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Jeffrey May
Director of Policy
Central Records Unit,
Room B-099
Import Administration
U.S Department of Commerce
14th Street and Constitution Ave., N.W.
Washington, DC 20230

Attention: Privatization Methodology

Dear Mr. May:

These comments are submitted on behalf of Nucor Corporation and Nucor Yamato Steel Co., United States producers of steel products. The comments address the methodology the U.S. Department of Commerce ("the Department") has proposed for identifying and calculating the benefits from subsidies bestowed upon a state-owned enterprise that was privatized after it received the subsidies. The Department requested such comments in *Notice of Proposed Modification of Agency Practice Under Section 123 of the Uruguay Round Agreements Act and Request for Public Comments.*[1]

As explained in the notice, the Appellate Body of the World Trade Organization ("WTO") has held that the methodology previously used by the Department in situations

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[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. 13,897 (Dep't Commerce Mar. 21, 2003) ("Privatization Proposal").

involving privatization was inconsistent with the General Agreement on Tariffs and Trade[2] and the Agreement on Subsidies and Countervailing Measures.[3] The WTO's Appellate Body decision has had the effect of constraining the Department's discretion to handle this issue in the manner it believes to be the most appropriate. We agree with the Department that "any analysis of a transaction must begin by identifying *the parties* to that transaction," and in a privatization, the parties are the old shareholders (the government) and the new shareholders.[4] Along with the Department, we "fail to see how {a privatization} transaction must be treated as having extracted from {the company} subsidies that previously had been conferred upon it."[5] The Appellate Body's decision in *United States – Countervailing Measures Concerning Certain Products from the European Communities*[6] reversed some of the excesses of the Panel's decision,[7] in particular rejecting the Panel's conclusion that:

> {o}nce an importing Member has determined that a privatization has taken place at arm's-length and for fair market value, it *must* reach the conclusion that no

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2 General Agreement on Tariffs and Trade, Oct. 30, 1947, 61 Stat. A-11, T.I.A.S. 1700, 55 U.N.T.S. 194, *as amended* General Agreement on Tariffs and Trade, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, Uruguay Round Agreements Act, Statement of Administrative Action, *reprinted* in H.R. Doc. No. 103-316 (1994) ("SAA").

3 Agreement on Subsidies and Countervailing Measures, at arts. 1-2, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, Uruguay Round Agreements Act, Statement of Administrative Action, at 1533, *reprinted* in H.R. Doc. No. 103-316 (1994) ("SCM Agreement").

4 Results of Redetermination Pursuant to Court Remand, Stainless Steel Sheet and Strip in Coils from France, Inv. No. C-427-815 (Jan. 4, 2002), *remanded by* Allegheny Ludlum Corp. v. United States, 182 F. Supp. 2d 1357 (CIT 2002) ("Allegheny Ludlum Remand").

5 *Id.*

6 *United States - Countervailing Measures Concerning Certain Products from the European Communities - AB-2002-5 - Report by the Appellate Body*, WT/DS212/AB/R (Dec. 9, 2002) ("AB Report").

7 *United States – Countervailing Measures Concerning Certain Products from the European Communities – Report of the Panel*, WT/DS212/R (July 31, 2002) ("Panel Report").

> benefit resulting from the prior financial contribution (or subsidization) continues to accrue to the privatized producer. [8]

The Appellate Body therefore rejected the notion that a privatization "at arm's-length and for fair market value" must always result in a determination of the extinguishment of the subsidy. It did reject the Department's "same person" method for deciding whether the subsidy passed through the privatization.[9]

In general, while the Department's proposal is a good attempt to try to make its practice consistent with the Appellate Body's decision, certain concepts should be further refined, particularly with respect to what constitutes "fair market value." The issue of concurrent subsidies also merits further elaboration.

I. THE APPELLATE BODY REPORT

The key portion of the Appellate Body Report, at paragraphs 122-124, was quoted at length in the Department's notice.[10] Paragraph 121 of the AB Report is also relevant:

> In effect, the Panel interpreted the *SCM Agreement* as containing an *irrebuttable presumption* that would compel investigating authorities to conclude that the remaining part of a benefit resulting from a prior financial contribution necessarily has been extinguished in all cases where there is privatization at arm's length and for fair market value. In other words, according to the Panel, a benefit can *never* continue to exist for the new owner after privatization at arm's length and for fair market value. We do not agree.[11]

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8 AB Report at ¶ 127, *quoting* Panel Report ¶ 8.1(d).

9 AB Report at ¶¶ 128 – 153.

10 Notice of Proposed Modification of Agency Practice, 68 Fed. Reg. at 13,899.

11 AB Report at ¶ 121.

The Appellate Body said, in other words, that even if it is found that privatization occurred at arm's length and for fair market value, the inquiry does not end there. There may still be situations in which the benefit could continue.

Without setting out particular examples, the Appellate Body posited that governments can "induce certain results" through its policies that appear to be "respectful of the market's inherent functioning."[12] "In privatizations, governments have the ability, by designing economic and other policies, to influence the circumstances and the conditions of the sale so as to obtain a certain market valuation of the enterprise."[13] In other words, just because the market finds the price offered by the government for the securities of the company to be acceptable, that is, "fair market value," such a finding by itself does not settle the issue. The Appellate Body clearly left it open for the Department to elaborate on this issue.

The ongoing efforts of the Polish government to privatize the largest Polish steel producer, Polskie Huty Stali ("PHS") represent exactly such a suspect transaction. The Polish government is currently soliciting and reviewing bids for PHS from a number of potential international investors. As part of the privatization process, the Polish government has attempted to "clean up" PHS's finances by moving substantial liabilities to other government agencies, by forgiving some amounts due government agencies, such as the Social Security Fund, by PHS, and by extending the time over which PHS must pay the remaining amounts. It is likely that PHS will receive most if not all of these subsidies before its actual sale occurs. At the same time, it is clear that the Polish government is providing these subsidies specifically to increase

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[12] AB Report at ¶ 123.

[13] AB Report at ¶ 124.

the value and viability of PHS. In a request submitted on March 21, 2003, Nucor and NYS asked that the Department investigate these subsidies under 19 U.S.C. § 3571 to determine whether the actions of the Polish government are having adverse effects on the interests of the United States.[14] We believe that the PHS privatization would make an excellent test case for the Department's new methodology.

Significantly, the actions of the Polish government in connection with the privatization of PHS are not limited to the bestowal of subsidies. The Polish government has also placed a number of conditions on the sale. First, any bidder must bid for all of PHS, which is comprised of four mills. It has imposed these requirements even though potential investors had expressed interest in buying individual mills, and even though selling the mills individually might well have brought the Polish government a higher total return. It appears that the decision to consolidate the four mills, and to require investors to purchase all of them, was taken specifically to ensure that the largest mill, Huta Katowice, remains in production. Before its consolidation into PHS, Huta Katowice was in dire financial condition, and it is questionable whether any private investor would purchase it unless required to do so as a condition of obtaining the other three mills in PHS.

The Polish government has imposed a number of other conditions on potential investors as well. One of the criteria for reviewing bids is the amount of new investment in PHS to which the investor will commit. Investors must also agree not to cut manning levels, except by normal retirement and other attrition. Finally, the investor must maintain all four of the PHS mills in

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[14] Letter from Wiley Rein & Fielding to U.S. Dep't of Commerce, Petition for Investigation Under 19 U.S.C. § 3571 (Mar. 21, 2003).

production for a specified period. None of these are conditions which a private seller would apply. Rather, they reflect the desire by the Polish government to achieve certain social objectives in connection with the privatization of PHS, rather than simply maximizing the amount it receives for PHS.

II. THE STAGES OF THE DEPARTMENT'S PROPOSED METHODOLOGY

The history of the privatization issue is one of the elimination of irrebuttable presumptions (or nearly irrebuttable presumptions) either way. First, the Department decided that privatization extinguished subsidies.[15] Then, it decided that it was assumed that subsidies continued through privatization.[16] The URAA eliminated the presumption that privatization extinguishes the subsidy, "even if the change in ownership is accomplished through an arm's length transaction."[17] The Panel Report at issue here held that "privatization at arm's length and for fair market value *presumptively* extinguishes any benefit received from the non-recurring financial contribution bestowed upon a state-owned firm."[18] The Appellate Body rejected the conclusion that the presumption was irrebuttable.[19]

After first determining whether the government has in fact transferred ownership of the company to other parties, the Department proposes to make an analysis of whether the

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15 Lime from Mexico, 54 Fed. Reg. 1,753, 1,754-55 (Dep't Commerce Jan. 17, 1989) (prelim. changed circumstances admin. review)

16 *Certain Hot-Rolled Lead and Bismuth Carbon Steel Products from the United Kingdom*, 58 Fed. Reg. 6,237 (Dep't Commerce Jan. 27, 1993) (final).

17 19 U.S.C. § 1677(5)(F) (2001).

18 Panel Report *as characterized by* AB Report at ¶ 126.

19 AB Report at ¶ 127.

transaction "was at arm's length for fair market value."[20] The Department proposes a non-exhaustive list of factors to be considered when deciding whether the selling price represented "fair market value." If the Department determines that the privatization was not at arm's length for fair market value, then it will find that the company continues to benefit from subsidies. Otherwise, it will be presumed that the subsidy was extinguished. That presumption can be rebutted by "demonstrating that, at the time of the privatization, 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)."[21]

A. <u>Fair market value</u>

As the Department has recognized, "fair market value" may be difficult to assess in actual situations. When investors eagerly buy the shares offered, is that a reflection of the possibility that the shares were priced too low, or are investors believing that the government will retain an interest in seeing that the enterprise not fail, so that the risk is lowered? Obviously, an enterprise can be sold at "fair market value" at a price less than what the original investors spent, as the current scavenging in the telecom industry attests, but there must be a way to assess whether the government has asked too little for the company.

The Department has signaled how it plans to apply an assessment of fair market value to a factual situation in the two Usinor privatization cases.[22] While the Department explored some

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[20] Notice of Proposed Modification of Agency Practice, 68 Fed. Reg. at 13,900.

[21] *Id.*

[22] Allegheny Ludlum Remand; Results of Redetermination Pursuant to Court Remand, Certain Cut-to-length Carbon-Quality Steel Plate from France, Inv. No. C-427-817 (Jan. 4, 2002), *remanded by* GTS Industries, S.A. v. United States, 182 F. Supp. 2d 1369 (CIT 2002) ("GTS Industries Remand").

useful concepts in these remand redeterminations, the cases were on their second remands, and the Department may have felt compelled to fit the facts into a finding of fair market value in order to avoid third remands. We believe that the facts of those cases point to a number of indicators that the French government had agendas other than fair market value.

In an Initial Public Offering ("IPO"), there will often be restrictions on the re-sale of stock by the initial investors and insiders, designed to give assurances both to the investing public that the venture capitalists are not going to immediately cut and run, and to the initial investors that the employees are not going to immediately cash out and disappear. There are, however, no restrictions on the stock sold to the public to prevent immediate flipping of the stock bought in the IPO. In the glory days during the stock market bubble in the United States, the IPO was often priced well under what the market thought the stock was actually worth, so that the favored few getting the initial shares could profit handsomely by flipping the stock as it jumped in price in the first days of trading.[23] The quick run-up in price following the IPO indicated that the IPO price was not at "fair market value."

While it might be normal to expect that the stock price would gradually increase as the company benefited from being privatized, a sudden run-up due to flipping by the initial purchasers on or soon after the offering date strongly points to the initial price being less than market value.[24] As a part of its analysis, therefore, the Department should examine trends in the stock price following the offering, when persons other than those who received the stock under

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[23] *See, e.g.*, Randall Smith and Susan Pulliam, *Buddy System: How a Technology-Banking Star Doled Out Shares of Hot IPOs*, Wall Street Journal, Sept. 23, 2002, at A1.

[24] *See* Allegheny Ludlum Remand. The initial offering in 1995 was at between FF 86 and FF 89. The disposal of the remainder of the French government's shares in 1997 was at FF 113. It would make a difference if the price had gone to FF 113 relatively quickly in 1995 or had gradually increased to FF 113 between 1995 and 1997.

the offering could trade it.[25] We recommend that the Department include among the factors to be considered to assess fair market value:

> Stock price trends following the offering: Once the privatized stock is issued to the initial purchasers, and those purchasers could sell that stock on public exchanges, did the price increase substantially on high volume, indicating that the market believed that the value of the company was higher than the price that the government set?

The first of the four factors suggested by the Department is "artificial barriers to entry."[26] As noted above, while restrictions on stock purchased by employees and initial investors is not unusual in IPOs, any restrictions on stock purchased by the general public would be inconsistent with trying to obtain the maximum return from the offering. The Department should carefully scrutinize any restrictions on holding periods or minimum purchase quantity, examining whether different classes of stock have been created, or whether there are any other advantages bestowed on those buying such stock.[27]

The proposed privatization of PHS represents a potentially typical situation. Rather than offering shares in PHS to all investors, the Polish government decided to seek a single "strategic"

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25 This would require somewhat different analysis than what the Department undertook in the Allegheny Ludlum Remand. There, the Department noted that the FF 86 price was over-subscribed, and that an international offering was at FF 89, and concluded that the "market clearing price for Usinor's shares was between FF 86 and 89." The Department concluded that "because the sales process for these two offerings was open and competitive, and because the government set market-clearing prices for the shares, we determine that full value was paid for the shares sold under the French and international offerings." The enthusiastic purchase of shares at both FF 86 and FF 89 does not, by itself, prove that full value was paid. A price in the secondary market in that range would suggest full value; a price in the secondary market significantly above that price would suggest less than fair value.

26 Notice of Proposed Modification of Agency Practice, 68 Fed. Reg. at 13,900.

27 It is not clear why, in the Allegheny Ludlum Remand, the so-called "stable shareholders," who for the privilege of having to purchase at least one million shares and having restrictions on when they could sell their stock, paid more for their shares than the general public. Under normal commercial considerations, a purchaser would buy such shares only if they were of a different class, with different rights, than the common shares. Either that, or the large shareholders had other inducements. The Department did not appear to explore this issue.

investor. In such a situation, the Department must assess whether the restrictions on the ability to purchase stock artificially depressed the price paid for the stock.

The second of the four factors suggested by the Department is independent analysis.[28] In the Allegheny Ludlum Remand, for example, the Department cited approvingly to the "independent analyses of the value of the shares," and said that "{o}bjective and independent valuations of a company will frequently provide a measure of the privatized company's full value." Anyone who has hired an "independent" consultant knows that consultants have a fine sense of what answer the client wants. An independent consultant opinion is often merely cover for what the client wanted to do anyway. We recommend that the second factor be amended to note: "Any views of the paid consultant will be compared with comments by the financial press regarding the reasonableness of the stock price, and will be compared with the stock price once the privatized shares are available to be traded on exchanges."[29]

One issue that arises is how to handle the situation when some of the shares are sold at a discount to a favored class. In the Allegheny Ludlum Remand, for example, employees paid a significantly lower price than other purchasers for their shares. The Department found that the employees received a benefit, but since the benefit was to employees rather than to the company, the subsidy was not countervailable. That, of course, was not the issue. The issue was whether the sale of stock was at "fair market value." The discount to employees was an indicator that "maximizing its return was not the government's primary consideration," as the fourth of the

[28] Notice of Proposed Modification of Agency Practice, 68 Fed. Reg. at 13,900.

[29] With regard to the third (highest bid) and fourth (committed investment) factors, we agree that these factors should be considered; *see id.*

Department's four factors puts it.[30] Then the question is how to quantify the amount of the subsidies that the company continues to enjoy, which will be discussed below.

B. <u>"Market distortion" factors</u>

As the Appellate Body reported:

> Of course, every process of privatizing public-owned productive assets takes place within the concrete circumstances prevailing in the market in which the sale occurs. Consequently, the outcome of such a privatization process, namely the price that the market establishes for the state-owned enterprise, will reflect those circumstances. However, governments may choose to impose economic or other policies that, albeit respectful of the market's inherent functioning, are intended to induce certain results from the market. In such circumstance, the market's valuation of the state-owned property may ultimately be severely affected by those government policies, as well as by the conditions in which buyers will subsequently be allowed to enjoy property.[31]

The four factors for determining market distortions listed in the Department's Notice are all factors that may be pertinent to the determination. Along with these factors, the Appellate Body emphasized overall government policies "that are intended to induce certain results from the market." The factors should indicate that this is the purpose of the inquiry, and allow for general considerations of this issue that may not be covered by the specific factors listed by the Department. We recommend that the factors be preceded by a preamble that sets forth the principles underlying the analysis:

> *Market Distortion Factors.* The market may appear to accept the terms of the privatization plan in a way that might indicate an arm's length transaction at fair market value, but governments may choose to impose economic or other policies that, albeit respectful of the market's inherent functioning, are intended to induce certain results from the market. In such circumstance, the market's valuation of the state-owned property may ultimately be severely affected by those government policies, as well as by the conditions in which buyers will subsequently be allowed to enjoy property. In the process of determining

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[30] *Id.*

[31] AB Report at ¶ 123.

> whether a transaction was at fair market value, the Department will also assess the government's policies as they pertain to privatization, to determine whether those policies might distort the market and the measurement of fair market value. The Department will consider whatever factors it deems relevant to its inquiry, including but not limited to:
>
> {the list of four factors in the Notice}

These factors may come into play in situations such as the privatization of Acciai Speciali Terni S.p.A., as discussed in the Redetermination in *Acciai Speciali Terni S.p.A. v. United States,*[32] as well as the proposed privatization of PHS, where, instead of the sale of shares to multiple purchasers who could turn around and sell them on the open market, the sale was of all of the shares to a single bidding company. In such a case, it may be more difficult to determine whether the price was "fair market value," but the market does not establish an independent valuation of the shares. In that remand, the Department decided that because the government accepted the highest bidder, at a price higher than what the independent consultants had suggested, it was at fair market value.

We believe that the Department did not give sufficient attention in that remand to the "GOI-imposed conditions on AST and its subsidiaries for several years after the sale" that the petitioners had pointed out.[33] Under normal commercial considerations, a seller would not be concerned with what the buyer did with the company after the sale. The same is true of the various conditions imposed by the Polish government in connection with the privatization of PHS. Such conditions would reduce the attractiveness of a purchase, and would lessen the price

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[32] Results of Redetermination Pursuant to Remand,Stainless Steel Plate in Coils from Italy, Inv. No. C-475-823 (June 3, 2002) *remanded by* Acciai Speciali Terni S.p.A. v. United States, Court No. 99-06-00364, Slip Op. 2002-10 (CIT Feb. 1, 2002) ("AST Remand").

[33] *Id.*

that a seller could reasonably expect to receive for the company. Post-sale conditions would also be a strong indicator that the government has chosen "to impose economic or other policies that, albeit respectful of the market's inherent functioning, are intended to induce certain results from the market."[34]

III. OTHER ISSUES

A. Continuing Benefit Amount

Some of the Redetermination Results discussed above, we believe, found circumstances that suggested that the privatization was not completely at fair market value, or was not completely free of an agenda that had goals other than revenue maximizing. The Department nevertheless found subsidy extinguishment in those cases, which may be due to a belief that extinguishment was an "either/or" proposition. Either the entire subsidy remained with the company after privatization, or it was entirely extinguished.

In situations like the privatization of Usinor, in which a portion of the shares were privatized at less than fair market value,[35] the Department should find that a portion of the subsidy was not extinguished. We believe, however, that it is not appropriate to try to develop a hard-and-fast formula for such a finding, but rather the Department should make its finding on a case-by-case basis.

[34] AB Report, ¶ 123.

[35] *See* Allegheny Ludlum Remand.

B. Concurrent Subsidies

The Department has often encountered instances in which, in the period before a company is privatized, its balance sheet is cleaned up by massive subsidies to make the company marketable. For instance, when privatizing AST, the state-owned holding company "de-merged" certain manufacturing activities into AST and another company, leaving most of the liabilities in a shell company, ILVA Residua. The Department correctly considered this to be a *de-facto* debt forgiveness.[36]

As the Department has recognized, subsidies provided to prepare a company for privatization are in a special category.[37] Cleaning up a company to make it fit for sale presents a buyer with assets that either would not exist or would not be worth buying. One of the main purposes of the countervailing duty law is to counter distortions in the market caused by government intervention.[38] Instead of letting a nearly bankrupt company go out of business, the government takes a loss on the debt owed by the company, and sells it to private investors at a bargain price. The price, even if at "fair market value" for what is being provided, is a bargain because unwanted liabilities have been scrubbed out. Capacity that would otherwise cease to exist is allowed to continue to produce, adding to global overcapacity and distorting the market. The Department should not treat these situations as "business as usual."

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[36] *See* Stainless Steel Plate in Coils From Italy, 64 Fed. Reg. 15,508, 15,512-13 (Dep't Commerce Mar. 31, 1999) (final).

[37] *See* Notice of Proposed Modification of Agency Practice, 68 Fed. Reg. at 13,901, n.10.

[38] *See, e.g.*, SAA at 911.

Subsidies provided within two years of a company's privatization should be considered as subsidies to the new owners, since they were, or may be presumed to have been, provided to benefit the new owners at the time of sale. The two-year period may be an arbitrary line, but it is consistent with planning to dispose of assets.

One issue is whether all types of subsidies would qualify for this treatment, since some subsidies such as reduced prices for inputs directly benefit current operations rather than the long-term health of the company. Because of the basic principle of the fungibility of money, however, it makes no sense to distinguish types of subsidies—reduced prices for inputs frees up money that could be used to pay down long-term debt, for instance.

Another issue is whether the consideration paid for the company by the private purchasers should be taken into account when determining the amount of the concurrent subsidy. We believe that it is appropriate for the Department to use the methodology that it described in the General Issues Appendix to *Certain Steel Products from Austria*[39] to determine what portion of the sale price can be attributable to the repayment of prior subsidies. That methodology would recognize that the new purchasers have benefited from concurrent subsidies, while taking into consideration the price they paid for the privatized shares.

C. <u>Other Issues</u>

For the other issues identified by the Department's Notice, such as private sales, partial or gradual sales, and effective control, we believe that such issues are very fact-intensive, and should be considered on a case-by-case basis. In general, however, we believe that the guiding

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[39] Certain Steel Products From Austria, 58 Fed. Reg. 37,217, 37,226 (Dep't Commerce July 9, 1993) (final); *see also* Stainless Steel Plate in Coils from Italy, 64 Fed. Reg. at 15509.

principle should be to take into consideration the policies of the government engaged in the privatizing, to assess whether agendas other than profit maximizing are being followed.

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We hope that the Department finds these comments useful in its consideration of its proposed Privatization Methodology. If there are any questions, please do not hesitate to contact the undersigned.

Respectfully submitted,

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Alan H. Price

Counsel to Nucor Corporation

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