August 30, 2002

PUBLIC DOCUMENT

BY HAND DELIVERY
The Honorable Faryar Shirzad
Assistant Secretary for Import Administration
U.S. Department of Commerce
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:

On behalf of Skadden, Arps, Slate, Meagher & Flom LLP, we hereby submit comments on the modification proposed by the Department of Commerce (the "Department") to its practice concerning the determination of whether home market sales to affiliated parties are made in the ordinary course of trade and thus may be used in the calculation of normal value in antidumping proceedings. We submit these comments pursuant to the Federal Register notice issued by the Department on August 15, 2002 seeking comments on the Department's proposed modifica-

tion of its "arm's-length" or "99.5 percent" test – i.e., the test performed to determine whether home market sales to affiliated parties were made in the ordinary course of trade.[1]

The Department is proposing a change to its arm's-length test to implement the findings of the World Trade Organization ("WTO") Appellate Body in United States – Anti-Dumping Measures on Certain Hot-Rolled Steel Products From Japan ("Japan Hot-Rolled").[2] In that case, the Appellate Body found the Department's current arm's-length test to be inconsistent with Article 2.1 of the WTO Anti-Dumping Agreement (the "AD Agreement").[3] The test found to be invalid by the Appellate Body provides that home market sales to an affiliated party may be considered to be within the ordinary course of trade if prices to that affiliate are, on average, at least 99.5 percent of the prices charged to unaffiliated parties.[4]

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[1]Antidumping Proceedings: Affiliated Party Sales in the Ordinary Course of Trade, 67 Fed. Reg. 53339 (Dep't Commerce Aug. 15, 2002) (Request for Public Comments) ("Request for Comments on Affiliated Party Sales").

[2]Id. at 53339.

[3]United States – Anti-Dumping Measures on Certain Hot-Rolled Steel Products From Japan, WT/DS184/AB/R (July 24, 2001), at paras. 158, 240(d) ("AB Report").

[4]Request for Comments on Affiliated Party Sales, 67 Fed. Reg. at 53339.

Under the Department's proposed change to its arm's-length test, home market sales to an affiliated party must have sales prices that fall, on average, between 98 percent and 102 percent of the sales prices charged for identical products to unaffiliated parties in order for sales to that affiliate to be deemed within the ordinary course of trade.[5] The Department is thus proposing to adopt a symmetrical test that treats sales to an affiliated party that have prices above the weighted-average price to unaffiliated parties exactly the same as it treats sales to an affiliated party that have prices below the weighted-average price to unaffiliated parties. We submit that there are other more acceptable options for implementing the Appellate Body's decision, including automatically using the downstream sales from an affiliated party to its customer in all instances or employing an asymmetrical test. If the Department nevertheless decides to adopt its proposed change, it should, at a minimum, modify that proposal for use in administrative reviews as described below.

In Japan Hot-Rolled, the WTO Appellate Body found the Department's current arm's-length test to be inconsistent with Article 2.1 of the AD Agreement based on the lack of "even-handedness" between the tests for determining whether low-priced and high-priced sales to affiliated parties were made in the

[5] Id. at 53340.

ordinary course of trade. The Appellate Body stated that "{i}f a Member elects to adopt general rules to prevent distortion of normal value through sales between affiliates, those rules must reflect, even-handedly, the fact that both high and low-priced sales between affiliates might not be 'in the ordinary course of trade.'"[6]

The Appellate Body found the Department's arm's-length test to lack the requisite even-handedness essentially for three reasons. First, low-priced sales are tested with a bright line rule – the 99.5 percent test – while the Department "does not have any standard, nor even guidelines, for determining the threshold" for high-priced sales.[7] Second, the Department automatically tests low-priced sales and excludes those that fail the 99.5 percent test, but does not test high-priced sales and automatically includes such sales.[8] Lastly, while all low-priced sales outside a "very narrow" range are excluded, "only 'aberrationally' high-priced sales are excluded."[9]

For purposes of antidumping investigations like that before the Appellate Body in Japan Hot-Rolled, the Department's proposed change to its arm's-

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[6]AB Report at para. 148.

[7]Id. at paras. 149, 151.

[8]Id. at paras. 149, 151-152.

[9]Id. at para. 152.

length test would address each of these concerns and, therefore, would be consistent with the Appellate Body's decision. In response to the Appellate Body's concerns, the Department's proposal would result in a bright line test for both low-priced and high-priced sales to affiliates, would automatically test low-priced and high-priced sales in every case, and would use a comparable test for both sets of sales. Thus, because the Department's proposal would address each of the concerns raised by the Appellate Body in its decision, it would be a defensible option for implementation of that decision.

Furthermore, as applied in the context of antidumping investigations only, the measure of price difference between sales prices to affiliated parties and unaffiliated parties to be used in the Department's proposed arm's-length test would also be defensible. As the Department has recognized, the arm's-length test is analogous to the dumping margin calculation. Before both the WTO Panel and the Appellate Body in the Japan Hot-Rolled case, the United States defended the reasonableness of the arm's-length test on that very basis. Indeed, the United States argued before the Panel in that case that

> {t}he 99.5 per cent test is a perfectly reasonable methodology by which to determine whether affiliated party sales can be considered equivalent to arm's-length sales, as demonstrated by the fact that it is virtually the same as the margin calculation – itself prescribed by the

> Agreement. Indeed, the test's methodology, which involves ex-factory price comparisons of a producer's sales weight-averaged by product, is nearly identical to the margin calculation. This is because the margin calculation and the arm's length test have parallel objectives: the former discerns whether there has been significant price discrimination between home market and target-country export sales; the latter discerns whether there has been significant "price discrimination" between affiliated and unaffiliated home market customer sales.[10]

Before the Panel, however, Japan complained that the analogy was flawed. Because that case involved an antidumping investigation, the *de minimis* standard for a dumping margin was 2.0 percent, not the 0.5 percent applicable in an administrative review. Thus, Japan argued that the 99.5 percent test, and the price difference of 0.5 percent that it measures between sales prices to affiliated parties and unaffiliated parties, was not analogous to and could not be justified by the *de minimis* standard applicable in an investigation.[11]

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[10]Second Written Submission of the United States to the WTO Panel in United States – Anti-Dumping Measures on Certain Hot-Rolled Steel Products From Japan (Sept. 13, 2000) at para. 26; see also Appellant Submission of the United States to the WTO Appellate Body in United States – Anti-Dumping Measures on Certain Hot-Rolled Steel Products From Japan (May 7, 2001) at para. 42, n.54 (same).

[11]See First Written Submission of Japan to the WTO Panel in United States – Anti-Dumping Measures on Certain Hot-Rolled Steel Products From Japan (July 3, 2000) at para. 160.

The Department's proposed change to the arm's-length test of using sales to affiliated parties where the sales prices fall within a band of 98 percent to 102 percent of sales prices to unaffiliated parties would resolve this perceived problem in antidumping investigations. Indeed, the Department's proposal would use a 2.0 percent threshold for low-priced and high-priced sales that is, in fact, identical to the *de minimis* standard prescribed by Article 5.8 of the AD Agreement for investigations. Accordingly, as applied in antidumping investigations, the Department's proposal would not only be consistent with the Appellate Body's decision, but also would resolve possible concerns relating to the arbitrariness of the measure of price difference to be used in the arm's-length test.

The Department should, however, modify its test in the context of administrative reviews. In a review, of course, the *de minimis* threshold for dumping is 0.5%.[12] As it has proposed doing in an investigation, the Department should also apply in a review the same *de minimis* standard for the arm's-length test that it

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[12]This threshold has been specifically endorsed by a WTO panel. United States – Anti-Dumping Duty on Dynamic Random Access Memory Semiconductors (DRAMS) of One Megabit or Above From Korea, WT/DS99/R (Jan. 29, 1999), at para. 6.90.

applies for the margin program. In other words, because the *de minimis* threshold in a review is 0.5%, the Department should apply a 99.5%–100.5% arm's-length test.[13]

There are two important reasons to utilize a 99.5%–100.5% test in administrative reviews. First, as indicated above, consistent treatment of the arm's-length and margin calculations makes the test more defensible at the WTO. Before the Panel, the United States was challenged by Japan for applying a 0.5% *de minimis* standard for the arm's-length test in an investigation having a 2% *de minimis* dumping threshold.[14] This inconsistency may have given rise to the Japanese claim that the threshold set by the 99.5% test was "statistically arbitrary."[15] Such a

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[13]Although this proposed test is symmetrical, we do not believe symmetry is required. Indeed, the Appellate Body itself stated that "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*." See AB Report at para. 154 n.113. All that is required is that both standards be reasonable.

[14]See United States – Anti-Dumping Measures on Certain Hot-Rolled Steel Products From Japan, WT/DS184/R (Feb. 28, 2001), at para. 7.97, n. 78 ("Panel Report"); see also First Written Submission of the United States to the WTO Panel in United States – Anti-Dumping Measures on Certain Hot-Rolled Steel Products From Japan (July 24, 2000) at para. 221; Second Written Submission of Japan to the WTO Panel in United States – Anti-Dumping Measures on Certain Hot-Rolled Steel Products From Japan (Sep. 13, 2000) at para. 123, n. 118.

[15]Panel Report at para. 7.94. It should be noted that because the Panel and Appellate body found the 99.5% test to "lack even-handedness," they never reached the issue of whether the 0.5% threshold itself had been arbitrarily selected.

perceived problem would not exist in administrative reviews were the Department to apply in the arm's-length test the same *de minimis* threshold that it does in the margin calculation (*i.e.*, 0.5%).

Second, as the Department has recognized, the wider the band, the greater the "potential for manipulating normal value through clustering of sales prices to affiliates at the lower end of the band."[16] This is especially true in an administrative review, where the potential for manipulation is far greater.[17] Under the proposed 98%-102% test, respondents in a review could cluster their affiliated sales prices at the very low end of the band (*i.e.*, 2% below the market price), without risking exclusion of those sales as outside the ordinary course of trade. The potential for such manipulation would be greatly reduced by a more narrow 99.5%–100.5% band test. As a matter of policy, therefore, it is appropriate to adopt a more narrow arm's-length band in the context of an administrative review.

In its request for public comment, the Department expressed the concern that "narrowing the band significantly (such as using a 99.5 percent – 100.5

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[16]Request for Comments on Affiliated Party Sales, 67 Fed. Reg. at 53340.

[17]During a period of review, unlike a period of investigation, respondents are well aware that their sales will be the subject of antidumping litigation, and can adjust their transfer prices accordingly.

percent test) would reduce the utility of such a test, as few affiliates would pass."[18] It is unlikely, however, that a 99.5%–100.5% test would lead to the extreme results envisioned by the Department. Because the arm's-length test operates on a weighted-average basis for all sales to an affiliate, unless transfer prices are deliberately set at non-arm's-length levels, more affiliates are likely to pass a 99.5%–100.5% test than the Department anticipates.

The Department also expressed the concern that "the narrower the band, the fewer sales to affiliates would be used, potentially resulting in fewer price-to-price comparisons and more use of constructed value in determining normal value."[19] It is unlikely, however, that application of a 99.5%–100.5% test would result in significantly greater use of constructed value ("CV"). Where affiliated party sales fail the test, the Department can perform price-to-price comparisons using the downstream sales of that affiliate. Moreover, even where a respondent is unable to report downstream sales, the Department can still base normal value on other sales to unaffiliated customers. Indeed, under the Department's practice codified at Policy Bulletin 98.1, it "will use constructed value as the basis for normal value only when

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[18] Request for Comments on Affiliated Party Sales, 67 Fed. Reg. at 53340.

[19] Id.

there are no above-cost sales that are otherwise suitable for comparison" (*i.e.*, contemporaneous, in the ordinary course of trade, and having a DIFMER not exceeding 20 percent). Finally, even in those rare instances where CV is the only remaining alternative, use of CV is more appropriate than using transfer prices where such prices differ from the arm's-length price by more than a *de minimis* amount.

In sum, if the Department decides to adopt its proposed change to the arm's-length test, it must, at a minimum, modify that proposal for use in administrative reviews. This modification would not only serve to reduce the potential for price manipulation, it would make the test more defensible before the WTO. Finally, the modification would be unlikely to "reduce the utility" of the arm's-length test, or lead to a significant increase in the need to resort to constructed value.

Respectfully submitted,

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Robert E. Lighthizer, Esq.
John J. Mangan, Esq.
Jeffrey D. Gerrish, Esq.
Daniel L. Schneiderman, Esq.

Stephen F. Munroe, Director Int'l Trade

On behalf of Skadden, Arps, Slate, Meagher & Flom LLP