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April 11, 2003

FILE NO: 59296.000002

By Hand

PUBLIC DOCUMENT
Total Pages: 16

Mr. Jeffrey May
Director of Policy
Central Records Unit, B-099
Import Administration
U.S. Department of Commerce
14th Street and Constitution Avenue, N.W.
Washington, DC 20230
Attention: Privatization Methodology

Re: Notice of Proposed Modification of Agency Practice Under Section 123 of the Uruguay Round Agreements Act and Request for Public Comment: Comments of ILVA S.p.A.

Dear Mr. May:

On behalf of ILVA S.p.A. ("ILVA"), we submit these comments in response to the Federal Register notice of March 21, 2003[1] concerning the Department's proposed change to its privatization methodology to conform with the WTO Agreement on Subsidies and Countervailing Measures ("SCM Agreement"). The purpose of the comments below are to highlight particular areas of concern for ILVA.

[1] Notice of Proposed Modification of Agency Practice Under Section 123 of the Uruguay Round Agreements Act and Request for Public Comment, 68 Fed. Reg. 13897 (Mar. 21, 2003).

Fair Market Value Test and the "Committed Investment" Criterion

The Department's proposal begins with the issue of fair market value. The Department phrases the issue as follows:

> The basic question before us in analyzing fair market value is whether the government, in its capacity as seller, sought and received, in the form of monetary or equivalent compensation, the full amount that the company or its assets were actually worth under existing market conditions.[2]

While ILVA would agree that the "basic question" is whether the seller received the full amount that the company was worth (based on the worth of the total transaction), the issue of what the government seller sought is irrelevant to the inquiry, for the same reason that the Department always measures a benefit, if any, by the benefit to the recipient and not the cost to the government.[3]

This distinction is important, because it explains how the Department goes astray when it identifies the criteria for determining whether the transaction price was for "fair market value", particularly the "committed investment" factor:

> Were there price discounts or other inducements in exchange for promises of additional future investment that private, commercial

[2] 68 Fed. Reg. at 13900.

[3] Acciai Speciali Terni v. United States, 206 F.Supp.2d 1344, 1359 (Ct. Int'l Trade 2002) ("the countervailing duty statute requires Commerce to calculate subsidies upon the basis of the benefit to the recipient rather than upon the cost to the government"), appeal docketed, No. 03-1058 (Fed. Cir. Nov. 5, 2002).

> sellers would not normally seek (e.g., retaining redundant workers, building or maintaining unwanted capacity), indicating that maximizing its return was not the government's primary consideration?[4]

The Department errs by focusing on the "primary consideration" of the government in selling the company or assets in question. When a government privatizes a company, it may have many motives. But the issue is not whether the government's motives are proper as the Department sees it (i.e., maximization of profit), but whether the deal is structured so that the terms of the deal itself do not constitute a subsidy, i.e., a benefit to the purchaser. As long as there is sufficient buyer competition, a transparent process (so that all parties understood what was being sold and could properly make their own valuation), and ultimately a sale to the highest bidder, then the sale was made at fair market value. It does not matter if the government added other stipulations as part of the deal, such as a requirement to retain a certain number of workers for a fixed period of time, as long as all of the bidders were aware of the stipulation and could value accordingly the deal as a whole.

Even if there are stipulations bundled as part of the overall agreement package that depress the price paid, the buyer ultimately pays the "fair market value" for the package, because all buyers in an open and transparent competition are aware of the stipulations, and

[4] 68 Fed. Reg. at 13900.

discount the stipulations based on how they individually determine that the stipulations detract from the overall value of the transaction. The government's motives are irrelevant.

For example, assume that the government is privatizing a steel mill with 100 workers, and announces a stipulation to all bidders that the buyer must agree to employ at least 100 workers for at least one year following the transaction. Different bidders might treat that stipulation differently when valuing the deal as a whole, and therefore when submitting their bids. Assume that Bidder Number One wants to operate the mill and Bidder Number Two wants to raze the mill and use the site as a toxic waste dump. Bidder Number One might well be planning to expand production at the steel mill and employ more than 100 workers, and therefore the government stipulation will not result in any discount of the value of the overall package to Bidder Number One. The effect of the stipulation on the valuation by Bidder Number Two differs, because Bidder Number Two did not plan to employ any workers, and therefore the overall cost of the package includes a deadweight cost of making payments to workers that were of no use to Bidder Number Two's plans for the property. The value is in the eye of the bidder, and each bidder is likely to view the overall package, with the government stipulations, somewhat differently, depending on the bidder's plan for using the company or asset that it purchased.

In fact, the ability to reach a satisfactory labor agreement often is a condition for sale even in private-to-private transactions. Press reports this week indicate that U.S. Steel Corp.

("U.S. Steel") may well prevail over AK Steel Holding Corp. ("AK Steel") in competition to purchase National Steel Corp. ("National Steel").[5] According to these press reports, AK Steel's bid for National Steel is $925 million and U.S. Steel's bid is $650 million in cash and $100 million in stock, but any acquisition of National Steel is conditioned on reaching a new labor agreement with the United Steelworkers of America, and thus far, only U.S. Steel has accomplished this.[6] Under the labor accord, U.S. Steel reportedly "would have to take back work it previously outsourced to contractors, cancel plans to sell some operations and provide incentives for early retirement for workers."[7] As a result of its agreeing to labor concessions that AK Steel has not, U.S. Steel may well acquire National Steel even though its bid is lower than AK Steel's bid, because only U.S. Steel's bid is an eligible bid (i.e., a bid that meets all requirements of the package as a whole, including labor requirements).[8]

Seen in this light, it becomes apparent that the Department's "committed investment" criterion is unnecessary and unhelpful in reaching the ultimate question of whether the privatization is being accomplished at fair market value. Market value is what the highest

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[5] "U.S. Steel, Union Set Tentative Pact, Boosting Bid," Wall Street Journal, April 10, 2003, at B2.

[6] Id.

[7] Id.

[8] Id.

bidder bids (taking into account all requirements, including labor requirements), not what the Department thinks that it should be, or what the seller would like to obtain. As such, the Department should eliminate this criterion.

Vague "Market Distortion" Factors

In addition to the criteria that the Department identifies to determine whether the privatization is for fair market value, the Department contends that a party could rebut the presumption that subsidies are extinguished in a privatization at fair market value if "the broader conditions necessary for the transaction price to fairly and accurately reflect the subsidy benefit were not present, or were severely distorted by government action (or, where appropriate, inaction)."[9]

ILVA is concerned that the proposed new "market distortion" criteria are too vague and sweeping, particularly the criterion regarding "basic conditions". Although the criteria identified in the "basic conditions" are lifted from language in the WTO Appellate Body opinion[10], that opinion does not require the Department to use those particular concepts as

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[9] 68 Fed. Reg. at 13900.

[10] United States--Countervailing Measures Concerning Certain Products from the European Communities, WT/DS212/AB/R (Dec. 9, 2002), ¶ 122 ("Under certain conditions (e.g., unfettered interplay of supply and demand, broad-based access to information on equal terms, decentralization of economic power, an effective legal system guaranteeing the existence of private property and the enforcement of contracts), prices will reflect the relative
(continued…)

decisionmaking criteria without further elaboration. The problem is that these criteria are too vague and sweeping to provide an appropriate guide to respondents.

The Department is obliged under the U.S. Constitution to make sure that any new rule that it promulgates clearly defines what type of conduct (in this case, what kind of economic conduct by the respondent company and government) will be sufficient to avoid countervailing duties. If the Department does not do so, then the rule is vague and violates constitutional due process guarantees.[11]

In the case of the Department's proposed new privatization rule, ILVA is particularly concerned that the discussion regarding "broader market distortions" is impermissibly vague.[12] The four criteria listed in this section require the Department to examine, and presumably would require the respondents to document in detail, the general macroeconomic conditions of the country in which the respondent is located. The first criterion asks the following question:

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scarcity of goods and services in the market…. However, such market conditions are not necessarily always present and they are often dependent on government action.").

[11] See Grayned v. City of Rockford, 408 U.S. 104, 108-09 (1972) ("[i]t is a basic principle of due process that an enactment is void for vagueness if its prohibitions are not clearly defined"); Thomas v. Hinson, 74 F.3d 888, 889 (8th Cir. 1996) ("[a] regulation is unconstitutionally vague if it fails to give a person of ordinary intelligence a reasonable opportunity to know what is prohibited").

[12] 68 Fed. Reg. at 13900.

> Are the basic requirements for a properly functioning market present in the economy in general as well as in the particular industry or sector, including unfettered interplay of supply and demand, broad-based and equal access to information, decentralization of economic power including effective safeguards against collusive behavior, effective legal guarantees and enforcement of contracts and private property?[13]

These type of broad macroeconomic issues are not clear-cut even in the best of circumstances and are difficult to evaluate in any modern economy, even the United States. Exactly what constitutes "unfettered interplay of supply and demand"? How does one measure whether access to information is "broad-based" and "equal"? How does one measure "decentralization of economic power"?

Moreover, the Department's proposal does not indicate whether these tests should be interpreted narrowly to the specific market in question (i.e., the market for the class or kind of merchandise being investigated or reviewed), or to the economy as a whole. Would the Department, for example, make a generic "basic requirements" determination for Italy, with the same results applied to all cases involving Italian merchandise?

The Department's proposal does not give any clue as to the benchmark for the economy in question. Must the economy under investigation have perfectly functioning markets? If not, how many flaws will the Department accept without concluding that "the market itself was so distorted by the government that there is a reasonable basis for believing that the transaction

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[13] Id.

price was meaningfully different from what it would otherwise have been absent the distortive government action"?[14]

Moreover, by opening the door to an additional set of vague and sweeping tests, the Department diminishes greatly the force of the presumption that a privatization at fair market value extinguishes any pre-privatization subsidies. The Appellate Body described the presumption as follows:

> We understand the Panel to be stating that privatization at arm's length and for fair market value privatization presumtively extinguishes any benefit received from the non-recurring financial contribution bestowed upon a state-owned firm. The effect of such a privatization is to shift the investigating authority the burden of identifying evidence which establishes that the benefit from the previous financial contribution does indeed continue beyond privatization. In the absence of such proof, the fact of the arm's-length, fair market value privatization is sufficient to compel a conclusion that the "benefit" no longer exists for the privatized firm, and, therefore, that countervailing duties should not be levied. This is an accurate characterization of a Member's obligations under the SCM Agreement.[15]

Although the Appellate Body did not intend the presumption to be absolute and irrebuttable, the Department's proposal guts the presumption entirely. The Department proposes to test whether the transaction meets the requirements necessary to conclude that it occurred at fair

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[14] 68 Fed. Reg. at 13900.

[15] United States--Countervailing Measures Concerning Certain Products from the European Communities, WT/DS212/AB/R (Dec. 9, 2002), ¶ 126 (emphasis original).

market value, only to then require respondent company to proceed to an entirely different set of vague tests that assess overall functionality of the market in the country in question. The Department sets forth these additional tests as a series of ill-defined traps that can result in a finding of subsidy pass-through even if the respondent has met the central test by showing that it receives no continuing benefit from the pre-privatization subsidies because the respondent paid fair market value for the previously subsidized entity. In essence, under the vague "basic condition" test, the Department could find that every privatized respondent in every case considered to date would be liable for countervailing duties, despite explicit findings that each such privatized respondent had been purchased at fair market value, because of some perceived flaws in the functioning of the market in which the respondent operates.

The Department could avoid the vagueness problem by changing this criterion so that it is consistent with the questions that the Department already addresses when it determines whether or not to classify a country as a "nonmarket economy country" ("NME") for purposes of determining normal value in an antidumping duty proceeding.[16] The NME criteria ask for

[16] See 19 U.S.C. § 1677(18)(B); see Inquiry Into the Status of the Russian Federation as a Non-Market Economy Country Under U.S. Antidumping Law, Unpublished Decision Memorandum (June 6, 2002), available at http://ia.ita.doc.gov/download/russia-nme-status/russia-nme-decision-final.htm.

the Department to determine whether the country in question "does not operate on market principles of cost or pricing structures",[17] and list six factors for the Department to consider.[18]

Although the purpose of the NME inquiry is different, the issues are similar because in both cases, the Department is trying to determine whether the economy responds to normal market signals. In the case of the NME inquiry, the Department is trying to determine whether costs and sales prices can reasonably be expected to reflect market outcomes, and therefore whether the typical antidumping duty calculation for market. In the case of the privatization issue, notwithstanding the fact that this criterion is listed separately from the "fair market value" criteria, the Department really is trying to determine whether the "basic conditions" of the economy are such that allow the market to yield a fair market value price that would be expected in a reasonably functioning market.

Given the similarity of the overall inquiry in the case of the NME test and the Department's "basic conditions" criterion for privatization cases, the Department should

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[17] 19 U.S.C. § 1677(18)(A).

[18] The factors are: "(i) the extent to which the currency of the foreign country is convertible into the currency of other countries; (ii) the extent to which wage rates in the foreign country are determined by free bargaining between labor and management; (iii) the extent to which joint ventures or other investments by firms of other foreign countries are permitted in the foreign country; (iv) the extent of government ownership or control of the means of production; (v) the extent of government control over the allocation of resources and over the price and output decisions of enterprises; and (vi) such other factors as the administering authority considers appropriate." 19 U.S.C. § 1677(18)(B).

improve the clarity of the test and increase certainty for respondents by applying the NME test in place of the Department's proposed "basic conditions" test. Although the Department could maintain its discretion to revisit an NME determination, the Department in the first instance should determine that the "basic conditions" to set a market value are present if the economy is a market economy, and that those conditions are not present if the economy is an NME.

"Legal Requirements" Factor

ILVA objects to the "legal requirements" factor. The Department proposes that the market might be "distorted", and therefore pre-privatization subsidies might not be extinguished despite a fair market value transaction, if there were "special regulations pertaining to this privatization (or privatizations generally) affecting worker retention, etc., that distorted the market price of the company or its assets."[19] ILVA's objections are the same as its objections regarding the "committed investment" factor for determining whether the transaction is a fair market value transaction, namely that the presence of a labor agreement, either in the form of a "special regulation" or as a contractual stipulation in the privatization deal, would not detract from the fact that the ultimate purchaser pays fair market value as long as there is sufficient buyer competition, a transparent process, and ultimately a sale to the highest bidder.

[19] 68 Fed. Reg. at 13900.

Moreover, unlike the criterion regarding "basic conditions," there is no support in the Appellate Body decision for the idea that a worker retention requirement by the selling government would taint a fair market value transaction to the extent that it would justify countervailing pre-privatization subsidies on the fair market value purchaser.

Finally, the Department justifies this "market distortion" criterion (as well as all of the other market distortion criteria) in part on the grounds that "[w]here a party demonstrates that the broader market or economic environment was severely distorted by government action such that there is a reasonable basis for believing that the transaction price was meaningfully different from what it would otherwise have been absent the distortive government action, the presumption of extinguishment will be rebutted."[20] However, the Department does not explain why a worker retention requirement by the selling government would constitute a "severe distortion" of the "broader market or economic environment" that would overcome the presumption that the fair market value transaction extinguishes the pre-privatization subsidies. The reality is that it is hard to imagine any worker retention agreement for any individual company about to be privatized that would have any significant effect on the economy as a whole in the country where the privatization took place, unless the economy in that country were extremely small and the company were extremely large. (We are unaware of any recently

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[20] 68 Fed. Reg. at 13900.

privatized steel companies in Liechtenstein.) Consequently, the Department should delete this criterion from its list of factors to consider in the privatization context.

<u>"Creation/Maintenance" Criterion</u>

The Department should also delete the criterion regarding "creation/maintenance". In this criterion, the Department asks whether "the presence of other heavily subsidized companies severely distort[s] the market price of the company or its assets in that industry"? First, it is not clear whether the Department is referring to "other heavily subsidized companies" in the industry globally, or just in the country in question. This criterion should not be used as an excuse for the Department to claim that the privatization rules should be ignored in the case of one particular industry, such as the steel industry, because there are so many steel companies globally that are subsidized. Second, if such distortion is taking place within the company in question, then the market value of the privatized company is indeed lowered, but that market value will be reflected in a lower sales price for the privatization transaction. There should be nothing disturbing about that outcome, because once again, the purchaser will have gotten what it paid for and no more, and therefore the purchaser is not being subsidized as a result of the transaction.

<u>"Concurrent Subsidies"</u>

Finally, the Department's proposal lists several additional issues that "require further elaboration." One of those issues is the following:

> The Department has long wrestled with the issue of subsidies given to encourage, or that are otherwise concurrent with, a privatization. Should a subsidy, e.g., debt forgiveness, given to a company to encourage or facilitate a privatization be considered a "pre-privatization" subsidy that can be extinguished during the privatization or a new subsidy to the new owner(s)?[21]

The answer to this question should be clear. The sole question is whether the "concurrent" subsidies were available to, and known by, all bidders during the process. If a government eliminates debt to make the company to be sold more attractive to all the purchasers and therefore hopefully to command a higher price in the bidding (something that private sellers do all the time when selling a company or assets), then the debt forgiveness should not be countervailable, because once again all of the bidders knew what they were buying, and could adjust their bids as appropriate. If, however, the government provided the debt forgiveness after the bids were finalized, then the debt forgiveness would not necessarily have been reflected in the bid price, and therefore the debt forgiveness should be treated as a new subsidy.

Conclusion

ILVA appreciates the Department's recognition that privatization at fair market value presumptively extinguishes subsidies. However, ILVA remains concerned that the Department's criteria for determining whether the privatization is at fair market value does not analyze the issue properly from the standpoint of the purchaser. Moreover, the Department

[21] 68 Fed. Reg. at 13901.

decreases the force of the presumption of extinguishment by adding an additional layer of "market distortion" criteria that is so vague and so sweeping that it functionally destroys the presumption that the Department is creating..

Respectfully submitted,

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Richard P. Ferrin