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Committee on Subsidies and
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UNITED STATES - IMPOSITION OF DEFINITIVE COUNTERVAILING
DUTIES ON IMPORTS OF CERTAIN STEEL PRODUCTS ORIGINATING IN
SEVERAL MEMBER STATES OF THE EUROPEAN COMMUNITY

Request by the European Community for Establishment of a
Panel under Article 17:3 of the Agreement

The attached communication, dated 19 May 1993, has been received from the Permanent Delegation of the European Community.

Introduction

- a) On 19 January 1993, the U.S. made definitive determinations imposing countervailing duties on imports of certain hot rolled lead and bismuth carbon steel products originating in France, Germany and the United Kingdom (U.S. Federal Register/Vol.58, pages 6221-6246, Wednesday, January 27, 1993).
- b) The Community considers that the imposition of these duties violates in several respects Article 4:2 of the Subsidies Code, which states :

"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 subsidized and exported product".

The U.S. have imposed countervailing measures in situations where no subsidy exists. Moreover, the methodology chosen by the U.S. to calculate the amount of a subsidy overstates such amount. Article 4:2 of the Subsidies Code does not permit the imposition of countervailing duties in excess of the subsidy found. Countervailing a non-existing subsidy is therefore a fortiori prohibited and contravenes Article 1 as well as Article 4 of the Subsidies Code.

The Community is of the view that a signatory of the Code must, in applying Article 4:2, ensure that its actions are consistent with logic, with economic reality and with the facts of the case under investigation; otherwise the terms of Article 4:2 are rendered meaningless.

The disputed U.S. CVD decisions are in several respects based on either hypotheses and assumptions or on speculations and subjective judgments, which override objective and verifiable facts of the cases and lead to determinations which contravene Articles 1 and 4:2.

- c) Hereunder the Community will group six such points relating to the determinations of the U.S. which, in the Community's view, violate its obligations under Articles 1 and 4:2 of the Subsidies Code.

1. 15 years allocation period

- 1.1 The U.S. have allocated "non-recurring" subsidies over a period of time which bears no relation to the duration of the benefit of such subsidies for the company receiving them. The U.S. have allocated these "non-recurring" subsidies over an arbitrarily chosen "amortization period" of 15 years. The practical consequence is that

a subsidy granted in 1978 is still countervailable in 1993. This period of 15 years is based by the U.S. authorities on the Class Life Assets Depreciation Range Tables of the U.S. Internal Revenue Service (IRS) relating to depreciation of physical assets in various industries. These IRS tax tables were adopted in 1977.

1.2 The U.S. Class Life Assets Depreciation Range system appears to have been amended in 1981. It is useful to note that, as a result, in the period covered by the above-mentioned CVD proceedings, U.S. steel companies were not required under U.S. tax provisions to depreciate their equipment over a period as long as 15 years. The current depreciation period for tangible property of U.S. Steel for tax purposes appears in fact to be seven years.

1.3 On 11 July 1985 the Committee on Subsidies and Countervailing Measures adopted Guidelines on amortization and depreciation. These Guidelines stipulate that any allocation period 'shall be based on reasonable and generally accepted financial and accounting principles' (Guidelines, point 2, underlining added).

The Guidelines determine as a general principle: "The investigating authorities should select a reasonable period for the firms being investigated" (Guidelines, point 3.2, underlining added).

1.4 Any method selected by investigating authorities to allocate subsidies over time should reflect the reality of the firms being investigated.

The method utilized by the U.S. does not reflect reality. Much of the subsidies monies were necessarily used for purposes such as payments to creditors, costs of plant closures and workers redundancies which would not give rise to benefits of lasting duration.

In no instance has the U.S. in these countervailing duty cases investigated what period could reflect reasonable and generally accepted financial and accounting principles for the investigated EC companies.

In these circumstances the U.S. method cannot be seen as "reasonable" as the Guidelines require.

1.5 Conclusion

Indeed this method leads to a countervailing of past subsidization the effects of which, by "all generally accepted financial and accounting principles", have ceased before the period of investigation. The U.S. method leads to countervailing duties which exceed the amount of the subsidy found to exist and it is therefore inconsistent with Article 4:2 of the Subsidies Code.

II. Recalculation of subsidies in excess of the amount granted by the Government

- 2.1 The U.S. has determined in several instances in these proceedings that a benefit derived from a grant (as well as any other subsidy which is considered as equivalent to a grant) is more than the actual amount of the grant. The U.S. considers that the value of a sum of money given as a gift is greater than the sum itself. A "stream of benefits" extending over time is therefore constructed and this "stream of benefits" form the amount to be countervailed (in the U.S. terminology: the 'reverse present value' methodology). This methodology leads to imposition of countervailing duties which can be in total two or three times the actual amount of the subsidy given by the granting authority and received by the beneficiary.

Even in applying this disputed methodology the U.S., in constructing the stream of benefit over time, uses a discount rate (based on a benchmark interest rate - see also para 5.3) which does not reflect economic or commercial reality, as is shown, e.g. by the use of IMF rates in the case of Germany (U.S. 58 Fed. Reg., 6234, January 27, 1993).

2.2 Conclusion

The Community considers that this methodology is inconsistent with Article 4:2 of the Subsidies Code. As mentioned above (para b of the Introduction) signatories have an obligation to identify the existence of a subsidy and its amount. This identification has to be based on ascertained facts and not on unrealistic benchmarks and hypothetical reasoning about whether the value of a sum of money has a greater value to the receiving company than the amount itself.

III. Allocation of subsidies over production

- 3.1 The amount of subsidies which the U.S. has found to be provided to a French company with both domestic and foreign subsidiaries engaged in the production of steel, are only allocated over the domestic production of that company. (Final affirmative countervailing duty determination: Certain Hot Rolled Lead and Bismuth Carbon Steel Products from France - comment 9, 58 FR. 6230 (January 27, 1993). The result of this allocation method is a virtual doubling of the countervailing duty since the subsidies are not apportioned over all the production of the company.
- 3.2 The Community is of the view that 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., benefitting a company's activities in general. Certain subsidies, by their very nature, favour a company in toto. If the total amount of such subsidies is nevertheless allocated only over a part of the production of the company therefore either a subsidy not received by the product is being imputed to it, resulting in an overstating of the effect of the subsidy on the countervailed products, or it should be demonstrated that the subsidy is tied to a part of the production.

3.3 In imposing anti-subsidy measures, a signatory must provide positive proof of the extent to which products have, in effect, benefitted from a subsidy. A subsidy, in respect of which it is not proven that it is tied to a part of production, should therefore be allocated over all production of a company.

3.4 The U.S. may not shift the burden of proof to defendant companies concerning the limited nature of a subsidy because this would lead to the unacceptable result that unless the company supplies evidence that the subsidies also encourage foreign production, the U.S. assumes that they only benefitted domestic production.

3.5 Conclusion

The Community is of the view that the U.S. 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 on the defendants than the U.S. imposes on itself.

The final result is the imposition of a countervailing duty in excess of the subsidy bestowed on the product that was the subject of the U.S. investigation (as prohibited by Article 4:2 of the Subsidies Code).

IV. Sale of assets

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

The U.S. has imposed countervailing duties on products from a company (UES) based in the UK because UES produced these products with assets it had purchased from British Steel, which allegedly had been subsidized in the past. The U.S. does so even though it found this purchase of assets to be at arm's length and at fair market value. The U.S. further determined that UES is an independent corporate entity, not controlled by British Steel or by the UK Government. (Final Affirmative Countervailing Duty Determination: Certain Hot Rolled Lead And Bismuth Carbon Steel Products From The United Kingdom, 58 Fed. Reg. (January 27, 1993, p. 6238).

4.2 The Community considers that the U.S. subsidy finding contravenes logic and economic reality because it ignores the simple fact that UES did not receive any subsidy. UES purchased assets at full market value. The fact that the seller may have been subsidised in the past does not mean that some of those subsidies benefit the purchaser. There is no basis in the Code to affirm (in the words of the US) that subsidies "adhere" to assets and "travel with them". If a company purchases assets from another company at market value, it receives no benefit from any subsidies which may have been granted to the seller of those assets.

4.3 Conclusion

The U.S. fails to demonstrate any reasonable basis for finding that a company's use of assets acquired at a fair market value in an arm's length transaction benefits in any way from subsidies previously bestowed on the company from which those assets were acquired. The U.S. has therefore violated Article 4:2 of the Code, by imposing duties on a product for subsidies which could not be 'found to exist'.

V. Equity and loans infusions by public authorities - so-called "equity-worthiness" and "credit-worthiness" methodologies

5.1 "Equity worthiness"

The U.S. methodology used to determine whether an equity infusion by public authorities contains elements of subsidization has as its basis an assessment of how a 'reasonable private investor' would behave faced with an investment decision in those circumstances, in order to assess whether the investment was 'consistent with commercial considerations'.

In the absence of a real private investor in the company concerned, the U.S. constructs how a 'reasonable private investor' would have acted at the time of the investment by the company. For that purpose the U.S. takes into account a number of mainly past financial indicators covering the two or three year period prior to the investment.

Even assuming that the potential subsidy element in an equity infusion made by a public investor should be measured against the behaviour of a private investor, the Community submits that this methodology leads to results which are contrary to logic, to economic reality and to the facts of the cases and are therefore in conflict with Article 4:2 of the Subsidies Code.

I) Choice of indicators

The indicators chosen by the U.S. concentrate predominantly on the past financial performance of the company. In disregarding almost completely future prospects of the company, effects of economic cycles, effects of restructuring efforts of the company and the nature and outlook of the market, the indicators used by the U.S. misrepresent how a real private investor would have assessed the opportunity for investment in the company.

II) Inside investor

The U.S. applies the standard from the point of view of an outside private investor only concerned with financial returns on a new investment. This standard ignores economic reality in many instances where private inside investors and creditors would have considered it reasonable to invest in a company on commercial and economic grounds.

The commercial interests of an inside investor or creditor are not dominated by short-term returns but rather by its interest to secure existing investments in a company and profitability in the longer term.

III) Equity infusions treated as a grant

The U.S. has determined that all equity investments in 'unequityworthy' companies are to be treated as grants. Treating equity investments as grants ignores the crucial distinction between the purchase of equity, which involves both an expected return and ownership interest, and a grant, which is a gift to the company.

This issue is closely linked to the validity of the U.S. determination that a company is not a sound investment. Even if one accepts *arguendo* that a company is at the moment of the capital investment not 'equityworthy', this does not mean that the provider of the equity abandons all his rights on future returns.

5.2 Creditworthiness

The U.S. has developed a comparable methodology to determine whether a company is creditworthy or not at the time a government provides a loan to the company.

The tests to determine 'creditworthiness' consist of a limited number of ratios in respect of illiquidity and debt. The U.S. appears to ignore broader economic and commercial elements such as: whether the company made profits at the time the loan was made and whether a restructuring of the company would change the outlook for the company.

5.3 Choice of "benchmark" rates

If a company is found to be 'uncreditworthy', then the U.S. compares loans provided by the Government with an apparently arbitrarily chosen benchmark interest rate for long-term loans to which it adds a risk premium. For instance the U.S. chose to apply IMF short-term maximum rates as benchmark rates, which do not reflect economic and commercial reality for the companies investigated, as evidence provided by the company has shown. The amount of the countervailing duties was therefore inflated beyond the actual amount of the subsidies (Determinations against France and Germany, January 27, 1993).

5.4 Conclusion

Given the U.S. choice of indicators of "equity-worthiness" and an analysis based on the reconstruction of a hypothetical private investor which ignores the commercial considerations of an "inside" investor or creditor, and regardless of whether a comparison with the behaviour of a private investor is an appropriate criterion to

Identify the subsidy element which may be contained in equity infusions by public authorities, this methodology results in the countervailing of equity infusions which do not contain an element of subsidisation, thereby violating Article 4:2.

Furthermore, even assuming that an equity infusion would contain an element of subsidisation, treating it as an outright grant ignores the legal and economic reality of the difference between the two, and thus overstates the amount of subsidy found to exist, thereby again violating Article 4:2.

Finally, the indicators on which the "creditworthiness" methodology is based, and the choice of "benchmark rates" also overstate the amount of subsidy, and violate Article 4:2.

VI. Debt forgiveness by private banks

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. The U.S. has found the private banks' debt forgiveness to be a subsidy. (Final Affirmative Countervailing Duty Determination : Certain Hot Rolled Lead and Bismuth Carbon Steel Products from Germany, U.S - FR 6233 of 27 January 1993).

6.2 The U.S. argue that the private banks' debt forgiveness "was required by the governments". The Community considers that the Government involvement in part of the debt reduction does not justify countervailing the debt reductions from private sources obtained by the company as this constituted an independent commercial decision made by private banks in order to maintain their interests as creditors of the company.

The Community considers that, like an inside investor, an "inside creditor" has to make an assessment as to what is the best manner of protecting his outstanding credits.

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

This aspect of the debt reduction package cannot however mean that the bank's debt forgiveness was in fact a subsidy. On the contrary, it is evidence that these banks negotiated as private creditors with their own interest in mind. The liquidity guarantee was the price to be paid by the Governments if these banks were to agree to the debt re-scheduling package.

6.4 Conclusion

The Community submits that in these circumstances, there exists no justification for a finding of subsidization as far as the debt forgiveness by private entities is concerned. The U.S. has countervailed an event which cannot be found to be a subsidy, and has thereby violated Article 4:2.

It has not proved possible to resolve any of the matters relating to these definitive countervailing duties and to develop a mutually acceptable solution through bilateral consultations or through conciliation under Article 17:2 of the Subsidies Code. The European Community therefore requests the Committee to establish a panel pursuant to Article 17:3 of the Subsidies Code, in order to have the facts of these matters reviewed and the rights and obligations of the Community and the U.S. clarified.

More specifically, the European Community requests that such a panel be established to find that the U.S. has infringed Articles 1 and 4:2 of the Subsidies Code in several respects, as explained in greater detail above.