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BY HAND

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U.S. Department of Commerce
14th Street and Constitution Avenue, N.W.
Washington, D.C. 20230

Re: **Comments of Gouvernement du Québec on the Proposed Modification of Agency Practice under Section 123 of the Uruguay Round Agreement Act**

Dear Mr. May:

This letter provides the public comments of the Gouvernement du Québec ("GOQ") on the proposed modification of the agency's methodology in reviewing the privatization of a formerly subsidized firm.

The Department proposes a methodology structured as a sequence of rebuttable presumptions. The baseline presumption "is that non-recurring subsidies can benefit the recipient over a period of time normally corresponding to the average useful life of the recipient's assets." That presumption may be rebutted if an interested party can demonstrate that a privatization occurred during the allocation period "in which the government sold its ownership of all or substantially all 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."[1]

A. The Department's Methodology Must Leave the Burden of Producing Evidence of Continuing Subsidy on the Accusing Petitioner.

The Department begins with the presumption that a privatized entity has benefited from previous subsidies bestowed upon a formerly subsidized entity. That benefit is allocated over a

1 68 Fed. Reg. 13897, 13899 (March 21, 2003).

period of time corresponding to the average useful life of the asset received. If the privatized entity demonstrates, however, that a privatization occurred during the allocation period and was made for fair market value and at arm's length, the presumption of a benefit is then rebutted. The burden of proof, however, always rests on the privatized entity under the methodology proposed by the Department.

The GOQ believes that the proposed methodology unduly shifts the burden of proof to the privatized entity before there has even been a showing that the entity is *currently* receiving subsidies. This is not consistent with WTO panel jurisprudence in this area, which emphasizes that no countervailing duty can be imposed absent a finding of current receipt of benefits from the prior subsidy by the privatized company.[2]

Hence, though it may be reasonable for the Department to presume that a non-recurring subsidy bestows a benefit over time where the receiving entity continues to be owned by the government that conferred the subsidy, the Department cannot properly presume that the benefit continues after the entity has been transferred to private ownership. The Department must have some affirmative basis for concluding that the subsidy has continued to benefit the now-privatized entity. The burden should remain on the party alleging the subsidy to provide such affirmative evidence raising a basis for believing that a benefit continues to accrue despite the privatization. Thus, the accusing party should bear the initial burden of alleging, and providing some affirmative supporting evidence, that the privatization did not extinguish the subsidy by virtue of the payment of fair market value.

Stated differently, the accusing party must carry its burden of providing evidence that conditions were present in the privatization that cause the privatized entity to continue to enjoy benefits from the prior subsidy. The Department cannot rightly place the initial burden on the privatized entity to rebut a presumption that the benefit continued beyond the privatization. Once the accusing party has come forward with evidence to raise a genuine issue of *current* subsidization,

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2 *See Countervailing Measures Concerning Certain Products from the European Communities*, WT/DS212/AB/R (December 9, 2002) at ¶ 85 ("The issues in this appeal relate solely to the impact of the privatization of the firms under investigation in these 12 countervailing duty cases on the *continued* existence of the benefit derived from a financial contribution. As the Panel stated the 'core legal question' before it was to determine whether a 'benefit' within the meaning of the SCM Agreement, which benefit is derived from a non-recurring financial contribution, *continues* to exist following a transfer of ownership of a state-owned enterprise to a new private owner at arm's length and for fair market value, where the government retains no 'controlling interest in the privatized producer' and transfers all or substantially all the property.") (emphasis supplied).

the Department may then shift the burden to the privatized entity of responding with countering evidence to show that the subsidy it allegedly receives was extinguished.[3]

B. The Department Should Clarify that in its First Point of Inquiry, it Will Confine its Analysis to the Privatized Firm

The first point of inquiry proposed by the Department is "whether a change in ownership in fact involves a government's sale to a private party of all or substantially all of a subsidized company or its assets, with the government retaining no controlling assets."[4] If the Department determines that the government has not transferred all ownership or effective control of the formerly subsidized entity, then the inquiry ends and the presumption of a continuing benefit remains. If, however, it appears to the Department that the government has relinquished all control over the formerly subsidized company, then the inquiry continues and the Department then looks to whether the sale of the firm was at arm's length and for fair market value.

In determining whether a government has relinquished all control over the assets of a firm, the Department should look only to the privatized firm itself. Where a government retains control over companies which were formerly related to the privatized entity, the Department must not conflate the control retained over those companies with that relinquished over the privatized firm. The Department's proposed language is unclear in this regard, and the GOQ requests, therefore, that in its final methodology the Department make clear that it intends to confine its analysis to the privatized entity.

C. The Department's Criteria for Analyzing Fair Market Value Should Not Be Unduly Restrictive.

As the Department points out in its Federal Register announcement, while the term "arm's length" is explained in the Statement of Administrative Action accompanying the passage of the Tariff Act of 1930, as amended, there is no statutory definition of "fair market value."[5] The

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3 The Government of Canada has taken a similar position in comments it submitted to the Department on May 23, 1997. Therein, the Government of Canada urges the Department to "consider as a rebuttable presumption that privatization of any state-owned enterprise at arm's-length and reflecting the current market value of its assets, including for example its debt obligations, extinguishes any previously received subsidies."

4 68 Fed. Reg. 13897, 13899 (March 21, 2003).

5 The Statement of Administrative Action provides that "the term 'arm's-length transaction' means a transaction negotiated between unrelated parties, each acting in its own interest, or between related parties such that the terms of the transaction had been negotiated between unrelated parties." Statement of Administrative Action at 258.

Department notes that in the past, when determining fair market value, it has applied a process-oriented approach in analyzing the facts and circumstances of a particular privatization and the resulting value paid. Here, the Department proposes a non-exhaustive list of factors that it will consider in making its fair market value determination, including whether (1) the government imposed exclusions on foreign purchasers or purchasers from other industries, (2) the government performed due diligence in determining the appropriate sales price and followed the recommendations of an independent analysis, (3) the highest bid was accepted, and (4) there were price discounts or other inducements in exchange for promises of additional future investment that private commercial sellers would not normally seek.

1. Fair Market Value Should Not Be Defined by Reference to Sale Price Alone.

The GOQ endorses the Department's approach to determining fair market value, but cautions that the Department should not apply the factors mentioned in its non-exhaustive list in a mechanical fashion. For example, instead of emphasizing highest price as a fundamental determinant of fair market value, the Department should look to a best-value approach, whereby the seller, in evaluating bids, looks not only at price but at the technical component of the transaction as well.

To illustrate, the Department must not treat the highest price offered by a company with no past performance and no proven track record in that particular industry as identical to a similar price offer made by a company with significant experience in the industry, or with significant resources to bring to the formerly subsidized entity. There are circumstances where the latter would represent a more appropriate offer. Hence, a seller's decision to opt for a bid slightly lower than other bids, but from a company with a history of success in the industry, should not be treated with suspicion by the Department. If the bid accepted is one that would have been accepted under market conditions by private commercial sellers, and if the seller can articulate a legitimate reason for choosing a lower bid in exchange for other advantages, the sale should be deemed to have been made at fair market value.

2. The Mere Existence of Conditions to the Sale Cannot Negate Fair Market Value.

Similarly, the Department should clarify that the mere inclusion of conditions that are not meant to restrict the bidding process will not be deemed artificial barriers to the entry of bidders. Conditions should only be deemed restrictive, or be seen as creating an artificial barrier to the entry of bids, if they operate to significantly restrict the universe of possible bidders. If the conditions are not unduly burdensome, and if there was no discrimination against any of the competitors, there must be a presumption that no benefit inured to the privatized firm.

For example, where the government seeks to include as a condition of sale that the privatized entity remain in the region, or that the buyer commit to some level of continued operations and consequent retention of personnel, the Department must not automatically treat the condition as an indication that the sale has not been made at fair market value. Even private commercial sellers place conditions on the sale of an asset where such conditions would ensure the continued viability of that asset. Private sellers have been known to reject bids that would result in a radical elimination of aspects of the business being sold where there are competing bids that propose to continue and improve the performance of current assets.

As a general rule, conditions placed on the sale do not automatically mean that the price paid is not a fair valuation of the actual value of the formerly subsidized company in light of legitimate commercial business objectives for the company. Moreover, where there is no logical or practical link between the condition placed on the sale and the prior subsidy benefit at issue, the fact that the privatization was carried out with conditions does not provide a rational basis for determining that the prior financial benefit has passed through to the privatized company.

The GOQ urges the Department to refrain from applying its non-exhaustive list of criteria in too reflexive a manner so as to result in an inflexible standard. While the Department statutorily retains the discretion "to determine whether, and to what extent, the privatization of a government-owned firm eliminates any previously conferred countervailable subsidies, [the Department] must exercise that discretion carefully through its consideration of the facts of each case and its determination of the appropriate methodology to be applied."[6] As the GOQ has stated on other occasions, the Department must probe the nature and character of the privatization process to determine if a benefit continues to exist. Failure to do so risks the danger of finding subsidies where none exist.

D. The Department Should Provide a Clear Safe-Harbor for Privatizations that are Carried Out by Independently-Administered Auctions or Certified as Legitimate by Post-Privatization Independent Audit.

One objective of the Department's new privatization methodology should be to provide clear and reliable guidance to governments that may engage in privatizations in upcoming years. Governments should be able to look to the Department's rules for specific privatization practices that will insure that their newly-privatized businesses will not face burdensome subsidy litigation in the years following the privatization. Such clarity and certainty is an important component in the successful transition to market economies in such countries, and the U.S. privatization

6 H.R. Rep. No. 103-826(I) at 110 (1994), reprinted in 1994 U.S.C.C.A.N. 3773, 3882.

methodology should provide such clarity by establishing specific "safe harbor" procedures that can be followed to preclude unnecessary countervailing duty investigations. The GOQ suggests two specific safe harbors.

1. Conduct of the Privatization by an Independent Authority Following Market Auction Procedures Should Be Treated as a Preclusive Safe Harbor.

To encourage privatizing governments to follow transparent procedures, the Department's methodology should establish a rule that where the privatizing government entrusts the privatization to an independent private advisor, and that advisor carries out the privatization through commercial auction procedures typically used in disposition of business units, the resulting privatization will be deemed to extinguish any prior subsidies.

Thus, retention by the privatizing government of a recognized private firm or consortium to structure the privatization, to deal with bidders, to receive and evaluate bids, and to make recommendations to the government on which bid to accept, should establish that the resulting privatization has produced a market-value, arms-length transaction. Absent evidence that the government interfered with this independent process, or declined unreasonably to follow the recommendations resulting from that process, the subsidy inquiry should end. Such clear rules will encourage governments to adopt independently-conducted processes that can easily be verified as arms-length and market-driven.

2. Conduct of a Post-Audit Independent Analysis Confirming the Market Nature of the Privatization Should Establish that the Market-Value and Arms-Length Criteria Are Met.

The Department's methodology should also encourage the use of post-privatization audits of the privatization by independent auditing analysts to confirm that the process followed by the privatizing government produced an arms-length, market-value transaction. Such post-event audits serve to discipline the privatization process as it is occurring, and they provide prompt confirmation of whether the terms of the privatization were transparent, unbiased, and delivered market value to the government.

Thus, the Department should recognize a further safe harbor where the privatizing government commissions an independent post-privatization audit, conducted by an appropriate independent auditing firm or entity not otherwise involved in the privatization process, that confirms that the process and results of the privatization meet the arms-length and market-value criteria. Such a rule would encourage timely independent review of the privatization and would thereby add certainty to the post-privatization business climate, because the privatized entity would be able to proceed with exports to the U.S. with reduced fear of intrusive countervailing duty litigation and U.S. producers would have basic assurance that competition from imports from the privatized entity will occur without the benefit of continuing subsidy benefits.

E. The Distortive Conditions Analysis Should be Limited to General Market Conditions.

If the evidence presented indicates that the transaction was conducted at arm's length and for fair market value, any previous subsidies will be presumed to have been extinguished and therefore noncountervailable. The Department's proposed methodology allows a petitioning party to rebut that presumption, however, by showing that the market conditions necessary for the transaction price to fairly and accurately reflect the subsidy benefit were not present or that the market conditions were distorted due to government action. If a party establishes that the transaction price was meaningfully different from what it would otherwise have been, absent the distortive government action, the presumption of extinguishment will have been rebutted.

The Commerce notice identifies a non-exhaustive list of factors that will be considered in determining whether distortive conditions might have existed, including whether (1) the basic requirements for a properly functioning economy are present in the country; (2) the government has used its prerogative in other areas to facilitate or effect the outcome of sale, in a way that a private seller could not; (3) special regulations pertaining to the particular privatization were present so as to distort the market price; and (4) other severely subsidized companies were present as to severely distort market price.

1. The Department Must Show More Than a "Reasonable Basis for Believing" that Distortive Conditions Were Present.

The Department's proposed methodology requires a party to demonstrate only that there is a "reasonable basis for believing" that the transaction price was meaningfully different from what it would otherwise have been absent distortive government action. That standard of proof is too lenient and amounts to a required showing of mere suspicion. If the Department cannot point to clear evidence that indicates the previous financial contribution continues to benefit the privatized entity, the Department must make a negative determination.

The standard should not be framed in terms of the Department's "basis for believing" that distortive conditions were present, but should require explicitly that the evidence, on balance and after consideration of the detracting evidence, must establish a positive demonstration that market distortion in fact occurred as a result of the government's action.

2. *The Department Should End its Inquiry if the Basic Conditions Identified in the First Criterion are Met.*

The first criterion asks whether the basic requirements for a properly functioning market are present in the economy in general and in the particular industry or sector in question. Those requirements relate to the basic definition of a market economy. When the government in question operates in a market economy, the inquiry should end there. The Department should reserve any further market distortion analysis for subsidy allegations involving non-market economies (to the extent subsidy claims are cognizable against NMEs) or transitional economies in the early stages of transformation from centrally-controlled to market-based structures.

The GOQ urges the Department to use care in applying the market-distortion analysis, for the prong raises the GOQ's concern that it will be used as a hook to find subsidies even after a privatization has occurred for fair market value and at arm's length.

3. *Added Conditions to the Sale of an Entity Do Not Reflect Distorted Market Conditions.*

The GOQ is concerned, as it noted above, that special conditions that may have been imposed, such as retention of current employees or the condition that the privatized entity remain in the region, will automatically be deemed to create distortive market conditions. These factors do not render the privatization sale a non-market transaction; nor do they mean that the price obtained was not a market price. There is no necessary relation between a subsidy provided to the pre-privatization entity and reasonable employee or location conditions that might be included as a transitional term to be observed by the privatized company. Concluding that such prior benefits would "continue" as a consequence of such privatization terms is neither logically nor economically correct.

Where the bidding process is transparent and the bids are sought from a wide range of potential bidders, any additional conditions to the sale cannot extinguish the integrity of the bidding process or the nature of the privatization transaction.

4. *The Department's Analysis Should Be Confined to the Private Entity Itself.*

With regard to the fourth criterion, the GOQ, subject to its earlier observations, urges the Department to confine its analysis to the privatized entity itself and not to the entire universe of companies that the privatizing government may control. Where a government relinquishes control or interest in an entity, but not in its previously related sister companies, the only transaction that matters is the process by which the formerly subsidized entity was privatized.

The government's continued ownership of other entities has no effect on the bidding price for the formerly subsidized entity, especially if the bids are sought from a broad range of countries and industry groups. Under those circumstances, the Department should tread cautiously. Where the Department determines that the sale was conducted at arm's length and for fair market value, and where there has been no interference in the basic conditions of the market, there can be no distortive market conditions.[7]

The GOQ thanks the Department for the opportunity to comment and looks forward to the final modification notice.

Very truly yours,

Hamilton Loeb
A. Jeff Ifrah
Lamia Matta
Counsel for the Gouvernement du Québec

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7 The GOQ appreciates the Department's assiduousness in soliciting comments respecting the unelaborated details of the proposed methodology. With regard to the question of continuing benefits where the Department determines that the privatization did not extinguish the benefits previously conferred, rather than propose an economic formula, the GOQ simply suggests an approach whereby the Department calculates the remaining benefits on a pro rata basis and allocates them accordingly over a period time.