United States - Countervailing Duties Concerning Certain Products from the European Communities

WT/DS212

Oral Statement of the United States at the Second Meeting of the Panel

March 20, 2002

I. <u>Introduction</u>

1. Thank you, Mr. Chairman and members of the Panel. The United States appreciates this opportunity to present its views regarding the issues in this dispute. The question here is about subsidies. There is no dispute that subsidies can be trade distorting and cause injury and can be countervailed, nor is there any dispute that injurious subsidies were provided in the cases at issue here . The only question here is whether a sale has removed the subsidy or the injury. I will first address the central issue before the Panel - - whether the privatization of a subsidized company automatically extracts those subsidies from that company. Then I will address a series of erroneous and highly misleading statements concerning that issue by the EC in its Second Written Submission. These responses make my statement today somewhat longer than I would like it to be, but I do not think that it would be appropriate to leave the EC's additional arguments unanswered. I will not address the issues related to "sunset" reviews and the U.S. statute in this statement, since these have been thoroughly addressed elsewhere in this proceeding.

2. Throughout this proceeding, the United States has emphasized that its new approach to privatization is fully consistent with the relevant provisions of the SCM Agreement. Articles 1 and 14 establish that a subsidy is created when a government makes a financial contribution to a person on terms more favorable than what that person could have obtained in the marketplace. The subsidy resides within that recipient and, if it is a non-recurring subsidy, may be allocated over time.[1]

3. The "benefit" that is allocated is not the theoretical or actual competitive advantage from the subsidy. The Agreement does not require the identification of any such advantage, and

[1] *United States - Imposition of Countervailing Duties on Certain Lead and Bismuth Carbon Steel Products Originating in the United Kingdom*, (hereafter "UK Lead Bar") WT/DS138/AB/R, adopted June 7, 2000, ¶ 58.

provides no mechanism by which it might be measured. The benefit to the recipient is measured under Article 14, and the result of that measurement is simply an amount of money.

4. The presumption that non-recurring subsidies may be allocated over time is not irrebuttable. Countervailable subsidies may be terminated in conjunction with a change in the ownership of the subsidy recipient in at least two ways. First, the recipient could repay the subsidy to the government in conjunction with the change in ownership, which would terminate the subsidy. Second, the recipient's productive assets could be transferred to a different legal person, cutting off the producer of that merchandise from the subsidy. In either one of these cases, the producer of the subject merchandise would no longer have the financial contribution and benefit required by Article 1.

5. This does *not* mean that a change in the ownership of a subsidy recipient *automatically* terminates the subsidy. The change in ownership does not by itself change the fact that the company has received a subsidy nor does it undo the benefit. It does not *itself* remove the subsidy from the recipient, or transfer the subsidy from the recipient to a different legal person. Because the subsidy has not been taken out of the recipient, it continues to reside in that recipient.

6. A government that sells a subsidy recipient to a private investor may receive money, but that money does not come out of the subsidized company - - it comes from the new owner in exchange for government shares of equal value. That money, therefore, is not a repayment of anything by the recipient. The subsidy remains in the company. In any event, the appropriate focus is not on what the government has received, but on what the subsidy recipient - - the company - - has repaid. As the Appellate Body has noted, subsidies are valued according to their benefit to the recipient, not their cost to the government.[2]

7. These basic principles govern the issue before the Panel and require the conclusion that a change in the ownership of a person that has received a subsidy does not automatically terminate that subsidy. Rather, as reflected in the U.S. approach to privatization, the key question is whether, following the change in ownership, the producer whose products are entering the United States (and causing injury) is the same person that received the subsidy. If so, then all of the requirements of the SCM Agreement have been satisfied with respect to that person, and that person remains subject to countervailing duties.

8. In challenging the U.S. approach, the EC initially tried to get around these basic principles by pretending that a change in the ownership of a subsidized company (which the EC

[2] *Canada - Measures Affecting the Export of Civilian Aircraft*, WT/DS70/AB/R, adopted 20 August 1999, ¶ 154.

called the "pre-privatization subsidy recipient") "fundamentally transformed" that company into a distinct new legal person (called the "post transaction entity"), for which the requirements of the SCM Agreement would have to be satisfied anew.[3]

9. This approach left the EC with two serious problems. First, it could not explain how a simple change in ownership of the company that had received the subsidy transformed that company into a new legal person - - the whole idea was contrary to the basic principles of company law. Second, the EC was unable to explain how a transaction between the seller and the buyer automatically extracted the subsidies from the company that was sold.

10. Consequently, the EC retreated from its initial position. First, it dropped the theory that a change in ownership automatically transformed the company sold into a new legal person,[4] in favor of the argument that subsidies are not received by legal persons, but by undefined "economic entities," within which the distinction between owner and company is meaningless.[5] Second, the EC downplayed references to fair market value and avoids explaining why a transaction between a seller and buyer would automatically extract subsidies from the company sold.[6]

11. In its Second Written Submission, the EC has come full circle, using its new "economic entity" terminology to repackage its original "new person" argument. The EC now asserts that subsidies are received by "economic entities" and that the privatization of such pre-privatization "economic entities" transforms them into different entities (presumably, "post-transaction economic entities"), for which the requirements of the SCM Agreement must be satisfied anew.[7]

12. The EC's reconstituted argument suffers from the same fundamental defect as the original. Despite numerous opportunities, the EC has still failed to explain why the payment of fair market value by new owners extracts a subsidy from the subsidy recipient. I will come back to this point later. First, however, I want to discuss the logical inconsistencies in, and the utter lack of support in the SCM Agreement for, the EC's new "economic entity" approach.

II. The EC's New "Economic Entity Approach

[3] 1[st] EC Submission at ¶ 10 - ¶ 11.

[4] *See* the EC's responses to U.S. Question Nos. 4 - 7.

[5] *See* the EC Response to Panel Question No. 9 (¶ 13).

[6] *See* the EC's responses to Panel Questions Nos. 3 and 14 and U.S. Questions Nos. 8 and 24.

[7] *See* the 2d EC Submission at ¶ 12 and ¶ 49.

13. The EC's new "economic entity" approach suffers from two fundamental defects. First, as the Appellate Body has stated**,** the recipient of a subsidy "must be a natural or legal person."[8] While the EC has not explained what an "economic entity" is, it clearly is intended to be broader than the legal person that received the subsidy. The simple fact is that subsidies are not received by economic entities - - they are received by legal persons. In *UK Lead Bar*, the subsidies in question were received by British Steel.

14. Second, the "economic entity" approach leads to one logical absurdity after another. The United States pointed out in its Second Written Submission that the EC has become very adept at discussing changes in ownership as if there were no parties to such transactions.[9] This tactic avoids having to explain exactly how a transaction between the government and the new owner automatically extracted subsidies from the company sold. This tactic is most vividly illustrated in paragraph 12 of the EC's Second Written Submission, where it summarizes its entire argument without explaining what is being sold, by whom, to whom or how the metamorphosis of the "economic entity" is accomplished.[10]

15. The reason why the EC is so vague about the economic entity, its dissolution, and reincarnation becomes very clear if one fills in the blanks in paragraph 12 consistent with the EC's new conceptual framework. Filling in those blanks (as the United States has done in Exhibit US-13) shows that the EC's new framework leads to the following conclusions.

- A government gives a subsidy to an "economic entity," consisting of both itself and the legal person to whom the subsidy was given.

- The government then sells a portion of the "economic entity" (formerly known as the company) to a new owner. This creates a new "economic entity" consisting of a portion of the pre-privatization entity and the new owner.[11]

- When the new owner writes the check, it is distinct from the legal person that received the subsidy (otherwise, the subsidy recipient would be buying itself from itself). The instant the transaction is complete, however, the subsidy recipient is merged with the new

[8] Report of the Appellate Body in UK Lead Bar at ¶ 58.

[9] 1st Written Submission of the United States, ¶¶ 6 - 9.

[10] See Exhibit US-13.

[11] See Exhibit US-13.

owner into a new post-transaction "economic entity," which has never received a subsidy.

16. The EC has coined the new term "economic entity" to obscure the simple fact that a privatization consists of a sale by a government of a subsidy recipient to a new owner. That the sale is *not* a sale of some other entity is demonstrated by the price paid – the fair market value of the legal person that received the subsidy. It is not the fair market value of some other, larger "economic entity." Calling the subsidy recipient different "economic entities" before and after the sale cannot change this simple fact. The legal person that received the subsidy does not necessarily change simply as the result of the sale, however many creative names the EC may devise for that person.

17. If the EC insists on maintaining this argument, it should at least attempt to give actual, responsive, answers to the following three questions:

a) Does the pre-privatization economic entity consist of both the government and the producing company? If so, does the government subsidize itself?

b) Is the new owner independent from the pre-privatization economic entity at the time of its purchase? If so, why does that payment automatically extract the subsidy from the independent entity that is purchased?

c) Does the legal person that received the subsidy lose its identity as a legal person at some point in this process? If so, when and why?

III. The Role of Fair Market Value

18. The EC's rather unrealistic account of privatization should not be allowed to distract the Panel from one key fact – the EC has completely failed throughout this proceeding to explain why the payment by a private purchaser to a government for a subsidized company extracts the subsidies from that company. If the EC intends to maintain that it has explained the mechanism by which a sale for fair market value extracts subsidies from the company sold, it should at least attempt to give credible, responsive answers to the following three questions.

a) If selling a subsidized company for 100% of fair market value eliminates 100% of the prior subsidies, why would not selling a subsidized company for 40% of fair market value eliminate 40% of those subsidies?

b) Suppose that a government owns 55% of subsidized Company A, and a private company the other 45%. The Government then gives Company A an outright grant of $1 million. Is Company A accountable for the full $1 million subsidy? If not, why not?

c) Now suppose that the Government sells its private partner a further 10% of the shares of Company A, for the fair market value of those shares, giving its partner majority ownership of Company A. Is 100% of the $1 million subsidy to Company A wiped out?

19. If the EC cannot provide a credible answer to these questions, it should admit that it has not made out even a *prima facie* case that a payment for fair market value extracts subsidies from a company, and it should admit that the only consequence of such a payment is that the purchasers themselves have not obtained a separate, new benefit.

IV. The EC's Second Written Submission Contains Many Erroneous and Highly Misleading Arguments

20. The EC's Second Written Submission contains a variety of new arguments that are so blatantly wrong or misleading that the United States feels it must respond briefly, even at this late stage of the proceeding. The answers of the United States to these new arguments are as follows.

The United States Has Never Argued that the Presumption That Subsidies May be Allocated over Time Is Irrebuttable.

21. The EC states that the United States has argued that the presumption that subsidies may be allocated over time is irrebuttable.[12] This is not true. The United States has stated very plainly in its Second Written Submission that this presumption may be rebutted by a demonstration that the subsidies have been paid back, or that the current producer of the subject merchandise is a different legal person from the subsidy recipient.[13]

The United States Has Not Argued that Subsidies Attach to Assets.

22. In its Second Written Submission, the EC asserts no less than four times that the United States believes that subsidies "pass through" in changes of ownership because they attach to assets.[14] In fact, the United States has not said that subsidies reside in assets. We have repeatedly stressed *quite the opposite* - - that subsidies reside in legal persons. If a subsidy recipient simply transfers its productive assets to a different legal person, the subsidies do not transfer to the person that buys the assets. The EC's assertion is astonishing in light of the United States' answer to the EC's Question Number 10:

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[12] *See* 2d EC Submission at ¶ 2.

[13] See 2d U.S. Submission at ¶ 4. and U.S. Response to Panel Question 1, at ¶ 3.

[14] *See* 2d EC Submission at ¶¶ 7, 8, 50, and 51.

> A sale of bare assets is treated differently from a stock sale. Assuming that the assets are sold to a different person than the person that originally received subsidies, the DOC will not find that the producer that operates the purchased assets is subject to countervailing duties.

The Department of Commerce Does Not Ignore the Distinction Between Companies and Owners in Administering the Countervailing Duty law.

23. The EC states that the Department of Commerce ignores the distinction between companies and owners,[15] so that, in effect, it applies an "economic entity" approach itself. This is a gross misstatement. An accurate description of DOC's practice is that, as a general rule, the Department treats companies and owners as completely distinct, but that it sometimes allocates subsidies to different producers within the same corporate group.

24. Let me begin with the general rule. The DOC does not allocate to producers subsidies that are given to investors; nor does it allocate to investors subsidies that are given to producers. I cannot give you a lot of citations to instances in which the Department has had to explain why it does not make such allocations, because the point is so obvious that no one has ever asked the Department to make such an allocation. For instance, the French Government gave massive subsidies to the bank Credit Lyonnais during the 1990's.[16] Credit Lyonnais owned 20% of the stock of the French Steel producer Usinor-Sacilor at that time. Nevertheless, the U.S. petitioners (who certainly are not reticent about alleging the existence of subsidies) have never even bothered to ask DOC to attribute some of the subsidies bestowed upon Credit Lyonnais to Usinor-Sacilor.

25. DOC also necessarily distinguishes between owners and companies each time it finds that a government has provided a subsidy to a government-owned company - - not to do so would be to imply that the government subsidized itself.

26. Now I will turn to the exceptions. I should first point out that the very existence of carefully crafted exceptions to the rule that legal persons are treated as distinct entities itself demonstrates the existence of the general rule.

27. The most obvious exception is where subsidies are nominally granted to a holding

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15 *See* 2d EC Submission at ¶¶ 16-17.

16 *See, e.g.*, Decision of the European Commission of 20 May 1998 Concerning Aid Granted by France to the Credit Lyonnais Group (98/490/EC) L221/28 - L221/80 8.8.98.

company that simply acts as a conduit for subsidies to one or more of its producing subsidiaries.[17] If the subsidies were allocated strictly within the holding company, they would never apply to the production in question, negating the remedy that CVD regimes are intended to provide. If one allocated subsidies strictly to the holding company, there would be no production subsidized.

28. Even so, the allocation of subsidies to the members of the group does not imply that there is no distinction between the various legal persons - - it implies that, in giving the subsidy to the holding company, the government was making an indirect grant to the various operating units. In fact, where the different companies within a group make different products, and the subsidies are tied to a particular product, those subsidies are not allocated to members of the group that produce other products.[18] For example, assume Company A owns Company B, but that both A and B produce different products. Assume also that the home government provides a grant to owner (A) specifically for the purchase of equipment to manufacture merchandise produced by Company B. The subsidy would be attributed to the merchandise produced by Company B, but not to the owner A.

29. Where the DOC does allocate subsidies across the combined production of a closely-related corporate group, it is because the various members of that group are all engaged in production of similar merchandise and essentially, function as one entity.[19] For example, assume Company A owns Company B, both of which produce the same product, and government provides an untied grant to A. In such an event, DOC would attribute the subsidy to the

[17] 19 CFR 351.525(b)(6)(iii) (contained in Exhibit EC - 32) provides:

> If the Secretary finds that the holding company merely served as a conduit for the transfer of the subsidy from the government to a subsidiary of the holding company, the secretary will attribute the subsidy to the products sold by the subsidiary.

See, e.g., Final Affirmative Countervailing Duty Determination: Brass Sheet and Strip From France, 52 FR 1218, 1220, 1223 (12 January 1987); *Final Affirmative Countervailing Duty Determination; Certain Carbon Steel Products From Austria*, 50 FR 33369, 33373 (19 August 1985) ("A. Equity Infusions" section) (portions of government equity infusions into Company A required by government to be transferred to affiliated Company B found not to be countervailable as Company B did not produce subject merchandise).

[18] CFR 351.525(b)(4) (Contained in Exhibit EC - 32). *See, e.g.*, *Final Affirmative Countervailing Duty Determination: Grain-Oriented Electrical Steel From Italy*, 59 FR 18357, 18365-18366 (18 April 1994) (analysis focusing on subsidies provided to producer of subject merchandise). *See also Final Negative Countervailing Duty Determination and Final Negative Critical Circumstances Determination: Certain Laminated Hardwood Trailer Flooring (LHF) From Canada*, 62 FR 5201, 5202 (4 February 1997) (where certain incorporated companies within a group of companies received subsidies and such companies were not directly involved in the production of LHF, DOC did not include those subsidies in its calculations).

[19] 19 CFR 351.525(b)(6)(ii) (contained in Exhibit EC - 32).

combined output of A and B. Or, if the firm that received an untied financial contribution is a holding company, including a parent corporation with its own production, then DOC would attribute the subsidy to the consolidated sales of the holding company and its subsidiaries.[20] When there is an insufficient identity of interests between the parent and the subsidiary to warrant treating the entities as one, DOC follows its general rule and does not allocate subsidies to the entire group.[21]

Money Is Not Fungible Between Investors and Producers.

30. The EC states that the distinction between owners and companies should be disregarded because money is fungible within "economic entities."[22] Generally speaking, money is fungible. But fungibility operates only within groups of entities that may be collapsed and treated as one. This does not include investors and producers. To treat money as being fungible between investors and producers, for example, would imply that, if one of the Panel members were to buy shares of IBM, IBM's creditors could attach that Panel member's assets to satisfy a debt of IBM. The fungibility of money does not extend this far.

CVD Exposure Is Comparable to Other Potential Liabilities.

31. In effect, the EC argues that, because CVD liabilities do not operate in *exactly* the same manner as potential tort liabilities, they are not potential liabilities at all.[23] The truth is that CVD exposure is very much like potential tort liabilities - - they are both potential burdens upon the earnings of the company that a prospective purchaser would take into account just as surely as it would take account of potential tort liabilities.

32. In any event, the EC's attempt to distinguish potential CVD liabilities is not persuasive. Both liabilities will become actual only if injured parties in the affected country bring some kind of legal action. Moreover, just as a subsidized steel producer could avoid CVDs by disgorging the subsidies or by ceasing to export to countries with CVD orders, a producer that has caused environmental damage in another country could well escape that potential liability by repairing

[20] 19 CFR 351.525(b)(6)(iii) (Contained in Exhibit EC - 32). *See, e.g.*, *Final Affirmative Countervailing Duty Determination: Certain Stainless Steel Wire Rod From Italy*, 63 FR 40474, 40495-40496 (29 July 1998) (discussion of DOC attribution practice).

[21] *Id.*, *citing Final Affirmative Countervailing Duty Determination: Ferrosilicon From Venezuela*, 58 FR 27539, 27542 (10 May 1993).

[22] 2d EC Submission at ¶ 13.

[23] *See* 2d EC Submission at ¶¶ 44 - 46.

that damage or by ceasing certain operations in that country.

33. Finally, CVDs are very specific to the subsidized producer - - the amount of the duty is calculated by dividing the subsidy to that producer for the year in which the merchandise is produced by that producer's total production during that year.

It is Not True that DOC's New Methodology Cannot Distinguish Between Distinct Legal Persons.

34. Finally, the EC asserts that DOC's new change in ownership methodology "is not a methodology which can distinguish between distinct legal persons."[24] This is ridiculous. As we have explained at some length, DOC's new methodology is *precisely* an elaborate test for determining whether the producer of the subject merchandise after a change in ownership is the same legal person as the person that received the subsidy before that change in ownership.[25] If it remains the same person, then, in contrast to the situation in *UK Lead Bar*, all of the requirements of the SCM Agreement have been satisfied with respect to that person, which remains subject to countervailing duties. Moreover, the Appellate Body did not, as the EC suggests, find that British Steel and UES were distinct legal persons. DOC had not yet developed its new test and, necessarily, had not applied it. There was, therefore no finding on this issue for either the Panel or the Appellate Body to review. The Appellate Body, accordingly, did not decide the issue, but simply treated British Steel and UES as distinct persons.[26]

35. In conclusion, the United States respectfully requests the Panel to reject the EC's contention that the sale of a subsidized company necessarily extinguishes those subsidies and to find that the U.S. approach – in which the Commerce Department analyzes certain factors to determine whether a company's change in ownership has resulted in a new legal person – is not inconsistent with the SCM Agreement.

36. Thank you for listening to these rather extended remarks. I will be happy to answer any questions that members of the Panel may have.

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24 *See* 2d EC Submission at ¶ 56.

25 *See* 1st Submission of the United States at ¶ ¶ 79 - 81.

26 See the discussion of this issue in the 1st U.S. Submission at ¶ ¶ 39 - 40.