

NORTH AMERICAN FREE TRADE AGREEMENT
ARTICLE 1904 BINATIONAL PANEL REVIEW
USA-97-1904-03

In the matter of:

CORROSION-RESISTANT CARBON
STEEL FLAT PRODUCTS
FROM CANADA

Before:

Howard N. Fenton, III
(chairperson)
William E. Code, Q.C.
Lisa B. Koteen
Shawna Vogel
Gilbert R. Winham

DECISION OF THE PANEL

Appearances:

For Stelco, Inc.: Willkie Farr & Gallagher (Christopher Dunn and Daniel L. Porter).

For the U.S. Department of Commerce: Office of Chief Counsel for Import Administration (Dean A. Pinkert).

For Certain United States Steel Producers: Skadden, Arps, Slate, Meagher & Flom LLP (Ellen J. Schneider).

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I. INTRODUCTION

This Binational Panel (“Panel”) was constituted pursuant to Article 1904 of the North American Free Trade Agreement to review the decision by the United States Department of Commerce, International Trade Administration (“Commerce”) regarding Commerce’s valuation of Stelco’s input prices in accordance with Commerce’s second administrative review of Stelco’s antidumping order.¹ Supporting Commerce’s decision as an interested party was Certain United States Steel Producers (“U.S. Steel Producers”). Commerce’s decision was challenged by Stelco Inc. (“Stelco”).

Stelco challenged Commerce’s decision on the grounds that: (1) Commerce’s decision improperly increased Stelco’s submitted actual costs for painting services undertaken by Stelco’s affiliated supplier, Baycoat; (2) Commerce rejected Stelco’s interest rate factor in favor of a recalculated factor that does not correspond to Stelco’s books and is distortive; and (3) Commerce’s final determination contains two clerical errors that were committed in calculating Stelco’s margin. Stelco requested that Commerce make changes to its antidumping duty order accordingly. In its response Commerce requested remand to reconsider its calculation of transfer price of Baycoat’s inputs to Stelco and to correct one of the clerical errors. For the reasons more fully set forth in this Opinion, the Panel remands the decision to the Department of Commerce for reconsideration.

II. BACKGROUND

On August 19, 1993, Commerce issued an antidumping duty order to Stelco, a Canadian manufacturer and exporter of corrosion-resistant carbon steel products.² On September 9, 1995, Commerce initiated its second administrative review of the antidumping duty order. The period of review was August 1, 1994, through July 31, 1995.³ As part of that review, Commerce issued a comprehensive antidumping questionnaire to Stelco to assist Commerce in determining Stelco’s sales and cost data regarding the subject products. On February 5, 1996, Commerce issued a supplemental questionnaire to Stelco in order to clarify information submitted by Stelco concerning Stelco’s costs of production. From April 15, 1996, to April 26, 1996, Commerce conducted a comprehensive verification of Stelco’s submitted questionnaire responses regarding

¹62 Fed. Reg. 18448 (April 15, 1997).

²Antidumping Duty Orders: Certain Corrosion-Resistant Carbon Steel Flat Products and Certain Cut-to-Length Carbon Steel Plate from Canada, 58 Fed. Reg. 44162 (August 19, 1993).

³62 Fed. Reg. 18448 (April 15, 1997).

its costs of production. A central element of this review was to compare transfer prices between Stelco and Baycoat (a firm which is 50% owned by Stelco) with Baycoat's actual costs of painting.

Based on Commerce's review, Commerce determined that Stelco reported Baycoat's actual costs rather than the transfer price between Baycoat and Stelco as evidenced by two individual painting order invoices.⁴ In Commerce's preliminary determination, it rejected Stelco's submitted costs of production and replaced it with a recalculated value for Baycoat's services. In response, Stelco argued that there was no legal or factual justification for Commerce to reject Baycoat's submitted actual costs of painting and that Commerce's methodology was inconsistent with Commerce's determinations in the original investigation and the first administrative review. Stelco also argued that Commerce used an improper methodology for comparing Baycoat's transfer prices to Baycoat's actual costs because Commerce refused to account for the fact that Baycoat remits half of its profits back to Stelco at the end of the year.

The Commerce Department also took issue during its review with the way Stelco calculated its "net interest rate factor" in determining the financial costs of production. The Department excluded payments to governments other than taxes from cost of sales. Stelco objected to the exclusion on the grounds that such costs were included in the cost of manufacturing and needed to be included in the cost of sales as well to accurately calculate the interest rate factor. (Commerce claimed that it excluded such costs from the cost of sales denominator because they were not included in the cost of manufacturing. 62 Fed. Reg. 18448, 18465 (April 15, 1997).)

Commerce issued its final determination for the second administrative review on April 15, 1997.⁵ In it, Commerce upheld its preliminary determination on all points. On May 12, 1997, Stelco submitted its request for this Panel to review Commerce's final determination.

III. STANDARD OF REVIEW

Articles 1904(2)-(3) of the North American Free Trade Agreement require the Panel to apply the standard of review provided in section 516A(b)(1)(B) of the Tariff Act of 1930, as amended.⁶ That standard of review requires that any determination unsupported by substantial evidence on the record, or otherwise not in accordance with law, be held unlawful by the Panel.⁷ The North American Free Trade Agreement also provides that decisions of the U.S. Supreme

⁴Commerce Department's Cost Verification Report, Non-Pub. R. Doc. 78, at 15.

⁵62 Fed. Reg. 18449 (April 15, 1997).

⁶19 U.S.C. 1516(a)(1)(B).

⁷*Id.*

Court and the U.S. Court of Appeals for the Federal Circuit are binding on this Panel.⁸

“Substantial evidence” has been defined by the Court of Appeals for the Federal Circuit as “more than a mere scintilla. It means such relevant evidence as a reasonable mind might accept as adequate to support a conclusion.”⁹ The Panel may not substitute its own judgment for that of the agency’s when there are two legitimate alternative views.¹⁰ In considering whether or not a decision is “in accordance with law” the Panel must defer “to reasonable interpretations by an agency of a statute that it administers . . .”¹¹

IV. DISCUSSION

A. Issue One

Cost of Production for Painting Services

The first issue presented to the Panel is whether the Department of Commerce has the discretion to use, as Complainant Stelco Inc.’s cost of production for painting steel coils, an average of sample invoice prices (“transfer price”) between Stelco and its affiliated painting supplier, Baycoat, rather than using Baycoat’s costs.¹² The Panel finds that the Department does have that discretion. The Department has requested, however, that the Panel remand the final determination to permit the Department to consider whether an adjustment to the transfer price is

⁸NAFTA Article 1904(3).

⁹*Matsushita Electric Industrial Co., Ltd. v. United States*, 750 F.2d 927, 933 (Fed. Cir. 1984).

¹⁰*Arkansas v. Oklahoma*, 503 U.S. 91, 113 (1992).

¹¹*National R.R. Passenger Corp. v. Boston & Marine Corp.*, 503 U.S. 407, 417, 112 S. Ct. 1394, 1401 (1992). “Since Commerce administers the trade laws and its implementing regulations, it is entitled to deference in its reasonable interpretations of those laws and regulations.” *PPG Industries, Inc. v. United States*, 712 F. Supp. 195, 198 (Ct. Int’l. Trade 1989) *aff’d*, 978 F.2d 1232 (Fed. Cir. 1992).

¹² Baycoat was established as a 50%-50% joint venture by Stelco and another producer of the product subject to the antidumping duty order, for the sole purpose of supplying painting services to its joint venture owners (sales to third parties are sales of scrap or seconds, not the product subject to the order). Each joint venture partner seats half of Baycoat’s directors and half of Baycoat’s profits is remitted to each partner at year-end. Stelco Inc.’s Response to Section A of the Administrative Review questionnaire for the Corrosion-Resistant Carbon Steel, Oct. 17, 1995, at 7-8, Non-Pub. R. Doc. 1.

appropriate, with the further request that the Panel approve the specific methodology the Department applied in its final results of review. The Panel grants the request for remand, although we decline to approve the specific methodology applied during the administrative proceeding.

The case presents the rather anomalous circumstance of a manufacturer arguing for the use of what it deems actual costs from a supplier rather than an artificially *high* invoice price. As the discussion below reflects, the statute and regulations were written to enable the Commerce Department to ignore invoice prices that are artificially *low* and rely on actual costs or market rates for constructing costs. Thus, this Panel must determine if the statute and rules applied to the novel circumstance here still accord the Department the same discretion.

Commerce may inquire into the cost of production (“COP”) of a product pursuant to 19 U.S.C. §1677b.¹³ Subsection (f) of 19 U.S.C. § 1677b provides special rules for calculation of cost of production and constructed value (until the Uruguay Round Agreements Act (“URAA”) amendments to the antidumping laws became effective in 1995, these rules applied only to constructed value; now they apply to COP as well. Pub. L. No. 103-465, 108 Stat. 4809 (1994)). Before discussing the statutory framework, the Panel will address whether Commerce’s acceptance of Baycoat’s costs as the value of painting services to Stelco in the original investigation and the first administrative review required Commerce to accept Baycoat’s costs again in this second review. The Complainant treats this as a threshold issue and we do so as well.

1. The Department’s Past Practice In This Case

Preliminarily, Stelco claims that the Department is bound by past practice, because in two earlier segments of this proceeding (the original fair value investigation and the first administrative review) the Department had accepted Stelco’s methodology of utilizing Baycoat’s fully allocated costs of production as the proper measure of Stelco’s costs for the painting services. Stelco cites the Department’s original investigation, in which the Department accepted Baycoat’s costs on the grounds that Stelco could not demonstrate an arm’s length transaction and the cost data from Stelco were in effect a transfer price because all profits from Baycoat were fully remitted to its owners at year end. Brief of Complainant Stelco Inc. at 22-27 (“Complainant’s Br.”). Stelco argues that, because the facts were the same for the earlier administrative proceedings as for the second review, this reversal of methodology renders the Department’s final results invalid.

¹³ Subsection (b)(1) describes generally when the Department may examine whether sales are made at less than COP and what happens when the Department determines that there are sales below cost. Subsection (b)(3) describes the elements of cost calculations, which are: (a) materials and fabrication; (b) selling, general and administrative expenses; and (c) packing expenses. 19 U.S.C. § 1677b(b)(1) and (b)(3).

The Department counters that its acceptance of Baycoat's costs as Stelco's cost in prior proceedings is irrelevant for a number of reasons: (1) this review was the first since implementation of the URAA, which provided new standards for determining costs; (2) in the investigation the Department had used Baycoat's cost because it was "in effect, the transfer price," thus demonstrating that the Department had never rejected its preference for transfer prices; (3) the Department had handled the issue inconsistently between the two prior proceedings and therefore there was no long-standing practice; and (4) the Department is permitted to change its methodology if it has good reason for doing so and provides sufficient explanation. Thus, the Department responds that it is not bound by administrative precedent on this point. Response Brief of the Investigating Authority to the Brief of Stelco, Inc. at 16-20 ("Response Br.").

Although it is understandable that by this second review Stelco had become accustomed to presenting Baycoat's cost of painting as its own cost, there is no evidence of Stelco's reliance on the Department's treatment of costs. The controlling statutory provision had changed between the first and second reviews. Commerce had clearly requested "transfer" prices, and the Department had a reasonable basis for changing its methodology. Therefore, we find that administrative precedent creates no bar to the Department's methodology in this proceeding.

2. Department's Methodology

As discussed above, the Department used an average of sample invoice prices between Baycoat and Stelco ("transfer price") as its starting point under § 1677b(f)(1)(A), rather than Baycoat's allocated costs, as submitted by Stelco. Section 1677b(f)(1)(A) provides:

Costs shall normally be calculated based on the records of the exporter or producer of the merchandise, if such records are kept in accordance with the generally accepted accounting principles of the exporting country (or the producing country, where appropriate) and reasonably reflect the costs associated with the production and sale of the merchandise. The administering authority shall consider all available evidence on the proper allocation of costs, including that which is made available by the exporter or producer on a timely basis, if such allocations have been historically used by the exporter or producer, in particular for establishing appropriate amortization and depreciation periods, and allowances for capital expenditures and other development costs.

This subsection directs the Department to base COP on the books and records of the producer of the merchandise and Stelco's normal practice, according to its questionnaire response, is to record the invoiced price as its cost of painting services. Non-Pub. R. Doc. 8.

Then the Department applied the provisions of 19 U.S.C. § 1677b(f)(2):

(2) Transactions disregarded

A transaction directly or indirectly between affiliated persons may be disregarded if, in the case of any element of value required to be considered, the amount representing that element does not fairly reflect the amount usually reflected in sales of merchandise under consideration in the market under consideration. If a transaction is disregarded under the preceding sentence and no other transactions are available for consideration, the determination of the amount shall be based on the information available as to what the amount would have been if the transaction had occurred between persons who are not affiliated.

Subsection (f)(2) gives the Department the option to disregard a transaction between Stelco and Baycoat if the transaction is not at market value or is not equivalent to an arm's length transaction. Stated differently, the Department is not *required* to disregard the transaction if it is not at market value. Rather, it *may* disregard it.

In this case, the Department decided not to disregard the transaction, relying on a single statement in Stelco's questionnaire response, to the effect that the transfer prices between Stelco and Baycoat were at market. Non-Pub. R. Doc. 6, at 9. The Department found that the transfer price satisfied the statutory standard and did "reflect the amount usually reflected in sales of merchandise under consideration in the market under consideration." 62 *Fed. Reg.* at 18464. The Department made this finding expressly because "Stelco acknowledged that Baycoat's selling prices were set at prevailing market rates and above cost in their response to the supplemental section D questionnaire response."

This conclusory statement about market value, unsupported by facts on the record, cannot fairly bear the weight of the standard in the statute. The Panel has seen no evidence of sales of painting services between unaffiliated parties to serve as a benchmark.¹⁴ On the other hand, even without such evidence, the statute offers no guidance regarding transfer prices when there is no comparison market value. Nor does the statute impose any obligation on the Department to make an independent finding of a benchmark market value or arm's length price. Therefore, on the face of the statute, the Department is within its discretion to utilize the transactions between Stelco and Baycoat.

The Department then compared the transfer price to the cost of production under 19 U.S.C. § 1677b(f)(3):

¹⁴At oral argument, Stelco's counsel asserted that there is no market for painting services because there are no unaffiliated providers from which Stelco could have obtained this service. No other parties contested this contention. Transcript at 19-23.

(3) Major input rule

If, in the case of a transaction between affiliated persons involving the production by one of such persons of a major input to the merchandise, the administering authority has reasonable grounds to believe or suspect that an amount represented as the value of such input is less than the cost of production of such input, then the administering authority may determine the value of the major input on the basis of the information available regarding such cost of production. If such cost is greater than the amount that would be determined for such input under paragraph (2).

The Department concluded that, as the transfer price was higher than the cost of production, the major input rule was not a basis for rejecting the transfer price.

The Panel notes that the facts before it do not fall within the fact scenario addressed by subsections (f)(2) and (f)(3).¹⁵ In particular, subsection (f)(3) was not designed to address the

¹⁵The legislative history of these provisions does not clearly constrain the broad discretion reflected in the language of the statute, but nonetheless suggests that the Department bears some responsibility to determine actual costs as accurately as possible. First, with respect to subsection (f)(1)(A), the relevant Senate Committee report explaining the URAA admonishes as follows:

The Committee expects the Commerce Department, in determining whether a producer's or exporter's records reasonably reflect the costs associated with the production and sale of the product in question, to examine the recorded production costs with a view to determining as closely as possible the costs that most accurately reflect the resources actually used in the production of the merchandise in question.

S. Rep. 412, 103d Cong., 2d Sess., Pt. 1, at 75 (1994). This does not mean that Commerce must utilize Baycoat's costs nor does it compel the Department to use invoice prices. Rather, it reinforces the position that the Department should try to ascertain Stelco's normal practice in

situation in which the input was transferred at a price that is artificially high, as in this case.

Thus, the Panel does not disagree with the Department that subsection (f)(3) does not require the rejection of the transfer price. However, the Panel is troubled that the result, the use of the transfer price, may result in costs that are greater than “the costs associated with the production and sale of the merchandise” as referred to in § 1677b(f)(1)(A).

In this review, the Department followed the strict standard set forth in *Final Results of Antidumping Administrative Review: Antifriction Bearings (Other Than Tapered Roller Bearings) and Parts thereof From France, Germany, Italy, Japan, Singapore, and the United Kingdom*, 62 *Fed. Reg.* 2081, 2115 (1997). This standard required the Department to choose the highest of (1) transfer price, (2) market value and (3) cost of production. The current Commerce regulations, promulgated after the final results of the review in the instant case, offer a more flexible approach because they state that the Department will “normally” follow the hierarchy. 19 C.F.R. § 351.407(b). The Panel finds this flexibility to be conducive to a fair application of the law and urges the Department to follow it.

Stelco contends that even if the Department may use the transfer price, the Department should adjust the invoice prices downward to take into account the remission of profits from Baycoat to Stelco (Complainants Brief at 50-53). The Panel observes that the return of profit in this case is independent of the number or value of sales of painting services to Stelco and is, therefore, not a sale by sale rebate; instead it is arguably in the nature of a return on investment set by agreement between Baycoat’s owners. (Non-pub. R. Doc. 32). In fairness, however, the Department could exercise its discretion to make some adjustment to the transfer price in light of the economic and commercial realities of the Stelco-Baycoat relationship and to address the requirement of § 1677b(f)(1)(A).

Therefore, for the reasons stated above, the Panel declines to follow the Department’s request that the Panel approve the Department’s methodology in this case.

3. “Collapsing” Entities To Avoid Use of Transfer Prices

As a subsidiary argument in its brief, Stelco asserts that the Department should have

costing painting services. The 1994 report language also suggests that the Department should seek accuracy. Indeed, the legislative history to the predecessor to current subsection (f)(3) states emphatically, “It is not the intent of the conferees that foreign market value be based on constructed value solely for the purpose of using this provision to increase dumping margins.” H. Conf. Rep. 576, 100th Cong., 2d Sess., 596, *reprinted in* 1988 U.S.C.C.A.N. 1547, 1629. The legislative history indicates, therefore, that Congress did not intend the statute to mandate a hard and fast rule that Commerce must choose the highest of the amounts found in subsections (f)(2) and (f)(3), if the result would unrealistically inflate COP.

treated Baycoat and Stelco as “collapsed” entities, which would have compelled the Department to use Baycoat’s costs rather than transfer prices between Stelco and Baycoat. When parties are collapsed, the Department declines to apply the major input rule, instead using costs for transactions between those entities. Complainant’s Br. at 40-50. At each stage of this Panel review, Stelco has progressively diluted its argument on this point, finally requesting only that the Department apply the “reasoning” behind the collapsing methodology as a basis for departing from the transfer price. Transcript, *supra*, at 40-42.

As Stelco is not requesting that Stelco and Baycoat should be treated as a single entity under the collapsing argument, but merely suggesting an analytical model, the Panel makes no finding on the applicability of the collapsing argument or on the exhaustion of remedies argument raised by the Department in response.¹⁶

B. Issue Two

Interest Rate Factor Calculation

Commerce’s questionnaire concerning the costs of producing the subject merchandise instructed Stelco to calculate a “net interest expense rate factor.” Stelco, in its antidumping questionnaire response, calculated an interest factor to be used in determining financial costs of production by dividing its total interest cost by the total company-wide cost of goods sold.

In its final determination, Commerce rejected Stelco’s calculation of the interest rate factor on the following grounds:

Stelco used internally calculated cost of sales figures to allocate financial expenses. This amount did not agree with the audited income statement. The audited consolidated cost of sales figure differed from the internal consolidated cost of sales figures in that Stelco separately identified corporate services and payments to governments other than income tax on the audited income statement and did not include these items in the consolidated cost of sales figures. We recalculated the consolidated cost of sales figure used in the net interest expense ratio based on the audited income statement because corporate services and payments to governments other than income taxes are general and administrative expense items which are properly excluded from cost of sales.

¹⁶The doctrine of exhaustion of administrative remedies provides that a party cannot raise an issue for the first time on appeal when it could have raised that issue before the lower adjudicatory body, in this case, the administrative agency. *Federal Mogul Corp. v. United States*, 862 F. Supp. 384, 402 (Ct. Int’l Trade 1994), *Sigma Corp. v. United States*, 841 F. Supp. 1275, 1281 (Ct. Int’l Trade 1993).

April 2, 1997, Memorandum from Peter Scholl to Christian B. Marsh, Pub. Doc. 195.

Stelco does not dispute Commerce's decision with respect to corporate services. The narrow issue before the Panel was whether Commerce's decision to exclude payments to governments other than income tax from the calculation of the cost of sales denominator for use in deriving the interest rate ratio was lawful.

Stelco, in its oral argument and written brief, maintained that the expense entitled "payments to governments other than income tax" is part of the calculation of the per unit cost of manufacture ("COM") for the subject merchandise. Consequently, to ensure a fair "apples to apples" calculation, such expense must be included in the calculation of the cost of sales denominator. Commerce argued that Stelco had not raised this argument before the agency, and was thus precluded from raising it before the Panel for the first time, another attempted application of the exhaustion doctrine by Commerce.

During the course of oral argument, the issue arose as to whether there was evidence on the administrative record in support of Stelco's assertion that payments to governments other than taxes were included in Commerce's calculation of the COM. Counsel for the complainant subsequently forwarded a letter to the Panel which appended documentation from the record which clearly indicated that Stelco had included these payments in COM in its submissions to Commerce during the administrative proceeding. Certain of these data were also included in Commerce's own verification exhibits. Therefore, Commerce cannot rely upon the defense that Stelco had failed to exhaust its administrative remedies because Stelco had included the payments to governments other than income taxes in COM and Commerce had verified it. This is not a question of legal argument, it is a factual question of whether or not the payments were included, and there is sufficient evidence to indicate that they were.

Commerce and Stelco are in agreement with the principle that where such costs are included in calculating the cost of manufacture, they must be included in calculating the cost of goods sold. If any element is in one side of the equation but not in the other, then the methodology used by Commerce cannot work. The conceptual basis for the formula is that "cost of manufacturing" as determined by a respondent is the per unit equivalent of "costs of goods sold" for the company as a whole. The financial cost borne by the company should apply to all products equally such that the ratio of financing costs to total costs of goods sold is equivalent to the ratio of financing costs to the COM of a particular product. Given this fact, to accept Commerce's argument that the exhaustion doctrine applies would be a clear triumph of form over function. Consequently, the Panel directs that Commerce recompute the net interest expense factor to include certain payments to governments other than income tax in Stelco's cost of sales denominator.

C. Issue Three

Clerical Errors

In its original complaint Stelco identified two clerical errors that it argued Commerce had made in calculating Stelco's final antidumping margin. The company argued that (1) Commerce's computer program double counted certain inland freight expenses for Stelco's further manufactured sales, and (2) that the Department's program failed to reflect the Commerce's decision to include imported expenses in the calculation of profit on constructed export price.

The Commerce Department agreed with Stelco's first assertion, and requested remand to correct the clerical error.¹⁷ Stelco abandoned its second assertion, declining to address Commerce's objection in its reply brief and indicating during oral arguments that it was dropping its claim.¹⁸

¹⁷Response Br. at 34. United States Steel Producers suggested that the initial clerical error regarding freight charges was more limited than Stelco asserted. *See* Response Brief in Support of the Final Determination Submitted on Behalf of Certain United States Steel Producers at 38-39. The Panel does not address this concern in as much as Commerce requested remand without reference to this qualification.

¹⁸Transcript at 64.

V. DISPOSITION AND PANEL ORDER

The Panel remands this matter to the Department of Commerce with the following instructions:

1. That the Department reconsider and explain the calculation of transfer price for the Baycoat inputs, and consider Stelco's argument that the transfer price of the Baycoat inputs should be recalculated to take account of Stelco's actual costs with regard to these inputs;
2. That the Department recompute the net interest expense factor to include certain payments to governments other than income tax, i.e., worker's compensation, unemployment insurance, pension plan expenses and property tax, as part of Stelco's cost of sales;
3. That the Department correct the clerical error double counting certain inland freight expenses for Stelco's further manufactured sales.
4. That the Department will return a determination on remand within 60 days of the issuance of this order.

Date of Issuance June 4, 1998

Signed in the original by:

Howard N. Fenton, III, Chairperson
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