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September 9, 2002

**BY HAND DELIVERY**

Mr. Faryar Shirzad
Assistant Secretary for Import Administration
Central Records Unit, Room 1870
U.S. Department of Commerce
14th and Constitution Ave., N.W.
Washington, DC 20230

**Re: Rebuttal Comments on the Department's Proposed Arm's Length Test**

Dear Mr. Shirzad:

The following rebuttal comments are submitted on behalf of Nucor Corporation, the Committee for Fair Beam Imports, and the Rebar Trade Action Coalition, in response to the submissions by other parties commenting on proposed modifications of the Department's policy regarding home market sales to affiliated parties in antidumping proceedings. These rebuttal comments are timely submitted pursuant to the extension to September 9, 2002, published on the Import Administration's web site. These comments do not respond to all points of concern raised by other parties, but briefly discuss a few salient issues.

## I. Sales by Affiliated Resellers Should Be the Basis for Normal Value

As we discussed in our August 30 submission,[1] the WTO decision that is at issue here[2] specifically held that it was permissible to use home market sales by affiliated resellers as the

[1] Letter from Wiley Rein & Fielding LLP to the Department of Commerce, at 1-3 (Aug. 30, 2002)

basis for normal value.[3] The decision furthermore did not specify that the Department have any limitations as to the use of these sales, other than that it be aware of any adjustments arising from the sale. We therefore recommended that, just as in the U.S. market, where the pertinent sale is the sale to the first unaffiliated purchaser, for appropriate comparison purposes the same standard should be applied to home market sales. In both markets, the starting price would be the price to the first unaffiliated purchaser, and in both markets adjustments would be made in order to take the price back to the ex-factory price. As we detail further below, however, where the affiliate further manufactures the item prior to sale, both the original sale and resale would be disregarded in the analysis.

The reason for using the price *from* the affiliated reseller rather than the price *to* the affiliated reseller in the home market is the same as the reason for using this starting price in the United States market—the price to the affiliated customer is subject to manipulation and can be an unreliable indicator of market value. For the United States market, the foreign producers are not given the opportunity to try to demonstrate that their prices to their affiliated customers are nevertheless valid. The result would be endless wrangling over the issue, determined on a case-by-case basis after much effort by all parties. Such wrangling currently occurs with regard to the question of the correct home market sale, with case-by-case, *ad hoc* results.[4] The WTO Antidumping Agreement, the WTO Appellate Body decision at issue here, and the statute all permit the Department to use the price by the affiliated reseller as the starting price. The

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[2] *United States- Anti-Dumping Measures on Certain Hot-Rolled Steel Products from Japan*, WT/DS184/AB/R (July 24, 2001) ("AB Report").

[3] AB Report at ¶¶ 165 –166.

[4] *See, e.g.*, Memorandum from Richard Moreland to Faryar Shirzad re: Issues and Decision Memorandum for the Less-Than-Fair-Value Investigation, at cmt. 3 (May 20, 2002) *Structural Steel Beams From Germany*, Inv. No. A-428-831 (investigation).

Department would increase the accuracy of the dumping margin if it simply set a bright-line test for affiliated reseller sales—they *will* be reported, and they *will* be used as the basis for normal value.

A number of commenting firms representing respondent interests argued instead for additional limitations on the use of sales by affiliated resellers.[5] Shearman & Sterling was concerned that "there is a risk that the proposed methodology may create impossible burdens for respondents that have established extensive distribution networks in their home markets."[6] Again, we note that this would not even be an issue if the affiliated reseller were in the United States instead of the home market. Foreign producers are expected to be able to obtain the necessary sales information from affiliated resellers in the United States, and almost all are quite able to do so. Currently, in the home market, the incentive is to find ways that such information is not obtainable. Foreign producers somehow find that companies in which they have an equity stake are uncooperative, or have record-keeping systems that somehow prevent the reseller from knowing the source of the merchandise. These are difficulties that foreign producers would find ways to resolve if it became the rule rather than the exception that the resellers' sales must be reported.

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[5] *See, e.g.*, Letter from O'Melveny & Myers LLP to the Department of Commerce, at 5-6 (Aug. 30, 2002)("O'Melveny & Myers Letter"). O'Melveny & Myers argued that the 5 percent test contained in 19 C.F.R. § 351.403(d) be performed only on the universe of affiliated resellers instead of all home market sales; *see also* Letter from Shearman & Sterling to the Department of Commerce, at 2 (Aug. 30, 2002)("Shearman & Sterling Letter"). Shearman & Sterling argued that sales to affiliated customers should be included if "it is demonstrated that the terms of those sales are equivalent to the terms of sales to unaffiliated customers."

[6] Shearman & Sterling Letter at 2.

We disagree with suggestions to reduce or exclude respondent's obligation to report downstream sales. We believe that these suggestions require a change to the regulations and cannot simply be implemented via a policy memo. However, if the Department finds that it is appropriate to change the regulations regarding downstream sales, we strongly disagree with all of these suggestions for policy reasons. As we have noted previously, it is precisely these downstream sales that provide the most accurate measure of whether dumping is occurring.

Instead, the Department should adopt the suggestions in our August 30, 2002 letter. We agree with Stewart & Stewart that the Department should eliminate the 5% threshold for reporting of downstream sales. Rather, the Department should establish a high evidentiary hurdle in place before excusing a respondent from reporting downstream sales.

## II. Sales to Affiliated Industrial Consumers Should Be Disregarded, or the Band for an Arm's Length Test Should Be Narrow

As we indicated in our August 30 comments (at 7-10), we believe the Department should reconsider its rationale for not disregarding home market sales to affiliated customers. Prices to affiliated industrial customers have the same taint as prices to affiliated resellers—they are subject to manipulation and are unreliable. Such home market sales, therefore, should not be used in the dumping analysis. The Department should also disregard sales to affiliated customers that further process the subject merchandise prior to resale. We recognize that engaging in a value-added analysis would prove overly burdensome. It is, as the Department considered, more appropriate to simply disregard those sales.

While most of the commenting firms, for different reasons, did not favor having any arm's length test at all, the firms representing respondent interests tended to favor a wide band if such a test were used, and the firms representing petitioner interests tended to favor a narrow

band (or a band that had a narrow downside). Respondent interests tended to favor a 95/105 test.[7] Such a wide band would make the arm's length test almost impossible to fail, rendering the test meaningless. It must be remembered that the Department's current methodology, which first calculates percentages for each CONNUM for which there are both affiliated and unaffiliated sales, and then weight-averages the percentages, combines percentages that are both above 100 and below 100. Thus, as we noted in our August 30 comments (at 4-5), a respondent could have home market sales of a model that matches to the subject merchandise that are 80 percent of the price to unaffiliated customers, and sales of a model that has no chance of matching to subject merchandise that are 120 percent of the price to unaffiliated customers, with the result that sales of all models to this particular affiliated customer are *on average* exactly equal (100 percent) to the sales to unaffiliated customers. While this is true for the Department's proposed 98/102 test, and it would be even more true for respondents' proposed 95/105 test. Such a standard would in effect write the arm's length test out of existence.

Two commenting firms, Collier Shannon and Dewey Ballantine, note that the Appellate Body decision specifically stated that it did not mandate that the arm's length "must necessarily be *identical*" for verifying high and low-priced sales to affiliates.[8] They propose 99.5/125 or 99.5/120 tests. These proposals address the concern expressed by the Department in its notice that a 99.5/100.5 test would result in "few affiliates" passing the test. The results would in most cases be similar to the results under the current test, about which the Department had no apparent problems prior to the WTO decision. The ranges proposed by Collier Shannon and Dewey

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[7] *See e.g.*, Letter from Sidley Austin Brown & Wood LLP (Aug. 30, 2002); Letter from O'Melveny & Myers (Aug. 30, 2002); Government of Korea.

[8] AB Report, at n.113 (emphasis in original).

Ballantine also correctly recognize that there is far more incentive to price *lower* to affiliated parties than there is to price *higher* to these purchasers. Therefore, either the 99.5/100.5 test proposed in our August 30 comments, or the 99.5/120 or 99.5/125 tests proposed by Collier Shannon and Dewey Ballantine, would be acceptable, in the event that the Department decides against our recommendation to do away with the arm's length test altogether and disregard transfer prices to affiliates.[9]

## III. **Burden of Proof**

Several commenters have suggested several considerations that, if adopted by the Department, would effectively shift the burden of proof from respondents to petitioners and to the Department. For example, Shearman & Sterling suggest that the mere existence of contemporaneous sales in commercial quantities should constitute evidence that the sales are in the ordinary course of trade. Shearman & Sterling also suggest that the Department adopt a rebuttable presumption that sales that fail the test are outside the ordinary course of trade, a presumption that can be overcome by evidence. We strongly disagree. If the Department adopts a rebuttable presumption, it will create an administrative quagmire. Moreover, the Department should not adopt these considerations because they contradict both the statutory presumptions and case law.

Congress clearly intended the Department to presume that affiliated party sales are "tainted." The mere existence of 19 U.S.C. § 1677b(a)(5) allowing the Department to use these

[9] We respectfully disagree with Skadden's suggestion that the test ranges be linked to the de minimis threshold for investigations and reviews respectively. There is simply no link between the two. It is merely coincident that the Department's current 0.5% arm's-length threshold matches the de minimis threshold used in reviews. However, if the Department insists that the ranges be linked to the de minimis marks, we agree with Skadden that there should be two ranges and disagree with Willkie's suggested implication that the 2% de minimis standard be applied to the arm's-length test in reviews.

sales demonstrates this because if the Department presumed that affiliated party sales were not tainted, this subsection would be redundant in light of the ordinary course of trade requirement. Congress made itself clear in the SAA:

> {S}ection 773(a)(1)(B) permits (but does not require) Commerce to base normal value on sales to related (now affiliated) parties in the home market. However, Commerce will continue to ignore sales to affiliated parties which cannot be demonstrated to be at arm's-length prices for purposes of calculating normal value.[10]

Likewise the legislative history states: "New Section 773(a)(1)(B) continues the practice of existing section 773(a)(5) of, in general, *not using sales to affiliated parties* as a starting price."[11]

Congress has clearly established the Department's ability to use affiliated party sales based on a presumption that a) these sales are tainted, and b) the party wishing to include these sales in normal value bears the burden of proof. The Courts have upheld this presumption.[12]

## IV. **Use Of Non-Price Factors**

Several commenters have discussed several non-price factors that the Department should consider in determining whether a sale between affiliates is made at arm's-length. Suggested non-price factors include level of trade, terms of sale, physical differences (DIFMER), industry practice, relative volumes, timing, and product mix, among others. Some commenters suggest that examination of these non-price factors is required by the WTO decision. Others, such as

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[10] Uruguay Round Agreements Act, Statement of Administrative Action, at 157, *reprinted in* H.R. Doc. No. 103-316 (1994)("SAA").

[11] H.R. Rep. No. 103-826, at 82 (1994) (emphasis added).

[12] The Department disregards sales due to the possibility of price manipulation when dealing with transactions among affiliated entities. *See SSAB Svenskt Stal AB v. U.S.*, 976 F.Supp. 1027, 1030 (Ct. Int'l Trade 1997) (stating that "Commerce's normal practice is to disregard the manufacturer's prices to its related distributors or dealers in calculating foreign market value unless the manufacturer demonstrates to Commerce's satisfaction that the prices are at arm's length").

Sidley, suggest that the Department consider non-price factors because its current price-only focus does not mirror a broader statutory definition of "ordinary course of trade." We disagree that the use of non-price factors is either a statutory obligation or is a requirement of the WTO decision. Moreover, the Department cannot adopt these considerations because they contradict both the statutory presumptions and case law.

The statute treats affiliated party sales differently than sales between non-affiliates when determining whether a sale is made within the ordinary course of trade. While the Department does consider non-price factors in determining ordinary course of trade for sales between non-affiliates, the Department only considers price in determining whether sales between affiliates are within the ordinary course of trade. The Courts have upheld the Department's interpretation of Congressional intent and have repeatedly rejected respondent arguments that the Department consider non-price factors in its arm's-length test.[13]

## V. **Specificity Of The Test**

Several commenters, have made suggestions regarding the specificity of the test, suggesting that test be conducted on a model-specific basis. We agree that the test be conducted on a model-specific basis only. Removing the 2nd "prong" of the test (i.e., weight-averaging the affiliate to non-affiliate model-specific comparisons by customer and comparing this second

[13] *NSK Ltd. v. United States*, Slip Op. 01-69 at 65-66 (June 6, 2001) ("The Court has repeatedly rejected the argument that Commerce should consider additional factors, that is, factors other than price, when determining whether sales prices to affiliated and unaffiliated parties are comparable. The Court finds no basis under the circumstances of this case to depart from its prior holdings in NTN Bearing, 24 CIT at ___, 104 F. Supp. 2d at 148 and NTN, 19 CIT at 1241, 905 F. Supp. at 1099 (disagreeing "with NTN that Commerce's arm[']s-length test is flawed because Commerce did not take into account certain factors proposed by NTN"). Accordingly, Commerce's application of the arm's-length test to exclude certain home-market sales to affiliated parties from the NV calculation is affirmed.").

level to the proposed 98/102 % thresholds removes a major ability of a respondent to game the system. The Department should close this loophole.

In addition, several commenters have suggested that the Department consider contemporeneity in its proposed test. We strongly disagree that the Department should consider contemporeneity in its arm's-length test. By considering contemporeneity, the Department introduces yet another loophole for respondents to manipulate normal value. For example, a respondent may easily manipulate its affiliated prices in months that have matching U.S. sales (within the 90/60 window) such that lower-priced affiliated party sales within matching months are included in the normal value calculations if the Department considers contemporeneity, yet sales of that model would be outside the ordinary had the test been conducted on a POR/POI basis. Moreover, the Department does not consider contemporeneity in its statutorily-defined sales-below-cost-of-production analysis.

Therefore, we strongly suggest that the Department conducts its arm's-length test on a POR/POI-specific, model-specific customer-specific basis only, as we have suggested in our August 30, 2002 letter. The Department should not aggregate all models to a particular customer in a 2nd "prong" and should not consider any period less that the POI/POR.

## VI. **Sales Without Comparison**

Willkie Farr suggests that the Department may be using inconsistent arm's-length tests. For example, Willkie Farr suggests that some tests set the customer–specific ratio to "." (which signifies failure of the test) when there are no comparison sales, however, other versions set the CONNUM-specific ratio to 0 and then calculate a weighted-average customer-specific ratio employing that 0. As a fix, Willkie Farr suggests that for sales that do no have comparison sales,

the Department set the CONNUM-specific ratio to 100 (i.e., equal to sales to non-affiliates), reasoning that its current practice is an unwarranted adverse assumption.

We agree that the Department should adopt a consistent test for all Offices within IA. However, the Department should adopt a test that sets the CONNUM-specific ratio to 0 and should not perform the 2nd prong of the test (i.e., weight-averaging all models to a particular customer). We disagree with Willkie Farr that the Department has built-in an adverse assumption in setting models without comparison to "."

Congress intended a presumption that affiliated sales are "tainted." If the Department lacks a comparison sale, this presumption applies. Whether or not the presumption is adverse or neutral to respondent, it is nevertheless a presumption required by the statute. In setting a sale without comparison to automatically fail the test, the Department is merely following through with Congressional intent. Moreover, any change to that intent must be enacted through the legislative process, not a simple policy change.

## VII. **Alternative Tests**

Willkie Farr argues that the Department should allow alternatives tests, such as a standard deviation test, if respondents shoulder the burden. We disagree. The Department needs a simple, predictable, and consistent methodology for determining arm's-length. Willkie Farr's suggestion will unduly increase the administrative burden on the Department.

If you have any questions concerning this submission, please do not hesitate to contact the undersigned.

Sincerely,

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