August 30, 2002

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The Honorable Faryar Shirzad
Assistant Secretary of Import Administration
U.S. Department of Commerce
International Trade Administration
Central Records Unit, Room 1870
14th Street and Constitution Avenue, N.W.
Washington, D.C. 20230

Attn**:** Affiliated Party Sales

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

Dear Assistant Secretary Shirzad:

Pursuant to the Department of Commerce's August 15 Notice requesting comments on the proposed modification of its practice concerning the determination of whether sales to ffiliated parties are made in the ordinary course of trade,[1] we hereby submit one original, six copies and one diskette of the following comments.

[1] 67 Fed. Reg. 53,339 (August 15, 2002).

Please do not hesitate to contact me with any questions or concerns regarding this request.

Sincerely,

Gary N. Horlick
of O'MELVENY & MYERS LLP

DC1:524892.1

Affiliated Party Sales in the Ordinary Course of Trade
Comments filed by O'Melveny & Myers LLP
August 30, 2002

Pursuant to the Department of Commerce's (the Department) August 15 Notice requesting comments on the proposed modification of its practice concerning the determination of whether sales to affiliated parties are made in the ordinary course of trade,[1] O'Melveny & Myers LLP provides the following comments.

I. Administrative Procedure Act ("APA") Rulemaking

As a threshold matter, while we appreciate the opportunity to comment on the Department's proposed arm's-length methodology, the alteration of the current test amounts to the creation of a rule which should be undertaken pursuant to the APA.[2]

Under the APA, a "rule" is defined as "the whole or part of an agency statement of general or particular applicability and future effect designed to implement, interpret, or prescribe law or policy."[3] The Department's proposed revision would require that the overall price ratio calculated for an affiliate fall within a band of between 98 and 102 percent of unaffiliated sales prices, in order for sales to that affiliate to be considered "in the ordinary course of trade" and used in the normal value calculation. A new test which alters the methodology for the normal value calculation will change the way in which the antidumping laws are implemented, is a statement of general or particular applicability, and thus must be considered a "rule" under the APA.

The U.S. Court of International Trade has held that the promulgation of a rule must comport with the notice and comment provisions of the APA.[4] The APA requires that when an agency issues a rule, it must publish a notice of rulemaking in the *Federal Register*, give interested persons a meaningful opportunity to participate in the rulemaking through written submissions, and "incorporate in the rules adopted a concise general statement of their basis and purpose."[5] Executive Order 12,866 of September 30, 1993, Regulatory Planning and Review, seeks to make this process more accessible and transparent. In doing so, it explicitly provides that part of the agency rulemaking responsibility is to "afford the public a meaningful opportunity

[1] *Antidumping Proceedings: Affiliated Party Sales in the Ordinary Course of Trade*, 67 Fed. Reg. 53,339 (Dep't Comm. August 15, 2002) ("August 15 Fed. Reg. Notice").
[2] 5 U.S.C. § 553 (2000).
[3] 5 U.S.C. § 551 (4) (2000).
[4] *See Carlisle Tire & Rubber Co. v. United States*, 10 C.I.T. 301, 305-06, 634 F. Supp. 419 (1986) (holding that the Department's promulgation of a rule that a particular *ad valorem* percentage is *de minimis* in all cases must be done in accordance with the notice and comment provisions of the APA).
[5] 5 U.S.C. § 553(b), (c) (2000).

to comment on any proposed regulation,[6] which in most cases should include a comment period of not less than 60 days."[7] Given that the Federal Register notice requesting comments on the proposed modification of the Department's practice was issued on August 15, 2002, and the due date for comments is August 30, 2002, the 15 day period provided for public comment falls far short of the 60 day period provided by Executive Order. While the opportunity to comment afforded by the Department is welcome, it does not satisfy the requirements of public participation in rulemaking as defined by the Executive Order interpreting the APA.

II. U.S. Commitments Under the Uruguay Round Agreements Act Statement of Administrative Action (SAA)

Subsection 123(g) of the SAA ensures that the Administration will consult with relevant Congressional committees and consider public and private sector views concerning any change in administrative practice that the Administration may propose in response to a WTO panel or Appellate Body report that finds the practice to be inconsistent with a Uruguay Round Agreement.[8]

In *United States – Anti-Dumping Measures on Certain Hot-Rolled Steel Products from Japan* ("*Japanese Hot-Rolled*"), the WTO Appellate Body found that the Department's 99.5 percent arm's-length test as applied was inconsistent with the obligations of the United States under Article 2.1 of the Antidumping Agreement.[9] The United States has previously argued that a general Commerce Department practice is not challengeable at the WTO. Rather, a party must challenge the specific application of the practice. Here, rather than simply alter its methodology in *Japanese Hot-Rolled*, the Department is proposing a change in methodology to be implemented in all future antidumping investigations. Thus, the Department is implicitly acknowledging that the overall practice of the arm's-length test is challengeable and more analogous to a "rule" under the APA than to a general "administrative practice."[10]

[6] The Executive Order defines "regulation" as "an agency statement of general applicability and future effect, which the agency intends to have the force and effect of law, that is designed to implement, interpret, or prescribe law or policy or to describe the procedure or practice requirements of an agency." Exec. Order No. 12,866, 58 Fed. Reg. 51,735, 51,737 (Oct. 4, 1993).
[7] *Id.,* 58 Fed. Reg. at 51,735, 51,740.
[8] 19 U.S.C. § 3533(g) (2000). *See also*, The Uruguay Round Agreements Act Statement of Administrative Action at § 123(g), *reprinted in* Message from the President of the United States Transmitting the Uruguay Round Trade Agreements, Texts of Agreements, Implementing Bill, Statement of Administrative Action and Required Supporting Documents, H.R. Doc. No. 5110, 103d Cong., 2d Sess. 352 (1994) ("SSA").
[9] Report of the Appellate Body, United States – Antidumping Measures on Certain Hot-Rolled Steel Products from Japan, AB-2001-2, WT/DS184/AB/R (July 24, 2001) ("Hot-Rolled Steel Appellate Body Report").
[10] It should be noted that the APA and section 123(g) of the URAA are not inconsistent with one another, and that in this case, both should be applied and followed.

III. The Department's Proposed Rule Does Not Resolve the Problems Found By The WTO Appellate Body in Hot-Rolled Steel Products From Japan.

In *Japanese Hot-Rolled*, the Appellate Body found the Department's 99.5 percent arm's-length test to be inconsistent with the United States' WTO obligations for several reasons.

While the Appellate Body acknowledged that the United States may exclude sales to affiliated parties that are not in the ordinary course of trade, it found that a price comparison ***alone*** was an insufficient basis to determine whether those sales were, in fact, in the ordinary course of trade.[11] Specifically, the Appellate Body noted that the price must be assessed "in light of the other terms and conditions of the transaction."[12] The Appellate Body noted several factors that might affect the analysis, including the degree of affiliation/control, whether the volume of the transactions was different, and whether the seller undertook additional liabilities or responsibilities in some transactions.[13]

The Appellate Body noted that the Antidumping Agreement obligation was to exclude ***all*** sales that are outside the ordinary course of trade, not just those that would tend to lower the normal value.[14] The Appellate Body noted that the Department's current 99.5 percent test failed to provide any practical possibility of excluding high-priced transactions that were outside the ordinary course of trade.[15]

The Appellate Body also objected to placing the burden on the exporters to demonstrate that prices to affiliates were aberrationally high. Specifically the Appellate Body found that Article 2.1 of the Antidumping Agreement requires the ***investigating authorities*** to ***ensure*** that the calculation of normal value is based on sales in the ordinary course of trade and that the burden to demonstrate the contrary should not be placed on the exporters (or, by analogy, on other interested parties).[16]

The Appellate Body stressed that any such test be applied "in an *even handed* way that is fair to all parties."[17] Moreover, the Appellate Body was concerned that the Department's methodology was unfair to exporters. In particular, the Appellate Body found that the Department's test, which automatically excluded low-priced transactions while automatically

[11] "Price is merely one of the terms and conditions of a transaction." Hot-Rolled Steel Appellate Body Report at para. 142.
[12] *Id.*
[13] *Id*.
[14] *Id*. at para. 145.
[15] *Id*. at paras. 151-153.
[16] *Id.* at paras. 153-154.
[17] *Id*. at para. 148.

including high-priced transactions, was not even-handed because it systematically operated to raise normal value and disadvantage exporters.[18]

At the heart of this issue is the determination of "normal value." The Act provides that normal value of the subject merchandise "*shall* be the price described in paragraph (B), at a time reasonably corresponding to the time of sale used to determine the export price or constructed export price."[19] That price is to be based on sales sold in the ordinary course of trade. Only if there are no such sales are the authorities to resort to alternative methods, such as constructed value.

In the *Japanese Hot-Rolled* dispute, the United States stated that "sales are in the ordinary course of trade if made under conditions and practices that, for a reasonable period of time prior to the date of sale of the subject merchandise, have been normal for sales of the foreign like product."[20] Moreover, the SAA described sales outside the ordinary course of trade as sales that "have characteristics that are not ordinary as compared to sales or transactions generally made in the same market."[21] The SAA further states that the Department will avoid basing normal value on sales "when the use of such sales would lead to irrational or unrepresentative results."[22]

In the *Japanese Hot-Rolled* dispute, the Appellate Body agreed that normal value must be calculated based on sales in the ordinary course of trade. Specifically, the Appellate Body stated: "Where a sales transaction is concluded on terms and conditions that are incompatible with 'normal' commercial practice for sales of the like product, in the market in question, at the relevant time, the transaction is not an appropriate basis for calculating 'normal' value."[23]

The question then is how to develop a reasonable, administrable test to determine when sales to an affiliate are on "terms and conditions that are incompatible with the 'normal' commercial practice for sales of the like product." Any such test must be even-handed, that is, it must not operate to automatically skew the normal value either up or down and must not operate to disadvantage the exporter. In looking at the administrability of such a test, the Department should not establish an irrebuttable presumption, but rather should establish clear guidelines as to how any presumption may be rebutted. This will improve the adminstrability by eliminating the need to address specious arguments in every case over whether sales to an affiliated party are

[18] *Id.* at para. 154.
[19] 19 U.S.C. 1677b(a) (1) (A) (*emphasis added*).
[20] Hot-Rolled Steel Appellate Body Report at para. 139.
[21] SAA at 164.
[22] *Id*.
[23] Hot-Rolled Steel Appellate Body Report at para. 140.

arm's-length or not, but will also enable the Department to consider all the relevant evidence in making its decision.

The test as proposed by the Department does not meet these concerns. The new rule proposed by the Department fails to meet the requirements of Article 2.1 of the Antidumping Agreement and the Appellate Body decision in a number of respects. First, it continues to apply a test (the 5 percent test) that ultimately requires the reporting of downstream sales in more cases than is necessary or appropriate. As such, this proposed methodology has a strong potential to be applied in a manner that would systematically tend to raise normal value -- through the required reporting of (normally) higher-priced downstream sales -- and disadvantage exporters. Therefore, the proposed test is not even-handed. Second, it continues to significantly restrict the preferred method of calculating normal value (a price to price comparison) by maintaining a range of acceptable transactions that is too narrow. Finally, it continues to be based solely on a price comparison and fails to provide for an opportunity for parties to rebut a presumption regarding whether the transactions are in the ordinary course of trade (for example, with arguments relating to terms and conditions of the transactions).

A. The Department Should Base its Determination on Whether to Disregard Downstream Sales on a Determination of the Volume of Non-Arm's Length Sales to Affiliated Resellers Only.

The Department stated its intention to continue its present practices with regard to the use of so-called downstream sales, including its practice of disregarding the downstream reporting requirement if sales to ***all*** affiliates account for less than 5 percent of total sales.[24] The possibility of reporting downstream sales exists only if the affiliate is a reseller. If the affiliate is an end-user (*i.e.*, one who consumes the foreign like product), then there is no subsequent resale to report. The Department's practice in such instances is to exclude any non-arm's length sales to an affiliated end-user when calculating normal value. Since those affiliated sales are excluded and there is no subsequent downstream sale of the foreign like product, these sales should not be included in the total volume of sales to affiliates when performing the 5 percent test.

Moreover, as long as the sales to the affiliate are in the ordinary course of trade, the Department will consider the sale between the affiliated entities for purposes of calculating normal value. Therefore, these arm's-length sales to affiliates should also be excluded from the volume of sales to affiliates when performing the 5 percent test.

[24] August 15 Fed. Reg. Notice.

Therefore, in determining whether downstream sales must be reported in order to enable an accurate calculation of normal value, the Department should limit its analysis to those sales where it may actually consider the downstream sales data – *i.e.*, non-arm's length sales to affiliated resellers. Thus, the numerator of the calculation should be limited to the quantity of sales to affiliated resellers that fail the arm's-length test and the denominator should be comprised of total home market sales.

Furthermore, in implementing any new arm's length test, the Department should not apply a *per se* rule whereby it requires downstream sales reporting in every instance where it determines that sales to affiliated resellers are outside the ordinary course of trade. In the Preamble to section 351.403 of its regulations, the Department noted that it "does not believe it necessary or appropriate to require the reporting of downstream sales in all instances. Questions concerning the reporting of downstream sales are complicated, and the resolution of such questions depends on a number of considerations."[25] Nothing in the Act or the AB Report requires the use of downstream sales in the calculation of normal value. As such, and consistent with its language in the Preamble to its Regulations, the Department should consider whether to require downstream sales reporting based on the particular facts and circumstances of each case, as opposed to strictly on whether sales prices to affiliates fall outside a particular band (and, thus, are presumptively outside the ordinary course of trade). A strict rule requiring downstream sales reporting where sales prices to affiliated resellers fall outside a particular price band risks systematically raising normal value and, therefore, would not be even-handed.

Finally, the Department should strongly consider not requiring the reporting of downstream sales by affiliated resellers if those sales are less than 20 percent of total home market sales. As noted above, the reporting of such downstream sales has become a major burden on the Department and respondents, often involving additional questionnaire responses and verifications of entities with only an indirect interest in the investigation. Petitioners' main interest in pursuing the reporting of downstream sales may well be the possibility (or likelihood) of the resulting use of facts available – as adverse as possible – which leads to further problems for the Department and increased litigation. The Department already considers 20 percent of sales below cost as not distortive of normal value. The Department should adopt an analogous provision with respect to affiliated resellers and not require downstream reporting if sales to affiliated resellers constitute less than 20 percent of total home market sales.

[25] 62 Fed. Reg. 27,296, 27,356. (May 19, 1997).

B. The Proposed Range of Acceptable Sales Prices Is Too Narrow.

Under the proposed methodology, the Department would require that sales to each affiliated party fall, on average, within 98 and 102 percent, inclusive, of sales prices of the same merchandise to all unaffiliated customers considered in the aggregate. It is noteworthy that the Appellate Body referred to the 99.5 percent test as "very narrow."[26] The range proposed by the Department is little improvement. In its discussion of the proposed test, the Department acknowledges that a band that is too narrow would serve little purpose because few affiliates could pass it. This has several consequences.

First, as the Department acknowledges, it could result in fewer price-to-price comparisons, which is the preferred method of comparison. Under the Department's regulations "the Secretary may calculate normal value based on that sale [to an affiliated party] only if satisfied that the price *is comparable to* the [unaffiliated] price."[27] For the Department to declare that only sales that are within 2 percentage points (plus or minus) of the average unaffiliated price are "comparable" is unduly restrictive and counter to the commonsense notion of the term "comparable."[28] This is particularly true given the Department's current practice of comparing each individual affiliated party's sales to all unaffiliated parties' sales taken together and its disregard of customer categories, levels of trade, quantities sold, etc. Furthermore, the Act and the Department's regulatory scheme favor price-to-price comparisons in determining normal value and calculating any antidumping margin. Accordingly, a Department rule whereby any sale to an affiliate that is outside of the overly-narrow 98% to 102% range of unaffiliated prices is presumptively outside the ordinary course of trade risks significantly reducing the number of home market sales prices eligible for use in calculating normal value and, thus, the number of available sales for comparison to U.S. sales.

Second, because the Department does not propose to change its practice of requiring the reporting of downstream sales where sales to affiliates are found to be at non-arm's length prices, it continues to impose onerous reporting requirements on affiliates, which would likely increase the use of facts available. The Department is aware of the significant difficulties faced by exporters in reporting downstream sales. In some circumstances it may be impossible for the exporter to obtain the cooperation of an affiliate that it does not control. In many situations, the

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[26] Hot-Rolled Steel Appellate Body Report at para. 152.
[27] 19 C.F.R. 351.403(c) (emphasis added).
[28] *See* Webster's Ninth New Collegiate Dictionary 267 (9th ed. 1998). "Comparable, adj., 1. capable of or suitable for comparison."

affiliate does not maintain records in such a way that it can trace its downstream sales back to the individual affiliated party transaction at the level of detail needed to respond to a Department questionnaire, or even at all. Increasing the instances in which downstream sales reporting would be required imposes an administrative burden on the Department as well, by increasing the number of companies that need to respond (and whose responses need to be analyzed and verified) and by increasing the complexity of the analysis.

In addition, establishing an onerous reporting burden for exporters is not an even-handed approach. Too narrow a band that operates solely to the disadvantage of the exporters will increase the use of facts available and will decrease the accuracy of the dumping calculation. Such a result is inconsistent with the requirements of U.S. law, of the WTO Agreement and of the Appellate Body determination in the *Japanese Hot-Rolled* case.

Therefore, we propose -- at a minimum -- to establish a wider price band of 95 percent to 105 percent. To the extent that the Department is concerned about deliberate manipulation of the margin by clustering prices at the lower end of the band, this can be addressed on a case-by-case basis if such a situation arises. The databases provided to the Department have each individual transaction reported which will enable the Department to check quickly whether such clustering is occurring. If it is, the Department can consider whether such behavior is a change in the normal pricing pattern with that affiliate (indicating a possible intent to manipulate) or whether there are other factors, such as a shift towards sales of lower value product to the affiliate which explain the pattern as a commercial transaction, and act accordingly.

C. The Department's Proposed Test Does Not Provide Interested Parties an Opportunity to Rebut the Presumption that Sales to Affiliates that Fail the Arm's-Length Test Are Outside the Ordinary Course of Trade.

Other than minimally increasing the range and adding an upper limit to that range, the Department's proposed test is similar to the 99.5 percent test rejected by the Appellate Body in *Japanese Hot-Rolled*. Specifically, it is a straight price comparison, without considering any terms or conditions of the transaction, which may also affect whether these prices are normal. As such, it fails to determine whether the transactions are in the ordinary course of trade. The proposed test also has a strong potential for being implemented in a manner that would systematically tend to raise normal value (through the reporting of the higher-priced downstream sales or, worse, through the application of adverse facts available because downstream sales cannot be reported) and disadvantage exporters. Therefore, the proposed test is not even-handed.

Both the Appellate Body and U.S. law require that the ordinary course of trade analysis be made on more than a single factor. The Appellate Body stated that "price is merely one of the terms and conditions of a transaction."[29] Moreover, the Court of International Trade has ruled that the Department must examine not just "one factor taken in isolation but rather . . . all the circumstances particular to the sales in question."[30]

As stated, the Department would average the prices (presumably by CONNUM, as has been the practice) to each affiliated entity and compare it to the weighted-average price of that CONNUM to all non-affiliated entities. We recommend that the test be conducted on a foreign like product basis, rather than a CONNUM-specific basis. Such an analysis is more consistent with an individual corporation's normal commercial practices, as pricing decisions are rarely, if ever, made on a micro-CONNUM level basis.

Parties (both respondents and petitioners) should be able to identify other factors that might affect the application of the arm's-length test in a particular case -- for example, whether the comparison should be made at the same level of trade and among the same category of customers (*e.g.*, distributor to distributor or end-user to end-user), or whether a particular product mix is sold to a particular group of affiliated customers but not unaffiliated customers (or vice versa). Similarly, as the Appellate Body noted, volume can significantly affect price comparability.[31] Thus, we believe that the Department should take into account parties' arguments that the comparisons should be made between comparable volume sales.[32]

Once such factors have been identified, the Department should take them into consideration in its analysis.

We respectfully request that the Department adopt the above-mentioned revisions to its proposed methodology for determining sales within the ordinary course of trade.

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[29] Hot-Rolled Steel Appellate Body Report at para 142.
[30] *Murata Mfg. Co. v. United States*, 17 CIT 259, 820 F. Supp. 603, 607 (Ct. Int'l Trade 1993).
[31] Hot-Rolled Steel Appellate Body Report at para. 142.
[32] For example, if the sales to the affiliates are at smaller volume per transaction than the typical sale to a non-affiliate, the upper end of the price band could be adjusted to account for the higher per unit prices likely to be charged for smaller volume sales, and vice versa.