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BY HAND DELIVERY

Mr. Faryar Shirzad
Assistant Secretary for Import Administration
Central Records Unit, Room 1870
U.S. Department of Commerce
14th and Constitution Ave., N.W.
Washington, DC 20230

Re: Comments on Commerce's Proposed Arm's Length Test

Dear Mr. Shirzad:

The following comments are submitted on behalf of Nucor Corporation, the Committee for Fair Beam Imports, and the Rebar Trade Action Coalition, in response to the Department's Request for Public Comment published in the Federal Register on August 15, 2002,[1] regarding proposed modifications of its policy regarding home market sales to affiliated parties in antidumping proceedings.

I. THE WTO APPELLATE BODY DECISION

An Appellate Body of the WTO reviewed a Dispute Resolution Panel's decision regarding *United States – Anti-Dumping Measures on Certain Hot-Rolled Steel Products from Japan*.[2] Among other issues, the Appellate Body upheld the Panel's decision regarding the

[1] *Antidumping Proceedings: Affiliated Party Sales in the Ordinary Course of Trade*, 67 Fed. Reg. 53339 (Aug. 15, 2002) ("Comment Request").

[2] *United States- Antidumping Measures on Certain Hot-Rolled Steel Products from Japan*, WT/DS184/AB/R (July 24, 2001) ("AB Report").

Department's "arm's length test," but reversed the Panel's decision regarding sales through affiliated resellers. In brief, the Appellate Body found that the Department's practice of performing an arm's length test that excludes sales to affiliated parties in the home market only when the prices are not within 99.5 percent of the prices to unaffiliated parties, but excludes "aberrationally high" prices only after the responding party requests their exclusion and demonstrates their "aberration," was lacking in "even-handedness."[3]

On the other hand, the Appellate Body approved the Department's practice of using the sales of affiliated resellers as the basis for normal value. The Appellate Body wrote that the Antidumping Agreement is "silent as to *who* the parties to relevant sales transactions should be. Thus, Article 2.1 does not expressly mandate that the sale be made by the exporter for whom a margin of dumping is being calculated. Nor does Article 2.1 expressly preclude that relevant sales transactions might be made downstream, between affiliates of the exporter and independent buyers."[4] The Appellate Body further noted that "when investigating authorities decide to use downstream sales to independent buyers to calculate normal value, they come under a particular duty to ensure the fairness of the comparison because it is more than likely that downstream sales will contain additional price components which could distort the comparison."[5] But the Appellate Body concluded that "reliance by USDOC on downstream sales to calculate normal

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[3] AB Report at ¶ 154.

[4] AB Report at ¶¶ 165-166 (emphasis in original).

[5] AB Report at ¶ 168.

value rested upon an interpretation of Article 2.1 of the Anti-Dumping Agreement that is, in principle, 'permissible'…."[6]

The Comment Request indicated that pursuant to arbitration between Japan and the United States, the United States has until November 23, 2002 to implement the Appellate Body's findings.[7] The Department's initial proposal, as set forth in the Comments Request, is to leave its practice regarding affiliated resellers unchanged, but to change the "99.5" test to a "98/102" test.[8] We respectfully suggest that the Department's proposal would substantially enhance the ability of respondents to manipulate home market sales to hide dumping. Meanwhile, the Appellate Body's approval of using the sales of affiliates as the basis for normal value provides the Department with a golden opportunity to close a loophole that respondents have long been using.

The Department can substantially improve the enforcement of the antidumping law, while following the Appellate Body's decision to the letter, by eliminating the arm's length test altogether while expanding the circumstances under which the Department will use the sales of the affiliated reseller as the basis for normal value. If the Department persists in using an arm's length test, there are important reasons why its proposed "98/102" band should be narrowed.

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6 AB Report at ¶ 172.

7 Comment Request, 67 Fed. Reg. at 53340

8 *Id.*

II. THE DEPARTMENT'S PROPOSED "98/102" TEST WOULD ENHANCE RESPONDENTS' ABILITY TO MANIPULATE HOME MARKET SALES TO HIDE DUMPING

The Department's current practice with regard to the "99.5" test is to make the analysis on a customer-by-customer basis.[9] For each affiliated home market customer, prices are first compared to prices to unaffiliated home market customers on a model-by-model basis, and a percentage difference calculated for each model. These percentages are then weight-averaged by quantity. If the aggregate percentage is above 99.5, then that customer "passes" the test.

It does not take a respondent with compliant affiliated resellers long to realize how to beat the system. For example, a respondent could route two types of sales through an affiliated party: subject merchandise sales it knows will never match to U.S. sales and sales that will match. A respondent would sell matching models at a low price (say 100 units at 80 percent of the sales price to non-affiliates) yet above cost. The respondent would sell non-matching models at a correspondingly high price (say 100 units at 120 percent of the sales price to non-affiliates). At the same time, sales of both models would be sold to unaffiliated customers at 100 units.

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[9] In the event that, notwithstanding these comments, the Department continues to employ an arm's length test on a customer-by-customer basis, the Department should clarify how it will conduct the test in cases where an affiliated customer has several shipping or billing locations resulting in multiple "customer codes" to the same customer. The current SAS programming language relies on the customer code field as a key to segregate models by customer. There has been little public discussion of how the Department has conducted the arm's-length test where a respondent has reported separate customer codes. However, in a recent case, the Department "collapsed" the multiple customer codes and performed the arm's-length test on an aggregate basis. *See Certain Cold-Rolled Carbon Steel Flat Products from France*, 67 Fed. Reg. 31204 (May 9, 2002) (prelim.). Commerce should clarify that it intends to continue this policy under any new arm's-length test.

Sales to the affiliate would nevertheless "pass" the arm's-length test because, on average, sales to that customer would be at 100 percent of the price to the unaffiliated customer.[10] Having passed the test, the affiliated reseller could then sell both the matching and non-matching models to the "true" customer at 100 percent of the price to the unaffiliated customer, without regard to margin implications.

It may be difficult to manage home market sales with such precision to pass a "99.5 percent" test. It is dramatically easier to manage home market sales to pass a "98.0 percent" threshold, and if the Department persists in implementing its proposed practice, we can expect to see an increase in this type of game.[11]

The Appellate Body decision, it may be noted, does not *require* the Department to use any "arm's length test" at all, and it would be more appropriate at this point to eliminate it completely. For affiliated resellers, the sale to the first unaffiliated purchaser in the home market should be used as the basis for normal value. Sales to affiliated industrial customers should be disregarded.

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[10] That is, the price of Model 1 (matching to U.S. sales) to the affiliated customer is 80 percent of the price of Model 1 to the unaffiliated customer, while the price of Model 2 (not matching) to the affiliated customer is 120 percent of the price of Model 2 to the unaffiliated customer. Weight-averaging, however, produces a result of 100 percent.

[11] If, notwithstanding these comments, the Department decides to continue to have an arm's length test, Nucor at least urges the Department to make the test model-specific rather than customer-specific. That is, any *models* sold to an affiliated customer at an average price less than 98 percent (or whatever percent is chosen) of the price to unaffiliated customers are excluded. This would significantly reduce opportunities to manipulate home market sales.

III. THE DEPARTMENT SHOULD STRENGTHEN ITS PRACTICE REGARDING AFFILIATED RESELLERS BY CONSIDERING THE SALE BY THE AFFILIATED RESELLER TO NORMALLY BE THE PERTINENT SALE

As discussed above, the Appellate Body ruled that it was perfectly acceptable to use the sale by the affiliated reslller as the pertinent sale for the calculation of normal value, as long as any additional adjustments were taken into account. The Appellate Body also never stipulated that an arm's length test *must* be used, only that such a test, if used, must be "even-handedly" applied to both prices above and prices below the prices to unaffiliated purchasers. In view of the difficulties with the proposed test discussed above, we strongly recommend that the Department eliminate the test altogether, and normally consider the sale by the affiliated reseller to be the pertinent sale.

Such a practice would mean that the comparison in the home market more closely mirrors the comparison in the U.S. market. In the U.S. market, the pertinent sale is the sale to the first unaffiliated purchaser, and appropriate adjustments are made. There is no reason why this cannot be applied in the home market as well. Making this change would obviate a number of problems that we have encountered in recent antidumping proceedings.

To take a hypothetical example, a respondent sells Model 1 in both the home market and in the United States. The sales price in the United States is $100, and in the home market the respondent can realize the equivalent of $120. Clearly, the respondent has every incentive to sell to an affiliated reseller in the home market for $90, have the affiliated reseller sell it for $120 and

take the mark-up, and make sure that there are no sales of the exact model to be subject to an arm's length test (and that the customer otherwise passes the arm's length test).

This change in practice would require no change in the statute, which already provides that sales by an affiliated party "may be used in determining normal value."[12] It would require a change in the regulations, in particular 19 C.F.R. §§ 351.403(c)-(d). Because of the tight deadline pursuant to the arbitration between the United States and Japan, discussed above, the Department will obviously need to announce the practice change first, while announcing that it intends to revise the regulations to conform to the new practice.

IV. SALES TO AFFILIATED INDUSTRIAL CONSUMERS SHOULD BE DISREGARDED

The Department's Comments Request indicated that it had considered other approaches. One possible approach in particular was the exclusion of all affiliated party sales. We believe that this approach should be used with regard to affiliated industrial consumers, *i.e.*, those purchasers who buy the like product for internal consumption rather than resale.

As discussed above, the Department already disregards affiliated party sales in determining U.S. price under section 772 of the Tariff Act of 1930. It would be far more "even-handed" to do the same in the home market. This would also be much easier to administer than

[12] 19 U.S.C. § 1677b(a)(5).

the proposed system and would eliminate a major avenue used by respondents to game the system.

We disagree with the Department's concern that the option of completely disregarding affiliated party sales will lead to fewer instances where the preferred comparison (i.e., to a sale in the home market) is made. Since the *Cemex* case, almost all sales and almost all cases manage to find *some* comparison to a home market sale rather than to constructed value.[13]

Moreover, the Department's concern is irrelevant, even if correct. Congress has established third country price and constructed value as alternative comparisons because Congress understood and expected that there would be occasions where the home market is either not viable or home market matches are not in the ordinary course of trade. These alternatives, while not first in the hierarchy, are no less valid comparisons. It would be inappropriate for the Department to exclude an alternative solution to its arm's-length test by effectively reasoning that statutory alternatives to home market price are undesirable.

We also disagree with the Department that such a practice would not be in accord with the assumptions of 19 C.F.R. § 351.403(c). The Department should be mindful of its own public discussion of this section and of the legislative history. The legislative history, the SAA, and the preamble to the Department's regulations all explain that while the use of sales to affiliates is

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[13] *See Cemex, S.A. v. United States*, 133 F.3d 897 (Fed. Cir. 1998); IA Policy Bulletin 98.1, which specifies that, henceforth, when all sales of a particular home market model are below cost, instead of going to constructed value the Department will go to prices of a similar model that remains above cost.

permitted, it is not required. The assumption, contrary to the Department's characterization, is that affiliated party sales are tainted and should not be used. The SAA states, "{S}ection 773(a)(1)(B) permits (but does not require) Commerce to base normal value on sales to related (now affiliated) parties in the home market. However, Commerce will continue to ignore sales to affiliated parties which cannot be demonstrated to be at arm's length prices for purposes of calculating normal value."[14] Likewise, the legislative history states, "New Section 773(a)(1)(B) continues the practice of existing section 773(a)(5) of, in general, not using sales to affiliated parties as a starting price."[15] (emphasis added). Thus disregarding all home market sales to affiliated industrial consumers would not be contrary to Congressional intent.

Historically, the ability to use these sales in calculating normal value hinged on an arm's length test that guarded against the possible manipulation of home market price whereby a respondent could sell at an artificially low price, thus reducing the margin calculation. Congress never intended, nor is there a need to screen out higher-priced sales to affiliates because the higher price is disadvantageous to respondent. Thus, there is built-in incentive to not sell at artificially high prices. This is the backdrop under which Congress allowed the use of affiliated party sales under section 773(a)(5) (previously 773(a)(3)). It would be a severe misinterpretation of Congressional intent if the Department believes that section 19 C.F.R. § 351.401(c) was based

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[14] Uruguay Round Agreements Act, Statement of Administrative Action, at 157, *reprinted in* H.R. Doc. No. 103-316 (1994) ("SAA").

[15] *See* H.R. Rep. No. 103-826, at 82 (1994).

on the assumption that sales to affiliates priced higher than sales to unaffiliated customers would be excluded.

Indeed, the Department stated the following in implementing 19 C.F.R. § 351.403(c):

> The purpose of an arm's-length test is to eliminate prices that are distorted…. We do not consider home market sales to affiliates at prices above the threshold to be depressed due to the affiliation. Therefore, the Department should treat such sales in the same manner as sales to unaffiliated customers. However, if a party wishes to argue that sales at high prices to an affiliate are outside the ordinary course of trade, the Department would consider such arguments on a case-by-case basis.[16]

The Department's proposed test represents a fundamental change in presumption under which Congress allowed the use of affiliated party sales. Disregarding all home market sales to affiliates (and using the sale to the first unaffiliated customer for sales *through* an affiliated party) is the best solution.

V. THE DEPARTMENT'S PROPOSED "98/102" METHODOLOGY RAISES OTHER PROBLEMS, AND THE DEPARTMENT SHOULD USE A "99.5/100.5" TEST

The Department internally considered various options to implement the WTO's decision before settling on a "band" ranging from 98 to 102 percent. In doing so the Department decided against a broader band (from say 95 to 105 percent) and a narrower band (from 99.5 to 100.5 percent). We agree with the Department that the broader band increases the opportunity for manipulation. However, we respectfully disagree with the Department's reasoning for not

[16] Antidumping Duties; Countervailing Duties, Final Rule, Part II, 62 Fed. Reg. 27296, 27356 (May 19, 1997) ("Preamble to the Regluations").

choosing a narrower band and urge it to adopt such a band in the event it chooses to continue to apply an arm's length test.

As discussed above, retaining the arm's length test but using a "98/102" band increases the ability of respondents to manipulate home market sales to hide dumping. If, notwithstanding these comments, the Department continues to believe that it must use an arm's length test, using a 99.5/100.5 test would make it more difficult to manipulate home market sales, and it would lessen the impact of affiliated sales on the margin calculation. Congress' express intent is that these sales are tainted and "generally will not be used." There is no obligation to use these sales. We therefore urge the Department to use a 99.5/100.5 test if it does retain an arm's length test.

We also disagree with the Department that a narrower band will necessarily result in more comparisons to constructed value ("CV"). As we state above, when an affiliated party fails the arm's length test, one simply uses the downstream sale. There is no reduction in the total number of sales in the home market database. There are only two scenarios that result in an increase in CV comparisons: (1) cases where there are no non-affiliated party sales to use in an arm's-length test (resulting in automatic failure), coupled with an inability on respondent's part to obtain downstream sale information; and (2) cases where the affiliate uses the merchandise to produce non-subject merchandise or where it consumes it in repairing its facilities (for example, a bearing is sold to an affiliate who uses it to repair its packaging machine) such that there is no downstream resale. The Department should consider the number of instances in which these

scenarios actually occur. Moreover, it is already the Department's stated policy that when these situations occur, using constructed value is exactly what it intends to do.[17]

A. Other Modifications to Department's Methodology

In addition, we urge the Department to consider the following modifications to the Department's methodology, in the event that it decides to continue to use an arm's length test.

Section 773(a)(1)(B) of the Tariff Act of 1930, as amended, requires that normal value be based on the price on which the foreign like product is sold…in the ordinary course of trade. The phrase "foreign like product" is defined at Section 771(16) through a hierarchy of choices. The "preferred" choice is identical merchandise, followed by similar merchandise, and finally by merchandise of the same general class or kind. We believe that the statutory framework requires that the Department's determination of whether a sale is made in the ordinary course of trade should be made on parallel basis (i.e., on an identical basis) as foreign like product. As an arm's-length test is conducted under the ordinary course of trade concept within 773(a)(1)(B).[18] Therefore, in the event that the Department decides to continue to use an arm's-length test, it should be performed on identical merchandise. To satisfy this statutory requirement, the Department should conduct its arm's-length test on a model-specific basis for each customer

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[17] Preamble to the Regulations at 27356 "where the only match is a downstream sale, the Department will base normal value on constructed value."

[18] *See, e.g., Stainless Steel Wire Rod From Sweden,* 63 Fed. Reg. 40449, 40452 (July 29, 1998) (final).

such that if any model to any particular customer fails, sales of that model to that customer will be disregarded.

This is a departure from the Department's current two-tier approach whereby affiliated party sales are compared first on a model-specific basis and then the sales to that customer as a whole are measured against a 99.5% threshold, resulting all sales to that customer either failing or passing the arm's-length test.[19] We believe that regardless of whether the threshold is 99.5% or the proposed range of percentages, the sales should be tested on a model-specific basis.

B. Issues that need further clarification

In addition to the above considerations, the Department should explain how its proposed arm's-length methodology would withstand judicial scrutiny. If the Department proceeds with its proposal, it will have two different arm's-length tests for sales between affiliated parties. The first concerns home market sales between affiliates of the foreign like product. This is the Department's proposed methodology. The second is the arm's-length test under Section 773(f)(2) where the Department chooses the higher of two options and Section 773(f)(3) where the Department chooses the highest of three options. Given that this latter test applies equally to both cost of production and constructed value, the Department will have a definition of foreign like product for price-to-price comparisons that differs with its definition of foreign like product

[19] *See* Comment Request at 53340

for constructed value. The Court of International Trade has recently remanded the Department on point.

> Specifically, in accordance with the precedent set by the CAFC in SKF USA Inc. v. United States, 263 F.3d 1369 (Fed. Cir. 001), the CAFC held that this case shall be remanded to Commerce for explanation "why [Commerce] uses a different definition of foreign like product' for price-based calculations for normal value than [Commerce] does for calculations of constructed value."[20]

Additionally, the Department will undoubtedly have to explain why it has a ceiling on one arm's-length test, while the other test has no upward limits. Conceptually, these two tests are at odds with each other, yet fall under the rubric "outside the ordinary course of trade."

If the Department does not initially believe that these two tests cross paths, we suggest that the Department look to the soon-to-be decided Final Determination of Sales at Less Than Fair Value: *Certain Cold-Rolled Carbon Steel Flat Products from France* (due by September 23, 2002) where these issues are joined. In that case, the Department is considering how to treat a transaction between affiliates where a sale to an affiliate is disregarded as per the 99.5% arms-length test, yet the same transaction is also an affiliated party purchase evaluated under the major input rule.

The Department's proposed methodology also does not state how it will treat sales to affiliated parties when there are insufficient or no matching sales to unaffiliated parties for comparison. However, in the Preamble to its regulations, the Department states that:

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[20] *FAG Italia v. United States*, 291 F.3d. 806, (Ct, Int'l Trade 2002).

> In order to perform such an arm's-length test, the Department must first establish that sales to unaffiliated purchasers are sufficient in number or quantity sold to serve as a benchmark for testing affiliated party transactions. If sales to unaffiliated purchasers are insufficient, we simply will not use sales to affiliated purchasers to determine normal value.[21]

The Department should clarify that when it finds an insufficient volume of sales (or no sales) to unaffiliated purchasers, it will continue its practice of disregarding these sales.

- The Department should further clarify that, in situations where a sale to an affiliate is disregarded and it is examining "downstream" sales, where the downstream reseller also sells to an affiliate, the Department will conduct an arm's-length test on those resales.

- The preamble to the current regulations states that the burden of proof that sales are outside the ordinary course of trade lies with the party making the claim.[22] The Department should apply this burden of proof to all affiliated party sales. The Department should adopt a policy that it will disregard all affiliated-party sales, unless and until a respondent has met its burden of proof. This will align Departmental practice with Congressional intent.

- Where a respondent sells to an affiliate in the home market, the Department looks first to that transaction. However, the Department may disregard that transaction if it

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[21] Preamble to the Regulations at 27355 (emphasis added).

[22] *See id* at 27356.

is not made at an arm's length price. At this point, the Department deletes these sales from the remainder of its margin calculations. The Department's current policy is that the disregarded upstream sale would not be appropriate to use in calculating CEP profit.[23] However, that policy was created under the assumption that only sales made at less than 99.5% of the price to unaffiliated parties would fail the test. Apparently, that definition is out the window. The Department should clarify how it intends to calculate CEP profit under a proposed arm's-length test that also excludes sales made at a higher price.

- The proposed methodology of using a banded test has an unintended effect that, again, conflicts with the Department's statements in the rulemaking process. Specifically, the upper limit has the effect of "capping" the CEP profit calculation. Removing the sales above 102 percent removes higher profit sales and thus places a ceiling on the CEP profit calculation.[24] The Department has specifically stated, "the statute does not authorize a cap on the amount of profit deducted from CEP."[25] Thus, the banded test has an unintended effect that the Department has not considered and is in violation of the Department's statutory obligations.

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[23] *See* Import Administration Policy Bulletin 97.1: Calculation of Profit for Constructed Export Price Transactions at pages 3-5 (Sept. 4, 1997).

[24] We note that excluding the sales priced lower than 98 percent also limits the profit calculation. However, Section 772(f) and the SAA at 825 clearly provide for a lower cap of zero percent.

[25] *See* Preamble to the Regulations at 27354.

In its Policy Bulletin 97.1, the Department cites no statutory authority for the premise that sales that fail the arm's-length test should be excluded from the CEP profit calculation. Given that the proposed banded test imposes a cap and given that the Department has interpreted the statute and Congressional intent to not cap CEP profit, we believe that the Department should reconsider its proposed use of a banded test.

If you have any questions concerning this submission, please do not hesitate to contact the undersigned.

Sincerely,

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