GENERAL AGREEMENT ON TARIFFS AND TRADE

RESTRICTED
SCM/167/Add.1
2 June 1993
Special Distribution

Committee on Subsidies and Countervailing Measures

Original: English

UNITED STATES: PRELIMINARY AND DEFINITIVE AFFIRMATIVE COUNTERVAILING DUTY DETERMINATIONS ON CERTAIN STEEL PRODUCTS

Request for Conciliation under Article 17 of the Agreement

Communication from the European Community

Addendum

The following communication, dated 27 April 1993, has been received from the Permanent Delegation of the European Community with the request that it be circulated as an addendum to SCM/167.

---

1. 15 years allocation period

Non-recurring subsidies, which in the past may have been provided to Community steel companies, have been allocated by the US authorities over 15 years (amortization period).

The Community considers that this method of calculation is not compatible with Article 4:2 of the Subsidies code and with the guidelines on amortization and depreciation as adopted by this Committee on 11 July 1985.

1.1 So-called "non-recurring" subsidies (e.g. grants) have been allocated by the US over a certain period of time, the amortization period. The principle that certain subsidies should be allocated over time, as such, is not disputed by the Community.[1]

However, the Community considers that the allocation of this kind of subsidies over a period of 15 years is arbitrary. The US authorities justify the selection of this period on the basis of the Class Life Assets Depreciation Range Tables (dating from 1977) of the US Internal Revenue Service (IRS) covering renewal of physical assets, which show a 15 year period for assets in the steel industry.

---

[1] This is without prejudice to the issue of which subsidies should be allocated over time, on which some differences exist.

1.2 The IRS tables were established in 1977 for tax purposes, and based on data gathered in the 1960s. They were in the end the result of a political decision to establish the tax depreciation tables for this industry.

The Class Life Asset depreciation Range Scheme has been repealed in 1985. US steel companies are no longer permitted to depreciate their equipment over 15 years for tax purposes today. The depreciation period for tangible property of US steel companies for income tax purposes is today actually <u>seven</u> years. Thus, the 15 year period is no longer relevant even to US steel companies.

Moreover, Courts in the US has consistently held that the use of a 15 year allocation period in countervailing duty investigations of steel companies is not in accordance with US law.

1.3 Since the period selected bears no relation to an exact calculation of the benefit which such a subsidy entails for a steel company over a period of time, the only explanation for the selection of the 15 year period appears to be "administrative convenience".

The US authorities claim that IRS tables provide them with a "consistent and predictable standard" for allocation non-recurring subsidies. Concern about "consistency" and "predictability", however, should not lead to a methodology which ignores economic reality.

1.4 The Subsidies Committee adopted on 11 July 1985 Guidelines on Amortization and Depreciation. These Guidelines stipulate that any allocation period' shall be based on <u>reasonable</u> and generally accepted financial and accounting principles' (point 2).

As a general principle the Guidelines determine that (point 3.2): "The investigating authority should select a reasonable period <u>for the firms being investigated</u>".

The guidelines supply various alternatives to allocate subsidies arising from a loan or from a grant, but none of these seem to cover the method which the US has used. The common thread running through the Guidelines appears to be that any method selected by investigating authorities should moreover reflect the reality of the industry being investigated.

1.5 The US countervailing duty cases which are the subject of this conciliation show that in no instance has the US investigated what the average commercial life of the assets of the EC steel industry actually is. This depreciation method does not correspond at all to the actual useful life of equipment used by the investigated steel industry in the European Community (or probably any other country).

1.6 Conclusion

The Community submits therefore that the US method of an across the board application of a 15 year amortization period for the allocation over time of "non-recurring" subsidies granted to the EC steel industry is arbitrary, it is not supported by the factual evidence submitted by EC companies to the US investigating authorities, it does not reflect economic reality and it is not based on generally accepted accounting principles for the firms being investigated. In these circumstances the US method cannot be seen as "reasonable" as the guidelines require.

This method leads to a countervailing of past subsidization whose effects by "all generally accepted financial and accounting principles", have ceased a long time ago. The US method leads therefore to countervailing duties which exceed the amount of the subsidy found to exist if calculated in terms of subsidization per unit (Article 4:2 of the Subsidies Code).

2. Recalculation of subsidies in excess of the amount granted by the government

Non-recurring subsidies have been recalculated in such a way that the total amount countervailed over time exceeds largely the amount of subsidy granted by the government. The Community considers that by this method countervailing duties have been levied in excess of the amount of the subsidy found to exist, in violation of Article 4:2 of the Subsidies Code.

Given the choice to treat equity infusions by public authorities in "unequityworthy" companies as if they were grants, this methodology has been applied throughout these decisions.

2.1 This issue, in US CVD practice, goes under the name of "reverse present value" methodology or "actualization of grants". In practice, the US determines (and has determined in several instances in these investigations) that a grant (as well as any other subsidy which is considered as equivalent to a grant) is more than its amount. The US considers that the value of a sum of money given as a gift is greater than the sum itself, that a "stream of benefits" extending over time has to be construed, and that such "benefit" is the amount to be countervailed. The question then is whether this methodology is consistent with the Code.

2.2 Article 4:2 of the Code states that "No countervailing duty shall be levied on any imported product in excess of the amount of the subsidy found to exist, calculated in terms of subsidization per unit of the exported product".

Footnote 15 to this provision states that "An understanding among signatories should be developed setting out the criteria for the calculation of the amount of the subsidy". Such an understanding, however, has not yet been developed.

Nevertheless, the provision of Article 4:2 still stands, and with it the obligation to identify the existence of a subsidy and its amount. This exercise has to be based on ascertained facts, and not on hypothetical reasoning.

2.3 There have been, and there continue to be differences of view as to when a subsidy exists. There are, however, cases where no such differences exist: if a company receives a gift from the government, in the form of a sum of money to which it has no title except the benevolence of the government, this is obviously a subsidy. Likewise, if the company is granted a tax exemption, that is, it does not pay what it owes to the government, this is obviously a subsidy too. At least in this type of situation the amount of these subsidies should not be an issue: if a sum of money is given as a gift, that is the subsidy; if a sum of money which should have been paid is not paid, that is the subsidy.[2]

Whatever latitude signatories may have in calculating the amount of a subsidy, absent the understanding referred to in footnote 15, such a calculation must be based on objective facts, and not on speculations or on subjective elements. In the case of a grant, the fact is that a sum of money is given as a gift.

2.4 Whether that sum of money has an even greater value to the company receiving it is at the very least a subjective judgement, if not pure speculation. Any criteria which can be used to determine the amount of this greater value can only be inherently arbitrary. In certain cases, this greater value could even be infinite, if that money were needed to save the company from bankruptcy, or if the company could not raise it at all (which can happen for reasons which have nothing to do with the soundness of a company's financial and economic position).

2.5 <u>Conclusion</u>

The Community submits, therefore, that the so-called "grant methodology" employed by the US violates Article 4:2 of the Code because any method chosen by a signatory must respect the obligation of Article 4:2 based on the objective facts of the case and not on speculation or subjective elements. The recalculation of the amount of a grant in such a way that the amount finally countervailed exceeds the sum paid by the government and received by the beneficiary company fails to respect this obligation.

---

[2]Depending on the circumstances of such a gift, it may or may not be appropriate to allocate it over a period of time, although serious divergences exist as to how such a period should be selected. The question here remains: <u>what amount</u> should be allocated over time.

3. Allocation of subsidies over production

"Untied" subsidies granted to a steel company producing in several countries have been countervailed by allocating the complete subsidy amount found only over the domestic production of that company.

The Community considers that the US has violated Article 4:2 of the Subsidies Code by levying a countervailing duty in excess of the subsidies benefiting the product concerned.

3.1 The benefits of subsidies which the US found to be provided to a French holding company with both domestic and foreign subsidiaries engaged in the production of steel, were only allocated over the domestic production of that holding company. (Final affirmative countervailing duty determination: Certain Hot Rolled Lead and Bismuth Carbon Steel Products from France - comment 9, FR. 6230 of 27 January 1993).

3.2 Subsidies which are not linked to a specific production unit or to production based in a particular region or country, should be considered as "untied", i.e. benefiting a company's activities in general. Certain subsidies, by their very nature, favour the holding company in toto. If the total amount of such subsidies is nevertheless allocated only over a part of the production of the holding group, an apparent mathematical error is made, resulting in an overstating of the effect of the subsidy on the countervailed products.

To prevent this, two possibilities are in principle available:

(1) the totality of the subsidies found is distributed over the consolidated production of the group (including the foreign production); of course, in this case the countervailing duty would be effectively imposed only against products from the country (countries) under investigation; or

(2) the non-French sales are eliminated from the denominator and at the same time the total amount of subsidies found (the numerator) is reduced pro rata. Without this reduction, the countervailing duty would exceed the amount of the subsidy actually present in the products produced in and exported from France.

3.3 The US concluded in its determination that the alleged subsidization by France had been tied to domestic production. The Community considers instead that, unless it is proven that subsidies are specifically tied to a part of the production of the company, they must be assumed to be "generally spread" throughout the company. It is therefore for the investigating authority to deliver the proof that a subsidy is "tied".

The US has justified its conclusions in this respect on the basis of some arguments which are not clear and not verifiable. For instance:

(Doc. position - comment 9):

> "On the record before us, after reviewing the programmes from which the subsidies at issue arose, and after considering the Government of France's (GOF) contemporaneous controlling ownership position in Usinor Sacilor, we concluded that the GOF was seeking to promote domestic social policy and domestic economic activities and therefore to encourage domestic production."

and further on:

> "(...) We do not have adequate evidence to give us a clear reason to believe that the benefits of the subsidies at issue encourage foreign production. We therefore allocated the benefits fully to domestic production, and we accordingly included in the sales denominator only sales attributable to domestic production."

3.4 The Community considers it to be completely irrelevant for the determination of the "tied" nature of a subsidy whether a government has a controlling share in a company.

3.5 Moreover, even if one starts from the same premise as the US does (i.e. that it is relevant to know whether subsidies are "tied" to domestic production), it is clear that if a signatory wants to impose anti-subsidy measures, it has to prove positively the extent to which products have benefited from a subsidy. A subsidy of which it is not proven that it is tied to a part of the production, should therefore be allocated over the total production of a company.

3.6 The US may not shift that burden of proof to the defendant companies because then the unacceptable result would be that unless the company supplies evidence that the subsidies also encourage foreign production (i.e. that they are untied, an almost impossible thing to prove), the US will assume that they only benefited domestic production. In the exact US terminology: "Unless we had a clear reason to believe that the benefits encouraged foreign production."

3.7 The consequence of this reasoning is that the US starts from a <u>presumptio nocentiae</u>: subsidies <u>must</u> have been tied to French production. Only if the defendant supplies evidence to give the US a "clear reason to believe" otherwise will it be accepted that the subsidies are <u>not</u> tied.

3.8 <u>Conclusion</u>

The Community is of the view that this way of reasoning is contrary to that of a fair and reasonable proceeding, it results in an impermissible and unnecessary shifting of the burden of proof and it actually imposes a higher standard of proof of the defendants than the US imposes on itself.

The final result is the imposition of a countervailing duty which exceeds the amount of the subsidy found to exist, if calculated in terms of subsidization per unit of the subsidized and exported products (Article 4:2 of the Subsidies Code).

4. Privatization and sale of assets

The US has countervailed products produced by an independent company with assets it had previously purchased at a fair market value from a steel company which had been subsidized in the past.

The Community considers that the US has failed to prove that a subsidy has been granted to the new owner of these assets because of subsidies granted to a different company prior to the sale of the assets and is thereby infringing Article 4:2 of the Subsidies Code

4.1 In these investigations the US has changed its position as to what happens to subsidies granted to a government-owned company when this is privatized. In the past, the US had considered that true privatization, that is, the sale of a company (whatever the legal form of this sale) to a private investor for a fair market value, "extinguished" subsidization which took place prior to the sale.

The new position taken by the US can be summarized by saying that whoever owns a company (the government or a private investor), benefit of a subsidy stays with that company unless and until it is repaid to the government, especially if that subsidy was used to purchase assets.

This position has consequences for two kinds of situation, closely interlinked, yet logically and factually distinguishable: (1) the privatization of a government-owned company, that is, the transfer of the entire company in the hands of a private investor; (2) the sales of productive assets by a government-owned company to a private investor.

4.2 Privatization of a government-owned company

4.2.1 The issue here is whether subsidies received by a government-owned company are "extinguished" by the privatization of that company, that is, by the sale of the government's ownership interest in the company to private investors.

4.2.2 The rationale of the original position taken by the US on this issue (that privatization at fair market value "extinguishes" subsidization that took place before privatization) appeared to be based on the absence of benefits arising from these past subsidies for the new private owner. The rationale for the new position, instead, appears to be based essentially on a sort of "organic" theory as the nature of a company: in other words, even if the owner of the company changes, the company itself does not change, and continues to enjoy the benefit of whatever subsidies it may have received before the change in ownership. This second theory misunderstands the relationship between the new, private owner and the company, where the new owner identifies itself with the company, at least as a provider of resources to the company itself.

4.2.3 The US approach is illogical because it ignores the fact that the market value of a company includes, inter alia, the benefit of whatever subsidies the company may have received in the past. By paying a fair market value for a government-owned company the new owner has repaid to the government what the market has judged was left of the subsidies granted to that company in the past. The new approach chosen by the US, instead, leads to the result that the amount of subsidies that a privatized company should repay to the government[3] may exceed the market value of the entire company itself.[4]

4.2.4 Furthermore, by not recognizing the difference between a public and a private owner of a company the US contradicts its own conceptual approach to government ownership. The US, contrary to logic and reality, insists in treating government ownership of a company differently from private ownership[5], for instance by treating capital infusions in a loss-making company always as subsidies in spite of the existence of similar actions by private owners. Here, instead, the US hides behind the legal separation between a company and its owners, and maintains that it makes no difference to the company whether it is owned by a government or by a private party.

4.3 Sale of assets by a government-owned company to a private investor

4.3.1 The issue here is whether subsidies received by one company could be attributed to a second, independent company because the latter owns some assets which were once owned by the former. Conceptually, this second issue is quite different from the first (the privatization of a government-owned company). Some of the arguments raised by petitioners, and some of the reasoning followed by the US Department of Commerce, however, appear to establish some sort of link between them (as will be shown later).

This case concerns the investigation on Lead and Bismuth Bars from the UK, relating to a company known as UES. UES is a joint venture between British Steel and a private company, GKN. The US verified that UES is an independent corporate entity, not controlled by British Steel or by the UK

---

[3]This is without prejudice to the issue of whether this amount, as calculated by the US, in any way reflects accurately the true amount of subsidies granted to any of the companies involved in these investigations. The Community has argued and will argue elsewhere that these calculations are not correct and in several instances violate the provisions of the Code.

[4]As in the cases concerning British Steel.

[5]As will be seen below, the so-called "equity-worthiness" methodology employed by the US Department of Commerce is inconsistent with logic and economic reality, as well as with the facts of the cases at hand.

Government, and that the transfer of assets between British Steel and UES at the time of the formation of the latter was an arm's length transaction, and that the assets were transferred at market value. Yet, the US determined that UES was subsidized because it had acquired productive assets from a company (British Steel) that the US had found had been subsidized in the past.

4.3.2 Subsidies "inhere" to the assets and "travel" with them "to their new home"

In other words, despite having found that the exporter (UES) had not itself received subsidies, despite having found that UES was independent of British Steel, despite having found that whatever assets had been transferred from British Steel to UES, this had been the result of an arm's length transaction (that is, in which UES paid to British Steel shares worth the full market value of those assets), the US nevertheless attributed a UES portion of subsidies received in the past by British Steel. To do so, it developed a theory according to which the subsidies were somehow "inherent" to the assets. In the words of the US Department of Commerce:

> "a company's sale of a 'business' or 'productive unit' does not alter the effect of previously bestowed subsidies. The Department does not examine the impact of subsidies on particular assets or tie the benefit level of subsidies to changes in the company under investigation. Therefore, it follows that when a company sells a productive unit, the sale does nothing to alter the subsidies enjoyed by that productive unit. The subsidies provided to a company presumably are utilized to finance operations and investments in the entire company, including productive units that are subsequently sold or spun off into joint ventures. Therefore, as the company disposes of its productive entities, these entities take a portion of the benefits with them when they 'travel to their new homes'."[6]

The use of expressions such as "it follows" and "therefore" appear quite inappropriate in this context. In fact, from the premise that "the Department does not examine the impact of subsidies on particular assets", or that "the subsidies provided to a company presumably are utilized to finance operations and investments in the entire company", one would expect the conclusion that a subsidized company continues to be subsidized even if it disposes of the assets which it may have purchased with the help of the subsidy. Here, instead, we have the opposite conclusion: a portion of the subsidy is disposed of together with a portion of the assets.

---

[6]Final Affirmative Countervailing Duty Determination: Certain Hot-Rolled Lead and Bismuth Carbon Steel Products from the United Kingdom, Federal Register, Vol. 58, No. 16 of 27.1.1993, p.6238.

In other words, subsidies received by one company were attributed to a different, wholly independent company because the latter owns some assets which were once owned by the former, even though the assets were purchased at market value. This is tantamount to saying that assets owned by a company which receives a subsidy are forever tainted by subsidization, and that an independent buyer, if he wanted to avoid countervailing duties, should repay the subsidy in addition to having paid a full market price for the assets.

4.3.3 The "anti-circumvention" argument

The rationale for this decision is far from clear. The Final Determination by the US gives only a sort of "anti-circumvention" argument:

> "This approach avoids creating an opportunity for circumvention of the CVD law. Should we determine that the original recipient of subsidies continues receiving the entire benefit of those subsidies, we would not only leave companies like BSC (i.e. British Steel Corporation) 'holding the bag', we would also invite subsidy recipients to sell off units that produce or export countervailed merchandise to the United States. In the end, a 'bubble' of subsidies would remain with a virtually empty corporate shell which would not be affected by any countervailing duties because it did not produce or export the countervailed merchandise to the United States."[7]

If this is the reason, it runs counter to the letter and the spirit of multilateral subsidies disciplines, whose objective is to prevent, if possible, adverse trade effects from the use of subsidies, and to provide remedies for countries affected if these adverse effects do materialize nevertheless. The point is not to countervail subsidies at all costs. The point is to countervail subsidies which benefit the exported products (and which cause injury, of course): if these goods are produced by a company which is not subsidized with assets that it has acquired at market value (and therefore, by any definition, unsubsidized assets) where is the benefit to the exported products? Where is the advantage that the exporters has over its competitors?

One of the reasons behind this determination seems to be the conviction that it is unthinkable that subsidies may go "uncountervailed", regardless of whether, in fact, they have any effect on the production and export of the products under investigation.

4.3.4 The "productive unit" as an "organic" entity

On the other hand, however, the idea that subsidies "travel with assets to their new home" is somewhat reminiscent of the "organic" theory which has prompted the US to consider that bona fide privatization of a

---

[7] Id.

company does not "extinguish" subsidies granted to that company before a privatization. Indeed, this would mean that a "business" or "productive unit" is an entity in its own right, and is forever subsidized, no matter how often it changes hand, until and unless the subsidy is repaid or its benefits "expire".[8] This is not altogether clear, but if it is true, there is a contradiction in employing these concepts.

Indeed, to go back to the issue of privatization for a moment, the US now maintains that the new owner of a privatized company is legally distinct from the company: therefore, the company remains subsidized even if the new owner has paid a fair market value for the company. In other words, the separation of legal personalities is the key concept, and the economic identity of the privatized company with its owner does not matter. But, when considering the sale of a "productive unit" the US seems to consider that this is a distinct entity, subsidized in its own right, regardless of whether it has a separate legal existence: here, it is the economic substance that matters. The result, however, is always the same: somebody buys productive assets (an entire company, or only part of it), pays full market value for it, and yet is liable to pay countervailing duties for subsidies he has never seen and never will see.

4.3.5 Logical consequences of this approach

Furthermore, the possible consequences of this approach are very far reaching and unpredictable. The Department of Commerce tells us that "The Department has applied this analysis only to a subsidized company's 'businesses' or 'productive units', which are are sold off. An analysis which would require the Department to examine each individual asset that a company sells would be administratively infeasible." One could legitimately draw the conclusion that, if the US were ever to find it "administratively feasible" to examine the sale of individual assets, purchasing even one machine from a subsidized company, at whatever price, would expose the buyer to countervailing duties.

The US also tells us that "A subsidized company's sale of productive units is a more reasonable basis on which to allocate the pass-through of subsidies." But the US precisely failed to demonstrate that any pass-through of subsidies has taken place.

4.4 Conclusion

The Community submits, therefore, in relation to the first issue (that is, privatization of a government-owned company), that the US has violated Article 4:2 of the Code by imposing countervailing duties in relation to

---

[8] Furthermore, logically this would also have to apply to the sale of such a productive unit from one private (but in hypothesis subsidized) company to another.

subsidies which no longer benefit the company held liable to pay such duties.

The Community submits as well, in relation to the second issue (that is, the sale of assets by a government-owned company to a private investor), that the US has failed to show that any of the subsidies mentioned above could possibly benefit the companies which were exporting to the US the products under investigation, and that it has therefore violated Article 4:2 of the Code, by imposing duties on a subsidy which could not be "found to exist" in relation to these products.

5. "Equity-worthiness" and "Credit-worthiness" methodology

The US has developed a methodology which determines whether a company is "credit-worthy" or "equity-worthy" or not. The Community considers that this methodology has led on several occasions to an unjustified finding of subsidization in relation to equity infusions and loans made by public authorities.

5.1 Equity infusions by public authorities - so-called "equity-worthiness" methodology

5.1.1 The position of the Community on this issue

The only reference that exists in the Subsidies Code to equity infusions by a government is contained in Article 11:3, where "government subscription to, or provision of, equity capital", is quoted among other "examples of possible forms of" subsidies. Apart from the (open) question of the relevance of the provisions of Part II of the Code for the interpretation of those of Part I (among which Article 4:2), nothing is said about when such equity infusions do constitute subsidies or contain an element of subsidization, let alone on how to calculate such subsidization.

In particular, although it is the opinion of many that the investment by public authorities in a commercial enterprise should not be considered as a subsidy if such investment is "reasonable", there is no consensus on the question. Indeed, government have many reasons to intervene in the sphere of economic activity, and all do so through many different instruments: direct investment in a company is one of such instruments.

For the sake of simplifying the discussion at this stage, the Community will not, at least for the time being, raise the issue of the proper standard of a "reasonable investor" or, more precisely, of what could be called a "reasonable public investor". It will be recalled, however, that the long-standing position of the Community on this question includes: (a) the conviction that governments have non-financial reasons to invest, and that all that can be asked of them is that their investment decisions do not distort competition in the marketplace, and that they cannot be asked to seek to maximize profits; and (b) that the existence of a subsidy, in whatever form, pre-supposes a cost for the government.

5.1.2 The "reasonable private investor" standard

The Community will focus, at this stage, on the standard chosen by the US in these cases, that is, the "reasonable private investor" (or, in other words, whether the investment is "consistent with commercial considerations"). A signatory to the Code, when choosing criteria it believes are appropriate to interpret and apply the provision of Article 4:2, must at least ensure that such criteria are consistent with logic, with economic reality and with the facts of the case under investigation.[9]

In order to determine whether an investment in a company is consistent or not with commercial considerations, the US appears to look first at whether there is substantial private investment in the same company and during the same period which can serve as a benchmark against which to measure the behaviour of the government. Absent such benchmark, the US has developed a methodology to determine whether that company was "equity-worthy" (that is, worth investing in for a private investor) at the time of the investment by the government.

The Community will not attempt to explain all the details of this methodology. However, US decisions and Regulations, as well as the process of bilateral consultations in relation to these investigations, show that the US takes into account a number of past financial indicators (financial ratios) within a time span of 2-3 years before the investment, and any independent studies generated for, or of the kind usable by, a prospective investor to judge the future prospects of the company.

5.1.3 The first flaw in this methodology is in the short-term nature of the indicators considered (which furthermore mostly refer to past performance of the company), and in the narrow horizon of indicators, which focus on the financial conditions of the company, without considering the nature and the prospects of the market, or the effects of the investments made by the company and/or of the restructuring that it may have undergone on the future of the company itself and therefore on its attractiveness for an investor.

5.1.4 This narrow focus on financial indicators is consistent with another methodological choice, which is perhaps the most serious flaw of the "equity-worthiness" analysis. If the US wants to construct a "reasonable"

---

[9]See, for instance, the Report of the Panel in US - Countervailing Duties on Fresh Chilled and Frozen Pork from Canada, DS7/R, BISD 38S/30 (11.7.1991), paragraph 4.8: "the decision as to the existence of a subsidy must result from an examination of all relevant facts. The Panel considered that the issue was not whether the United States had applied a methodology for establishing facts consistent with Article VI:3 but rather whether the facts which the United States did take into account were all the facts relevant for the determination it has made."

commercial investor, this must be at least consistent with economic reality. In real life, private investors are not necessarily outsiders, seeking a relatively rapid maximum return from their capital.

It is often commercially justifiable for an inside investor to make continued investment even in a loss-making company where a reasonable outside investor would not have invested in that company. Investors in (as well as creditors of) economically distressed companies routinely decide, on perfectly sound economic and financial grounds, to keep investing money in those companies. Whereas it is reasonable to believe that an outside investor expects a return on the investment within a certain period of time, the inside investor is more likely to be motivated by the desire to safeguard and recover the existing stake in the company. Indeed, an inside investor may lose all or substantially all of this existing stake if the company is liquidated or goes bankrupt, and thus is motivated to keep the enterprise in operation, even though this may require additional investments. If the company is kept in operation, the inside investor may recover a larger percentage of the investment than would otherwise be the case. Furthermore, an inside investor's access to information about the company's investment plans and knowledge of its management structure and ability puts him in a better position than an outside investor to know the company's prospects for future profitability, regardless or even in spite of its past performance.

5.1.5 The US is, and has long been, aware of these considerations[10] but has consciously chosen to ignore them in favour of a narrowly intended outside investor standard:

> "We do not believe that we should have a separate standard for an 'inside investor'. We believe that, in general, both inside and outside investors make investment decisions at the margin. As we stated in the final Affirmative Countervailing Duty Determination; Steel Wheels from Brazil, 54, FR 15523 (April 18, 1989) 'a rational investor does not let the value of past investment affect present or future investment decisions. The decision to invest is only dependent

---

[10]For instance, the US Department of Commerce has stated in the past that "The fact that the British Government's equity infusions during the review period may have been 'rational' from its viewpoint has no bearing on how a private outside investor would, at that time, have assessed the prospects for a reasonable rate of return within a reasonable period of time. The tests that BSC proposes as a measure of equityworthiness may be useful tools for corporate management in deciding how long to operate a loss-incurring company, but they are not relevant to the 'reasonable investor' test." Stainless Steel Plate from the United Kingdom, Federal Register, Vol. 51, of 11.12.1986, pp.44656,44657.

on the marginal return expected from each additional equity infusion'.[11]"

The notion of "inside investor", instead, is grounded in economic reality, and the choice by the US to ignore it is purely artificial and in conflict with such reality.

5.2 <u>Equity infusions treated as grants</u>

Furthermore, whereas in the past the US had calculated the amount of subsidy involved in a government equity infusion, when they are considered to be "inconsistent with commercial considerations", according to the so-called "Rate of Return Shortfall" (RORS) methodology[12] it has now concluded that "the RORS methodology does not provide an accurate measure of the benefit arising from government equity investments in unequity-worthy companies", and therefore determined that "equity investments in unequity-worthy companies will be treated as grants given in the year of the equity investment".[13] The practical result of this departure from the US' own established practice has been a considerable increase in the amount of subsidization found in these cases. But, even setting aside the question of whether it is appropriate to calculate the subsidy element which may be contained in an equity infusions as if it were a grant (that is, as a gift to the company[14]), the way the US applies its own methodological choice is illogical and inconsistent with reality. Indeed, there is a basic fallacy in the argument that there is no difference between an investment in an "unequity-worthy" company and an outright grant: a grant is a donation with no expectation of any kind of return by the donor; an equity infusion, instead, gives the investor at least some claim on the company's assets, as well as on its earnings if and when the company's fortunes change. Furthermore, in some cases an investment will be made in order to enhance the value of a company in view of its sale, or of the sale of shares in the company, and the investor (the government) will recover in whole or in part the investment.

---

[11]Final Affirmative Countervailing Duty Determination: Certain Hot-Rolled Lead and Bismuth Carbon Steel Products from the United Kingdom, Federal Register, Vol. 58, No. 16, of 27.1.1993, p.6245.

[12]Based on the comparison between the company's rate of return on equity and the national average rate of return on equity, on an annual basis.

[13]Final Affirmative Countervailing Duty Determination: Certain Hot-Rolled Lead and Bismuth Carbon Steel Products from France, Federal Register, Vol. 58, No. 16, of 27.1.1993, p.6223.

[14]And setting aside also the fact (discussed elsewhere) that US methodology on the calculation of grants also violates, in the Community's view, Article 4:2 of the Code.

It is worth quoting *in extenso* what the US Department of Commerce had to say on this point[15]:

"As explained above, we have determined that the RORS methodology does not adequately measure the benefit arising from an equity investment in an unequityworthy company. If we find a company to be unequity-worthy, that findings tantamount to saying that a reasonable investor would not invest in the company. Therefore, from the company's point of view, any equity capital it receives from the government is equivalent to a grant. Consequently, we have measured the benefit to the recipient company using the grant methodology. However, this does not mean that grants and equity are the same. Normally equity investments are made with some expectation of return. Grants are not. As respondents have pointed out, this is what distinguishes grants from equity infusions."

This sort of circular reasoning explains nothing, but does show clearly that, whatever the opinion on the choice to treat equity infusions as grants, its application by the US fails to take into account legal and economic reality.

5.3 Loans by public entities - so-called "credit-worthiness" methodology

This methodology is based on a philosophy similar to that underlying the "equity-worthiness" method. The main purpose and practical effect of a finding of "uncredit-worthiness" would appear to be that a risk premium is added when reconstructing a benchmark interest rate against which a government loan is measured. This has an effect both on the determination of the existence of a subsidy element and on the calculation of its amount.

The kind of analysis performed for this purpose also resembles the "equity-worthiness" analysis, in its insistence on short term financial indicators (mostly of past performance), and in its ignorance of indicators of future performance such as market prospects, the restructuring and management changes that a company may have undergone, as well as in its refusal to consider that creditors, just like shareholders, in some instances may have an interest in keeping a company afloat in order to safeguard their outstanding exposure in respect of that company.

Thus, many of the criticisms addressed to the so-called "equity-worthiness" analysis also apply to the "credit-worthiness test".[16]

---

[15]Final Affirmative Countervailing Duty Determination: Certain Hot-Rolled Lead and Bismuth Carbon Steel Products from the United Kingdom, Federal Register, Vol 58, No. 16, of 27.1.1993, p.6245.

[16]Furthermore, the choice of "benchmark" interest rates also appears questionable, at least in certain cases (e.g. because of the use of IMF rates, which do not accurately reflect the situations being investigated).

(Footnote Continued)

5.4 "<u>Equity-worthiness" and "credit-worthiness": their relationship with the judgement of the market</u>

5.4.1 In both these analyses the US Department of Commerce substitutes its judgement to that of the investor or the lender, respectively. The rationale is obviously that, although the judgement on the soundness of an investment or lending decision, including the appreciation of the risk involved, is ultimately a subjective one, the investigating authorities need an objective term on comparison to evaluate whether these were true investment/lending decisions or subsidies. The US purports to do this by looking at the factors that a rational and "reasonable" investor or lender would have looked at when taking the decision to invest or to lend.

The Community is firmly of the opinion that the US looks at the wrong factors in carrying out this exercise, and therefore arrives at the wrong conclusions as to the existence of subsidies in such cases. There is, however, another disturbing element in the way this methodology works in practice. It may happen[17] that a company which has been judged "unequityworthy" and/or "uncreditworthy" at different times is finally found to be "equityworthy" and/or "creditworthy" at the time when a CVD investigation is carried out. In other words, the US Department of Commerce has substituted its judgement to that of the investing or lending government, but in the end the judgement of the government as to the soundness of the investment or lending decision has been vindicated by the market, and even the US, on the basis of the most narrowly construed notions of "reasonable" investor or lender, has to admit it. Yet, the US continues to countervail that investment or that loan as if they were subsidies instead.

5.4.2 This reasoning has been countered with the argument that, if the investigating authorities were to follow this line, then they would also be entitled to follow it in the opposite situation. That is, if a company is "unequityworthy" or "uncreditworthy" at the time of the investigation all equity infusions or loans could be countervailed as subsidies, even though the company was "equityworthy" or "creditworthy" at the time the investment or the loan was made.

5.4.3 The two situations, however, are not symmetrical. This can best be shows as follows:

(a) A company is in a bad situation in a certain year. Nevertheless, the government decides to go ahead and to invest in that company. A few

---

(Footnote Continued)
The Community reserves the possibility to raise this question in greater detail at a later stage.

[17] As it happened, for instance, in the case of the French steelmaker Usinor Sacilor: see Final Affirmative Countervailing Duty Determination: Certain Hot-Rolled Lead and Bismuth Carbon Steel Products from France, Federal Register, Vol. 58, No. 16, of 27.1.1993, p.6221.

years later that company is subjected to a CVD investigation, and the investigating authority determines that the company was "unequityworthy" at the time the equity infusion was made. This investment should therefore be considered to be a subsidy. Yet, when this determination is made, the company is "equityworthy", because its situation has greatly improved (perhaps because of that equity infusion).

This means that, despite the appearances, the government had correctly assessed the risk involved in the investment, and the market has confirmed that judgement. Thus, that equity infusion should not, after all, be considered a subsidy.

(b) A company is in a not too bad (or even good) situation, and the government decides to invest in the company. A few years later that company is subjected to a CVD investigation, and the investigating authority determines that the company was "equityworthy" at the time the equity infusion was made, and thus that no subsidy was involved. Yet, by the time the CVD investigation is carried out, the economic situation has changed for the worse and the company has become "unequityworthy".

This means that, even though the government had correctly assessed the risk involved in the investment, this turned out to be a bad investment, and the government has made a loss on it. Still, an investment gone sour is not a subsidy.

5.5 <u>Conclusion</u>

The Community submits, therefore, that the methodology employed by the US to determine whether an equity infusion or a loan made by public authorities constitutes a subsidy or contains an element of subsidization is fundamentally flawed. Even if one accepted, for the sake of argument, the assumptions on which it is based, this methodology is nonetheless inconsistent with plain logic, with economic reality, and with the facts of the cases investigated. For these reasons, this methodology is liable, in certain cases, to result in findings of subsidies where none existed, and in other cases in an exaggerated calculation of the amount of the subsidy, thus violating Article 4:2 with the imposition of countervailing duties in excess of the amount of existing subsidization.

6. <u>Debt forgiveness by private banks</u>

The US has countervailed debt forgiveness provided by private banks to a steel company.

The Community considers that there is no justification for countervailing such actions by a private party, taking into account that there has been no financial contribution at all from the granting authority. The Community thus considers that the US has thereby infringed Article 4:2 of the Subsidies Code.

6.1 The Governments of Germany and Saarland (one of the German Länder) negotiated a debt reduction package with the steel company Saarstahl. Private German banks contributed to the restructuring of the company by forgiving part of the debt Saarstahl owed them. (Final Affirmative Countervailing Duty Determination: Certain Hot-Rolled Lead and Bismuth Carbon Steel Products from Germany, US - FR 6233 of 27 January 1993).

This debt forgiveness was considered countervailable by the US "because it was required by the governments as part of a government led debt reduction package for Saarstahl and because the two governments guaranteed the future liquidity of Saarstahl, thereby, implicitly assuring the private banks that the remaining portion of Saarstahl's outstanding loans would be repaid."

6.2 The first argument used by the US is that the private banks' debt forgiveness "was required by the governments". In this respect, while it is clear that Saarstahl benefited from these debt reductions, the Community is of the view that the government involvement in part of the debt reduction does not justify countervailing all the debt reductions obtained by a given steel company.

If the private banks had acted on instructions, either in law or otherwise, from the government, it would be perhaps arguable that these private banks' actions were instrumental to a government's subsidy policy and that their debt forgiveness should therefore be considered as a subsidy.

But nowhere has it been demonstrated that this was the case. The governments may have made the initial approach to request the private creditors to forgive a part of Saarstahl's debt. The two governments were also prepared to act to safeguard their own interests in the company's survival. However, this cannot mean that the action of the banks was required or mandated by the governments, nor that it was anything other than an independent commercial decision to forgive part of their debt in order to protect their interests as creditors of the company.

The Community considers, (as argued <u>in extenso</u> under chapter 5), that, like an inside investor, an "inside creditor" has to make at some instances an assessment as to what is the best manner of protecting his outstanding credits.

6.3 The second argument by the US is that the future liquidity of Saarstahl was guaranteed to the banks by the two governments, and this was an implicit assurance that the remaining portion of the outstanding loans would be repaid.

This element, however, does not prove that the bank's debt forgiveness was in fact a subsidy. To the contrary, it is a strong indication that these banks negotiated as private creditors with their own interest in mind. The liquidity guarantee was the price to be paid by the government if these banks were to agree to the debt rescheduling package.

6.4 Conclusion

The Community submits that in those circumstances there exists no justification for a finding of subsidization as far as the debt forgiveness by private entities is concerned.

Since Article 4:2 of the Subsidies Code does not permit countervailing duties in excess of the amount of the subsidy found, the countervailing of a non-existent subsidy is *a fortiori* prohibited.