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PUBLIC DOCUMENT

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Central Records Unit - Room B-099
Import Administration
U.S. Department of Commerce
14th Street and Constitution Avenue, NW
Washington, D.C. 20230

ATTN: Privatization Methodology

RE: Comments of the Brazilian Steel Institute and Member Companies

Dear Mr. Secretary:

On behalf of the Instituto Brasileiro de Siderurgia, or Brazilian Steel Institute, and its member companies, Aços de Minas Gerais, Companhia Siderúrgica Nacional, Companhia Siderúrgica Paulista, Companhia Siderúrgica de Tubarao, and Usinas Siderúrgicas de Minas Gerais (hereafter referred to as "the Brazilian steel producers"), we submit these comments on the Department's proposed modified methodology for determining whether government subsidies have been extinguished by privatization.

OVERVIEW

As a general matter, the Brazilian steel producers support the new methodology proposed by the Department to the extent that it recognizes that the presumption that nonrecurring subsidies continue to benefit the recipient over a period of time is rebutted if it is demonstrated that a privatization has occurred "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." We note that a new methodology examining the underlying privatization transaction is called for not only by the decision of the WTO Appellate Body, but also by three out of four U.S. Court of International Trade decisions interpreting the U.S. Court of Appeals' decision in Delverde III.[1] We believe that it should be clear from these decisions that an arm's length privatization at market value extinguishes the subsidy, and the burden of showing the continuation of the subsidy under such circumstances should be high. The first part of the Department's proposed methodology is consistent with a presumption that an arm's-length privatization at fair market value extinguishes prior subsidies.

We also agree with the Department's "process oriented approach to analyzing the facts and circumstances of a particular privatization and the resulting value paid." Unfortunately, the standards to be applied by the Department in its process oriented approach are ill defined, often wrong, and insufficiently linked to the issue of whether fair market value was paid for what was received by the purchaser.

Finally, the Department has added a set of open ended and equally ill defined factors to determine whether, even if the sale is determined to be at market value, "the market itself was so distorted by the government 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

[1] Two decisions by Judge Barzilay, *Allegheny Ludlum Corp. v. United States*, Slip Op. No. 2002-114 (September 24, 2002), and *GTS Industries S.A. v. United States*, Slip Op. 2002-115 (September 24, 2002), specifically held that pre-privatization subsidies were extinguished by an arm's length sale at fair market value. A third opinion, by Judge Wallach, *Acciai Speciali Terni Sp.A. v. United States.,* Slip Op. O2-10 (February 1, 2002), found that the Department's "same person" methodology violated *Delverde III.* Only one opinion, *Acciali Speciali Terni Sp.A. v. United States,* Slip Op. No. 02-51 (June 4, 2002), upheld the Department's "same person" methodology. Unlike the other three opinions, *Acciali Speciali Terni* contains virtually no explanation of the rationale underlying its determination, and does not distinguish the court's rulings in the other three cases.

action." It remains unclear whether and how these factors affect the issue of market value and whether the Department will even require any linkage between each of these factors and the determination of market value. Furthermore, there is no rationale for the Department to assume that government actions in any economy determined not to be a non-market economy are any more or less distortive. All government actions create some form of distortion; these factors leave open the issue of which distortions are relevant and why and which are not.

In short, although the Department started from the correct premise, it has superimposed a set of conditions, which, ultimately, do not allow any country to determine whether or not the privatization it undertakes will eliminate the pre-privatization subsidies. Indeed, the regulations appear to invite yet another round of litigation in the WTO rather than providing clear, concise, WTO consistent rules.

I. WHILE THE DEPARTMENT'S PROPOSAL FOR DETERMINING WHETHER A SALE IS AN ARM'S-LENGTH SALE FOR FAIR MARKET VALUE IDENTIFIES RELEVANT CRITERIA, THE CRITERIA SHOULD HAVE A HIERARCHY AND BE SUBJECT TO IMPORTANT QUALIFICATIONS

As a general matter, the Brazilian steel producers believe that the Department's criteria for determining whether a sale is made for fair market value are relevant to the inquiry. However, they should be applied in a hierarchy, modified to eliminate irrelevant considerations, and be evaluated in the context of the transaction as a whole.

A. In A Country Not Designated As A "Non-Market Economy" By the Department, A Sale Based On An Independent Valuation Near or Above the Minimum Price Recommended in the Independent Valuation Should Be Presumed to Be At Market Value.

We believe that in any process oriented analysis; the most important factor has to be the determination of the appropriate value of the asset or entity being privatized. As such, factor (2)

would seem to be the starting point for any analysis and should provide the parameters for evaluating any other factors. Indeed, we believe that a sale which is based on an independent analysis and which sets a minimum price based on that analysis should be presumed to be at market value if the sale is consummated near[2] the minimum price or at a price above the minimum price. This should certainly be true in the case of any economy that has not been designated as a non-market economy by the Department for purposes of the U.S. antidumping law. Thus, the combination of an independent valuation, a sale near or above the amount of the independent valuation, and the fact that the sale occurred in an economy not designated by the Department as a non-market economy should create a presumption that the sale was at market value.

B. All of the Other Factors Cited By the Department Should Be Qualified to Reflect Business and Economic Realities and Should Only Overcome the Presumption of A Sale At Fair Market Value if the Evidence Is Clear and Convincing That These Factors Had a Substantial Effect on the Transaction At Issue.

1. Factors (1), (3) and (4) Are Applicable to Many Transactions Between Private Parties

BIDDER QUALIFICATION

The Department suggests that "overly burdensome/unreasonable bidder qualification requirements" could suppress demand. The emphasis must be on the words "overly burdensome" and "unreasonable." A transaction should not be ruled to be not at fair value simply because there are restrictions on the bidders. For example, it would be perfectly normal for any seller (government or not) to put capital restrictions (such as bid bonds or minimum capital commitments) on bidders to assure solvency or ability to pay for the assets. Such requirements would merely assure against frivolous or sham bids and would not be "unreasonable."

[2] We use the standard of "near," rather than "at," because an inconsequential variation between the respondent valuation and the actual price paid should not overcome the arm's-length presumption.

Similarly, virtually every country in the world has some restrictions on foreign investment in certain industries, including the United States. These range from absolute prohibitions to limitations on the degree of foreign participation. There are also limitations on purely domestic participation. For example, historically how many television stations can be controlled by a single entity or by an entity in a single market has been restricted. There may also be limitations based on competitive concerns; in the United States most major acquisitions are reviewed by either the Department of Justice or the Federal Trade Commission and may be blocked because of anti-competitive effects.

Ultimately, the Department of Commerce should not be involved in determining whether constraints placed on investments in foreign countries are overly burdensome or unreasonable. Nor should the Department be concerned about whether the maximum possible number of bidders qualified. The issue should be whether or not there were sufficient bidders with sufficient resources to create a market driven result. Normally if the price set based on the independent evaluation or a higher price ultimately was paid by the purchaser, a market driven result should be assumed.

HIGHEST BIDDER

The Department's suggestion that a sale, which was not awarded to the highest bidder, might vitiate the fair value of the transaction is overbroad. There are numerous situations, even in the United States, where sales may be awarded to a lower bidder, without in any way diminishing the fair market value of the transaction. For example, in the ongoing bankruptcy purchase of the assets of National Steel, the lower bid by U.S. Steel may prove preferable to the higher bid by AK Steel if the U.S. Steel offer includes labor conditions more acceptable to the unions. If the bid were awarded to U.S. Steel despite its nominally lower bid, it would be because there are non-price components of

the bid (labor conditions) which themselves have a value. The mere fact that the lower nominal bid is the one accepted does not mean that the transaction is not for fair value.

Similarly, a seller may sell to a bidder with a lower price depending on the terms of the offer. For example, an all cash offer may be preferred to a part-cash part-stock offer or an offer, which is paid for fully in stock. even if the latter two are higher. The opposite might also be true because it provides the seller with the possibility of realizing more than the cash offer depending on how the stock market reacts to the sale.

Simply put, it is overly simplistic to say that fair market value is the highest price one can obtain and, therefore, any standard, which is based on this assumption, is flawed.

Equally flawed is the notion that fair market value is somehow related to whether or not the price paid was in cash or a close equivalent. In fact, most major acquisitions are not made for cash, but involve a combination of stock or other securities, assumption of debt, and some cash. The suggestion that a seller is only maximizing its return if it is receiving cash or a close equivalent defies reality and certainly has nothing to do with whether the transaction was at fair market value. The notion that an "imbalanced" (whatever that means) swap of bonds for equity somehow affects whether fair market value has been paid or whether the government is interested in maximizing its revenue is equally absurd. Bonds are simply an alternative "currency" and so long as they are permitted to be used by all bidders, they should have no affect on whether market value is paid. If the bonds are not worth the face value in the market, then this will be reflected in the bidders' evaluation and be equalized in the bidding process. Furthermore, where the independent entity undertaking the valuation is aware of the use of alternative currencies, this would be taken into

account in the valuation process and be reflected in the determination of the fair market value of the entity being sold.

In summary, whether the highest bid is accepted is not necessarily an indication of whether fair market value has been paid. One must look at the independent valuation and the broader circumstances of the sale rather than assuming that the highest bid is necessarily the only bid at fair market value. Similarly, the issue of whether cash or other form of payment is made does not bear on the issue of whether fair market value is paid. There is nothing inherent in permitting the use of other "currencies," such as bonds, to pay for an acquisition that affects whether the acquisition is at fair market value.

COMMITTED INVESTMENT

The Department suggests that "inducements in exchange for promises of additional future investment (*e.g.*, retaining redundant workers)" may mean that "maximizing its return was not the government's primary consideration." Again, however, the promises of retaining workers does not vitiate the fair value of the transaction. As noted, a U.S. Steel bid for National may prove preferable over a higher nominal bid because of U.S. Steel's commitment to retain workers or to provide special health benefits to them. The commitment to retain workers is part of the value paid for the transaction. It is an element of determining fair value, rather than a factor that vitiates the fair value of the transaction.

PROPOSED CHANGES TO FACTORS AFFECTING DETERMINATION OF FAIR MARKET VALUE

In sum, the Department should alter its proposed change in practice regarding the treatment of pre-privatization subsidies after privatization as follows:

1. There should be a presumption that a privatization transaction in a country which is not a non-market economy is at fair market value if there has been an independent analysis of the proper value of the assets or entity being sold and the sale has been made at or above the price recommended by the independent analysis.
2. The presumption of a sale at fair market value described above can be rebutted if, based on an analysis of the transaction as a whole, it is demonstrated by clear and convincing evidence on the record that the government did not receive fair market value in the transaction.
3. Whether the transaction is at fair market value may be affected by limitations on the number of eligible participants if the number of participants or the resources available to these participants are insufficient to create a market driven transaction and the limitations on the participants are the result of criteria both specific to the transaction in question or the privatization process itself and not based on economic considerations. Normally, such a transaction would have to be below the price recommended by the independent analysis, unless the independent analysis anticipated limitations on the eligible participants in arriving at its recommended price.
4. Whether the transaction is for fair market value may be affected by whether or not the government accepted the highest bid. However, several additional factors need to be considered in this circumstance. First, whether the circumstances surrounding the transaction might have caused a private seller to consider a bid other than the lowest bid. Second, consideration should be given to the extent to which the

accepted bid differed from the highest bid. Third, consideration should be given to the extent to which the accepted bid was above the price recommended by the independent analysis.

5. Whether the transaction is for fair market value may be affected by conditions attached to the sale, such as retaining redundant workers for a period of time. In these circumstances, consideration should be given to whether the conditions are reflected in the price paid by the buyer, are conditions that might occur in a transaction between private parties, and provide a benefit rather than a penalty to the buyer.

The above-proposed changes in the Department's proposals are intended to accomplish three objectives. First, to recognize the reality that transactions between governments and private parties in market economies based on independent analyses should be presumed to be at fair market value. There is simply no basis to presume otherwise. Second, to ensure that factors that affect commercial transactions between private parties are not used as the basis to determine that transactions between the government and private parties are not at fair market value. Third, to ensure that there is a relationship between any factor, which may affect fair market value, and its actual effect on fair market value as evidenced in the price actually paid.

II. THE DEPARTMENT'S "CONDITIONS" FOR REBUTTING THE PRESUMPTION OF EXTINGUISHMENT ARE OVERLY PERMISSIVE, SET TOO LOW A STANDARD FOR SHOWING "SEVERE DISTORTION", AND BEAR NO RELATIONSHIP TO THE TRANSACTION AT ISSUE.

The Department's conditions for rebutting the presumption of extinguishment are on their face absurd. The Department apparently seeks to ignore that there are substantial differences from country-to-country in the tax structures, regulatory systems, the level of social benefits, and a variety

of other government interventions. For example, is the fact that the United States' environmental regulations impose enormous environmental burdens on the operation of a coke oven' and that South Africa does not, mean that there is a severe distortion in South Africa that affects the market value of a South African mill? Does the fact that Canada has a system of national health care and the United States does not mean that the fair market value for a mill in Canada, which reflects the absence of heavy health care obligations, is not at fair market value because there is severe government induced distortion? Does the fact that the labor laws of one country require the provision of a high level of fringe benefits and job security and those of another country do not, mean that there is a severe government induced distortion in the country where the government provides better conditions for its workers? Is the fact that a government lowers duties to increase competition in an industry where prices are rising in order to better control inflation, an action that undoubtedly lowers the value of companies in that industry, a severe market distortion? What is the benchmark against which a distortion is measured, who determines that benchmark, and who determines whether it affects the market value of an entity?

The Department states that the presumption of the extinguishment of the subsidy may be overcome, even if the transaction were at arm's length for fair market value, if "the broader conditions . . . were severely distorted by government action." While the concept of "severe distortion by government action" is not unreasonable per se, the Department's standard for proving it is too broad for two reasons.

First, the standard is too low. The Department states that the parties can demonstrate "severe distortion" by showing that there is a "reasonable basis for believing that the transaction price was

meaningfully different from what it would otherwise have been." This "reasonable basis for believing" is far too low a standard.

The standard articulated by the Department in the proposal is quite close to the standard of "reason to believe or suspect" that is contained in two statutory provisions, one for the initiation of cost investigations in dumping cases, and one for the issuance of affirmative preliminary dumping and countervailing duty determinations. In both those cases, the Department has interpreted this standard as requiring only the most flimsy evidence to support Department action. For example, the Department has initiated cost investigations on the basis of a single below-cost sale allegation and a cost investigation having been conducted in an earlier segment of the proceeding. Similarly, it has in the past issued "affirmative zero" preliminary countervailing determinations based on past or potential subsidies alone, even when the evidence of current subsidies is non-existent.

It is not reasonable for the Department to determine that a market is "severely distorted" on the basis of such a flimsy standard. It must be remembered that, under the Department's methodology, the question of "severe distortion" only arises after the evidence has already demonstrated that the sale is at arm's length for fair market value. While it is conceivable that conditions may exist to overcome the presumption of extinguishment of the subsidy even where fair market value has been paid, those circumstances are limited, and the standard of showing them should necessarily be high. Hence, the Department should restate the standard such that **the presumption of extinguishment should be rebuttable by clear and convincing evidence that "severe market distortion" exists.** In the absence of such evidence, the Department should not overturn the presumption of extinguishment that follows an arm's length sale at fair market value.

Second, the standard bears no relationship to the transaction at issue. Virtually every act of a government affects values of assets in a country, because it affects the costs and consequently the return on investment. Thus, housing prices in the United States have been stronger than would be anticipated in a recession because the government, more precisely the Federal Reserve, has acted to lower interest rates. Is this the market distortion or is the market distortion, when the Fed moves to raise interest rates, which, in turn, depress housing prices? If a government sells property while low interest rates have increased property values, is the buyer not paying market value or is the buyer not paying market value when the government sells the property when interest rates are high and property values low? If the same factors affect purely private transactions as affect government-to-private transactions, why is the purely private transaction at market value while the government-to-private transaction not at market value?

Ultimately, companies operate under the regulatory, tax and other conditions imposed by the country in which they operate. The government's actions inevitably affect market value, whether the asset or company is owned by a private entity or by the government and whether the seller is a private entity or the government. The question is whether or not there are specific actions by the government related to and affecting the value of the entity it is privatizing that are different from the conditions which affect the value of other entities in the country at issue. Thus, the standard which should be applied is whether the government has taken actions affecting the value of the specific entity being privatized or entities in the industry in which the privatized entity operates which affect the value of the entity and which do not affect other entities or sectors in a similar manner. In short, has the government acted specifically to significantly affect the value of the privatized entity apart from actions, which are applicable generally?

A. The "Basic Conditions" Set Forth in the Proposal for Determining "Severe Market Distortion" are Ill Defined, Unreasonable, and Overly Broad

The Department's proposal suggests that one factor for determining "severe market distortion" is whether "the basic requirements for a properly functioning market" are present. However, the standard "properly functioning market" is not defined, and the term is extremely ambiguous. Indeed, the Department's proposal is extremely broad, encompassing whether there is "unfettered supply and demand"[3] in "the economy in general." Under such a broad standard, government interventions that are common and widespread around the globe could be taken as evidence of the lack of a properly functioning market, when such interventions are quite normal.

It must be remembered that a considerable level of government intervention in the market exists even in the most market-oriented economies. All governments in the world impose taxes, restrict the use and transfer of capital in some form, and restrain market activities. Thus, for example, in 1971 the United States imposed price controls on a wide variety of products. Yet the existence of price controls could easily be considered a factor that inhibits "the unfettered interplay of supply and demand" in the economy in general. To suggest that the existence of government price controls in an economy means that a fair-market value sale does not eliminate a subsidy, however, is ridiculous. While it may, as may many government actions, affect the market value of an asset or company being sold, it does not prevent the asset or company from being sold at fair market value.

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[3] Although the Department has taken the language of this factor from the Appellate Body report, it has done so out of context. The Appellate Body goes on to explain that government interference in the market necessary to overcome the presumption of fair market value must be government action specifically directed at affecting fair market value in the privatization itself.

Similarly, many governments, including the United States, impose laws that restrict the value of assets both in the economy in general and of particular sectors of the economy. For example, the U.S. Pension Benefit Guarantee Corporation ("PBGC") assumes the pension liabilities of bankrupt companies, allowing companies to purchase corporations without assuming all of their liabilities. This artificially increases the price of the corporation, thus restricting the "interplay of supply and demand." It does not mean that the sale of the assets of bankrupt companies -- such as the pending sales of National Steel and Bethlehem Steel -- are not at arm's length or for fair market value, or that the "benefit" of the government bailout passes through to the new owner. And the U.S. government imposes restrictions on the use of wetlands and on the development of land where endangered species live, thus limiting the demand for such assets. That does not mean that the sale of such lands is not at fair value, or that a pre-sale subsidy on such land necessarily passes through to the new owner.

Given that most governments restrict market operations to some extent, the standards that the proposal sets forth to determine whether the "basic conditions for a properly functioning market" exist are too broad and vague. Application of the "unfettered interplay of supply and demand" standard, in particular, could permit normal market behavior to be used as a justification for overturning the presumption of extinguishment.

Other factors are equally vague and subject to potential abuse. What, for example, does "decentralization of economic power" mean? Is economic power decentralized in France, where a large portion of economic power is in Paris or concentrated in government owned entities? And what do "safeguards against collusive behavior" mean? Would any anti-collusion law have to be judged as equal or better than the U.S. antitrust law to pass muster?

Many of the examples given in the proposal seem to reflect an idealized view of how the economy operates in the United States rather than the real way that economies (including the U.S. economy) actually operate. This bias is particularly striking in the case of developing countries. The level of government involvement in the economy is likely to be greater in developing countries than in highly developed countries, if for no other reason than the private capital markets in developing countries are smaller. Moreover, economic power in developing countries tends to be more centralized than in developed countries, simply because there are fewer economically developed areas. However, does this really mean that there is not a fair market value in these economies?

The fact is that the Department's examples of "basic conditions" are so broad and vague that they could be used to overcome the presumption of extinguishment in virtually any country. Rather than rely on questionable examples, the Department must examine whether government actions are such that they actually and significantly distort the market value of the enterprise being privatized relative to their effects on other enterprises or other sectors.

B. The Department Must Be Cautious in its Use of "Related Incentives" as a Basis for Overturning the Presumption of Extinguishment.

The Department is overbroad and in many cases simply wrong to cite government action "to facilitate or affect the outcome of a sale" as a basis for overturning the presumption of extinguishment. Virtually any government action can "affect the outcome" of the privatization. Moreover, even those government actions that are specifically directed to the privatization transaction are more likely to affect the price of the transaction than to constitute "severe market distortion." The Department is wrong to suggest that a government's use of its authority "to tax or set duty rates to make to make the same more attractive to potential purchasers" is evidence of severe market distortion. Rather, it is a factor that goes to the value paid for what is purchased.

In fact governments take actions which specifically alter the value of enterprises all the time, whether specific to certain enterprises and sectors or generally. For example, whether the government assumes the added costs of heightened security at airports or forces airlines to assume these costs will affect the value of an airline and of companies located near an airport. Similarly, if the government relaxes clean air standards, the value of companies that are heavy polluters will change because the costs of complying with clean air standards will change. This, in turn, will affect the value of the company. The question, again, is not whether the government has taken an action which affects the fair market value of the company being sold, the question is whether the action is related to the sale, affects its market value, and, where it reduces its market value, is anticipated by the buyer to be altered after the sale so as to constitute an incentive to the buyer. Specifically, is the government taking actions which have the effect of manipulating the fair market value at the time of the sale with the expectation by the buyer that the action will ultimately be changed so as to increase the value of the asset or entity which has been purchased?

Nor does the presence of government action "to facilitate the sale" necessarily mean that the prior benefits pass through to the new owners. The question that the Department must consider is whether the price paid for the assets received still reflects fair market value after the government action is taken into account. If it does, then the benefit received prior to privatization is extinguished.

The Department should amend this factor to reflect the economic reality that all governments engage in activities that affect market transactions. The appropriate question is not whether the government action "affects or facilitates" the sale in a way that a private seller could not. Rather, the question is whether the government action was intended to facilitate the sale for less than fair market

value with a view to later reversing the action so as to effectively provide the buyer the asset or entity at less than market value.

C. The Factor of "Legal Requirements" Should be Rephrased to Apply Only to Requirements that Prevent the Sale from Being at Fair Market Value.

Like the two previous factors, the Department's discussion of the "Legal Requirements" factor is so general that it encompasses activity that may be a common part of market transactions. The statement provides that "special regulations . . . affecting worker retention . . . {could} distort the market price." This is not necessarily true. As has been seen in the competition between U.S. Steel and AK Steel for the assets of National Steel, the issue of worker retention is an integral part of the market price of the assets. The purchase of National Steel is a purchase of a privately-owned company and the bidders are privately-owned companies. The government acts only as an arbitrator, in the person of the bankruptcy judge. Yet the issue of worker retention is so much a part of the market value that it may well result in the party with the nominally lower bid (U.S. Steel) winning the bid in preference over a higher nominal bid. The question of worker retention, thus, does not "distort" the market price; it is an essential part of determining the market price.

The Department should drop the concept that government regulations affecting worker retention are evidence of a distortion in the market price. While they do affect the market price, they would have to be extremely restrictive (such as requiring a level of employment far in excess of what is economically justifiable) in order to vitiate the fair market value of the sale.

D. The Department Should Drop the "Presence of Other Heavily Subsidized Companies" as a Factor for Overturning the Presumption of Extinguishment.

The Department's inclusion of the "presence of other heavily subsidized companies" as a factor showing "severe distortion" is unreasonable. The fact that other companies are subsidized --

whether in other industries or in the industry under investigation -- is hardly evidence that the privatization in question does not "fairly and accurately reflect" the market value for the privatized asset.

Of even greater concern, the use of this factor as a criterion for overturning the presumption of extinguishment may make it very difficult for countries that are just beginning the process of privatization to see their pre-privatization subsidies extinguished. Developing countries are much more likely to have numerous companies (and even industries) that receive government subsidization, because of the relative scarcity of private capital in those countries. When such countries begin the process of privatization, the first privatizations will necessarily occur in an economy where there are other companies and industries that are subsidized. By allowing the presence of other subsidized companies to be considered a factor vitiating the fair market value of the sale, the Department would make it extremely difficult, if not impossible, for the early privatizations to be considered to be made at fair market value, since there would necessarily be other government-owned companies yet to be privatized.

Whether a company is sold for fair market value should be determined in the context of the sale in question. It is irrelevant whether, at the time of the sale, there are other government owned and subsidized companies that have an effect on the price of the company being privatized. The question is whether at the time of the privatization the buyer paid fair market value. If, as was the case in Brazil, it was anticipated that all of the steel companies would be privatized, then the fair market value will reflect this. If it is not anticipated that other companies will be privatized and that the privatized company will have to compete against subsidized government owned companies, the fair market value of the privatized company will reflect this factor. The question is only whether or

not at the time of the privatization the sale reflected the market value given the existing and anticipated competitive, regulatory, tax and economic environment at that time.

III. THE DEPARTMENT SHOULD MAKE CLEAR THAT "SUBSIDIES GIVEN TO ENCOURAGE PRIVATIZATION" DO NOT PREVENT THE EXTINGUISHMENT OF THE SUBSIDY IN AN ARM'S-LENGTH SALE FOR FAIR MARKET VALUE

The Department should make clear that the fact that a government provides companies with subsidies to make them marketable does NOT prevent the extinguishment of the subsidy by an arm's length sale at fair market value. As the WTO and U.S. courts have recognized, when a party pays fair market value for an asset (even if the asset is a whole company), all prior subsidies, regardless of when given, are extinguished. The new owners do not receive any benefit from the prior subsidies.

A simple example illustrates why this is so. Suppose that a government gives a pizza delivery company a delivery van for free. The pizza delivery company clearly receives a subsidy. Suppose further that the pizza delivery company decides to sell the van two years later, and that the blue book value of the van is $10,000 in mint condition. If the company sells the van for $10,000, the new owner has not received any benefit from the government, because it has paid fair market value for the asset, the same that it would have paid without a subsidy to the pizza delivery company.

Carrying this example one step further, suppose that the van is not in mint condition, but has a number of paint scratches, reducing the actual value of the van to $8,000. The government pays for a paint job to the van to restore it to mint condition. Now the pizza delivery company sells the van for $10,000, its market value in mint condition. Clearly, the pizza delivery company has received an additional subsidy. But the new owner has not. It has still paid the $10,000 market value for a van in mint condition, the same that it would have paid without the subsidy to the prior owner.

As the example makes clear, once the new owner pays fair market value for the asset, the subsidy to the prior owner does not pass through to the new owner; it is extinguished

To take a more relevant example, when the PBGC assumed the pension liabilities of National Steel and Bethlehem Steel following those companies' entry into Chapter 11 bankruptcy proceedings, it made those companies more attractive for sale. (Indeed, the U.S. steel industry made clear that no one would purchase these companies without a reduction of the pension liabilities.) However, if the new owners of those firms in fact pay fair market value for the assets that they do obtain, they have received no subsidy from the PBGC. They have paid what the assets are actually worth. The assumption of the pension liabilities by the PBGC, in other words, is a subsidy that is fully extinguished when the sale of the assets occurs at fair market value.

The sole question, then, is whether the price paid in the sale reflects the fair market value of the asset (the company) <u>as it is at the time of the sale</u>. If the subsidies "given to encourage privatization" somehow allow the purchaser to pay less than fair value, then perhaps those subsidies pass through to the new owner. However, if the new owner in fact pays fair market value for the assets (even if the assets are the corporation itself), then the subsidy is equally extinguished, regardless of when or for what reason the subsidy was given.

IV. THE DEPARTMENT'S PROPOSED METHODOLOGY SHOULD BE TRIGGERED AS SOON AS THE GOVERNMENT HAS RELINQUISHED EFFECTIVE CONTROL OF THE COMPANY BEING PRIVATIZED.

The Department has requested comments on two issues, "partial or gradual sales," and "effective control." These two issues are aspects of the same question, namely, when does it become appropriate to trigger the Department's methodology to establish the presumption of the extinguishment of a pre-privatization subsidy? In our view, **the Department's methodology should**

be triggered as soon as the government in question relinquishes effective control over the corporation.

The issue of "partial privatizations" is one of determining whether the partial privatization has reached the stage of relinquishment of effective control. The pre-privatization subsidies cannot be said to be "extinguished" until such time as the government has given up its control of the asset. It is possible that the government's sale of a part of its ownership may reduce the extent to which the pre-privatization subsidies pass through to the entity after the sale. However, it cannot be said that the pre-privatization subsidies are extinguished completely until or unless the government has relinquished effective control.

The question whether the government has relinquished effective control over the corporation is one that must be determined by the Department on a case-by-case basis, taking into account all of the various means by which parties may exercise control over the corporation.[4] To be sure, a sale of government shares that reduces the government's equity ownership in a company from 90 to 80 percent, without relinquishing any other control mechanisms, does not constitute the effective relinquishment of control. On the other hand, it may be possible for a government to relinquish control even when it retains a majority of the shares of the corporation -- for example, when government shares are converted into non-voting shares or are, by some other mechanism, stripped of any power to affect the management of the corporation.

The question of "effective" control may well require the Department to examine numerous documents beyond the level of share ownership. For example, in Brazil it is not uncommon for buyers of privatized corporations to establish a "control group" of parties owning more than a certain

[4] The Department's regulations, 19 C.F.R. 351.102(b), defining an "affiliated person" addresses similar considerations in assessing effective "control."

level of ownership. This control group, which together constitutes a majority of voting share ownership, votes its shares as a bloc on matters of significant corporate concern, thereby effectively freezing out non-members from any real control of the corporation. If, for example, the Brazilian government reduced its shareholding in a corporation to the point that it was no longer a member of the control group, then it would be relinquishing effective control even though it might still have more than a nominal percentage of share ownership.

The question of "gradual" privatizations should also be viewed in light of the question of effective control. Once a government has relinquished effective control, even if the privatization has not been completed, it is appropriate to apply the Department's proposed methodology. Thus, even though a government may maintain a minimal or token residual ownership of shares, if it has truly relinquished effective control of the corporation then it has effectively sold its interest in the corporation. In such circumstances, the pre-privatization subsidies would have been extinguished.

V. IN CASES WHERE OWNERSHIP IS EXERCISED THROUGH HOLDING COMPANIES, THE DEPARTMENT'S METHODOLOGY SHOULD BE TRIGGERED WHEN THE GOVERNMENT RELINQUISHES ACTUAL EFFECTIVE CONTROL

The Department has specifically requested comments on whether the proposed methodology should be triggered where "the changes occur at a level several times removed from the actual respondent," as where the government relinquishes ownership of a holding company that owns an interest in the operating company only through intermediary holding companies. The Brazilian producers believe that this is, once again, a question of whether there is loss of "actual effective control." Where the government does not have, or has relinquished such control, the pre-privatization subsidy should be presumptively extinguished.

VI. VALUATION OF SUBSIDIES IN PRIVATIZATIONS FOR LESS THAN FAIR MARKET VALUE SHOULD BE THE DIFFERENCE BETWEEN FAIR MARKET VALUE AND THE PRICE PAID

The Department has also requested comments on how to value subsidies after a privatization when that privatization is not at fair market value. Here, the pizza delivery truck example used above is instructive. The seller had received from the government a truck valued at $10,000, which at the time of sale was worth $8,000. The government provided a further subsidy of $2,000 to restore the truck to mint condition. As a consequence, the truck had a value of $10,000 at the time of the sale. If the purchaser pays $10,000, the purchaser is not receiving any benefit because fair market value has been paid. However, if the purchaser pays less than the fair value for the asset -- for example, if the new owner had paid $8,000 for a truck with a market value of $10,000 -- then the new owner would receive a benefit in the amount of the difference between the value paid and the fair market value. Thus, the measure of the subsidy when a sale is at less than fair market value is the difference between the fair market value of the asset or company sold and the actual price paid for that asset or company. In the case of the pizza truck, $2,000.

As has been established by the WTO Appellate Body and the U.S. courts, a subsidy benefit does not pass through to the new owners in a privatization transaction if that transaction is at fair market value. Thus, logically, the extent to which a benefit passes through to the new owner when the sale is not at fair market value must necessarily be the difference between the fair market value and the actual price paid.

CONCLUSIONS

As proposed, the Department's new privatization methodology would not bring Department practice into conformity with its WTO obligations. While the Department's proposal

that an arm's-length sale at fair market value presumptively extinguishes any pre-privatization subsidies that may have been conferred prior to sale is the correct starting point, the balance of the proposed methodology is flawed, likely to lead to continued results that are inconsistent with U.S. obligations, and so vague as to, as a practical matter, provide absolutely no guidance as to when a sale is or is not at fair market value.

If a privatization takes place in a market economy at a price which independent analysis has determined to be fair market value, there should be a heavy burden placed on those seeking to challenge whether the sale was, in fact, at fair market value.[5] The proposed criteria for determining whether a sale is at fair market value provide no hierarchy for the determination. In addition, application of the criteria, without further clarification and specific limitations on how they are applied, could lead to a finding that normal commercial behavior vitiates the fair market value of the privatization transaction. The Department needs to reformulate the factors and provide specific clarifications and limitations on their application.

The Department has also proposed to examine so-called "broader conditions" which, if demonstrated, would invalidate a determination that the sale was at fair market value. Most of these conditions have no relationship to the transaction being examined. In addition, all of the conditions are vague and overbroad. Finally, an unreasonably low threshold -- "reasonable basis for believing" -- is proposed for using vaguely defined criteria of questionable relevance to overturn what has

[5] For example, the Department has asked for comments on how its privatization analysis might intersect with the Department's practice, regarding non-market economies in the subsidies and countervailing duty context. As a general matter, the same level of thresholds should be used to find that a presumptively fair market value privatization is nevertheless countervailable as are applied by the Department to determine that a market economy country should be re-designated as a non-market economy country.

already been established to be a sale at fair market value based on a higher evidentiary standard. If these broader conditions are included at all, they need to be substantially revised.

Respectfully submitted,

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