

September 9, 2002

PUBLIC DOCUMENT

BY HAND DELIVERY

The Honorable Faryar Shirzad
Assistant Secretary for Import Administration
U.S. Department of Commerce
Central Records Unit, Room 1870
14th Street and Constitution Avenue, N.W.
Washington, D.C. 20230

Attn: Affiliated Party Sales

Re: Antidumping Proceedings: Affiliated Party Sales in the
Ordinary Course of Trade

Dear Assistant Secretary Shirzad:

On behalf of Skadden, Arps, Slate, Meagher & Flom LLP, we hereby submit rebuttal comments on the modification proposed by the Department of Commerce (the "Department") to its practice concerning the determination of whether home market sales to affiliated parties are made in the ordinary course of trade. We submit these rebuttal comments pursuant to the Federal Register notice issued by the Department on August 15, 2002 seeking comments on the Department's proposed modification of its "arm's-length" or "99.5 percent" test.¹

¹Antidumping Proceedings: Affiliated Party Sales in the Ordinary Course of Trade, 67 Fed. Reg. 53339 (Dep't Commerce Aug. 15, 2002) (Request for Public Comments) ("Request for Comments on Affiliated Party Sales").

As discussed in our original comments filed on August 30, 2002, the Department's proposed "98-102 percent" arm's-length test, if appropriately modified for use in administrative reviews, is an acceptable methodology.² Many of the tests proposed by other commenters, however, are contrary to the Department's regulations, are unsupportable before the WTO, or are simply bad policy.

1. The Department Should Not Adopt a 95% – 105% Test

Several commenters propose that the Department adopt a broader band 95% – 105% arm's-length test.³ These suggestions should be rejected for two reasons. First, none of these commenters have suggested a rationale for why 5 percent (as opposed to, for example, 4 or 6 percent) is a reasonable threshold. The selection of this number appears to be entirely arbitrary.

In contrast, a 2 percent threshold for investigations (as in a 98–102 percent test) and a 0.5 percent threshold for reviews (as in a 99.5–100.5 percent test) are not arbitrary at all. To the contrary, these would apply the same *de minimis* standards for the arm's-length test that are used in the margin program. That is,

²Skadden, Arps, Slate, Meagher & Flom LLP's Comments Regarding Affiliated Party Sales (Aug. 30, 2002) ("Skadden Comments") at 2 (Public Document).

³O'Melveny & Myers LLP's Comments Regarding Affiliated Party Sales (Aug. 30, 200) ("O'Melveny Comments") at 8 (Public Document); The Republic of Korea's Comments Regarding Affiliated Party Sales (Aug. 30, 2002) at 5 (Public Document); Sidley Austin Brown & Wood LLP's Comments Regarding Affiliated Party Sales (Aug. 30, 2002) ("Sidley Austin Brown & Wood Comments") at 6 (Public Document).

where “price discrimination” between affiliated and unaffiliated transactions is less than the relevant *de minimis* threshold used in the margin program (i.e., 0.5 or 2.0 percent), the sales will not be excluded. Using a consistent *de minimis* standard for both the arm's-length and margin calculations makes the test reasonable and thus more defensible before the WTO.⁴

Second, as the Department has recognized, the wider the band, the greater the “potential for manipulating normal value through clustering of sales prices to affiliates at the lower end of the band.”⁵ A 95–105 percent band would exacerbate this problem considerably. Respondents could set their affiliated party prices as much as 5 percent below unaffiliated prices without risking the exclusion of such sales from normal value. Indeed, it would permit many respondents to eliminate dumping margins altogether without having to alter their pricing behavior toward unaffiliated customers.

One commenter suggests that the “fictitious markets” and “ordinary course of trade” provisions already provide “mechanisms for directly addressing efforts by a respondent to manipulate margins through the prices at which it sells to affiliates.”⁶ This argument is without merit. As the Department has noted, “a

⁴For further discussion of the arm's-length test/margin program analogy, see Skadden Comments at 8.

⁵Request for Comments on Affiliated Party Sales, 67 Fed. Reg. at 53340.

⁶Sidley Austin Brown & Wood Comments at 6.

fictitious market analysis is extraordinary.”⁷ It requires that a petitioner make “a timely and adequately substantiated allegation”⁸ which includes “evidence that the decrease in the price of home market sales of the foreign like product was accompanied by an increase in the price of sales of different forms of the foreign like product.”⁹ Clearly, this seldom used provision was not intended to address the much more common situation where affiliated party prices are below unaffiliated prices.

As for the “ordinary course of trade” provision, the whole purpose behind the arm's-length test is to determine whether affiliated party sales are, in fact, “outside the ordinary course of trade.” If the Department were to adopt the suggested 95-105 percent test, all sales within that band would automatically be considered within the ordinary course of trade, even if sales prices are clustered at the lower end of the band.¹⁰ These provisions, therefore, would provide no protection against affiliated party price manipulation by respondents.

2. The Department Should Not Adopt a “Cushion” Methodology

⁷Certain Corrosion-Resistant Carbon Steel Flat Products From Japan, 64 Fed. Reg. 12951, 12956 (Dep't Commerce Mar. 16, 1999) (final results).

⁸Id. at 12955.

⁹Furfuryl Alcohol From the Republic of South Africa, 62 Fed. Reg. 61084, 61085 (Dep't Commerce Nov. 14, 1997) (final results).

¹⁰These sales may be considered outside the ordinary course of trade (for reasons other than affiliation) if, for example, they fail the cost test. However, even sales 5 percent below unaffiliated prices may nevertheless pass the cost test.

One commenter advocates a “cushion” approach, whereby sales would pass the arm's-length test “as long as there is a sufficient quantity of sales to unaffiliated customers at prices above and below the average price for sales to affiliates.”¹¹ This proposal has already been considered and rejected by the Department for two primary reasons. First is the problem of “calibrating the appropriate cushion size.”¹² The commenter uses a 20 percent “cushion” in one illustration, but suggests no rationale for why that amount is reasonable.¹³ As with the suggested 5 percent *de minimis* threshold, the number appears to be entirely arbitrary. Second, as the Department has recognized, a “cushion” methodology may constitute an “overly narrow definition of the 'normal' price range of sales to affiliated parties.”¹⁴

We agree with the Department, but would add that a “cushion” methodology is even more susceptible to manipulation than a band methodology. Respondents could set average affiliated party prices at levels considerably below average unaffiliated levels. As long as the respondent makes the requisite quantity of unaffiliated party sales at prices just below the affiliated party level, all sales will

¹¹Shearman & Sterling Comments Regarding Affiliated Party Sales (Aug. 30, 2002) (“Shearman Comments”) at 8-9 (Public Document).

¹²Request for Comments on Affiliated Party Sales at 53341.

¹³Shearman Comments at 9, n.8.

¹⁴Request for Comments on Affiliated Party Sales at 53341.

pass the “cushion” test. For example, suppose producer X sells 50 widgets to affiliate A at \$100 each, and 150 widgets to unaffiliated customer U at \$200 each. Assuming a required “cushion” of 20 percent, Company X could sell 55 more widgets to U at \$95 a piece in order to force all sales to A to pass the arm's-length test. The sales to A would pass the “cushion” test despite the fact that the average affiliated party per-unit price (i.e., \$100) is more than 40 percent below the average unaffiliated price (i.e., \$172).

Finally, according to the commenter,

Because [the Department's proposed] methodology focuses on a comparison of the average prices for sales to affiliated and unaffiliated customers, it does not provide any indication whether the sales to affiliates fell within the normal range. For example, suppose that 90 percent of the sales to unaffiliated customers and 100 percent of sales to affiliated customers were all made at a price of 200. If 10 percent of the sales to unaffiliated customers were made at a price of 300, the average price for sales to unaffiliated customers would be 210. The average price for sales to affiliated customers (200) would then differ from the average price for sales to unaffiliated customers by 5 percent – even though the prices for the sales were identical to the prices for 90 percent of the sales to unaffiliated customers.¹⁵

What the commenter appears not to realize is that the affiliated customer sales in its own example would also fail under its proposed “cushion” approach. Because there are zero sales to unaffiliated customers at prices below the affiliated party price of 200, all of the affiliated party transactions in its example would fail.

¹⁵Shearman Comments at 8.

3. The Department Should Not Adopt a Standard Deviation Statistical Test

Willkie Farr argues that “the proposed 98/102 percent test is too narrow and therefore does not adequately recognize variability within a respondent's data.”¹⁶ The commenter illustrates this by showing that “even if a foreign manufacturer sells from a price list and charges exactly the same price for a CONNUM to both affiliated and unaffiliated customers,” where prices change from month to month, sales to the affiliate may fail the test “simply because the quantities in different periods of time vary.”¹⁷ Willkie's solution to this perceived problem is a proposed “standard deviation” test, which it suggests is “a better indicator of outlier transactions that should be excluded from the dumping calculation.”¹⁸ This proposal should be rejected.

As an initial matter, the perceived problem identified by the commenter can be easily remedied without resort to a complex and, as described below, flawed standard deviation approach. Indeed, a simple contemporaneity requirement as performed in the margin program (for administrative reviews) would ensure that sales do not fail the arm's-length test due to price fluctuations over time.

¹⁶Willkie Farr & Gallagher Comments Regarding Affiliated Party Sales (Aug. 30, 2002) (“Willkie Comments”) at I.B (Public Document).

¹⁷Id.

¹⁸Id. at II.C.

Furthermore, under the proposed standard deviation approach, sales would be excluded only where it can be determined “with 95 percent confidence” that affiliated-party prices could not to have resulted from normal price variability.¹⁹ The Department, in rejecting this proposal, correctly concluded that “such tests typically are much more conservative about what constitutes an outlier than is appropriate in an antidumping context.”²⁰ Indeed, as the United States argued before the WTO Panel in the Japan Hot-Rolled case, a standard deviation methodology:

errs significantly on the side of inclusion – it excludes only those affiliated-party prices that can be shown to a high degree of certainty not to have resulted from normal price variability. In effect, the proposed statistical approach simply lowers the threshold at which sales to affiliated parties will be considered to be arm’s length sales. While lowering the threshold for accepting affiliated-party sales may provide increased certainty that those sales prices excluded from the normal value calculations were in fact influenced by affiliation (rather than by normal price variability), it provides no assurance that those sales prices included were not so influenced.²¹

In the Hot-Rolled investigation, Japanese respondent NKK proposed the very same standard deviation test now espoused by the commenter. The Department rejected that approach, finding it “would increase the likelihood of testing error when pricing to affiliated and unaffiliated customers is not the same

¹⁹Id. at Attachment 1.

²⁰Request for Comments on Affiliated Party Sales at 53341.

²¹First Written Submission of the United States to the WTO Panel in United States – Anti-Dumping Measures on Certain Hot-Rolled Steel Products From Japan, (July 24, 2000) (“First Written Submission of the United States”) at para. 224.

(*i.e.*, the error of finding that affiliation has not affected price when, in fact, it has).²²

We agree with the Department's conclusion that such statistical tests “would allow certain affiliated party sales to be deemed to be in the ordinary course of trade, including affiliated party sales with prices below unaffiliated sales prices, that we believe would distort dumping calculations.”²³

4. The Department Should Not Reconsider Its Practice Regarding Reporting Requirements for Downstream Sales

Two commenters requested that the Department alter its practice with respect to when it will require the reporting of downstream sales. In particular, O'Melveny argues that “the Department should strongly consider not requiring the reporting of downstream sales by affiliated resellers if those sales are less than 20 percent of total home market sales.”²⁴ In the alternative, it argues that the Department should modify its current 5 percent test to exclude from the denominator all sales to affiliated end-users.²⁵ Shearman & Sterling asserts that “the Department should also allow respondents to forego any reporting of resales by affiliated

²²See Hot-Rolled Steel from Japan, 64 Fed. Reg. 24329, 24342 (May 6, 1999) (final determ).

²³Request for Comments on Affiliated Party Sales at 53340-41.

²⁴O'Melveny Comments at 6.

²⁵Id. at 5-6.

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resellers where the prices for sales to the affiliated resellers are found to be higher than the prices for sales to unaffiliated customers.”²⁶

These suggestions are beyond the scope of the comments solicited by the Department. The Department proposes to modify the test used to determine whether affiliated party sales were made at arm's-length, not the test used to determine whether downstream sales must be reported. Moreover, the 5 percent test for reporting downstream sales, unlike the 99.5 percent arm's-length test, is already codified in the Department's regulations. 19 C.F.R. § 351.403(d) provides:

If an exporter or producer sold the foreign like product through an affiliated party, the Secretary may calculate normal value based on the sale by such affiliated party. However, the Secretary normally will not calculate normal value based on the sale by an affiliated party if sales of the foreign like product by an exporter or producer to affiliated parties account for less than five percent of the total value (or quantity) of the exporter's or producer's sales of the foreign like product in the market in question.

The two O'Melveny proposals, i.e., that (i) the 5 percent threshold be changed to 20 percent, and (ii) the denominator be modified from “the total value (or quantity)” of home market sales to a subset of those sales, are both in conflict with the regulation. To amend this test would thus require formal rulemaking proceedings.

With respect to Shearman's proposal that the Department not require respondents to report downstream sales where the upstream sales fail the 98-102 percent test on the high side, there is an additional problem. Even though the

²⁶Shearman Comments at 13.

upstream sales prices may exceed the average unaffiliated price, the downstream sales prices may be higher still. Only the respondent, who possesses the data, knows whether this is the case. If the downstream prices are higher, the respondent will opt not to report them. If they are lower, the respondent will report them. This creates the opportunity for respondents to manipulate normal value by reporting only those sales that produce the most advantageous results.

5. The Department Should Not Adopt a DIFMER Adjustment

One commenter suggests modifying the proposed 98-102 percent arm's-length test to compare sales of non-identical products using a DIFMER adjustment.²⁷ We believe such an approach would add unnecessary complexity to the analysis. Moreover, even this commenter does not argue that the suggested modification is necessary to bring the test into compliance with the WTO Appellate Body's decision. Indeed, the proposed 98-102 percent test already meets the Appellate Body's requirement that the standard be "even-handed."

6. The Department Should Not Permit Affiliated Party Sales to be Used in the Calculation of Normal Value Where the Arm's-Length Test Cannot be Performed

According to Willkie Farr, where the arm's-length test cannot be performed (because there are no comparable sales to unaffiliated customers), the

²⁷Hunton & Williams Comments Regarding Affiliated Party Sales (Aug. 29, 2002) ("Hunton & Williams Comments") at 2 (Public Document).

current approach makes “an unwarranted adverse assumption that these sales are outside the ordinary course of trade.”²⁸ Willkie proposes adopting the opposite approach: assume that all such sales pass the arm's-length test.²⁹ This proposal is well beyond the scope of the comments solicited by the Department, and is not required to bring the test into compliance with the WTO. Moreover, the proposal is contrary to the Department's regulations, and would therefore require formal rulemaking proceedings in order to implement.

The reason why an arm's-length test is applied in the first place is that affiliated party prices are inherently suspect.³⁰ For that reason, there is a presumption that they should be excluded from the normal value calculations unless they can be shown to have been made at arm's-length prices. This presumption is codified in the Department's regulations, which state that

If an exporter or producer sold the foreign like product to an affiliated party, the Secretary may calculate normal value based on that sale only if satisfied that the price is comparable to the price at which the exporter or producer sold the foreign like product to a person who is not affiliated with the seller.³¹

²⁸Willkie Comments at II.B.

²⁹Id.

³⁰See First Written Submission of the United States at para. 205 (“It is generally recognized that sales to affiliated customers are inherently suspect and may form an unreliable basis for the dumping calculations”).

³¹19 C.F.R. § 351.403(b) (emphasis added).

Willkie's proposal is, therefore, in conflict with the Department's regulations. Moreover, as a matter of policy, adoption of the Willkie proposal would be disastrous. Were the Department to adopt such an approach, a respondent could easily make all of its home market sales through a subsidiary. Because there would be no sales to unaffiliated customers, all sales to this affiliate would necessarily pass the test. Clearly, the current methodology – which would require the reporting of the reseller's downstream sales prices to unaffiliated customers – is superior.

7. The Department Should Not Limit Application of the Arm's-Length Test to Majority Owned Affiliates

Willkie proposes that the Department “consider requiring application of the test only to affiliates with which the respondent has cross ownership of 50 percent or more.”³² This proposal is well beyond the scope of the comments solicited by the Department, and is not required to bring the test into compliance with the WTO Appellate Body's decision. Moreover, the proposal is contrary to the Department's regulations, and would therefore require formal rulemaking proceedings in order to implement.

The Department's regulations state that

If an exporter or producer sold the foreign like product to an affiliated party, the Secretary may calculate normal value based on that sale only if satisfied that the price is comparable to the price at which the

³²Willkie Comments at II.D.

exporter or producer sold the foreign like product to a person who is not affiliated with the seller.³³

The term “affiliated party” as used in the regulations has “the same meaning as in section 771(33) of the Act.”³⁴ Pursuant to the Act, the following persons “shall” be considered affiliated: “any person directly or indirectly owning, controlling, or holding with power to vote, 5 percent or more of the outstanding voting stock or shares of any organization and such organization.”³⁵ The Department must, therefore, apply the arm's-length test to all persons meeting this definition of affiliation.

8. The Department's Proposed Test, Even If It Results in Greater Use of Downstream Sales, Will Not Run Afoul of the WTO's “Even-Handedness” Requirement

O'Melveny argues that the Department's proposed test “is not even-handed” because it “has a strong potential to be applied in a manner that would systematically tend to raise normal value – through the required reporting of (normally) higher-priced downstream sales – and disadvantage exporters.”³⁶ This argument must be rejected.

³³19 C.F.R. § 351.403(b) (emphasis added).

³⁴19 C.F.R. § 351.102(b).

³⁵19 U.S.C. § 1677(33)(E).

³⁶O'Melveny Comments at 5 (Public Document).

Using downstream unaffiliated prices in lieu of upstream affiliated party prices which have failed the arm's-length test cannot “disadvantage” exporters. Downstream sales prices between unaffiliated parties, whether higher or lower than upstream affiliated party prices, constitute a superior basis for normal value because they necessarily reflect arm's-length pricing for the foreign like product. The arm's-length price in many cases may be higher than the affiliated party price, but it is not “unfair” to use that price as the basis for normal value. To the contrary, normal value would be understated were the Department to reject downstream arm's-length prices in favor of lower upstream affiliated party prices.

In its report, the Appellate Body noted that the United States “acknowledged that the downstream sales of the affiliated company are likely to be higher priced than the excluded sales to the affiliated company.”³⁷ Nevertheless, the Appellate Body sanctioned the use of downstream sales, expressing no concern that normal values might be higher as a consequence.³⁸ Therefore, the Department's test, even if it results in greater use of downstream sales, does not run afoul of the “even-handedness” requirement.³⁹

³⁷United States – Anti-Dumping Measures on Certain Hot-Rolled Steel Products From Japan, WT/DS184/AB/R (July 24, 2001) (“AB Report”) at para. 168, n. 121.

³⁸Id. at para. 173.

³⁹As discussed in our original comments, the Department should apply a
(continued...)

9. The Department's Proposed Test Will Not Result in Fewer Price-to-Price Comparisons

O'Melveny also argues that the Department's test will “significantly restrict the preferred method of calculating normal value (a price to price comparison) by maintaining a range of acceptable transactions that is too narrow.”⁴⁰ It is difficult to see how this can be true if, as O'Melveny also argues, the proposed test will increase the use of downstream sales. Where affiliated party sales fail the arm's-length test, the Department can still perform price-to-price comparisons using the downstream sales of that affiliate. Moreover, even where a respondent is unable to report downstream sales, the Department can base normal value on other sales to unaffiliated customers. Indeed, under the Department's practice codified at Policy Bulletin 98.1, it “will use constructed value as the basis for normal value only when there are no above-cost sales that are otherwise suitable for comparison” (*i.e.*, contemporaneous, in the ordinary course of trade, and having a DIFMER not exceeding 20 percent). The proposed test is unlikely, therefore, to lead to a significant increase in the need to resort to constructed value.

³⁹(...continued)

99.5% – 100.5% test in administrative reviews. Skadden Comments at 7-8. For the reasons discussed therein, such a test also would not violate the “even-handedness” requirement.

⁴⁰O'Melveny Comments at 5 (Public Document).

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