April 14, 2003

202-508-8190

Total Pages: 11

Comments on Proposed Modification of Privatization Methodology

Public Document

BY HAND

Jeffrey May
Director of Policy
Central Records Unit, Room B-099
Import Administration
United States Department of Commerce
14th St. & Constitution Ave., N.W.
Washington, DC 20230

Re: Privatization Methodology

Dear Director May:

We are writing, on behalf of the Arcelor S.A., its subsidiary Usinor, and their affiliates, to comment on the Department's recent notice of the proposed modification of its "privatization methodology" that was published in the Federal Register on March 21, 2003.[1] As described in the Department's notice, this proposed methodology is intended to

[1] *See* 68 Fed. Reg. 13897.

implement the December 9, 2002, decision by the WTO Appellate Body in *United States — Countervailing Measures Concerning Certain Products from the European Communities*.[2]

For the reasons set forth below, we believe that the Department's newly proposed methodology cannot affect the conclusions the Department has reached in its recent remand determinations involving the privatization of Usinor — which held that the privatization of Usinor "extinguished" any benefit of pre-privatization subsidies. Nevertheless, in order to avoid confusion in other cases, we urge the Department to clarify several aspects of its proposed methodology to more properly reflect the requirements of U.S. and international law.

1. The Privatization Methodology Adopted by the Department Must Be Consistent with the U.S. Court Decisions Analyzing the Privatization of Usinor under the Requirements of the U.S. Statute

As the Department is aware, the privatization of Usinor has been reviewed by the Department in two recent remand determinations. In both of those remands, the Department concluded that the privatization of Usinor was accomplished through an arm's-length transaction for fair market value, and that the privatization therefore "extinguished" the benefit of any pre-privatization subsidies to Usinor and its subsidiaries.[3]

[2] *See* WT/DS212/AB/R.

[3] *See* Results of Remand Determination Pursuant to Remand, *Allegheny Ludlum Corp. v. United States*, CIT No. 99-09-00566 (Jan. 4, 2002); Results of Remand Determination Pursuant to Remand, *GTS Industries, S.A. v. United States*, CIT No. 00-03-00118 (Jan. 4, 2002).

These remand determinations have been upheld by the Court of International Trade.[4] And, importantly, although the Department has appealed these decisions, the Department's notice of the proposed modification of its privatization methodology has cited these remand determinations as "a useful initial framework."[5]

The two recent remand determinations were based on a finding that the U.S. statute compels the conclusion that the privatization of Usinor necessarily "extinguished" the benefit of pre-privatization subsidies. Nothing in the Appellate Body's decision requires a different result. And, in any event, whatever methodology the Department may now adopt in response to the Appellate Body's decision must be consistent with the requirements of U.S. law — and must therefore result in the conclusion that the privatization of Usinor "extinguished" the benefit of any pre-privatization subsidies.

2. The Court-Approved Analysis of the Usinor Privatization Should Be Applied to Existing Orders and Reviews and to Any Future Cases

The Department's notice of the proposed modification of its privatization methodology does not indicate any "effective date." We believe that it would be helpful if the final notice clarifies that, as a general matter, the proposed new privatization methodology will apply immediately to any pending investigations and reviews (except to the extent that, as in the two remand determinations involving Usinor, the privatization issues have already been resolved by court decisions interpreting the current U.S. statutory

[4] *See Allegheny Ludlum Corp. v. United States*, Slip Op. 02-114 (Sep. 24, 2002); *GTS Industries, S.A. v. United States*, Slip Op. 02-115 (Sep. 24, 2002).

[5] *See* 68 Fed. Reg. at 13900.

provisions).[6] In addition, in order to ensure that countervailing measures are not improperly imposed on merchandise that is not benefitting from subsidies, it may also be appropriate for the Department to consider self-initiation of changed circumstances reviews of any countervailing duty orders in which the alleged subsidy recipient had been privatized after the subsidies were received.

3. The Proposed Privatization Methodology Described in the Department's Notice Should Be Clarified

a. Because the Department Has an Obligation to Consider whether Pre-Privatization Subsidies "Survived" a Privatization, It Cannot Transfer the "Burden of Proof" onto Respondents

Under the methodology described in the Department's notice, the initial "baseline presumption" will be that non-recurring subsidies continue to benefit the recipient over the average useful life of the recipient's assets. However, this presumption may be rebutted by an interested party (*i.e.*, the respondent) "demonstrating that, during the allocation period, a privatization occurred in which the government sold its ownership of all or substantially all

[6] In this regard, we also note that the effect of the Department's recent remand determinations concerning the Usinor privatization should be independent of whatever "effective date" is adopted in the Department's notice. As mentioned, the two recent remand determinations were based on an analysis of the Usinor privatization in light of the requirements of the U.S. countervailing duty statute. Principles of *res judicata* therefore require that the findings made in those remand determinations must apply to any actions taken under the statute concerning the same transaction. Thus, the Department must apply the conclusion that the privatization of Usinor extinguished any pre-privatization subsidies to any existing orders and reviews involving the Usinor privatization and to any future cases in which the outcome depends on an analysis of the same facts under the same statutory provisions.

of a company or its assets, retaining no controlling interest in the company or its assets, and the sale was an arm's-length transaction for fair market value."[7]

This formulation suggests that the initial burden of proof will be on the respondent to demonstrate both that there was a privatization and that that the privatization was effected through an arm's-length transaction for fair market value. Imposing this burden on the respondent is, however, inconsistent with the requirements of U.S. law and the international agreements permitting the imposition of countervailing duties.

The Court of International Trade has observed that the Department's analysis of the effect of any change in ownership must include an examination by the Department of the transaction itself:

> The Court in *Delverde* … was explicit enough in its description of when a rule can be considered *per se* that the decision provides clear guidance. A methodology is *per se*, and therefore contrary to the statute, when it determines that a subsidy continues to be countervailable to a new owner following a change in ownership without looking at the transaction itself. The Federal Circuit directed that any methodology must examine the facts of the sale to determine if the new owner, "paid full value for the asset and thus received no benefit from the prior owner's subsidies…."
>
> … The Federal Circuit in *Delverde* laid out certain criteria that at a minimum any new methodology must include. First, Commerce cannot rely on any *per se* rule. Second, it must look at the facts and circumstances of the TRANSACTION, to determine if the PURCHASER, received a subsidy, directly or indirectly, for which it did not PAY ADEQUATE COMPENSATION.[8]

---

[7] *See* 68 Fed. Reg. at 13899.

[8] *Allegheny Ludlum*, 182 F.Supp.2d 1357, 1365-66 (Ct. Int'l Trade 2002); *GTS Industries*, 182 F.Supp.2d 1369, 1377-78 (Ct. Int'l Trade 2002).

The WTO Appellate Body has also held that once the investigating authority is informed of a change in ownership, it must conduct an inquiry to determine whether the subsidy benefit continues to exist:

> In sum, we reject the characterization made by the United States of our rationale in *US – Lead and Bismuth II*, and we reaffirm our finding in that case that an investigating authority, in an administrative review, when presented with information directed at proving that a "benefit" no longer exists following a privatization, must determine whether the continued imposition of countervailing duties is warranted in the light of that information. *This obligation is premised*, not on the creation of a new legal person, as the United States insists, but *on the possibility that such a change in ownership has affected the continued existence of a benefit*.[9]

In short, the only "burden" that can properly be placed on the respondents is the "burden" of showing that there has been a change in ownership. Once this burden has been met, it is the Department's responsibility to determine whether the conditions exist that allowed the subsidy benefit to continue after the privatization. The Department cannot avoid this responsibility by putting the "burden of proof" on the respondents.

b. The Determination whether the Privatization Occurred at "Fair Market Value" Must Be Based on a Consideration of All Relevant Evidence

The Department's notice suggests that, in determining whether a privatization occurred at fair market value, the Department will focus primarily on the process used by the government to sell the privatized company. We agree that consideration of the

[9] *United States — Countervailing Measures Concerning Certain Products from the European Communities*, WT/DS212/AB/R (Dec. 9, 2002), ¶ 144 (emphasis in original deleted, additional emphasis added).

privatization process may be important. Indeed, the price determined through a fair and open sales process is, by definition, the "fair market value." Thus, if the Department finds that a fair sales process was used, it must necessarily also find that the price represented the "fair market value" of the privatized company. In this regard, it should be noted that the Department has already determined that the process used to privatize Usinor was fair and open, and that the price paid by purchasers in that process represented the fair market value of Usinor.

Nevertheless, it should be noted that an exclusive focus on the privatization process in other cases may be unduly restrictive. Just because a fair and open process results in the fair market value, it does not necessarily follow that a process that is less than ideal cannot result in the fair market value. Suppose, for example, that a government decides to sell a company to a single bidder without any competition. That process, alone, might not guarantee that the sale occurred at the "fair market value." However, if this hypothetical sole bidder agreed to pay a price that is identical to the price a winning bidder would have paid if the process had been more open, then the price paid is necessarily the equivalent of the "fair market value."[10]

The Department is, of course, required to consider all relevant evidence in reaching its determinations. It may not, therefore, ignore evidence (such as independent and objective

[10] In this regard, the government's "intent" in selling the company is not dispositive on the issue whether the buyer paid the "fair market value." As long as the price paid by the buyer is equivalent to the price the winning bidder would have paid in a fair and open sales process, the buyer has paid fair market value.

analyses of the value of the privatized company) demonstrating that the price paid by the buyer represented the fair market value. While the existence of a fair and open sales process may be dispositive, the absence of such a process is not.

c. No Separate Consideration of the "Broader Market or Economic Environment" Is Appropriate where the Privatization Occurred through an Arm's-Length Transaction at Fair Market Value

Any sale of a company involves a bundle of assets and liabilities — or, in legal terms, of rights and obligations. In any sale, the seller may choose to structure that bundle to include or exclude particular items. A company may, for example, be sold with or without its debts. It may be sold with subsidiaries or other companies, or it may be sold stripped of any affiliates. It may be sold subject "as is" or subject to various contractual obligations (for example, to continue to purchase services from, or provide services to, its former parent). The seller's choice of the items that will be include in the bundle that is being sold, and those that will be stripped from that bundle, has a necessary impact on the price a buyer is willing to pay, and hence on the fair market value of the bundle offered for sale.

In a privatization, a government may choose to include items in the bundle offered for sale that diminish the total value. It may, for example, sell a steel mill with an obligation that the purchaser retain some specified number of workers. Or, it may sell the mill subject to a legal regime that imposes additional costs on steel producers — in the form of strong labor laws that limit the flexibility of the work-force, or strict environmental rules that require costly pollution abatement measures, or rigorous consumer protection laws that make the mill strictly liable for any defects in the steel it sells. Or, even more broadly,

the government may sell the steel mill in a domestic economy that provides disadvantages to steel production (through low import duties that encourage import competition, or through macroeconomic policies that discourage consumer spending, or through education policies that result in a poorly skilled work-force, or through poor policing and lax protection of property rights that makes ownership insecure). Alternatively, the government may enhance the value of the bundle by adopting policies that are the opposite of all of these. Put simply, there is no market transaction that is unaffected by government action, because the value of any item reflects myriad government policy choices on scores of issues.

In its notice of the proposed modification of its privatization methodology, the Department has apparently undertaken to review the choices made by a government in putting together the bundle of rights and obligations that will be sold in the privatization transaction, to determine which of the included rights or obligations are somehow not legitimate. In addition, the Department proposes to cull through the range of possible government actions or inactions that might affect the functioning of the market in which the privatization occurs to distinguish between those that "distort" the transaction and those that do not. Such efforts are, however, unnecessary.

It is of course true that the fair market value of the privatized company necessarily reflects all of the conditions under which the sale is made — including the bundle of rights and obligations offered for sale, and the government policies that affect them. However, this does not mean that the value of the individual items included within the bundle is in

any way distorted. Instead, it means only that the total fair market value reflects the sum of values (positive and negative) for each of the rights and obligations offered.

For example, a seller may choose to sell a steel mill together with a waste site that will be costly to clean up, in a legal regime that will require the purchaser to pay the clean-up costs. The bundle offered in this sale is clearly less valuable than a bundle that consisted only of the steel mill without the waste site (or with the waste site under a legal regime that did not require a clean up). This does not mean, however, that a buyer who purchases the combination of steel mill and waste site at a lower price than the steel mill would have fetched separately has somehow gotten the steel mill at an unfairly low price. Instead, it means only that the final price paid reflects both the positive value of the steel mill and the negative value (*i.e.*, expected cost) of the required clean-up of the waste site.

The same analysis would hold if the steel mill was sold not with a waste site, but with requirements for worker retention, committed investment or continued operations. In such cases, the final price paid would reflect both the positive value of the steel mill and the negative value (*i.e.*, expected cost) of the other obligations included in the bundle offered for sale. The value of the steel mill might be subsumed within the total price assigned to the overall bundle of rights and obligations, but it would never be distorted.

In these circumstances, the third prong of the Department's proposed methodology collapses. The fair market value of the privatized company will always be reflected, undistorted, in the overall fair market value of the bundle of rights and obligations being sold in the privatization. The Department should, therefore, revise its proposed methodology to focus exclusively on whether the privatization was accomplished through

an arm's-length transaction at fair market value, without further analysis of any additional rights or obligations included by the government in the bundle offered for sale.

*   *   *

Please do not hesitate to contact us if you have any questions.

Respectfully submitted,

Jeffrey M. Winton
Christopher M. Ryan
Quentin M. Baird

Counsel for Arcelor and Its Affiliates