BEFORE THE
WORLD TRADE ORGANIZATION
APPELLATE BODY

United States - Countervailing Measures Concerning Certain Products from the European Communities

(AB-2002-5)

APPELLANT'S SUBMISSION OF THE UNITED STATES OF AMERICA

September 19, 2002

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Service List

APPELLEE
H.E. Mr. Carlo Trojan, Permanent Delegation of the European Commission

THIRD PARTICIPANTS
H.E. Mr. Luiz Felipe de Seixas Corrêa, Permanent Mission of Brazil
H.E. Mr. K.M. Chandrasekhar, Permanent Mission of India
H.E. Mr. Eduardo Pérez Motta, Permanent Mission of Mexico

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I. INTRODUCTION

1. The United States appeals the findings of the Panel in this dispute because they reflect misinterpretations of the *Agreement on Subsidies and Countervailing Measures* ("SCM Agreement"), misapply the teachings of the Appellate Body in *Lead and Bismuth II (AB)*,[1] and depend on the mistaken premise that a change in the shareholders of a subsidized company automatically negates subsidies received by the company prior to the change.

2. In *Lead and Bismuth II (AB)*, the Appellate Body found that subsidies are received by the legal persons upon whom they are bestowed (rather than the production engaged in by such persons). Consistent with that finding, the U.S. Department of Commerce ("USDOC") revised its change-in-ownership methodology, and now takes the position that subsidies are received by legal persons and may be attributed only to the production of *those persons* until subsidies are fully amortized. If either the shares or assets of a subsidy recipient are sold to new owners (for fair market value or otherwise), USDOC determines whether the subsidy recipient continues to exist as the same legal person and produce the subject merchandise. If the producer is the same person that received the original subsidy, it continues to be accountable for that subsidy. If the producer is *not* the same person upon whom the subsidies were bestowed, its merchandise is not subject to countervailing duties ("CVDs") on account of those subsidies.

3. The Panel in this proceeding rejected the Appellate Body's teaching that subsidies are received by legal persons, finding instead that subsidies actually are received by composite entities consisting of the legal person upon whom they are bestowed together with that person's

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[1] *United States - Imposition of Countervailing Duties on Certain Hot-Rolled Lead and Bismuth Carbon Steel Products Originating in the United Kingdom*, WT/DS138/AB/R, Report of the Appellate Body adopted 7 June 2000 ("*Lead and Bismuth II (AB)*").

shareholder(s).[2] Because a sale of a subsidy recipient's shares, for fair market value or otherwise, would (by definition) change the company/shareholder mix, such a sale would (by definition) automatically destroy the composite entity that received the subsidy and create a new, unsubsidized, composite entity.

4. There is no basis in the SCM Agreement for the Panel's finding. Subsidies are received by legal persons – not by hybrid entities in which companies and shareholders that are distinct for every other purpose are merged for the sole purpose of extinguishing prior subsidies. The day after the shares of a subsidy recipient are sold to new shareholders, that recipient remains the same legal person. The original subsidies continue to reside in that person and have exactly the same effects as they had the day before. The reason why the Appellate Body concluded in *Lead and Bismuth II (AB)* that the original subsidies at issue did *not* continue to benefit the producer in question was precisely because that producer was not the same legal person that had received those subsidies.

5. Article 14 of the SCM Agreement unambiguously refers to the "recipient" of subsidies and identifies a "firm," not a combination of a firm and its shareholders, as that recipient. The recipient's shareholders have a claim on any increased earnings that are generated by the subsidies, but they do not receive, or have any claim to, the subsidy itself. Article 14 also describes "equity infusions" as subsidies. By definition, an equity infusion goes into a company, and not to its shareholders. The distinction between companies and their shareholders is firmly established around the world, but the Panel ignored that distinction. The Panel violated the

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[2] *United States - Countervailing Measures Concerning Certain Products from the European Communities*, WT/DS212/R, Report of the Panel circulated 31 July 2002 ("Panel Report").

customary rule of interpretation reflected in Article 31(4) of the *Vienna Convention on the Law of Treaties* ("Vienna Convention") by giving a special meaning to the terms "recipient" and "firm" in the absence of any indication that the Members so intended.

6. In sum, where, following the sale of the shares of a subsidy recipient to new owners for fair market value (or otherwise), that recipient continues to exist as the same legal person, the subsidies continue to be attributable to that recipient (until they are fully amortized). The Panel's findings to the contrary rest on the impermissible premise that, for purposes of the SCM Agreement, subsidies are received by fictional hybrid entities. The Panel's findings must, therefore, be reversed.

7. Finally, the Panel erred in finding the a provision of the U.S. countervailing duty statute to be WTO-inconsistent. The Panel applied the wrong legal standard in assessing the WTO-consistency of the provision. Moreover, in ascertaining the meaning of the provision, the Panel failed to make an objective assessment within the meaning of Article 11 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* ("DSU"). This finding of the Panel also must be reversed.

II. THE PANEL ERRED IN FINDING USDOC'S REVISED PRIVATIZATION METHODOLOGY TO BE INCONSISTENT WITH THE SCM AGREEMENT

A. Background

8. In this section, the United States explains how USDOC revised its original privatization methodology in a manner consistent with the Appellate Body's findings in *Lead and Bismuth II (AB)* and how the EC's challenge to this revised methodology unfolded before the Panel in the instant dispute. In Section II B, below, the United States will explain in detail why USDOC's

revised methodology is consistent with the SCM Agreement, as interpreted by the Appellate Body in *Lead and Bismuth II (AB)*.

1. USDOC's Original Privatization Methodology

9. In 1993, USDOC devised a methodology to address changes in the ownership of subsidized companies. This methodology was based on the concept that subsidies, once received, were allocated to the recipient's production and continued to be attributable to that production following a change in ownership of the recipient. At the same time, USDOC provided for a reduction in the prior subsidies following a change in ownership, by crediting part of the price paid for the company (determined according to a formula known as "*gamma*") against prior subsidies.[3]

10. USDOC's "*gamma*" approach was an avowed compromise between two competing policies – on the one hand, that a change in ownership of a subsidized company should be regarded as immediately and automatically negating any prior subsidies to that company and, on the other hand, that a change in ownership of a subsidized company, as such, should be regarded as having no effect on subsidies previously bestowed upon that company. USDOC regarded the second policy as legally correct, but adopted the *gamma* approach to encourage privatization.

11. As noted, *gamma* was based on the premise that a subsidy, once received and valued, remained attributable to production until fully amortized. As a result of the focus on production (rather than the legal person upon whom the subsidy was bestowed), it was not necessarily

[3] The extent to which the prior subsidies were treated as having been paid back depended upon the amount of subsidies remaining unamortized at the time of the sale, in proportion to the price paid. That same proportion of the price paid was then credited as having been used to repay the prior subsidies. The ratio of the remaining unamortized subsidies to the purchase price was called "*gamma*," and the entire methodology became known by this name.

relevant whether the subsidy recipient remained the same legal person following the sale of its shares or assets.

2. The Panel Report in *Lead and Bismuth II*

12. USDOC applied the *gamma* methodology in three administrative reviews of a CVD order on lead and bismuth steel from the United Kingdom, in which it addressed the following situation. The U.K. Government had bestowed large non-recurring (*i.e.*, amortizable) subsidies on British Steel Corporation ("BSC"). USDOC had allocated a *pro rata* share of these subsidies to BSC's specialty steels division, which produced the lead and bismuth steel in question. Three transactions followed. First, BSC transferred the specialty steels division to a partnership called United Engineering Steels ("UES"), in return for shares in UES.[4] Second, British Steel itself was privatized, becoming British Steel, plc ("BS plc").[5] Third, BS plc purchased UES, renaming it British Steel Engineering Steels ("BSES").[6] USDOC treated the specialty steels division as having been sold for fair market value and the panel considered the producers of the specialty steel in question (UES and then BS plc) to be distinct legal persons from BSC.

13. The EC's argument to the panel focused mainly on the undisputed proposition that a person who pays fair market value for the shares (or assets) of a company (whether it has been subsidized or not) exchanges value for equal value and therefore does not receive a benefit as a

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[4] Each of the joint venture partners in UES contributed one half of UES's assets and received one half of UES's shares. USDOC found that the negotiations of these proportions between BSC and its joint venture partner (Guest, Keen & Nettlefolds) reflected an arm's-length assessment of the value of those assets, so that, in effect, each partner contributed assets to the joint venture in exchange for the fair market value of those assets in UES shares.

[5] BS, plc, was identical to BSC in all respects except one – it had new shareholders. While USDOC did not conduct a formal analysis of the corporate identity of the post-transaction entities, no party to the administrative proceeding, including either the EC or BS plc, raised any objections to USDOC's finding on this issue.

[6] Because, as discussed below, the panel found that the "benefit" from the pre-privatization subsidies at issue was cut off by the first two transactions, it did not address this third transaction in its report.

result of the transaction.[7] According to the EC, because the *purchaser* does not receive a benefit from a purchase for fair market value, it followed that any subsidy previously bestowed upon the company (or division) purchased is extinguished by the sale.[8] Thus, the EC argued that the unamortized portion of the subsidies originally bestowed upon BSC, and allocated to the specialty steels division, were extinguished as a result of the sale of that division for fair market value.

14. The United States completely agreed that someone who purchases a productive unit for fair market value exchanges value for equal value and therefore itself receives no benefit as a result of the transaction. The United States did not agree, however, that the fact that the *purchaser* does not receive a benefit from the sale automatically negated the benefit originally bestowed upon the recipient (and allocated to that productive unit).

15. The panel sided with the EC. First, citing the Appellate Body report in *Canada Aircraft*,[9] the panel found that subsidies were bestowed upon "legal or natural persons" and not on production, as such, so that merchandise could be subject to CVDs only if it were established that the legal person producing that merchandise had itself received a subsidy.[10] Second, the panel found that the company that had received the subsidies in question (BSC) and the company that produced the subject merchandise (mostly UES) were distinct legal persons. This was so because, in forming UES, each of the joint venture partners had received the fair market value of

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[7] *United States - Imposition of Countervailing Duties on Certain Hot-Rolled Lead and Bismuth Carbon Steel Products Originating in the United Kingdom*, WT/DS138/R, Report of the Panel, as modified by the Appellate Body, adopted 7 June 2000, Attachment 1.1, paras. 50-67 ("*Lead and Bismuth II (Panel)*").

[8] *Id.*, paras. 105-110.

[9] *Canada - Measures Affecting the Export of Civilian Aircraft*, WT/DS70/AB/R, Report of the Appellate Body adopted 4 August 1999 ("*Canada Aircraft*").

[10] *Lead and Bismuth II (Panel)*, paras. 6.65 - 6.69. *See also id.*, paras. 6.78 and 6.79.

the assets it contributed.[11] The panel concluded that USDOC could not attribute the BSC subsidies to UES or its output, and also that the transaction had created no new subsidy attributable to UES.[12]

3. The Appellate Body Report in *Lead and Bismuth II*

16. The Appellate Body agreed with the panel, based on its own findings in *Canada Aircraft* that subsidies are received by natural or legal persons, and that CVDs may not be assessed on goods produced by persons who have not received subsidies.[13] The Appellate Body also accepted the panel's conclusion that UES was a distinct new legal person that could not be held accountable for subsidies bestowed upon BSC.[14] It did *not,* however, accept the Panel's basis for this conclusion. Whereas the panel had concluded that BSC and UES were distinct legal persons *because of* the payment of consideration for the specialty steels unit,[15] the Appellate Body simply stated that, "given the changes in ownership leading to the creation of UES," USDOC was required to determine whether UES itself had received a financial contribution and benefit.[16] The Appellate Body's references to the payment of fair market value simply indicated that the transaction had not bestowed a new subsidy upon UES or its shareholders.

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[11] *Id.*, para. 6.70. Thus, the payment of fair market value played two roles in the panel's analysis. First, it established that UES was a distinct person from the specialty steels division. *Id.* Second, it ensured that the purchasers had not received a benefit, so that the benefit originally attributable to the specialty steels division was eliminated. *Id.*, para. 6.81.

[12] *Id.*, paras. 6.70 - 6.71.

[13] *Lead and Bismuth II (AB)*, paras. 57 and 58.

[14] *Id.*, para. 62.

[15] *Lead and Bismuth II (Panel)*, para. 6.70.

[16] *Lead and Bismuth II (AB)*, para. 62. The Appellate Body did not specify the factors that rendered UES a distinct legal person, but simply treated it as such, stating twice that its findings were based on "the particular circumstances of this case." *Id.*, paras. 64 and 75(b).

17. In addition, apparently in recognition of the highly unusual nature of the facts presented – the central transaction being not a privatization via a stock sale, but rather the 1986 spin-off/joint venture transaction which created UES – the Appellate Body repeatedly stated that its holding was limited to the facts before it.[17] The Appellate Body also made clear that allocated benefits from a non-recurring subsidy may be presumed to be countervailable in later years (throughout a reasonable allocation period), and that the burden rests on a respondent wishing to avoid an offset for such benefits to *demonstrate* that the subsidy in question has been rescinded.[18]

4. USDOC's New Privatization Methodology

18. Following the adoption of the reports in *Lead and Bismuth II*, USDOC revised its change-in-ownership methodology. Given the Appellate Body's finding that subsidies are received and retained by persons, USDOC switched its emphasis away from the production to which the subsidy originally had been allocated, and instead focused on the legal person upon whom the subsidy had been bestowed. Consistent with the Appellate Body's findings, if the producer of the subject merchandise was the same person that had received the subsidy, then USDOC would conclude that it retained the subsidy and remained subject to CVDs, pending full amortization. If the producer of the subject merchandise was a different person from the subsidy recipient, USDOC would conclude that the new producer never received that subsidy and could not be subject to CVDs on its account. In order to determine whether a producer of subject merchandise and a subsidy recipient should be treated as the same person, USDOC developed a test informed

[17] *Id*., paras. 67-69, 74-75.
[18] *Id*., paras. 62-63.

by upon the basic principles of corporate law in the United States and other countries that govern these determinations in every other context.[19]

5. USDOC's Application of Its New Methodology in *GOES from Italy*

19. The first instance in which USDOC applied its new methodology was an administrative review of the CVD order on grain-oriented electrical steel ("GOES") from Italy.[20] GOES was originally produced by the specialty steels division of ILVA, the Italian-Government-owned steel producer. In the early 1990s, the Italian Government privatized the specialty-steels division in three stages. First, the specialty steels division was split off from ILVA and separately incorporated as Acciai Speciali Terni S.r.l. ("AST"). Second, in order to facilitate the sale, the Government forgave outright a massive amount of AST's debt. Finally, in 1994, the Government sold its shares in AST through a public stock offering to KAI, a holding company jointly owned by German steelmaker Hoesch-Krupp and a of private Italian companies.[21]

20. Following the stock sale, AST continued operations under the same name, with the same assets and liabilities (including the same reduced debt-load), using substantially the same workforce to manufacture the same products in the same facilities, and selling those products to substantially the same customers.[22] Thus, under its new ownership, AST was (and represented itself as being) the same company. This was in sharp contrast to the situation in *Lead and Bismuth II,* where three different corporate entities were involved, and the question was whether

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[19] *Corporation Practice Guide*, para. 2710 (Aspen Law and Business 1997), Exhibit US-1.

[20] *Grain-Oriented Electrical Steel from Italy*, 66 Fed. Reg. 2885 (Dep't Commerce 12 January 2001) (final admin. review), Exhibit EC-7.

[21] *Id.*

[22] *See GOES Issues/Decision Memorandum, supra*, at section entitled "Change in Ownership", Exhibit EC-7.

subsidies bestowed upon one could be attributed to another. Here, there was only one company, even in name, both before and after the change in ownership in question.

21. USDOC found that "all important aspects of AST's business remained essentially unchanged before and after the sale to KAI," and, accordingly, found AST to be the same person both before and after the sale.[23] Therefore, the subsidies that the Italian Government had bestowed upon AST before the sale remained attributable to AST following the sale.[24]

22. It is well established that subsidies, once identified and valued, are simply fixed sums of money which may be allocated over time. There is no requirement to analyze the extent to which the recipient succeeds in enjoying the benefit, or whether the shareholders succeed in reaping larger profits, before assessing CVDs.[25] Accordingly, the potential liability for CVDs remains until the end of the amortization period, regardless of whether intervening events arguably decrease (or increase) the advantage that the recipient or its shareholders could derive from them.

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[23] *See* Final Results of Redetermination Pursuant to Court Remand, *Acciai Special Terni v. United States*, Court No. 99-06-00364 (Ct. Int'l Trade 19 December 2000), Exhibit EC-6, in which USDOC stated as follows:

> [T]he Department has applied a new change in ownership approach ... . The first step in this approach is to examine whether the firm under review is the same person as the one that received the subsidies. To make this determination, where appropriate and applicable, we analyze factors such as (1) continuity of general business operations, including whether the successor holds itself out as the continuation of the previous enterprise, as may be indicated, for example, by use of the same name, (2) continuity of production facilities, (3) continuity of assets and liabilities, and (4) retention of personnel. No single factor will necessarily provide a dispositive indication of any change in the entity under analysis. Instead, the Department will generally consider the post-sale entity to be the same person as the pre-sale entity if, *based on the totality of the factors considered*, we determine that the entity sold in the change-in-ownership transaction can be considered a continuous business entity because it was operated in substantially the same manner before and after the change in ownership. (Emphasis supplied).

[24] *Id*.

[25] The EU has not disputed the proposition that certain subsidies should be allocated over time. Nor could it, given that it uses such an approach for purposes of its own CVD legislation. In this regard, the drafters of the SCM Agreement appeared to take it for granted that certain subsidies should be allocated over time. Thus, Annex IV, paragraph 7, refers to "[s]ubsidies . . . the benefits of which are allocated to future production ... ."

6. Subsequent Applications of USDOC's New Methodology

23. Several of the privatizations to which USDOC applied its new methodology were very similar to the privatization of AST (a mere change in the stock ownership of the legal person that received the subsidy, with no change in the subsidy recipient itself) and, therefore, produced the same result (the subsidy remained attributable to that person). Two USDOC determinations made since the circulation of the Panel Report, however, involved different situations and produced different results. The first of these was a lease/sale of assets by a government-owned company in Trinidad and Tobago to a private company. Under the lease and later after the sale, the subject merchandise was produced by that private company using the assets formerly owned by the Government of Trinidad and Tobago. USDOC found that, because the company that produced the subject merchandise was not the same person upon whom the subsidies had been bestowed, its production could not be subject to countervailing duties on account of the prior subsidies.[26]

24. The second determination involved a Brazilian subsidy recipient that had been sold to another company that produced merchandise subject to a CVD order. USDOC found that, following the sale, the purchaser had broken up the company it purchased, so that the company no longer existed. Consequently, subsidies granted to that company before it was sold could not be attributed to production by the purchaser, which was a completely different entity.[27]

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[26] *Final Determination of Countervailing Duties: Carbon and Certain Alloy Steel Wire Rod form Trinidad and Tobago*, 67 Fed. Reg. 55810 (Dept. Of Commerce, 20 Aug. 2002) and accompanying Issues Memorandum from Richard W. Moreland to Faryar Shirzad, No. C-274-805 (23 August 2002). These documents can be found on USDOC's website at <http://ia.ita.doc.gov/frn/summary/2002aug.htm>.

[27] *Final Determination of Countervailing Duties: Certain Carbon and Certain Alloy Steel Wire Rod from Brazil*, 67 Fed. Reg. 55805 (Dept. Of Commerce, 30 Aug. 2002) and accompanying Issues Memorandum from

(continued...)

25. These two determinations confirm what was clear all along; namely, that USDOC's new methodology does not (as the EC has sometimes alleged) always result in a finding that subsidies remain countervailable following a change in ownership. Rather, USDOC's new methodology simply applies the principles identified by the Appellate Body in *Lead and Bismuth II (AB)* to the facts of each case. Where the subsidy recipient remains the same legal person following the change in ownership and continues to produce the subject merchandise, it remains accountable for the subsidies received. Where, following a change in ownership, the producer of the subject merchandise is a different person from the subsidy recipient, it cannot be held accountable for those subsidies.

7. The EC's Challenge to USDOC's New Methodology

26. In the present dispute, the proceedings before the Panel necessarily centered on *GOES from Italy*, the only one of the twelve determinations before the Panel in which USDOC had applied its new methodology.[28] The EC was never clear about *exactly* why the *GOES from Italy* determination was inconsistent with the SCM Agreement. Instead, the EC relied on various general formulations, such as:

> A change-in-ownership, for fair market value and at arm's length, [means] that pre-privatization financial contributions did not confer a benefit on the privatized company.[29]

[27] (...continued)
Richard W. Moreland to Faryar Shirzad, No. C-351-833 (23 Aug. 2002). These documents can be found on USDOC's website at <http://ia.ita.doc.gov/frn/summary/2002aug.htm>.

[28] The other eleven determinations involved applications of the now discarded "*gamma*" methodology. See Panel Report, paras. 2.5-2.33, 2.36-2.49.

[29] Panel Report, para. 4.54.

By such formulations, the EC apparently sought to take advantage of the undisputed proposition that someone who pays fair market value for shares or assets simply exchanges value for equal value, and therefore personally receives no benefit. By invoking this proposition, without specifying *who* was paying *whom* for *what,* the EC sought to expand this proposition into a far more radical one. The EC's real proposition was as follows:

> Because ***the purchasers*** of a company's shares for fair market value obtain no benefit from their purchase, such a purchase also automatically removes any previous subsidies from ***the company purchased.***

27. Among the most obvious questions raised by this assertion were the following:

> What provision of the SCM Agreement renders a subsidy to a company such as AST non-countervailable, simply because that company's shares were sold to another person for fair market value, in a transaction to which the company itself is not even a party?
>
> Why should AST, which the EC did not even *allege* became a different legal person as a result of the sale of its outstanding shares, be freed from its CVD exposure by that sale, when it unquestionably retained all of its other liabilities?

28. The EC had no answers to these questions. Whenever they were posed (either by the United States or the Panel), the EC simply reformulated its position once again. These reformulations always emphasized that a purchaser for fair market value obtains no benefit, but never addressed the fact that, in a sale of shares, the company whose shares are sold is not a party to the transaction, and not normally considered to be affected by that transaction.[30]

29. Having acknowledged that subsidies "reside[] with the natural or legal person which originally received the subsidy,"[31] the EC had to explain how the sale of shares in a subsidy

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[30] The EC had many different variations of this basic refrain, notable examples of which may be found in its First Written Submission to the Panel, paras. 7, 57, 69, and 157. *See also id.*, paras. 11, 16, 52, 64, 72, 132, 139, 148, 152, 155, 156, 162.

[31] Panel Report, para. 4.21.

recipient to a new set of shareholders (for fair market value or otherwise) could eliminate that company's CVD liabilities, but not its other liabilities. The EC attempted to solve this problem by making a completely unsupported assertion – that the sale by a government of a subsidized company automatically transforms that company into a new, unsubsidized, person, notwithstanding that, by every known indicator of corporate identity, the company sold remains *exactly* the same.

30. The EC set out this assertion in the "conceptual framework" for its first written submission where it explained that it would use the term **"pre-privatization subsidy recipient"** to describe the recipient of the subsidies prior to the privatization and **"post-transaction entity"** to describe the entity producing the goods which are subject to investigation by [USDOC] ... ."[32]

31. The United States pointed out that the EC had provided no justification whatsoever for this assertion, and that the law of most jurisdictions in the world provides *exactly the opposite* – *i.e.*, that a change in the ownership of a company does *not* change the company's identity or free the company from its previous liabilities.

32. The EC's only response was that "privatization involves a fundamental transformation of a government-owned and controlled entity into a privately-owned, market-oriented company."[33] In other words, the sale of a government-owned company to private shareholders *somehow* transforms that company into a new and different company because such a sale is "fundamental." This "reasoning" is a mere tautology – there is nothing "fundamental" about a change in ownership under the SCM Agreement unless some provision of the Agreement *makes* it

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[32] *Id.*, paras. 4.18-4.19.
[33] *Id.*, para. 4.4.

fundamental. The EC could point to no provision in the SCM Agreement even *addressing* changes in the ownership of subsidized companies, let alone rendering such changes "fundamental."

33. In an attempt to clarify matters, the United States addressed the following question to the EC in its first written submission to the Panel:

> What *exactly* is it about a change in ownership for fair market value that transforms the legal person sold into a distinct new legal person? Is it the change in ownership of the legal person, *per se*, or the payment of fair market value for that legal person? Why? If the EC believes that a new legal person is automatically created by a change in ownership, how does the EC reconcile this conclusion with the provisions of EC company law cited above?[34]

34. In response, the EC simply stated that it did not, after all, argue that a change in ownership necessarily transformed a person into a distinct new legal person.[35] It gave no further explanation. At the first meeting with the Panel, the EC continued to avoid answering this question until, eventually, the EC simply was forced to repudiate the "conceptual framework" of it first submission.[36]

35. In its second written submission, the EC abandoned its original argument that the privatization of a state-owned company transforms it into a new legal person. Instead, the EC began to assert that subsidies are not bestowed upon legal persons at all, but upon "economic entities" consisting of both the legal person that nominally received the subsidy and also the shareholders of that person.[37]

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[34] First US Submission, para. 46.

[35] Panel Report, paras. 4.16-4.23.

[36] The EC's abandonment of its prior position occurred toward the end of the third day of the first meeting with the Panel.

[37] Panel Report, paras. 4.30, 4.35.

36. The United States raised two obvious objections: (1) that the distinction between companies and shareholders is a fundamental distinction recognized in virtually every country; and (2) that the Appellate Body previously had found that subsidies are received by legal persons, not vaguely-defined "economic entities" consisting of both such persons together with their shareholders.[38]

37. Having no answer to these objections, the EC simply extended its new thesis with the further unsubstantiated assertion that the normal distinction between companies and shareholders must be disregarded in analyzing the existence of subsidies.

8. The Panel Report

38. The Panel accepted the EC's new argument. Despite acknowledging the Appellate Body's finding that subsidies are received by legal or natural persons,[39] the Panel concluded that subsidies are received by entities (which the Panel named "producers")[40] that include *both* the legal person upon whom the subsidy is, in fact, bestowed and the shareholder(s) of that person.[41] Where the subsidy recipient is state-owned, the Panel called this composite entity a "state-owned producer."[42] The Panel next found that the sale of a company's shares, by changing the company-shareholder mix, creates a new and different composite entity, which the Panel named the "new privatized producer." Having defined the new "producer" as distinct from the

[38] Panel Report, paras. 4.26-4.30.
[39] *Id.*, para. 7.47.
[40] *Id.*, para. 7.54.
[41] *Id.*, paras. 7.54-7.56.
[42] Note that this designation is contradictory, because the "producer" is a hybrid of the company and the shareholder. Where the state is the shareholder, it cannot own the hybrid "producer" without owning itself.

"producer" that received the subsidies, the Panel unavoidably concluded that the new "producer" could not be held accountable for the subsidies received by the other "producer."[43]

39. The Panel could have stopped there. If the producer of subject merchandise is a brand-new entity, there is, by definition, no basis for attributing to it subsidies bestowed upon someone else, before the new entity even existed. Like the EC, however, the Panel did not stop there. It sought to support its conclusion with various economic arguments that were unnecessary, incorrect, and inconsistent with one another.

40. First, the Panel found that "a privatization . . . for fair market value reverses the presumption that the benefit of a non-recurring financial contribution . . . will continue to accrue to a recipient during the allocated period."[44] In addition to having no basis in the text of the SCM Agreement, this finding was unnecessary to the Panel's ultimate conclusion. If the new producer of the subject merchandise is a new person that has never received a subsidy, then it is irrelevant whether the current shareholders of that producer paid fair market value for their shares. The new producer has no subsidy regardless of the price paid.[45]

41. Next, the Panel stated that "the United States seems to be 'attaching' the benefit to the production activity"[46] and went on to emphasize that CVDs are "<u>not</u> designed to counteract all market distortions."[47] This is exactly the *opposite* of what the United States argued. The United

[43] Panel Report, para. 7.72.

[44] *Id.*, para. 7.76.

[45] Conversely, if a privatization for fair market value reverses the normal presumption that benefits could be allocated over time, then, after such a privatization, there would be no benefit *even if the person privatized remained the same person.*

[46] Panel Report, para. 7.80.

[47] *Id.* (emphasis in original).

States emphasized many times that it accepted the Appellate Body's finding in *Lead and Bismuth II (AB)* that subsidies are bestowed upon legal or natural persons, and *not* on production.[48]

42. Finally, the Panel stated that the payment of fair market value for the company "includes the repayment to the government, as the shareholder of the state-owned producer, of the subsidy as valued by the market at the time of privatization."[49] Once again, this theory is completely unnecessary to the Panel's conclusion. If, following the privatization, the subject merchandise is being produced by an entity that has not received a subsidy, that merchandise is not countervailable *regardless* of whether the government was repaid.[50]

43. These contradictions illustrate the basic dilemma faced by the Panel. Its report ultimately was based on the simple assertion that the sale of a subsidy recipient's shares destroyed that recipient and created a new entity that had never received a subsidy. Evidently recognizing the lack of justification for this conclusion, it sought to give it a gloss of economic appeal by adding arguments that were incorrect and irrelevant.

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[48] First US Submission, paras. 39 - 42. As the United States explained:

> The SCM Agreement provides a mechanism for valuing the subsidies themselves – the benefit received by the recipient on terms inconsistent with commercial considerations ... . To the extent that the effects on trade of subsidized merchandise are considered, this is done as part of the injury analysis.

Oral Statement of the United States at the First Meeting of the Panel (19 February 2002), para. 5.

[49] Panel Report, para. 7.82.

[50] Moreover, repaying a subsidy would require repayment of the remaining unamortized amount. Repayment of the remaining *market value* of the subsidy (which might be more or less than the remaining unamortized amount) would require calculations which the Panel did not even attempt. See the explanation in Section II B 1, below.

B. The Panel's Errors

44. Thus far, we have described in general terms the principal errors of law in the Panel Report: the Panel's finding that subsidies are bestowed upon hybrid company/shareholders, rather than legal or natural persons; and its misreading of the Appellate Body's findings in *Lead and Bismuth II (AB)*. We will address these, and other, matters in detail below. First, however, it is important to address the basic economic misconception that appears to have been behind these mistakes – the Panel's assumption that the sale of the shares of a subsidy recipient for fair market value somehow negates that subsidy.

1. The Panel Erred in Relying on the Proposition That the Sale of a Subsidized Company for Fair Market Value Automatically Extinguishes Any Subsidies

45. Key to the Panel's findings was its adoption of the EC's fiction that subsidies are bestowed upon composite company/shareholder(s) so that, when the shareholder element of the composite changes, a new composite is created that cannot be regarded as having received the original subsidies. The Panel was not deterred by the fact that the EC could provide no justification for this conclusion. The explanation for the Panel's willingness to accept the EC's argument appears to have been its conviction that, however dubious the reasoning, the *result* urged by the EC – that subsidies are no longer countervailable after the sale of the recipient's shares for fair market value – was correct, at least as a matter of economics. As the Panel explained at one point:

> . . . the privatized producer must now compete according to market rules and can no longer take advantage of the below-market cost benefits to which the state-owned producer had access.[51]

Accordingly, before addressing the errors in the Panel's legal analysis, it is useful to first explain why the *result* reached by the Panel, as a matter of economics, is also wrong.

46. In essence, the Panel's error was to consider the economic effects of a sale from the perspective of *the new shareholders*, rather than from the perspective of *the legal person producing the subject merchandise,* or the parties injured by the subsidized imports in question. This led the Panel to erroneously conclude that a privatization eliminates the effect of a subsidy. The following demonstrate the errors in the Panel's economic analysis.

47. **Nephew, Inc**. Suppose that a young man who lives in a small town has a very rich uncle. One day, the rich uncle decides that the young man needs a career. Notwithstanding that the market for rental units in the town is already crowded, the uncle forms a company for his nephew ("Nephew, Inc."), and builds a large new apartment building, which he gives to that company. When the new building is complete, the vacancy rate for rental units in the town doubles, depressing rent (and the price for rental units) throughout town. Some time later, the nephew decides to sell his shares in Nephew, Inc. for their fair market value (which is now less than what the new building cost to build).

48. The buyer of Nephew, Inc's. shares does not obtain a benefit as a result of its purchase. The buyer simply exchanges value (money) for equal value (the shares).[52] This does *not* mean, however, that the uncle's actions have been negated. This would occur only if the rents in town

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[51] Panel Report, para. 7.80.

[52] Although Nephew, Inc. may not be worth much, the share price would have reflected its depressed value.

returned to their previous levels. But there is absolutely no reason to conclude that the mere transfer of ownership of Nephew Inc's. shares would have this result – the apartment building still exists and is still depressing rents all over town. Thus, following the change in ownership, the benefit originally bestowed upon Nephew, Inc. continues to have very real effects on both Nephew, Inc. (which still owns a building that would not otherwise exist) and the owners of the other rental units in town (who are still receiving depressed rent).

49. Similarly, in the steel industry, a change in the shareholders of a subsidy recipient does not remove the new equipment, extract knowledge from the workers, or increase the previously lowered debt load. In particular, a steelmaker's debt per ton of steel output, and the price it must receive to cover fixed or total costs, does not change simply by virtue of a stock sale. The artificially enhanced competitiveness generated by the subsidies is not reduced. On the day before and the day after the sale of some or all of a steel producer's shares for fair market value, the same legal person continues to make the same products on the same equipment using the same workers and management at the same costs and in the same volumes, and continues to sell that steel through the same channels of distribution.

50. The basic economic point is that subsidies shift the recipient's supply curve and, as a result, also change the point at which supply and demand for the products made by the recipient intersect in the marketplace. A subsequent privatization does not move the supply curve back to where it had been, and thus, from the perspective of the recipient firm (and its competitors), does not affect the continued existence of the subsidy. The fact that a government may own the recipient company's shares one day and private parties own them the next is immaterial to the economic analysis.

51. **Cement Company** If a government bestows a $200 million grant upon a cement company, the "benefit to the recipient" (the company) is $200 million. The benefit to *the shareholders* (the increase in the value of their shares) may be much lower (say, $50 million), because the government's investment may not increase the expected earnings of the company enough to raise the value of the shareholder's stock by the full $200 million.[53] In such a case, the SCM Agreement dictates that amount of the subsidy is the benefit to *the recipient* ($200 million), not the benefit to the shareholders ($50 million).

52. This basic distinction between the benefit to the subsidy recipient and the benefit to the shareholders continues when the company is sold. Suppose that, one year later (when the remaining unamortized amount of the subsidy is $180 million) the company's shares are sold for $400 million. If the new shareholders pay fair market value for the company, the price, presumably, is $50 million higher (less depreciation) than it would have been absent the subsidy. If the new shareholders pay less than fair market value (for example $370 million) they receive a new benefit in the amount of the difference ($30 million). Regardless of the price paid, however, the sale of the subsidy recipient's shares, as such, does not negate the subsidy. As discussed above, this is evident from the fact that the sale has no effect on the producer or its production. But it is *also* clear from the fact that the amount of any such new benefit to the purchaser of the shares (here, $30 million) bears no necessary relationship whatsoever to the $180 million

[53] If the company is commercially unsound, as were the steel companies involved in the CVD determinations at issue in this dispute, the benefit to the shareholders necessarily will be less than the full $200 million.

unamortized amount of the original subsidy to the company whose shares are purchased (or the $50 million original value of that subsidy.)

53. Part of the Panel's problem is that it confuses the subsidy with the added earnings generated *by* the subsidy. The stock purchaser gets the added earnings, but the company itself has (and keeps) the subsidy which generates those added earnings.[54] "Returning" or "repaying" a subsidy would require repayment *by the company itself* of the remaining unamortized amount. Paying to the government the *market value* of the subsidy – the value of the earnings it is likely to generate – is a totally different matter. To appreciate this, one need only consider the case of a failing and heavily indebted firm with a large *negative* market value which receives a $5 billion subsidy that brings the fair market value of the firm's stock up to a positive $10. A purchaser two months later who buys the stock for $10 may be paying fair market value, but he cannot be said to be *repaying* the $5 billion subsidy.[55]

54. Neither the EC nor the Panel ever offered a satisfactory explanation of these issues. In particular, the EC has never offered a satisfactory response to the following question:

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[54] The subsidy is also by definition *greater* than the added earnings; otherwise it is not a subsidy at all since a firm capable of turning a $100 infusion into extra earnings worth $100 is, of course, an "equityworthy" firm.

[55] The observation that providing subsidies to a state-owned producer increases (somewhat) the government's stock value – an increase converted into cash at privatization – is important for another reason: it highlights the fact that the cost to the government providing the subsidies was from the moment of bestowal somewhat less than the subsidies' face amount. A $100 subsidy to a troubled state-owned firm might increase the stock value by $40, so that the net cost to the government is just $60. But there can be no dispute that the benefit to the recipient firm is *precisely* the face amount provided – $100. Nor can there be any dispute that Article 14 of the SCM Agreement allows an authority to countervail the full benefit to the recipient – again, the full $100. The SCM Agreement does not limit CVDs to the lower amount of the cost actually experienced by the subsidizing government; in fact, this is a limitation the EC tried, and failed, to achieve during the Uruguay Round negotiations. Under Article 14, the cost actually experienced by the subsidizing government is not relevant in the slightest. Properly understood, the Panel's findings impermissibly imposes a cost-to-government standard for subsidy calculations and must be reversed for that reason as well.

> If all of the shares of a subsidized company are sold to new shareholders for 75% (or 50%, or 25%) of their fair market value, what happens to the subsidies that were bestowed upon the company? Under the EC's theory, it would seem that the new hybrid company/shareholders (being a brand-new entity that has never received a subsidy) cannot be held accountable for *any* of the original subsidies. Is this correct?

The United States submits that the reason why the EC has not given an answer is that any responsive answer would reveal that the EC's true position is that *any* payment for the shares of a subsidized company negates those subsidies, and that it is irrelevant whether fair market value is paid.

2. The Panel Erred in Rejecting the Normal Distinction Between Companies and Their Shareholders and Finding Instead that Subsidies Are Received by Aggregate Company/Shareholders, Which the Panel Misnamed "Producers"

55. In the previous section, the United States demonstrated that, while a change in the ownership of a subsidized company may not result in the bestowal of a new subsidy upon the new shareholders, it does not negate the benefit originally bestowed upon the company that is sold. In response, it could be said that this raises the question of whether the SCM Agreement regards the subsidy recipient as the company, its shareholders, or (as the Panel found) both. As demonstrated below, the SCM Agreement regards subsidies as bestowed upon legal or natural persons.

a. The ordinary meaning of the terms in the SCM Agreement indicates that subsidies are received by legal persons, not hybrid economic entities

56. Article 31(1) of the Vienna Convention provides that: "a treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose." While Article 1 of the SCM Agreement says

nothing about the entity to which financial contributions and benefits are provided, Article 14 uses the term "recipient," which the Oxford English Dictionary defines as "a person who or thing which receives something."[56] Thus, the ordinary meaning of subsidy "recipient" is the legal (or natural) ***person*** upon whom the subsidy is bestowed. Consequently, construing "recipient" to include both this person *and also* its shareholder (or shareholders) does violence to its ordinary meaning.

57. While neither Article 1 nor Article 14 uses the term "producer," the Panel sought to redefine that term in a way that does violence to its ordinary meaning. The definition of "producer" is "a person or thing which produces something ... ."[57] Construing "producer" to include both this person *and also* its shareholder(s) is untenable.

b. The context in which subsidy recipients are discussed in the SCM Agreement supports the conclusion that subsidies are received by legal persons

58. The context in which the term subsidy "recipient" is used and referred to confirms the ordinary meaning. Article 1 defines "financial contributions" to include direct transfers of funds (such as grants, loans, and equity infusions), revenue forgone, and the provision of goods and services. Each of these listed items indicates a contribution from a government to a legal person who is the producer and subsidy recipient. Loans are made to producers, not to their shareholders (or both together). Shareholders are not liable on such loans and, conversely, the company is not liable on loans made to shareholders.[58] For funds transferred, the payee is the

[56] *See* The New Shorter Oxford English Dictionary (Clarendon Press 1993), Vol II, at 2501.

[57] *See* The New Shorter Oxford English Dictionary (Clarendon Press 1993), Vol II, at 2367.

[58] The fact that a large shareholder may guarantee a loan to a company, or that a company may guarantee a loan to a large shareholder only confirms this point – a guarantee is necessary because, absent such a guarantee, there (continued...)

company, not its shareholders (and not both). "Equity," by definition,[59] must be invested in a company. If money is given to individual shareholders, whatever it is, it cannot be equity.

59. Article 14 provides additional context by explaining methods of valuing the "benefit to the recipient." Article 14(a) governs the provision of "equity capital" (which, by definition, is an investment in a company). Article 14(b) states that:

> a loan by a government shall not be considered as conferring a benefit, unless there is a difference between the amount that ***the firm*** receiving the loan pays on the government loan and the amount that ***the firm*** would pay on a comparable commercial loan which ***the firm*** could actually obtain on the market. . . . (Emphasis supplied).

This recognizes that a loan is received by a "firm" (a company), not some aggregate of a firm and its shareholders. The term "firm" is also used repeatedly in Article 14(c), which applies to loan guarantees. Finally, Article 14(d) applies to the provision of goods or services or purchase of goods by a government. A government cannot purchase goods made by a company from the shareholders – it must purchase those goods from the company itself.

c. The distinction between companies and shareholders is so well-established that, absent any explicit indication to the contrary, it must be assumed to apply for purposes of the SCM Agreement

60. The Panel's rejection of the normal distinction between shareholders and companies in for purposes of the SCM Agreement is completely unsupported. Accepting such an unsupported assertion might be plausible if it were in accord with the normal conventions governing liabilities, so that it was reasonable to assume that this is what the Members intended.

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[58] (...continued)
would be no liability.

[59] The New Shorter Oxford English Dictionary (Clarendon Press 1993), Vol I, at 843, defines "equity" as ". . . 6. The issued share capital of a company (also: equity capital); the shareholder's interest in a company . . . ."

Disregarding the distinction between companies and shareholders, however, flouts the corporation laws of the United States, the EC, and all advanced industrial countries, which have as their very cornerstone the concept that companies are legal persons distinct from their shareholders, so that a company's liabilities are specific to the company, and are not to be attributed to the shareholders. The Panel's implicit assertion is that the WTO Members decided to depart from this bedrock principle of law *sub silentio*.

61. In the EC, a company's liabilities generally survive under a new shareholder. Liabilities are not avoided because the company "merely changed its name."[60] The factors in the EC include whether the company under the new shareholder "continued to manufacture the same product at the same place with the same staff."[61] Under U.S. law, if a change in ownership is accomplished through a sale of shares, the new shareholder steps into the shoes of the prior shareholder, and the company remains legally responsible for all of the company's existing and

[60] *SCA Holding Ltd. v. Commission of the European Communities*, Case T-327/94, 1998 ECJ CELEX LEXIS 1139 (Ct. First Instance 1998), Exhibit US-2. The question is addressed in the context of liability for anti-competitive practices in Commission Decision (89/515/EEC) Relating to a proceeding under Article 85 of the EEC Treaty (Welded steel mesh), O.J.EUR.COMM. No. L 260/1 (Sept. 6, 1989) ("Welded Steel Mesh"), which states in relevant part that "where the infringing undertaking itself is absorbed by another producer, its responsibility may follow it and attach to the new or merged entity." The Commission made clear that "{i}t is not necessary that the acquirer be shown to have carried on or adopted the unlawful conduct as its own. The determining factor is whether there is a functional and economic continuity between the original infringer and the undertaking into which it was merged." *Id.*, para. 194.

[61] In fact, in the precise area at issue here, EC law treats changes in ownership as irrelevant to the question of whether prior subsidies are actionable. EC state aid regulations plainly state that selling a subsidy recipient does nothing to extinguish previously-bestowed subsidies: "The assessment of rescue or restructuring aid is not affected by changes in the ownership of the business aided. Thus, it will not be possible to evade control by transferring the business to another legal entity or shareholder." *Community Guidelines on State Aid for Rescuing and Restructuring Firms in Difficulty*, O.J.EUR.COMM. No. C 368/12 at 368/14 (Dec. 23, 1994), extended by *Commission Communication Concerning the Extension of the Guidelines on State Aid for Rescuing and Restructuring Firms in Difficulty*, O.J.EUR.COMM. No. C 67/11 (Mar. 10, 1999). Thus, a change in ownership is irrelevant to whether a subsidy is illegal, and if a subsidy is illegal, EC regulations require full repayment, including principal and interest from the time the aid was disbursed, whether or not the recipient is later sold or privatized. *See, e.g.*, O.J.EUR.COMM. No. L 95/19 at 95/24 (Apr. 10, 1997); O.J.EUR.COMM. No. C 113/9 at 113/12 (Apr. 24, 1999).

potential liabilities.[62] While the United States has not reviewed the law of every advanced industrial jurisdiction in the world, it confirmed for the Panel that a corporation's liabilities are not attributable to its shareholders under the laws of most countries.[63]

62. Indeed, the International Court of Justice has acknowledged the widely-accepted distinction in municipal law between a company and its shareholders. As stated by the Court in the *Barcelona Traction* case:

> Separated from the company by numerous barriers, the shareholder cannot be identified with it. The concept and structure of the company are founded on and determined by a firm distinction between the separate entity of the company and that of the shareholder, each with a distinct set of rights. The separation of property rights as between company and shareholder is an important manifestation of this distinction. So long as the company is in existence the shareholder has no right to the corporate assets.[64]

63. While the Panel agreed that the law of the United States and many other WTO members makes a distinction between companies and their shareholders, the Panel did not find it "appropriate" to recognize this distinction for purposes of the SCM Agreement because the SCM Agreement does not *explicitly* refer to this distinction.[65] The Panel found that the SCM Agreement referred only to the "recipient" of a subsidy or to the "producer" of the subject merchandise, and found it more logical to construe these terms to refer to a combination of the

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[62] For example, if the company owes back taxes or has liabilities based on past environmental problems, it continues to owe those taxes and retain those liabilities after the sale. Should the liability materialize, the new shareholder may find that his earnings are less than he hoped – but no one would question the company's responsibility to pay. This would include the possibility of facing CVDs if the company, having received subsidies, elected to export and, in doing so, caused injury to an industry in the importing country. In AST's case, of course, large portions of the ILVA group's export trade to the United States was actually subject to CVDs in 1994, as the Italian authorities and AST's purchaser (KAI) were quite well aware.

[63] See the authorities cited First US Submission, paras. 16 and 17; and Second US Submission, para. 11.

[64] *Case Concerning the Barcelona Traction, Light and Power Company, Limited* (Second Phase), International Court of Justice, Judgement of 5 February 1970, para. 41.

[65] Panel Report, para. 7.50.

actual recipient and its shareholders, rather than simply the recipient producer itself. Here, the Panel simply ignored the customary rule of interpretation reflected in Article 31(4) of the Vienna Convention, which provides that "[a] special meaning shall be given to a term if it is established that the parties so intended." In ignoring the ordinary meaning of the terms of the SCM Agreement, as reflected in widely accepted principles of municipal law, the Panel sought to accord a "special meaning" to these terms. However, neither the Panel nor the EC provided a scintilla of evidence that the drafters of the SCM Agreement intended any such special meaning.

64. The Panel asserted, as one of its reasons for standing normal corporate law principles on their head, that "[a]ny artificial distinction between owners (shareholders) and company ignores the relationship between a company and its owners, *and it is this relationship that changes upon privatization*."[66] The suggestion that what a company owes to its owners differs based on whether those owners are governmental or private is unsupported by reference either to the law of corporations or to the SCM Agreement. It is also in direct conflict with the record evidence in the 12 cases before the Panel that the purchasers in every case bought and held *exactly* the same legal instruments (common stock shares) that the governments had held before privatization. Stock companies owe their shareholders one thing and one thing only: their distributable earnings at the end of each fiscal year. The rights a stock certificate conveys do not change just because someone buys that certificate – even if a private citizen buys it from a government, or vice versa.

[66] Panel Report, para. 7.54 (emphasis added).

d. The Appellate Body has found that subsidies are received by legal or natural persons

65. Given the overwhelming reasons to recognize that subsidies are, in fact, received by the companies upon which they are bestowed, it is not surprising that the Appellate Body found in *Canada Aircraft*[67] and *Lead and Bismuth II (AB)*[68] that subsidies are, in fact, received by legal or natural persons. The Panel's response to the Appellate Body's finding is hard to fathom, but appears to be that, while the "benefit" of a subsidy admittedly accrues to the legal person that received it, and "must be viewed from the perspective of a natural or legal person,"[69] "the concept of benefit is independent of the legal business structure established pursuant to national corporate law,"[70] so that "there should be no distinction between the advantage or benefit conferred by the financial contribution to the company or to the shareholders, i.e. the owners of the company."[71]

66. The Panel's "answer" to the Appellate Body was nothing more than an assertion that, although subsidies are received by legal persons under the SCM Agreement, they should be treated as if they were not. However, when the Appellate Body found that benefits are received by legal persons, it necessarily was referring to such legal persons as defined by "the legal business structure established pursuant to national corporate law." Consequently, this "legal business structure" cannot simply be disregarded for this very purpose. But that is exactly what the Panel did. The Panel is saying that, while benefits may accrue to the legal persons upon

[67] *Canada Aircraft*, paras. 154-156.
[68] *Lead and Bismuth II (AB)*, para. 58.
[69] Panel Report, para. 7.46.
[70] *Id.*, para. 7.50.
[71] *Id.*, para. 7.51.

whom they are bestowed, they *really* accrue to that person *and* its shareholders. This exercise in self-contradiction is simply a cover for ignoring the Appellate Body's teachings.

67. This contradiction is not excused by any ambiguity in the Appellate Body reports. In *Lead and Bismuth II (AB)*, the Appellate Body ruled that the subsidies were bestowed upon British Steel (a legal person). After the changes in ownership "leading to the creation of UES and [then] Bsplc/BSES" (new legal persons), USDOC was required to see whether these new persons had received a benefit.[72] The Appellate Body found that the original subsidies to British Steel had not been bestowed upon these new legal persons. The Appellate Body never suggested that the subsidies resided within hybrid entities consisting of these various legal persons together with their shareholders.

e. The Panel relied upon incorrect economic assumptions in rejecting the distinction between a company and its shareholders

68. The Panel adopted the conclusion of the panel (but not the Appellate Body) in *Lead and Bismuth II* that there is no distinction between a company and its shareholders under the SCM Agreement because shareholders have a claim on the earnings of a company.[73] This conclusion is supported by two speculations that, particularly in the context of the steel industry, are dubious. First, the Panel states that:

> The value of a company depends on its ability to generate returns for its shareholders. Where this ability has been improved by the subsidization, the value of the benefit conferred by a financial contribution should be reflected in the overall market value of the company which received it ... . For the purpose of benefit determination based on market criteria, there should be no distinction

[72] *Lead and Bismuth II (AB)*, para. 62.
[73] Panel Report, paras. 7.51-7.52.

> between the advantage or benefit conferred by the financial contribution to the company or to the shareholders, i.e. the owners of the company.[74]

69. The fact is that subsidies are, by definition, investments that the market would not have made (so that the government had to step in to supply the investment). Accordingly, there is *every* reason to assume that they are simply *bad* investments – investments that do not raise the value of a company's shares by the full amount invested, because they do not increase the expected earnings of the company sufficiently.

70. Secondly, the Panel quotes with approval the conclusion of the panel (but not the Appellate Body) in *Lead and Bismuth II* that "the [new] owners' investment in the privatized company will be recouped through the privatized company providing its shareholders a market return on the full amount of their investment."[75] This is *pure* speculation. The ability of the new shareholders to obtain a market return on their investment depends on the market price of steel, the future performance of the managers and the employees, and the behavior of the other firms in the market, which no shareholder is in a position to control. Thus, the actual return on the new shareholders' investment in the company's shares cannot be known in advance.

71. The panel's speculation is also beside the point. It may be perfectly true that, if the new shareholders pay $200 million, they expect a market return on that investment. But this $200 million goes to the old shareholders, not into the company. The expectation of the new shareholder on their investment is precisely the same as the expectation of the old shareholders.

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[74] *Id*., para. 7.51.
[75] *Id*., para. 7.52.

Otherwise, the old shareholders would have been willing to part with their shares for less than $200 million.

72. The Panel seems to have been laboring under a fundamental misunderstanding of the nature of equity subsidies. In the Panel's view, in order for a firm to benefit over time from an equity subsidy, a government must not only make an initial investment *decision* inconsistent with the normal practice of private investors, but must then *behave* in a certain way in the months and years that follow. Apparently, if the investor/shareholder behaves in an undemanding fashion, the firm can continue to benefit from the equity subsidy and may face CVDs as a result, but if the investor/shareholder is "market-oriented" and displays a strong will to "recoup" the full value of its investment, the firm's benefit will dissipate (or disappear immediately) for *that* reason and in a manner wholly unrelated to normal subsidy amortization. This is the only way to make sense of the Panel's frequent statements about the post-privatization shareholders' (presumed) fixation on earnings: the Panel believes that a firm that has received an equity subsidy cannot continue to benefit from that subsidy if it has hungry, demanding shareholders.[76]

73. Nothing could be further from the truth. Once an investor has given funds irrevocably to a firm in exchange for shares, the return on its investment depends in part on many factors beyond the investor's control, even if the investor controls the company. This is equally true for a government or a private investor. Such an investor holds nothing other than a claim on the

[76] *See, e.g.*, Panel Report, para. 7.60 ("[T]he owners of the privatized company should be *profit-maximizers, set on obtaining a market return* on the entirety of their investment in the privatized company. Ultimately, therefore, the owners' investment in the privatized company *will be recouped* through the privatized company providing its owners a market return on the full amount of their investment.");and *id.*, para. 7.80 ("the privatized producer must now compete according to market rules and *can no longer take advantage* of the below-market cost benefits to which the state-owned producer had access") (emphases added).

firm's distributable earnings (if any) – earnings that depend largely on supply and demand in the marketplace and, in any event, are influenced by shareholders only insofar as they influence management. The appetite of the shareholders may conceivably affect the distribution of earnings, but it does not affect earnings, as such.

74. That is why, under Article 14(a) of the SCM Agreement, the existence of a countervailable benefit in the case of an equity infusion depends on whether the investment *decision* is consistent with the normal practice of private investors. The patience (or lack thereof) *later* displayed by the government/investor is irrelevant. The patience (or lack thereof) displayed by a subsequent private investor is equally irrelevant.

75. A second question that neither the EC nor the Panel ever answered is the following:

> What is the EC's basis for asserting that subsidies are received by hybrid company-shareholders (called "economic entities" by the EC and "producers" by the Panel), rather than the legal persons upon whom they are formally bestowed? How does the EC reconcile this with the Appellate Body's finding that subsidies are received by legal persons?

If the EC does not provide a satisfactory answer to this question, the United States submits that this is because the EC's assertion lacks any foundation and cannot be reconciled with the Appellate Body's analysis.

f. The assertion that subsidies are received by composite entities, consisting of the producer upon which they are bestowed and its shareholders, is irrational

76. The conclusion that subsidies are received by the legal persons upon whom they are bestowed is also supported by simple logic. Governments subsidize producers, not their

shareholders.[77] One entity must be accountable for the money, must reflect the benefit on its financial statements, and must be responsible for repayment (to the extent that repayment is required).

77. The logic of regarding subsidy recipients as legal persons can be appreciated by attempting to apply the SCM Agreement as the Panel would have it applied – without a distinction between shareholders and companies. This would lead to the following conclusions:

- In the case of a government-owned company, the government gives a subsidy to an "economic entity" (which the Panel calls a "producer") consisting of both itself and the legal person to whom the subsidy was given. Thus, the government is subsidizing itself.

- If the government then sells a portion of its shares in the "economic entity" to a new shareholder, this somehow creates a new "economic entity" consisting of a portion of the pre-privatization entity and the new shareholder.

- When the new shareholder writes the check to pay for its shares, it is distinct from the legal person that received the subsidy (otherwise, the subsidy recipient would be buying itself). The instant the transaction between the old and new shareholders is complete, however, the subsidy recipient is merged with the new shareholder into a new post-transaction "economic entity," which has never received a subsidy.

78. The Panel's position also creates an additional logical problem: If a complete change in the ownership of a subsidy recipient automatically extinguishes those subsidies, then it would follow logically that a partial change in ownership would partially extinguish those subsidies.

[77] This is not to say that there are not some instances, notably in the case of a holding company and its wholly-owned subsidiary or subsidiaries, in which subsidies to the holding company might not be attributed to the subsidiary that is actually engaged in the production. Such a decision would, in practice, treat the subsidy as granted to the corporate group in question. There is ample precedent for this in both corporate law and accounting and there are rules that govern when such related parties may be collapsed and treated as the corporate group which, in substance, they are. This does not mean that the fundamental distinction between investors and the companies in which they invest is not valid.

Because the EC never responded to questions on this subject in any meaningful way and the Panel never addressed the issue, the United States will simply note these questions here.

> Assume that a cash subsidy is provided to a publicly-traded company whose stock trades daily on an exchange, for fair market value. As a result, the day after the subsidy, the company has somewhat different shareholders. Is a new company/shareholder hybrid created so that the subsidy is automatically eliminated? Is the subsidy diminished? If so, how can a subsidy given to a publicly-traded company (whose stock generally turns over in a matter of months) ever be countervailed? How does the EC's countervailing duty practice take this into account?
>
> Suppose that there is a publicly-traded corporation in which one person holds a 40% share, which (because it is by far the largest block of shares) gives that person control of that corporation. The next largest shareholder (who owns 10%) then buys an additional 41% of the stock, acquiring a 51% interest. Does this change in the company/shareholder composite transform the company into a new legal entity, so that it is no longer subject to CVDs for the previous subsidies? Why?

79. The United States considers that the reason why neither the EC nor the Panel ever provided a satisfactory response to the issues raised by these questions is because neither had any real idea of why a change in the ownership of a company's shares should automatically affect a prior subsidy to that company.

80. In conclusion, when faced with the question "who receives a subsidy," the Panel was not faced with a selection between two equally logical and orthodox alternatives – quite the opposite. The answer given by the United States is the plain meaning of the SCM Agreement, supported by the context of that Agreement, consistent with the laws governing economic organization in the advanced industrial world, consistent with the findings of the Appellate Body, and the only way that the Agreement can logically be interpreted. The answer invented by the EC and accepted by the Panel is contrary to the plain meaning and context of the Agreement, inconsistent with the

laws governing economic organization in all advanced industrial countries, contrary to the findings of the Appellate Body, and carries with it a number of absurd implications. In this situation, it was error for the Panel to find that the only permissible interpretation of the SCM Agreement was that subsidies are received by hybrid producer-shareholder entities, and not simply the companies upon which they are bestowed.

g. The EC, in applying its own CVD law, has recognized that subsidies are received by the companies upon which they are bestowed

81. In applying its own CVD law, the EC has often described subsidies as being received by the legal person upon whom they were bestowed – not some composite of that person together with its shareholders. Thus, in its final CVD determination on Rubber from Taiwan, the EC confirmed its preliminary findings concerning "the countervailable *subsidies* ***obtained by the exporting producers."***[78] In that preliminary determination, the EC had found a financial contribution "by the Government of Taiwan in the form of taxes forgone ***and a benefit accrue[d] to the recipient (i.e., the producer concerned)*** by not having to pay a certain amount of taxes."[79] In the case of a preferential loan, the EC also noted that, "a benefit [was] *conferred* ***on the recipient of the loan."***[80]

82. In a preliminary determination on wire from India and Korea, the EC noted that India's duty exemption scheme "conferr[ed] a benefit ***upon a company*** which can import goods free of

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[78] Council Regulation (EC) No. 1994/2000 of 18 September 2000, Imposing a Definitive Countervailing Duty and Definitively Collecting the Provisional Countervailing Duty Imposed on Imports of Styrene-Butadiene-Styrene Thermoplastic Rubber Originating in Taiwan, O.J.EUR.COMM. L/238/8 (2000), ¶ 13 (emphasis supplied).

[79] Council Regulation (EC) No. 1092/2000 of 24 May 2000 Imposing a Provisional Countervailing Duty on Imports of Styrene-Butadiene-Styrene Thermoplastic Rubber Originating in Taiwan, O.J.EUR.COMM. L/124/26 (2000) ¶27 (emphasis supplied).

[80] *Id.*, ¶¶ 36-41 (emphasis supplied).

customs duty."[81] In that same determination, the EC noted that a reduction in export duties benefitted the recipient by "lowering the duties payable or fully exempting ***him*** from paying the import duties."[82] Also in that determination, the EC noted that a preferential loan by the Korean Government constituted a "benefit ***to the company***" in the amount of the difference between the interest rate charged by the Korean Government and the commercial rate of interest[83]

83. Thus, outside the context of this proceeding, the EC has repeatedly referred to subsidies as being received by legal persons – the companies upon which the benefits were bestowed. This is hardly surprising – it is simply the ordinary usage of the words necessary to describe the transfer of a benefit from a government to a producer. This usage demonstrates that, outside the context of this dispute, the EC understands the import of the terms in Article 14 of the SCM Agreement in the same way as the United States.

3. The Panel Misread the Appellate Body's Findings in *Lead and Bismuth II*

84. The Panel read *Lead and Bismuth II (AB)* as standing for the proposition that, following the sale of British Steel's specialty steels division and formation of UES, USDOC was required to find that the financial contribution and benefit requirements were satisfied anew for UES (and BSplc), before imposing CVDs on steel produced by UES.[84] According to the Panel, this was not because the Appellate Body considered UES to be a distinct person upon whom subsidies had never been bestowed, but instead was because there had been a change in ownership for

[81] Council Regulation (EC) No. 618/1999 of 23 March 1999, Imposing a Provisional Countervailing Duty on Imports of Stainless Steel Wire Having a Diameter of 1 mm or More Originating in India and the Republic of Korea, O.J.EUR.COMM. L/79/25 (1999), ¶ 23 (emphasis supplied).

[82] *Id.*, ¶ 40 (emphasis supplied).

[83] *Id.*, ¶ 59.

[84] Panel Report, para. 7.67.

consideration.[85] Thus, according to the Panel, even if the Appellate Body had considered UES to be the same person as BSC, it still would have found UES to be free from subsidies. This is a misreading of the Appellate Body's findings.

85. As discussed above, *Lead and Bismuth II* involved large subsidies that the U.K. Government bestowed upon BSC in the 1970's and 1980's, followed by the sale of BSC's lead bar division, which was combined with a privately owned and unsubsidized lead bar operation to create a third entity – UES. Because UES was the producer and exporter of most of the lead bar upon which the CVDs were assessed that became the subject of the WTO inquiry, this discussion focuses on UES (rather than UES's successor in the specialty steels business, BS plc).[86] Also as noted above, under USDOC's "*gamma*" methodology for addressing changes in ownership, it did not matter whether BSC and UES were distinct legal persons. Consequently, USDOC had made no findings on this issue for the *U.S. - Lead and Bismuth II* Panel or Appellate Body to review.

86. The findings of the panel and the Appellate Body in *Lead and Bismuth II* shared the same basic premise – each treated the subsidy recipient (BSC) and the producer of the subject merchandise (UES) as distinct legal persons. Accordingly, both the panel and the Appellate Body insisted that the requirements of the SCM Agreement for imposing CVDs be satisfied anew for UES, and found that USDOC had failed to meet this requirement. Because USDOC had not satisfied this requirement, both the panel and the Appellate Body concluded that USDOC could not impose CVDs on steel produced by UES.

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[85] Panel Report, paras. 7.68, 7.70.

[86] The entries in question took place over three years. By the third year, UES had been acquired by British Steel, plc. (the successor to British Steel) and renamed British Steel Engineering Steels ("BSES"). In other words, the company that received the subsidies (BSC) and the producer of the merchandise facing duties (UES) were two distinct legal persons.

87. As we have noted, however, there was an important difference between the two reports. The panel based its conclusion on the finding that the change in ownership for consideration, *per se,* rendered the subsidy recipient (BSC) distinct from the company that produced the merchandise (UES).[87] Although the Appellate Body accepted the Panel's conclusion that British Steel and UES were distinct legal persons, it did *not* adopt the Panel's reason for reaching this conclusion. The Appellate Body simply stated that, given the changes in ownership leading to the creation of UES, USDOC was required to determine whether UES had itself received a financial contribution and benefit.[88] The Appellate Body did not identify the specific factors dictating that UES must be treated as a distinct legal person, and twice stated that its determination was based on "the particular circumstances of this case."[89]

88. That this key difference between the panel and Appellate Body reports was not an accident, but a deliberate omission, becomes especially obvious when the key passages of the two reports are compared. The panel's explanation of how the new entity was created was as follows:

> . . . We, however, are in no doubt that, for the purpose of determining "benefit", a clear distinction should be drawn between BSC, and UES and BSplc/BSES respectively. This is because ***the changes in ownership leading to the creation of UES and BSplc/BSES*** involved the payment of consideration for the productive assets etc. acquired by those entities from BSC.[90]

When the Appellate Body reached this same point, its explanation was notably different:

> . . . In this case, given ***the changes in ownership leading to the creation of UES and BSplc/BSES,*** the USDOC was required under Article 21.2 to examine, on the

[87] *Lead and Bismuth II (Panel)*, para. 6.70.
[88] *Lead and Bismuth II (AB)*, para. 62.
[89] *Id.*, paras. 64 and 75(b).
[90] *Lead and Bismuth II (Panel)*, para. 6.70 (italics and underscoring added).

basis of the information before it relating to these changes, whether a "benefit" accrued to UES and BSplc/BSES.[91]

89. The highlighted portions of the two passages are ***identical***. Thus, the Appellate Body began the key passage of its report with a direct quote from the corresponding paragraph of the panel's report. The use of the identical phrase can hardly have been a coincidence. After starting with that quoted phrase, however, the Appellate Body diverged sharply, as may be seen by comparing the underscored portions. Whereas the panel emphasized that the changes in ownership leading to the creation of new legal persons had "involved the payment of consideration" for assets, the Appellate Body simply stated that, "given" the creation of these new legal persons (who were the producers of the subject merchandise), USDOC was required to determine whether these new persons had received a benefit.[92]

90. The Appellate Body exercised greater judgment than the panel in limiting its findings to the facts before it. In the Appellate Body's view, the key fact was **not** that the new shareholders may have paid fair market value. The key fact was that the company under investigation (UES) was a different person from the subsidy recipient (British Steel). This is why the revised U.S. methodology, which focuses squarely on whether the producer of the subject merchandise is the same legal person upon whom the subsidies were bestowed, is perfectly consistent with the Appellate Body's findings.

[91] *Lead and Bismuth II (AB)*, para. 62 (italics and underscoring added).

[92] The payment of fair market value was no minor issue – it was one of the EC's central arguments in the proceeding. *Lead and Bismuth II (Panel)*, paras. 6.36, 6.89.

4. Article 27.13 of the SCM Agreement Provides Contextual Support for the Proposition that Subsidies May Remain Countervailable after the Recipient Has Been Privatized

91. Not only does the SCM Agreement *not* suggest that a mere change in ownership of a subsidized company terminates the countervailability of those subsidies, the only provision in the Agreement that actually addresses pre-privatization subsidies – Article 27.13 – provides contextual support for the U.S. argument that the general rule is that pre-privatization subsidies remain countervailable. Article 27.13 provides that:

> The provisions of Part III shall not apply to direct forgiveness of debts, subsidies to cover social costs, in whatever form . . . when such subsidies are granted within and directly linked to a privatization programme of a developing country Member, provided that both such programme and the subsidies involved are granted for a limited period and notified to the [SCM] Committee and that the programme results in eventual privatization of the enterprise concerned.

92. This provision creates an exception from Part III (on Actionable Subsidies) for certain types of subsidies provided by developing country Members in conjunction with privatization. Although Article 27.13 does not expressly state the general rule to which this exception applies, it strongly implies that there is a general rule that subsidies bestowed on a government-owned company prior to privatization *may be actionable after privatization*. Plainly, there would have been no need for such an exception if the general rule was that a change in ownership *automatically* cut off liability for pre-privatization subsidies *in every case.*[93]

93. In *Lead and Bismuth II (AB)*, the Appellate Body found that "nothing in

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[93] As previously noted by the Appellate Body, "[t]he principle of effective interpretation . . . reflects the general rule of interpretation which requires that a treaty be interpreted to give meaning and effect to all the terms of the treaty. For instance one provision should not be given an interpretation that will result in nullifying the effect of another provision of the same treaty." *Turkey – Restrictions on Imports of Textile and Clothing Products*, WT/DS34/AB/R, Report of the Appellate Body adopted 19 November 1999, footnote 327.

[Article 27.13] . . . supports the United States' position" that no determination of a benefit to the current producer had to be made following the change in ownership at issue there."[94] That statement does not diminish the importance of Article 27.13 in this proceeding. The Appellate Body based its finding on the understanding that a distinct new legal person was created in conjunction with the transactions in question. It then concluded that Article 27.13 did not support the United States' position that no new benefit determination need be made *with regard to that distinct new person*. That conclusion is not relevant here, where the current producer is exactly the same person upon which the subsidy was bestowed.

5. The Panel Drew the Wrong Conclusions from the U.S. Court Decisions Addressing Privatization, Which Concern a U.S. Statutory Provision With No Parallel in the SCM Agreement, Conflict With Each Other, and Are Subject to Appeal

94. The Panel cited decisions of the U.S. Court of International Trade and the Court of Appeals for the Federal Circuit in support of its reasoning.[95] These decisions do not support the Panel's conclusions for several reasons. First, the Federal Circuit decision in *Delverde III*[96] (like *Lead and Bismuth II (AB)*) is based on the assumption that the legal person producing the subject merchandise was completely distinct from the legal person that had received the subsidy. Second, both *Delverde III* and the adverse decisions of the Court of International Trade rest on the "change in ownership" provision of the U.S. statute, which has no corollary in the SCM Agreement. Third, there is now a split on that issue between the judges of the Court of International Trade, with the Chief Judge fully endorsing USDOC's reading of the U.S. statute.

[94] *Lead and Bismuth II (AB)*, paras. 59-60.
[95] Panel Report, paras. 7.79 and 7.150.
[96] *Delverde SrL v. United States*, 202 F.3d 1360 (Fed. Cir. 2000), Exhibit EC-5 ("*Delverde III*").

This split ultimately will have to be resolved by the Court of Appeals for the Federal Circuit. Until then, there is no clear precedent, even under U.S. law (which, in any event, is not the same as the SCM Agreement).

95. In *Delverde III*, the U.S. Court of Appeals for the Federal Circuit addressed the sale of assets from one private pasta producer (that had received government subsidies) to another private pasta producer. The Court understood the post-sale producer to be a completely distinct legal person from the subsidy recipient. The Court found that the new producer/exporter could not be held accountable for CVDs merely because "that person bought corporate assets from another person who was previously subsidized."[97] This understanding that the subsidy recipient and the producer of the merchandise were completely distinct legal persons was at the core of the Court's decision, and stands out in sharp contrast to the situation in AST, where the very same person that received the subsidy produced the subject merchandise.

96. In addition to being based on very different facts, than AST, *Delverde* relied upon a special provision in the U.S. statute which addresses changes in ownership.[98] The Court explicitly "read[] this provision together with [the financial contribution and benefit requirements]" to reach its conclusion.[99] Because of the Court's reliance upon a statutory

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[97] *Delverde*, 202 F.3d at 1366.

[98] This provision, 19 U.S.C. §1677(5)(F), provides as follows:

> A change in ownership of all or part of a foreign enterprise or the productive assets of a foreign enterprise does not by itself require a determination by the administering authority that a past countervailable subsidy received by the enterprise no longer continues to be countervailable, even if the change in ownership is accomplished through an arm's length transaction.

[99] *Delverde*, 202 F.3d at 1366.

provision with no corresponding provision in the SCM Agreement, *Delverde III* provides no reliable guidance on the question before the Appellate Body.

97. The recent decisions of the Court of International Trade opposed to Commerce's new privatization methodology are based on the change-in-ownership provision and on the Federal Circuit's application of that provision to the facts of that case. In the case cited by the Panel (*GTS Industries*), the Court of International Trade, after noting that "the *Delverde* decision assumed the sale of assets from one private company to another,"[100] ruled that *Delverde* interpreted the *change-in-ownership provision* as "requiring Commerce to determine if the subsidy continued to benefit the post-privatized corporation."[101]

98. In addition to these deficiencies of the U.S. Court decisions as guidance on the issue before the Appellate Body, there is now a conflict in the Court of International Trade concerning the validity of USDOC's new change-in-ownership methodology under the U.S. statute. In a recent decision involving the precise facts in this proceeding (the AST privatization), the Chief Judge of the court recently upheld USDOC's new privatization methodology in its entirety, concluding that "[i]t is reasonable to consider criteria developed in the corporate context for determining whether a company that has undergone a change in ownership carries on substantially the same business after the change in ownership and therefore remains responsible for previously incurred liabilities."[102] The Chief Judge expressly found that USDOC's

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[100] *GTS Industries v. United States*, 182 F. Supp. 2d 1369, 1376 (Ct. Int'l. Trade 2002).

[101] *GTS Industries v. United States*, 182 F. Supp. 2d at 1378. The other decisions of the Court of International Trade that agree with *GTS Industries* are: *Acciai Speciali Terni v. United States*, Court N. 99-06-00364 (Ct. Int'l Trade 1 February 2002), *Allegheny Ludlum Corp. v. United States,* 182 F. Supp. 2d 1357 (Ct. Int'l. Trade 2002), and *Ilva Lamiere E Tubi S.R.L. v. United States*, 196 F.Supp.2d 1347 (Ct. Int'l Trade 2002).

[102] *Acciali Speciali Terni v. United States*, Court No. 01-00051 (Ct. Int'l Trade, 4 June 2002).

methodology for determining whether a subsidy continues to benefit a producer following a change in ownership was not inconsistent with the Appellate Body's finding in *Lead and Bismuth II (AB)*, given that both cases are limited to their unique facts and that the facts involved in *Lead and Bismuth II* are "clearly distinguishable" from the facts presented in the GOES case.[103]

6. Companies (Such as AST) That Have Received Both a Financial Contribution and a Benefit May be Subject to CVDs Consistent With the SCM Agreement Regardless of Whether Their Shareholders Have Changed

99. The nature of countervailable benefits is made plain by Articles 1 and 14 of the SCM Agreement. A countervailable benefit is that part of a financial contribution that is obtained on terms more generous than those which the recipient could have obtained commercially. Once identified and valued, countervailable benefits are simply fixed sums of money that may be amortized over reasonable schedules. In order to impose CVDs to offset such benefits, there is no requirement to analyze whether the recipients succeed in "enjoying" the benefits or whether their shareholders reap additional profits. These requirements are not found in the SCM Agreement.

100. Because countervailable benefits are simply fixed amounts of money, the method by which they may be terminated is straightforward — the recipient must pay back any amount that has not been amortized.[104] The United States agrees that such a repayment could occur in conjunction with a change in ownership and, under its new methodology, investigates any claim

[103] *Id.*, p. 20.

[104] This is not to say that all countervailable benefits are received in the form of cash. However, the value of a countervailable benefit is measured in terms of money, and thereby reduced to money.

that such a repayment has occurred (along with its basic inquiry into whether the producer of the subject merchandise is a different person from the subsidy recipient).

101. Because the SCM Agreement does not require that a subsidy has any particular effect upon its recipient in the first place in order to be countervailable (or provide any means for attempting to measure such an effect) the SCM Agreement does not require investigating authorities to re-value subsidies following events that arguably reduce (or increase) the competitive benefit to be derived from them. To insinuate such a requirement is to confuse the countervailable subsidy with the effect of the subsidy. If the SCM Agreement required investigating authorities to measure the effect of subsidies as a condition of imposing CVDs, it surely would have furnished some mechanism by which such a complex estimate might be attempted. It does not.

102. Thus, the SCM Agreement provides no basis for concluding that a change in the shareholders of a subsidy recipient (for fair market value or otherwise) *automatically* eliminates the benefit conferred on the company. The Panel's report reaching the opposite conclusion must be reversed.

III. THE PANEL ERRED IN FINDING THAT SECTION 1677(5)(F) IS INCONSISTENT WITH U.S. WTO OBLIGATIONS

103. In addition to its claims regarding the twelve specific U.S. countervailing duty determinations, the EC also claimed that a provision of the U.S. countervailing duty statute was inconsistent with U.S. WTO obligations. The provision in question is Section 1677(5)(F), which was added to the countervailing duty statute in 1994 as part of the Uruguay Round Agreements

Act.[105] Section 1677(5)(F) addresses the issue of changes in the ownership of subsidized companies, and provides as follows:

> A change in ownership of all or part of a foreign enterprise or the productive assets of a foreign enterprise does not by itself require a determination by the administering authority that a past countervailable subsidy received by the enterprise no longer continues to be countervailable, even if the change in ownership is accomplished through an arm's-length transaction.

104. Of course, the Panel's findings concerning the statutory provision were wholly derivative of its findings on the fundamental issue presented in this dispute: whether a sale of outstanding common stock, *whether or not* it occurs at fair market value, automatically changes the subsidy recipient (the stock issuer) into a new person that can no longer be charged with having received previously-bestowed subsidies. A reversal of the Panel on that basic issue would also mean reversal of the findings against Section 1677(5)(F). However, the findings against the statutory provision are invalid for several other reasons as well.

105. The Panel correctly recalled that, in order to successfully challenge the WTO-consistency of a statute, as such, the complainant must demonstrate, and the Panel must find, that the statute in question requires authorities to act in a WTO-inconsistent manner or, put another way, that the statute precludes authorities from acting in a WTO-consistent manner.[106] Given that the Panel already had found (albeit incorrectly) that the sale of a subsidized firm at arm's-length and for fair market value extinguishes pre-privatization subsidies, the question before the Panel was whether Section 1677(5)(F) required the United States to act in a WTO-inconsistent manner.

[105] Technically, the provision is section 771(5)(F) of the Tariff Act of 1930, as amended, which, for purposes of the United States Code, is codified as 19 U.S.C. 1677(5)(F). To avoid confusion, we will use the Panel's designation of "Section 1677(5)(F)".

[106] *See* Panel Report, paras. 7.120-7.122 and reports cited therein.

106. The Panel failed to follow the standard that it had correctly articulated, however. Instead of considering whether Section 1677(5)(F) precluded the DOC from reaching WTO-consistent results in actual cases, the Panel said the question was whether Section 1677(5)(F) "would allow the United States to systematically conclude" that subsidies are "automatically" extinguished in the event of a sale that is at arm's-length and for fair market value.[107] The articulation and application by the Panel of this incorrect standard constituted legal error and the Panel's conclusion that Section 1677(5)(F) is inconsistent with the WTO should be reversed.

A. The Panel Applied the Wrong Legal Standard in Assessing the WTO-Consistency of Section 1677(5)(F)

107. The Panel began its analysis of the WTO-consistency of Section 1677(5)(F) by accurately noting that "[o]nly legislation that 'requires' a violation of GATT/WTO rules can be found to be inconsistent with WTO rules."[108] Recognizing the traditional GATT/WTO distinction between mandatory and discretionary legislation, the Panel cited three recent panel reports for the proposition that "legislation 'as such' is considered mandatory if it cannot be applied in a manner consistent with the SCM Agreement."[109]

108. Notwithstanding this correct description of the traditional GATT/WTO approach, several paragraphs later the Panel articulated a different standard. The Panel said that it is not enough that legislation does not preclude authorities from reaching WTO-consistent results in actual cases. Instead, according to the Panel, legislation is WTO-inconsistent if it does not

[107] Panel Report, paras. 7.132, 7.152, 7.156.
[108] Panel Report, para. 7.120.
[109] Panel Report, para. 7.121.

"systematically" allow for WTO-consistent results in actual cases,[110] or if it does not "automatically" reach a particular result.[111]

109. Nowhere in the report did the Panel justify its new standard or explain the textual basis for it. This is because there is no basis for such a standard. Nothing in the SCM Agreement requires Members to adopt *per se* rules in their domestic legislation that provide for "systematically" reaching conclusions considered to be correct by a panel. By imposing such a requirement, the Panel added to the obligations of Members in contravention of Articles 3.2 and 19.2 of the DSU.

110. Indeed, the Panel itself found that Section 1677(5)(F) does not provide a *per se* rule that subsidies are not extinguished by an arm's-length sale at fair market value. Thus, the Panel found nothing to prevent the United States from making a case-by-case finding that subsidies are extinguished in such a situation. The statute provides sufficient discretion to permit the United States to make findings case-by-case that are consistent with the WTO. The burden was on the EC to demonstrate that Section 1677(5)(F) required the United States to act in a WTO-inconsistent manner. The EC failed to meet that burden – it did not demonstrate where the United States lacked the discretion to make findings consistent with the WTO. What basis then was there for the Panel to impose the additional requirement that a Member's laws must require "systematic" or "automatic" findings?

111. This new obligation could have perverse, unintended consequences. For example, a Member might maintain a generally-worded statute which it applies to imports from both WTO

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[110] *See, e.g.,* Panel Report, paras. 7.132, 7.140 and 8.1(d).
[111] Panel Report, para. 7.152.

Members and non-WTO Members. Because the statute is generally worded, the importing Member has the discretion to reach WTO-consistent results in the case of imports from WTO Members, and, in the case of imports from non-WTO Members, results that would be considered WTO-inconsistent if applied to a WTO Member. Under the Panel's standard, however, the maintenance of such a statute would be problematic, because the statute would not "systematically" provide for WTO-consistent results. A similar problem would exist for those Members under whose legal systems the WTO agreements are directly incorporated into domestic law.

112. In conclusion, the correct legal standard for judging the WTO-consistency of legislation as such is whether the legislation mandates WTO-inconsistent action or, put differently, precludes WTO-consistent action. The Panel erred by failing to apply this standard. For this reason, the Panel's finding that Section 1677(5)(F) is WTO-inconsistent is in error and should be reversed.

B. In Ascertaining the Meaning of Section 1677(5)(F), the Panel Failed to Make an Objective Assessment Within the Meaning of Article 11 of the DSU

113. The use of the wrong legal standard is sufficient to reverse the Panel's finding of a WTO-inconsistency. The United States would note in addition, however, that having identified an incorrect legal standard, the Panel then attempted to apply this incorrect standard to the facts by ascertaining the meaning of Section 1677(5)(F).[112] In so doing, the Panel committed two additional errors. First, the Panel failed to perform an objective assessment of the matter as

[112] The Panel said that ascertaining the meaning of municipal law poses a question of fact, *see* Panel Report, para. 7.125, and the United States proceeds on that basis.

required by Article 11 of the DSU, and, as a result, failed to find that the *Delverde III* opinion – on which the Panel relied – is ambiguous. This failure to recognize the ambiguous nature of the *Delverde III* opinion, in turn, caused the Panel to erroneously find that Section 1677(5)(F) is mandatory legislation that violates U.S. WTO obligations.

114. Turning first to the Panel's failure to perform an objective assessment, in *EC Hormones*, the Appellate Body summarized the obligation imposed on panels by Article 11, in pertinent part, as follows:

> The duty to make an objective assessment of the facts is, among other things, an obligation to consider the evidence presented to a panel and to make factual findings on the basis of that evidence. The deliberate disregard of, or refusal to consider, the evidence submitted to a panel is incompatible with a panel's duty to make an objective assessment of the facts.[113]

For the reasons set forth below, the Panel violated this obligation.

115. To begin with, in questions issued following the first meeting with the Panel, the Panel asked the United States whether Section 1677(5)(F) would permit a methodology under which the sale of a government-owned firm at arm's length and for fair market value means that the privatized firm cannot be considered to benefit from pre-privatization subsidies. The United States replied to this question as follows:

> As we explained in our brief and during our oral presentation, the change-in-ownership provision provides DOC with the discretion to evaluate each change-in-ownership situation on its own merits. If an evaluation of all the facts and circumstances of a particular privatization or a change in ownership warrants a finding that as a result of an arm's length, fair market value privatization the post-sale company does not enjoy a benefit from past subsidies, then such a finding can be made. There is nothing in the language of the change-in-ownership provision,

[113] *European Communities - Measures Concerning Meat and Meat Products (Hormones)*, WT/DS26/AB/R, WT/DS48/AB/R, Report of the Appellate Body adopted 13 February 1998, para. 133.

> or in the legislative history of that provision which would prevent DOC from making such a finding. Accordingly, section 1677(5)(F) would permit DOC to make a finding that a sale of a State-owned company for fair market value and at arm's length would not result in a benefit to the privatized company.[114]

116. At the second meeting with the Panel, the Panel asked a similar question, although this time it added the concept of a methodology "systematically" resulting in the proper conclusions. Again, the United States answered that the DOC "could comply with such findings within the parameters of the existing Section 1677(5)(F)."[115]

117. Thus, the United States told the Panel at least two times that if the Panel were to interpret the SCM Agreement so as to require the EC's preferred outcome, the United States could issue CVD determinations consistent with such an interpretation without having to amend Section 1677(5)(F). However, notwithstanding the principle that a "Member can reasonably expect that considerable deference be given to its views on the meaning of its own law",[116] and notwithstanding the fact that the Panel itself found that "the plain wording of Section 1677(5)(F) . . . does not require a violation of the SCM Agreement",[117] the Panel proceeded to find Section 1677(5)(F) to be WTO-inconsistent. It did so primarily by misreading the opinion of the U.S. Court of Appeals for the Federal Circuit in the so-called *Delverde III* case.[118]

118. In *Delverde III*, the issue before the Federal Circuit was whether a determination based upon the "*gamma* methodology" previously used by the DOC was lawful under the U.S. CVD

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[114] *U.S. Replies to Questions from the Panel* (4 March 2002), para. 65.

[115] Panel Report, para. 7.155.

[116] *United States - Sections 301-310 of the Trade Act of 1974*, WT/DS152/R, Report of the Panel adopted 27 January 2000, para. 7.19.

[117] Panel Report, para. 7.156.

[118] The full name of the case is *Delverde, Srl v. United States*, 202 F.3rd 1360 (2000), submitted as Exhibit EC-5.

statute. The court concluded that it was not because the DOC had "conclusively presumed that Delverde received a subsidy from the Italian government . . . simply because it bought assets from another person who earlier received subsidies."[119] In addition, with respect to Section 1677(5)(F), the court stated that:

> [Section 1677(5)(F)] clearly states that a subsidy cannot be concluded to have been extinguished solely by an arm's length change of ownership. However, it is also clear that Congress did not intend the opposite, that a change in ownership always requires a determination that a past countervailable subsidy continues to be countervailable, regardless whether the change of ownership is accomplished through an arm's length transaction or not. If that had been Congress's intent, the statute would have so stated. Rather, the Change of Ownership provision simply prohibits a per se rule either way.[120]

119. The main reason why its was error to draw broad conclusions (as the Panel did) from the *Delverde III* decision about the meaning of Section 1677(5)(F) is that the appellate court had before it in that case a set of very peculiar facts, unlike those presented in the vast majority of change-in-ownership cases (and those presented in the 12 determinations at issue in this dispute). The *Delverde III* court understood the key transaction before it involved a purchase of assets ***from*** a subsidized company, and not a change in the ownership ***of*** a subsidized company. The purchaser was therefore by definition a person separate from the subsidy recipient (the seller), and the only subsidy it could possibly have received would have been a new subsidy obtained by buying the assets at a price below their market value. That was the context in which the court made all of its comments on Section 1677(5)(F). The court's decision was necessarily driven by (and as a matter of U.S. law, its holding was limited to) the particular facts presented. Anything

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[119] *Delverde III*, 202 F.3d at 1367.
[120] *Id.*, at 1366.

else in the opinion, including any discussion of how Section 1677(5)(F) might apply in the very different circumstances of a change in the ownership ***of*** a subsidy recipient (such as through a stock sale) is *obiter dicta*.

120. There is an additional source of ambiguity arising from *Delverde III*. According to the Panel, the court used the terms "arm's-length transaction" and "fair market value" interchangeably.[121] From this, as well as from the court's reference to *per se* rules, the Panel then concluded that the court had found that "Section 1677(5)(F) prevents a *per se* rule that privatization at arm's-length and for fair market value extinguishes the benefit *vis-a-vis* the privatized producer."[122]

121. However, a statement by the court later on in its opinion undermines the Panel's conclusion that the court considered the terms "arm's-length transactions" and "fair market value" to be interchangeable and that the court considered a methodology which focused on the existence or absence of fair market value to be an impermissible *per se* rule. In describing what the DOC should have done, the court stated as follows:

> Had Commerce fully examined the facts, it might have found that Delverde paid full value for the assets and thus received no benefit from the prior owner's subsidies, or Commerce might have found that Delverde did not pay full value and thus did indirectly receive a "financial contribution" and a "benefit" from the government by purchasing its assets from a subsidized company "for less than adequate remuneration.[123]

This passage suggests that, in the court's view, while the fact of an arm's-length sale of assets may not be enough to warrant a finding that a firm no longer benefits from a prior owner's

[121] Panel Report, para. 7.148.
[122] Panel Report, para. 7.149.
[123] *Delverde III*, 202 F.3d at 1368.

subsidies, that fact coupled with the payment of what the court called "full value" would be enough to warrant such a finding.[124] At a minimum, this passage renders the court's opinion ambiguous.[125]

122. In its comments on the Panel's interim report, the United States expressly noted that the Panel appeared to have overlooked this portion of the court's opinion.[126] However, neither in the "Interim Review" section nor in the "Findings" section did the Panel even mention – let alone discuss – this portion of the court's opinion.[127] Thus, the Panel appears to have deliberately disregarded, or refused to consider, evidence submitted to it. Consistent with the Appellate Body's findings in *EC Hormones*, the Panel thereby violated its duty under Article 11 of the DSU to make an objective assessment of the facts.

123. The Panel stated that "the current state of the law in the United States today is that expressed by the US Court of Appeals for the Federal Circuit in *Delverde III*."[128] That being the case, the Panel should have found that the current state of the law in the United States is unclear

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[124] The court appeared to use "full value" as a synonym for "fair market value."

In this regard, the United States notes that the court referenced its own earlier decision in *British Steel plc v. United States*, 127 F.3d 1471 (Fed. Cir. 1997). In that case, the Federal Circuit reviewed a decision by the U.S. Court of International Trade ("CIT") in which the DOC argued, and the CIT found, that a privatization transaction was at "arm's length" but not for "fair market value". *British Steel plc v. United States*, 924 F. Supp. 139 (Ct. Int'l Trade 1996). Interestingly, the CIT judge in that case was the same judge who wrote the opinion in *Saarstahl I*, an opinion which the Panel appears to have regarded as having treated the concepts of "arm's-length transaction" and "fair market value" interchangeably. Panel Report, ¶ 7.142.

[125] Indeed, as discussed above, the judges on the U.S. Court of International Trade currently disagree on the interpretation of *Delverde III*. The judge in the *GTS Industries* and *Allegheny Ludlum* cases, for example, appears to read *Delverde III* as applying broadly to all change-in-ownership transactions, while the Chief Judge appears to read the decision more narrowly.

[126] *Request by the United States for Interim Review* (27 May 2002), para. 45.

[127] The Panel also ignored the court's statement that it considered the findings of the panel in *Lead & Bismuth II* to be "not inconsistent with our holding." *Delverde III*, 202 F.3d at 1369. Given the Panel's own heavy reliance on the panel report in that case, the Panel's interpretation of *Delverde III* as requiring a WTO-inconsistent result is all the mor puzzling.

[128] Panel Report, para. 7.150.

insofar as the meaning of Section 1677(5)(F) is concerned. As noted above, the Panel itself acknowledged that the plain text of Section 1677(5)(F) did not mandate WTO-inconsistent behavior. For the reasons set forth above, *Delverde III*, properly interpreted, cannot be said to unambiguously require that the statute be applied so as to generate results considered WTO-inconsistent by the Panel.

124. A similar situation arose in the *US Tobacco* dispute. In that dispute, the panel found that the word "comparable," as used in the U.S. legislation at issue, was ambiguous and susceptible to a range of meanings.[129] As a result of that finding, the panel concluded that it had not been demonstrated that the legislation could not be applied in a GATT-consistent manner.[130] Such an approach is consistent with the proposition that one should not presume that a WTO Member will act in violation of its WTO obligations.[131]

125. In this case, instead of presuming that the United States would exercise its discretion under Section 1677(5)(F) in a WTO-inconsistent manner, the Panel should have found that the EC had failed to demonstrate that Section 1677(5)(F) is WTO-inconsistent.

IV. CONCLUSION

126. For the foregoing reasons, the United States requests that the Appellate Body reverse the following findings by the Panel:

(a) The Panel's finding - set forth in paragraph 8.1(a) of the Panel Report - that the six determinations in the original investigations, based on the *gamma* methodology (cases nos. 1

[129] *United States - Measures Affecting the Importation, Internal Sale, and Use of Tobacco*, DS44/R, BISD 41S/131, Report of the Panel adopted 4 October 1994, para. 123.

[130] *Id.*

[131] *Chile - Taxes on Alcoholic Beverages*, WT/DS87/AB/R, WT/DS110/AB/R, Report of the Appellate Body adopted 12 January 2000, para. 74.

- 6), are inconsistent with the SCM Agreement*, to the extent that* these findings rely upon the conclusion that a change in ownership automatically creates a "new privatized producer" that is a different legal person from the subsidy recipient and that the payment of fair market value for a company's shares negates previous subsidies provided to that company.

(b) The Panel's finding - set forth in paragraph 8.1(b) of the Panel Report - that the determination made in the context of an administrative review, based on the *gamma* methodology (case no. 7), is inconsistent with the SCM Agreement, *to the extent that* this finding relies upon the conclusion that a change in ownership automatically creates a "new privatized producer" that is a different legal person from the subsidy recipient and that the payment of fair market value for a company's shares negates previous subsidies provided to that company.

(c) The Panel's finding - set forth in paragraph 8.1(b) of the Panel Report - that the determination made in the context of an administrative review based on the same person methodology (case no. 12) is inconsistent with the SCM Agreement.

(d) The Panel's finding - set forth in paragraph 8.1(c) of the Panel's report - that the four administrative determinations made in the context of sunset reviews, based on the *gamma* methodology (cases nos. 8 - 11)) are inconsistent with the SCM Agreement, *to the extent that* these findings rely upon the conclusion that a change in ownership automatically creates a "new privatized producer" that is a different legal person from the subsidy recipient and that the payment of fair market value for a company's shares negates previous subsidies provided to that company.

(e) The Panel's finding - set forth in paragraph 8.1(d) of the Panel's report - that the "change-in-ownership" provision of the U.S. CVD law, 19 U.S.C. § 1677(5)(F), is inconsistent

with Articles 10, 14, 19 and 21 of the SCM Agreement and, for that reason, is not in conformity with Article 32.5 of the SCM Agreement and Article XVI:4 of the WTO Agreement.

BEFORE THE
WORLD TRADE ORGANIZATION
APPELLATE BODY

United States - Countervailing Measures Concerning Certain Products from the European Communities

(AB-2002-5)

EXECUTIVE SUMMARY OF THE APPELLANT'S SUBMISSION OF THE UNITED STATES OF AMERICA

September 19, 2002

I. THE PANEL ERRED IN FINDING USDOC'S REVISED PRIVATIZATION METHODOLOGY TO BE INCONSISTENT WITH THE SCM AGREEMENT

A. Background

1. In *Lead and Bismuth II*, the Appellate Body found that subsidies are received by the legal persons upon whom they are bestowed. Subsequently, USDOC revised its change-in-ownership methodology. Consistent with the Appellate Body's finding, if the producer of the subject merchandise was the same person that received the subsidy, then USDOC would conclude that it retained the subsidy and remained subject to CVDs, pending full amortization. If the producer of the subject merchandise was a different person from the subsidy recipient, USDOC would conclude that the new producer never received that subsidy and could not be subject to CVDs on its account. In order to determine whether a producer of subject merchandise and a subsidy recipient should be treated as the same person, USDOC developed a test informed by upon the basic principles of corporate law in the United States and other countries that govern these determinations in every other context.

2. The first instance in which USDOC applied its new methodology was an administrative review of the CVD order on grain-oriented electrical steel ("GOES") from Italy. USDOC found that all important aspects of AST's business remained essentially unchanged before and after the sale to KAI, and accordingly, found AST to be the same person both before and after the sale. Therefore, the subsidies that the Italian Government had bestowed upon AST before the sale remained attributable to AST following the sale.

3. Several of the privatizations to which USDOC applied its new methodology were very similar to the privatization of AST and, therefore, produced the same result. Two more recent determinations, however, involved different situations and produced different results. These two

determinations confirm that USDOC's new methodology does not always result in a finding that subsidies remain countervailable following a change in ownership. Rather, USDOC's new methodology simply applies the principles announced by the Appellate Body to the facts of each case.

4. Despite acknowledging that subsidies are received by legal or natural persons, the Panel found that subsidies are received by entities that include *both* the legal person upon whom the subsidy is, in fact, bestowed and the shareholder(s) of that person. The Panel found that the sale of a company's shares, by changing the company-shareholder mix, creates a new and different entity, which the Panel named the "new privatized producer." Having defined the new "producer" as distinct from the "producer" that received the subsidies, the Panel unavoidably concluded that the new "producer" could not be held accountable for the subsidies received by the other "producer."

B. The Panel's Errors

5. The Panel's error was to consider the economic effects of a sale from the perspective of *the new shareholders*, rather than that of *the legal person producing the subject merchandise,* or the parties injured by the subsidized imports in question. This led the panel to conclude that the privatization eliminated the effect of the subsidy, when it did nothing of the kind. Subsidies shift the recipient's supply curve and, as a result, also change the point at which supply and demand for the products made by the recipient intersect in the market place. A subsequent privatization does not move the supply curve back to where it had been, and thus, from the perspective of the recipient firm (and its competitors) does not affect the continued existence of the subsidy. The

fact that a government may own the recipient company's shares one day and private parties own them the next is immaterial to the economic analysis.

6. The ordinary meaning of subsidy "recipient" is the legal (or natural) ***person*** upon whom the subsidy is bestowed. Consequently, construing "recipient" to include both this person *and also* its shareholder (or shareholders) does violence to its ordinary meaning. The ordinary meaning of the SCM Agreement is confirmed by the context in which the term subsidy "recipient" is used and referred to. Article 1 defines "financial contributions" to include direct transfers of funds (such as grants, loans, and equity infusions), revenue forgone, and the provision of goods and services. Each of these listed items indicates a contribution from a government to a legal person who is the producer and subsidy recipient. Article 14 provides additional context by explaining methods of valuing the "benefit to the recipient."

7. The Panel's conclusion that the WTO Members rejected the normal distinction between shareholders and companies in drafting the SCM Agreement is completely unsupported. The Panel effectively has given the terms of the SCM Agreement a special meaning without satisfying the requirements of the customary rule of interpretation reflected in Article 31(4) of the Vienna Convention.

8. The Appellate Body found in *Canada Aircraft* and *Lead and Bismuth II* that subsidies are received by legal or natural persons. The Panel's "answer" to the Appellate Body was nothing more than the statement that, although subsidies are received by legal persons under the SCM Agreement, they should be treated as if they were not.

9. The Panel adopted the conclusion of the *Lead and Bismuth II* panel (but not the Appellate Body) that there is no distinction between a company and its shareholders under the SCM

Agreement because shareholders have a claim on the earnings of a company. This conclusion is supported by two speculations that, particularly in the context of the steel industry, are dubious. First, the Panel states that there should be no distinction between the advantage or benefit conferred by the financial contribution to the company or to the shareholders, i.e. the owners of the company. The fact is that subsidies are, by definition, investments that the market would not have made (so that the government had to step in to supply the investment). Accordingly, there is *every* reason to assume that they are simply *bad* investments - - investments that do not raise the value of a company's shares by the full amount invested, because they do not increase the expected earnings of the company sufficiently. Secondly, the Panel quotes with approval the conclusion of the panel in *Lead and Bismuth II*, that "the [new] owners' investment in the privatized company will be recouped through the privatized company providing its shareholders a market return on the full amount of their investment." This is *pure* speculation. The ability of the new shareholders to obtain a market return on their investment depends on the market price of steel, the future performance of the managers and the employees, and the behavior of the other firms in the market, which no shareholders are in a position to control. Thus, the actual return on the new shareholders' investment in the company's shares cannot be known in advance.

10. The arguments supporting the conclusion that subsidies are received by the legal persons upon whom they are bestowed are reinforced by simple logic. Governments subsidize producers, not their shareholders. One entity must be accountable for the money, must reflect the benefit on its financial statements, and must be responsible for repayment (to the extent that repayment is required). The Panel's position also creates an additional logical problem: If a complete change

in the ownership of a subsidy recipient automatically extinguishes those subsidies, then it would follow logically that a partial change in ownership would partially extinguish those subsidies.

11. In applying its own CVD law, the EC has often described subsidies as being received by the legal person upon whom they were bestowed – not some composite of that person together with its shareholders.

12. The Panel misread the reports in *Lead and Bismuth II*. There was an important difference between the panel and Appellate Body reports. Although the Appellate Body accepted the Panel's conclusion that British Steel and UES were distinct legal persons, it did *not* adopt the Panel's reason for reaching this conclusion. The Appellate Body simply stated that, given the changes in ownership leading to the creation of UES, USDOC was required to determine whether UES had itself received a financial contribution and benefit. The Appellate Body did not identify the specific factors dictating that UES must be treated as a distinct legal person, and twice stated that its determination was based on "the particular circumstances of this case."

13. Not only does the SCM Agreement *not* suggest that a mere change in ownership of a subsidized company terminates the countervailability of those subsidies, the only provision in the Agreement that actually addresses pre-privatization subsidies – Article 27.13 – provides contextual support for the United States' argument that the general rule is that pre-privatization subsidies remain countervailable. Although Article 27.13 does not expressly state the general rule to which this exception applies, it strongly implies that there is a general rule that subsidies bestowed on a government-owned company prior to privatization *may be actionable after privatization*. Plainly, there would have been no need for such an exception if the general rule

was that a change in ownership *automatically* cut off liability for pre-privatization subsidies *in every case.*

14. The Panel cited decisions of the U.S. Court of International Trade and the Court of Appeals for the Federal Circuit in support of its reasoning. These decisions do not support the Panel's conclusions for several reasons. First, in *Delverde*, the U.S. Court of Appeals for the Federal Circuit addressed the sale of assets from one private pasta producer (that had received government subsidies) to another private pasta producer. The Court understood the post-sale producer to be a completely distinct legal person from the subsidy recipient. In addition to being based on very different facts, than AST, *Delverde* relied upon a special provision in the U.S. statute which addresses changes in ownership. The Court explicitly "read[] this provision together with [the financial contribution and benefit requirements]" to reach its conclusion. The recent decisions of the Court of International Trade opposed to Commerce's new privatization methodology are based on the change-in-ownership provision and on *Delverde's* application of that provision to the facts of that case. In the case cited by the Panel (*GTS Industries*), the Court of International Trade, after noting that "the *Delverde* decision assumed the sale of assets from one private company to another," ruled that *Delverde* interpreted the *change-in-ownership provision* as "requiring Commerce to determine if the subsidy continued to benefit the post-privatized corporation."

15. In addition to these deficiencies of the U.S. Court decisions as guidance on the issue before the Appellate Body, there is now a conflict in the Court of International Trade concerning the validity of USDOC's new change-in-ownership methodology with the U.S. statute. In a recent decision involving the precise facts in this proceeding (the AST privatization), the Chief

Judge of the court recently upheld USDOC's new privatization methodology in its entirety, concluding that "[i]t is reasonable to consider criteria developed in the corporate context for determining whether a company that has undergone a change in ownership carries on substantially the same business after the change in ownership and therefore remains responsible for previously incurred liabilities."

16. The nature of countervailable benefits is made plain by Articles 1 and 14 of the SCM Agreement. A countervailable benefit is that part of a financial contribution that is obtained on terms more generous than those which the recipient could have obtained commercially. Once identified and valued, countervailable benefits are simply fixed sums of money that may be amortized over reasonable schedules. In order to impose CVDs to offset such benefits, there is no requirement to analyze whether the recipients succeed in "enjoying" the benefits or whether their shareholders reap additional profits. These concepts are not found in the SCM Agreement.

17. Because countervailable benefits are simply fixed amounts of money that create potential liabilities under the SCM Agreement, the method by which they may be terminated is straightforward — the recipient must pay back any amount that has not been amortized. The United States agrees that such a repayment could occur in conjunction with a change in ownership and, under its new methodology, investigates any claim that such a repayment has occurred (along with its basic inquiry into whether the producer of the subject merchandise is a different person from the subsidy recipient).

18. Thus, the SCM Agreement provides no basis for concluding that a change in the shareholders of a subsidy recipient (for fair market value or otherwise) *automatically* eliminates

the benefit conferred on the company. The Panel's report reaching the opposite conclusion must be reversed.

II. THE PANEL ERRED IN FINDING THAT SECTION 1677(5)(F) IS INCONSISTENT WITH U.S. WTO OBLIGATIONS

19. According to the Panel, legislation is WTO-inconsistent if it does not "systematically" allow for WTO-consistent results in actual cases, or if it does not "automatically" reach a particular result. However, the correct legal standard for judging the WTO-consistency of legislation as such is whether the legislation mandates WTO-inconsistent action or, put differently, precludes WTO-consistent action. The Panel erred by failing to apply this standard. For this reason, the Panel's finding that Section 1677(5)(F) is WTO-inconsistent is in error and should be reversed.

20. Having identified an incorrect legal standard, the Panel then attempted to apply this incorrect standard to the facts by ascertaining the meaning of Section 1677(5)(F). In so doing, the Panel committed two additional errors. First, the Panel failed to perform an objective assessment of the matter as required by Article 11 of the DSU, and, as a result, failed to find that the *Delverde III* opinion – on which the Panel relied – is ambiguous. This failure to recognize the ambiguous nature of the *Delverde III* opinion, in turn, caused the Panel to erroneously find that Section 1677(5)(F) is mandatory legislation that violates U.S. WTO obligations.