposes of the arm's-length test.

With respect to the comment regarding a perceived inconsistency between the arm's-length standard as set forth in the Proposed Modification and the statutory requirements for valuing affiliated party inputs (sections 773(f)(2) and (3)), we disagree that the arm's-length test must apply the standard or test used for valuing affiliated party inputs. These tests are employed for different purposes in analytically distinct areas of the dumping analysis. As for the CIT remand cited by the commenter, we note that this remand concerned a separate issue relating to the statutory definition of "foreign like product" as the term is used in various parts of the antidumping statute. The commenter did not explain the relevance of this court decision, nor do we believe that the modification of the arm's-length test depends on or implies any application of different definitions of the term "foreign like product."

[41] *Preamble* at 27356.

With respect to the request for clarification on our intended practice regarding insufficient unaffiliated party sales, we confirm that, consistent with the preamble to our regulations, affiliated party sales will not be used where there are insufficient unaffiliated party sales for use in the arm's-length test.

With respect to the comment on burden of proof, we believe the Department's regulations speak for themselves, namely that affiliated party sales will be used only where the Department is satisfied that the price to an affiliate is comparable to unaffiliated prices.[42]

With respect to the request for clarification regarding affiliated party sales used in determining CEP profit, the Department's current practice is to exclude non-arm's-length sales and include downstream sales of the same merchandise where such sales are reported. We have not changed that policy.

9. Treatment of downstream sales

Aside from the methodology used to determine whether sales to affiliates are made in the ordinary course of trade, numerous commenters submitted proposals regarding the use of downstream sales by affiliated parties where upstream sales fail the arm's-length test.[43]

[42] 19 CFR 351.403(c)

[43] *See* page 7, above, and Proposed Modification, 67 FR at 53340, for a summary of the Department's practice concerning downstream sales.

Several commenters maintain that the 98-102 percent test, if adopted, will increase reliance on downstream sales and will, as a result, create greater potential for facts available given the frequent reluctance on the part of affiliated resellers to provide information regarding downstream sales. One commenter suggests that, in order to balance this likely effect, the current "five percent" exemption for reporting downstream sales[44] should be broadened to a "20 percent" exemption, analogous to the rule for determining whether "substantial quantities" of sales were made below cost. Under this approach, the Department would not request downstream sales for any respondent whose comparison market sales to affiliates comprise less than 20 percent of the value (or quantity) of all comparison market sales of the foreign like product. Alternatively, this commenter suggests applying the five percent test on a different basis than that currently used. Specifically, instead of determining whether sales to *all* affiliates are less than 5 percent of total sales of the foreign like product, the Department would under this proposal determine whether only those sales of merchandise to affiliates that (1) failed the arm's-length test and (2) are resold (not consumed) are less than five percent of all sales of the foreign like product, and would not request any downstream sales if this standard was met.

Another commenter suggests that the Department should not request downstream sales under the following circumstances: (1) where sales to an individual affiliate constitute less than one percent of all comparison market sales of the foreign like product, regardless of whether the five percent exemption is met in the aggregate; (2) where respondents demonstrate that downstream

[44] *See* section 351.403(d) of the Department's regulations, specifying that the Department generally will not calculate normal value based on downstream sales where sales of the foreign like product to affiliated parties constitute less than five percent of the total value (or quantity) of the respondent's sales of the foreign like product in the market in question.

sales prices are *lower* than upstream sales prices, provided they agree that upstream prices would be used in determining normal value; and (3) where resales are made in small quantities or at different levels of trade than the other comparison market and U.S. sales.

Other commenters propose stricter reporting requirements and expanded coverage of downstream sales. One suggestion is to eliminate or lower (to 0.5 percent) the five percent exemption for reporting downstream sales in order to counteract what is likely to be a larger amount of sales disregarded – particularly high-priced sales – under the revised test compared with the 99.5 percent test.

Another commenter recommends a different standard be applied in investigations and reviews regarding the respondent's obligations to report downstream sales. This proposal would allow for downstream sales to be disregarded in investigations when a respondent demonstrates to the Department that it cannot obtain such sales, but would require respondents to include, as a condition of sale to affiliates, a requirement that such affiliates provide information on their sales in antidumping reviews. This proposal would have the Department issue a statement of practice pertaining to administrative reviews providing, among other things, that "[i]f a respondent claims that it is otherwise unable to submit the downstream sales data of an affiliated seller, the Department will apply adverse facts available."

Finally, another commenter asks that the Department make clear that it will apply an arm's-length test to downstream sales, where such sales are sold to a second-level affiliate.

Department's Position: We have not changed our requirements regarding downstream sales based on these suggestions. With respect to the five-percent threshold for reporting downstream sales by affiliates set forth at section 351.403(d) of the Department's regulations, the proposals to raise or to lower this standard do not address the proposed change in the arm's-length test itself. In any event, we do not believe that a change in the regulations is warranted by these suggestions.

The adoption of the five-percent threshold was based on the premise "that imposing the burden of reporting small numbers of downstream sales often is not warranted, and that the accuracy of determinations generally is not compromised by the absence of such sales."[45] We continue to believe that a five-percent standard normally balances these considerations appropriately. The proposed 20 percent standard is too high to warrant confidence that exceptions to reporting downstream sales based on this threshold would not compromise the accuracy of our determinations. On the other hand, the proposed 0.5 percent threshold is based on a misplaced analogy to the *de minimis* dumping standard in administrative reviews. We do not believe that exempting downstream reporting where a respondent sells less than five percent of the foreign like product to affiliates, and basing normal value on other sales or on constructed value, gives rise to concerns about the accuracy of our determinations.

With respect to the proposal that the sales of the foreign like product used to determine whether the five-percent threshold is met should be narrowed to only those that fail the arm's-length test and are not consumed by the reseller, we continue to believe that the five-percent standard, as

[45] *Preamble* at 27356.

stated in the regulation, is appropriate. The assessment by the Department, in the preamble to the regulations, that excusing reporting of downstream sales would not compromise the accuracy of its determinations was predicated on a finding that the respondent's *total* sales of the foreign like product to affiliates were less than five percent of all sales of the foreign like product. While we may determine in certain cases that it is appropriate to excuse downstream reporting along the lines suggested by this commenter, we do not believe the proposal could be applied generally without compromising accuracy. For similar reasons, we also disagree with the proposal to exempt individual affiliates from reporting downstream sales based on the proposed "one-percent" standard, though we may exempt reporting of such sales in individual cases. In our view, the five-percent standard, based on a company's aggregate sales to all affiliates, provides a reasonable test for whether to exempt a respondent from downstream reporting.

Regarding the proposal that we exempt respondents from downstream sales reporting where they can show such sales were made at prices below the relevant upstream sale and agree to use the upstream sale in its place, we do not believe it would be appropriate to address such hypothetical situations. We will do so if and when such issues are raised in a case.

Regarding the proposal that we exempt downstream sales made at different levels of trade than other comparison market sales or U.S. sales, such an exemption could conflict with our practice of matching U.S. and comparison market sales at different levels of trade in the absence of comparable sales at the same level of trade. As such, it could inappropriately reduce the number of price-based comparisons in the dumping analysis. However, as stated in the Preamble to the Department's regulations, the Department does not believe it necessary or appropriate to require

the reporting of downstream sales in all instances, though the Department will require a respondent to demonstrate in each segment of a proceeding that the reporting of downstream sales is not necessary.

Regarding the proposal that we exempt downstream sales made in small quantities, as noted above, we believe that, as a general matter, the correct level at which to determine whether sales are so small as to warrant not reporting is at the level of the upstream sale between affiliates. This is the level at which the five-percent threshold is applied. Any other requests for exemptions from reporting based on a small quantity of sales would need to be considered on a case-by-case basis.

Regarding the proposal that we apply different standards in investigations and administrative reviews regarding a respondent's claim that it cannot submit downstream sales data, we disagree with the suggestion that we automatically resort to adverse facts available in administrative reviews. We will continue to determine, based on the facts of each case, the extent to which an individual respondent has failed to cooperate by not providing requested information. This approach is consistent with our statutory and WTO obligations regarding the use of adverse facts available. While we do not disagree in principle with the suggestion that a respondent who has participated in an initial investigation may be expected in subsequent administrative reviews to have gone to greater lengths to secure such data, any finding of uncooperativeness must be made with reference to the particular facts of each segment of the proceeding.

Finally, we intend to continue our practice of applying the arm's-length test to any sales made to affiliated parties, including downstream sales to second-level affiliates.

10. *Proceedings/entries governed by revised arm's-length test.*

One commenter argued that the Department's proposed timetable for applying the new methodology with respect to other proceedings and segments of the Japan hot-rolled proceeding *other than* the investigation (*i.e.*, reviews initiated on the basis of requests received on or after the first day of the month following the date of publication of the Department's final notice of that new methodology) would contravene section 129(c) of the URAA (19 U.S.C. § 3538(c)). That section, the commenter claimed, requires that such changes be implemented only with respect to *entries made*, not proceedings requested or initiated, on or after the implementation date.

Department's Position: The Department's timetable for applying its new methodology beyond the Japan hot-rolled investigation is legally permissible and appropriate. Specifically, contrary to the commenter's assertions, section 129 of the URAA applies only to changes implemented with respect to the segment of the proceeding that gave rise to the WTO challenge. That is, section 129 of the URAA applies only to changes made as a result of "an *action* by the administering authority in a proceeding under title VII . . . [that] is not in conformity with the obligations of the United States under the Antidumping Agreement . . .." Section 129(b)(1) (emphasis added). Therefore, the timing provisions of section 129(c) (which deal with

implementation under section 129) also apply only to changes to measures "as implemented" with respect to the segment of the proceeding which served as the basis for the WTO challenge.

In contrast, changes in agency practice (such as this change with respect to the arm's-length test) made in connection with an adverse WTO panel or Appellate Body are governed by a different provision of the URAA. *See* section 123(g) of the URAA. Section 123 has its own "effective date of modification" provision (section 123(g)(2)). This provides for a single limitation on the effective date: "the final rule or other modification may not go into effect before the end of the 60-day period beginning on the date on which consultations [with the appropriate congressional committees on the proposed content of the modification] begin [unless the President determines that an earlier effective date is in the national interest]." Because this new methodology will "go into effect," for other proceedings and other segments of the Japan hot-rolled proceeding, after the 60-day period will have ended, the timetable for implementation is lawful. Thus, Commerce's decision to apply its new methodology prospectively, beginning with segments of proceedings initiated on or after November 23, 2002,[46] is proper.

The fact that, under the proposed implementation timetable, the new arm's-length methodology "would affect" margins on imports which entered prior to the implementation date, but for which the margins would be calculated in a review initiated after the implementation date, does not compel the result urged by the commenter. The commenter's broad reading of the legislative history of section 129 does not provide authority for extending the effective date provision of

[46] *See* "Timetable" section, below.

that section to areas covered instead by section 123, especially given that section 123 has its own, different, provision that controls such a new methodology.

It is significant that section 123 uses the term "go into effect" (which refers to the beginning of use of a methodology), rather than language of section 129, which refers to which entries will be affected. There is no legislative inconsistency with the use of a new methodology "affecting" entries made prior to the date on which the methodology changed. Indeed, except where otherwise specified (as in section 129 with respect to the actions of the Department in the contested segment of the proceeding), the Department's practice has normally been to begin application of a new methodology with respect to segments of proceedings requested or initiated after a given date, rather than applying different methodologies within the same segment of the proceeding. *See, e.g.*, Section 291(a)(2) of the URAA (the URAA amendments shall "take effect" on the date the WTO Agreements enter into force and "shall apply with respect to" reviews initiated pursuant to a request filed after such date); 19 CFR § 351.701 (regulations implementing the changes made by the URAA "apply to all administrative reviews initiated on the basis of requests made after June 18, 1997" (the "effective date" provided in the notice of final rule published in the Federal Register on May 19, 1997).

11. Applicability of Administrative Procedures Act to revised arm's-length test.

One commenter contended that the change to the arm's-length test is tantamount to creating a rule as set forth in 5 U.S.C. § 553 of the Administrative Procedures Act (APA). More specifically, citing Carlisle Tire & Rubber Co. v. United States, 10 C.I.T. 301, 305-06 (1986)

(Carlisle), the commenter suggests that the Department's notice and comment procedures should comply with those set forth under APA. In this commenter's view, the 15 day notice and comment period provided by the Department falls short of the 60 day period required under the APA.

Department's Position: As discussed above, the revised arm's-length methodology has been developed taking into account the finding in the AB Report that the application of the 99.5 percent arm's-length test in the underlying investigation was inconsistent with the obligations of the United States under Article 2.1 of the AD Agreement. As a result, the revised arm's-length test represents a methodology consistent with section 2.1 of the AD Agreement in accordance with the AB Report. Unlike the methodologies contested in Carlisle, our arm's-length methodology does not create an inflexible rule. In short, the Department's arm's-length methodology is not subject to the APA because, unlike the methodology underlying Carlisle, it only interprets the law.

The Department also notes that section 123(g) does not provide for application of the APA within the context of the remediation of the Department's practice. Section 123(g) only requires, in relevant part, that the Department provide the public with the proposed change, an explanation of how that change would implement the panel or Appellate Body report, and an opportunity for comment. Consequently, under a plain language reading of section 123(g), the Department's announced change in practice would not be subject to the notice and comment procedures of the APA.

Timetable

This methodology will be used in implementing the Japan Hot-Rolled findings pursuant to section 129 of the URAA. In accordance with section 129(c)(1) of the URAA, the section 129 determination in Japan Hot-Rolled will establish new cash deposit rates for all producers for whom the investigation rates are still applicable and will apply with respect to unliquidated entries of the subject merchandise which are entered, or withdrawn from warehouse, for consumption on or after the date on which the United States Trade Representative directs the Department to implement that determination. With respect to other proceedings and other segments of the Japan hot-rolled proceeding, the new methodology will be applied in all investigations and reviews initiated on or after November 23, 2002.[47]

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Faryar Shirzad
Assistant Secretary
for Import Administration

Date: November 8, 2002

[47] This is a slight modification of the Timetable as set forth in the Proposed Modification. Previously, the Timetable anticipated that the implementation of this practice would go into effect with respect to investigations initiated on the basis of requests received after the publication date of this notice, and for reviews initiated on the basis of requests received in the month following publication of this notice. Upon further consideration, we have determined that it is appropriate to employ this methodology in all investigations and reviews initiated on or after November 23, 2002.